Private Sector: Impact of the Gaza blockade and strategies to cope with the consequences

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ABSTRACT

This research paper examines the effects of the Gaza blockade on the private sector in the Gaza Strip. The paper was informed by thorough review of literature and experiences influencing and shaping the private sector performance in the Gaza Strip over, at least, the past decade.

The private sector in the Gaza Strip has undergone more than a decade of strife since 2000. The blockade in place since 2006, the 2008 Israeli military assault and the internal division have created a challenging environment characterized by high unemployment, poverty rates, irregular and disorganized crossings, political division and internal struggle, absence of a clear economic policy for Gaza, a legislative vacuum, and a burgeoning informal economy.

Prepared for Pal Think for Strategic Studies to be presented at a conference titled *"Assessing the damage of the Gaza blockade and strategies to cope with the consequences",* the paper is constructed in three main sections:

- ***Economic overview of the Gazan economy:*** This section documents the recent history and current status of the Gazan economy through the review of the economic context in correlation with four distinct periods of economic activity since the establishment of the Palestinian National Authority (PNA) in 1994.
- ***Current challenges and opportunities:*** This section discusses the current challenges and opportunities facing the private sector in the Gaza Strip.
- ***The way forward:*** This section presents some recommendations.

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EXECUTIVE SUMMARY

The focus of this paper is to examine the effects of the blockade on the private sector in the Gaza Strip. The paper was informed by thorough review of literature and experiences influencing and shaping the private sector performance in the Gaza Strip over, at least, the past decade.

Prepared for Pal Think for Strategic Studies to be presented at a conference titled *"Assessing the damage of the Gaza blockade and strategies to cope with the consequences",* the paper is constructed in three main sections:

Economic Overview of the Gazan Economy

The private sector in the Gaza Strip has undergone more than a decade of strife since 2000. The blockade in place since 2006, the 2008 Israeli military assault and the internal division have created a challenging environment characterized by high unemployment, poverty rates, irregular and disorganized crossings, political division and internal struggle, absence of a clear economic policy for Gaza, a legislative vacuum, and a burgeoning informal economy. Specifically, the economic activity can be classified into four distinct periods since the establishment of the Palestinian National Authority (PNA) in 1994

- ***The Palestinian Private Sector in the Gaza Strip: Pre-2000 Conditions:*** During the period 1995–1999, the Palestinian economy witnessed a period of unprecedented economic growth, with real GDP growing at an annual average rate of 8.5%, combined with a substantial increase in public and private investment. This was sufficient to reduce employment by 11 percentage points and increase GDP per capita by an annual average of 4.3%.
- ***The Palestinian Private Sector in the Gaza Strip: 2000-2006:*** The period between 2000 and 2006 was marked by: i) the start of the second Intifada which resulted in a partial closure policy imposed by Israel on the Gaza Strip as a means of collective punishment in September 2000; ii) the Israeli unilateral disengaged from the Gaza Strip in August 2005; iii) the parliamentary elections which was won by Hamas and resulted in an international boycott of the Palestinian government in January 2006; iv) intensification of the Israeli closure policy on the Gaza Strip to a complete closure after the capture of an Israeli soldier in mid 2006; and v) Public investment nearly ceased as almost all government funds were used to pay civil service salaries and cover operating costs. The IMF, private investments declined by over 15% between 2005 and 2006.
- ***The Palestinian Private Sector in the Gaza Strip: The year 2007:*** In the summer of 2007, a policy of full blockade was imposed by Israel on the Gaza Strip. Only 11 essential goods were allowed into Gaza, bringing the private sector to a complete halt, specifically: i) more than 75,000 workers in different private sectors were laid off; ii) businesses lost trade partners in Israel and the West Bank, causing those businesses to seek other suppliers inside the Gaza Strip; and iii) about 98% of Gaza's industrial were forced to shut down either temporarily or permanently including most factories located in the Gaza Industrial Zone. The devastating effect of the 2007 closure continued all through 2008. With only a limited amount of goods being permitted to enter Gaza, all aspects of Palestinians life were affected.
- ***Effect of the 2008/2009 Israeli military assault on the Private Sector in the Gaza Strip:*** The private sector in Gaza received an additional blow caused by the Israeli military assault in 2008/2009. The private sector (excluding agriculture) endured a loss estimated to be about USD 131.9 million. The agriculture sector has also been severely affected; over 46% of the agricultural land in the Gaza Strip was damaged or became inaccessible. The agricultural sector sustained direct damages estimated at about USD 18.7 million. The damages caused to these establishments were meant to hit the productive assets of each of them, which means that either the owner will not be able to re-construct again due to the high costs involved or it will take the Gaza Strip a long time to re-construct given that those damages will require the lifting of the closure in order to import needed construction materials.

