

Proposed Policies and Programmes of Incentives for Gaza's Industry Development

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ



ورقة عمل بعنوان

سياسات وبرامج التحفيز المقترحة لتطوير الصناعة في قطاع غزة

مقدمة إلى مؤتمر

تنمية وتطوير قطاع غزة
بعد الانسحاب الإسرائيلي

2006

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مقدمة من:

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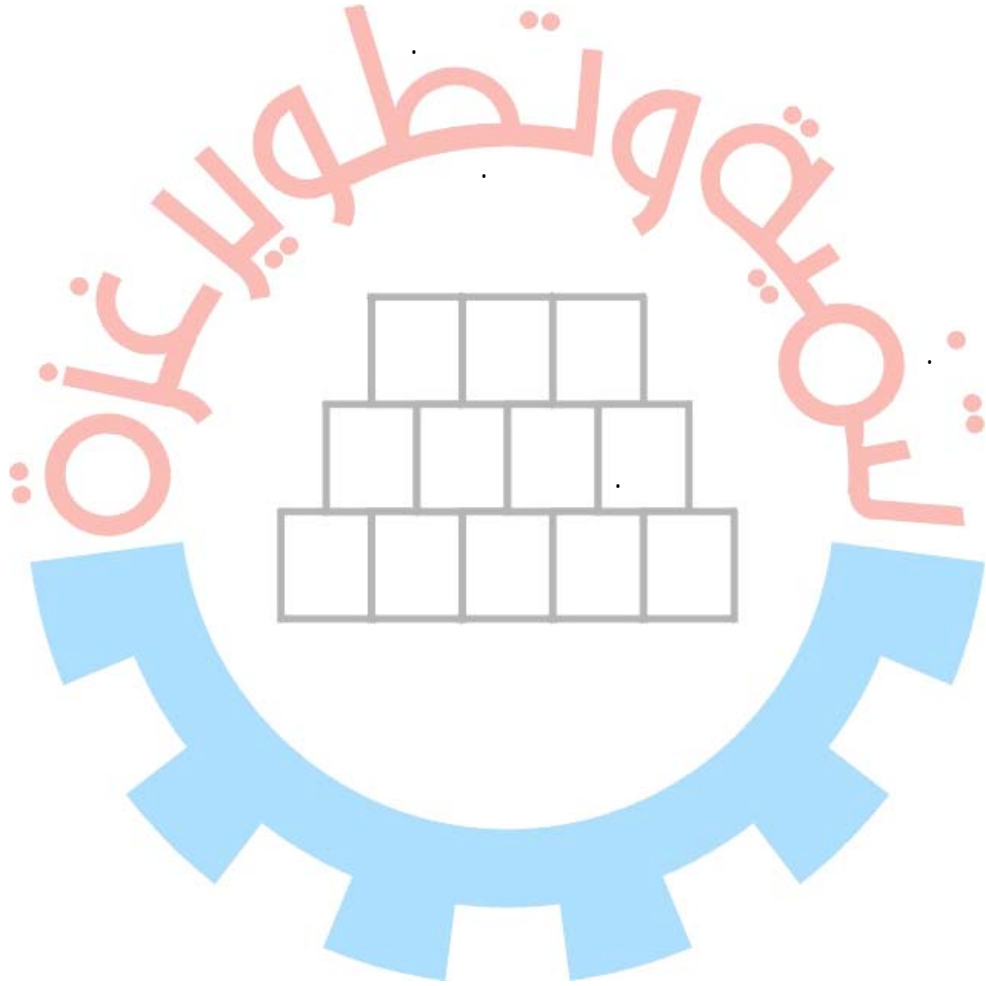
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1- Introduction

The aim of this paper is to identify the policies, programmes which are needed to improve the industrial sector in the Gaza Strip. The study focuses on the policies which are needed to be implemented “immediately”¹ rather than those which might be envisaged within long-term scenarios. It is important to point out that the measures and projects which are essential to improve and develop industry in the Gaza Strip are deeply intertwined, that it will be extremely difficult to draw a demarcation line between those needed to be achieved immediately and those required at a later point in time. The selection of appropriate projects and relevant implementation modalities along any point on this spectrum is contingent on overriding economic, political and technological circumstances of the territory.

