Private Sector-Led Economic Revival of Gaza – Overview

December, 2016
Introduction: The Economic Potential of Gaza

Gazan GDP per capita today is one quarter below its level in 1994, over 20 years ago (measured in constant prices). At this level it is 60% below the GDP per capita of the West Bank, compared to a gap of only 15% in 1994. These figures represent lost GDP of huge magnitude. According to various analyses, if not for the political misfortunes of Gaza, its GDP per capita would have been today 100% to 200% higher (in constant prices).

This lost GDP is forecasted to be regained over a period of 7 to 10 years from returning to normal economic conditions. In conjunction with other growth engines, Gaza is expected to show long term GDP growth of around 10% a year (on average). Its GDP per capita is forecasted to triple over 10-15.

At this fast pace of growth, total employment in Gaza (number of employed people) is forecasted to triple too over this period. This is expected to reduce unemployment from the present rate of above 50%, to below 20% in 10 years, and about 10% in 15 years.

Weaknesses and strengths of the Private Sector in Gaza

Weaknesses and impediments

A recent comprehensive work, presenting the findings of Enterprise Surveys conducted in eight economies in the MENA region, helps in putting the weaknesses and constraints of the Gazan private sector (and Palestinian firms at large) in regional perspective.

Unsurprisingly, political instability has been identified by Palestinian firms as the most significant impediment. However, only one third of Palestinian firms singled out political instability as their top obstacle; in comparison to 50%-60% in other politically-troubled economies (Egypt, Tunisia, Yemen and Lebanon).

This may indicate the relative severity of other impediments that the Palestinian private sector is facing.

Unreliable provision of electricity is the second most damaging impediment in Gaza. Firms in Gaza have been facing 29 electricity outages per month, on average, in comparison to only two outages per month in the West Bank. Losses due to power outages averaged over 22% of annual sales for firms in Gaza, in comparison to 5% on average in the eight MENA countries which were surveyed (in this respect the situation

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2 Portland Trust, "Global Palestine, Connecting Gaza", p. 79; and Nashashibi, and Gal, and Rock, p. 43.

3 World Bank, European Bank and European Investment Bank, "WHAT'S HOLDING BACK THE PRIVATE SECTOR IN MENA? LESSONS FROM THE ENTERPRISE SURVEY" (July 2016). This study summarizes surveys in 8 MENA non-oil economies, which were conducted in 2013 – 2014.

4 World Bank et al, ibid, p. 21.
in the West Bank is much better, with just above 1% losses due to power outages. Access to financial services is another major obstacle for Gazan and West Bank firms. Banks account for only 3% of finance for working capital, which is well below the average of 10% of the eight MENA countries which were surveyed. Approximately 30% of Palestinian formal private sector firms do not have a check or savings account and so cannot use the financial system. Only 6% of Palestinian firms have made use of loan facilities or a line of credit, compared with MENA (eight countries) average of close to 30%.  

These weaknesses combine with Gaza's complex network of administrative, political, security and other constraints - generating a most unfriendly environment for the business sector.

**Strengths**

Notwithstanding the weaknesses mentioned above, the Gazan economy has noticeable strengths. These strengths can enable and sustain strong long-term growth, under appropriate political and economic conditions.

- **The Small Size of the Gazan Economy**
  The size of the Gazan economy is less than 1% of the Israeli economy or one third of the West Bank, in terms of GDP. Development-wise the smallness of the economy, and the small geographical size of Gaza, is a great advantage. It enables planners to approach the task of developing Gaza as a medium-scale regional development project. This conceptual observation implies that a small set of well-chosen local projects can make a dramatic difference.

- **Resilience and Ample Unemployed Resources**
  The private sector of Gaza has shown remarkable strength and resilience, whenever the political situation allowed economic forces to work. Under appropriate political and economic conditions, this resilience will be translated into speedy mobilization of ample, unused production capabilities: (1) ample and highly educated workforce, (2) high percentage of unused production capacity in industry, construction, agriculture, and other productive branches of the economy, and (3) other resources and capabilities that can be used or re-activated (elaborated below).

- **Close Connections with the Large, Advanced, Israeli Economy**
  Under stabilized security and political conditions, the relatively giant Israeli economy provides huge economic-growth opportunities for Gaza: (1) Israel is an immediate, ready market for Palestinian exports, sub-contracting to Israeli industries, etc., (2) Israel can re-absorb large numbers of Gazan workers (as it has done with West bank workers), (3) Israel is a ready reservoir of technical know-how, and marketing channels, and (4) cooperation and partnerships with Israeli companies in export-oriented joint-ventures vis-à-vis other markets.