Current Challenges and Opportunities

The current political Palestinian division has created a situation in the Palestinian political system that may have not existed in the world or in history for that matter. Dealing with two governments with each having its own policies adds additional burdens over the affected population. The private sector in Gaza may be one of the most affected segments of the community that have to deal with this awkward situation.

- ***Duplication of Authority:*** Duplication of authority has increased the cost of doing business in the Gaza Strip leaving private sector firms at a disadvantage compared to competitive products imported directly through the official crossing or those smuggled through the tunnels.
- ***The Tunnel Trade:*** Tunnel trade has created resurgence in consumption and imports. On the other hand, the Gaza landscape portraits a week productive sector coupled with lack of foreign income from exports due to blockade. A picture that does not provide the room to support the long-term viability and growth of the Gazan private sector. It is estimated that by 2010, about 80% of Gazan imports come through the tunnels, which employ around 25,000 workers. As a result of the relief in demand from the tunnel import and service economy, Gazan GDP grew a total of 47% between 2009 and 2011, while unemployment dropped to 32% from a high of 45% in 2008.
- ***Availability of Skilled Workers:*** The damage sustained by the private sector in addition to the stoppage in operations has caused the laying off of workers who, in most part, have not been able to find a job in their line of work utilizing their skills. As a result, they have been forced to perform unskilled jobs. In addition and due to the shutdown of the industrial sector, no new workers have been trained to acquire new skills. As a result and when the relative ease of restriction on imports through the Gaza crossing with Israel and the availability of raw material coming through the tunnels, the private sector is finding it more difficult to hire skilled workers adding to their burden for investing in training of unskilled workers.
- ***Electricity, Fuel and Water Supply:*** Caused by several reasons, the Gaza Strip suffers from severe shortages in electrical power in the Gaza Strip. As a result many, if not all, private sector establishments use their own generators for the supply of needed electricity. This is also constrained by the lack of fuel available to operate these generators. Water is another problem facing the private sector. The lack of development efforts, the continued blockade which restricts the import of material needed for infrastructure activities especially sewage handling projects, sewage will also continue to seep into the aquifer aggravating the problem even further.

The Way Forward

The paper, informed by the provided analysis, identified the following recommendations for reviving the private sector:

1. Immediate end of the blockade
2. Tax Incentives for the private sector
3. Empowering private sector institutional platforms
4. Development of new skills
5. Opportunities for restoring lost markets
6. Focus on developing employment intensive sectors
7. Identify niche to better direct development efforts
8. Transition to strategic projects

ECONOMIC OVERVIEW OF THE GAZAN ECONOMY

The following section presents a review of the economic context of the Palestinian economy in the Gaza Strip. Review of literature illustrated that over a relatively short period of time the Gaza Strip has been subject to a series of external shocks. Specifically, the economic activity can be classified into four distinct periods since the establishment of the Palestinian National Authority (PNA) in 1994.

The Palestinian Private Sector in the Gaza Strip: Pre-2000 Conditions

During the period since the establishment of the PNA in 1994 and until 2000, the Palestinian economy performed relatively well and started to gain some ground. To this end, the Palestinian Gross Domestic Product (GDP) expanded from USD 3.65 billion in 1994 to USD 5.3 billion in 2001[1]. Supported by the international community, the PNA started to create and invest in re-building the Palestinian economy and related institutions. Furthermore, the Palestinian Legislative Council (PLC) engaged in passing new legislation and reviewing existing laws[2] that would facilitate a legislative and legal environment supportive for the growth of the Palestinian economy. Within that context, this period witnessed new private investments in almost all sectors of the economy including industry, service and particularly construction. Specifically, more than 80% of the private investment was in the construction industry.

Box1: Gaza Strip private sector: Pre -2000

During the period 1995–1999, the Palestinian economy witnessed a period of unprecedented economic growth, with real GDP growing at an annual average rate of 8.5%, combined with a substantial increase in public and private investment. This was sufficient to reduce employment by 11 percentage points and increase GDP per capita by an annual average of 4.3%.