The study employs both primary and secondary data collected in the following

manner:

- 1) Palestinian Statistics.
- 2) Reviewing the literature including, books, reports, statistics and articles.

This study consists of two sections: 1) The Characteristics of Gaza's industrial establishments; 2) policies and programmes of incentives.

2- The Characteristics of Gaza's industrial establishments

During the Israeli occupation period (1967-1993) Gaza's economy remained undeveloped (world Bank, 1993). Industrial establishments were mainly dominated by small-scale establishments and with low capitalization levels (Central Bureau of Statistics (CBS), 1994). The Israeli occupation's policies had contributed significantly to the underdevelopment of Gaza's economy (El-Farra and Macmillan, 1999). In addition, there were some other internal constraints contributed to the problem. The internal constraints were mainly attributed to the local business owners and managers in their lack of experience in management, production and marketing (El-Farra & Wakelam, 1999).

During the Palestine National Authority (PNA) period² the characteristics of Gaza's industrial establishments were very similar to the pre-1994 period. Table 1 shows that in 2003 Palestinian industry consists of 13,693 establishments with total employment at about 60,186 persons. PNA industrial establishments are still dominated by small-scale establishments with average employment size of about 4.4 persons in 2003. It contributed with 12.5% only to the total employment in the PNA (Table 1). However, it contributed with 9% only to Gaza's employment in 2003 (El-Farra, Rafati, 2005).

¹ Short-term and medium-term strategies.

² The PNA was established since 1994 after the signing of transitional agreement between Israel and the PLO.



Low capitalization level was a characteristic feature of PNA establishments. Gaza's overall establishment has average invested capital at about \$10,000 per establishment in year 2003. Low employment and low invested capital in Gaza's industrial establishments reflected negatively on the level of productivity in Gaza's establishments. Table (1) reveals that industrial sector contributed with 15.2% to PNA GDP in 2003.

*Table 1 –
Some Industrial Indicators in the Palestinian Territories*

| year | industrial Contribution to the PNA Employment % | industrial Contribution to the PNA GDP % | Number of Persons Engaged | Number of Industrial Establishment |
|------|---|--|---------------------------|------------------------------------|
| 1996 | 16.2% | 11.5% | 50,690.0 | 10,925.0 |
| 1997 | 15.9% | 11.9% | 61,775.0 | 13,464.0 |
| 1998 | 15.2% | 13.2% | 63,748.0 | 14,210.0 |
| 1999 | 15.5% | 17.4% | 72,660.0 | 14,849.0 |
| 2000 | 14.3% | 15.7% | 76,918.0 | 14,509.0 |
| 2001 | 14% | 11.2% | 69,572.0 | 14,605.0 |
| 2002 | 12.9% | 10.8% | 65,526.0 | 14,179.0 |
| 2003 | 12.5% | 15.2% | 60,186.0 | 13,693.0 |

Source: Palestine Central Bureau of Statistics. *industrial Census, different Issues*. Ramallah-Palestine.

The lack of industrial development in Gaza is attributed to the policies of Israeli occupation, lack of government support and as well to the local Palestinians due to their lack of vital industrial experience, marketing and management. The Israeli policies, effectively controlled or at least significantly influenced all major dimensions of manufacturing and industrial development - from the funding and licensing of investment, through input purchases and provision of physical infrastructure to source and market access.

At the internal level³ the examination of local business attitudes and their managerial practices revealed that these practices were hindrances to industrial development.

³ We mean by internal constraints those shortcoming which are attributed to the indigenous Palestinians.