- **Access to Arab Markets**
  Under stabilized security and political conditions, Gaza too will be able to benefit from its access to the large Arabian Gulf import-markets. Additionally, various possibilities of economic cooperation with Egypt and other Arab markets as well.

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• **Favourable Trade Agreements with all Important Potential Trading Partners**
  Gaza too can benefit from the wide network of favourable trade agreements of the PA with the EU, EFTA, the USA, Canada, and others; in addition to the Palestinian membership of GAFTA.

• **Exceptionally Large International Economic Support**
  The international donor community is ready to support, in a most generous way, the rehabilitation and economic development of Gaza.

• **Geographical Advantages**
  All these strengths can be enhanced by the multiple location advantages of Gaza, which can be leveraged to: (1) making Gaza the main international gateway of Palestine, and one of the main outlets for regional transit trade on the Mediterranean; (2) developing Gaza as a focal point for Palestinian trade and cross-border economic cooperation with Egypt (especially the Suez Canal Corridor, which is expected to be the fastest growing region of Egypt over the coming decades); and (3) developing trade and economic cooperation with the southern parts of Israel (especially the Israeli Negev, which is expected to be among the fastest growing parts of Israel over the coming decades).

### Development Strategy Based on Leveraging Strengths

The private-sector-led development strategy is based on leveraging these strengths – as per the following guidelines:

• **Harmonize traditional strengths of the Gaza private sector with new capabilities.**

• **Expand the private sector of Gaza to include new strong players from outside:**
  - Encourage joint ventures and other forms of cooperation between the local business community and Arab, international and Israeli companies.
  - Encourage major companies from the West Bank, as well as large Arab and foreign companies, to join forces with local Gazan companies, and work together on projects in Gaza.

• **Use the Gaza Rehabilitation Plan⁶ as a historic opportunity for strengthening the private sector:**
  - Let the private private-sector lead reconstruction and rehabilitation projects in all sectors; including energy, water and other fields of infrastructure as detailed below.
  - Enhance private sector leadership in implementation of the already approved and budgeted Gaza Rebuilding Projects.

• **Enable the business sector of Gaza to expand out of Gaza, by taking part in the vast opportunities opened by regional economic and business cooperation in various fields and areas:**
  - Work together with foreign and Arab companies to promote projects and enterprises which require cross-border or regional cooperation
  - Enable the business sector of Gaza to take part in Egypt's Suez Canal Corridor flagship development plan and Sinai development projects
  - Enable the business sector of Gaza to take advantage of Saudi and other Gulf countries' support to these projects

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• Apply lessons from Gazan economic history (with required adaptation to the new conditions and economic environment), mainly successful export-driven agricultural and industrial activities.
• Apply lessons from successful private-sector-led, export-driven development strategies in Jordan and other countries in the region.
• Use the following strengths as the mainstays of private sector re-structuring and growth strategy:
  o Gaza's young and educated population and high-quality work force.
  o The proven resilience and the dynamic and entrepreneurial spirit of Gaza's business community.
  o Gaza's historical extensive trade-relation networks with Israel, and the wide-ranging business network of Gazan business people in other regional markets.

Political Envelope and Economic Policy Enabling Measures

Successful implementation of the strategy suggested in this report, would require a political and economic eco-system that will support and enhance private sector activity, trade, and particularly revival of exports from Gaza.

The plan outlined here assumes a political will to accept practical de-facto arrangements, which will allow structuring of such an eco-system, in spite of the political complexities that surround Gaza. This assumption is based on the common interest of all parties in avoiding the high political, security and human risks associated with the continuation of the present situation.

The security considerations, embedded in the solutions outlined in this document, will be developed and tested, at first, in relation to the designated area of the NGIZ. Then, following successful application in this designated area, it will be easier for the parties to agree on expansion of economic and trade enabling measures to other parts of the Gaza Strip.

Trade Policy Enablers

Stabilization and rationalization of the regulatory framework that govern the foreign trade of Gaza

Though constraints on trade with Israel and the West Bank have been considerably relaxed, Gaza's external trade with and through Israel is still subject to severe restrictions, and frequent changes; while trade through Egypt is almost entirely blocked.