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The Palestinian Private Sector in the Gaza Strip: 2000-2006

Starting September 2000 and after the start of the second Intifada, Israel began to tighten its closure policy on the Gaza Strip and gradually blocked all its five operational crossing points into the Gaza Strip from Israel. This closure of Gaza's borders has been the major cause of economic deterioration and decline in the private sector activities.

In the year 2000 the Gaza GDP was estimated at about USD 1,328 million.[3] Table 1: The Gaza Strip GDP 2000 – 2006, presents the composition of the Gaza GDP in value and percentage terms for the years 2000 and 2006. The year 2006 is the year just before Israel intensified its closure policy in 2007 (as discussed in the next section). The figures below clearly show the effect of the partial closure policy imposed by Israel during the second Palestinian Intifada as a means of collective punishment. The sectors most affected by the

Box2: Gaza Strip private sector: 2000-2006

The period between 2000 and 2006 was marked by:

- The start of the second Intifada which resulted in a partial closure policy imposed by Israel on the Gaza Strip as a means of collective punishment in September 2000.
- The Israeli unilateral disengaged from the Gaza Strip in August 2005.
- The parliamentary elections which was won by Hamas and resulted in an international boycott of the Palestinian government in January 2006.
- Intensification of the Israeli closure policy on the Gaza Strip to a complete closure after the capture of an Israeli soldier in mid 2006.
- Public investment nearly ceased as almost all government funds were used to pay civil service salaries and cover operating costs. The IMF, private investments declined by over 15% between 2005 and 2006.

[1] Dan Cork, "The Palestinian Economy Post Olso : Unsustainable Development", July 2001, http://www.thejerusalemfund.org/ht/display/ContentDetails/i/2106/pid/2254
[2] The first Palestinian parliamentary elections took place in 1996 and the PLC was created.
[3] PCBS, National Accounts Statistics, 2000, Unpublished.

closure were the productive sectors namely: the construction sector which received the greatest impact reflected by a decrease by 72.99%, the manufacturing sector which showed a decreased by 33.82%, and agriculture which showed a decrease by 26.44%.

Table 1: The Gaza Strip GDP 2000, 2006

GDP per Sector	2000 *USD million*	Percent Contribution	2006 USD million	Percent Contribution	Percent Change
GDP (Constant Prices, 1997)	1,328		1,244		-6.32%
Agriculture and Fishing	113.1	8.52	83.2	6.69	-26.44%
Mining and Manufacturing	164.4	12.38	108.8	8.75	-33.82%
Construction	85.9	6.47	23.2	1.86	-72.99%
Wholesale and Retail Trade	128.4	9.67	125.3	10.07	-2.41%
Transport, Storage and Communication	36	2.71	65.2	5.24	81.11%
Financial Intermediation	45.1	3.4	42.2	3.39	-6.43%
Other Services	372.9	28.08	403.7	32.45	8.26%
Public Administration and Defense	239	18	231.9	18.64	-2.97%
Households with Employed Persons	2	0.15	2	0.16	0.00%
Other (public owned enterprises, taxes)	73.6	5.54	158.6	12.75	115.49%

The decline in GDP growth and in economic activities had its impact on the socioeconomic conditions in the Gaza Strip. Unemployment drastically increased between 2000 and 2006. Table 2 below provides a profile of the employment conditions in the Gaza Strip for the third quarter of 2000 and 2006. The third quarter was chosen for comparison due to the fact it was the last quarter prior to the start of the second Intifada and the imposed partial closure on the Gaza Strip. The labor force participation decreased from 39.9% to 35.2%, while the unemployment rate increased from 15.6% to 36.3%. This was due mainly to the loss of jobs in the private sector, as it appears in the decrease in GDP between the two years by about 6.3%.

Table 2: Profile of Labor Force Conditions, Q3 2000 and 2006[4]

Labor Force Indicators	Q3/2000	Q3/2006
Labor Force Participation Rate	39.9%	35.2%
Unemployment	15.6%	36.3%
Employed in Agriculture	16.0%	9.2%
Employed in Construction	15.7%	4.6%
Employed in Manufacturing	12.3%	5.6%
Employed in Services	38.3%	56.2%

At the sectoral level, employment in the private sector also changed significantly in these two periods as the percentage of employment in the agriculture sector decreased from 16% to 9.2%. Likewise, employment in the construction sector decreased from 15.7% to 4.6%, and the percentage of employment in the manufacturing sector also dropped from 12.3% to 5.6%. The decreased percentage in each of these sectors is a reflection of their inability to create new jobs due to the restrictions imposed on trade and the closure of Gaza's borders. The only sector that showed an increase in the percentage of employment is the service sector[5], which increased from 38.3% to 56.2% which is due in part to the fact that people started to create small self-employment projects.