These constraints may be summarised in seven points: 1) business locations, the size of buildings and their facilities- the majority were rarely suitable for their present, let alone their future, needs. The great majority had never conducted feasibility studies and in those instances where such studies had been carried out they were either inaccurate or never carefully implemented. This was largely attributable to the lack of local expertise and to the business owners themselves who were seeking cheap short term solutions; 2) shortage of skilled labour in Gaza's industrial is partly attributed to the lack of appropriate education and training for the needs of Gaza's industry.; 3) the majority of industrial establishments rely on imported raw materials and price was the most important criterion in their purchase; 4) price again was the most important criteria when purchasing machinery; running costs, maintenance, skilled labour for the machinery and market capacity for the products were largely ignored; 5) an indication of the poor quality of Gaza's products; 6) there is a widespread misunderstanding of the concept of 'marketing' which to most firms was synonymous with 'selling', and 7) the lack of understanding of good management practice have all contributed to the lack of industrial development. The concentration on family and friends in ownership and recruitment can be seen in the authoritarian management style adopted by many companies. Although many firms experienced a shortage of capital they are averse to accepting loans or forming common projects outside the family. There was often a lack of separation between the owner's assets and those of the firm which often led to liquidity problems for the firms (for further details see, El-Farra, 2004; El-Farra and Wakelam, 1999).

With regards to government support, the PNA never adopted real incentive policies suitable to Palestinian establishments. The only step was made by the PNA was issuing the investment law which mainly suitable for large and external investment. In addition, all imports and exports were never organized or monitored to suit PNA industries. This resulted in high failure rate among Gaza's industrial establishments (Ashour and El-Farra, 2002).

3- Policies and programmes of incentives.

Over the short- and long-terms, the following incentive policies should be adopted:

1) Advocating Labour-Intensive Industry

Reviewing Gaza's industrial establishments suggested that the majority of the industrial sector employed poor, outdated technology. It was also noticed that those who used advanced machines faced maintenance problems that were attributed to the lack of experience of industrialisation in general and to the lack of reliable technicians in particular. It will be necessary for Gaza's industry to make the most effective use of its labour force and facilitate the transfer of the appropriate new industrial technology, to allow for needed advances in productivity and quality. Such transfer of technology should be where the level of sophistication and productivity is low, particularly in the sub-sectors of metal, textiles, clothing and wood products. Labour intensive industries should be favoured wherever possible. The adoption of the



strategy of labour-intensive industries is suitable for Gaza's unique circumstances, where the unemployment rate is very high specially among new graduates. In 2003 about 44% of Gaza labour force age (15-24) were unemployed (El-Farra and Rafati, 2005). Gaza should adopt a model which encourages the use of labour-intensive technology, while product quality, cost and productivity should not be sacrificed. Encouraging labour-intensive technology was stipulated in the Law for Encouragement of Investment, which made a link between the amount of invested capital and the size of the work force, which is permanently employed on a project. Investing \$100,000 in a modern factory does not often create permanent jobs for ten workers, unless the factory follows a policy of labour-intensive technology.

2) Incentives for Small-scale Projects

This study advocates and defends the policy of supporting small-scale industries in Gaza as the most appropriate and viable model for the Strip, rather than supporting large-scale projects. Introducing such a model can be justified on the bases of a number of elements as follows:

