



The economy of the private sector in the Gaza Strip (Reality and Challenges)

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The private sector is one of the important sectors that contribute to economic development and reducing unemployment. Developing the private sector can raise incentives, and enable the creation of a market-oriented business system that works effectively and achieves economic growth. Private sector institutions provide economic returns for the economy as a whole and for individuals and investors, especially in societies that adopt free market. Therefore, all developed and developing countries seek to enhance and raise the efficiency of the private sector because of its impact on economic development.

Since its establishment, the Palestinian Authority has been working on revitalizing the private sector for its inherent importance in improving economic growth rates and eliminating unemployment. Thus, it was necessary to put in place legislations and programs to ensure this. Economist Douglas North believes that institutions are the ones that give each economy its own incentive structure. It is the development of this structure that determines the direction of economic change towards growth, stagnation or decline.

The Palestinian private sector in the Gaza Strip is facing the threat of complete collapse with the outbreak of the Corona pandemic, and the continuation of the strict Israeli siege imposed on more than two million Palestinians for the fourteenth year in a row. Precautionary measures imposed by Hamas's governmental agencies in Gaza to confront the Corona pandemic, ravaged the economic private sector in terms of reducing the number of workers and daily working hours.

Therefore, this paper will focus on many points in this regard, as follows:

The reality of the private sector in the Gaza Strip:

The role of the private sector in any economy is measured by the extent of its contribution to the gross domestic product, total exports and its ability to absorb the workforce. It is natural that this role varies from one economy to another depending on a set of factors that are based on the political and economic systems.

It also depends on the availability of an investment environment, which in turn depends on the existence of supportive laws and legislations that regulates economic life, the availability of human capital, and the efficiency and consistency of economic policies with each other. The private sector in the Gaza Strip suffers from many crises and systematic Israeli policies that can destroy the infrastructure of the Palestinian economy. This is all added to the new COVID crisis, which caused many losses to the private sector in the Gaza Strip, loss of production capacity, and the layoff of many workers.

Indicators affecting the private sector in the Gaza Strip:

There are many requirements that must be met in order for the private sector to flourish. They are as follows:

1.Product Growth Rate (GDP growth rate):

There is a reciprocal relationship between private investment and the rate of product growth. Increased investment, whether in resource development or in research and development, has a positive impact on productivity, and thus increases the Gross Domestic Product growth rate. Also, increasing the GDP rate would give investors an indication of optimism about the future of aggregate demand and economic performance, which motivates them to implement new projects.

In order to know the impact of GDP growth on investment in the private sector, we must present GDP growth rate in the Gaza Strip. The following table shows the growth rate of GDP in the Gaza Strip from (2015 - 2020):

**Table1: GDP growth from2015 - 2020
Base year 2015**

Year	2015	2016	2017	2018	2019	2020
GDP growth	1.38	9.13	-7.69	-3.51	0.40	-12.32

Source: Palestinian Central Bureau of Statistics

The table shows the instability of GDP growth in the Gaza Strip, and that it has reached (-12.3%) in 2020. This shows the weakness of economic growth in the Gaza Strip, which negatively affected the activity of the private sector.

2.Bank loans:

New facilities/businesses depend mostly on bank loans to finance their projects. Therefore, we find that the availability of bank loans would support the increase in private investment, especially in developing countries. The following table shows the volume of direct credit facilities provided to the private sector during the period (2015 - 2020).

Table 2: direct credit facilities provided to private sector (2015 - 2020)

Year	2015	2016	2017	2018	2019	2020
Facilities growth	19.52	24.82	20.12	8.63	5.09	5.24

Table 2 shows that the growth rate of facilities offered to the private sector has noticeably dropped during 2020 as compared to 2016. This, in turn, was negatively reflected on the private sector's ability to invest and produce.

3.Exchange rate:

Investment is affected by fluctuations in the exchange rate of the national currency, which usually result from economic reform programs offered to developing countries, and which is accompanied by a rise in the rate of inflation as a result of an increase in exports, a lack of imports and a rise in their prices. This leads to a general decrease in spending and to high interest rates that negatively affect investment.