Following the period after the start of the second Intifada, Israel began to intensify its closure policy. Table 3 below provides data on the number of closure days (partial and full) imposed on the Gaza Strip

[4] PCBS Labor Force Survey, various issues
[5] Employment in the service sector does not include the public sector.

for the period October-December 2000. The closure policy was forced on the Gaza Strip for 85 days of the fourth quarter of 2000. Of these days, 75 were partial closure, which limited the amount of goods entering the Gaza Strip. During times of a full closure, Israel prohibited travel from the north to the south of the Gaza Strip; thus limiting the ability of people and goods to move freely and creating a devastating effect on the private sector. This policy of partial closure continued throughout the period until the imposition of the full blockade in the summer of 2007.

Table 3: Internal Closure Imposed on the Gaza Strip (October-December 2000)[6]

Type of Closure	Number of Days	Percent of Days affected
Partial Closure	75	82%
Full Closure	10	12%

The Palestinian Private Sector in the Gaza Strip: The year 2007

Following the capture of an Israeli soldier in mid-2006, Israel imposed a complete closure on the Gaza Strip. This imposed closure only allowed 11 essential goods to be imported into the Gaza Strip, bringing the private sector to a complete halt. In the Gaza Strip, about 55% of all employment (110,000 jobs) is generated within the private sector. As a result, more than 75,000 workers in different private sectors were laid off[7]. In addition, businesses lost trade partners in Israel and the West Bank, causing those businesses to seek other suppliers inside the Gaza Strip. Due to unpredictability of these closure policies, Israeli businesses became reluctant to renew relationships with their partners in Gaza.

The industrial sector was also heavily dependent on imports of raw materials and machinery from Israel and abroad, with almost 80% of these imports coming from Israel.[8] In addition, the industrial sector depends mainly on the border crossing points for the transfer of their products to West Bank markets and the export to Israel and the outside world. Prior to the imposed closure in 2007, the industrial sector exported about 750 truckloads per month (during peak time of May-June) of finished products including furniture, food, textile products, and cash crops.[9] At the time of the closure imposed on the Gaza Strip, 529 truckloads of products were ready for export. Therefore, these goods had to be sold on the local market at a fraction of their export prices. Meanwhile the balance of goods is being held in warehouses pending the reopening of Gaza's crossings.[10]The closure resulted in a massively negative impact on the private sector where it forced about 98% of Gaza's industrial operations (3,800 out of 3,900) to shut down since mid-June 2007[11], either temporarily or permanently, including most factories located in the Gaza Industrial Zone.[12] The remaining 100 industrial establishments continued to function partially using remaining stocks of raw material or locally produced raw material as in the case of food processing.

The boxes below provide a profile of four industrial sectors that rely heavily on the export of their products to Israel. Since the start of the imposed closure on Gaza, these sectors, mainly the furniture and garment industries have been hard hit; forcing the majority of them to close down or function using leftover stock or low quality raw materials procured on the local market. In the case of furniture, wood from shipping pallets and boxes were used to produce low quality products to meet the needs of the local market and were sold at high prices due to the shortages of these products. The devastating effect of the 2007 closure continued all through 2008. With only a limited amount of goods being permitted to enter Gaza, all aspects of Palestinians life were affected.

[6] UNSCO Report on the "Social and Economic Conditions in the West Bank and Gaza", Spring 2001
[7]PalTradePresentation to PSCC, July 2007
[8] Palestinian Shipper's Council (2007). Gaza Strip – Real Crisis – How long for?
[9] Ibid.
[10] OCHA, "The Closure of the Gaza Strip: The Economic and Humanitarian Consequences", December 2007.
[11]Paltrade, "The Private sector perspective to cope with the current Economic Crisis in Gaza Strip", September 2008
[12] Ibid

Box3: Impact of the 2007 closure on the furniture industry[13]

The furniture industry has a yearly total output of about USD23 million. Around 76% of Gaza's furniture production is for export to Israel and during peak seasons (May-June), furniture worth USD30-40 million is exported each month. For the last six months, 400 truckloads of furniture worth USD8 million have been stranded in the Gaza Strip, waiting to be shipped to Israeli and other international markets. The 2007 import and export ban on any produced furniture has led to the closure of most of the 600 furniture businesses in the Gaza Strip and the laying off of approximately 95% of their staff. By the end of November 2007, the industry was employing only about 100 workers out of 6,000-8,000, and operating at less than 5% of its capacity.

