Palestine Economic Policy Research Institute (MAS)

Political Economy Analysis of the Palestinian Private Sector

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FOREWORD

MAS is pleased to publish in this study an examination of the Palestinian economy undertaken in 2018 that goes beyond the current literature to present a comprehensive analysis of the contribution of the private sector economy to national development. It is rooted in an appreciation of the pivotal role of the different economic activities of the private sector institutions within the broader context of public economic policy leadership and regulation. It analyses external and internal structural constraints, the (dis)enabling environment, dynamic factors impacting the private sector, as well as the main areas for strengthening the private sector economy performance, resilience and prospects.

When MAS was first approached by our partners for this study (EUREP and AETS/Cardno), MAS was interested and ready to work on producing a "political economy analysis", because as we have known from the outset of our work, all research on the Palestinian economy is by nature political. Without an appreciation of how political considerations can (and often do) override the usual functioning of markets and economy, little can be understood or done in our exceptional circumstances.

This study, though commissioned within the context of EUREP's preparation for its next generation of private sector support in Palestine and prepared alongside other reviews undertaken by the AETS/Cardno project team, was drafted with the general research and policy making public in mind, including Palestinian and international parties.

Last but never least, a special thank you goes to AETS/Cardno and EUREP for funding this study.

Dr. Nabeel Kassis
Director General

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Table of Abbreviations and Acronyms

APIC	Arab Palestinian Investment Corporation
CEO	Chief Executive Officer
CSOs	Civil Society Organisations
DBI	Doing Business Index
DFID	United Kingdom Department for International Development
EU	European Union
EUREP	European Union Representative Office
FDI	Foreign direct investment
GDP	Gross Domestic Product
GRM	Gaza Reconstruction Mechanism
GVA	Gross Value Added
ICT	Information and Communication Technology
MAS	Palestine Economy Policy Research Institute
MSMEs	Micro, Small and Medium Enterprises
NGO	Non-Governmental Organization
NPA	National Policy Agenda
OPM	Office of the Prime Minister
PADICO	Palestine Development and Investment Company
PALTRADE	Palestine Trade Centre
PCBS	Palestinian Central Bureau of Statistics
PER	Protocol on Economic Relations
PFCCIA	Palestinian Federation of Chambers of Commerce, Industry and Agriculture
PFI	Palestinian Federation of Industries
PIF	Palestine Investment Fund
PITA	Palestinian Information Technology Association of Companies
PLO	Palestine Liberation Organisation
PNA	Palestinian National Authority
PMA	Palestinian Monetary Authority
PMHC	Palestinian Mortgage Housing Corporation
PSC	Palestinian Shippers' Council
PSCC	Private Sector Coordinating Council
R&D	Research and Development
SLED	Sustainable Local Economic Development
SME	Small and Medium Enterprise
SMIS	Standardization Management Information System
UNCTAD	United Nations Conference on Trade and Development
UNRWA	United Nations Relief and Works Agency for Palestine Refugees
USAID	United States Agency for International Development
VA	Value Added
VAT	Value Added Tax
WTO	World Trade Organization

Executive Summary

This study addresses the obstacles faced by the private sector in the light of the potentials shown by different Palestinian economic sectors, both at the level of large corporate ventures and sectors and small and medium enterprise development. The study identifies the private sector as:

- The driving force of the national economy that produces tradeable goods and services;
- The shock absorber for the national economy, especially in more deprived regions such as Gaza, whereby private sector enterprises sometimes can cope better than the PNA fiscal system with the volatility and uncertainty of the overall economic climate;
- The formal, larger and medium-scale, “modern” corporate institutions engaged in many activities, which demonstrate a steady process of capital accumulation and advocate for an environment that fosters free enterprise and greater competition and competitiveness;
- Including a more numerous and diverse “traditional” small and micro business establishments, in manufacturing, trade, and services activities, that provide sustenance to much of the population not engaged in formal employment;
- A growing international trading community with global reach, rich logistic and facilitation experience and capacity, an increasingly critical sub-sector of the wider business community;
- A vocal lobby of sectoral representative institutions (and trade unions) whose credibility and effectiveness are constrained by limited membership, weak advocacy, the absence of formal dialogue and collective bargaining mechanisms with Government, and political factionalism.

The failure of Palestinian and donor policy and programming to manifestly improve conditions, to grow the private sector or to restructure a deformed economy and imperfect market (at best having been in the realm of damage limitation), is the core problem driving this critical analysis of the conditions and prospects of the Palestinian private sector. The next generation of private sector support needs to focus on strategic sectors, structural economic bottlenecks and the institutional and sectoral sources of change that can accumulate and deploy Palestinian economic wealth and power in a manner that bolsters prospects for development as well as national liberation and sovereignty.

While sustained economic development will be elusive short of independence, this does not necessarily mean that some of the economic levers of Israeli occupation controls cannot be challenged, and their adverse impact alleviated. This can begin within the limits of the current configuration of Palestinian-donor-Israeli relations, to set the scene for a comprehensive new policy framework. This would entail not only a focus on enabling a more vibrant and productive private sector in activities that have demonstrated vitality and ability to compete globally. Equally needed are initiatives of an “entrepreneurial state” that nurtures, invests, takes risks and leads a process of resilient economic development appropriate to Palestinian realities and assets. In such an environment, external challenges may be better withstood and the private sector potential mobilized.

The core interests of the private sector may be found at the intersection between three sets of factors:

- the real market conditions and the opportunities they create in terms of comparative sectoral growth and possibilities for income and profit generation;
- the extent to which private sector institutional development enables the advocacy for, and pursuit of, a set of sector-specific economic policy demands; and,
- the political space permitted for their inclusion within Government policy making processes.

From a performance review of the seven core activities of the private economy (Industrial, Construction, Internal Trade, Transport and Storage, Information and Communications Technologies (ICT), Non-financial Services (including tourism) and Financial Intermediaries), it becomes clear that productive capital accumulation is proceeding apace in some areas, in the form of assets and through value added creation. This process follows a different distribution between Gaza and the rest of Palestine, with industry less significant in the former than in the latter. However, capital accumulation is not translated into productive investment at a rate needed to spur sustained economic growth, job creation and productivity gains across the board. The approach of “picking winners” is often not favored in design of trade and fiscal policy. But the Palestinian National Authority (PNA) cannot simply leave the distorted Palestinian market to weed out failure or reward success. In the Palestinian context, the definition of "winners" and the selection criteria that might be applied, depend largely on what sort of economic structural transformation is envisioned and how economic decisions are shaped by deep-seated, overriding political challenges that Palestine must tackle in the coming few years.

Among the large-scale actors working in the private sector economy is the PIF, operating as the Palestinian sovereign wealth fund. PIF has recently diversified its market operations into productive sectors such as energy, agriculture, industry, marketing and trade logistics, alongside previous investments in real estate projects and other corporations. The market role of this source of catalytic public investment has been cooperative and aimed at crowding in private investment in risky environments. It provides an alternative model to other large investment corporations, many of whose major shareholders are constituted by leading members of prominent business families.

An important new phenomenon is financialization of the Palestinian economy and formation of distinct social/income group class interests, as well as the emergence of perceptible inequalities. Different indicators may be cited to point to the sort of forces at play, which confirm that important transformations underway in the Palestinian corporate and investment scene, as well as in the underpinning social capital. Financialization is an important process both because of its role in facilitating mobilization of resources for investment and intermediating economic transactions in general. But in a fragile situation such as Palestine, excessive deepening of the financial economy also can create risks for the banking sector and indebted households and overshadow the real economy.

The process of class formation assumes different proportions in different regions. This serves to further differentiate and divide the Palestinian people, otherwise united in the national cause. Inequality takes many forms in the Palestinian context, owing to the legacy of different regimes, political and economic forces and cultural traditions at play amidst the relatively unregulated and laissez faire market in Palestine. Sharpening of class and income inequalities can only spell trouble down the road for the stability of the private sector economy and its social utility effectiveness. If despite economic growth and perceived wealth in some urban settings, youth remain unemployed and poverty is not reduced, the sustainability of the current configuration may be put at risk. To avert social crisis, more intensive and explicit efforts are warranted that acknowledge and alleviate inequality gaps in income, between regions, in access to services and in exercise of political influence.

The proliferation of institutions and personalities active on behalf of the private economy has meant that the main needs of each sector have been well articulated over the past years. These private sector advocates have generally done a good job of elaborating clear statements of sectoral policy, reform and investment needs, and are sure to be found at the table of any public-private or donor inspired activity concerning their sector. They are recognized by Government and the public as representative of their sector, even though it appears that significant strata are only partially represented by existing bodies. Notwithstanding their established institutional capacity and technical know-how, the limited reach and resources of these institutions, and the absence of a public investment priority/guidance lead from Government, combine to diminish their ability to effect change in the direction they advocate.

Numerous and complex procedures in the business and trade environment constrain and frustrate investment initiatives and promotional efforts for local products and exports. These include Israeli obstacles and diversions to the transportation network, which fragment the Palestinian territory and separate regional markets from each other. This increases the difficulty of achieving economies of scale in investment decisions and business planning and creates distortions in market indices and price levels for goods and services between regions and within some sectors experiencing irrational price inflation. Uncontrolled trade borders with Israel further aggravate the constitution of coherent domestic markets, as smuggled or low-cost goods are marketed from/through Israel to the detriment of local producers and sometimes in violation of consumer safety and health standards.

Highly cited by private sector actors is a perceived mediocre and incoherent PNA institutional service delivery, notwithstanding satisfactory performance in the core functions of education, health and security. Business and investment promotion facilities provided by PNA agencies remain separated and fragmentary, and the much-vaunted single-window concept has yet to materialise. As for financial incentives provided or guaranteed by government for different categories or sectors of business, there are no PNA legal or policy provisions other than the Investment Promotion Law, which is seen to offer only a minimal set of incentives and is inadequately enforced. Above all, Government faces regular private sector calls for greater policy direction, focus and leadership that the business community feels necessary for it to invest and operate in such a risky and uncertain environment. The National Policy Agenda is acknowledged as an acceptable framework or statement of intention, though it seen as generic and weak on a mobilizing vision. The handful of existing modalities for engagement with the private sector either lack the authority to effect policy or function as little more than platforms to mobilise endorsement for policy decisions already taken or contemplated.

Palestinian entrepreneurs and new “men of capital” have succeeded despite the odds in building an economy where opportunities are defined as much by ability to mobilize repressed potential as by the possibilities for incremental increased integration in regional and global markets, instead of exclusive integration with Israel. But the picture is more dynamic than static. Social and economic processes underway, a largely unfettered market space for developing new products and consumption patterns and light touch regulation of conditions affecting competition, combine to create upside opportunities as much as to aggravate downside risks.

The role and expectations of the Palestinian private sector have been transformed in the past years. It increasingly demands that the PNA should uphold the responsibilities of the State that it claims to be. This means cleaning up the business environment, providing policy leadership upon which national economic independence depends, and assuming the risk of investment enabler and risk taker where appropriate, or removing its controls and heavy hand where needed. So, just as the dynamic of the peace process was replaced with one stressing the right and need for formation of the State of Palestine, we now are witnessing the other side of the statehood coin, whereby “citizens” and business are emphasizing the need for the State to live up to its obligations to them. This is a dynamic process of a social contract under formation between the State and citizens that only a major national emergency (war, strife, economic crisis) could divert or postpone.

The interaction between national and social imperatives proceeds perversely in the Palestinian context, whereby socio-economic demands can detract from national liberation as time and the changing world around presses for better government and broader based economic dividends no less than independence. As social contestation develops on different issues, this intensifies public demands for professional political leadership, public institutional effectiveness and democratic accountability. Palestinian political division has created inefficient and ineffective public services in Gaza, in particular as related to health, education and business sector services. From the private sector perspective the government fails to address strategic challenges or their governance promises. This has compounded public disillusionment with the role of government in promoting economic growth.

No less influential than the foundational factors and dynamic processes shaping the performance and prospects of the private economy, political challenges loom on the horizon whose impact can be significant for economic stability. The underlying political nature of the Palestinian development *problematique* is not novel, but political prospects harbor renewed risk. These elements of an uncertain political scene which are of concern here in terms of the possible impact on private sector growth include: Palestinian national reconciliation, democratic rebuilding and geographic unity; the regional scene and the Middle East peace process; Israeli policies which impacy Palestinian economic prospects; and the changing relation between donors and Palestine.

While the overall picture of the macro economy is dim, there are bright spots in the private sector economy where growth has occurred, employment has been assured, technology has been acquired and adapted and capital investment generates both private and public returns. However, successes are haphazard and fragmented, growth has been uneven and has favored activities that respond to the distorted demand structure of the economy and binding constraints. A new approach to private sector support requires a clear statement of public sector obligations and commitments to providing the best policy, legal and procedural climate for enabling vigorous private sector growth. Donors will need to consider the most suitable modalities for support among the many deployed in the past.

The next generation of PNA policies and donor support aimed at liberating the forces of private enterprise and improving the functioning of markets needs to think wide and big, and act narrow and small. Policies and interventions should focus on key pivotal issues whose impact will at once address macro/micro and external/internal dimensions of constraints on the private sector. This means engaging with credible and catalytic private sector partners, representative of their economic sector or institutional form. The essential drivers of future private sector growth may be identified as:

- the adoption of an explicit public policy orientation and involvement in strengthening strategic sectors of the private economy, increasing the resilience and vigour of the national economy and reducing vulnerability to external shocks;
- a public and private investment focus on pivotal competitive productive activities whose reinforcement will help them to lead growth in other areas of the economy;
- institutionally, change is powered both by fostering a strong corporate sector (the top-end of the market leaders, including medium and large enterprises), and nurturing the SME sector;
- Adopting more effective and inclusive modalities for economic policy making, building credible representative institutions that ensure wider and active private sector engagement in powering growth and making policy, and which government partners with, not only listens to.
- Reintegrating Gaza into the national economy and making up for its lost development decade

Introduction: terms of reference, structure and methodology

This paper has been prepared as part of an assignment undertaken by AETS/Cardno UK – MAS to assist the EUREP in the design of projects for a "project pipeline" related to development of the private sector under the current adverse circumstances and in line with the EU Joint Strategy and the Palestinian National Authority's economic plans. The assignment called for a comprehensive assessment of the environment for identifying new programmes/projects that can transcend the major constraints relevant to Palestine. This includes this political economy analysis of the Palestinian private sector.

The terms of reference for this paper aim to address the obstacles faced by the private sector in the light of the potentials shown by different Palestinian economic sectors, both at the level of large corporate ventures and sectors and small and medium enterprise development. The paper includes a comparative examination of the macro distribution of wealth and economic power and representation, as well as of the institutional, legal and policy frameworks governing the business environment in different Palestinian territories. The analysis is substantiated by literature research on current economic performance and current institutional and policy frameworks, supplemented by stakeholder consultations. The paper assesses the relative impact of different internal and external constraints, and the prerequisites for increasing the resilience and vigour of the private sector and national economy and reducing its vulnerability to external shocks, enhancing predictability of the PA business environment, and adopting more effective and inclusive modalities for economic policy making.

Following established methodology for *political economy analysis* (DfID 2009; ODI 2013, USAID 2016), the paper begins with an assessment of the conventional wisdom regarding the identity and role of the Palestinian private sector (Chapter 1) and the challenges it faces, in particular overriding *foundational constraints* (Chapter 2). Chief among these constants has been the relentless process of Israeli settlement of the occupied territory and limited Palestinian living (physical) and economic (policy) space that were bequeathed by the Oslo framework. This sets the scene for an analysis (Chapter 3) of the distribution of wealth, economic power and institutional representation, in the context of the political culture of Palestinian nationalism and the formal and informal frameworks which regulate the business environment - *the rules of the game*.

The prospects for structural transformation of the Palestinian economy are further shaped by parallel *dynamic processes* for much of the past 25 years of state-building, an inconclusive yet self-renewing peace process and persistent Palestinian contestation of occupation (Chapter 4). In this regard, the direction of development of Palestinian National Authority (PNA) political institutions that assumed many of the ruling functions of the pre-Oslo PLO can act either to motivate or to discourage key economic actors and the demands and expectations placed upon government. Meanwhile, normal processes of formation of distinct socio-economic classes proceed apace and exercise an influence on the shaping of markets and economy. The impact of political change such as Palestinian national reconciliation, accelerated Israeli settlement pressures and new "economic peace" offerings, donor fatigue and limited resources, all pose new opportunities, challenges and choices (*here and now*) for Palestinians and their development partners. By narrowing its focus to key, promising or ailing sectors of the economy the paper assesses (Chapter 5) the relative impact of different political economy constraints and potentials and identifies prerequisites for private sector renewal and growth

This paper has been prepared beginning with a literature review of the political economy of prevailing policies and strategies to develop the private sector. This also entailed analysis of PCBS sectoral survey statistics on key private sector growth indicators since 2010, examining performance of (non-agricultural) private economy employment, wage compensation, output, capital formation and fixed asset accumulation. This helps draw a clearer picture of where growth is taking place in the private sector economy and what form and outcomes it entails. The analysis also identifies the key pending structural macro-economic constraints adversely affecting private sector growth and their relative significance and impact. A set of binding constraints is identified that, if addressed coherently and even without removing them fully, could have a positive impact on growth. Structured interviews were also conducted with influential and expert Palestinian business, government, legal and economic thought leaders, within an adapted political economy analysis investigation framework, to increase insight into the interplay between the political and the economic in this study.

1. The Palestinian private sector's function within the Palestinian economy

This chapter begins with by defining a typology of the private sector according to the different dimensions that the term signifies. This is aimed at grounding the analysis of the paper within the issues and features of the Palestinian economy for which international support and national policies should account. In line with standard political economy approaches, this is followed by a review of the "theory of change" that has guided previous policy and programme interventions under the rubric of "support to the private sector". In the light of a statement of the basic problem that this paper addresses, a new narrative of change is suggested (and further elaborated in Chapter 5).

1.1. The identity and role of the Palestinian private sector

There are multifaceted dimensions within which the Palestinian private sector may be conceived, indeed several identities that it embodies.[1] While no one program can usefully target all components/levels of the private sector, efforts that engage it can bear fruit if carefully envisioned in the context of these below dimensions of its structure and role.

To begin with, the private sector should be understood to comprise all economic activities that are not operated by Government or civil-society organizations (CSOs). With a significant share of GDP and jobs, the public sector in the Palestinian context is synonymous with government expenditure (mainly current) on providing public services. However, the public sector has no role in operating productive, commercial or other market activities. Hence, the private sector, in its widest definition, accounts for over two-thirds of the Palestinian economy, as measured through indicators of output, employment, investment and capital accumulation (analysed below).

In referring to the private sector, it is thus not helpful to juxtapose it against the public sector, which may be a pertinent line of enquiry for economies with significant operation of state owned enterprises and a corresponding imperative of 'privatisation'. Instead, the private sector should be defined in the context of its role in addressing the broader challenges faced by the Palestinian national economy. This in turn calls for a better understanding of its heterogeneity and internal sectoral structure, the differential stages of its institutional formation and its relation to the political system, as well as the complex market dynamics that determine performance of different activities (industry, trade, services, banking, IT, etc). Accordingly, it may be said that the problems and needs of the "private sector", are synonymous with those the "productive and (non-public) services sectors" of the national economy, and what is good or bad for one is equally the case for the other.

At another level elaborated further below, the private sector may be differentiated in terms of its institutional structure, which ranges from larger registered corporate bodies which account for a small proportion of private sector establishments, to small and medium informal sector enterprises. Less institutionalized are single-owner and family businesses whose sheer number and combined weight generates significant household income and products and services for the market. When thus defined, the performance and needs of the private sector may well diverge between those relevant to established entities with a proven track record, modern administration and large scale complex operations, and small or micro enterprises (registered or informal) that require a tailored development strategy to survive and grow.

Another corporate form has recently made some inroads in the Palestinian business scene, namely start-ups funded by venture capital, usually led by a younger founding generation, technically and managerially highly qualified to compete in global marketplaces. Paraphrasing the CEO of one such successful business (with invested capital of $10 million, employing 70 hi-tech graduates), a start-up is 'a company that is tackling hard challenges in order to unlock a large opportunity, either by disrupting an existing space in the market or by creating a new one' (Interviews). This implies mobilizing a group of professionals with diverse talents and a

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[1] This typology of the private sector in its varied dimensions was elaborated through interviews with stakeholders.

willingness to tackle a share of a major global market opportunity in a situation where the probability of failure is large. Smart start-ups try to avoid significant downside risks such as fixed-asset heavy or labour intensive business models, debt financing etc. This institutional form represents yet another layer of the Palestinian corporate spectrum, compared to larger, more cautious or traditional business models, that has the potential to change the business culture and to generate returns in an inherently risky landscape.