The following table shows the exchange rate and interest rate changes in Palestine during the period of 2018 - 2020:

Table (3) Interest rates and exchange rates between 2018 and 2020

	US Dollar \$		Jordanian Dinar JD		Shekel NIS		Exchange rate USD/Shekel	
	deposits	loans	deposits	loans	deposits	loans	Buying	Selling
2018	2.27	5.87	2.57	6.48	2.07	7.14	3.766	3.76
2019	2.85	5.93	3.21	6.84	2.52	7.07	3.57	3.56
2020	2.43	5.52	2.62	6.84	2.23	6.88	3.44	3.43

Table (3) shows that there is a large gap between the interest rate on deposits and the interest rate on loans in the three major currencies, and this affects private investment. The high interest rate on loans leads to reluctance to borrow, in addition to the weak interest rate on deposits which negatively affects the size of deposits in the three currencies. Consequently, this leads to a weak ability of the banking system to lend. We also note the low and fluctuating rate of exchange of the dollar against the shekel, which affects the ability of the private sector to import and export.

4. Taxes:

Taxes have a direct negative effect on private investment through their impact on the incomes available to the family sector. They also lead to reduction in saving and in investment, due to the direct relationship between the level of income and the level of saving and that taxes imposed on income lead to a decrease in investment. The following table shows direct taxes in Palestine during the period 2015 - 2020:

Table (4): Tax revenue growth during the period 2015 - 2020

Year	2015	2016	2017	2018	2019	2020
Tax revenues	0.43	3.2	21.2	10.47	-8.93	-3.4

Table (4) shows an increase in the growth rate of tax revenues in 2017, reaching 21.2%, but it significantly decreased in 2020 as a result of the private sector's inability to pay taxes in addition to the closure of many facilities and projects in the private sector.

5. Government spending and crowding out the private sector:

Government spending affects investment in the private sector through many channels:

a. It can have a negative impact, when state revenues decline or when government spending is reduced to address inflation or the growing deficit in the public budget. On the other hand, it can positively affect it when government spending rises, directly or indirectly. The following table shows the growth of total revenues in Palestine during the period 2015 - 2020

Table (5) Growth rate of total government revenues during the period 2015 - 2020

Year	2015	2016	2017	2018	2019	2020
Total revenues	1.05	23.3	1.51	-2.79	-4.79	5.28

A. Table (5) shows the fluctuation in the growth rate of the total revenues. We notice an increase to 23.3% in 2016 compared with 1.05% in 2015. We also find that the growth rate of total revenues decreased in the years 2018 and 2019, respectively, and this is due to the economic conditions in Palestine in general and the Gaza Strip in particular from closing the crossings and preventing the arrival of raw materials to the Corona pandemic, which cast a shadow over most economic sectors, and led to a decrease in local revenues and tax revenues. All this was generally reflected on the decrease in the growth rate of total Palestinian revenues.

B. Government spending on infrastructure (electricity, transportation, roads ...) may have a positive complementary effect on private investment, so investors are not obliged to bear these costs because the state has taken care of them, and in this case the investment becomes efficient. But in Gaza Strip, things are different, where infrastructure is continuously destroyed due to successive attacks on Gaza Strip and the electricity crisis leads to investors paying high costs in order to secure electricity, using generators, for their operations. Of course this has a negative impact on investment. The following table shows the percentage of wages and salaries from government spending during the period 2015 - 2020:

Table (6): Percentage of wages and salaries from government spending during the period (2015-2020) in US dollars

Year	2015	2016	2017	2018	2019	2020
Government spending	3,445.0	3,661.7	3,794.8	3,660.0	3,659.9	3,954.9
Wages and salaries	1,759.5	1,927.2	1,953.6	1,657.8	1,677.6	1,890.9
Percentage of wages and salaries from government spending	51.07	52.63	51.48	45.29	45.84	47.81

Table 6 shows that wages and salaries take up a large percentage of government spending and this reflects the small amount of government spending directed to the private sector, and to infrastructure and development expenditures, and thus the negative impact on the capacity of the private sector.