Required enabler: continue relaxing trade constraints, at an accelerated pace; aiming, ultimately, at free flow of imports and exports of Gaza with and through Israel and Egypt, except for an agreed set of security-related limitations. This process will advance in parallel to the implementation of the security guarantees that support the envisioned long term truce.
Extensive expansion of lists A1, A2 and B

Given the economic border that has been built between Gaza and Israel, Gaza can be allowed higher degree of freedom in applying independent customs tariffs and other trade policies that are better suited to Gaza’s economic situation and development needs.

The experience gained from the development and application of an independent Palestinian customs tariff system in Gaza, will also serve the PA and Israel in future discussions on a new economic regime that will replace the Paris-Protocol-based regime.

Allowing free import of fuels and other energy products from Arab countries

Import of fuels from Israel hurts the competitiveness of Palestinian industry; contributes considerably to the higher cost of living in the West Bank and Gaza; and constitutes a heavy macro-economic burden. Prices of fuels are substantially lower in the Arabian Gulf. If allowed to import fuels from there, the Palestinians would be able take advantage of even more favourable prices. Furthermore, they may be able to receive part of these fuels as grants. The Gulf counties have done this in recent years for Egypt (at a scale tens-times larger than the Palestinians may need), and in the past also for Jordan.

Required enabler: allow free import of fuels from Arab countries into Gaza – starting with import through Egypt and Israel; and later on shifting to direct import through a designated terminal in the Gaza port (see the section on the Gaza Port below).

Allowing free import of construction materials into Gaza

Significant relaxation of constraints on entry of construction material into Gaza, especially since the first half of 2015, has facilitated a jump in import of building material into Gaza; which accelerated progress in reconstruction. As of the middle of 2016, close to one half of completely destroyed houses were already rebuilt or under construction; and 60% of approximately 170,000 housing units that were damaged had been repaired.

However, the mechanism which was set up in cooperation between Israel and the PA under United Nations supervision, (the GRM - Gaza Reconstruction Mechanism) could not ensure continuous and sufficient flow of construction material. In the second quarter of 2016 Israel banned entry of cement for almost two months in response to reports of materials being syphoned to the black market. The ban put a near halt to construction work in Gaza, causing financial damage and the temporary loss of thousands of jobs. In the following months a 42% drop was recorded in the volume of cement going into Gaza. Other obstacles that have held back the reconstruction process included, inter alia: limited number of vendors and contractors authorized to engage in reconstruction.
as part of the GRM, restrictions on the amount of construction materials entering each day and restrictions on entrance of other items on the dual-use list.\(^7\)

**Required enabler:** streamline the operation of the GRM in a way that will allow uninterrupted flow of construction material into Gaza. This streamlining process can also advance in parallel to the implementation of the security guarantees supporting the envisioned long term truce.

**Relaxation of constraints on import of "dual use" items**

The present "dual use" system that applies to Gaza is in place since the middle of 2010. Under this system, Israel allows entrance of most civilian goods into the Gaza Strip, while blocking a list of forbidden products (prior to this, all items were blocked save for a list of permitted items). The "basic list" that applies also to the West Bank includes weapons and internationally recognized dual-use materials and technologies, plus more than 50 additional other items described as "materials and equipment that are intended for civilian use and are also suitable for military use". Among these additional items: fertilizers, chemicals and raw materials for manufacturing, metal pipes, lathes, optical equipment and navigation and surveying accessories.

On top of this "basic list" of blocked items, Israeli authorities published lists of items forbidden only to enter Gaza (except with individual permits). The first Gaza-specific list was published in 2010, Additional Gaza-specific lists were published in March 2015 (48 more items) and in November 2015 (adding 13 more items). Some of the items are specific, such as ammonium chloride, graphite powder, asphalt, castor oil, asbestos insulation, or wood panels more than 2 cm thick and wood planks thicker than one centimetre and wider than 5 cm. Others are broad categories of products, including communications equipment, watercraft, heavy vehicles, building bricks of all kinds, UPS components, smoke detectors, cranes and heavy lifting equipment, heavy machinery, and more.

These restrictions affect almost every industry and many aspects of daily life in Gaza. The ban on import of wood planks, in addition to lacquers and glues, has crippled the furniture industry of Gaza. Shortages are reported of items like wooden doors, and manufacturers are finding themselves unemployed. The construction industry is hampered by restrictions on import of critical equipment, such as cement mixers and pumps, moulds, and wood; and so on in other industries.\(^8\)

**Required enabler:** revision of "Dual Use" list. Base the revised list on the internationally agreed lists of weapons and dual-use materials and technologies\(^9\); while screening and reducing additional items.