The identity of the private sector is also shaped by how private economic agents interact with, and place demands on, economic policy and decision making. This affects the extent to which different sectoral activities (industry, banking, trade community, etc.) or entities (large corporations or SMEs) are represented collectively in economic governance processes, as discussed further below. In Palestine, around a dozen sectoral representative institutions constitute an identifiable and vocal private sector lobby representing a swath of members, mainly medium scale businesses. Chambers of commerce in all regions form the backbone of this representative network. Furthermore, prominent business community leaders and CEOs of major corporations, alongside individual sectoral specialists, play their own individual roles in advocating for and representing certain private sector interests and perspectives in dealings with government, donors and international investors.

Finally, the identity and performance of the private sector is affected by the relative weight of, and relations between different social formations, also analyzed further below. These include most notably the classes of individuals, families or businesses who are accumulating assets and deploying capital, and those salaried, waged and other employees and self-employed who are forming a new Palestinian middle class. These middle and higher income groups have greater political and economic influence than the poorest, disadvantaged, unemployed and marginal strata of the Palestinian labor force. Those Palestinians who exist at the margins of the private sector mainly depend for their subsistence on spillover effects of productive sector growth or government transfers of some sort. While “class conflict” may not be on the Palestinian agenda, income and lifestyle disparities appear to be sharpening between the richest and lower income groups, between those who have income/wealth, power or access, and those who don’t. This has rendered “social justice” a popular demand among different social and professional strata seeking their better salary or working condition, with implications for private sector prospects that go beyond the issue of corporate social responsibility.

From a macro-economic perspective, the private sector plays a no less significant role within the economy of

These constitutive elements of the identity of the Palestinian private sector should be kept in mind when contemplating how best to encourage positive change, empowerment and better performance of the Palestinian market economy. To conclude, the private sector is at once:

- *The driving force of the national economy that produces tradeable goods and services;*
- *The shock absorber for the national economy, especially in more deprived regions such as Gaza, whereby private sector enterprises sometimes can cope better than the PNA fiscal system with the volatility and uncertainty of the overall economic climate;*
- *The formal, larger and medium-scale, “modern” corporate institutions engaged in many activities, which demonstrate a steady process of capital accumulation and advocate for an environment that fosters free enterprise and greater competition and competitiveness;*
- *As well as a more numerous and diverse “traditional” small and micro business establishments, in manufacturing, trade, and services activities, that provide sustenance to much of the population not engaged in formal employment;*
- *And a growing international trading community with global reach, rich logistic and facilitation experience and capacity, an increasingly critical sub-sector of the wider business community;*
- *More or less represented by a vocal lobby of sectoral representative institutions (and trade unions) whose credibility and effectiveness are constrained by limited membership, weak advocacy, the absence of formal, binding or other dialogue and collective bargaining mechanisms with Government, and political factionalism.*

Gaza than in the West Bank, by employing two-thirds of the work force, about 30% of whom are salaried under contract. Average daily wages in the private sector are considerably less than public sector comparators, somewhat dissimilar to the West Bank. The private sector economy generates an estimated 80% of tax revenue flows to both the Gaza *de facto* and PNA governments (Interviews). As a result of the ongoing restrictions, the Gaza private economy has been deindustrialized, while the share of agriculture in the economy is now half of what it was twenty years ago, and the economy's capacity to export has deteriorated. The private sector is highly import-dependent, with exports negligible due to the blockade. Further, partly as a result of handling costs and double handling, imposing dual use list, imported raw materials are highly expensive, which has a negative impact on transaction costs for local production. No doubt the private sector landscape in Gaza is even dimmer than the rest of the occupied territory.

Over 90% of private firms in Gaza are Small and Medium-sized Enterprises (SMEs) and SME's are known for their propensity to employ and buy locally. Financing for small enterprise is mostly secured through families' own savings, with big businesses having lines of credit with domestic banks, despite the high risk and high rates that bank borrowing entails under current conditions. Around 90% of private sector firms are sole traders (owned by one person) indicating significant potential for formalization and growth if provided with the right market information and systematic enabling environment.

1.2. The conventional theory of change regarding the private sector role and needs

The policy and programme framework adopted by the PNA and donors for Palestinian private sector development has been premised on a recognition that its prospects are shaped by two broad sets of constraints, each with its distinct impacts. On the one hand the external constraint constituted by Israeli occupation and denial of sovereignty has maintained a range of limitations on policy making at the macro level for economic development, as well as on structural economic deformations and persistent market failures (UNCTAD 2017). At the same time, various internal constraints related to the quality of Palestinian human capital and effectiveness of institutions as well as the overall regulatory and business environment are perceived to have an important impact on the strength and direction of private sector empowerment (World Bank 2017).

It has been generally assumed by the PNA, donors and international agencies that however significant the impact of external constraints on the economy and private sector, tackling them is beyond reach in the absence of a political settlement that ends occupation and enables independence (Taghdisi-Rad 2011). Hence, almost all efforts to develop the Palestinian private sector for the past decade addressed the internal constraints while making little progress on alleviating external constraints on trade facilitation for example or access to Area "C" natural resources. This focus was largely defined by the limited policy toolbox to which the PNA has had resort under the Paris Protocol. Since the 1990s, conventional economic policy advice from donors and international institutions (globally and to the PNA) has hardly shifted. It continues to emphasize the need to liberalize and remove barriers to trade, financial flows, property and labour markets, to privatize public utilities, and generally to restrict public sector involvement in the economy to social service provision, infrastructure and public good investment and regulation (World Bank 2014), alongside sustained fiscal consolidation (IMF 2017).

Any concept of the role of the state in the economic development beyond that risked being perceived as interventionist and reflecting the heavy hand of government. In the 1990s, distributing commercial rents and monopolies to various Palestinian private sector investors (eg. import licenses or telecom networks) by the PNA, while maintaining direct levers over others (eg. fuel products), was part of a political process of maintaining leading edge for the PNA in the economy and in negotiations with Israel as much as serving public revenue considerations of the era (Khan 2004). This was followed since the 2000s by a rollback of government involvement in commercial ventures and in monopoly arrangements, though keeping in place some protection of rents accorded to the private sector in key sectors.

"Reform of the business environment" has become a mantra of both public and private sector policy-makers as well as international partners. The premise here has been that incremental policy or legal reforms and piecemeal support programmes should, according to the rulebook, over time create an enabling environment to ignite the potentials of a stifled private sector (USAID 2017). But the standard rules of policy reform do not *a priori* apply in the Palestinian case, and many development partners have learnt over time that structural and dynamic political factors mean that business as usual in Palestine is not usual business.

This has entailed a lopsided and ill-focused treatment by the PNA and donors alike that ignored the fundamental weaknesses, externally and internally generated, that in fact determine the performance of the private economy and its prospective role in a process of economic development. Considerable policy and programme efforts and resources have been invested in improving the regulatory and doing-business climate. However, the Palestinian economy is in its third year of yet another bout of cyclical stagnation, its skewed structural features exhibit a stunted transformation, inequalities abound, the Israeli economy remains predominant and the PNA policy reform toolbox has been exhausted under current arrangements and agreements.

Though often not reached by PNA or donor reform programmes focusing on the legal and business environment, the private sector in Gaza has shown extraordinary resilience during the decade-long blockade of Gaza and the accompanying economic and political instability. The Gaza private sector has proved its dynamism and ability to adapt to changes, emerging from uncertain conditions with new survival strategies that have uplifted the whole economy. However, industry, agriculture, and services to a lesser extent, face major constraints on growth and competitiveness by high production costs stemming from: dual use list, small economies of scale; high prices on imported material; and, a double taxation system. Such costs are further compounded by complex "border" procedures, incurring repeated procedural expenses and delays. The competitiveness of private sector in Gaza is also handicapped by poor access to affordable soft financing and loan guarantees; low levels of competency and strategic thinking; imports that are not subject to local inspection; weak support and guidance by public institutions; and, a fragile context which disincentivises investment in agriculture.

Surveying Palestine's embattled economic landscape and strained social fabric of 2018, a decadeof economic policy and programming seems to have had minimal cumulative effect on resolving widely acknowledged structural weaknesses or failings. This discouraging record provides good motivation to consider at this point of political change in Palestine and the region, and at this latest stage of the struggle of the Palestinian people for an end to occupation and achieving independence, whether the prevailing policy approach has missed its target or perhaps mis-defined it. A reflection is warranted as to the assumptions made by the PNA and donors about which of the weaknesses of the Palestinian economy were primary or amenable to alleviation, which sectors could power growth and which agents of change were the most effective.

This failure of Palestinian and donor policy and programming to manifestly improve conditions, to grow the private sector or to restructure a deformed economy and imperfect market (at best having been in the realm of damage limitation), is the core problem driving this critical analysis of the conditions and prospects of the Palestinian private sector. The next generation of private sector support needs to focus on strategic sectors, structural economic bottlenecks and the institutional and sectoral sources of change that can accumulate and deploy Palestinian economic wealth and power in a manner that bolsters prospects for development as well as national liberation and sovereignty.

1.3. Exploring a new narrative

Such a reflection cannot but note that through its own momentum, a process of capital accumulation and concentration has been launched in Palestine and that growth, however volatile, proceeds apace, as examined in Chapter 2. Meanwhile distinct social classes with diverse interests and demands are forming, in different productive and service sectors of the economy, and differentially between regions, boasting a large, but increasingly low-income, middle class. Given the abnormal external environment, these developments have followed distorted trajectories, with stark contrasts emerging between rich and poor, cities and villages, core and periphery regions, and owners of capital and owners of labor, posing new risks to economic stability (Interviews), as analysed in Chapter 3. Prolonged occupation precludes the very prerequisites (sovereign institutions and an open market economy) for managing such processes in a manner that stimulates economic development, alleviates inequality and retains an effective regulatory role for the State (UNCTAD 2006).

Today, business leaders and economic policy makers are questioning long-held beliefs about what needs to be done to enable development of a productive, competitive and vibrant economy, even if only focusing on constraints amenable to alleviation (MAS Economic Conference 2016). This reflects a mixture of re-discovering some essential truths about the prerequisites for, and stages of, development and the introduction of new business, financial and innovative economic models whose mastery is the key to integration in regional or global markets.

For example, from the past twenty years exclusive focus on "export-led development", the idea is gaining traction that local production should substitute as much as economically feasible with imported finished products. If you cannot compete and occupy part of your domestic market, you will not be able to compete globally (Interviews). This is discernable in public statements by industrialists on different occasions, newsletters and other publicity literature of Palestinian industrial federations and in many of the interviews conducted for this study. Whereas the PNA from the outset shunned investment in productive sectors, energy and utilities or housing, or marketing, its sovereign wealth fund is now taking a different tack and focusing its risk-taking and investments precisely in those sectors (PIF 2016). Reclaiming an agricultural sector neglected for decades has become a necessary element of many an investor and donor agenda (MAS 2017a), as much as the PNA considers it part of securing national economic, social and food security (OPM 2017).

The Palestinian industrial lobby has made "protection of national industry" an acceptable and attractive public demand (MAS Conference 2016). The goal of "Palestinian economic independence" has been inscribed in the National Policy Agenda (NPA) and an autonomous Palestinian trade and tariff regime is increasingly viewed as necessary (OPM 2017). A younger generation of entrepreneurial, risk-taking investors is pressing for a more competitive environment in which the reward to business and capital derives from merit and ability to compete with quality products in the global economy, and not from political or other favoritism protecting accumulated wealth (Interviews). For some of them, occupation poses a secondary set of downside risks compared to those rooted in an uncompetitive business environment. Many private sector entrepreneurial initiatives have failed owing to a combination of business weaknesses, policy vacuum and Israeli restrictions (eg. a bold mushroom farming start-up, Zein, 2017), but the lessons from such experiences are useful in conceiving future Palestinian private sector development and support programmes.

A new vision and commitment are warranted to address the most amenable of the range of external constraints affecting the growth and development of a Palestinian economy for an independent state, including those affecting sovereign economic functions and the dynamics of economic structural transformation. Without such focus, the private sector, however defined or positioned, cannot play its expected role therein. Renewed programmes that work only within the existing, limited policy space and outdated economic models may deliver limited results, but these will fall short of a transformative impact. Yet, no component of the private sector is organized or coherent enough to invest in a transformative economic agenda without the Government taking the political, policy and regulatory lead. Hence, the private sector will not outbid the political leadership or cross national "red-lines", especially those related to economic or political relations with Israel or openly confronting Government in a way that could be perceived as threatening a fragile security and social fabric (Interviews).

The future of the Gaza Strip economy depends on building a vibrant private sector, fully integrated with the rest of the Palestinian areas and efficiently operating in a highly enabling business environment. For that to happen, Gaza freedom of movement of people and trade, in and out of the Strip, needs to be secured. The business agenda should be linked with a national agenda, its use of national economic resources unrestricted by political division, and its access to domestic, regional, and world markets unhindered. It will also depend on creating a decent work environment, institutional connections with NGOs and public institutions and close and mutually rewarding business connections with the neighboring countries. The Palestinian economy has no hope of

While sustained economic development will be elusive short of national liberation and independence, this does not necessarily mean that some of the economic levers through which Israeli colonial controls are exercised cannot be challenged, and their adverse impact alleviated. This can begin within the limits of the current Paris Protocol and configuration of Palestinian-donor-Israeli relations, all the while aimed at accumulating Palestinian economic weight and rights in the current balance of power to set the scene for a comprehensive new policy framework (Jamil 2017). This would entail not only a focus on enabling a more vibrant and productive private sector in activities that it has demonstrated its vitality and ability to compete globally. Equally needed are supporting initiatives of an "entrepreneurial state" that nurtures, invests, takes risks and leads a process of resilient economic development appropriate to Palestinian realities and human, social and financial capital assets (Zein, 2017; Mazzucato, 2016). In such an environment prospective external challenges may be withstood, and the private sector's potential be mobilized.

realizing its potential without a connection between its two major territorial parts, making any reconstruction talk that leaves out this connection unrealistic. Any attempt to lend support to Gaza's private sector must as a point of departure seek to reduce the political constraints that are overwhelming the cause of Gaza's weak private sector. Without that, short-term reconstruction and sustained recovery will be unattainable, and long-term development will remain a pipe dream.

2. Foundational factors determining private sector economic growth

The prospects, and ability, of the Palestinian private sector to fulfill its role of driving Palestinian economic growth and development and effect structural sustained transformation are first and foremost contingent upon the impact of range of structural (foundational) factors reviewed in this chapter. These structural factors alternatively constrain or potentially empower private enterprise and free market operation. They include macroeconomic challenges that must also be addressed by public and private sector joint efforts to frame and orient private-sector specific interventions. To the extent that adverse impacts can be mitigated, or positive impacts enhanced, support programs can be judged to be effective and well targeted.

2.1. Occupation, denial of sovereignty, economic dependency

Few observers or experts would deny that the structural constraint that most profoundly shapes the prospects for private sector development is the pervasive impact of Israeli military rule, settlement expansion, natural resource control and movement and access regulation system. Along with its corollary denial of Palestinian sovereignty and statehood, Israel's domination of all Palestinian economic and political domains is the constant in the equation that determines private sector freedom of movement and space to operate, much less flourish. Its significance cannot be discounted, since occupation restrictions can be more or less severe, violent force more or less prevalent and arbitrary disruption of normal business (or learning to expect the unexpected) more or less the rule (Interviews).

Over many years of dealing with Israel from a subordinate position, Palestinian businesses have devised complex avoidance, delaying or adapting mechanisms to continue to operate within some parameters of viability and profitability (Interviews). However much it may be in the interest of business to maintain normal relations with Israeli suppliers, intermediaries, employers and officials, the security-first logic of Israeli occupation always trumps common sense. The sheer weight and momentum of Israel's system of control is such that all Palestinians are equally targeted and liable to suffer at the hands of the occupation authorities.Sovereignty and political independence is the obvious key to resolving this inherent contradiction between the Palestinian private sector and occupation. ,intheir absence the best that the private sector can hope for is general political stability, This means in good times, better collective representation of their interests directly and indirectly with Israeli authorities, and in the downturn protection of their business interests and assets (Interviews).

The impact of an "adverse path dependence" on Israel in trade, monetary, fiscal, labor, resource utilization, technology and other vital areas of private sector activity has meant that Palestine has been subject to all the pressures of globalization and liberalization as other developing economies (UNCTAD 2006). But this has proceeded under the burden of occupation and with no resort to protective, supportive or alternative development strategies. Even though the Paris Economic Protocol (PER) and Oslo Accords were perceived as pathways for pursuing autonomous Palestinian economic and development policies, after 25 years they have come to restrict Palestinian economic self-determination, while exposing the economy to the interplay of international, regional and Israeli economic forces. There are few Palestinian or international analysts or experts who do not agree that this policy framework is redundant, if not adverse, and should be abandoned (Samour 2016).

The adversity of occupation goes beyond the issue of movement and access restrictions to the core issues of control over natural resources and constraints on economic management and policy-making space. Hence, the "normal" development path of the Palestinian economy and the trajectory of its transformation from an agrarian economy has been distorted and rendered subservient to Israeli security and economic or political interests (Interviews). The productive potentials of the Palestinian economy have been subject to constant attrition in a context of confrontation with occupation and settlement. Despite sustained efforts by the PNA to shoulder its social and economic governance responsibilities in preparation for statehood, Palestine has yet to chart the most appropriate path of structural transformation that would establish the firm bases of an independent economy for an independent state (Interviews).

The direction of political developments in the coming years is a major unknown (see below), either entrenching the one state reality or somehow rescuing the prospect of an independent Palestinian state. In any case, reversing dependency trends upon Israeli and transforming the distorted structure of the economy bequeathed by prolonged occupation should be the first tasks of any sovereign Government tasked with reconstruction and development (Interviews). These imperatives may be discerned in some Government policy statements such as the NPA or Ministerial pronouncements, though actual efforts on the ground don't reflect such an ambitious vision (MAS Economic Conference 2016). Furthermore, the institutional capacity of government to challenge the profound economic legacy of occupation is bound by a continuing commitment to existing agreements, despite a sense of frustration and impotence generated by the indefinite prolongation of the Oslo self-government arrangements amidst overwhelming Israeli force. Breaking free of these confines is as much a prerequisite for improving the prospects of the Palestinian business community as it is important for Government to be able to exercise the sovereign functions it has been denied.

2.2. The struggle for national self-determination from revolution to statehood

A no less significant dimension of the enduring Palestinian political economy landscape is the credibility of a governing political class still seized with the imperative of achieving the goals of the Palestinian national movement (Interviews). Continued assumption by the PLO/PNA of this heavy responsibility remains wholly in tune with the refusal of the Palestinian people in their different domains under Israel to bow to a logic of permanent occupation and national oppression, which inevitably touches every facet of life and opportunities for every Palestinian regardless of class, region, creed or faith.

Certainly, the prospects of security, peace and statehood seemed promising and attainable in the 1990s after decades of exile, where the Palestinian private sector played its role from the outset in investing in development, expanding its reach and organizing its operations. Increasingly, private sector actors came to demand greater economic freedom and representation with a view to building the free market economy to which the PNA was committed; the sector's role came to be seen less as subordinate to the imperatives of the national liberation movement and more as setting the tone for statehood readiness. The turbulence, division and growing diplomatic uncertainty experienced since the 2000s only served to heighten the dichotomy between the businesses, as usual approach favoured by market agents and the financial and economic implications of recurrent national emergencies generated by Israeli occupation.

The Palestinian "national front" comprising the liberation movement factions and the "patriotic bourgeoisie", is a coalition witnessed throughout the Third World since the wave of 20th century post-colonial independence experiences (Prashad 2007; Fanon 1965). It still defines and frames the relation between business and Government and remains a potent formula for nation-building in a hostile and uncertain environment. However, the underlying tensions between the financial and economic interests of the private sector on the one hand, and its inevitable role as part of the national movement, on the other, will continue to shape its performance and limit its ability (or willingness) to initiate change in either the policy environment or its investment and profit/loss calculations (Interviews). To the extent that private sector interests remain closely correlated with strategic national economic development, a relation which is reinforced by Israeli opposition to fully autonomous Palestinian economic power, the private sector will prefer that Government take the lead.