6. Economic stability:

Change in money supply rate is one of the most important indicators of macroeconomic stability. These changes are reflected in the rate of inflation, product and employment levels and aggregate demand. It is expected that instability of the growth rate of money supply will increase the uncertainty of the business sector and investors about the future economic situation, which drives them to postpone their projects, until there is a clearer vision about the future. It is no secret to anyone that the situation in Gaza Strip is economically unstable, as it has been suffering shortage of liquidity in the three currencies used in the Palestinian economy. This has negatively been reflected onto investment in the private sector.

7. Political stability:

Political stability is one of the components of the political environment and an element necessary for investment. Countries that are politically unstable cannot provide a proper atmosphere for foreign or local investment, thus limiting the

economic sector's ability to absorb and make good use of investment. Instability delays development steps. Our political situation is not a secret and there are many problems facing the Palestinian political system, which have negatively affected the private sector with all its components.

8. External debt:

External debt is a problem with a double impact on the economies of developing countries. They are the main source of financing development plans investments in foreign currencies necessary to import capital goods such as machinery and equipment, so there is no harm in having external debts as long as countries use them well in project that support growth. However, when it is time to repay those debts, with interest, that can affect investment atmosphere. The following table shows the amount of external debt for Palestine during the period 2015 - 2020:

Table (7) Total outstanding external debt during the period (2015 - 2020) in million dollars

Year	2015	2016	2017	2018	2019	2020
Total External Debt	1,070.8	1,043.9	1,041.9	1,031.7	1,218.0	1,324.6

Table (7) shows an increase in the existing external debt during the year 2020 compared to the year 2018, as it amounted to approximately (1031) million dollars in 2018, rising to (1324) million dollars during the year 2020. Also, the majority of debts were not invested properly in pushing the wheel of economic development or revitalizing productive projects. Rather, most of the money from external debts was used to fill the deficit in the public budget.

Corona pandemic economic effects on the private sector in the Gaza Strip:

The Corona crisis is different. It is unlike anything that Palestine had been through in contemporary times. This crisis is health related that has affected real economy, and has spread to the financial sector and the private sector. Of course, there have been government measures to confront the crisis, which had an impact on the private sector as follows:

1. Full lockdown:

Final results of this study indicated that (37%) of the establishments in the Gaza Strip had to fully close down for a number of days as a result of the government's precautionary measures that required closure to combat the spread of the new Corona virus. The percentage of institutions that were closed based on the size of the institution was as follows: (Small institutions 36%, medium enterprises 37%, and large enterprises 47%).

Service providing institutions were subjected to closure at a rate of (48%), the highest among others, while the institutions of financial and insurance activities were the least to close at a rate that did not exceed 22%.

The following table shows the percentage of closure according to the nature of economic activities during the period March 5 to May 31 - 2020)

Table (8) Percentage of establishments that closed as a result of government measures, disaggregated by economic activity

Economic activity	Industrial	construction	Internal trade	Service provision	Transport and storage	Communications	Financial and insurance
% of closure	27	39	15	40	9	24	6

In terms of the number of days of closure, small establishments were closed 24%, medium establishments 25%, and large establishments reached 21%.

The following table shows the rate of closure by economic activity in the Gaza Strip:

Table (9) Percentage of closing days a result of government measures, disaggregated by economic activity

Economic activity	Industrial	construction	Internal trade	Service provision	Transport and storage	Communica-tions	Financial and insurance
% of closure	27	39	15	40	9	24	6

Table (9) shows that the services sector has the highest percentage of closing days, reaching 40%, followed by the construction sector at 39%, while the lowest percentage of closing days was noticed for the financial and insurance activities sector, which was at approximately 6%.

