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THREE YEARS AFTER THE 2014 GAZA HOSTILITIES

BEYOND SURVIVAL: CHALLENGES TO ECONOMIC RECOVERY AND LONG TERM DEVELOPMENT

May 2017



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Authored by: **Mohammed Samhouri, Ph.D**

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Foreword

The year 2017 marks ten years of the siege of Gaza. Already weakened by years of economic blockade and isolation, the 2014 hostilities wreaked further damage to Gaza's infrastructure, housing, and economy, with dire consequences for Palestinians in Gaza. 90% of Gaza's drinking water is unsafe for human consumption, and more than 60% of the population is reliant on humanitarian aid. The progress of the reconstruction effort remains far too slow, due to a lack of funding and access restrictions. The UN has warned that Gaza may be uninhabitable by 2020 unless immediate action is taken. The humanitarian crisis in Gaza threatens Palestinian stability and is a serious threat to a strong and unified State of Palestine.

This report is a welcome and timely contribution to ongoing discussions about the future of Gaza's economy. Gaining an understanding of the challenges faced by Gaza's entrepreneurs and business owners is critical to building an action plan for transformative change. It is clear from this comprehensive report that Gaza's private sector has not recovered from the devastation of the 2014 hostilities, on top of the havoc already wreaked by the economic blockade.

Compensation to businesses has failed to cover the cost of the hostilities, causing many of them simply to cease operations. In too many cases, the ones that remain are operating at a significantly reduced capacity. Under blockade, exports have fallen to 15% of their previous level, indicative of the destruction of the local economy. This has led to a catastrophic loss of jobs, at a time when a rapidly growing population desperately needs them. Unemployment in Gaza is now the highest in the world, with 60% of youth out of work.

Overcoming all of these challenges is reliant on the reconstruction and bolstering of a strong and resilient economy, giving Gaza's households the opportunity to invest in their own lives and the long-term sustainable development of their community. This starts with the private sector, by encouraging entrepreneurship and business expansion led by the people of Gaza, for Gaza. A strong private sector is critical for providing the employment that the young Gaza population so desperately want and deserve.

We must heed this report's call for a fresh approach if we are to support Gaza's private sector to thrive, not just survive. This approach must see Gaza not as a humanitarian burden, but for its incredible development potential driven by its resilient and innovative people. To support Gaza's entrepreneurs and business owners to recover and rebuilt their livelihoods and enterprises, there is a critical need for unsustainable but vital relief measures to be complemented by programmes that focus on long-term development and sustainability.

To achieve this, it is clear that we need a unified and coherent strategy for building a strong and resilient economy in Gaza. That is one of the reasons why we convened the Gaza Reconstruction and Recovery Group (GRRG), an interagency platform led by UNWRA Gaza and the United Nations Development Programme (UNDP/PAPP). Together, our cooperation has enabled us to strengthen coordination, communication and information exchange among UN agencies and Gaza's NGOs. Our role is to support Palestinian government institutions in Gaza to achieve the targets set in the 2015 Damage Needs Assessment and Gaza Recovery Framework. Gaza's economy requires a strategic shift in policy forwarded by a unified coalition of state and non-state actors, supported by the GRRG. Only by working together can we overcome the challenges outlined in this report and rebuild an innovative and entrepreneurial private sector that Gaza's resilient communities deserve.

I wish to extend my thanks to the Author of the report, Dr Mohammed Samhouri, and to all those who contributed to its production.

Roberto Valent

Special Representative of the Administrator

United Nations Development Programme

Programme of Assistance to the Palestinian People



Three years after the 2014 hostilities (08 July – 26 August), Gaza is yet to recover from the extensive destruction caused by the conflict. A crippling Israeli economic blockade (land, air and sea), now entering its eleventh year, continues to take a debilitating toll on all aspects of life in the occupied Palestinian territory, with a loss in potential GDP of over 50%.¹ One-third of Gaza's arable land, and more than half of its Oslo-agreed fishing waters – both unilaterally declared by Israel as high risk / no-go zones – remain off-limits to Gazan economic use. Isolated and under severe restrictions on movement of people and trade, Gaza's economic troubles are further compounded by continued chronic shortages in electricity, water², and fuel supplies, and by an unconventional institutional and regulatory environment caused by ten years of Palestinian internal political split.

Despite reported progress in housing and infrastructure repairs³, three years after the latest hostilities Gaza's reconstruction is proceeding slower than expected and falling behind schedule. As of 31 December 2016, the latest update from the World Bank indicates that only 51% (US\$1.796 billion) of the US\$3.5 billion pledged for Gaza reconstruction at the October 2014 Cairo Conference has been disbursed.⁴ Of the disbursed funds, only US\$670 million, or 17% of the estimated US\$3.875 billion estimated recovery and reconstruction plan of the Palestinian government – titled "Detailed Needs Assessment (DNA) and Recovery Framework for Gaza Reconstruction" – were allocated to finance priority needs in five identified sectors affected by the 2014 war.⁵ Critically, only US\$16 million of the disbursed money was allocated to meet the productive sector's recovery needs estimated by the DNA at US\$602 million.⁶

Without any real change in the status quo, and with the government's DNA programme currently underfunded, Gaza's economic recovery remains a distant goal. However, given the scale of Gaza's ongoing economic predicament, inaction will have serious and widespread consequences, including higher rates of unemployment, poverty and food insecurity, worsening infrastructure, the dwindling of even basic public services, including education and healthcare; continued environmental degradation and deepening institutional decay.

Gaza's population (43% of which is under the age of 15) is growing at a rate of 3.3% per year (2016),⁷ recently surpassing the 2 million mark. Its young labour force is increasing by 4.5% per year, with the majority of new entrants to the labour market – estimated at 35,000 annually – becoming unemployed. Currently, the unemployment rate for youth (aged 15-29) of 56.0% is the highest in the world and is only likely to increase.⁸ Gaza's economy, however, has stagnated for the past ten years, with average annual real GDP growth rate over the last decade (2006-2016) not exceeding 1.44% (and only 0.17% for the period 2006-2014), while Gaza population grew by 38.4% over the same period. Based on the findings of an IMF report, output growth of at least 4.5% per year is needed just to absorb the new entrants to the job market.⁹ Thus, GDP growth that surpasses population growth will be required in order to reduce both chronic unemployment, currently at 40.6%,¹⁰ and to improve ongoing sub-standard living conditions.

Gaza's private sector, the engine of future economic growth potential, is presently incapacitated due to the blockade, restrictions on movement and access to natural resources and markets, the strict application of "dual-use" items list system, and recurrent destructive wars. A 2016 UNDP survey of Gaza's private sector two years after the war (Chapter three, Section C, and the Annex) reveals the sector's continued decline (in terms of capital assets, production and sales, employment, and exports; all at 50%-60% of

¹ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (19 September 2016), p. 5.

² For more on this, see Gisha, *Hand on the Switch: Who's responsible for Gaza's infrastructure crisis?* (January 2017).

³ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (May 4, 2017), Annex 2, pp. 30-33.

⁴ World Bank, *Reconstructing Gaza - Donor Pledges* (April 6, 2017). The World Bank is mandated by the PA and Norway (as the AHLC chair) to keep track of, and periodically report on, the disbursement progress of the financial pledges made at the October 2014 Cairo conference for reconstructing Gaza.

⁵ State of Palestine, *Detailed Needs Assessment (DNA) and Recovery Framework for Gaza Reconstruction* (August 2015). The five sectors are: infrastructure, productive, social protection, social development, and governance. The DNA is supported by the EU, the UN and the World Bank.

⁶ See Figure (6), Chapter (3) in this report.

⁷ Palestinian Central Bureau of Statistics (PCBS), *Summary of Demographic Indicators in the Palestine by Region* (PCBS website). West Bank annual population growth, meanwhile, is 2.5%.

⁸ Palestinian Central Bureau of Statistics (PCBS), *Labor Force Survey* (October-December, 2016), February 13, 2017.

⁹ IMF, *West Bank and Gaza: Labor Market Trends, Growth and Unemployment* (December 2012).

¹⁰ Palestinian Central Bureau of Statistics (PCBS), *Labor Force Survey* (October-December, 2016), February 13, 2017.



their pre-2014 war levels). This has been exacerbated by grossly inadequate international financial support to address the extensive damage and losses caused by the war and to help initiate recovery. Further analysis of Gaza's current business environment (Chapter four) reveals a very small, micro enterprise-based private sector that has been operating for years, but mainly since 2006, under considerable internal and external pressure. The emerging picture also reveals a very poor business climate that touches on all aspects of business activities, from investment decisions, to production operations, to the delivery of final output. In such a constrained business climate, the degree of risk and uncertainty for investors is extremely high, the cost of doing business is frequently prohibitive, and the level of confidence among private sector agents is correspondingly low.

For years, the international community has been providing financial and technical support, in addition to the badly needed humanitarian aid, in an attempt to alleviate the adverse impact of the stringent conditions under which Gaza businesses are operating, in order to ensure their continued survival. Currently, donors' incremental, project by project, ad hoc approach to providing assistance has provided only limited success in bolstering Gaza's private sector.

It is clear that a fresh approach is needed to create a sustainable private sector that can boost Gaza's resilience. Gaza's economy requires a fundamental long-term strategic policy shift from the international development community, under which short-term measures are complemented by programmes that focus on long-term sustainability. In this alternative approach, Gaza needs to be looked at for its strategic development potential rather than as a humanitarian burden.

This study proposes an alternative approach to be implemented within the context of the Palestinian government's DNA recovery and reconstruction programme. The proposed approach consists of three inseparable core components: (1) Accelerated short-term financial support to address the urgent needs of Gaza's private sector, as identified by the DNA framework and by Gazan business owners. To be effective however, these short-term measures should be linked to a longer term plan, as an integral part of a strategic view to Gaza's economic future. (2) The design of a comprehensive plan for the medium- and long-term development of Gaza's private-sector-led economy. The plan, which is currently missing from the DNA framework, should be based on an in-depth analysis of Gaza's business climate, and on sector strategies, and be utilised afterward as a core guide of where future international and domestic investment should be allocated. (3) A persistent effort by the international community to resolve the political conditions that are the root cause of Gaza's humanitarian crisis. For short-term interventions to be effective, and for a long-term strategic plan to have a real chance of successful implementation, a mechanism to ensure short- and long-term stability of political and security conditions must be in place.

This last component is the most challenging of all, and yet, there is no other way out. If the root causes of Gaza's economic crisis are political, then that is where the first step of a sustainable solution must be found.