Well before the Israeli occupation of the West Bank and Gaza, indeed prior to the establishment of the State of Israel in 1948, Palestinian private business and capital were strong allies, funders and leaders of the national movement (see below). This remained the case in the diaspora after 1948, whereby successful Palestinian businessmen and middle classes working in the Arab Gulf countries became funders of the PLO (Khalidi 2015). Since the 1994 Oslo Accords, the PNA came to embody the aspirations of the private sector for national independence and sovereign Government. Today's Palestinian private sector did not form itself either after 1994 and the establishment of the PNA, or after the occupation of the West Bank and Gaza in 1967, or even in the wake of 1948. What has come to constitute and represent the private sector in Palestine in 2017 has its roots in a thriving Palestinian Arab economy before the *Nakba*. Indeed, many of its defining features today were evident early in the past century, both in terms of class value systems and institutional forms.

In an in-depth and most recent treatment, the Palestinian historian Sherene Seikaly has researched the emergence of the Palestinian capitalist class, whom she depicts as “Men of Capital” and “Women of Thrift” (Seikaly 2016). The former were urban, wealthy businessmen who tried to achieve some power in society and politics, “shaping new forms of social hierarchy just as rebels and radicals were dislodging them” (Seikaly 2016 p. 14). They entertained visions of an ideal social body—the ideal social man and his ideal partner, the thrifty domestic manager. Their self-definition was not only through their confrontation with Zionism, but part of a broader Arabist revival, throwing off outdated traditions and ushering in modern, intellectual exchange and pluralism. Seikaly unearths new archival research that epitomizes this class’s self-expression: *al-Iqtisadiyyat al-‘arabiyya* (the Arab Economic Journal), published from 1935 and expressing the interests and visions of a group of “intellectuals, men of science, art, education, capital and works” (Seikaly 2016, p. 26).

These men of capital combined commitment to free enterprise and private property with opposition to colonial rule and the Zionist movement. Not all capitalists took this stance, some opposed the 1936-39 revolt, and even left Palestine. But *Iqtisadiyyat* emphasized economics as a distinct realm to be studied, understood and inculcated. Aside from the natural Palestinian demand for independence, “the remaining aims of politics are economic... Politics are a means, while economics are not just the goal, they are the ends” (Seikaly 2016, p. 33). Seikaly’s presentation of the Palestinian Chambers of Commerce as “nascent institutional spaces in the 1940s” (Seikaly 2016, p. 125), bringing together men of capital from different political backgrounds, adds to the picture of class formation that she tracks. The Chambers had a common interest in capital accumulation, free trade, and components of a healthy economy, “guarding the nation’s public good” (Seikaly 2016, p. 126).

This review helps to remind us of the breaks and continuities in Palestinian economic thought and structures. Seikaly’s examination of the Mandate period reveals a more colorful, changing, and dynamic economic landscape of people, classes, and institutions than usually assumed in history or in many narratives of Palestinian business and economic elites. These observations highlight how important capital accumulation, class formation, and even conflict, are to the development of a “normal” society and economy. They show that just as the fellah and the patriot have their place in Palestinian national history, so do the businessman, the landowner, and the modernizing men and women of capital play their role.

2.3. Ten key national economic development challenges affecting private sector growth[2]

Under current circumstances, assumptions regarding the imminence of statehood have ceded way to a heightened uncertainty as to when and how occupation may be terminated, and sovereign statehood assumed. Even under an optimistic scenario that ushers in independence within a medium-term horizon, the damaged fabric of the Palestinian economy and its human and natural resources will require sustained policy attention, investment and good management to begin to break with the legacy of occupation. Palestine faces both the abnormal structural distortions of the economy and markets caused by occupation, as well as the “normal” challenges of development for a small, effectively land-locked, “free-market” economy with a narrow natural resource base and an open trade regime.

The impacts of occupation on the macro-economy at once compound and reflect the constraints facing the growth of the productive capacities of the private sector, whose vitality is essential to the correction of macro-imbalances. At the same time, distortions in the economic enabling environment render efforts to resolve macro and sectoral blockages more difficult. Meanwhile, Palestinian social cohesion is at risk from worrying trends affecting human capital (eg. youth unemployment, low female labor force participation and educational-labor market mismatches). A range of political constraints such as legislative vacuum, weak public political engagement and public service institutional weaknesses further complicate the tasks ahead. Regional inequalities have also become accentuated in recent years, and peripheral areas (Gaza, Area C, Jerusalem) have been proportionately more severely affected by occupation owing to their isolation, sustained Israeli repression, as well as the absence of PNA effective jurisdiction.

2 Unless otherwise mentioned, statistics in this section are from PCBS 2017a, 2017b, and PCBS 2017c.

This interaction of cross-sectoral impacts of continuing occupation and denial of sovereignty calls for a coherent policy response. Failing to address these challenges comprehensively will entrench deeper, irreversible structural weaknesses down the road. The following key national economic challenges are as much of concern to the private sector as they are the responsibility of Government to address through relevant policy measures.

a) *Chronic volatility in growth of the domestic economy and national income*

The volatility of the Palestinian economy's growth path and its vulnerability to external shocks is indicated in the spurts of high growth in some years (10% and above per annum for the economy in 2005 and 2011 and much more in Gaza in cases of recovery from war) and deep or mild recession in others (eg. after 2002 and since 2014, respectively). Needless to say, such an unstable growth trajectory implies a insecure and discouraging environment for entrepreneurship and investment and delivers anaemic per capita income growth. Indicative of the extent to which the economy depends on external (factor and transfer) income sources, the ratio of Palestinian GDP to Gross National Disposable Income (GNDI) has exceeded 80% only in the past few years, better than earlier decades but still low.

b) *Excessive conspicuous private consumption expenditure burdens import bill and depresses savings for productive investment*

Among the macroeconomic burdens associated with an open and liberal trade regime and a weak domestic economic base under occupation is the propensity of imports to dominate final consumption expenditures. The latter have exceeded GDP by 20% in recent years (and as much as 35% more in recessionary periods like 2005-2006). The free market economy adopted by the PNA precludes direct intervention to limit imports (especially those related to conspicuous forms of consumption fuelled by domestic and non-domestic sources of income) or to influence consumer preferences. But this macro imbalance remains a major symptom of structural impediments to building a productive, self-reliant national economy.

The other side of the high consumption/import components of aggregate demand is the low share of investment from GDP, around 20% in 2016 (MAS 2017b). The impact of the insecure environment created by occupation has not always been as adverse, as the investment rate had reached above 40% by 1999 and remained above 20% even in the difficult years after 2000. As much as 80% of private investment is found in relatively safe havens, especially residential construction and commercial buildings, much of it debt-powered. Such an investment performance is well below Arab regional averages (around 30%) and the even higher rates of investment (above 40%) of successful developing countries. This is especially problematic when, in an economy like Palestine's facing massive reconstruction and development challenges, over $6 billion of private, financial and corporate sector savings are retained abroad (MAS 2017b).

c) *Low public development expenditures discourage private risk-taking*

The PNA has had restricted means since 2000 to respond to the multitude of public goods investments that any responsible government must assume, especially in the areas of physical infrastructure, natural resource and ecological management, provision of basic utilities and services, research and development, as well as investment risk-taking in the specific Palestinian situation (Interviews). Whereas PNA development expenditures in 2011 ($294 million) were equivalent to as much as 16% of gross fixed capital formation, by 2016 the ratio had halved to under 7%, with development expenditures at around $200 million (MAS 2017b). Several factors have depressed public investment, such as a chronic budgetary deficit, the need to maintain the public payroll at current levels, diversion of donor resources to humanitarian relief and the limited resources for public investment.

d) *Weak productivity growth, restricting competitiveness*

The most significant cross-cutting challenge to growth affecting most sectors of the economy is the low and stagnant, and in some cases declining, productivity, reflecting a major cause of low competitiveness of Palestinian products in local and international markets. As measured by total GDP per total labour input, average productivity per worker has fallen from around $9500 in 2010 to $9100 by 2015, compared to levels of around $21000 in Jordan and $75,000 in Israel (Conference Board 2016). Low productivity is a catch-all indicator of many of the external impacts of occupation and the internal weaknesses that constrain production and investment and distort sectoral economic structure and the normal operation of markets. The issue is examined with respect to the (non-agricultural) private sector economy, further below.

e) *Industrial sector incoherence*

With the decline of the share of industry in GDP to around 13% by 2016, compared to above 20% twenty years earlier, the process of "de-industrialisation" of Palestine appears to be advancing, a critical distortion of the usual growth and development trajectory. Most local industry is unable to capture a significant share of local markets under the liberal trade regime in place or to break through Israeli trade facilitation barriers to reach international markets. Industry absorbs less than 14% of the employed, compared to 18% twenty years ago. Some progress in recent years has been noted in light manufacturing which can process local raw materials and activities which have established a track record of entrepreneurial innovation, high investment, higher productivity and competiveness. However, the limited prospects for most industries and the absence of a PNA industrial policy create disincentives to investment in new technologies or to replenishing depreciating capital stock.

f) *Steady decline of traditional agriculture*

Meanwhile, agriculture underpins Palestinian social resilience and continued presence on the land, as well as national food security, but has suffered most from prolonged occupation. Its share in GDP has collapsed to 3.2% in 2016, down from 12% in 1994 and over 20% at the end of the 1980s. Its share of employment has also fallen precipitously, to 7.4% (from 13% in 1995). While the "normal" dynamics of structural transformation are in evidence, inequitable competition with subsidised Israeli agriculture and its sophisticated production and marketing capacities is at the heart of the sector's dismal situation. Low-cost skilled and less skilled family labour is in abundance and, even under existing water and land constraints, different branches have proved their viability. However, constraints affecting inputs, local marketing, export access, processing, storage and distribution facilities contribute to agricultural decline.

g) *Tourism not able to assume leading role in services*

The creation of a Palestinian government and the expansion of public services since 1994 led to a doubling of the contribution of the public services sector to more than a quarter of GDP by 2013, shrinking slightly to 21% by 2016. No less significant has been the sustained growth and diversification in the range of private services, which already accounted for over a third of economic output before the first intifada and continue to be the leading economic cluster, generating around 45% of Palestinian GDP. Though tourism's share of overall service sector GDP is very low, based on the unique historical, religious and cultural assets of Palestine this sector remains the obvious, potential Palestinian "competitive advantage" service branch. While internal organization and regulation could be improved, the overriding challenge is the domination by Israel of hotels, guides, tour operators and tourist flows, by virtue of its annexation and full control of Jerusalem, the centre of any Palestine tourism package. Nevertheless, tourism constitutes the leading pole for future services development owing to its linkages with a cluster of related services, which together account for some 15% of GDP).

h) *Information and Communication Technologies sector constrained*

Though relatively small, the information and communication technologies sector is, along with financial intermediation, the fastest growing and most productive service branch in Palestine. It has generated a growing interest in higher education in ICT related disciplines as ICT skills are required in all sectors of the economy. Even though Palestine is faced with a problem of a surplus in the number of graduates in that sector owing to educational-market mismatches, there is no national innovation system to better orient educational outcomes and embed technological capacities in local industrial or other production processes. There is weak public sector involvement or leadership of research and development in this sector or others, which further limits the space for its development. The direct impacts of occupation on ICT are felt especially in the weak network infrastructure in outlying areas, restricted imports of equipment and access to cellular wavelengths, as well as stiff competition with lower-cost Israeli providers.

i) *Israeli control over Palestinian external trade and fiscal leakage*

Perhaps the most significant economic achievement of the last decade has been in reducing trade dependence on the Israeli economy, which is today a source/destination for only around half of total Palestinian trade in goods and services (as calculated by PCBS 2017b and UNCTAD 2013). Though Israel is still Palestine's largest trading partner and exerts controls over 100% of Palestinian trade and transit trade, the Palestinian trade deficit with Israel in 2015 was for the first time since the occupation less than 20% of GDP, falling as low as 16.5% by 2016, compared to levels of 40% ten years ago. According to monitored foreign trade flows Israel is still the dominant export sector market: 87% of total Palestinian exports of goods and services are destined for Israel. Although the Palestinian market represents only 3% of Israeli foreign trade and is not economically vital for Israel, Israeli control over the Palestinian trade flows is a security weapon used for collective punishment, a major constraint to production and exports and an additional cost on imported goods.

Furthermore, trade arrangements at the border crossings and in ports allow leaking to the Israeli Treasury of an estimated at $300 million a year of potential PNA trade taxes lost by Palestinian indirect imports through Israel (UNCTAD, 2013). This is in addition to what is not monitored due to tax evasion and smuggling and other revenue leakages intrinsic to trade arrangements in place, estimated at up to $285 million (World Bank, 2016). These sources of continuous haemorrhage for the Palestinian Treasury are missed opportunities to finance public investment or other pressing uses of such legitimate tax resources.

j) *Public finance imbalances*

The PNA faces enormous challenges in managing public resources and growing expenditure commitments, under the differentiated responsibilities of governance in all centres of population. Despite the diversity and complexity of the challenges of managing financial resources and meeting social and other needs, PNA public finances recorded clear progress in recent years in the areas of performance and financial sustainability, linking tax revenues with the rationalization of expenditures. However, some aspects of the public budget features imbalances, between current and investment expenditures, between regions and between sectors, and in the financial capacity to bear the burden of welfare of the groups and areas affected by occupation, reflected in (Khalidi 2016):

- The high percentage of Government current consumption expenditures, compared to small share of the development budget;
- The distribution of current expenditure concentrated in public administration and security, compared to the operational requirements of vital service sectors;
- Inadequate guiding criteria for current expenditure priorities that reflect developmental or humanitarian needs.

2.4. The debilitating impact of a decade of political and geographic division on the private sector in Gaza

Israeli actions in controlling the Palestinian economy, especially in Gaza, depends on twofold policies as Sara Roy (2016) has analysed in depth, concluding that the Israeli government wants to (a) prevent the emergence of a competing Palestinian economy, and (b) preclude the establishment, in any form, of a Palestinian state. Hence, Gaza barely survives closure and separation for more two decades, atop political division. In the face of isolation, separation, closures, disengagement, blockade, intra-Palestinian splits and recurrent wars since 2006, Gaza's business sector at present is too weak and too small to have a dynamic or vibrant role in the national economy. The precipitous decline in the share of manufacturing and agriculture sectors in Gaza's GDP, for example, makes it difficult to organize coherent productive clusters tailored to the interaction between the two sectors and supply of their needed inputs, domestically produced or imported.

Even with the present low level of related services that are provided domestically, they are still too dependent on Israel and West Bank resources, which are very difficult to access freely. Furthermore, the prevailing high degree of uncertainty and political instability, makes it difficult to have efficient and profitable backward and forward linkages, or to have an innovative R&D industry through local universities and technical colleges geared to the development of new and improved products.

The Israel separation (from Gaza) policy has been institutionalized by the operation of the Gaza Reconstruction Mechanism (GRM), and the dual use list. This was evidenced, for example in 2017, with Israeli tightening of the closure with around 10 new measures imposed that put more restrictions on access and movement of people and trade in and out of Gaza. Institutionalizing the GRM mechanism, limited working permits, and shortage in energy supply and the restricted areas to access, have resulted in extensive damage to Gaza's productive assets, caused great financial losses to business owners, inflated production costs and introduced an unprecedented degree of uncertainty and risks to the business environment, resulting in further de-formalising the private economy.

As discussed in the first two Chapters, the private sector presents a complex and multifaceted landscape of institutional forms and interests facing a formidable array of structural challenges posed by occupation and denial of sovereignty. It is also has an essential, if not leading, role in the Palestinian national economic and political systems and mission. The private sector economy also bears the brunt of the macroeconomic imbalances outlined above and must be the focus of any future policy and programme efforts to empower and renew the national economy.

3. The private economy and the distribution of wealth and of power

This chapter aims to map the terrain of private economic activity, beginning with an examination of the private sector from the angles of the structure and performance of the main components of the (non-agricultural) private economic activities. It delves into the private sector's institutional development at different levels, and it reviews the formal and informal features of the business environment that combine to create opportunities or disincentives for private sector growth. The chapter examines the potentials for the private sector playing the leading role in building a national economy and its institutional capacity for influencing public policy making and regulatory reform affecting the economy.

As shown in the below analysis of the sectoral structure of the Palestinian economy, and in most other contemporary research and analysis, the process of structural transformation in this context has been uncharted, spontaneous and distorted by the contours of both occupation constraints and absence of public policy. Palestinian economic transformation (both from the sectoral/supply side and the aggregate demand side) has been largely an outcome of the interplay of exogenous constraints and opportunities within restricted policy space, rather than the dynamics of sectoral investments and growth and the usual sequencing of transformation from an agrarian to an industrialised/service economy. Hence the trajectories of different sectors' performance do not exhibit consistent or clear direction, with growth setbacks and spurts often unexpected and inexplicable through conventional economic analysis.

The core interests of the private sector may be found at the intersection between three sets of factors:

- the real market conditions and the opportunities they create in terms of comparative sectoral growth and possibilities for income and profit generation;
- the extent to which private sector institutional development enables the advocacy for, and pursuit of, a set of sector-specific economic policy demands; and,

- the political space permitted for their inclusion within actual Government policy making processes.

To the extent that private capital and asset accumulation proceeds without external shocks or excessive government intervention and that private sector agents are empowered, then their overall weight in determining economic policy and national political outcomes is strengthened. But the reach of private financial (or capital) interests is hindered by a complex and cumbersome business regulation environment and Government performance widely considered by the private sector as lethargic, at best (Interviews). Private sector actors must also contend with public cynicism towards their agenda being wholly profit-oriented, as well as calls for greater social responsibility and engagement in the national struggle and commitment towards national economic goals such as productive sector investment and reducing dependence on Israel (Da'na 2014).

3.1. Growth sectors, strategic economic assets[3]

The sectoral structure and performance of the private sector economy reflects above all what is feasible in the circumstances, lucrative to investors and employees and secure in terms of likely demand for goods and services. An examination of the performance of the main sectors powering private sector growth and capital accumulation can identify where income is being generated in the economy, where change is taking place, and where technological and productivity advances are occurring. This, in turn, helps to better position policy interventions and investments for most effective, or most needed, private sector growth.

This section reviews the seven main activities undertaken by enterprises of the private sector economy and it excludes the self- and informally-employed in these activities, as well as the agricultural economy, public services and government administration. Available PCBS data allows for evaluation according to key performance indicators for these seven activities, namely: Industrial, Construction, Internal Trade, Transport and Storage, Information and Communications Technologies (ICT), Non-financial Services (including tourism) and Financial Intermediaries. Available indicators reviewed are: value added, employment, investment, capital asset accumulation and wage compensation, which in turn to identify potential areas for, and blockages to, growth and structural transformation.

Together in 2016, formal enterprises in these seven activities generated value added (VA) of some $8.2 billion, (or 61%) of the Palestinian GDP of $13.4 billion (see statistical tables in annex). The self-employed and informal parts of these sectors added another 12% of GDP, while agriculture (3%), public sector (15%) and VAT and customs (9%) accounted for the balance of GDP. This formal enterprise sector comprised 143,000 establishments, which employed some 475,000 salaried workers, equivalent to 55% of the total domestically employed labour force or 75% of the salaried work force that year (with public services accounting for the rest).

Gross Fixed Capital Formation (investment) of these activities totalled $342 million (only 4% of VA), while compensation of employees amounted to over $2 billion (26% of VA). The total accumulated market value of the fixed assets of these activities in 2016 was over $10 billion, including the gross additions that year to the existing capital stock of $360 million. Clearly this part of the (non-agricultural) private sector is the central arena for generating future Palestinian growth and constitutes the broad target area for future support.

Three activities/sectors (Industry, Internal trade and Non-financial services) dominate the private sector economy, and have for many years, while newly emerging ICT and Financial Services are exhibiting vitality, leaving the more stagnant construction and transport behind in most indicators. Together the three leading activities of this formalized private sector account for 98% of private sector establishments 91% of employees, 81% of value added and 63% of investment. Dominating these activities is internal trade with 36% of all establishments, 39% of employees and value added, but only 9% of investment. Industry contributes slightly more to value added than do Services (21% and 20%, respectively in 2016). But in terms of share of investment and share of establishments and employees it lags behind Services, which is the second largest sector after Trade in terms of the latter two indicators.

[3] Unless otherwise mentioned, statistics in this section derive from PCBS 2017c.

Nevertheless, these three sectors are the wealthiest in terms of fixed assets, together constituting a growing and predominant share (over 80% by 2016) of the value of total accumulated private sector (productive) capital, or 23%, 26% and 39% for industry, trade and services, respectively. While growth in the number of establishments, employees and value added in the three dominant activities has picked up since 2013, compared to stagnation in other activities, their share of capital formation has been falling against the increasing share of investments in ICT and Finance activities.