Of course, the government's measures led to stopping production supplies such as raw materials and other production requirements. In turn, the level of production and/or sales volume declined by about half, forcing about 14% of Palestinian institutions to lay off part of their workers to face this crisis.

2. Demand Shocks:

Demand Shocks are basically a decrease in average sales/production by 50% compared to normal. Most organizations reported that sales/production volume decreased by 93% during the last three months, with a decrease in average sales/production by (55%) compared to normal. Institutions working in the field of finance and insurance recorded the highest decrease in average sales/production by (100%), followed by construction and industry by (94%).

The following table shows the percentage of institutions that witnessed a decrease in production compared to the normal situation according to economic activity:

Table (10) Percentage of establishments that witnessed a decrease in production by economic activity in the Gaza Strip.

Economic activity	Industrial	construction	Internal trade	Service provision	Transport and storage	Communica-tions	Financial and insurance
% of closure	94	94	93	94	90	92	100

As for the percentage of change in institutions' production, institutions working in the field of finance and insurance recorded the highest percentage of decrease in the average sales/production by 68%, followed by the institutions working in the field of services with a rate of 58%.

The following table shows the average rate of change in institution's production, disaggregated by economic activity in the Gaza Strip.

Table (11): Average rate of change in enterprise production by economic activity in the Gaza Strip

Economic activity	Industrial	construction	Internal trade	Service provision	Transport and storage	Communica-tions	Financial and insurance
Decrease percentage	-56	-52	-54	-58	-47	56	-68

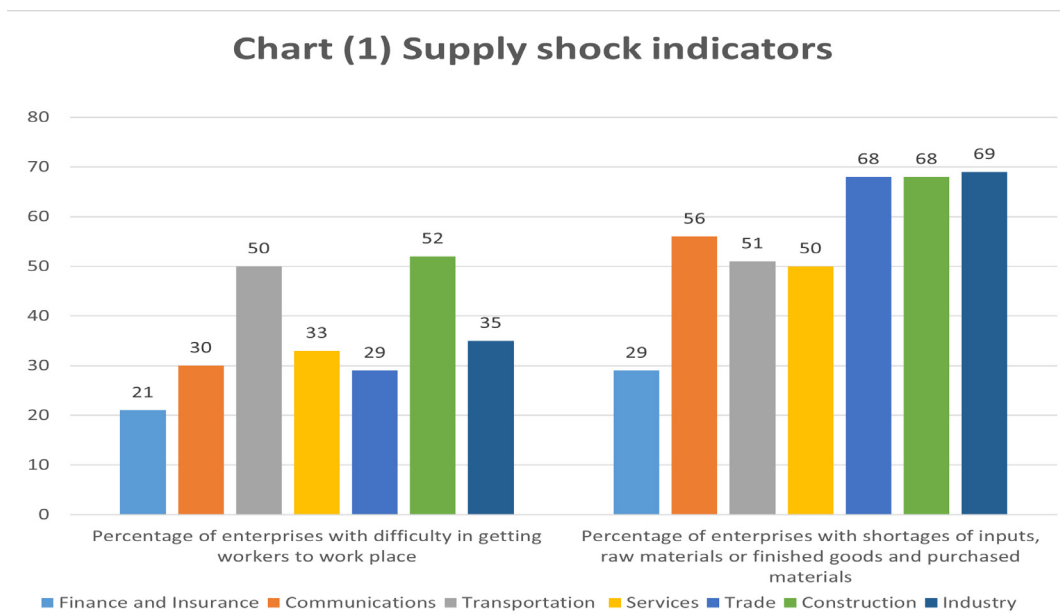
The main reason for the decrease in production and sales is related to the decrease in consumption in general, where consumption decreased by more than 5% during this period. The decline in production in the construction sector was due to prioritizing essential sectors needed to ensure health and food security for people in the face of the pandemic during the lockdown. Food and pharmaceutical industries, including preventive and medical supplies, as well as supply chain industries such as paper and plastic industries, have operated, in addition to ensuring the flow of supply chain of goods and facilitating the movement of internal and export trade. This pandemic was also reflected in the complete

cessation of operation of many industries, especially tourism and craftsmanship, while footwear, leather, clothing and other industries partially stopped operating.