Under unchanging political conditions, the future of Gaza and its inhabitants is bleak. When the UN is already predicting Gaza to be unliveable by 2020, then those with high stakes in the future of a fragmented State of Palestine should take a moment for serious pause.

Key Messages

Message One:

Conditions in the Gaza Strip are looking increasingly grim, with no real prospects in sight without a political resolution. The underlying political factors that led to the most recent hostilities remain unchanged: Israel's economic blockade, the internal Palestinian political divide, and fragile security conditions. Urgent action must be taken to speed up the reconstruction process, reconcile the Palestinian political division, and ease Israeli restrictions on the movement of people and goods. **Only once political problems have been resolved can lasting peace and long-term development be guaranteed.**

Message Two:

The statistics on socioeconomic conditions in Gaza remain bleak. More families are falling into the poverty trap, increasing food insecurity and aid dependence. 56% of young people in Gaza, aged 15-29, are presently without a job.¹¹ Appeals for development and humanitarian funding for Gaza by international organizations are persistently falling short of targets.¹² Vital projects to reconstruct Gaza's infrastructure or improve the provision of even basic public services are routinely delayed due to insufficient funds or by Israeli restrictions, delays or denials on the entry of raw materials, critical equipment, spare parts, and technical experts.¹³ Restrictions on movement in and out of Gaza remain largely in place. **Overall humanitarian conditions in Gaza have deteriorated to breaking point, with severe and far-reaching consequences.**

¹¹ PCBS figures for the 4th quarter, 2016. According to ILO latest figures, unemployment rate among new college and high-school graduates in Gaza is estimated at a staggering 75%. See International Labor Office, *The situation of workers of the occupied Arab territories, Report of the Director-General, International Labor Conference, 105th Session, Geneva, May 2016*, p. 5.

¹² An August 2016 UN report observed that "Funding remains the main concern in the livelihoods and social protection sector, with the Humanitarian Response Plan [HRP] being significantly more underfunded this year [2016] than at the same time last year (32% vs. 50% last year)." See United Nations, *Gaza: Two Years After* (August 26, 2016), p. 6. In December 2016, OCHA reported that only 47% of the requested \$571 million to finance HRP 2016 has been secured. See OCHA, *Humanitarian Bulletin* (December 2016), p. 1.

¹³ For example, 23 water, sanitation and hygiene items are currently on the Israeli-enforced "dual-use items" list, at a time when 70% of Gaza population have access to piped water only for 6-8 hours every 2-4 days. See UNSCO, *Report to the Ad Hoc Liaison Committee* (New York, 18-19 September 2016), p. 25-26.



Message *Three*:

Gaza's private sector is yet to recover from the losses sustained from three devastating rounds of war that caused extensive and widespread damage to its productive assets. This is in addition to the damage caused by the crippling Israeli economic blockade, now entering its eleventh year. Severe restrictions on imports and exports have driven some out of business, forced others to relocate abroad, and left those who remain working well below capacity. Isolated and cut off from supply chains, their struggle to survive is compounded by the continued acute shortages in electricity, water, and fuel, and by an unusual regulatory environment, caused by the Palestinian split that looks increasingly permanent with each failed round of reconciliation talks. ***Gaza's private sector continues to languish under extremely difficult operating conditions. Its resilience, vitality, and future potential are rapidly vanishing.***



Message *Four*:

Three years after the 2014 war, very little has been done to improve the economic conditions in Gaza, with international efforts so far proving highly unsustainable. As a result, socioeconomic conditions seem to be deteriorating at a much faster rate than available donor funds can contain them¹⁴. Incremental, stopgap international measures to save what remains of Gazan businesses are not making a tangible dent in the dire conditions, except perhaps to ensure their survival in an attempt to prevent or delay total collapse of the economy. ***The existing international approach to dealing with Gaza's multi-faceted crises is not working. Time has come for a fundamental change in how donors address Gaza's economic calamity.***

Message *Five*:

Any attempt to lend support to Gaza's private sector should, as a point of departure, start with serious actions on redressing "political instability" to reverse its damaging course. What is now needed is a complete lifting of the crippling Israeli blockade; free movement of people and trade; unfettered access to all of Gaza's farmland and territorial waters; and an end to Gaza's economic separation from the West Bank, and its virtual isolation from regional and international markets. Without this, economic recovery and long-term development will remain unattainable. Funding and technical support that reach Gaza under unchanged political conditions will, at best, result only in slowing the pace of the decade-long deterioration of the business environment, with little real impact on the prospects of sustained recovery or long term development in Gaza. ***A more assertive role by the international community is needed beyond the provision of financial and technical support, in order to secure political and security stability for short-term recovery and long-term development.***

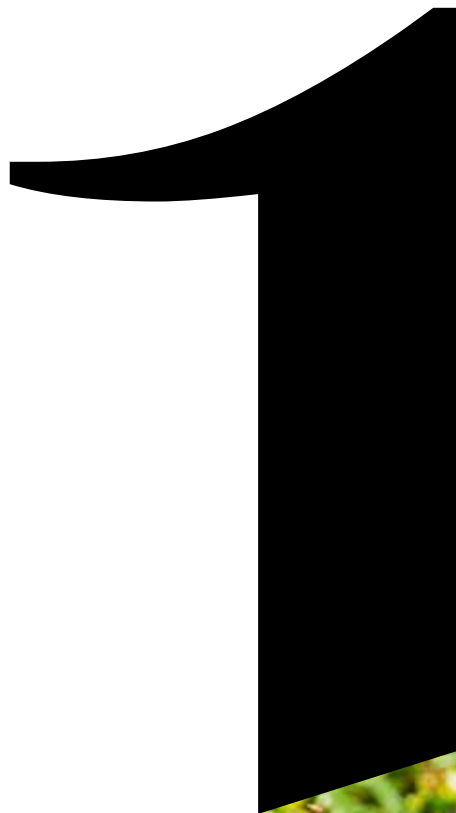
¹⁴ See *supra* note 12







CHAPTER



Introduction

Three years after the end of the 2014 Gaza hostilities, conditions in the Strip are looking increasingly grim, with no real prospects in sight for a way forward. The structural factors that brought all aspects of life in Gaza to near breaking point on the eve of the latest hostilities are still actively in play and continue to wreak havoc. These include: the internal Palestinian political divide, the suffocating Israeli economic blockade (both entering their eleventh year), and the fragile security conditions. Worse still, post-war attempts to give Gaza much needed respite have fallen short: the reconstruction process is slow, attempts to reconcile the Palestinian split have thus far failed, the Palestinian Government of National Consensus (GNC) remains unable to govern¹⁵, and Israeli measures to ease restrictions on movement are still far below the desired level. Meanwhile, despite political and financial problems resulting from changing regional dynamics and an end to the tunnel trade, Hamas remains in control.

Three years since the 2014 hostilities, the statistics on socioeconomic conditions in Gaza remain bleak and extremely troubling. More families are falling into the poverty trap, increasingly becoming food insecure, and relying more and more on foreign aid for basic survival. More adults, especially the educated youth, are becoming unemployed, desperately looking for jobs that do not exist. International organizations appeal for funds to provide humanitarian relief and work programmes for Gaza's impoverished and jobless population are persistently falling short. International projects to rehabilitate Gaza's crumbling infrastructure or improve the provision of essential public services are routinely delayed, either due to inadequate funds and/or restrictions of access of essential equipment and materials into the Strip.

Three years after, Gaza's private sector – the focus of this report – is yet to recover from the losses sustained from three devastating bouts of war that caused extensive and widespread damage to its productive assets, while still struggling to survive the crippling decade-long economic blockade. Severe restrictions on imports and exports imposed by Israel have driven some firms out of business, forced others to relocate to neighbouring Arab countries, and left those who remain open working well below their productive capacity. Isolated and cut off from supply chain, their struggle to stay in business is further compounded by the continued acute shortages in electricity, water, and fuel, and by an unconventional regulatory environment caused by the Palestinian split that looks increasingly permanent with each failed round of reconciliation talks.

Three years since the 2014 hostilities, very little has been done to improve the economic conditions in Gaza, with international efforts to sustain the unsustainable have proven difficult to succeed. Socio-economic conditions, as a result, seem to be deteriorating at a much faster rate than donors' funds can contain them. Incremental stopgap international measures to save what remains of Gaza's businesses have proven insufficient in reducing dire humanitarian conditions, except perhaps to prevent or delay the total collapse of the besieged economy.

¹⁵ The GNC was formed on June 2, 2014 after Hamas and Fatah reached an agreement called "Al-Shati' Declaration" in Gaza on April 23, 2014 to form a government of technocrats. Two major sticking problems, however, still hinder the work of the GNC in Gaza: the integration of the 40,000+ Hamas-appointed government employees into the PA payroll, and the effective control of Gaza border crossings with Israel and Egypt.



Three years after, the construction and recovery process is two years behind schedule, with only 25% of the estimated US\$152 million losses sustained during the war by 5,153 private sector establishments disbursed as compensation.¹⁶ Approximately, 60,000 people continue to be displaced.¹⁷ Big donors have not fully delivered on the pledges made at the “Cairo Conference on Reconstructing Gaza” in October 2014. As of December 31, 2016, overall disbursement stood at only 51% of the US\$3.5 billion pledged for rebuilding Gaza.¹⁸ Of funds that have been disbursed, only US\$670 million, or 17% of the US\$3.875 required by the DNA plan, have been allocated to the five priority sectors identified.¹⁹ Of this, only US\$16 million of the US\$602 million requested in the DNA has been allocated to rebuilding the productive sector.²⁰

Three years since the hostilities, Gaza remains a war-torn area, a man-made disaster, an open air prison,²¹ isolated and besieged from all sides. Its economy has been crushed, its 2 million people – half of them under the age of 15 – are traumatized and abandoned, and its civilian infrastructure and public services, both social (health, education, and housing) and physical (roads, water, energy, and sanitation), are largely dysfunctional. So precarious are the conditions, that the UN reported in 2012,²² and again in 2015,²³ that the whole of Gaza could be unliveable by the year 2020.

Under these dire conditions, Gaza’s economic recovery remains a distant and largely unattainable goal. If and when recovery does occur, as in the recent past, it is usually short-lived, mostly driven by donor funds rather than private investment, and always overwhelmed by new adverse shocks. Under the status quo, long term development remains impossible. However, inaction will only lead to greater hardship, including higher rates of unemployment, poverty, food insecurity, environmental degradation and institutional decay.