More problematically, the average productivity (VA per employed) in 2016 in Industry, Trade and Services was $18000, $17000 and $11000, respectively, while much higher in ICT ($74000), finance ($50000) and construction ($27000). Over the past five years, productivity growth of the Palestinian private sector economy has been stagnant (at an average annual of -0.1%) with shocks to productivity one year followed by gradual but insufficient recovery. There are many structural and cyclical factors behind stagnant Palestinian productivity growth over time, especially those impacts on the economy discussed above. The overall fragility of the economy may be noted for example in 2013 and 2014, when productivity plunged by over 3% annually, after having grown slightly in the preceding two years. But the recovery from deep productivity declines rarely compensates: cumulative productivity growth in 2015 and 2016 was only half the fall of the preceding two years.

Further research could identify exactly where productivity growth is blocked, where it is most fragile and vulnerable to external shocks, and where interventions could improve robust productivity potential. But from the past six years' experience, of the three predominant private economy activities, only Trade demonstrates strong average annual productivity growth (2.4%), though it too has experienced two-year periods of sharply declining productivity. Industrial productivity has been volatile, as high as 21% in 2012 and as low as -19% in 2015, with an average annual decline over the period of almost 1%. Productivity growth is also strongly negative in Transport and ICT activities, while generally positive in Finance and other sectors, though no sector has escaped some productivity declines in one year or more. Hence, what might be good (or bad) for one sector is not necessarily the case across the board: in none of these six years was productivity increasing in all seven activities.

It is important to recall that in Gaza, GDP growth from 2010 to 2016 fluctuated wildly, falling following the impact of Israeli aggression in 2009 and 2014 and then recovering somewhat afterwards. Economic data also shows a clear discrepancy in the sectoral contribution to the GDP between 1995 and 2016, particularly for industry, construction and services, which diverged from a positive contribution to growth in 2006-2013 to a negative one since. In general, services outperformed other sectors over the period of 1995-2016. Specifically, internal trade, repair and maintenance, the food industry and construction show significant contribution in Gaza economy. Given that investment in industry is costly, the growth in services is higher and faster.

Food processing contributes the highest value added to the Gaza private economy ($59 million) followed by manufacture of other non-metallic mineral products ($58million). Repair and installation of machinery and equipment feature the highest GVA, followed by manufacture of food products. Construction of buildings and manufacture of other non-metallic mineral products (i.e. stone and marble) also feature a significant contribution to GVA. Manufacture of other non-metallic mineral products, food products and chemical products feature the highest investment rates. The number of establishments in manufacture of fabricated metal products is the highest of any single industrial branch in Gaza (1,005), followed by manufacture of furniture (708). Internal trade establishments account for 61% of the total number of enterprises in the private sector, followed by services (retail and wholesale) establishments (26 %) and industrial establishments (12%).

In the light of the above performance review of the seven core activities of the private sector economy, it becomes clear that productive capital accumulation is proceeding apace in some areas, in the form of assets and through value added creation. This process follows a different distribution between Gaza and the rest of Palestine, with industry less significant in the former than in the latter. In any case capital accumulation is not translated into productive investment at a rate needed to spur sustained economic growth, job creation and productivity gains across the board.

Indeed, the fruits to labor from economic activity are neither significant, nor increasing. When considering the distribution of the return on capital by private sector activity, data on the share of labor in output shows that the ratio of compensation of employees to GVA between 2010 and 2016 is volatile year on year. Overall, the share of labor in the private sector economy averaged 26% in 2016, with the rest of VA distributed among rents, interest and profit (on which data is not published). This ratio has only increased over the six-year period in two activities (especially in ICT, rising from 13% to 27% and less so industry, rising from 21% to 28%). The share of labor in output is lowest in Trade (between 15-20%) and highest in Finance (43%) and features a high, though falling, ratio in Services and Transport (under 40% in 2016) and a lower stable ratio in Construction (25%).

While there are some bright niches of new products and markets, it appears that there are no clear sectoral leaders or especially promising activity that has a track record of sustained market or financial success (Interviews). Those sectors/activities which provide for a large share of employed, wage shares output and asset accumulation have not exhibited stable growth, productivity gains or catalytic levels or forms of investment. For those activities which perhaps have better financials and stronger corporate performance, their contribution to GDP and employment is not so significant (Interviews).

Great emphasis has been placed on "export-led development" by the conventional economic policy wisdom advocated by private sector, government and donors, but in the Palestinian context this focus solely on export competitiveness has failed on two counts at least. To expect exports to be the main engine of productive sector growth for an isolated economy such as Palestine's whose external trade and transport flows and borders are held hostage by an occupying power, is dubious to begin with. More problematic is perhaps the idea that the dynamics of comparative (or competitive) advantage will work normally in distorted market conditions and that, hence, domestic market demand may be satiated by more "competitive" imports from Israel or the rest of the world. Such a policy disposition has neither created new competitive Palestinian export industries, nor has enabled processes of structural transformation to proceed in a way that domestic markets are also targeted by industrial, agricultural and service sector growth.

The approach of "picking winners" is generally not favoured (by conventional policy and business leaders) in design of trade and fiscal policy (Interviews). But public authorities cannot simply leave the distorted Palestinian market to weed out failure or reward success. In the Palestinian context, both the definition of "winners" and the selection criteria that might be applied, depend largely on what sort of economic structural transformation is envisioned nationally and how economic decisions are shaped by deep-seated, overriding political challenges that the Palestinian authorities and people must tackle in the coming few years (Interviews).

> *Therefore, if industrial policy is considered as a prerequisite to developing stronger productivity and upstream (e.g. with agricultural) and downstream (e.g. with trade) inter-sectoral linkages, then support should nurture both competitive, thriving "infant industries" capable of producing for export and domestic markets as well as ailing but strategically important sectors (Jamil 2017). On the other hand, if the national economic vision for Palestine entails more concentration on building the services economy, this would require special policies and programmes to transform tourism from a faltering sector dominated by Israel into a pole with which related services may interact. While not mutually exclusive, such options require a determined and well-elaborated set of economic policies, well beyond the NPA.*

3.2. Financialization and accumulation of capital

An important new phenomenon reviewed here is financialization of the Palestinian economy and formation of distinct social/income group class interests, as well as the emergence of perceptible inequalities. Different indicators may be cited to point to the sort of forces at play, which confirm that important transformations underway in the Palestinian corporate and investment scene, as well as in the underpinning social capital. Some analyses have focused on the nexus of common interests between Palestinian, Arab Gulf and international finance as indicative of a more advanced stage of capitalist development in Palestine acquiring a force of its own and distinct interests that transcend the national domain (Hanieh 2013).

Financialization, or the increasing preponderance of the financial sector within the macro-economy, is an important process both because of its role in facilitating mobilization of resources for investment and intermediating economic transactions in general. But in a fragile situation such as Palestine, excessive deepening of the financial economy also can create risks for the banking sector and indebted households. Furthermore, an overly financialized economy can overshadow the real economy and pose risks for broader economic stability that are beyond the regulatory power of the fiscal or monetary authority, as was witnessed during the 2008 global financial crisis and its aftermath. This adds another dimension to the distorted process of economic structural transformation noted above, whereby an unfettered free market dynamic can play a role in shaping consumption and production patterns in directions that could be detrimental to broader socio-economic development interests.

Perhaps the most obvious feature of the Palestinian economy today, compared to 25 or even 10 years ago, is the strength, expansion, stability and profitability of the financial sector, especially commercial banking and related financial regulation. Since the 1990s, the assets of deposit banks operating in Palestine have grown from around 15% of GDP to almost 45% by 2015; by 2016, private sector deposits reached $10.5 billion or some 75% of GDP (MAS 2017b). While financial services do not dominate the economy (at less than 4% of GDP), strong growth in value added, employment and other indicators (reviewed above) is as much part of "normal" economic development as financial sector success creates new policy and structural challenges.

Well monitored by the Palestinian Monetary Authority (PMA) the Palestinian banking system performs according to global corporate and financial management standards and helps to pull the rest of the economy forward while also providing intermediation between savings and investment (BoP). This landscape has been totally transformed since the establishment of the PNA when there was only one small Palestinian bank and another Jordanian bank with limited operations in Palestine. Today the four major Palestinian banks (Bank of Palestine, Palestine Investment Bank, Al Quds Bank and the National Bank) demonstrate a diversified number of major shareholders (10 between them, mostly private but including the public Palestine Investment Fund). They also have between them four subsidiaries mainly active in real estate financing.

Financialization of the economy of course extends beyond the scale or share of banking sector, and can be discerned when examining the increasingly sophisticated structure of six of the major holding corporations (PADICO, PIF, APIC, Massar, PMHC and Paltel). Between them, these big six hold shares in some 20 financial institutions or equity funds, some 10 real estate development funds and groups, as well as another 10 construction, industrial telecommunications and commercial corporations (Radi 2017). In this dimension of corporate development, and a network of players, a strong but small institutional cluster contrasts with the less complex SMEs, the predominant form of Palestinian business.

Among these large-scale actors working in the private sector economy is the Palestine Investment Fund (PIF), the investment arm of the public sector with assets valued at around $800 million in 2016 (PIF 2017) with strong growth to $990 million by the end of 2017 (PIF 2018). PIF has recently diversified its market operations engagement into productive sectors such as energy, agriculture, industry, marketing and trade logistics, alongside previous investments in real estate projects and other corporations. The PIF Board is composed of representatives of major Palestinian companies, and economic leaders and businessmen, reporting to a General Assembly of 30 people appointed by the President of the State of Palestine. The market role of this significant source of catalytic public investment has been generally cooperative and aimed at crowding in private investment in environments that require a risk taker to be able to take a loss of need be (Interviews). It provides an alternative model to other large investment corporations, many of whose major shareholders are constituted by leading members of prominent business families.

Some in the private sector consider the PIF accountability to political authority as uncompetitive. They view its market position as effectively subsidized by the fact that it is handling public funds, notwithstanding the high transparency in its financial reporting and the Fund being treated by government as just another large investor (Interviews). Ultimately, as an enterprise whose assets are public-sector owned and whose investments do not benefit individual financial interests but rather aim at having a catalytic effect on the national economy, its small share of the market and the strategic investments it makes point to its overall positive market role.

Another important indicator of the growing influence of finance upon Palestinians lives' and the sustaining of aggregate demand in the economy has been the vigorous expansion of private credit to households, and the growing weight of indebtedness for a significant proportion of lower and middle-income groups in a generally anaemic economic environment. By 2016 credit facilities to the private sector totalled $5.5 billion (MAS 2017b). The two most significant forms of credit facilities both in terms of scale and growth in recent years, are those provided to households for real estate and construction and private consumption (totalling around $1.4 billion each). It is estimated (MAS 2017b) that around half of these private credit facilities are provided to government employees (around $1.3 billion). According to the PMA, a growing amount of the credit extended for real estate has been facilitated by an emerging mortgage finance market, which grew from $40 million in 2007 to $376 million in 2016. While credit facilities for trade activities is the third most significant form of credit facilities (over $1 billion), agricultural and industrial credit are low and hardly growing over time.

The implications of the long term economic horizon of the concentration of private investment (and credit) in real estate are not encouraging for the development of a productive and self reliant private sector. Palestinian private savings have always flowed mainly into residential and real estate (non-tradeable) as a safe and economically rational choice, even before the establishment of a large and robust banking sector. This phenomenon has not only deprived the economy of resources for productive investment, but equally has in recent years encouraged speculative asset price bubbles in certain regions (especially around the economic and administrative center of Ramallah) which have skewed prices upwards and encouraged an apparent over-supply of (widely unaffordable) housing. So while significant private savings rest immobile, but relatively safe, in housing stock, the banking system is able to offer generous levels and terms of private credit that ends up fuelling non-tradeable, rent seeking or import intensive consumption.

Money flows into Gaza through a range of channels, specifically public revenues, external support (foreign aid), a limited number of exports, credit/deposit facilities, and Foreign Direct Investment (FDI). It is further retained and circulated through spending by local consumers, businesses and government actors on local products and services (SLED, 2017). Bank deposits from Gaza, especially by the private sector, are around $1.1 billion and with consistent increases over time. Credit to the private sector of some $1 billion is not much less than Gaza deposits and also has grown consistently. The services sectors and private consumption enjoy more credit than other sectors. West Bank depositors dominate the market at some nine times the scale of Gaza; similarly credit facilities in the West bank are six times greater than Gaza. It has been empirically demonstrated that the Gaza industrial and agriculture sectors suffer from a negative lending gap. This is especially damaging for small and medium enterprises, which typically are more concentrated in agriculture and manufacturing. The gap is especially large for agriculture, confirming the intuition that credit rationing has been operating more for small and medium enterprises in rural areas (Interviews).

The share of Gaza in foreign aid flows is estimated at around 40% of about $766 million in 2017, however there is no transparent documentation that shows how exactly how much aid was allocated to Gaza (Interviews). Much of the aid that flows into Gaza retains a humanitarian focus. Whilst justified in the light of repeated humanitarian crises stemming from repeated conflict and invasion, essential services and reconstruction efforts have been placed ahead of development projects, which have the potential for greater long-term impact through local financial irrigation and the local multiplier (SLED, 2017). Foreign aid to Gaza has traditionally motivated consumption over development, with a relatively small proportion directed to economic development (Sakher et al. 2011). The World Bank reports (2016) that of all projects submitted though the GRM, 27% of infrastructure projects were completed, compared to 19% of commercial projects and only 5% percent of industrial projects.

Coordination within the aid system and between donors and government actors has been weak, and characterized by a lack of transparency. There is no clear and coordinated vision for the use of foreign aid to develop the Gaza economy; nor are there plans at a government level to guide or employ aid to the full benefit of the local economy – a challenge compounded by political division (Interviews).

3.3. Class formation

An additional process that adds to the complexity of factors affecting the prospects of the Palestinian private sector is the impact of the emergence of distinctive social class differences. This includes an apparent, but still unmeasured, "one percent" who maintain opulent life-styles, with homes, vehicles, clothing and conspicuous consumption projected as symbols of a prestigious social status recently acquired or sought. The contrast between the "lives of the rich and famous" with the masses of middle and lower income groups is stark, as in many developing economies where the fruits of growth and wealth accumulation are unevenly distributed. Sharp disparities in income levels between different social classes reflect the differential average income earned in different labour markets, as well as a weak social safety net and protection system for the most disadvantaged Palestinians.

According to available information, around a third of wage earners in the private sector are paid under the legal monthly minimum of around $400 (PCBS 2017a). The daily wage of about 69.2% of private sector employees in Gaza Strip, and 17.4% in the West Bank, is below the minimum wage, at about NIS 748 monthly in the Gaza Strip compared with NIS 1,068 in the West Bank. Public sector workers salaries are above that, within a range of $400-500 for the lowest grades, up to $1000 for middle grades and up to $1800 for senior (sub-Ministerial) grades (State of Palestine, 2017). The average wage of workers in the private sector is lower than the average wage of workers in the public sector by 11% in the West Bank and by 50% in Gaza Strip (MAS 2017b). There is also a noticeable gendered wage gap: the total daily wage for females working in the private sector in the West Bank is about 74% of males' daily wage, while the gap is less in the public sector.

Another part of the segmented private sector labour market is constituted by the 15% of (West Bank) semi and higher skilled workers who can earn from $1000-$3000 monthly (PCBS 2017a). The median daily wage for work in Israel is over twice that of the domestic market (MAS 2017b), provoking a constant drain of relatively well-skilled labor from the local economy. Only in the private corporate sector, which employs a small share of the labour force do salaries reach above $10000 for CEOs and other top managers (Interviews).

Of the few analyses of social transformation in Palestine, one writer (Sourani 2006) has attempted to identify

> *The process of class transformation assumes different proportions in different regions (between urban and rural, West Bank, Gaza, Jerusalem and Area C, refugee/non-refugee, Ramallah/rest of West Bank, etc.) But this only serves to further differentiate and divide the Palestinian people, otherwise united in the national cause. Inequality takes many forms in the Palestinian context, owing to the legacy of different regimes, political and economic forces and cultural traditions at play amidst the relatively unregulated and laissez faire market in Palestine. Sharpening of class and income inequalities can only spell trouble down the road for the stability of the private sector economy and its social utility effectiveness. If despite economic growth and perceived wealth in some urban settings, youth remain unemployed and poverty is not reduced, the sustainability of the current configuration may be put at risk. To avert social crisis, more intensive and explicit efforts are warranted that acknowledge and alleviate inequality gaps in income, between regions, in access to services and in exercise of political influence (MAS Economic Conference, 2016).*

what may be considered a middle class as accounting for some 60% of the population, comprising employees in the public, private and Israeli labour markets small entrepreneurs and self-employed professionals and traders. They may be categorized within monthly average household income categories of $2500-5000 (monthly), $1000-2500 and the lowest income group earning less than $1000. According to this analysis, the former two categories constitute less than 10% of the total middle class, and have grown with the expansion of the PNA and development of the economy and its service sectors. Overall, the middle class may be defined (Sourani 2006) by its weak productivity (as many are in public sector or services/trade jobs), which is largely attributed to not owning any means of production, investment or capital accumulation (beyond bank debt-fuelled home ownership). It is also distinguished by a high propensity to conspicuous consumption, a process also powered by easy consumer credit from an omni-present financial intermediation system. Finally, the middle class tends to be passive and under-represented politically, partly owing to allegiance to the government (in both the West Bank and Gaza) for access to jobs and services. This is also because of an attachment to the stability and security that political non-engagement offers, especially noted in the West Bank over the past decade, a sort of "escape from politics" (Khalidi and Samour 2011).

Traditionally, Gaza's economy was driven by a family-based social elite before the first intifada as large Gaza clans benefitted from inherited wealth and political connections and dominated commerce, land ownership and enterprises. Following the shocks of the first and the second intifadas, the role of social and economic elites diminished over time to the advantage of new political leaders connected to PLO and non-PLO factions. Following Oslo and establishment of the PNA, the role of political and militant leaders was pronounced in the climate of growing uncertainty and legal fragility (Interviews). The traditional family elites have retained some alliance with the PLO and Hamas leaders through shared businesses, family relationships and protection of investment, etc. The traditional Gaza elite also benefit from their status by securing employment for their relatives in PNA institutions aiming to reclaim some of their influence in socio economic life (Interviews).

Since the Palestinian division since 2006 new dynamics came into play as hitherto disadvantaged social strata have become increasingly involved in the political system in Gaza (Interviews). With the emergence of a dominant security force in Gaza and the conditions of blockade and legal divergence (from the PNA), the new political leaders have access to fiscal resources generated by distorted market conditions, through regulation of clandestine tunnel trade and other taxation imposed to fund a parallel administration of Gaza. The traditional Gaza social and economic elite have little voice today as a newly emergent leadership largely from underprivileged refugee backgrounds are riskier, younger and enjoy connections with the ruling authorities (Interviews). As a result of these dynamics, along with the chronic isolation and separation from the rest of Palestine amidst political division, the middle class has been squeezed in Gaza as a vast lower-income class predominates. High-income social strata are also diminishing, under the rule of the new elite and little involvement in political and economic life by traditional social formations.

3.4. Private sector institutional development and economic policy making

The PCBS reports that in 2012, there were some 123,000 operating establishments in the private sector, 83,000 of which were in the West Bank (See Annex 2). By legal status, 108,000, or 88% of the total, were sole proprietorships, 11% were private companies less than 1% were public shareholding companies. Some 23% of West Bank establishments were in Hebron, followed by 17% in Nablus and 14% in Ramallah/Bireh, while 41% of Gaza Strip establishments were in Gaza city. By employment scale, some 111,000 (88%) of private sector micro establishments employed only 1-4 persons, 11,000 (8%) were small and medium scale employing 5-19 persons and only 1,150 (1%) of establishments employed 20 or more persons. Most of all enterprises (60%) are concentrated in wholesale and retail trade and vehicle repair activities, and 95% of these are micro sole proprietorships. The second largest group of establishments is in manufacturing (14%), where a slightly smaller proportion of establishments (77%) employ less than 5 persons. These figures depict a retarded formalization of the private sector, and create a challenging landscape for its future institutional development, and for representation of its different components' interests (in terms of scale and business model).