Box4: Impact of the 2007 closure on the food and beverages industries sector[14]

Reports indicate that 16 of its 32 member food and beverage manufacturing companies had shut down completely and laid off all of their employees by the end of October 2007. Among those that closed down were the three largest employers within the food and beverages sector, which employed a total of 900 workers. The remaining factories were operating at 30% of their usual operational capacity. The downturn in the food and beverages sector was caused by a combination of three factors: 1.) limited availability of raw materials due to import restrictions; 2.) the freeze on exports, which prevented many of the companies from exporting their products to the West Bank and regional markets; and 3.) contracting local demand due to the reduction in consumers' purchasing power. Reportedly, the total direct losses sustained by the food and beverage industries sector until the end of October 2007 exceeds USD 3 million.

Box5: Impact of the 2007 closure on the garment and textile industry[15]

Under normal circumstances, the garment and textile industry would have an estimated total output of USD 24 million a year, representing 9% of the total value of the industrial sector, and producing about five million pieces of clothing of which 90% were being exported to Israel. The closure of the Gaza Strip has led to the collapse of most of Gaza's garment factories. In November 2007, approximately ten out of 960 establishments, or just 1%, remained opened, employing about 50 part-time workers (out of 16,000 prior to mid-June 2007).

Box6: Impact of the 2007 closure on the construction industries[16]

The construction sector was also hard hit in 2007 due to the prohibition on import of needed construction materials including cement, steel rods, and aggregates. By the end of November 2007, all remaining stock of construction material in the Gaza Strip had been consumed. All construction factories had shut down, including 13 tile factories, 30 ready-mix concrete factories, 145 marble cutting factories, and 250 cement brick-making factories; causing the loss of 3,500 jobs.

Effect of the 2008/2009 Israeli military assault on the Private Sector in the Gaza Strip

The private sector in Gaza received an additional blow caused by the Israeli military assault in 2008/2009; this was in addition to damages sustained by the imposed closure of 2007. One Year after the War, a UNDP Report: estimated the value of damages incurred by the private sector, (excluding agriculture) to be about USD 131.9 million.[17] Table 4 below provides a breakdown of these losses as estimated by the Palestinian National Early Recovery and Reconstruction Plan (PNERRP). The damages

[13] OCHA, "The Closure of the Gaza Strip: The Economic and Humanitarian Consequences", December 2007.
[14] World Food Program, "Rapid Food Security Needs Assessment in Gaza Strip: Effect of Import Restrictions and Freeze on Exports on the Food Security in Gaza Strip", Survey Report, December 2007
[15] Ibid
[16] Ibid
[17] This estimate is consistent with that of the Private

caused to these establishments were meant to hit the productive assets of each of them, which means that either the owner will not be able to re-construct again due to the high costs involved or it will take the Gaza Strip a long time to re-construct given that those damages will require the lifting of the closure in order to import needed construction materials.

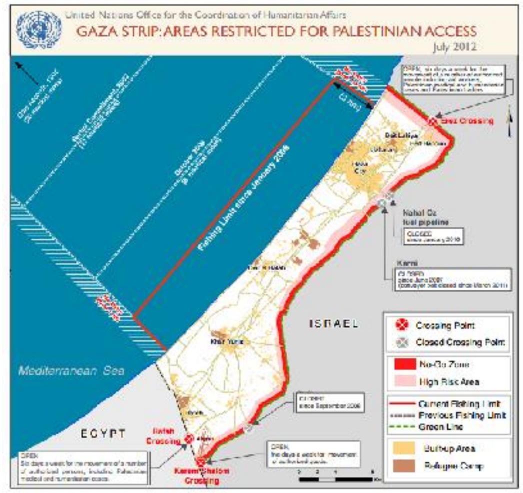
Table 4: Breakdown of value of damages incurred by the private sector as estimated by the Palestinian National Early Recovery and Reconstruction Plan (PNERRP)