3. Supply shocks:

51% of the institutions reported difficulty in importing inputs, raw materials or finished goods and purchased materials. Activities most affected by these difficulties were construction activities by (73%), trade by (71%) and industry by (69%).

The following figure shows indicators of supply shocks:



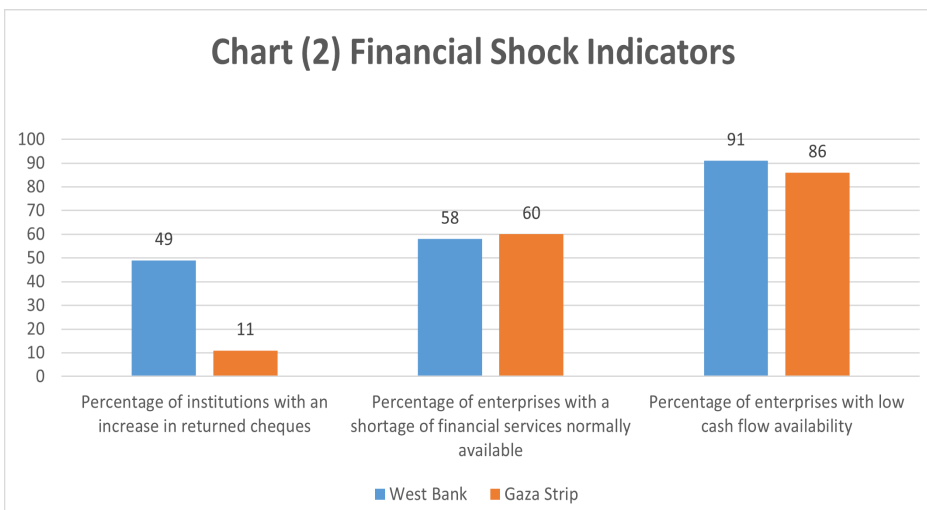
The reason for the increase in percentage of institutions that have a shortage in the supply of inputs is the closure of global markets and the resulting confusion and slowdown in the supply chain at the global level, which led to difficulty in securing production inputs and raw materials. In addition, producing countries were unable to export essential items as they also had been facing the same pandemic which affected the economies of countries. There was always an effort to provide materials and facilitate the operation of some vital industries such as

medical industries and others. During the pandemic, about 53 industrial facilities were established and operated to produce preventive and health supplies.

4. Financial shocks:

89% of the institutions face a decrease in the availability of cash flow. This in turn increased the percentage of bounced checks by 11% in the Gaza Strip, while 59% of the institutions reported difficulty in accessing financial services available in the normal situation.

The following figure shows the indicators of financial shocks in the Gaza Strip and the West Bank.