The clearest institutional address for formal representation of the sector in its broadest definition is the "Private Sector Coordination Council (PSCC)", comprising twelve sectoral bodies: Association of Banks in Palestine, Palestinian Construction Union, Palestinian Federation of Chambers of Commerce Industry and Agriculture, Palestinian Insurance Federation, Palestinian Federation of Industry, Palestinian Businessmen Association, Palestinian Trade Centre - PALTRADE, Palestinian Information Technologies Association, Palestinian Shippers' Council, Arab Hotel Association, and since 2017, the Businesswomen Forum and Association of Auditing Companies. These institutions cover the main sectors of the private (non-agricultural) economy, and are reflective of the broader sectoral constituency and agendas on whose behalf they advocate. While most have a voluntary membership system, membership in several of the PSCC members (e.g. Insurance Association, Banks Association, Industrial Federation, Chambers of Commerce, PITA) is obligatory by law, which also designates them as the formal private sector partners with government, on Higher Councils or with international counterparts. So it is clear that the PSCC members represent their constituents' interests and policy demands, collectively or sectorally, and Government deals with them on that basis (Interviews). While serving primarily a coordination role between its twelve constituents, the PSCC is not an autonomous institution *per se*, it has no standing secretariat or even a website, and its chair rotates between the members twice a year. It is essentially the sum of its components and no more.

The PSCC constituent institutions' active members are mainly drawn from medium or large scale enterprises, and for most they number in the dozens or hundreds, except for the Federation of Palestinian Chambers of Commerce, Industry and Agriculture (FPCCIA) which include all formal enterprises (66,000 members) and the (sixteen) Industrial Federations which include several thousand members. Hence the PSCC constituent institutions are mostly managed by representatives of the larger, more active, well-established companies and business leaders in their sectors. The benefits of membership in these associations differ between institution, but includes problem solving, certification, technical assistance, and most notably, policy advocacy with the Government. Their activities include implementing donor supported projects as well as joint Conferences and consultations with Government (e.g. MAS Economic Conference 2016).

All PSCC member institutions charge annual membership fees, but these only cover basic core functions, and often project related funding is needed in order to attract qualified technical personnel to provide services to members. Many Palestinian enterprises will be members of at least two of these institutions, since there is not a strict division of sectoral specialisation between them. In recent years, donor initiatives aimed at different sectors of the private economy have been implemented by consortia or two or more PSCC members, attesting to the usefulness of pooling resources and the need to harmonise overlapping constituencies and program areas. While developing the capacity to offer more and better services to members would make these institutions more effective and less dependent on donor-funded project type operations, members put the greatest premium on their influence on policy making, even if it is advisory and not authoritative.

In recent years, political factionalism has been more noted in the governance of these representative institutions, attesting both to their growing significance in rules making processes and general political polarisation in Palestine (Interviews). Affiliation to the ruling parties in the West Bank and Gaza and avoiding being perceived as a tool of political opposition in each region is a necessary ingredient of their ability to maintain access to government policy makers. These institutions are seen by some business leaders to be as much a part of the Palestinian political system as they are professional technical associations of different sectors. Their status is not dissimilar to the Palestinian workers trade unions, which arose as part of the PLO social agenda in support of the liberation movement but without a legally binding or effective collective bargaining function.

Meanwhile, the concerns of the vast community of Palestinian small business are advocated by Chambers of Commerce based in each of the cities and main governorates. The Chambers typically have a large membership; all businesses are by law are supposed to be registered with them. However, these Governorate-based bodies have local reach at best and limited impact beyond information sharing, local economic development initiatives and certain accepted market monitoring, coordination and regulation functions. The Federation of Chambers is designated by law as the private sector interlocutor in several joint policy making bodies/Higher Councils and in international fora, just as the Businessmen Association represents Palestine in international Business Councils.

Political factionalism naturally plays a role in the governance of the Chambers as well as other representative institutions, as it does in local government, with their political makeup reflecting the political tendencies dominant in the cities in which they operate. But the Chambers generally focus on their technical, representative role of all businesses in their regions. Boards are usually composed of traditional, senior business leaders from major families or younger technocrats. Often bypassed by donor resources or reform programmes, the Chambers at the local level remain the private sector institutions closest to local businesses and the regional differences and comparative advantages within the private economy. In terms of sheer number of members and their combined potential, they are seen by some as the most democratically legitimate representative institution of the private sector (Interviews).

The private sector also features individual champions who, regardless of their own industrial or financial interests, have come to be recognized as legitimate advocates for a range of private sector policy demands (Interviews). The membership of the Boards of major Palestinian public economic institutions or regulatory bodies includes many of these "captains of industry". They reflect a mixture of home-grown traders turned industrialists turned investors, returnee diaspora businessmen and business development and economic experts. For example, a glance at the composition of the Boards of some private sector representative institutions and public-sector institutions that engage private sector actors shows a diverse membership (Annex 3). No one person or family, political faction or region dominates these bodies, further suggesting their broad-based representation, even as some members are more active or vocal than others in advocating for their sectoral interests and there are only a handful of women in these leadership bodies. These private sector champions operate both within the sphere of these representative institutions as well as on their own, pursuing their specific or sectoral interest and demands. In some cases, these are second or third generation family-based businesses. This adds an additional dimension to the makeup and behaviour of the private sector, whereby traditions of family solidarity and age seniority take precedence over imperatives of corporate formalization or modernization coming from the younger generation.

The constituent institutions of PSCC are active in Gaza in catering to its special conditions. For example, the PFI, the Chamber of Commerce and PALTRADE in Gaza played significant role in advocacy, research and providing services to its members, though the contribution of such organizations is not always sustained over time (Interviews). In dealing with the multifaceted political environment and geographic separation, the PSCC on the one hand reflects the heterogeneous structure of private sector representatives in two regions, and on the other hand dealing with three governments (*de facto*, PNA and Israel). This dilemma weakens the role of the PSCC in the presence of different agendas and mistrust among the parties. In this mine field, the PSCC can only be expected to make a limited contribution at the political level as they have to intermediate their concerns between competing political agendas and legal/administrative frameworks (Interviews). As depicted by one private sector stakeholder, "between irregular meetings, smiles are exchanged, hypocrisy is maintained, security issues dominate, media coverage is ensured, snacks are available and public relations are upheld" (Interviews). Meanwhile, nothing improves on the ground, and sometimes on the day following such a private sector meeting, Israel deliberately tightens the blockade resorting to the dual use list, illegal import fees are imposed by the de-facto government, and the taxes remotely applied by the PNA are collected at pre-shipping (Interviews).

In this minefield, one example is depicted in the north of Gaza, as a matrix of interests is exchanged by different

*The proliferation of institutions mentioned above and personalities active on behalf of the private economy (interviewed or listed in the Annexes) has meant that the main needs of each sector have been well articulated over the past years, in conferences, workshops, publications, projects and governance decisions. These private sector institutions and advocates have generally done a good job of elaborating clear statements of sectoral policy, reform and investment needs, and are sure to be found at the table of any public-private or donor inspired activity concerning their sector. They are recognized by Government and the public as representative of their sector, even though it appears that significant strata (defined by scale, region, sector, age group) are only partially represented by existing bodies and many potential members never reached (*Interviews*). Notwithstanding their established institutional capacity and sectoral technical know-how, the limited reach and resources of these institutions, and the absence of an economic policy and investment priority guidance lead from Government, combine to diminish their ability to effect change in the direction they advocate.*

actors at the commercial border crossing. The de-facto government represented by one ministry is mainly interested in collecting more taxes while the private sector is demanding more facilities to manage the flow of goods through the single main gate. Meanwhile the PNA calls upon the private sector to not pay taxes to the de-facto government while enterprises are asking the PNA to facilitate more working and visit permits to the West Bank, Israel and outside word. In this scene, a mixture of formal and informal black-market operators easily emerges, composed of individuals from the main players. In another setting, in the south of Gaza where Rafah borders with Egypt, the scene is reproduced, only more complicated and governed by the black-market actors (tunnel economy), including Egyptians, illegal traffickers and local clans. In both situations, only those who understand the game among the formal and informal actors may survive and the market is replete with anecdotes of business people who lost their business due to their rationality. Meanwhile, a new emerging economic elite is being produced within a complex network of political, social, business actors.

However, absent real public intervention, there is some good news from among Gaza private sector institutional actors, which recently conducted several visioning exercises such as "Gaza Connected", "Sustainable Local Economic Development Strategy for the Gaza Strip (SLED)", "Gaza 2020". In particular, Gaza Connected has articulated a master plan for Gaza development which goes well beyond reconstruction to provide Gaza with the infrastructure underpinnings necessary for its sustainable development. Two Palestinian conglomerates, PADICO and CCC have been at the forefront of this effort together with the Portland Trust, the Bank of Palestine and the PALTEL group. They also envisage developing tourism, housing, IT and digital entrepreneurship, agriculture and manufacturing. These companies will work in partnership with the Palestinian Investment Fund and the Gaza private sector.

The SLED presents a comprehensive framework for strengthening the Gazan economy, including strategic objectives and proposed activities under seven priority areas. It was developed in a process that engaged government entities, businesses, donors, civil society actors and academics. The strategy is a step towards a common vision for development among the actors that engage in the Gaza economy. It is asset-based and opportunity focused; and aims to maximise economic opportunities in a way that is inclusive, environmentally sensitive, and improves welfare.

3.5. Regulation of economic activity: business environment discourages investment

Numerous and complex procedures in the overall business and trade environment constrain and frustrate investment initiatives and promotional efforts for local products and exports. These include Israeli obstacles and diversions to the transportation network fragment the Palestinian territory and separate regional markets from each other. This increases the difficulty of achieving economies of scale in investment decisions and business planning and creates distortions in market indices and price levels for goods and services between regions and within some sectors experiencing irrational price inflation. Uncontrolled trade borders with Israel further aggravate the constitution of coherent domestic markets, as smuggled or low-cost goods are marketed from/through Israel to the detriment of local producers and sometimes in violation of consumer safety and health standards.

The PNA has worked extensively over the years to put in place the necessary legal, regulatory and public institutional framework to manage the free-market economy enshrined in the Palestinian Basic Law. This process has seen its ups and down, with periods of intensive "institution-building" (in the late 1990s, and again after 2009) followed by others featuring complacency or inertia (Interviews). The narrative of success or failure of government in Palestine differs by vantage point, with much of the private sector pointing to gaps in the legal framework, weaknesses in enforcement, inadequacy of government services or material support to business, poor economic and utility infrastructure, bureaucratic complexity and lack of information transparency (Interviews).

Such indicators compose the World Bank's Doing Business Index (DBI). Palestinian private and government policy makers usually resort to this index when highlighting achievements, or in identifying areas for more intensive efforts. Indeed, both through the lofty goals embodied in the NPA and through Ministerial and other official pronouncements, government regularly affirms its commitment to enabling private sector growth and responding to the business community demands for better governance. Palestine's success in improving its position on the DBI in 2017 was linked to specific legal and institutional reforms that had been pending and were seen to have a significant impact on the business climate (Donia al Watan 2017). But since Palestine is not and should not be compared to, say, Finland, assessment of the business environment according to standard global indicators can entail quantifying the unquantifiable, or making inappropriate comparisons and judgment about performance and priority areas for reform.

However, related government procedures still lack adequate facilitation, rationalization and transparency (Interviews). A multi-tiered legal system complicates and prolongs litigation, rendering the reform effort under occupation futile or redundant in some cases, since Israeli security and legal interests trump all other jurisdictions. The business/trade legal environment features laws and regulations that call for intensive government implementation measures or revision in other areas. Certainly, the regulatory and supervisory role of governmental authorities over economic activity requires careful consideration and renewal (Interviews). But reform for the sake of reform can be counter-productive. Further development of new laws may be called for if absolutely needed and after careful study, but not simply because a gap might exist.

For historic and political reasons, there are inevitable gaps in the legal framework with limited enforcement reach of Palestinian government agencies (Jafari 2016). In the Palestinian context, the absence of a legislative review process, limited democratic accountability and weak popular participation in law making since at least a decade, means that passing new laws risks further complicating an already incoherent legal system, even if a certain legal reform appears to be needed. Some experts, donors and specific interest groups have stressed a range of gaps in the legal framework that hamper various economic processes, and draft economic laws have been discussed to address some of those areas (companies, competition, foreign trade, etc) (Sectoral Working Group, 2017; EU, 2017). Other legal experts suggest that new law making at this stage of Palestinian political and institutional development could be counter-productive, for constitutional and political reasons (MAS Economic Conference 2016). Of greater concern to many private sector advocates is the inadequate enforcement of those laws agreed and adopted in the past ten years. This may be attributed to institutional, financial or political failure and it is especially at the latter three levels that the business environment most clearly suffers from inadequate, and insufficient, government.

Highly cited by private sector actors consulted for this study is a perceived mediocre and incoherent PNA institutional service delivery (beyond satisfactory performance in the core functions of education, health and security). For example, in the case of government services for business, the much vaunted "one-stop shop" concept has been advocated over the past twenty years, with many plans and projects aimed at designing central repositories and systems for government business information, procedures, forms and services. However, business and investment promotion facilities and information provided by PNA Ministries and agencies remain as separated and fragmentary as ever, and once again the idea is on the government's agenda as one of its priority projects (Palestine Exports Council 2017). As for possible financial incentives (tax breaks/facilities, subsidies, specialized credit) provided or guaranteed by government for different categories or sectors of business, there are no PNA legal or policy provisions other than the Investment Promotion Law, which is seen to offer only a minimal set of incentives and is inadequately enforced (Jafari 2016).

There is a need to strengthen institutional and human capacities in the Government and to further clarify its function and responsibility to protect the public interest and manage essential services, utilities and public goods. Such clarity in the definition of the economic mission of government would encourage private sector partnerships, with public investment leading risk-taking for major development projects. But clear vision is not enough, and a political will to improve performance and efficiency must be evident at every level of public sector leadership and service. Monitoring and evaluation of implementation of public sector policy commitments according to measurable criteria and indicators is lacking and would help to keep goal-setting within the realm of the achievable, not only the desirable.

Above all, Government faces regular private sector calls for greater policy direction, focus and leadership that the business community feels necessary for it to invest and operate in such a risky and uncertain environment (MAS Economic Conference 2016). The NPA is acknowledged as an acceptable framework or statement of intention, though it seen as generic and weak on a mobilizing vision. In the absence of a more elaborate and explicit set of economic policies, the private sector continues to expect government to provide a concrete a guide for prioritized action and investment decision making. The handful of existing modalities (Councils, Task

Forces, etc) for engagement with the private sector are either seen lacking the authority to effect policy or little more than platforms to mobilise endorsement for policy decisions already taken or contemplated (Interviews).

3.6. Business culture

It is natural that a range of informal channels or ad-hoc arrangements for interaction between private sector players and Government are regularly mobilized for addressing problem areas or obtaining public services that would otherwise be systematically provided. Family, regional and personal connections of course play a prominent role in enabling private agents access to public sector decision makers, sometimes at the highest Ministerial level or often though mid-level public officials in a decision making or process facilitating position. A second access route for individuals or sectoral lobbies to obtain services, information or decisions from government is provided by political connections, which in the current make-up of the PNA largely relate to the leading Palestinian political movements in each of the West Bank and Gaza Strip (Interviews). A no less significant asset in private sector dealings with Government is wealth: financial or economic status can play a significant role in ensuring access to Government decision making processes, depending on the scale of the business, significance of the sector concerned and social status of the concerned investor.

As in many Arab or developing countries, family (clan or tribe) is an important factor in organizing and generating economic activity and income, especially at the small and medium enterprise or farm level. From a theoretical vantage point, it might be argued that traditional family structures and patriarchy impede the potentials for even, just and gender-neutral economic development. In fact, there are numerous Israeli sociological and political economy analyses of the issue in relation to the Palestinian Arab minority in Israel, which have generally considered the *hamula* (extended clan) structure of Palestinian rural society as an obstacle to modernization and economic empowerment (Khalidi 1988). But such research is often conducted through an orientalist (neo-colonial) lens that assumes what is good or normal progress for one society is applicable across the board to others. Such research has not been conducted with respect to the occupied territory; however, it is known that a large proportion of the micro and small enterprise sector and self employed are family-run, employ family members, benefit from family financing and are often situated in family homes. On the other hand, each city (and village) has its own leading families which naturally have influence in local economic and political affairs depending on their size, their inherited (land or other) wealth and their own solidarity.

Naturally, family ties tend to become strained and less significant as families grow in number, generations or in economic assets and status. While businesses built by fathers (first generation) and inherited by sons (second generation) often succeed, second generation inherited wealth can as equally lead to business alliances as to rivalries between brothers and cousins. Just because several of the prominent Palestinian businessmen, for example, may be from the same family (the Masris and Akers of Nablus or the Qawasmi and Jabary clans of Hebron, or the Shawa and Rayyes families of Gaza, or the Husseinis and Nusseibehs of Jerusalem, etc), should not be interpreted as implying that these families constitute a coherent economic or financial bloc, that they work as partners or that they cannot compete with, or be rivals to, each other. The point is that in the fragile economic and political environment of Palestine the basic family unit, and the extended family network, remain a potent safeguard of broader economic subsistence and social cohesion. Even if family affiliation can sometimes open doors that might otherwise remain closed, the important role of family on balance in sustaining the private economy should be noted and seen as an incentive to success and overall development

Such informal arrangements in doing business are of course not particular to Palestine, and indeed each country or economic system demonstrates its own business culture and rules that transcend the formal, codified domain. In this Palestinian case the extent to which trans-sectoral identities based on family/region, political affiliation or income status take precedence over formal, legal institutional obligations of government is a function of two main factors. On the one hand, the core problem of lack of sovereignty means that each PNA Ministry and official is acutely aware of, and enfeebled by, the inherent limits to their functions, even those which are not necessarily of a sovereign nature. Hence, informal resolution of problems or ensuring provision of government services is a necessary complement to the incomplete governance framework in place. On the other hand, as part of the Palestinian political culture and Arab traditions of hospitality, even senior and middle levels officials are accessible to any person who needs to make a representation to government. So, the fact that individuals may resort to personal contacts to facilitate their business or resolve problems, is accepted as standard operating procedure and should not be misunderstood as favouritism or clientelism.

Another important influence on the modalities and purposes of private sector informal access to government intervention is the role of the PNA in mediating with Israeli authorities for certain services, permits or other economic facilities for which Israel is final arbiter. While formal systems in place assure a modicum of equitable treatment, in some matters (eg. obtaining Business Men Card – BMC or work permits for entry to Israel, import or export clearances), personal contacts and relations with PNA officials (economic, security or civil affairs) help to speed or decide otherwise delayed or pending issues with Israeli authorities. In some periods, the PSCC member institutions played a coordinating role in allocating such permits, though currently only the PNA Civil Affairs Ministry is in a determining position to obtain Israeli approvals, Direct contacts by investors, developers or traders with Israeli civil administration or security/economic officials is also accepted, sometimes required, for business and trade facilitation. As facilitator of last resort, often invisible to the ordinary Palestinian, Israel retains an influential position in shaping the space for economic policy making and private sector growth.

4. Dynamic factors shaping Palestinian private sector growth

Certainly, the foundational factors reviewed above play their role in limiting economic horizons and options, and increasing the challenges of doing business. However, Palestinian entrepreneurs and new "men of capital" have succeeded despite the odds in building an economy where opportunities are defined as much by ability to mobilize unexploited (repressed) potential as by the possibilities for incremental increased integration in regional and global markets, instead of exclusive integration with Israel.

The portrait of the private economy in Palestine that emerges from the preceding chapters depicts a range of daunting economic and political challenges and a disparate set of actors, activities, institutional forms and investment orientations. A lack of clarity in national, or government, economic policy leaves private sector actors bereft of the leadership they seek in conditions of profound uncertainty. Despite this dilemma, the private sector is succeeding in creating income for a large part of the workforce and in accumulating productive capital and retaining wealth. Over time, the private economy has kept the national economy growing, albeit partially fuelled by a reliance on the boost to aggregate demand from PNA public sector expenditures and notwithstanding the volatile and uncharted path of economic growth.

As analyzed in the below sections, the picture is more dynamic than static. Social and economic processes underway, a largely unfettered market space for developing new products and consumption patterns and light touch regulation of conditions affecting competition (as discussed above), all combine to create upside, loophole opportunities as much as to aggravate downside risks. The most pervasive of these dynamic processes is the set of critical political variables which can foil the best laid economic plans or strategies. This section reviews these processes, as they too can limit or stimulate private economic growth.