Sub Sector	Estimated Costs (USD)		
	Building & Equipment	Goods	Total
Industrial			
Aluminum Workshops	1,163,795	0	1,163,795
Construction	36,785,928	100,000	36,885,928
Plastic	3,557,276	0	3,557,276
Agriculture	4,436,000	0	4,436,000
Pharmaceutical	120,000	0	120,000
Chemicals	1,445,000	0	1,445,000
Fabric	1,684,839	0	1,684,839
Furniture	947,751	0	1,091,751
Carpentry	4,476,004	0	4,476,004
Metal workshops	6,682,855	0	6,682,855
Tailors	698,929	0	698,929
Paper	8,000	0	8,000
Industrial Total	**62,006,417**	**0**	**62,250,417**
Commercial			
Commercial Enterprises	51,937,244	11,842	51,949,086
Commercial Shops	9,798,801	7,632,006	17,430,867
Commercial Total	**61,736,045**	**7,643,908**	**69,379,953**
Services			
Contractors	2,989,074	0	2,989,074
Information	133,000	0	133,000
Insurance	67,850	0	67,850
Information Technology	340,680	0	340,680
Tourist Facilities	4,585,536	0	4,585,536
Trucking	10,000	650	10,650
Services Total	**8,126,140**	**650**	**8,126,970**
Grand Total	**131,868,602**	**7,888,558**	**139,757,160**

A comprehensive survey performed by the Gaza Private Sector Council indicated that 268 establishments were totally destroyed and 432 sustained damage. Around 40% of the affected establishments (297) were industrial, small and medium size enterprises mainly in food, textile, garment, furniture and plastic sectors. The remaining 60% were commerce, construction, and fuel establishments. Though much of the damage was sustained by establishments that had already shut down due to the closure as discussed above, the damages sustained due to the Israeli military assault, meant that these businesses will not be able to recover quickly once conditions improve.[18]The Palestinian Federation of Industries (PFI) later issued new figures for the number of damaged industrial establishments. According to PFI, 324 businesses were damaged, of which 44% were partially damaged and 56% were totally damaged. More than 90% of the destroyed factories and business were in GazaCity and the northern part of the Gaza Strip.[19]

[18] OCHA, "Locked In: The Humanitarian Impact of the Two Years of Blockade on the Gaza Strip", Special Focus, August 2009
[19] PFI, KonradAdendauerStiftung, "The Need for a Post-War Development Strategy in the Gaza Strip", March 2009

The agriculture sector has also been severely affected by the Israeli military assault with over 46% of the agricultural land in the Gaza Strip being damaged or becoming inaccessible, particularly because of the Israeli declared land and sea buffer zone around the Gaza Strip. Approximately 16-17% of agricultural land was severely damaged by bombing, the movement of military vehicles, and indiscriminate actions, such as the leveling of 17.5% of orchards and mature trees, along with 9.2% of open fields. In addition, over 4,000 cattle, sheep, goats and more than one million birds and chickens (broilers and egg layers) were killed during the Israeli military assault, with evidence of livestock being the direct target of Israeli machine guns. Estimates of the cost of damages to the agricultural sector are very consistent, and show that agriculture sustained damages worth about USD 18.7 million as a direct impact of the Israeli military assault.[20]



CURRENT CHALLENGES AND OPPORTUNITIES

The current political Palestinian division has created a situation in the Palestinian political system that may have not existed in the world or in history for that matter. There are examples of divided countries governed by two separate governments, however each is ruling entirely over one geographic location. In the Palestinian case, we have two governments ruling over one geographic area, the Gaza Strip. This situation is affecting every Palestinian in the Gaza Strip. Some people may have to deal with this on daily basis and others may have to deal with it occasionally. Having this said, dealing with two governments with each having its own policies adds additional burdens over the affected population. The private sector in Gaza may be one of the most affected segments of the community that have to deal with this awkward situation. The political division manifests itself in different forms and daily routines in the private sector operations. Furthermore, the tunnel smuggling constitutes another challenge facing the private sector despite the role it played in easing up the closure on Gaza and relieving Gazans suffering.