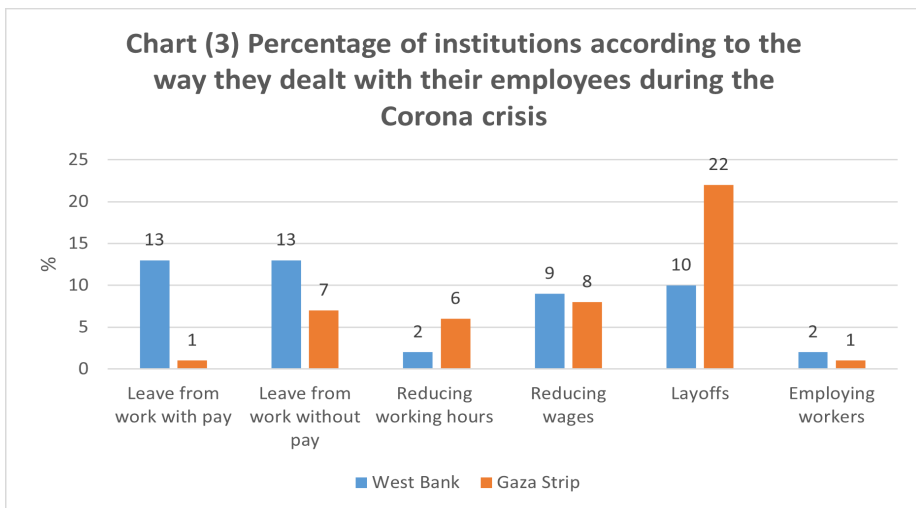


The government has taken several steps to face shortage of liquidity during the lockdown. It transferred support provided by donor-funded projects towards the pandemic and provided liquidity to facilities and individuals to ensure continuity of their business. It facilitated the holding of meetings of public bodies according to health requirements in order to distribute profits to shareholders. Total of distributed profits reached 130 million dollars, distributed to 46 thousand people. In addition, the government expedited the approval of financing non-profit companies in order to pump liquidity in the Palestinian market, with a total of 25 million dollars, the majority of which was in the southern governorates.

In order to face liquidity shortage, institutions have adopted several mechanisms for financial settlement:

To meet shortage in cash flow, 39% of establishments were forced to delay payments to suppliers and workers, while 36% of other establishments had to take loans from family or friends to cover the cash flow shortage. This had a negative impact on employment where 13% of institutions were forced to lay off workers, and 7% gave some of the workers unpaid leaves.

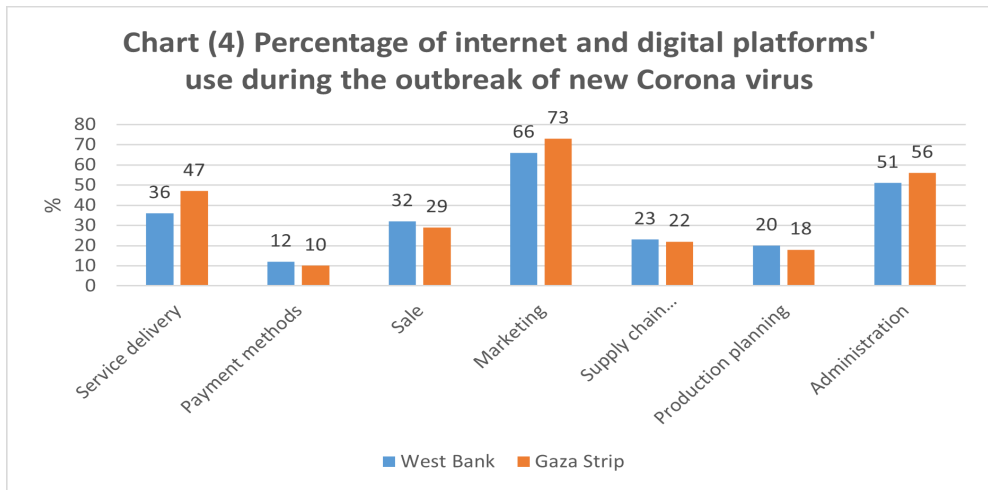
The following chart shows the percentage of institutions according to the way they dealt with their employees in the Gaza Strip and the West Bank during the crisis:



5. Using digital solution:

13 % of organizations started using or increased their use of the internet, online social media, niche apps or digital platforms in response to the coronavirus outbreak; The main use of these digital solutions was for marketing by 69% of these organizations, managing business by 53%, and service delivery by 40%.

The following chart shows the percentage of internet use, online social media, customized applications, or business digital platforms in response to the outbreak of the new Corona virus.



The percentage of workers who worked remotely from home was 6% of the total workers. It was mainly work in telecommunications activities with 18% of the total workers, followed by service activities with 8% of the total workers, and trade with 5% of the total workers.