High population growth combined with severe restrictions on movement suggest that the only hope for a better economic future for Gaza lies in its private sector’s ability to become the driver of economic change and productive employment. How this can be successfully delivered remains a daunting challenge.

The focus of this report is the current state of Gaza’s private sector, and its future potential role. Its main objective is to conduct an analysis of the main challenges that are currently dominating Gaza’s business environment, and to propose ideas and actions for strengthening the sector to reduce the present economic crisis.

This report is structured into five chapters and an annex. This introduction constitutes chapter one. It establishes the groundwork for the discussion that follows in the rest of the document, and places it in its broader context. Chapter two presents an overview of Gaza’s economy over the past decade (2006-2016). It reflects on the exceedingly adverse political developments and shocks that crippled private sector operations, led to Gaza’s stark economic decline, and resulted in the emergence of a crippling socioeconomic and humanitarian crisis. The chapter also looks at how the grossly strained political setting since 2006 has negatively affected the growth performance, size, and structure of Gaza’s economy. Chapter three pays special attention to the 2014 hostilities, the damage and losses it wrought to the private sector, the Palestinian government plan for recovery, and the state of the donor-funded reconstruction efforts. The chapter also presents a summary of the main findings of a 2016 UNDP survey of Gaza’s private sector. Chapter four takes a closer look at the main determinants of Gaza’s business environment. The chapter conducts a brief analysis – based on data and information from UNDP workshops and surveys held in the first half of 2016 – to identify key impediments and constraints that are responsible for the near destruction of Gaza’s private sector. Chapter five concludes the report by presenting a critical assessment of the international development community’s current approach in dealing with the mounting challenges facing Gaza’s business community, and proposes an alternative strategic framework. The report’s annex presents a number of charts and diagrams to help graphically illustrate the main findings of the 2016 UNDP survey.

16 UNDP, *Economic Recovery and Development in the Gaza Strip* (July 26, 2016).

17 OCHA, *2017 Humanitarian Response Plan, January-December 2017* (December 2016), p. 6..

18 World Bank, *Reconstructing Gaza - Donor Pledges* (April 6, 2017)

19 State of Palestine, *Detailed Needs Assessment (DNA) and Recovery Framework for Gaza Reconstruction* (August 2015). The five sectors are: infrastructure, productive, social protection, social development, and governance. The DNA is supported by the EU, the UN and the World Bank.

20 See Figure (6), Chapter (3) in this report.

21 “David Cameron: Israeli blockade has turned Gaza Strip into a ‘prison camp,’” *The Guardian* (27 July 2010).

22 United Nations, *Gaza in 2020: A Liveable Place?* (August 2012).

23 UNCTAD, *Developments in the economy of the Occupied Palestinian Territory, Report on assistance to the Palestinian people* (6 July 2015).



CHAPTER



Gaza Economy, 2006-2016: A Decade of Continued Decline



The struggle of the Gaza private sector is rooted in the significant challenges posed by turbulent shocks to the Gaza economy of the past ten years. The history of the Gaza economy since 1994 has been one of continued decline in real terms, where economic growth has failed to match pace with population increases and the entry of young people into the labour market. This economic stagnation has largely been caused by a series of highly disruptive and destructive events that have adversely affected its growth performance and vastly reduced its productive potential. As a result, Gaza's total real GDP over the entire two-decade period remained virtually stagnant, "only a couple of percentage points higher" than it was in 1994, while that of the West Bank increased by 245% over the same period.²⁴

Until the year 2000, Gaza's burgeoning labour force found job opportunities in the fledgling public sector of the Palestinian Authority (PA) and inside Israel. The importance of these two sources of employment, however, began to diminish, as the PA's staffing of its new institutions was near complete, and job opportunities in Israel were curtailed following the second intifada (2000-2003). With the private sector operating under severe restrictions on access and movement of people and trade, its ability to invest and create alternative jobs was limited. Furthermore, jobs, exports and economic growth lost through the declining share of Gaza's manufacturing and agriculture sectors in the economy has failed to be matched by other industries, further compounding the problem.²⁵

As a result, Gaza's standards of living have deteriorated, poverty and unemployment rates have soared, and the reliance on international assistance to sustain the Gazan population – which more than doubled between 1994 and 2014 – has dramatically increased. According to World Bank counter-factual analysis, Gaza's GDP, under "normal" conflict-free conditions, should have shown equivalent growth to that witnessed in the West Bank over the past two decades, however this has not materialised.²⁶

This chapter reflects on some of the adverse political developments and events that hit Gaza since 2006 and led to its stark economic decline. Major shocks to the economy will be reviewed, and their socioeconomic consequences will be discussed. The chapter also looks at how Gaza's extremely strained political setting since 2006 has produced a highly volatile economic growth performance with a considerable loss of potential GDP gains, and changed the sectoral composition of its economic structure. By doing so, this chapter (and the next) sets the stage for the analysis that will follow in Chapter four of the various impediments that stifle Gaza's business environment. The devastating impact of the 2014 war, the extensive damage and losses it wrought to the private sector, the Palestinian government's DNA programme for reconstruction and recovery, and the current state of the donor-funded reconstruction efforts will all be the subject of discussion in the next chapter.

²⁴ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (May 2015), p. 15.

²⁵ See Figure (4) later in this Chapter.

²⁶ Ibid.

A. GAZA POST-2006 ECONOMIC DECLINE

The current economic situation in the Gaza Strip finds its roots in an unfavourable political setting since the Israeli unilateral disengagement from Gaza in September 2005.²⁷ Since then, a series of highly disruptive and destructive developments have occurred over a ten-year period, to form a restrictive business environment, characterized by a high degree of risk and uncertainty. Each one of these post-2005 developments represented, in its own way, a strong shock to Gaza's largely underdeveloped economy that was barely recovering from three years of sharp decline during the second intifada. Collectively, these adverse shocks, one after another, created a series of unprecedented humanitarian and socioeconomic crises in Gaza, with its size, scope, and complexity only increasing over time.



Subsequently, Gaza remains geographically, politically, and economically disconnected from the rest of the Palestinian State, and remains highly dependent on external trade in goods and services, mainly with Israel and the West Bank. Thus, these adverse developments have proved extremely costly for Gaza's population and its young and growing labour force.

B. DISENGAGEMENT, BLOCKADE, AND INTRA-PALESTINIAN SPLIT

In September 2005, Israel unilaterally disengaged from the Gaza Strip, evacuated some 8,000 Jewish settlers from 21 settlements, and ended its 38 year-long military presence inside the territory. After the disengagement, Israel continued to retain exclusive control over Gaza's airspace and territorial waters, its population registry, electromagnetic space, and the exit/entry of goods to and from Gaza.²⁸ In November 2005, a US-sponsored Agreement on Movement and Access (AMA) was reached between Israel and the PA in an attempt to revitalize the Palestinian economy and boost Palestinian-Israeli trade relations. The agreement aimed to improve Gaza's cross-border commercial transactions with Israel, allow for a secure passage for goods and people between Gaza and the West Bank, facilitate agricultural exports from Gaza's ex-Israeli settlements, operate EU-monitored Rafah border crossing for passengers and exports, and resume talks on constructing Gaza's seaport and re-operation of Gaza airport.²⁹

²⁷ For more on this, see Mohammed Samhouri, *Gaza Economic Predicament One Year after Disengagement: What Went Wrong?* Middle East Brief no. 12, Crown Center for Middle East Studies, Brandeis University (November 2006).

²⁸ The digging and operation of hundreds of tunnels along the border between Gaza and Egypt during the 2007-2013 period, however, allowed large quantities of goods to be smuggled into Gaza away from Israel's direct control.

²⁹ For the full text of the agreement, see World Bank, *The Palestinian Economy and the Prospects for its Recovery* (Washington, DC, December 2005), Annex 4.



Two months after the signing of the AMA, however, events in Gaza took an unexpected turn when the Islamic movement Hamas emerged victorious in the Palestinian legislative elections that were held in January 2006. This surprise development represented **the first political shock to hit post-disengagement Gaza economy**. Following their electoral triumph, the Hamas-led Palestinian government (formed in late March 2006) refused to heed to the Middle East Quartet's (the US, the EU, the UN, and Russia) three conditions: recognizing Israel, renouncing violence, and accepting previous Oslo agreements. Thus, Israel suspended the monthly transfer of Palestinian tax money, collected on the Palestinian Government's behalf according to the terms of the 1994 Paris Protocol on Economic Relations (PER). It also further tightened its restrictions on Palestinian movement and access. Both measures – along with the suspension of donors' *direct* budgetary aid to the Hamas-led Palestinian government– resulted in a crippling financial crisis.³⁰

The second political shock to hit Gaza's economy came after the Hamas armed takeover of the entire Gaza Strip on 14 June 2007, marking the beginning of a bitter Palestinian internal political division that continues until today. Soon after Hamas took over, Israel firmly closed its commercial crossings with Gaza, and suspended the "Gaza customs code," which was used to identify imported goods *en-route* to Gaza through Israeli ports. On 19 September 2007, Israel officially declared Hamas-run Gaza as a hostile entity, further intensified its longstanding restrictions on the movement of people to and from Gaza (in place since 1991), and imposed a sweeping economic blockade on the Palestinian coastal enclave, including significant reduction in the supply of fuel and electricity to Gaza;³¹ **the third powerful shock to hit the Gaza economy in a twenty-month period**. With this Israeli policy firmly in place, virtually no exports were allowed to exit Gaza,³² and only essential international humanitarian assistance, along with a very limited range of basic consumer goods and fuel, were allowed to enter.

The economic impact of the Israeli policy vis-à-vis Gaza was devastating. In addition to the heavy and unprecedented destruction caused by multiple Gaza conflicts, **which, together, represent a series of powerful shocks to hit Gaza's economy during the period 2008-2014** (a subject that will be discussed in some detail in the next chapter), the Gaza private sector was decimated by other major Israeli-imposed, blockade-related constraints: (1) severe restrictions on the import of materials considered 'dual use' (i.e. they could be used for military purposes), for example construction materials like aggregate, steel bars, and cement, as well as machinery parts;³³ (2) Military-enforced restrictions on access to Gaza's agricultural land adjacent to Israeli borders, and to Oslo-agreed fishing waters in the Mediterranean;³⁴ (3) chronic shortages of potable water, electricity, and fuel;³⁵ and (4) a complete ban on all exports from Gaza to Israel and the West Bank, the two traditional markets for 85% of Gaza's merchandise exports.