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\(^7\) Gisha, “Two Years, 360 degrees" part 1: construction; Gisha, “ Two years later: The long road to reconstruction and recovery” (August 2016), pp. 2-3, 5.

\(^8\) Gisha, “Two Years, 360 degrees”, ibid; Gisha, "Dark-gray lists" (2016), pp. 3-6

Enabling trade and economic relations between Gaza and Egypt

Required enablers:

- Open the Rafah-Sinai border for free movement, in parallel to the implementation of the security guarantees supporting the envisioned long term truce.
- Enable and encourage trade of Gaza with and through Egypt, as an additional trade route that supplements trade with and through Israel.
- Enable and encourage cross-border economic cooperation between Gaza and Sinai.

Export and Investment Promotion Measures

Export promotion

Support and enhance the renewal of exports from Gaza, following the first steps which were taken in 2015:

- Continue improving processes, and removing impediments, for exports from Gaza to Israel; to and through Jordan via the King Hussein Bridge; and sales to the West Bank.
- Develop and rapidly implement a set of export incentives for exports from Gaza to Israel, as well as Arab and international markets.

Incentives for Investment in Productive and Export-Oriented Branches of the Economy

- Set "fast track" approval procedures for import of industrial machinery and equipment.
- Set "fast track" approval procedures for entry of Arab and other investors to Gaza.
- Develop and quickly implement a set of investment incentives to Palestinian, Arab and international industrial and agricultural companies expressing interest to invest in Gaza. Start immediately with a program based on existing proven incentive packages, which are applied in other countries, and amend the program as it develops.\textsuperscript{10}
- Expand, diversify and apply to Gaza the political risk insurance programs offered in the Palestinian territories by the Multilateral Investment Guarantee Agency (MIGA); as well as other risk insurance programs.

Solutions for the Medium and Longer Terms

Successful implementation of the suggested solution in the designated area of a North Gaza Industrial Zone (NGIZ) is expected to open the way for a wider set of solutions for the medium and longer terms:

- Additional industrial Estates

\textsuperscript{10} Given the financial difficulties of the PA, this and the other recommendations for incentives are directed to the donor community.
The Eastern Industrial Estate (EIE) on the Gazan-Israeli border east of Gaza City; and The Rafah Industrial Estate (RIE) on the Egyptian border, in the south-western part of the Gaza Strip.

**Widened Network of Commercial Crossings**

As Gaza will gradually shift towards normal economic conditions, the volume of import and export trade that passes through the commercial crossings with Israel would grow steeply. The daily number of export and import trucks may jump 4 to 6 times in 2-3 years, and then continue growing at a double-digit pace for probably a decade. Thus, the development of a network of large, modern and efficient commercial crossings, which will serve and facilitate trade, is another corner stone of the suggested plan. Each of the commercial crossings is planned to function as a land-port, which will serve a large adjacent industrial estate, and will be connected to the planned transportation infrastructure of Gaza.

This plan suggests a network of three additional land commercial crossings, which will be developed as large land ports, in addition to the planned Gaza Seaport and the Erez land crossing:

- The Kerem Shalom Crossing will continue functioning as a major commercial crossing, but will gradually shift to trade with the southern parts of the Gaza Strip, goods related to the RIE (construction materials, etc.), and trilateral trade between Israel, Gaza and Egypt.
- The Karni-Al-Muntar Commercial Crossing will be re-activated as well. It will function as a second crossing serving the central part of the Gaza Strip, and the adjacent EIE.
- The Rafah Crossing will be developed and activated as a full-scale commercial crossing, functioning as the gateway for the Gaza trade with Egypt. It will also serve the RIE and cross-border economic cooperation with Egypt.

Designated bonded storages (as defined by Israeli customs regulations) will be developed beside each of the Israel-Gaza crossings.

**Focused Solutions for the Industrial Sector**

As mentioned above, this plan envisions the industrial estates of Gaza to be the focal points of industrial development. As such, the industrial estates are expected to generate massive indirect employment outside the estates, which will be even larger than direct employment inside the industrial estates.

The guidelines suggested for the development of the industrial sector of Gaza at large relate to the following sub-sectors and activities:

**Construction material industries**: driven by import substitution, leveraging the huge demand for housing and other construction projects (generated and financed by the Gaza rehabilitation program).