4.1. The changing role of the private sector from peace building to state formation

In the first phase of the development of the modern Palestinian private sector, during the era of globalization and liberalization of the 1990s, its anointed role was closely linked to the ongoing peace process that held promises of independence and prosperity (Interviews). The basic dynamic of that period was forward looking, open and cooperative, both between government and business and between the Israeli and Palestinian economies. Hence, opportunities provided by government, in some cases guided by political favouritism, allowed for markets to flourish, public and private investment to take shape and new productive and commercial initiatives take hold. The downside risks in the political and business environment until the outbreak of the second Intifada were minimal compared to growing opportunities for enterprise that were reflected in the golden years of 1999 and

2000. Then, growth was high, trade was flowing easily, unemployment and poverty were low, investment had accelerated, and government finances was in surplus. Palestinian-Israeli economic cooperation was still acceptable and despite minimal progress, the basic premise accepted by all parties was that Palestinian economic growth and development was good for building the foundations for peace, hence the private sector needed to be empowered to lead that process (World Bank 1999).

This rosy scenario was rudely shattered by the following decade which began in violent confrontation between the PNA and Israel and closed with an Israeli war against Gaza and a deepening Palestinian political schism. Aside from the obvious adverse impacts over the 2000s of repeated shocks to the national economy and the viability of the private sector, the collapse, then revival (and since then, again, collapse) of the peace process, required a major reorientation of the dynamics of private sector operations. Not only did the business environment and trade openness deteriorate severely under Israeli security repression, but markets became fragmented and hence smaller (West Bank- Jerusalem-Gaza) and Israeli policy transformed from posing as the generous facilitator of Palestinian economic activity in the 1990s to a hostile colonial administrator since the 2000s (UNCTAD 2006).

The consequent detachment of the private sector from the peace building process was framed since the 2010s with a new Palestinian political programme centred on institutional reform for state formation despite continued occupation and internal political and geographic division. Such a goal may have appeared implausible when first unveiled by the PNA under the 2009 program “Ending the Occupation and Building the State” (PNA 2009), followed in 2011 and 2012 by the PLO bid for member state status in international fora. Yet in as many aspects as not, a State of Palestine does exist today, however non-sovereign, institutionally limited and weak, politically divided and geographically disjointed its status might be. The state formation process has not yet reached the critical tipping point of independence, yet it cannot be ignored that the PNA today provides or embodies many of the services, representative functions and symbols of statehood, and could immediately assume more absent the structural political constraints.

Hence the role and expectations of the Palestinian private sector have been transformed in the past years. It increasingly demands that the PNA should uphold the responsibilities of the State that it claims to be. This means cleaning up the business environment, providing policy leadership to the private sector upon which national economic independence supposedly depends, and assuming the risk of investment enabler where appropriate, or remove its controls and heavy hand where needed (Interviews). So, just as the dynamic of the peace process was replaced with one stressing the right and need for formation of the State of Palestine, we now are witnessing the other side of the statehood coin, whereby “citizens” and business are emphasizing the need for the State to live up to its obligations to them (MAS Economic Conference 2016). This is a dynamic process of a social contract under formation between the State and citizens that only a major national emergency (war, strife, economic crisis) could divert or postpone.

4.2. The quality of institutions and social demands for public services

With the growing challenge of meeting the obligations of statehood as the PLO has raised its level of insistence on recognition of its legitimate national rights, the PNA has recognized that through its NPA entitled "Putting Citizens First". A whole pillar of the NPA rests on the goals of better governance and service delivery, more accountability and responsiveness of government and a social justice agenda that aims to combat poverty, unemployment and marginalization. This is a dynamic that has gained traction since the first protests at PNA tax changes in 2012, social and trade union movements and strikes for better wages or work conditions in sectors such as teachers, universities (staff and students), legal professions, and the popular engagement with the minimum wage law and revision of the social security system (Jamil 2016; MAS 2017c). It might be that with the continuous postponement of national liberation, impatient social strata are less willing to defer demands upon the "system" than they might have been in periods when confrontation with occupation was on the agenda or when the peace process seemed to be going somewhere.

The interaction between national and social imperatives proceeds perversely in the Palestinian context, whereby socio-economic demands can detract from national liberation as time and the changing world around presses for better government and broader based economic dividends as much as for national liberation. As social contestation develops and takes distinct forms on different issues, this can only be expected to intensify public demands for professional political leadership, public institutional effectiveness, and democratic accountability.

Again, this is not a dynamic peculiar to Palestine and has been witnessed in numerous post-colonial situations in the Arab countries and globally when the emphasis of popular political activism shifted from a focus on the nation to concern with class, sectoral or provincial interests and needs (Khalidi 2012). In most cases, the leading parties and veterans of the liberation era retained positions of power through generally undemocratic and increasingly repressive means (such as in the Arab socialist countries). In other cases, these movements were able to accommodate the transition from national liberation to the business of statehood with greater engagement of private sector and mass support for their policies based on an enduring credibility of the independence generation (eg. in Algeria or South Africa).

With time, and with the advance of globalisation and liberal economic policy, models of "economic nationalism" have been superseded by less centrally-guided, more free-market arrangements for the distribution and sharing of wealth and political power, with the borders between the two often blurred and unregulated in many developing countries (Prashad 2012). A whole new category of such developing countries has been constituted in recent years, the "emerging" middle-income powerhouses of Brazil, China, India and South Africa, where capitalist market economics have replaced socialist or state-led development (even as China stands apart from that in some respects). But in these situations, the post-independence political and economic systems and the governing elites have changed dramatically, for better or worse. And in contrast to Palestine, they have occurred in a *post*-independence scenario, not amidst an ongoing confrontation with occupation.

Palestinian political division has resulted in inefficient and ineffective public services in Gaza, in particular as related to health, education and business sector services. From the private sector perspective the government fails to address many strategic challenges or their governance promises (Interviews). This has compounded public disillusionment with the role of government in promoting economic growth. In particular, complicated procedures and arbitrary regulatory changes applied depress the business enabling environment. Lack of alignment between Ministries' agendas and policies towards the private sector reflects a lack of clarity in the distribution of mandates, functions and resources between relevant public authorities. Shortage of market information available to the private sector for planning and investment, the inability of the Investment Promotion law to create an investment enabling environment and the presence of a significant sized informal economy have added up to poor government performance in supporting the private economy in Gaza.

4.3. Factoring in the current political outlook in economic decision making

No less influential than the foundational factors and dynamic processes reviewed above shaping the performance and prospects of the private economy, political challenges loom on the horizon and their potential impact can be significant for economic growth or stability if unaddressed. The essentially political nature of the Palestinian development *problematique* is not novel, but new political developments harbour both promise and renewed risk. Briefly, we note these elements of an uncertain political scene which pundits and analysts may have opinions as to which directions might emerge, but are of concern here in terms of the possible adverse or beneficial impact on private sector growth.

- *Palestinian national reconciliation, democratic rebuilding and geographic unity*

The prospect of resolving the decade-old Palestinian political schism, on the one hand, and renewal of leadership and democratic legitimacy of the PNA on the other is widely considered by the private sector and Palestinian public opinion as the key to designing or launching any transformative economic agenda, legal reform or institutional sovereignty. Recent steps reaffirmed political commitment to these goals, but change has come slowly and piecemeal and in 2018 neither comprehensive Palestinian unity nor democratic rebuilding appeared imminent. While continuation of the status quo on both these counts is wholly "sustainable", if undesirable, this does not automatically translate into an economic status quo, since much of the positive private sector development in recent years was built on a premise of political progress. The various social forces bubbling below the otherwise placid surface of the current status quo are seen by some private sector actors and analysts as leading to some form of upheaval sooner rather than later, directed against the Israeli occupation or the political and economic ruling regime, or even both.

In the case of Gaza, enjoying some basic freedoms that Palestinians in the West Bank take for granted is the urgent and immediate need, which requires lifting the blockade establishing a unified government. Gaza private sector stakeholders believe that good leaders could still achieve both these essential goals, and many have concluded that both ruling Palestinian political leaderships have failed to meet their needs (Interviews). They are looking forward to new political leadership with more economic oriented and open-minded agendas, concerned with ordinary people's miserable lives and the challenges they face. From their experience, a next generation of Palestinian economic and political leaders should be energetic, inspired, accountable, transparent, honest, ethical, capable of helping people achieve better lives (Interviews). The price that the PNA has had to pay to maintain civil stability, in terms of the lack of democratic renewal, security subordination to Israel, intensified Israeli settlement, weak transparency and accountability, does not encourage people in Gaza to accept the same cost (Interviews). Furthermore, rather than offering incentives and exemptions to Gaza, recent imbalanced treatment by the PNA of Gaza such as cutting the salaries of public employees and reduction of the power supply for several months only deepen mistrust (Interviews).

- *The regional scene and the Middle East peace process*

While the Arab region continues to suffer from the past five years of civil, ethnic and religious strife, with once powerful nations such as Iraq, Syria and Egypt humbled by internal and external pressures, Palestine has been spared such disintegration and insecurity. Arguably, Ramallah is currently one of the safest cities in the Middle East compared to the turmoil surrounding Palestine. This angle is not lost on Palestinians of all walks of life, regardless of social, economic or political affiliation. However, the rapidly changing Arab political scene, which has always impacted Palestinian politics and struggle, has increased uncertainty for the PLO as it attempts to navigate its regional and international alliances to maintain the cause of Palestine at the top of all agendas. The political shocks received in 2017 to the prospects for peace have further dimmed the outlook for Palestinian political renewal as well as for sustained economic recovery and rebuilding. Meanwhile, the regional landscape, wars with Israel and internal strife in the past decade imparted Palestinians in Gaza with many lessons that have served to reinforce a mass "escape from politics" (Interviews).

- *Israeli perspectives on Palestinian economic prospects*

On the other hand, maintaining the status quo means maintaining the current "quality of life". Accordingly, one of the political challenges that the PNA will have to face, with or without renewal of peace negotiations, is the continued Israeli policy of offering economic facilitation inducements as a crude substitute for political justice. The vision of economic peace pursued by the Israeli government for the past decade (UNCTAD 2009) amounts to “granting” in generous gestures to the Palestinian economy what are otherwise Israel’s minimal obligations as the occupying power under international law (Khalidi 2017). For Israel, Palestinian economic growth is only good insofar as it can be diverted to maintaining dependence on Israel for goods, finance, trade and jobs. Similarly, economic relations with Palestine have only ever been significant to the extent they advance Israeli national security and economic interests (UNCTAD 2009). The success of the PNA in incrementally breaking free of the different shackles placed by Israel on the productive economy (especially in trade and access to natural resources) without having to acquiesce in a political *quid pro quo* will be of the utmost significance in the challenge of shifting the balance of economic power in the overall struggle for statehood.

- *Donors and Palestine*

According to the OECD, donor aid to Palestine totalled $35 billion between 1993 and 2016 (Tartir 2017), most of it disbursed in the past decade. Around $24bn (70% of the total) was allocated between 2006 and 2016, at an average of $2.2bn per year, and $560 per capita per year. The top 12 donors to Palestine over the past five years provided around 89 percent of overall aid, with the US, the EU, Norway, Germany and Britain alone providing a combined 70% percent of aid. This prolonged financial engagement by many countries has over the years constituted a committed investment in Palestinian economic performance, fiscal sustainability, social and humanitarian services, security and the rule of law. Limited donor aid until 2001 was almost wholly devoted to development expenditures and infrastructure, while the following years it expanded and shifted to humanitarian crisis relief. Since the mid-2000s donor aid grew quickly to ensure PNA fiscal solvency (budget support) and its ability to stimulate aggregate demand through ensuring public sector salaries. After 2010 aid also began to focus on PNA public institutional building and a range of private sector support programmes.

Regardless of impact evaluation of different forms and periods of aid, both donors and recipients have reached levels and limits of fatigue, each for different reasons. Alongside changing donor priorities in Palestine, and the pressure of crises elsewhere in the region upon shrinking foreign aid resources in developed economies, it is only reasonable to expect that donor aid in Palestine will be increasingly limited and restricted in terms of allocation. This requires not only donor reconsideration of priorities and expected outcomes of their support programmes, but equally Palestinian leadership to ensure that limited aid is channelled to the national priority areas that donor aid is the last resort or most effective in addressing.

> *From the vantage point of the Gaza private sector (Interviews), aid is often perceived to be accompanied by specific, and sometimes conflicting, political agendas. The “no contact policy” deepens political division, and marginalizes Gaza actors from reconstruction planning and vetting. There is a perception that a lack of internal coordination and coherent sets of priorities within the donor community has forced many civil society associations to accept without challenge the will of donor groups. An absence of shared vision allows individual donors, large and small alike, to impose their cultural, political and social agendas on Palestinian society*

5. Key economic pivots of an agenda for private sector survival and growth

The preceding review has emphasized the myriad dimensions of the identity, institutions, activities and performance of the Palestinian private sector(s). Indeed, the very term “private sector economy” without additional specification is somewhat vague an object for policy treatment, since the terrain of the private sector economy is so vast and differentiated. The political economy analysis has also considered the challenging macro and micro economic, business and policy environment in which the private economy manages to survive, though hardly flourish. This includes the broader social development and regulatory implications of the growth of a capitalist market economy under continued Israeli occupation, no sovereignty and ensuing light weak regulation and enforcement. While the overall picture of the national economy is dim at the macro level, there are clear bright spots in the private sector economy where growth has occurred, employment has been assured, technology has been acquired and adapted and capital investment generates both private and public returns.

However, successes are haphazard and fragmented, growth has been uneven and has favoured activities that respond to the distorted demand structure of the economy and binding constraints that preclude a developmental impact of any growth achieved. For example, division of the West Bank into Areas A, B and C distorts urban expansion or land usage and precludes access to essential resources. Similarly, Israeli restrictions on international trade, employment of large numbers in Israeli labor markets and severe limits on PNA economic jurisdiction and authorities preclude a range of policy and investment decisions necessary to address the chronically weak performance of the private economy. Equally, business climate and legal reform has been pursued only in areas where the PNA has jurisdiction under Oslo. This has meant postponing reform in areas where it has no enforcement capacity or which would further complicate an incoherent legal system, however critical problems might be.

A new approach to private sector support also requires a clear statement of public sector obligations and commitments to providing the best policy, legal and procedural climate and leadership for enabling vigorous private sector growth. Finally, donors will need to consider the most suitable modalities for support among the many deployed in the past, from technical assistance, research and planning, legal reform, investment guarantees and partnership, technology transfer, infrastructure grants, etc.

Hence, the next generation of PNA policies and donor support aimed at liberating the forces of private enterprise and improving the functioning of markets needs to think wide and big, and act narrow and small. Policies and interventions should focus on key pivotal issues whose impact will at once address macro/micro and external/internal dimensions of constraints on the private sector. This means engaging with credible and catalytic private sector partners, representative of their economic sector (industry, tourism, trade, finance, etc) or institutional form (corporate/scale).

5.1. Private economy growth drivers and enablers

The analysis in this study has comprehensively surveyed the range of foundational and dynamic factors which overall create a disenabling environment for Palestinian private sector growth, though not one totally devoid of opportunity. In none of the dimensions of the private sector examined (sectoral, institutional or the policy and regulatory climate) did we note growth performance that is uninhibited by one or another of the impediments or disincentives in place. This does not mean that there are not winners and new players in the current configuration, nor that economic loss is inevitable. But commercial and investment success in the Palestinian context is measured not so much by profit, exports or sustained growth, as by maintaining market presence and the ability to adapt to adverse and uncertain conditions and simply survive. So long as the national economy is shackled by occupation restrictions and non-sovereign authorities, the private economy in all its dimensions and activities will suffer, and at best survive.

Therefore, the coming challenge for policy and programme funding is to bolster, nurture and emulate winners, and to relieve, develop and empower losers who should be winning. Private economy support needs to span the government realm as well as the private sector itself, and at once focus on engaging promising new actors and weaker, but essential institutional partners who must also be drivers of change if it is to be sustainable.

Based on the information analyzed here, the essential drivers of private sector growth may be identified as:

a) the adoption of an explicit public policy orientation and involvement in strengthening strategic sectors of the private economy,
b) a public and private investment focus on pivotal activities whose reinforcement will help them to lead growth in other areas of the economy;
c) institutionally, change is powered both by some of the top-end of the market leaders, including medium and large enterprises, and the smaller and micro sectors; as well as
d) credible representative institutions that can ensure wider and more active private sector engagement in powering growth and making policy and which government partners with, not only listens to.

More specifically this means that the following broad criteria should guide future efforts:

A. The sort of *public policy* stance needed to enable private sector growth entails a reinforcement of recent trends among policy makers and investors. These favour:

- domestic productive economic activities;
- import substitution alongside export promotion;
- downstream and upstream inter-sectoral trade-production-distribution linkages;
- intensified efforts at streamlining the business procedural environment; and,
- careful but selective legal reform.

No less important is that government needs to rationalize and coordinate business facilitation services needed from key functional Ministries and agencies (especially Finance, National Economy, Agriculture, Investment Promotion, Industrial Zones). This should add up to an explicit and coherent Government policy position (e.g. White Paper) on economic, trade, fiscal, investment and innovation targets that can be used as a benchmark to measure government performance over time in provision of the necessary enabling environment.

B. The main *productive activities* that have attracted the lion's share of investment and accumulated assets, as well as accounting for the bulk of employment and output, are trade, industry and services. However much smaller sectors like Finance and ICT have grown in the current environment, the predominance of trade (largely channelling imports) may well be the reverse side of the relative weakness of domestic production of goods and services. Indeed, a thriving trade sector reflects excessive reliance on imports and the distorted profit margins created by the range of non-tariff and facilitation barriers engendered by occupation. Nevertheless, it is important to encourage the versatility of Palestinian traders in applying and enhancing their skill and resource bases to diversify import sources, facilitate exports and render the national economy less dependent on Israel.

As for industry and services, their potential (as well as agriculture's) to produce for local and export markets is well-established. The growth/employment/investment generating potentials of these activities are profound and the recent record of some Palestinian industrial production, marketing and corporate advances is promising. To the extent that PNA trade policy can integrate an industrialization prerogative, then existing winners can consolidate achievements and new competitive industrial branches can arise. Amongst services, the leading role of tourism and its strong links with other services and creative industry activities must feature as a central part of any strategy to bolster a viable, independent and efficient national economy.

C. In terms of *corporate form and scale considerations* of private sector institutional development, experience has shown that no one size fits all in the specific Palestinian conditions. Larger corporations and holding companies play an important role in financial expansion and employment generation. The growing diversification of their areas of involvement, especially in domestic production, is an important element of a powerful private sector. The increasingly rich landscape of equity investment in private companies, new corporate models such as start-ups and credit financing guarantees for economic activities will help to build a stronger Palestinian business environment over time.

But the process of formalisation and corporatization of the economy is not one that can be assured or even desirable in all activities, given the uncertain conditions. The numerous smaller, informal family-based production units help to diffuse the concentration of economic wealth and political power. The proliferation of small and micro enterprises also provides a source of economic and household resilience, as well as a useful counterbalance to growing inequality in income distribution and political access. The latter is generated by the rise of big capital interests embedded within a poorly regulated, open market, amidst a social and political landscape fraught with insecurity for the less fortunate classes. Hence, for Palestinian private sector growth prospects, larger/corporate can be good, but smaller/family-based is beautiful.

D. The *credibility and voice of the private sector representative institutions* is limited by two main features of their function and role. As they generally represent members which have crossed a certain threshold of size, income, organization and formalization, their constituencies reflect only a portion of the sectors they should represent. In addition, the attitude of government to these actors and their advocacy entails a courteous and open-door treatment of their demands, to the extent they are enunciated specifically, without conceding private sector interests a determining influence on ultimate policy decisions. This public-sector position of taking private sector advocacy on an advisory basis is understandable when there is a distinct public sector economic vision and lead that overrides narrow sectoral interests (as in A above). But the absence of formal mechanisms to empower private sector influence on public policy-making is part of a vicious circle that weakens these institutions' effectiveness in the eyes of both their sectoral constituencies and government officials.

   Hence, if these institutions are to enhance their potential to drive change and become full partners in policy-making, they need to upgrade their capacity to provide services to existing members and attract new ones from the broader sectoral pool. Technical support provided though those representative institutions which feature wide membership is also important. While they remain part of the national political consensus, that should not prevent private sector institutions from elaborating, advocating and acting collectively to demand better public policy and services that cater to their specific interests, even if their activism raises some political eyebrows. That calls for the member institutions of the PSCC to give it a more explicit and overarching identity and mission statement that would foster clustering and lessening duplication between institutions and programmes within the PSCC.