By 2010, three years into the economic blockade, close to 70% of industrial establishments in Gaza were forced to shut down, with the rest operating on less than half of their production capacity,³⁶ labor productivity declined by 20% on average (36% in the manufacturing sector);³⁷ household's welfare declined by 14-27%;³⁸ and economic cost of the blockade during the 2007-2010 period estimated at \$1.9 billion, or 23.5% of the Palestinian GDP in 2010.³⁹ By the end of 2014, the crippling blockade, along with three rounds of military operations, took their toll on Gaza's GDP, slashing its potential growth by 50%, and rendering real per capita income 31% lower than it was in 1994.⁴⁰ As a result, unemployment skyrocketed, and poverty levels recorded new highs, reaching 43% (over 60% among youth, the highest in the world) and 39%, respectively.⁴¹ Over 80% of Gaza's population of 1.9 million are aid-dependent⁴², and approximately half are food insecure⁴³. According to United Nations figures, Gaza's humanitarian crisis, as well as changes to the classification requirements, meant the number of Palestinian refugees in the Gaza Strip receiving UN food assistance jumped from 72,000 refugees in 2000 to 868,000 refugees in 2015.⁴⁴

30 For more on this see Karim Nashashibi, *Palestinian Finance under Siege: Economic Decline and Institutional Degradation*, OCHA Special Focus (April 2007). Also see Mohammed Samhouri, *Looking Beyond the Numbers: The Palestinian Socioeconomic Crisis of 2006*, Middle East Brief 16, February, Brandeis University Crown Center for Middle East Studies, Brandeis University (February 2007).

31 See the Israel Ministry of Foreign Affairs, Security Cabinet declares Gaza hostile territory (September 19, 2007).

32 The Israeli ban on exports from Gaza continued until mid-2000. After that, between 2011 and 2014, only a very small fraction (less than 5%) of the pre-2007 export level was allowed to leave Gaza. In February 2017, the average monthly number of truckloads exiting Gaza was only 35% of their mid-2007 pre-blockade level. See UNSCO, Report to the Ad Hoc Liaison Committee (Brussels, May 2017), p. 15.

33 "Dual-use items" are civilian goods viewed by Israel as having potential military use. The list of dual-use goods includes a wide range of items like capital equipment, raw materials, spare parts, chemicals, fertilizers, etc. For more on this, see Gisha's two publications: *Checking the "dual-use" list twice* (January 31, 2016) and *Information Sheet: Dark-Gray List* (January 31, 2016).

34 An estimated 35% of Gaza's agricultural land (about 17% of Gaza's total area size), and more than half of its Oslo-agreed 20 nautical miles territorial waters, are inaccessible to the Palestinians due to the Israeli-enforced security buffer zone inside Gaza along the Israeli-Gaza border, and the Israeli naval blockade along the entire coast of Gaza. For more on this, see United Nations and World Food Programme, *Between the Fence and a Hard Place: The Humanitarian Impact of Israeli-Imposed Restrictions on Access to Land and Sea in the Gaza Strip*, Special Focus (August 2010).

35 See B'Tselem, "Water crisis in Gaza Strip: Over 90% of water un-potable" (February 6, 2014); and OCHA, *The Humanitarian Impact of Gaza's Electricity and Fuel Crisis* (July 2015).

36 See Portland Trust, *The Private Sector in Gaza*, Economic Feature (December 2010), Table 2, p. 3.

37 Haggay Etkes and Assaf Zimring, "When Trade Stops: Lessons from the Gaza Blockade 2007–2010," *Journal of International Economics*, Vol. 95, Issue 1 (January 2015), pp. 16–27.

38 Ibid.

39 Applied Research Institute- Jerusalem (ARIJ), *The Economic Costs of the Israeli Occupation for the Occupied Palestinian Territory* (September 2011), p. iv and p. 4.

40 See World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (May 27, 2015), p. 6.

41 Ibid, p. 5 and 14.

42 UNRWA, *Gaza Situation Report 149* (June 23, 2016).

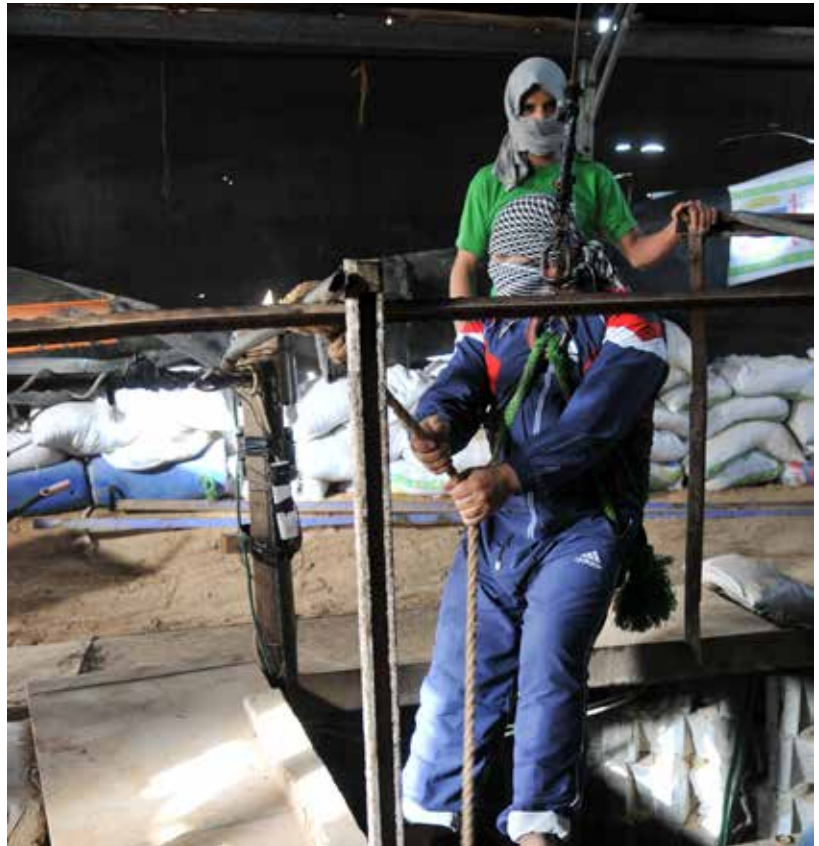
43 UNRWA, *Gaza Situation Report 123* (December 20, 2015).

44 See, UNRWA, *Gaza Situation Report 93* (May 22, 2015). As of October 2016, this number of Gaza refugees in need for UN food assistance has jumped to 930,000. See Bo Schack, Director of UNRWA Operations in Gaza, *Denied a human standard of living: The Gaza blockade has entered its tenth year* (October 21, 2016).

C. GAZA'S INFORMAL TUNNEL ECONOMY, 2007 - 2013

To circumvent the tight economic blockade, Gaza turned underground, openly digging a vast network of cross-border tunnels (over 1,500 by some counts) along the 13-kilometer border with Egypt.⁴⁵ Smuggling tunnels largely defined the economy of the Gaza Strip for the most part of 2007 to 2013, were the site of bustling economic activities in southern Gaza, and a vital lifeline for the Strip's short-term survival. These tunnels provided a wide range of basic consumer goods and fuel supplies to the besieged population, delivered building materials to the construction sector, created thousands of direct and indirect jobs for unemployed Gazans, and were a major source of tax revenues for the Hamas-run government.

All this, however, started to change after July 2013. With a new political leadership in Cairo viewing the Gaza tunnels as a threat to the country's national security, Egypt began systematically demolishing them from the Egyptian side of the border, a process that reached its zenith in November 2014 with the establishment of a 1,000-meter wide buffer zone along the Gaza-Egypt border.⁴⁶



The impact of the destruction of the smuggling tunnels on Gaza economy was immediately felt, especially in the three areas where tunnels were a vital source of essential goods and money: (1) building materials, (2) fuel supplies, and (3) tax revenues. Construction sector, for instance, contracted by more than 70% between mid 2013 and early 2014,⁴⁷ resulting in workers layoffs and further worsening the already high unemployment rates in Gaza. Fuel shortages, on the other hand, severely affected fuel-operated Gaza Power Plant which had to operate at half of its capacity, leading to longer periods of power outages that ranged between 16-18 hours a day, further disrupting water supplies, and sewage treatment, and other critical basic services;⁴⁸ and Finally, the sharp reduction in tax revenues led to an acute financial crisis that crippled Hamas ability to make regular and full monthly payments to its 40,000+ civil and security employees that Hamas hired after its armed take-over of Gaza in mid 2007.

D. THE DAMAGING IMPACT OF THE ISRAELI BLOCKADE

The deleterious impact of the blockade, repeated military operations against Gaza, and the continued internal Palestinian political division, on the performance, size, and structure of Gaza's economy during the past decade is unmistakable. Three aspects of such a detrimental impact are particularly notable: (1) the highly volatile and erratic nature of economic growth since 2006; (2) the diminishing size of Gaza's contribution to the total Palestinian GDP; and (3) the changing structure of the Gaza Strip economy, with the persistent shrinking share of the manufacturing and agriculture sectors in total output, and the rise in the shares of wholesale and retail trade, services, and public administration sectors. Each one of these three adverse and highly transformative developments will be discussed separately below.

⁴⁵ Tunnel trade existed before 2006, but on a much smaller scale than the one existed after the imposition of the Israeli economic blockade. For more on this, see Nicolas Pelham, "Gaza's Tunnel Phenomenon: The Unintended Dynamics of Israel's Siege," *Journal of Palestine Studies*, Vol. 41, No. 4 (summer 2012), pp. 6-31.

⁴⁶ Reuters, Egypt to deepen buffer zone with Gaza after finding longer tunnels (November 17, 2014). It was later reported that Egypt planned to expand the buffer zone to two kilometers. See Middle East Monitor, Egypt to expand buffer zone with Gaza (April 28, 2015).

⁴⁷ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (September 22, 2014), p. 9.