- a) It is difficult to monopolise the products of small-scale industries. Competition among these industries should encourage the rise of a large number of industrialists among the middle class and low-income group. The economic situation in the Gaza Strip cannot stand for monopoly.
- b) The lack of financial resources and the small size of available markets locally and regionally dictate that Gaza should follow a policy of supporting small-scale industries. Large-scale industries require large amounts of capital, technical and administrative skills and large markets which are difficult to achieve in the Strip. The recently formed partnerships in Gaza died after a few years of their existence. This is due to several reasons, including management failure to operate as a team.
- c) Small businesses are probably better able to absorb new workers more quickly than large businesses and require relatively little aid and professional guidance in comparison to big firms.
- d) An obvious problem which Gaza faces is the inability to attract significant foreign investment. This problem will continue for several years, because the competition will be significantly high with the surrounding regional economies, and Israel will be the most attractive economy in the region. The lack of attractive investment opportunities in Gaza is primarily due to the structural imbalances and distortions in the local economy and the lack of political stability. Even if the suggested industrial development programmes were applied, Gaza will remain, at least in the short-term, relatively unattractive to foreign investments.
- e) The large-scale industries need a large number of highly qualified workers in the technical and administrative fields. These qualified people usually demand high wages. Gaza lacks such skilled people and paying them high wages is beyond its available resources. Therefore, during the initial stages, the small-scale industries could constitute centres for training and some of their workers can gain good qualifications which are needed for large-scale



industries. Such qualified and skilled workers could shift to work in large-scale industries in the future.

- f) Developing and enhancing the small-scale industries facilitates the geographical diffusion of industries. It is possible to spread such small-scale industries to the areas which require economic activities for job creation, thereby increasing the purchasing power of regional residents. This strategy helps to enhance and spread industrial and administrative expertise among a wide spectrum of people in various classes.

In addition, pursuing a programme suitable to the industries in Gaza may help in tackling the structural imbalances of industries and accelerate the process of development. According to the recent experience of some countries (e.g., Israel) with small businesses, those businesses which enjoyed government support, ranging from financial assistance to professional guidance, have managed to expand production, increase profits and absorb new workers at relatively little cost (Attiya, 1995). The support of small businesses, the newly established and the long standing ones, was neglected by the Law of Encouraging Investment in Palestine.

In many developing countries, incentives for industrial projects constitute an important and integral part of the policy instruments available to create a conducive atmosphere for investment in industry and to promote industrialisation. The absence of a comprehensive and sustainable incentive policy could be a major obstacle to industrialisation in a developing area such as Gaza. The policy of industrial incentives involves the use of various policy instruments to attract investment and direct it to fulfil specific development objectives. The general objectives of these incentives may include reducing the cost of the project's establishment, helping to identify viable investment opportunities, feasible financing, cost of input concessions and import duties concessions. Industries in their early stages of development are likely to have high initial costs thus impairing their ability to compete with imports. Tariff protection for infant industries will have the effect of raising the price of imported goods to domestic buyers, which will induce them to increase their consumption of import substitutes at higher prices than would otherwise have been the case, but will keep the price competitively lower than that of imports. "These higher prices attract resources into the import-competing industries and cause output to expand. This is the protective effect of the tariff" (Corden, 1980, p. 48).

Tariff protection is not the best policy for promoting industry because of its resource allocation and income distribution effects. Protection means favouring a certain sector relative to other sectors of the economy. This in turn will induce factors of production to shift to the favoured sector but at loss of economic efficiency. The income distribution effects of the tariff result from this adverse income effect on consumers due to the rise in domestic prices. Import duty concessions are widely used in many developing countries as an important incentive to promote industry. This is a more preferable mechanism to tariff barriers for the support of local industries (Khirbash, 1990).



3) Mechanisms for Promoting Small-scale Industries in the Gaza Strip

The following are some suggested mechanisms that may be used to assist small industries in Gaza:

a) Business Advisory Unit

The project should be supported by experts in the business sector and related areas. These experts should be able to provide instruction and consultation services to help small businesses and factories to become more efficient and to improve their management skills, business performance and profitability. The experts should provide guidance on a variety of subjects, including general management, production management, marketing and financial management, human resources management, information systems, and quality control. The business monitoring programme should target the following projects:

- i) Projects which employ ten persons or less⁴.
- ii) Industries located in designated areas for industry, and areas which have limited industrial activities such as the southern part of Gaza.
- iii) Industries which have forward and backward linkages either with other industries or the agricultural sector which include animal feed, cartoon, plastic and food products. It is important to establish connections between Gaza's productive sectors, in order to reduce the industrial cost because of high-cost imported material and to solve the problem of marketing of agricultural products and gaining better income from these products.