5.2. Public policy: increasing the resilience and vigour of the national economy and reducing vulnerability to external shocks

Unless the building of a Palestinian national economy is perceived as a national security endeavour, and its growth and social welfare is treated as a public good, there is little reason to expect any dramatic transformation in the current landscape of the private sector economy. Simply put, private sector agents of change cannot play their role if public authorities do not do their job. That function goes beyond making doing business easier and related legal framework, however important that may be in ensuring some measure of predictability in the business environment.

Only government is equipped and mandated to tackle the macroeconomic and structural distortions that have been avoided or inaccessible to date. Significant donor resources have been allocated in recent years to policy studies, strategies, projects and management reforms for several key Ministries (especially National Economy, Finance, Agriculture, Education, Local Government, Justice). So there has been plenty of time and adequate expert and technical consultation, deliberation and decision making. Action on these studies, plans and draft reforms is now the order of the day.

Hence public economic policy will need to adopt a more prominent and decisive leadership profile in coming years as the struggle to impose Palestinian statehood, even in non-sovereign conditions, is expected to intensify. The economics of national liberation under liberal market conditions cannot afford leaving the private sector alone, to do as it sees fit with its own resources. This calls for a pro-active and outward looking national economic security posture that aims to reduce vulnerability to external shocks through greater self-

Government needs to send an unequivocal message of confidant leadership to private sector actors, and demonstrate in practice that it is working to resolve the big problems, such as:

- A trade and tariff policy that nurtures and rewards domestic productive (primary and secondary) sectors;
- An industrial development policy that clusters, upgrades and organizes manufacturing to better compete domestically and produce for export;
- A trade facilitation support system that tackles Israeli obligations toward Palestinian transit trade and opens direct trade routes for Palestinian goods;
- A fiscal policy that puts a greater premium on expenditures on the development budget, vital social services and welfare requirements than on consolidation as an end in itself;
- An energy independence strategy that allows for diversification of sources and forms;
- Intensified risk taking by public investment funds in the private economy that creates a crowding-in effect on private investment.
- Reforming Ministries and public institutions involved in the economy and in serving the business community through:
    - rapid completion of government service single-window projects;
    - investment in programme-based budgeting and planning;
    - human resource retooling and streamlining;
    - establishing empowered Ministerial task forces on key economic policy issues (eg trade, industry, agriculture, fiscal, innovation, labour, tourism); and,
    - holding the top management of public institutions accountable for achieving specific annual performance targets.

Support programmes can encourage such a new economic policy both through technical cooperation that relies on Palestinian expertise in institutional reform and human resource development and donor political networking in resolving trade and fiscal bottlenecks and impediments within Israel's prerogative. Furthermore, with the fiscal viability of the PNA less at risk than any point in the past decade and the credibility and stability of the financial system, deficit financing should not be a cause for alarm or permanent fiscal reform. Surely, only limited donor resources may be available in the coming years for financing PNA expenditures and as much of these as possible should be dedicated to the development budget. But it remains in the interest of the international community and its obligation to the prospects of peace and to the national rights of the Palestinian people, that donors should not turn their back on Palestine.

5.3. Investment and aid to competitive, productive sectors of the national economy

The analysis here has confirmed that even in adverse conditions, Palestinian businesses in a variety of types of (industrial, service and agricultural) activities, have succeeded in competing with subsidized Israeli and cheap international imports. When Palestinian productive or service activities have been sheltered from unfair competition with Israel (e.g. by the terms of the Paris Protocol), they have performed very well, for example in ICT or financial services, with or without oligopoly positions. In less protected sectors, when Palestinian industrialists pursue investment diversification into real estate, trade, or services, this is a sign not only of financial sophistication, but equally of having established a profitable core business that can weather uncertainty and stiff competition. And when Palestinian farmers operating in the most disadvantageous conditions are able, for example, to export in 2017 some $130 million worth of vegetables and fruits to Israel and, increasingly, regional markets, this is a vital sign of the untapped potential of the Palestinian economy. Meanwhile, Palestinian tourism operators and hotels have improved their service offer and package amidst overwhelmingly unfair competition from Israeli counterparts; yet tourist arrivals to Palestine increased exponentially in 2017,

Unlocking such untapped resources is something that private investment knows best how and when to do, and any (tax, business procedures facilitation or other) incentives that government can provide in this respect are welcome. But existing financial instruments and credit facilities offered by the commercial banking system are not tailored to specific sectoral needs, conditions and corporate forms or at attractive enough rates to stimulate recalcitrant demand. While the constraints on demand for productive sector credit may be ameliorated in time (depending on political or policy shifts), in the near term greater specialization of commercial bank credit lines for productive investment supported by PMA incentives and international financial seed funds and guarantees (Abdel Karim 2018).

with a vast market waiting to be reclaimed.

5.4. Nurturing small and medium enterprise; fostering a strong corporate sector

In addition to a better focus on key (income and employment generating) economic activities, the next generation of PNA and donor private sector support policy and programmes must also aim to strengthen the institutional fabric of the private economy through a two-pronged approach. The business acumen and institutional achievements of the existing large, formal, corporate sector should not be underestimated and their ability to create new markets and sources of employment should be factored into future national investment plans and policy decisions. Alongside a strong corporate sector, the medium and small enterprises which constitute the backbone of the private sector economy, require more vigorous technical and credit support to lead a process of formalization and upgrading throughout the economy's productive sectors. As firms graduate from small to medium to large scale and diversify their sectoral holdings, this calls for shepherding and showcasing their success, while providing relief, technical guidance, retraining and restricting to promising enterprises struggling to remain solvent. Many of the latter type are suffering the effects of market imperfections and failure rather than from an unviable business model.

Large and medium scale corporations need additional political and financial guarantees for their investments if they are to continue to consolidate their contribution to growth and competitiveness. But they should also play a key role in transferring experience, business knowledge and networks to smaller, viable enterprises, both directly and through programmed interventions. Palestinian corporate social responsibility is not simply a matter of demonstrating commitment to social welfare. It should equally entail providing professional and technical leadership, and investment partnerships to the less formalized, weaker elements of the private sector economy whose business and capital development is in all actors' interests. While there is a role for government in promoting such cross-sectoral and cross-scale partnerships and providing any possible intermediation, this is primarily a task for private sector institutions and interested donors to pursue.

5.5. Adopting more effective and inclusive modalities for economic policy making

> *Formalization of any economy is a process that moves at its own pace over time, in the Palestinian case dictated by a range of considerations: family ties and social structure, external structural constraints, narrow tax capture, and lack of credit and business development services. In uncertain economic and political conditions and with a fragile governance and legal system, there are even some advantages in not trying to force the pace of formalization. Instead, a focus is needed on creating an incentive structure managed by government and the banking sector and a long term inclusion strategy that rewards voluntary formalization and that promotes investment that entails scale upgrading.*

The various forums, councils, task forces and ad-hoc committees that have been established over the recent years to include private sector actors in public policy making remain largely sounding board bodies, bereft of executive authority or any binding advisory role. Inclusion of sectoral representative institutions or the PSCC in such partnerships is never neglected. However, private sector voices are often muted or their demands overlooked owing to these joint bodies' own lack of coherence, clarity of purpose and internal coordination, or preponderance of government representatives in such bodies. Some of the forums dealing with economic issues meet at best twice a year, with periods of inactivity in between. The task of managing these bodies and taking decisions usually ends up in the lap of a handful of the key players in the area concerned.

This needs to change if any of the recommendations in the preceding sections are to be realized. In the absence of democratic legislative policy review, the national and social responsibility of the private sector and other civil society participants in such bodies is even more critical. They need to transcend their narrow sectoral constituencies and interests and envision their role in such private-public dialogue as part of a greater mission of national economic and social development. This requires holding government accountable for its plans, policies and actions, regardless of the executive powers of this or that forum. Government also needs to engage with the private sector through such joint councils as active partners and stakeholders, not passive recipients of policy or project support.

But it also requires private sector institutions to be more comprehensive representatives of their sectors, to widen and activate their membership, continue to rotate leaderships, and to boldly advocate and pursue with government for specific measures and reforms that would unleash private sector growth. It is not enough that private sector institutions affirm their support for the national political agenda, but their credibility depends on their actively pursuing their members' sectoral agendas and vital interests. Future programmes should include supporting the strengthening of the legitimacy and reinforcing the management and service provision capacity of all the PSCC constituent institutions.

The Chambers of Commerce and Industry (at the Federation and local levels) deserve special attention in institutional upgrading, given their deep historical record, their comprehensive geographic spread and their universal membership. Despite their weaknesses, they remain the most direct channels for ensuring that all sectors, scales and forms of business are directly reached and included in policy reform dialogue. Individual Chambers' intimate knowledge of local economic conditions can inform and better focus programmes and projects for private sector development and reinforcing these institutions skills and service capacity can ensure more inclusive economic policy making.

5.6. Reintegrating the Gaza economy

Considering the specific and especially adverse conditions in Gaza, certain priority issues affecting the reintegration of Gaza into the national economy and making up for the lost development decade must be kept in mind over and above those reviewed above (Interviews):

- Immediate end of the blockade and completing political reconciliation;
- National initiatives supporting the local products;
- Public-private partnerships at the level of development plans creating a common vision, prioritising initiatives, strategies, for the benefit of both business and citizens;
- Reforming the taxation system to incentivize the production and use of local products and services;
- Establishing export support and promotion funds;
- Projects to promote industrial activities (management and personnel, production capacity, financial capacity);
- Plan and activities for institutional capacity building in the principles and practice of corporate social responsibility (economic, social and environmental aspects);
- Exemption of raw and middle product materials used in production and manufacturing from taxation and customs duties and avoiding double taxation;
- Programmes encouraging youth and women's entrepreneurship programs;
- Consumer protection and awareness about the quality of local products;
- Strengthen Palestinian Standards Institute (PSI) and inspection of quality and safety of raw materials;
- Public and donor funding and incentives to private spending on R&D, improved research-industry links, business capacity development including business support services and initiatives for ICT skills and diffusion targeting low-income groups and the informal economy;
- Exchange expertise in R&D programs with the outside world to promote entrepreneurs in agricultural and industries know-how;
- Establishing genetic engineering and industrial based research institutions to support local production linked with universities;
- Rehabilitation of existing and damaged production lines;
- Develop the ICT Infrastructure; and,
- Incentivise the development of renewable energy, recycling and fishing based processing industries.

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14. Mohammed Skeek. Chief Executive Officer of Paltrade
15. Rami Abu Sha’aban. Marketing Consultant - Private Sector
16. Saif Odeh. Policies and Research Department- Palestinian Monetary Authority
17. Mohamed Tenerh. University of Coventry – UK, Lecturer of Economic Development
18. Nabil Hamad, Businessman
19. Jalal Shabat. Lecturer, Al-Quds Open University

Annexes

Annex 1: Private sector enterprises main economic indicators (PCBS 2017c)

Table 1: Percentage of compensation of employees to gross value added by economic activity

	2010	2011	2012	2013	2014	2015	2016
Industrial Activities	21.1%	24.2%	22.7%	25.3%	28.7%	30.8%	27.5%
Construction Activities	24.1%	32.6%	29.5%	25.7%	17.1%	25.6%	25.0%
Internal Trade Activities	13.5%	12.1%	14.8%	18.1%	18.0%	14.9%	14.7%
Transport & Storage Activities	36.9%	46.2%	38.0%	42.7%	45.4%	33.8%	37.9%
Information & Communications Activities	12.8%	11.8%	14.3%	20.6%	27.9%	25.8%	27.1%
Non-financial Services Activities	40.7%	43.8%	42.6%	46.1%	58.8%	35.9%	40.0%
Total of Financial Intermediaries	45.6%	44.6%	38.2%	46.0%	46.7%	44.3%	43.4%
Total	23.0%	23.2%	24.7%	28.0%	31.3%	25.5%	26.0%

Table 2: Percentage of gross capital formation by economic activity

	2010	2011	2012	2013	2014	2015	2016
Industrial Activities	23.6%	25.7%	24.0%	22.0%	22.7%	12.9%	11.7%
Construction Activities	1.0%	1.7%	0.9%	1.0%	1.0%	0.6%	0.5%
Internal Trade Activities	11.8%	10.9%	19.1%	11.5%	7.7%	9.3%	8.8%
Transport & Storage Activities	2.9%	1.6%	3.3%	2.4%	1.3%	1.7%	1.8%
Information & Communications Activities	33.4%	30.6%	18.3%	18.7%	17.1%	41.8%	40.3%
Non-financial Services Activities	17.9%	18.6%	28.4%	34.0%	36.9%	18.8%	20.8%
Total of Financial Intermediaries	9.3%	10.8%	6.1%	10.3%	13.3%	15.0%	16.1%

Table 3: Productivity by Economic activity (000)

	2010	2011	2012	2013	2014	2015	2016
Industrial Activities	20.0	17.9	21.7	20.4	19.9	16.1	18.0
Construction Activities	30.8	22.3	26.8	27.4	38.7	27.1	26.8
Internal Trade Activities	15.3	16.6	15.4	15.1	15.7	17.2	17.4
Transport & storage Activities	17.4	15.0	15.4	15.0	15.4	14.4	13.3
Information & Communications Activities	120.4	109.5	92.9	89.0	67.9	97.9	73.3
Services Activities	10.5	10.2	11.1	10.8	9.9	11.0	10.7
Total of Financial Intermediaries	46.4	49.1	58.7	42.4	43.5	46.2	46.9
Total	17.4	17.4	17.8	17.2	16.6	17.2	17.2

Table 4: Productivity Growth Rate (%)

	2010	2011	2012	2013	2014	2015	2016
	2011	**2012**	**2013**	**2014**	**2015**	**2016**	**Annual Average**
Industrial Activities	-10.6	21.4	-5.9	-2.9	-18.8	11.6	-0.9
Construction Activities	-27.8	20.5	2.2	41.2	-30.0	-1.1	0.8
Internal Trade Activities	9.0	-7.6	-1.7	4.0	9.3	1.1	2.4
Transport & storage Activities	-13.3	2.3	-2.7	3.1	-7.0	-7.2	-4.1
Information & Communications Activities	-9.0	-15.2	-4.2	-23.8	44.2	-25.1	-5.5
Services Activities	-2.7	8.9	-2.4	-8.4	11.2	-2.7	0.7
Total of Financial Intermediaries	5.8	19.5	-27.7	2.7	6.2	1.3	1.3
Total	0.4	2.1	-3.1	-3.6	3.4	0.3	-0.1

Chart 1: Percentage of private sector contribution to GDP by economic activity

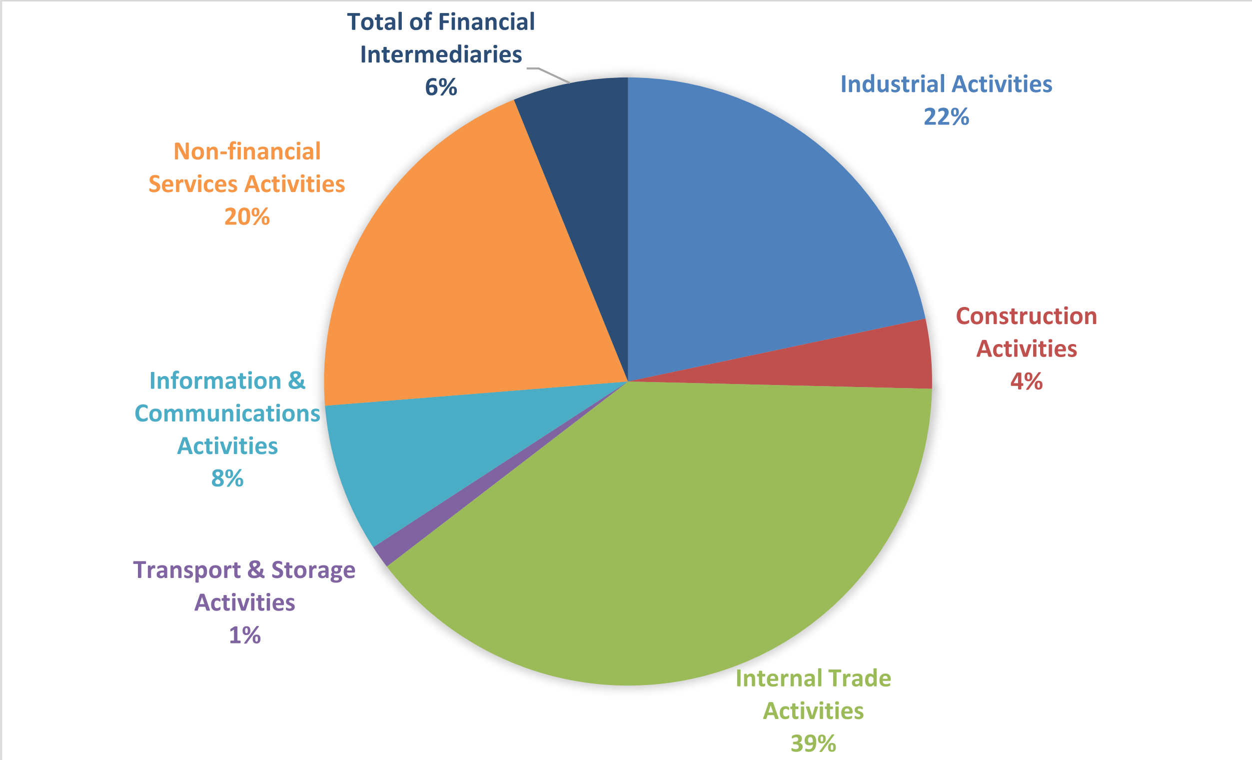


Chart 2: Percentage of private sector contribution to employment by economic activity

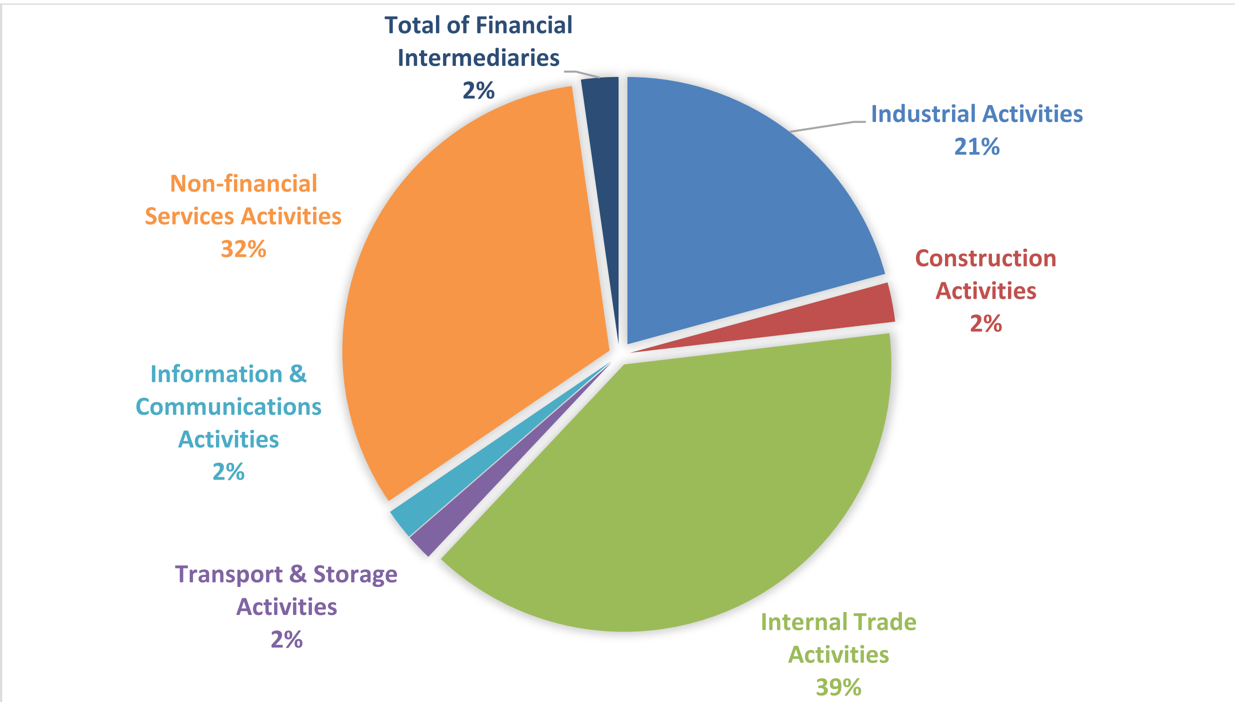


Chart 3: Percentage of compensation of employees to gross value added by economic activity