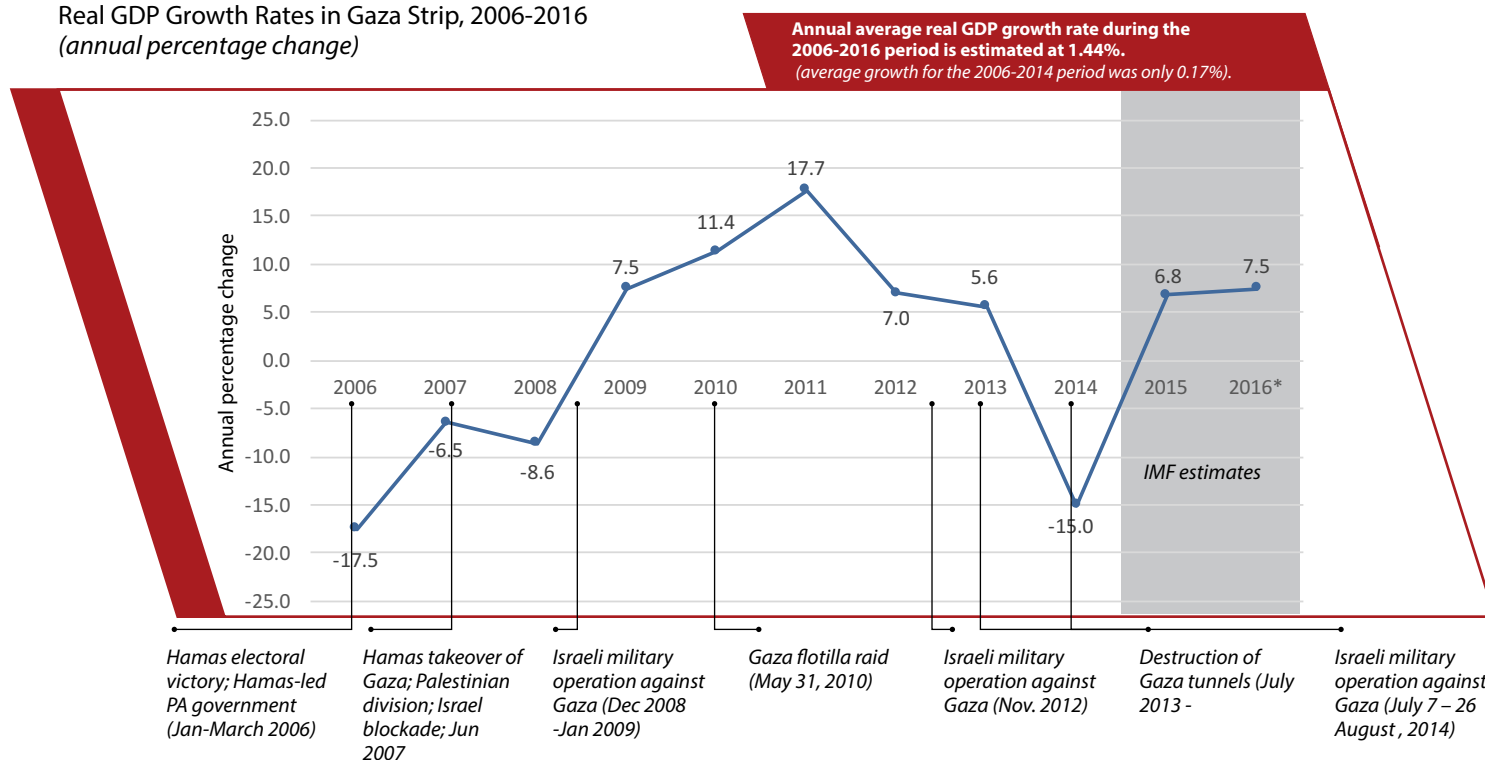
⁴⁸ In July 2015, OCHA reported that due to electricity and fuel shortages, "more than 70% of households in Gaza are being supplied with piped water for 6-8 hours only once every two to four days." See OCHA, *The Humanitarian Impact of Gaza's Electricity and Fuel Crisis* (July 2015), p. 1. Furthermore, up to 95 million liters of raw or partially treated sewage are discharged into the Mediterranean Sea every day. See EWASH, *Let it flow: How the Israeli blockade has brought Gaza to the brink of a water and sanitation disaster* (21 March 2016).

As Figure (1) shows, real GDP growth in the Gaza Strip since 2006 has been extremely volatile and erratic, directly affected by successive shock waves to the economy. Between 2006 and 2008, growth rates were all in the negative, mainly due to three consecutive political and security developments: (1) the tightening of the Israeli restrictions following Hamas' surprise electoral victory in January 2006 and the formation of the Hamas-led Palestinian government two months later; (2) the imposition of a tight economic blockade in June 2007 after Hamas' armed takeover of Gaza; and (3) the first major military operation against post-disengagement Gaza at the end of 2008 and early 2009.

Figure (1)

SHOCKS AND VOLATILITY:

Real GDP Growth Rates in Gaza Strip, 2006-2016
(annual percentage change)



Note: Data for period 2006-2015 are from Palestinian Central Bureau of Statistics⁹ (PCBS), *Major National Accounts Variables by Region for the Years 1994-2015 (at constant 2004 Prices)*. Figures for 2016 are taken from IMF, *West Bank and Gaza, Report to the Ad Hoc Liaison Committee* (10 April 2017), Table 1, p. 22.

Real GDP growth picked up between 2009 and 2011 for two main reasons: (1) post-war recovery and reconstruction activities following the March 2009 Sharm El-Sheikh international conference where donors pledged a total of US\$4.84 billion for Palestinian Government financial support and for Gaza reconstruction,⁴⁹ and (2) the limited easing of Israeli restrictions on access and movement following the Turkish flotilla incident.⁵⁰ Recovery, however, was short-lived. Three new adverse developments between 2012 and 2014 sent Gaza's real GDP growth rates tumbling from 17.7% in 2011 to -15% by the end of 2014: (1) the Gaza conflict in November 2012, (2) the beginning of the destruction of Gaza's smuggling tunnels by Egypt starting mid-2013, and (3) the launch of the deadliest Gaza conflict in July/August 2014. An IMF estimate for real GDP growth rate in 2016 puts the figure at 5.5%.

49 For more on this see, *Conclusions by the Chair, The International Conference in Support of the Palestinian Economy for the Reconstruction of Gaza, Sharm El-Sheikh, Egypt, 2 March 2009* (www.unispal.un.org).

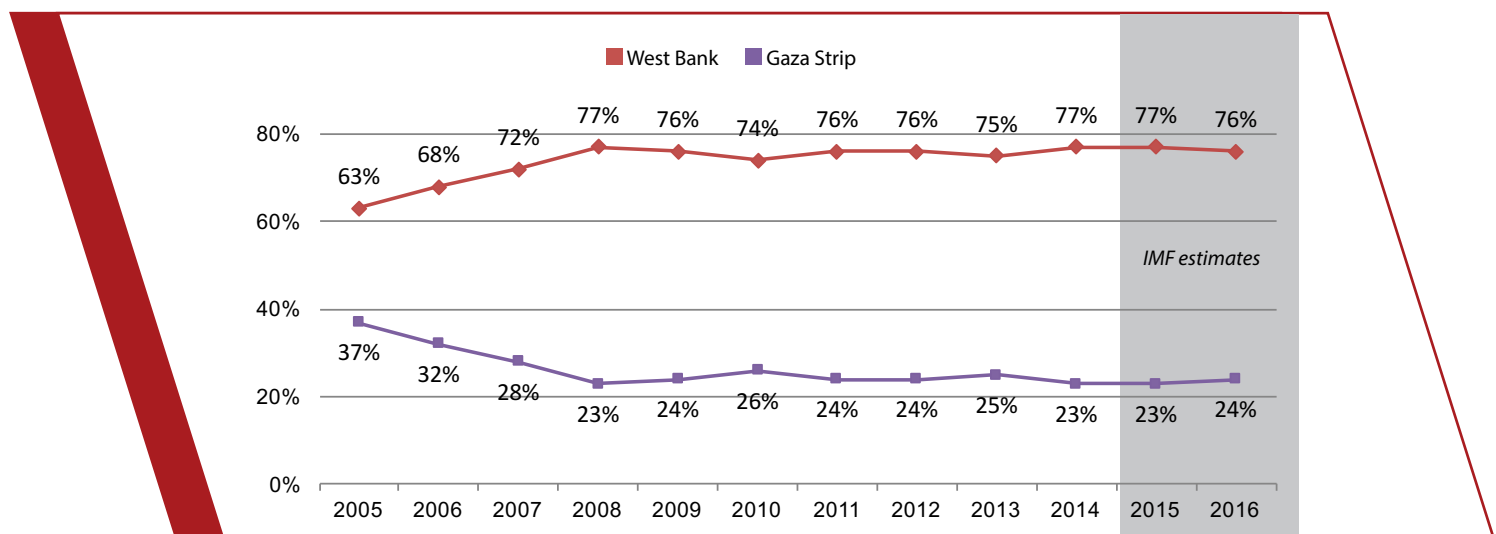
50 The Guardian, *Israeli attack on Gaza flotilla sparks international outrage* (May 31, 2010). As a result of the international pressure, Israel allowed the entry of most civilian goods into Gaza, but continued to restrict/pan the entry of "dual-use" items. Construction materials for internationally financed and administered projects were allowed to enter Gaza, and limited amount of exports were permitted to leave the Strip.

Two points are important to note concerning Gaza's real GDP growth over the entire ten-year period. **First**, that the source of upward trends in economic activities after each slump in growth was not an increase in Gaza's productive assets size or performance, but rather was mostly driven by a surge in foreign aid disbursed for reconstruction following the 2008/09 and 2014 wars, and by a rise in wholesale and retail sales. **Second**, that over the course of the past decade (2006-2016), average annual growth in real GDP was a meagre 1.44% (or only 0.17%, if we exclude 2015 and 2016 growth figures), leading to persistent decline in real per capita income, and higher rates of unemployment and poverty, as was discussed earlier in this report.

The second major adverse impact of the tumultuous 2006-2016 decade on Gaza's economy is evident in the falling size of Gaza's contribution in the total Palestinian GDP, which had significant negative implications on socioeconomic disparities between the Gaza Strip and the West Bank. Figure (2) below shows that since 2005, the Gaza Strip share has been steadily declining, tumbling by more than a third, from 37% in 2005 to an estimated low of 24% in 2016, with most of the drop taking place between the turbulent 2005 - 2007 period.