- Conventional light manufacturing industries: reviving and developing the main "old" industrial sectors - textile and garments and furniture.
- Advanced small-scale distributed industrial production and niche activities.\(^{11}\)

**Revival of Agriculture – Focused Export-Driven Solutions**

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\(^{11}\) These suggestions are partly in line with “Global Palestine: Connected Gaza”, pp. 66-67.
The agricultural sector was historically a most important pillar of the Gazan economy, and a major employer. The last decades have seen grave decline of this sector. The decline of agriculture reflects the combined impact of multiple constraints: shortage of water and deterioration in the quality of available water, dwindling availability of land for agricultural use, severe limitations on exports, and more.

Nevertheless, the potential of agriculture is still large; and the solutions suggested in this plan would enable this sector to tap its potential.

These solutions build on successful past experience, and combine: (a) creation of new sources of water for agriculture; (2) removal of constraints on agricultural exports and import of agricultural inputs; (3) intensive use of scarce agricultural lands; and (4) focusing on high-value, employment-intensive, export-oriented crops.

- **The Construction Sector as a Generator of Long-Term Sustainable Growth**
  The large-scale Gaza rehabilitation and reconstruction program presents huge opportunities for the construction sector in Gaza. The guidelines suggested aim at seizing these opportunities, and use it as a powerful generator of long-term, sustainable economic growth and employment.\(^\text{12}\)

- **Trade and Transit Trade Development, Using the Location Advantages of Gaza\(^\text{13}\)**
  As indicated above, Gaza is blessed with unique location advantages; which can transform it into an important regional trade and business centre. More specifically, this plan suggests aiming high in this regard. Namely, leveraging Gaza location advantages to develop multi-level trade services: locally as Palestine’s main international trade gateway; and regionally, as an important east Mediterranean trade and business centre, and as one of the main gateways on the Mediterranean for regional transit trade.
  The industrial estates, in conjunction with the transportation solutions suggested below, would provide the required infrastructure for the transformation of Gaza into such a trade centre. In order to achieve this ambitious goal, the private sector of Gaza must be helped by Arab and international companies that have the required knowledge and experience, as well as the professional and financial capacities, for making this transformation.

- **Private Sector Led Development of Infrastructure**
  Development of basic economic infrastructure is critical for long-term, sustainable economic growth in Gaza. The plan claims that, given the political environment that surrounds Gaza, the best way of implementing these projects is by handing them to the private sector, under BOT or other financing arrangements. This way has become customary in execution of large infrastructural projects in the GCC, Egypt and other countries in the region.

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\(^\text{12}\) These guidelines integrate, inter alia, suggestions presented in "Global Palestine: Connected Gaza", p. 60; and various publications of Gisha, mainly Gisha, “Two years later: The long road to reconstruction and recovery” (August 2016), p. 5

\(^\text{13}\) These suggestions are partly in line with the suggestions of "Global Palestine: Connected Gaza", p. 68 and elsewhere.
In the case of Gaza, an internationally-guaranteed BOT contract, which will be awarded to a consortium of strong international or Arab companies with Gazan private-sector companies, would probably be the only feasible way to get financing and to ensure the execution and longevity of the project.

Furthermore, this would be another way of strengthening the private sector of Gaza, by bringing in strong international and Arab companies in various fields of infrastructure, and empowering the local private companies.

The plan suggests contracting these projects to the private sector, under internationally-guaranteed BOT (Build, Operate, Transfer) or BOO (Build, Own, Operate) agreements.

- **Information Technology and Other Advanced Services**
  The new, unconstrained eco-system of the NGIZ (and later on also in the EIE) would facilitate cooperation between Gazan IT firms and the relatively giant Israeli IT and other advanced industries.

- **Enabling Re-Entry of Workers from Gaza into Israel**
  In the West bank, where Palestinians are allowed to enter Israel for work, the economic contribution of work in Israel is enormous. Re-entry of workers from Gaza into Israel would have even stronger effect.

- **Cross-Border Economic Cooperation with Egypt and Israel**
  The new eco-system, which is envisioned to develop, would open vast opportunities for cross-border economic cooperation with Israel and Egypt. Some aspects of cross-border cooperation are expected to be of especially high economic importance, including, inter alia:
    - Development of the Gaza Marine gas field, and the integration of Palestine into the new, emerging gas industry system of the east Mediterranean
    - Involvement of the Gazan private sector in Egypt's flag-ship "Suez Canal Corridor" mega-project; and most important possible synergies with the economy of Gaza at large.

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14 In line with the suggestions of "Global Palestine: Connected Gaza", p. 72.