Duplication of Authority

The duplication of authority created by the political division can be seen in the additional costs an importer incurs in order to sell his products in the West Bank market. Importers had to rent or buy new storage space, deal with additional transportation cost, hire accountants in the two areas to deal with the two tax authorities and open bank accounts in the West Bank in order to be able to deal with Israeli supplier who do not deal with Gaza Banks.

Box7: Duplication of authority & the private sector

Duplication of authority has increased the cost of doing business in the Gaza Strip leaving private sector firms at a disadvantage compared to competitive products imported directly through the official crossing or those smuggled through the tunnels.

Another example on the additional burdens carried by the private sector is the issue of paying taxes. A presidential decree was issued on June 28, 2007 exempting Gazans from paying taxes and fees. Although this may sound as good news to the private sector, however this decree was not approved by

[20] EuropeAid: Damage Assessment andNeeds Identification in the Gaza Strip - March 2009

the local tax authorities in Gaza which means private entities will have to continue paying taxes. This issue has created a point of tension especially with companies headquartered (HQ) in the West Bank as PalTel, banks, insurance companies, etc. These companies are not in a position to pay taxes to the government in Gaza as they have consolidated accounts in the HQ in the West Bank and therefore taxes are only paid through the HQ. Several examples can be found on this challenging situation as is the case with the Bank of Palestine and PalTel.

The Tunnel Trade

By 2010, with no outlet for exports and no imports of raw and intermediate materials for productive sectors, domestically produced goods in the Gaza Strip almost vanished. About 32% of the total firms in Gaza (2,577) had been driven out of business.[21] The inability to fulfill internal demand domestically through imports coming through Israel drove Gazans to reroute their resources to exploit the one loophole to the blockade of trade that existed, the tunnels in the south of the Gaza Strip.

According to a recent Concept Note published by BirZeitUniversity[22], it is estimated that by 2010, about 80% of Gazan imports come through the tunnels, which employ around 25,000 workers. As a result of the relief in demand from the tunnel import and service economy, Gazan GDP grew a total of 47% between 2009 and 2011, while unemployment dropped to 32% from a high of 45% in 2008. Although this has relatively relieved Gaza from a long closure and hard times, the growth in GDP may not be sustained if the current growth is not supported by growth in the economy productive base, mainly the industrial sector. The growth in domestic tourism and construction sectors over the past year is one of the contributing factors in the GDP growth.

Box8: Tunnel trade and the private sector

Tunnel trade has created resurgence in consumption and imports. On the other hand, the Gaza landscape portraits a week productive sector coupled with lack of foreign income from exports due to blockade. A picture that does not provide the room to support the long-term viability and growth of the Gazan private sector.

The tunnels are being used to bring in most of the essential goods into the Gaza Strip, such as food, cloth and fuel. However, by mid-2010, Israel started to “relax” the imposed closure on Gaza allowing additional goods, mostly consumables, to enter Gaza. The variety of goods Israel allows into the Gaza Strip has expanded gradually, especially after the events surrounding the International Activists Flotilla and the Israeli government declaration to "ease" the closure in June 2010. Since then, the volume of goods entering the Strip grew to some 40% of need, as measured against figures from 2005. As a result, the need to bring in consumables through the tunnels has decreased and thus more tunnels became underutilized freeing those tunnels to bring in other needed material such as cement, aggregates, and steel rods.

One of the major problems associated with the tunnel trade is the lack of government supervision on the quality goods. Goods smuggled through the tunnels vary from edibles to medicine, spare parts, cement, etc. These goods directly affect the quality of private sector production. Raw material used in the food industry do not abide by any standard, spare parts for cars and machinery are not inspected for defects while cement is not tested for use in residential and commercial purposes. The lack of supervision on the quality of these products led to brining in cheap products that compete with the locally produced ones at higher prices.

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21 The Palestine Economic Policy Research Institute and The Portland Trust. (Dec 2010). The Private Sector in the Gaza Strip
22The Impact of Tunnel Trade on the Private Sector in Gaza

The tunnel economy has created a new category of people who are leading the real estate and construction activities in Gaza. According to recent news items covered by local news websites, the tunnels have created an estimated 600 new millionaires.

Availability of Skilled Workers

The damage sustained by the private sector in addition to the stoppage in operations has caused the laying off of workers who, in most part, have not been able to find a job in their line of work utilizing their skills. As a result, they have been forced to perform unskilled jobs. In addition and due to the shutdown of the industrial sector, no new workers have been trained to acquire new skills. As a result and when the relative ease of restriction on imports through the Gaza crossing with Israel and the availability of raw material coming through the tunnels, the private sector is finding it more difficult to hire skilled workers adding to their burden for investing in training of unskilled workers.