Figure (2)

WEST BANK AND GAZA STRIP SHARE in Palestinian GDP, 2005-2016



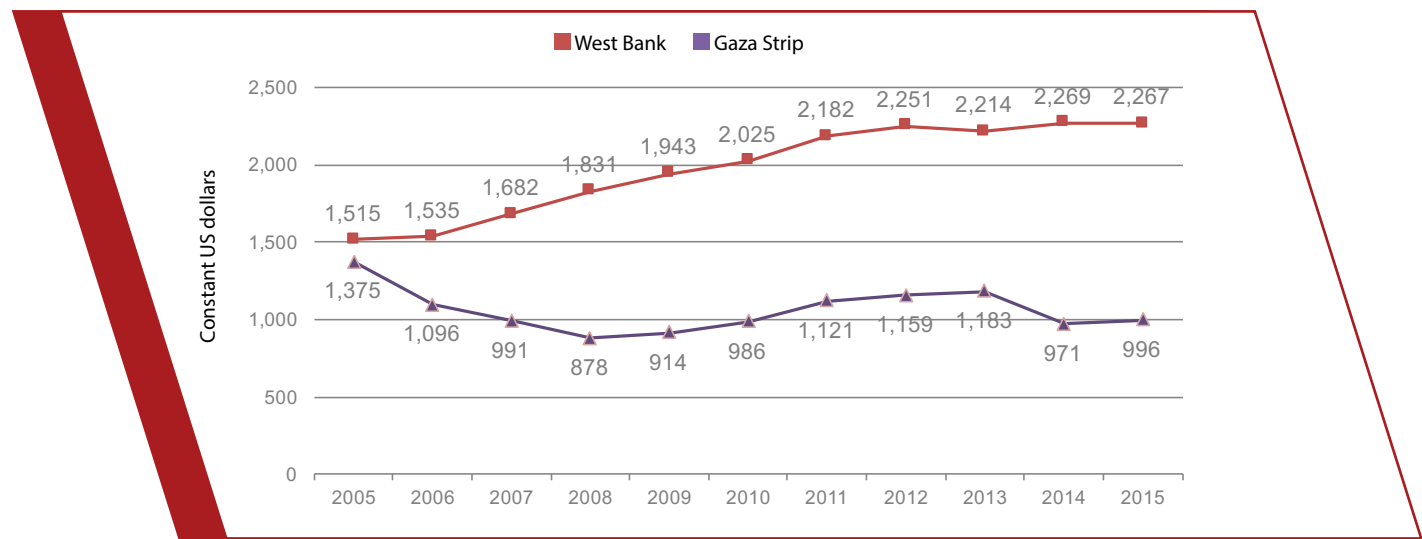
Note: Data for the (2006-2015) period are from PCBS, while the figure for 2016 is an IMF estimate. Sources: PCBS, Major National Accounts Variables by Region for the Years 1994-2015 (at constant 2004 Prices); and IMF, West Bank and Gaza, Report to the Ad Hoc Liaison Committee (10 April 2017), Table 1, p. 22.

The fall in Gaza's share in Palestinian total output reflects not only a continued decline in economic activities in the Gaza Strip, but, more worryingly, it indicates a progressive widening of the gap, both in output and income levels, between the two territorially-disconnected and, since 2007, politically-divided parts of the Palestinian areas. This yawning economic gap between the two regions has eventually translated into a lower GDP per capita income in Gaza compared to West Bank as can be seen in Figure (3), with correspondingly higher unemployment, poverty, and food insecurity rates in the former than the latter as shown in Table (1).⁵¹

⁵¹ For more on the widening income gap between West Bank and Gaza, see World Bank, Economic Monitoring Report to the Ad Hoc Liaison Committee (May 27, 2015), p. 16. While high rates of food insecurity in Gaza have largely to do with widespread unemployment and poverty rates rather than a shortage of food, both former indicators are direct outcome of the blockade- and restriction-driven economic decline in Gaza since mid-2007.

Figure (3)

WIDENING DISPARITIES:
GDP per capita in West Bank and Gaza, 2005-2015
(in US\$, in constant 2004 prices)



Source: Palestinian Central Bureau of Statistics (PCBS).



A third negative impact on Gaza economy as a result of the turmoil and disruptions that dominated the 2006-2016 decade is related to the continued erosion of the productive capacity of Gaza's economy as reflected in the changes of the sectoral composition of its output structure (Figure 4). This was seen in the progressive fall in the share of the manufacturing and agriculture sectors in Gaza's GDP (at 5% and 8%, respectively, in 2014), and the rise of domestic services, and public administration sectors in the economy (at 32% and 30%, respectively, in 2014). This transformation is particularly troubling since manufacturing and agriculture are the sectors that have the greatest potential contribution to Gaza's long-term GDP growth, merchandise exports, and productive employment. This decline in the share of these two sectors in Gaza's total economic output is a direct outcome of the formidable constraints (i.e., the restrictions on access and movement of people and goods, political uncertainties and mounting business risks that deter investment, economic blockade, multiple rounds of destructive wars, etc.) under which the two sectors have been operating since 1994, and particularly after the imposition of the Israeli economic blockade in mid-2007.⁵²

Table (1)

	West Bank %	Gaza Strip %
General Unemployment Rate (Q4/2016)	16.9	40.6
Males	14.2	33.2
Females	28.5	64.4
Youth Unemployment Rate (Q4/2016)*	26.6	56.0
Males	20.7	48.2
Females	51.4	77.8
Poverty Rate (2014)	16	39
Deep Poverty Rate (2011)**	7.8	21.1
Food Insecurity Rate (2014)	16.3	46.7
Sever Food Insecurity Rate (2014)	5.5	28.4

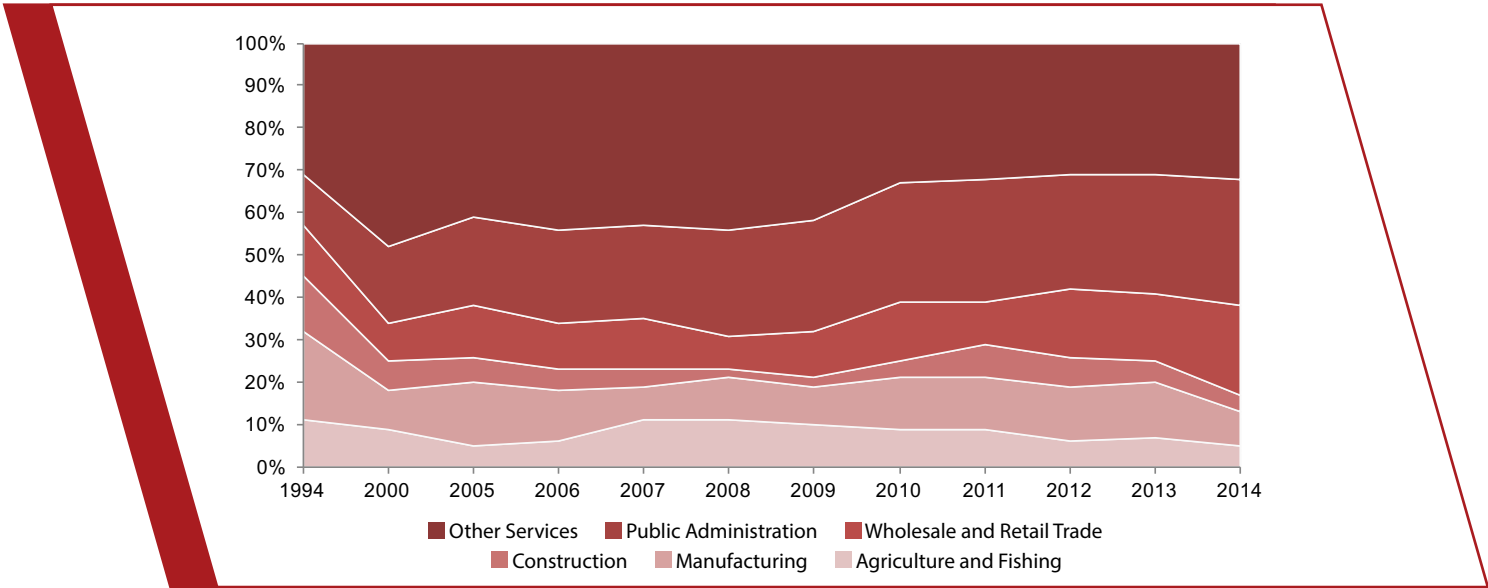
* Age (15-29); ** Latest data available

Source of unemployment figures, PCBS, Labor Force Survey (October-December, 2016), Round (Q4/2016), 13 February 2017. Source for the 2014 poverty rates, World Bank, Economic Monitoring Report to the Ad Hoc Liaison Committee (September 30, 2015), p. 4; Source for the 2011 deep poverty rates, PCBS, Poverty Rates Among Individuals According to Household Monthly Consumption in Palestine by Region, 2011. PCBS defined poverty line for West Bank and Gaza at US\$ 637/month for a family of five (two adults and three children). Deep poverty is defined by the UNDP at (or less than) US\$ 509 a month for the same family of five. See, UNDP, Palestine Human Development Report (2014), p. 53. Source of food insecurity figures: Palestinian Central Bureau of Statistics and Food Security Sector, Socio-Economic & Food Security Survey 2014, State of Palestine (May 2016), p. 35 and 37.

⁵² According to eng. Mohammed al-Bakri, the director of the Gaza Agriculture Department, these restrictions have resulted in a sharp decline in the number of Gaza farmers, from 100,000 in 2006, to 18,000 in 2016. See Al-Monitor, Gaza agriculture on brink of collapse (Oct. 21, 2016).

Figure (4)

THE CHANGING STRUCTURE OF GAZA STRIP ECONOMY:
Sectoral Shares of GDP, 1994-2014
(in percent)



Source: Palestinian Central Bureau of Statistics (PCBS), *Value Added by Economic Activity and Region for the Years 1994- 2014*.





CHAPTER





Gaza Three Years After: Post-war Reconstruction and Recovery

Along with the stifling economic blockade of mid-2007, Gaza had to endure the terrible experience of being subjected to three large-scale military operations in under six years: first, in December 2008/January 2009; then in November 2012, and again in July/August 2014; with the cost of the total *direct* physical damages of the three wars combined estimated at three times the size of Gaza's annual GDP.⁵³ The last hostilities were the deadliest and most devastating of all. It lasted 51 days, and wrought unprecedented carnage to Gaza's civilian population and caused widespread destruction to its already weak economy and failing infrastructure including schools, universities, hospitals, water and sanitation systems⁵⁴, communication networks, and Gaza's only power plants, public buildings, industrial assets and agricultural land. Over 60% of Gaza's housing stock sustained significant damage, with high-rise residential buildings flattened, and entire neighbourhoods across the eastern Gaza Strip were reduced to rubble or rendered uninhabitable⁵⁵. An estimated 485,000 people (28% of Gaza's population) became internally displaced at the height of the seven-week hostilities.⁵⁶ The psychological trauma to those who survived the conflict, and those who sustained lifelong physical injuries, is no less painful.⁵⁷ Two years after the 2014 hostilities, "one out of four children (225,000) was still require psychosocial support and 33,000 needing specific case management."⁵⁸



⁵³ UNCTAD, *Report on UNCTAD Assistance to the Palestinian People: Developments in the economy of the Occupied Palestinian Territory* (Geneva, 6 July 2015), pp. 10–11. The study added that the overall cost would be much higher if one takes into account the indirect losses caused by the three wars, e.g., the lost human capital and the loss of future incomes that could have been generated from destroyed and damaged productive assets.