Losses of the private sector as a result of the recent war on the Gaza Strip

Many sectors operating in the Gaza Strip, including industrial, commercial, agricultural, medical and infrastructure sectors, incurred heavy losses as a result of the deliberate targeting of working facilities by the Israeli occupation warplanes. This has caused large financial losses that were initially estimated at 300 million dollars, in addition to the difficulty of reviving many of these facilities due to their complete destruction.

Targeting Palestinian facilities and factories aims to destroy the rest of the Gaza economy, inflict a great level of losses in the private sector, and economically stifle more than two million people living in the Strip. Deliberate targeting of economic facilities that do not pose any threat to the occupation comes in the context of systematic destruction of the Palestinian economy, and is part of policies of tightening the continuous Israeli blockade on Gaza for 15 years. Within the industrial and commercial sectors, losses reached 30 million dollars after the occupation bombed a number of factories, shops and recreational parks.

As for the infrastructure, Israel bombed residential homes, totaling more than 1174 housing units that were totally destroyed and at least 7,073 housing units, with moderate to partial damage. On the agricultural level, warplanes bombed hundreds of acres of agricultural land in Khan Yunis in the south and Beit Lahia in the north, in addition to damaging a large number of agricultural crops, in addition to destroying a number of poultry and livestock farms in the border areas. As for the health sector, 20 health facilities have been targeted since the beginning of the aggression, including the Qatari Red Crescent.

The continuous aggression of the occupation has seriously affected commercial activities. Closing the Karm Abu Salem, which is the only commercial crossing with the Gaza Strip, is considered a war crime as it deprives people of getting food and living a decent life.

These losses show that, over the course of its successive attacks on the Gaza Strip, the occupation has deliberately destroyed economic facilities and caused severe damage to private and public sector properties. The number of factories completely and partially damaged as a result of being targeted by the occupation war machine during the aggression in May 2021 was 31 factories from various industrial sectors, while the occupation continues to target industrial and economic facilities as part of its war on the Strip, to destroy the remaining economic facilities.

Chronic and urgent challenges facing the private sector:

There are numerous challenges facing the private sector in the southern Palestinian governorates, under the current circumstances, and they include:

- Failure to compensate some factories destroyed since the war of 2014. There are many important factories that have not been compensated until this moment, which led factory owners to borrow at a high cost to return to work in production, thus affecting the production costs of local industries.
- The non-transfer of tax returns in the Gaza Strip for nearly 13 years, while in the West Bank they have not stopped. This weakens the ability of the private sector in the Gaza Strip to sustain production.
- Competition from the government sector against the private sector in many important investment projects, which represent a mainstay in the Palestinian economy. This, in turn, weakens the role of the private sector in advancing economic development and combating unemployment.

- Absence of the role of the Palestinian Investment Fund in encouraging private investment, absence of mechanisms in managing the funds of the Palestinian Investment Fund, lack of a vision and a comprehensive plan on how to use money of the Fund, and lack of clarity on the Gaza Strip's share of the funds of the Palestinian Investment Fund.
- The high interest rates when borrowing from banks in the Gaza Strip, in addition to the complicated conditions for obtaining loans, which in turn leads to the reluctance of many private sector investors to borrow from banks.
- The clear conflict of powers about who to be in charge of the reconstruction file, which will negatively affect the reconstruction process in terms of the time period, and will lead to its delay.
- Holding goods worth nearly 120 million dollars at the crossings, which led to the private sector incurring losses of 20 million dollars as a result of this.
- Lack of protection of local products and absence of control or restrictions on imported products especially Egyptian products which enter Gaza Strip so easily and with no restrictions and competes with the local products. Therefore, the government should draw up commercial agreements that regulate the relationship with neighboring countries and maintain the local Palestinian product.