Electricity, Fuel and Water Supply

As a result of the damage sustained to the Gaza Power Generation Plant at the start of the second Intifada and the lack of fuel to operate the remaining turbines coupled with an old distribution network has caused severe shortages in electrical power in the Gaza Strip. As a result many, if not all, private sector establishments use their own generators for the supply of needed electricity. This is also constrained by the lack of fuel available to operate these generators. Although fuel availability has improved since tunnels started to bring in fuel from Egypt, there is still a problem in the inconsistent supply of this fuel. At times of fuel shortages, fuel prices on the black market increase tremendously adding another burden to the operation of the private sector. A recent UN report[23] said that "Palestinians in Gaza face regular power cuts as provision of electricity remains well below demand". As the report continue to say that the cuts affect every aspect of Palestinian life including private sector, homes, services, etc.

Water is another problem facing the Gaza Strip in general and the private sector in specific. According to the same UN report, Gaza depends almost completely on the underlying water aquifer which is not re-charged with the same amounts of current abstraction. With the decline in ground water and the infiltration of sea water to the ground aquifer and thus increasing salinity, the ground water of Gaza will no longer be usable by 2016 and the aquifer will be beyond repair by 2020. The lack of development efforts, the continued blockade which restricts the import of material needed for infrastructure activities especially sewage handling projects, sewage will also continue to seep into the aquifer aggravating the problem even further.

THE WAY FORWARD

Realizing the damaging impact of the imposed closures coupled with the political conflict on the private sector in the Gaza Strip. The need to identify opportunities for the private sector to cope with the current challenging business environment through recognizing business alternatives have become more pressing. Over the past two years, efforts has been invested in devising a number of coping plans for the private sector in the Gaza Strip, with special focus on the major productive sectors. Among others, the March 2011 Economic Strategy for the Gaza Strip and the Private Sector Perspective to Cope with the Current Economic Crisis in Gaza Strip are two documents that intended to address private sector coping strategies trough formulating a revitalization plans.

[23]United Nations Country Team in the occupied Palestinian territory, "Gaza in 2020: A Livable Place?", August 2012

This paper and based on the above analysis provides the following recommendations for reviving the private sector:

9. ***Immediate end of the blockade:*** There is an international consensus that something must be done to lift or ease Israel's blockade of the Gaza Strip, yet little has been made to date to effectively materialize efforts into results. Reactivating economic activity can not do with out the firm commitment towards the immediate ending of the blockade
10. ***Tax Incentives for the private sector:*** The heavy burden incurred by the private sector due to the above mentioned factors, have placed a financial and operational problems on the private sector. Financial problems include accumulated debt to banks, inability to access new finances and the need to re-invest in order to either repair damages or maintain machinery that has not operated for years resulting in damages to some parts.
11. ***Empowering private sector institutional platforms:*** The private sector is the engine of economic development. True empowerment of pillar organizations representing the private sector is needed. This includes special consideration for the provision of institutional support (technical and managerial) to facilitate a proactive engagement in shaping and influencing the changeable operating environment and advocating for the interest and advancement of the private sector.
12. ***Development of new skills:*** Provision of vocational training to inject t new skilled workers in the labor market
13. ***Opportunities for restoring lost markets:*** Encourage joint ventures between businesses in the Gaza Strip and the West Bank which would help in restoring lost markets.
14. ***Focus on developing employment intensive sectors:*** Pay special attention for the development of sectors that are able to generate the highest number of employment opportunities. For example, the industrial sector in the Gaza Strip employs approximately 20% of the labor force (around 90% of which are currently unemployed)[24]. Specially, these sectors include construction, tourism and other industrial sectors such as furniture.
15. ***Identify niche to better direct development efforts:*** Focus efforts currently involved in the development of the ICT sector (not restricted by the blockade as much as other private sectors) towards outsourcing opportunities which can also contribute positively to employment generation.
16. ***Transition to strategic projects:*** Start the implementing strategic projects that will support private sector growth such as water desalination, electricity generation, sewage treatment and new roads.

[24] PFI publication: The Gaza Industries After a year of siege "Press Release"