⁵⁴ During the war, 20,000 meters of water network pipes and 15,000 meters of sewage networks and carrier lines were damaged; 11 water reservoirs partially damaged; five tanks completely destroyed; and 12 sewage pumping stations partially damaged. See Association of International Development Agencies (AIDA), *Charting a New Course: Overcoming the Stalemate in Gaza* (April 13, 2015), p. 8. The report also has other statistics on the damage sustained in various sectors (including health, education, energy, agriculture, and private businesses).

⁵⁵ DNA report (August 2015), p. 25. A total of 171,000 housing units were affected by the 2014 war, of which 11,000 were completely destroyed; 6,800 were severely damaged (i.e., rendered uninhabitable); 5,700 sustained major damage; and 147,500 minor damaged units. See Shelter Cluster Palestine, *SC Factsheet* (October 2016), p. 1.

⁵⁶ OCHA, *Gaza Emergency Situation Report* (4 September 2014), p. 2.

⁵⁷ James S. Gordon, "Gaza isn't just a physical wreck. The psychological damage is even worse," *Washington Post* (November 3, 2014).

⁵⁸ OCHA, *Humanitarian Bulletin* (August 2016), p. 1.

A. THE DEVASTATING PHYSICAL IMPACT OF THE 2014 WAR

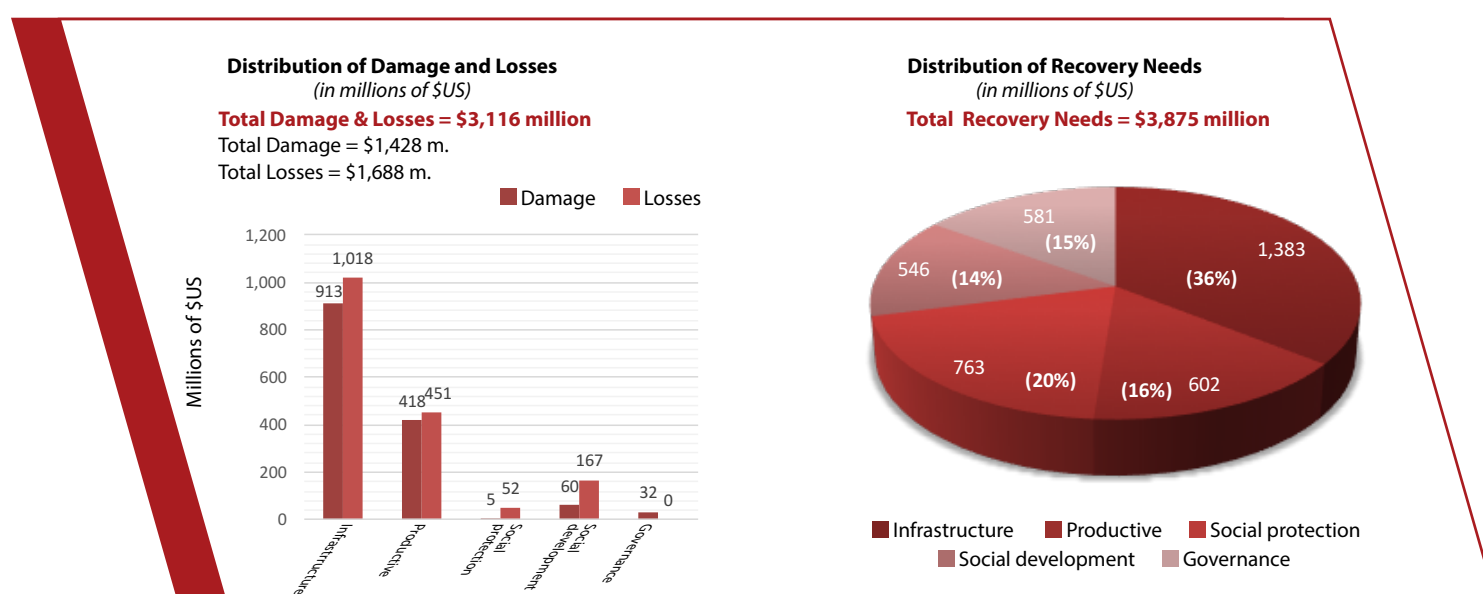
Figure (5) shows the destructive impact of the 2014 war as detailed by the Palestinian government's DNA calculations of the total physical damage and economic losses in five main sectors, along with the estimates of total reconstruction and recovery needs in each sector. The DNA defines damage as "the monetary value of public and private sector infrastructure and assets destroyed in the war". Losses, on the other hand, are defined by the DNA as "the changes in economic flows arising from the war that continue until the achievement of full economic recovery and reconstruction - in some cases lasting for several years."⁵⁹

The left-hand side of Figure (5) shows that total physical damage and economic losses are estimated at US\$3.1 billion (\$1.4 billion in damage and \$1.7 billion in losses). The share of the infrastructure sector (which includes housing, energy, water network, sanitation, roads, etc.) is the highest, with total damage and losses close to US\$2 billion. About 64% of *all* damage and 60% of *all* losses were incurred by this sector. This was followed by the productive sector (mainly agricultural and manufacturing activities) with its share of *total* damage and losses estimated at US\$869 million (or 29% of the total damage and 27% of the total losses). Three other sectors were affected by the conflict, but to a lesser degree. This includes the sectors of social development, social protection, and governance that came in distant third, fourth and fifth places respectively.

Figure (5)

THE 2014 ISRAELI HOSTILITIES AGAINST THE GAZA STRIP:

Damage, Losses, and Total Recovery Needs



Source: State of Palestine, *Detailed Needs Assessment (DNA) and Recovery Framework for Gaza Reconstruction* (August 2015), pp. 13-15.

The right-hand side of Figure (5) shows the distribution of recovery needs among the five affected sectors. The DNA estimated the total funds required to finance all reconstruction and recovery needs at US\$3.875 billion to be disbursed over a three-year period. As expected, the share of the infrastructure sector which sustained 62% of the *total* damage and losses was the highest, with recovery needs estimated at US\$1.383 billion, or a little over a third (36%) of the total reconstruction and recovery needs. This was followed by the social protection sector with recovery needs estimated at US\$763 million (or 20% of total allocated funds). The remaining three sectors - the productive, governance, and social development sectors - were allocated US\$602 million (16%), US\$581 million (15%), and US\$546 million (14%) of the DNA estimated total recovery needs respectively.

⁵⁹ See *Detailed Needs Assessment (DNA) and Recovery Framework*, p. 32.

B. GAZA PRIVATE SECTOR: DAMAGE, LOSSES AND RECOVERY NEEDS

Gaza's productive sector was the second highest sector to incur damage and losses during the 2014 hostilities. According to DNA calculations, total *direct* damage to private sector physical assets was estimated at US\$418 million, while *indirect* losses due lost income and business opportunities as a result of the war reached US\$451 million, bringing the sector's total figure of both damage and losses to US\$869 million. This is about 28% of the overall cost of war to Gaza's economy as estimated by the DNA.



Table (2)

	Damages	Losses	Recovery Needs
Agriculture	266	284	297
Non-Agriculture	144	136	301
Tourism	8	0	1
ICT	0	31	3
Total	418	451	602

Source: *Detailed Needs Assessment (DNA) and Recovery Framework*, p. 141.

Within the productive sector, as shown in Table (2), agriculture was the most affected sector by the 2014 war, with total damage and losses estimated by DNA at US\$550 million (US\$266 million for the damage and US\$284 million for the losses). According to DNA, "agricultural losses were steep, as was widespread destruction of cultivated land, greenhouses, livestock and poultry farms, water wells, irrigation networks and other productive assets. Fishermen lost equipment and were denied access to the sea during and after the war, devastating their earning capacity and making their households highly food insecure."⁶⁰ Manufacturing and small non-agricultural businesses were the second highest areas within the productive sector to be affected by the war. Damage and losses were estimated at a total of US\$280 million (US\$144 million for damage and US\$136 million for losses). DNA estimated that "over 5,420 [non-agricultural] facilities were affected, with greatest impact amongst the smallest business owners and 29,299 jobs were put at risk by the crisis."⁶¹ Other businesses within the productive sector, like tourism and ICT, were also affected by the war, albeit to a lesser degree.

Somewhat similar results were obtained from a comprehensive survey, conducted in the immediate aftermath of the war, by the Ministry of National Economy in collaboration with the Palestinian Federation of Industries, Gaza's Chamber of Commerce, and Businessmen Union, with the support from UNDP. A total of 5,519 establishments were surveyed to assess the damage and losses sustained by non-agriculture private sector facilities.⁶² Of the surveyed facilities, 84% were small businesses (with asset value under US\$30,000); 10% were medium enterprises (with asset value between US\$30,000 and US\$100,000); and 6% were large businesses (with asset value above US\$100,000). The outcome of the survey revealed direct damage of US\$187 million (which included value of damages to buildings, infrastructure, raw materials, finished products that were in inventory and were destroyed, equipment, and furniture), and indirect losses of US\$86 million (which included salaries and other benefits that different business owners paid to staff during the crisis, despite the suspension in activities). This brought the total cost, both direct and indirect, to US\$273 million, an estimate that is 15% lower than the DNA figure for the total damage and losses incurred by the non-agricultural sector.⁶³

A more recent survey of Gaza's private sector was conducted by UNDP in mid-2016. The last section of this Chapter, along with the report annex, will present a summary of the survey main findings.

⁶⁰ See *Detailed Needs Assessment (DNA) and Recovery Framework*, p. 27.

⁶¹ *Ibid.*, p. 27.

⁶² See UNDP/PAPP, *Strategic Programme for Livelihoods and inclusive economic growth through Employment Creation, Micro Enterprise Recovery & Private Sector Development for Gaza* (no date).

⁶³ The apparent discrepancy between the DNA and UNDP-supported post-war survey figures for the estimated total damage and losses incurred by the non-agricultural private sector establishments could be explained by two things. First, the number of businesses in the UNDP-supported survey is higher than the DNA survey by about 100 establishments; this could, although not necessarily, account for the higher value of the direct damage estimate in the former (at \$187 million) compared with the latter (at \$152 million). Second; unlike the DNA survey, the UNDP-supported survey for the non-agricultural sector losses did not seem to account for "lost future income opportunities; hence the lower estimate of these losses in the latter (at \$86 million) than the former (at \$167 million).