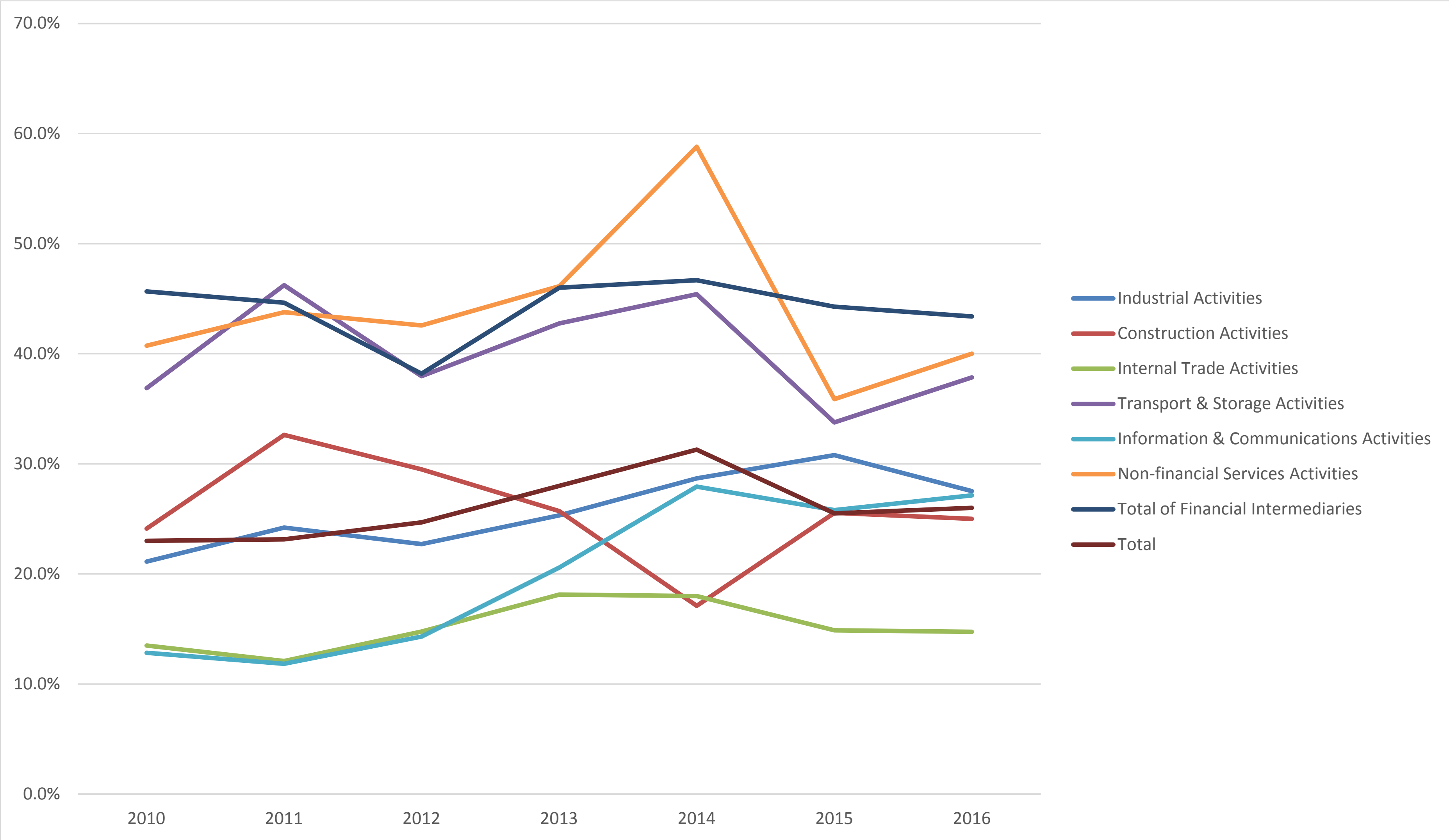


Chart 4: Gross Capital Formation by economic activity

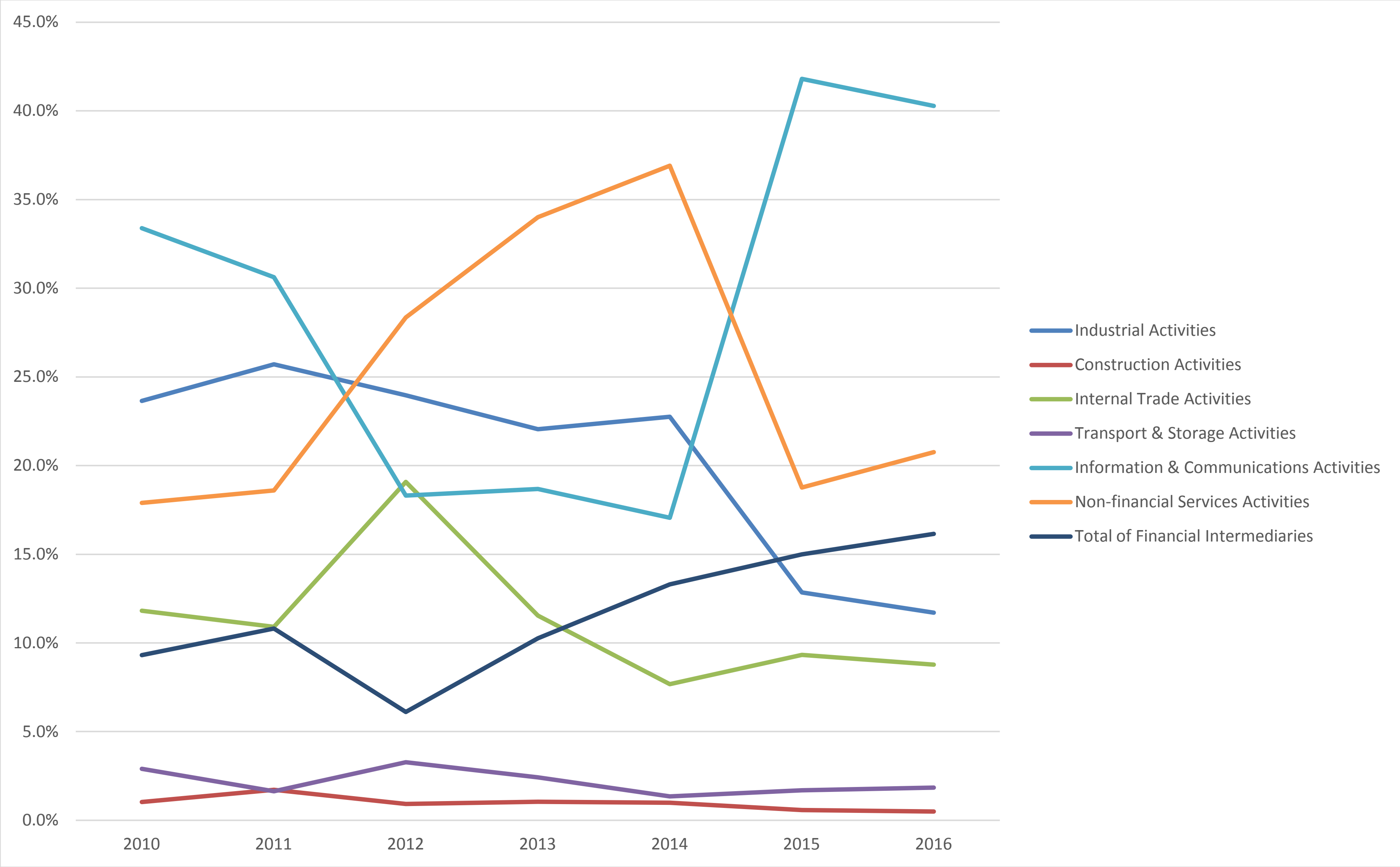
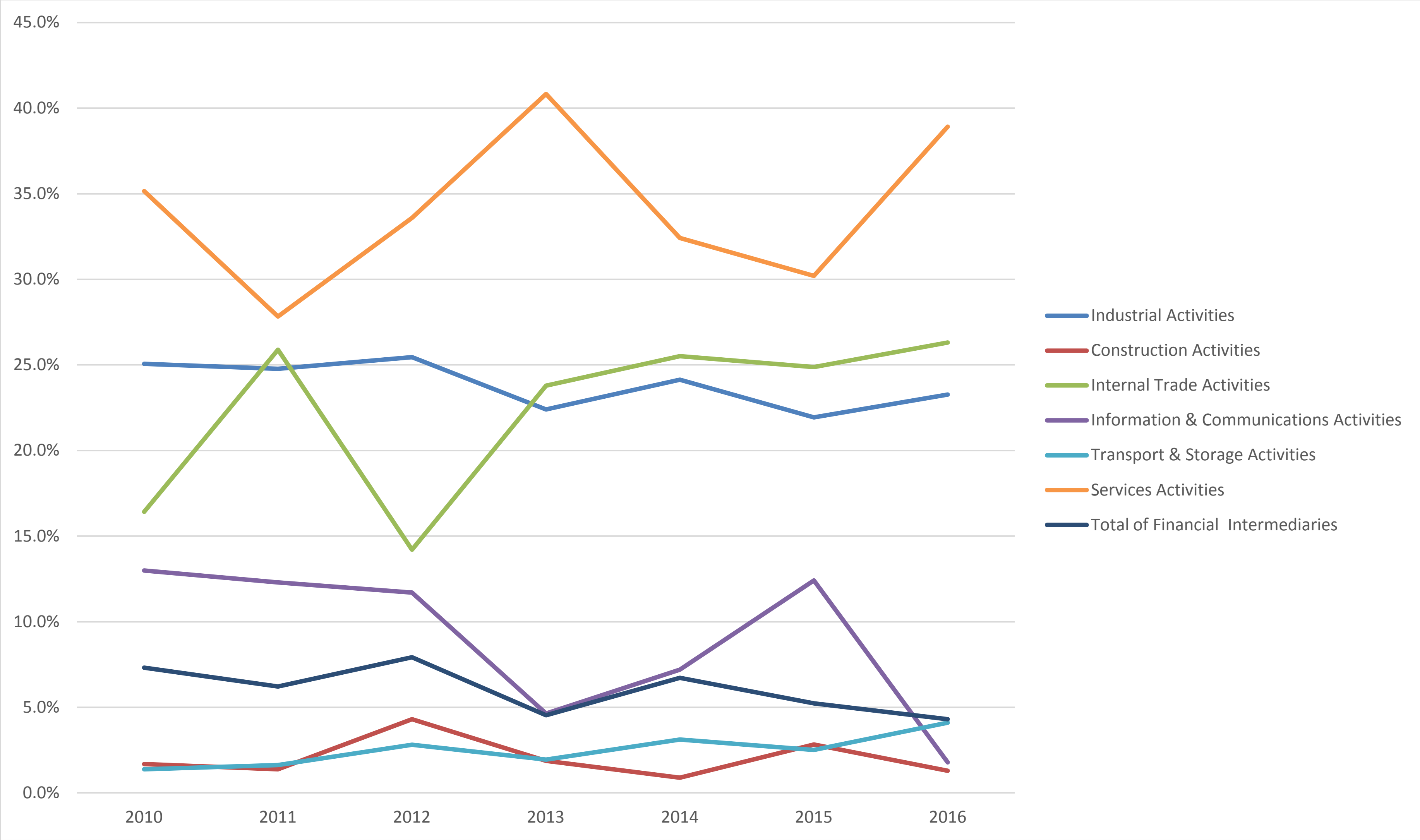


Chart 5: Percentage of market value at end of year by economic activity



Annex 2: Key features of private sector establishments

Table 1. Number of Operating Establishments in the Private Sector by Governorate and Legal Status, 2012

Governorate	Total	Legal Status							
		Not Stated	Foreign	Public Shareholding Co	Shareholding Co	Limited Part	General Partnership Co	Defacto Co	Sole Proprietor
Palestine	**123,247**	**105**	**53**	**547**	**2,877**	**574**	**2,640**	**8,171**	**108,280**
West Bank	**82,280**	**102**	**50**	**405**	**2,040**	**317**	**1,981**	**5,467**	**71,918**
Jenin	**10,624**	7	1	30	98	20	171	546	9,751
Tubas	**1,461**	4	-	12	4	3	40	58	1,340
Tulkarm	**6,393**	13	4	19	58	30	99	459	5,711
Nablus	**14,346**	9	10	82	536	62	367	1,264	12,016
Qalqilya	**3,829**	2	-	34	36	6	162	162	3,427
Salfit	**2,257**	-	-	9	9	9	36	19	2,175
Ramallah & Al-Bireh	**12,127**	17	17	101	733	66	251	839	10,103
Jericho & Al-Aghwar	**1,144**	3	1	8	20	8	51	80	973
Jerusalem	**4,475**	-	1	9	15	19	28	114	4,289
Bethlehem	**6,654**	8	11	36	151	3	216	499	5,730
Hebron	**18,970**	39	5	65	380	91	560	1,427	16,403
Gaza Strip	**40,967**	**3**	**3**	**142**	**837**	**257**	**659**	**2,704**	**36,362**
North Gaza	**6,782**	-	-	11	189	29	110	368	6,075
Gaza	**16,701**	1	3	84	513	196	419	779	14,706
Dier Al-Balah	**5,308**	-	-	15	53	8	36	608	4,588
Khan Yunis	**7,397**	-	-	20	45	12	60	497	6,763
Rafah	**4,779**	2	-	12	37	12	34	452	4,230

* Data Except those parts of Jerusalem which were annexed by Israel in 1967.Source (PCBS 2017d)

Table 2: Number of Operating Establishments in the Private Sector by Employment Size Group, 2012

Economic Activity	Employment Size Group						
	+100	50-99	20-49	10-19	5-9	1-4	Total
Mining and quarrying	-	2	5	43	128	109	**276**
Manufacturing	27	54	335	935	2,700	13,373	**17,424**
Electricity, gas, steam and air conditioning supply	7	3	5	4	9	33	**61**
Water supply; sewerage, waste management and remediation activities	-	-	3	7	37	394	**441**
Construction	7	7	42	94	152	322	**624**
Wholesale and retail trade; repair of motor vehicles and motorcycles	5	20	153	537	3,015	69,882	**73,612**
Transportation and storage	2	9	51	115	276	547	**1,000**
Accommodation and food service activities	6	11	73	143	585	5,978	**6,796**
Information and communication	12	10	42	89	162	629	**944**
Financial and insurance activities	13	10	53	143	140	735	**1,094**
Real estate activities	1	1	4	5	27	291	**329**
Professional, scientific and technical activities	2	6	35	85	421	3,380	**3,929**
Administrative and support service activities	4	1	8	23	146	1,758	**1,940**
Arts, entertainment and recreation	-	2	21	75	250	1,611	**1,959**
Other service activities	8	23	98	244	650	12,015	**13,038**
Activities of households as employers;	-	-	-	-	-	6	**6**
Activities of extraterritorial organizations and bodies	-	1	1	4	5	4	**15**
Not stated	-	-	-	-	0	15	**15**
Total	**94**	**160**	**929**	**2,535**	**8,703**	**111,082**	**123,503**

* Does not include Auxil. Activity Establishments. Source (PCBS 2017d)

Annex 3: Membership of boards of selected private and public sector institutions (2017)

1. Palestinian Investment Promotion Agency

Representative	Organisation	Position
Ms Abeer Odeh	Ministry of National Economy	Minister of National Economy
Mr Luai Hanash	Ministry of Finance and Planning	General manager
Ms Reem Karazon	Energy and Natural Resources Authority	General Manager
Mr Mohieldin AL-Ardah	Ministry of Local Government	General manager
Mr Suleiman Zuhairi	Ministry of Communications and Information Technology	Deputy Minister
Mr Tareq Al-Masri	Ministry of National Economy	General Manager
Ms Nida Al-Ayaseh	Ministry of Tourism and Antiquities	General Manager
Mr Roubin Joulani	The Palestine Trade Centre (Paltrade)	PalTrade representative
Mr Mohammad Al-Amour	Palestinian Businessmen Association	PBA representative
Mr Iyad Al- Hindi	The Federation of Palestinian Chambers of Commerce, Industry and Agriculture	FPCCIA representative
Mr Tareq Sous	The Palestinian Federation of Industries	PFI representative
Mr Haytham Wahidi	Palestinian Investment Promotion Agency	CEO

2. Palestinian Monetary Authority

Representative	Position
Mr Azzam Shawwa	Governor and Chairman
Mr Shihadeh Hussein	Deputy Governor
Mr Bashir Rayyes	Member
Mr Farid Ahmad Ghannam,	Member
Mr Ibrahim Barham	Member
Mr Taalib Sarie	Member
Mr Iyad Joudeh	Member
Ms Samia Jubran Toteh	Member

3. Palestinian Investment Fund

Representative	Position
Mr Mohammad Mustafa	PIF Chairman
Mr Maher Masri	Member
Mr Azzam Shawwa	Member
Mr Mohammad Abu Ramadan	Member
Mr Nabil Sarraf	Member
Mr Samer Khoury	Member
Ms Lana Abu Hijleh	Member
Mr Tareq Aggad	Member
Mr Mazen Sinkrot	Member
Mr Mohammad Nasr	Member
Mr Tamer Bazzari	Member

4. Palestinian Businessmen Association

Representative	Position
Mr Samir Zraiq	Chairman
Mr Osama Amr	Vice Chairman
Mr Kamal Tayyem	Treasurer
Mr Kamel Mujahed	Secretary
Mr Amin Haddad	Member
Mr Joseph Nesnas	Member
Mr Khader Al-Jrashi	Member
Mr Zeyad Anabtawi	Member
Mr Salem Abu-Khayzaran	Member
Mr Imad Lahham	Member
Mr Anan Anabtawi	Member
Mr Mohammad Al-Amour	Member
Mr Ya'qoub Hassounah	Member
Mr Reyad Sa'd	Member of the Supervisory Board

5. Palestinian Banks Association

Representative	Organisation	Position
Mr Joseph Nesnas	Cairo Amman Bank	Vice Chairman
Mr Hani Naser	Secretary	Arab Islamic Bank
Mr Salah Hidmi	Al-Quds Bank	Treasurer
Mr Issa Basha	Jordan Ahli Bank	Board Member
Mr Ibraheem Al- Hanash	Jordan Kuwait Bank	Observer
Mr Mohammad Al-Barghouthi	The Housing Bank for Trade & Finance	Observer
Ms Bayan Kasem	Palestine Islamic Bank	Observer
Mr Muntaser Al-Sashtary	Jordan Commercial Bank	Observer
Mr Jamal Hourani	Arab Bank PLC	Observer
Mr Issa Kassis	Palestine Investment Bank	Observer
Mr Rushdi Al-Ghalayini	Bank of Palestine	Observer
Mr Riad Abu Shehadeh	Palestine Monetary Authority	Observer

6. Palestinian Trade Centre (Paltrade)

Representative	Position
Mr Arafat Assfour	Chairman
Mr Faisal Al- Shawwa	Vice Chairman
Mr Abd Al- Hakeem Foqaha	Secretary
Mr Hani Hayek	Treasurer
Mr Robein Al-Joulani	Member
Ms Sameh Thawabteh	Member
Mr Nafez Nieroukh	Member
Mr Hussein Hijaz	Member
Mr Tayseer Al-Ostath	Member
Ms Waddah Bsaiso	Member
Mr Wadee' Al-Masri	Member

7. Palestinian Federation of Industries

Representative	Position
Mr Bassam Walweel	Chairman
Mr Ali Al-Hayek	Vice Chairman
Mr Nour Deen Jaradat	Secretary
Mr Odeh Shehadeh	Secretary General
Mr Mohammad Bsaiso	Treasurer
Mr Hassan Abu-Libdeh	Member
Mr Tareq Sous	Member
Mr Basem Khoury	Member
Mr Rafeeq Abu-Dawood	Member
Mr Ali Barham	Member
Mr Ayman Sbeih	Member
Mr Mohammad Herbawi	Member
Mr Majed Abu-Farha	Member
Mr Naser Jaradat	Member
Mr Roubin Joulani	Member
Mr Fo'ad Odeh	Member
Mr Osama Na'san	Member

8. Palestinian Information Technology Association

Representative	Position
Mr Yahya Al-Salqan	Chairman
Mr Nahed R. Eid	Vice Chairman
Mr Khaled Sabri	Secretary
Mr Saeed Zeid	Treasurer
Mr Aref Hanaysheh	Member
Mr Michael Younan	Member
Mr Raed Elayyan	Member
Mr Mohannad Shurrab	Member
Mr Mohammad Abu-Nahla	Member