The business monitoring institution should have four stages:

- a) An introductory meeting will be set up to decide if the business is appropriate for the project.
- b) The co-ordinator will decide which expert is best suited to be consulted on this case and the owner will be asked to give his approval to this decision.
- c) The needs of the business will be defined and the appropriate conclusions will be given.
- d) The recommendations of the experts will be implemented, and their guidance and directions will be continued.

According to the experience of countries who adopted this assistance mechanism (e.g., Israel) a significant number of the industries which enjoyed this service have become more profitable, and businesses have expanded and hired additional employees (Attiya, 1995).

b) Loan-Fund to Help Small Industries

The aim of this fund is to provide soft loans to help individuals establish or expand small industries. This fund will be designed to help entrepreneurs to obtain credit, which is difficult to achieve, especially for new businesses because banks insist

⁴ This study considers that industries employ ten persons or less small-scale and 11+ persons large-scale.



on receiving securities from the borrower which are worth more than the actual loan. This loan fund should be administered by a local Bank and the suggested industrial investment bank. Finance may be given to businesses to purchase equipment or for working capital. The loan should be for a period of five years, and in the first year of the business, it should not be required to pay back anything. The loan which may be granted should not exceed \$20,000 in order to avail this service to a large number of businesses. In order to prevent abuse of the fund, the borrower should present as a security the lien on the fixed assets financed by the loan and a personal guarantee. The loan process should commence by filling out the required forms, which should be made available at the two banks. The industrialist will be requested to produce a plan for the business, which will be carefully examined. A committee will be established by the Ministry of economy to co-ordinate between the banks. The committee will oversee the applications submitted to the banks and monitor their implementation.

c) Fund to Promote Industrial Exports

This institution should aim to boost exports by sharing the responsibility for risks which the exporters assume. In addition, the fund should highlight the importance of marketing orientation and use of the necessary tools to achieve optimal marketing skills. The fund shall also provide exporters with credits, earmarked for developing marketing programmes and other marketing innovations.

4) Conclusions

Gaza's industrial establishments are undeveloped. They are dominated by small-scale establishments and with low capitalization level. The Israeli policies, lack of local experts in management and production and lack of government support to the sector were contributed to the problem. The study concluded that the PNA should a practical incentive policies to upgrade industrial sector in the Gaza Strip. The absence of a comprehensive and sustainable incentive policy could be a major obstacle to industrialisation in Gaza. The policy of industrial incentives involves the use of various policy instruments which may include reducing the cost of the project's establishment, helping to identify viable investment opportunities, feasible financing, cost of input concessions and import duties concessions. Industries in their early stages of development are likely to have high initial costs thus impairing their ability to compete with imports.

The following incentive policies and programmes need to be adopted in order to alleviate the underdevelopment of the sector:

- 1- Advocate labour intensive industry to absorb the high unemployment rate in the Strip. The model of labour-intensive technology should be applied while product quality, cost and productivity should be maintained.
- 2- Provide incentives and support for small-scale projects. This incentives should be provided to small newly established and existed ones. The mechanisms of incentive programmes include: 1) business advisory unit. This project should be supported by experts in the business. This advisory unit should provide consultation services to small businesses to become more effective in management, marketing and production. 2) loan-fund to help small industries.



This fund should provide soft loans to individuals who establish or expand small industries. This fund will be designed to help entrepreneurs to obtain credit which is difficult to get from other sources. The loan should not exceed \$20000 and to be repaid over 5 years and the recipients should be exempted in the first year. 3) Establish fund to promote industrial exports. This fund aims to boost exports by sharing responsibility for risks which the exporters assume. This fund should highlight the importance of marketing orientation and to achieve optimal marketing skills for Gaza's businesses.

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