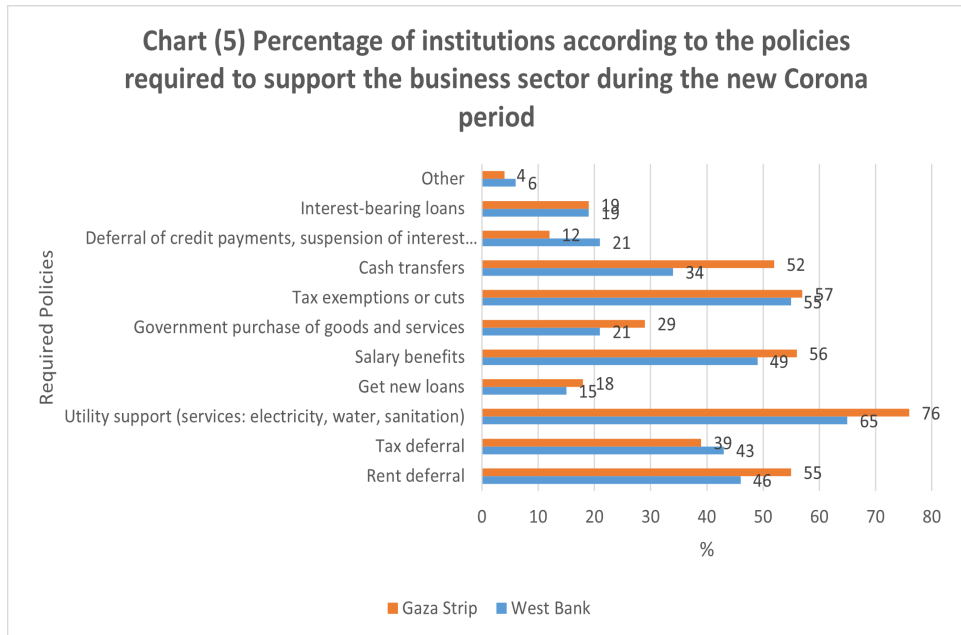
Recommendations:

In light of the previous presentation, the paper recommends the following:

1. Supporting infrastructure needed for switching to digital economy. This can be done through: establishing a national and international fund to support technological development in Palestine. This fund can receive local national contributions, as well as donations from international bodies supporting Palestine, taking measures to encourage investment in the Palestinian technological sector, working to engage Palestinian expertise in the field of technology and further developing them, and limiting their exploitation by Israeli companies and finally establishing diplomatic relations with a digital and technological depth with technologically advanced countries in order to counter Israeli restrictions

- Supporting the business sector with services including electricity, water and sanitation. When institutions were asked about policies required to support the business sector, 69% chose the utility support policy, 55% of the institutions chose tax exemptions and reductions, and 49% chose to postpone rent.

The following figure shows the percentage of institutions according to the policies required to support the private sector:



- Enabling the Palestinian government to develop oil and natural gas resources off the coast of Gaza, and this would secure the resources required for the rehabilitation, reconstruction and revival of Gaza's economy. It would also enhance the financial position of the Palestinian National Authority and the Palestinian economy in general.
- In light of the limited possibility of achieving additional growth in the public sector, the private sector is important to the Palestinian economy as it is a main engine for development and economic growth in the conditions of an unfavorable investment environment. It is also an important employer of labor, and has an important and fundamental role in reducing dependence on foreign aid. The Gaza Strip is characterized by the advantage of high

consumption due to its large population, and this is what encourages investors to invest in it. Perhaps what happened recently is the best proof of this, where many investors were attracted to establish their investment projects, especially commercial malls, in the camps of the Gaza Strip due to the population density.

5. Given the high rate of unemployment in the Gaza Strip, it is necessary to encourage small and medium enterprises because of their prominent role in achieving economic development and alleviating unemployment. It is necessary to put pressure on the lending institutions that provide soft loans to ease their procedures for the different groups of society so they can benefit from these loans in productive projects.
6. It is important to work on approving a strategic development rescue plan to advance the private sector in the Gaza Strip and looking into establishing a free trade zone to stimulate trade with the outside world. There is also a need for transparency in investment policies between state institutions and the private sector, with the information link needed to establish projects, and to consolidate cooperation between private sector companies, non-governmental organizations and public institutions

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