C. GAZA RECONSTRUCTION THREE YEARS LATER: TOO LITTLE, TOO SLOW?



Less than two months after the end of the 2014 hostilities, on 12 October, a major international conference was held in Cairo to mobilize international financial resources to support the recovery and reconstruction of Gaza.⁶⁴ Participants pledged a total of US\$5.4 billion for the State of Palestine, of which US\$3.5 billion were earmarked for Gaza over a three-year period: 2014-2017.⁶⁵ Donors were asked to channel their financial contributions through the Palestinian government's "single treasury account" in order to empower the Palestinian Government of National Consensus in Gaza. The whole recovery and reconstruction process was to be conducted under the newly established "Gaza Reconstruction Mechanism" (GRM), a UN-brokered temporary agreement between Israel and the Palestinian government, reached in September 2014, to facilitate and monitor the import of essential goods and building materials (otherwise restricted from entry to Gaza since they are considered by Israel as "dual-use" items) needed for post-war reconstruction and recovery.⁶⁶

Three years after the hostilities, however, Gaza reconstruction, despite reported significant progress made in housing and infrastructure repairs,⁶⁷ is proceeding slower than planned and falling behind schedule. As of 31 December 2016, the latest update from the World Bank indicates that only 51% (US\$1.769 billion) of the US\$3.5 billion pledged for Gaza at the Cairo Conference has been disbursed. Of the disbursed funds, only US\$670 million, or 17% of the DNA's US\$3.875 billion reconstruction and recovery programme, were allocated to finance priority needs in five identified sectors affected by the 2014 war.

Only US\$16 million, as Figure (6) shows, were allocated to meet recovery needs of the productive sector. While the Cairo pledges do not represent the only funding stream for reconstructing Gaza, the dismal \$16million allocated by Cairo Conference donors for Gaza's productive sector – just 3% of the US\$602 million estimated by DNA for the recovery needs of that sector – demonstrate the low priority given by donors to this sector, despite its critical role in building a strong, resilient and sustainable Gazan economy. Given the extensive damage and losses it has sustained, and its crucial role in short-term recovery and long-term growth and development, the productive sector in Gaza is yet to receive the commensurate share of the donor funds that are earmarked for Gaza reconstruction.

⁶⁴ See, *Conclusions by the Chair, Cairo Conference on Palestine: Reconstructing Gaza* (Cairo, 12 October 2014).

⁶⁵ Of the \$3.5 billion total pledges that were intended for Gaza reconstruction, only 72%, or \$2.5 billion, came in new funding. The remainder sum, close to \$1 billion, was a combination of existing commitments (\$315 million), reallocation of existing commitments (\$477 million), and assistance disbursed during the conflict (\$194 million). See World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (27 May 2015), p. 27.

⁶⁶ GRM began operation in October 2014. For more on the GRM, see Office of the UN Special Coordinator for the Middle East Peace Process, *Gaza Reconstruction Mechanism: Fact Sheet* (October 9, 2014). Also see GRM website (<http://grm.report/#/>)

⁶⁷ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (May 4, 2017), Annex 2, pp. 30-33 United Nations, *Gaza: Two Years After*, United Nations Country Team in the State of Palestine (August 26, 2016), p. 4.

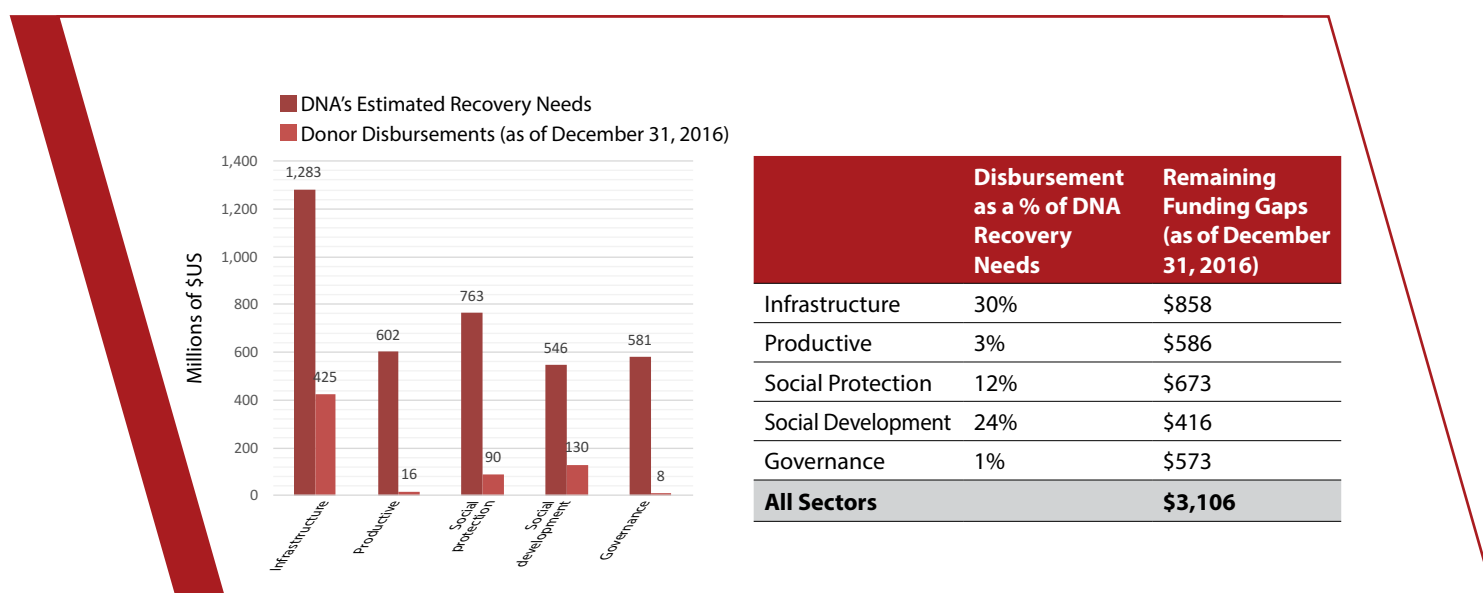
Alarming, a comparison between the actual amount of donor funds disbursed, and the magnitude of the DNA's recovery needs that were met as of 31 December 2016 shows that the Gaza reconstruction and recovery process remains grossly underfunded, and that progress in meeting recovery needs in the DNA's five sectors has been largely uneven, and large funding gaps still remain (Table 3).

More alarmingly still, is the fact that of the US\$1.769 billion disbursed funds, only 37.3% (US\$670 million), as shown in Figure (6), went to finance the DNA programme. The remaining 62.7% of the disbursed funds, close to US\$ 1.126 billion, were allocated to other uses in areas outside the DNA.⁶⁸

Figure (6) - Table (3)

DNA'S SECTORAL RECOVERY NEEDS, ACTUAL DONOR DISBURSEMENTS, AND REMAINING FUNDING GAPS

(in millions of \$US, unless otherwise stated)



Two reasons are usually cited to explain the slow pace of Gaza reconstruction and recovery process:

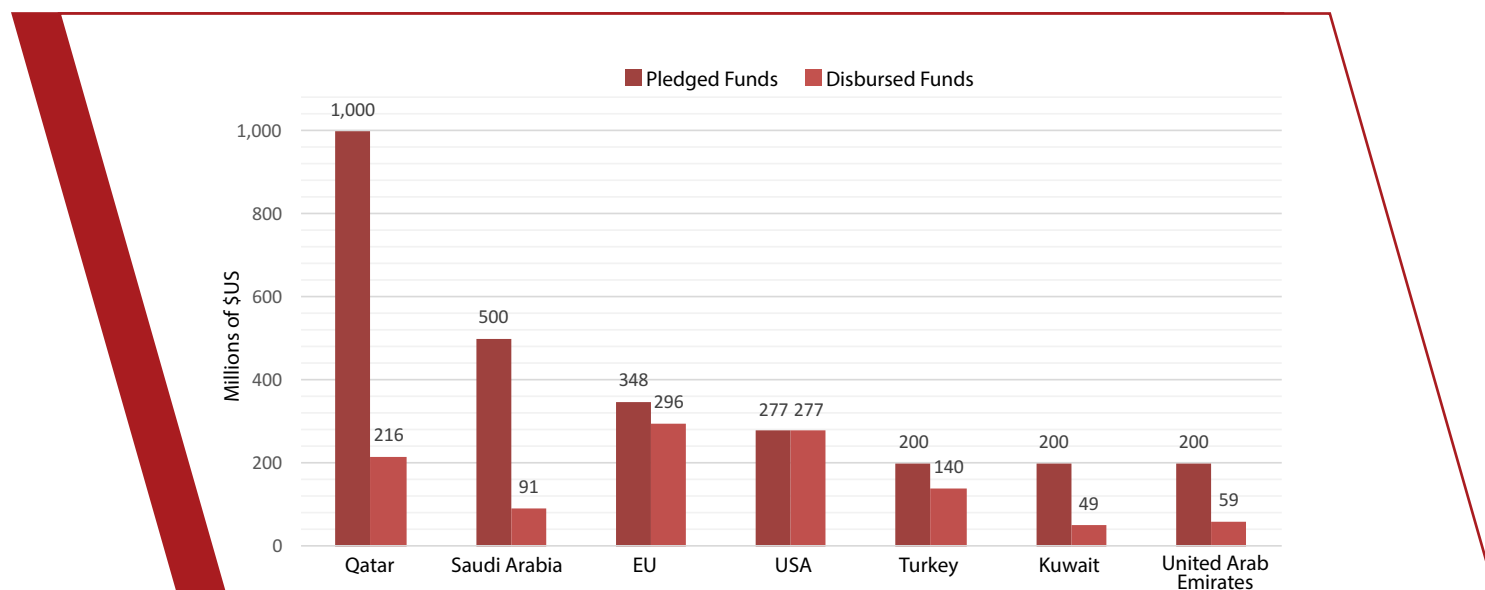
(1) Except for the US, EU and Turkey (three relatively big donors, with a disbursement to pledges ratio of 100%, 85% and 70%, respectively), other big donors are not fully delivering on the pledges made at the 2014 Cairo Conference. Over half (54.3%) of the US\$3.5 billion financial pledges made in support for Gaza reconstruction over the 2014-2017 period, came from four oil-rich Arab Gulf countries: Qatar (US\$1 billion), Saudi Arabia (US\$500 million), Kuwait (US\$200 million), and United Arab Emirates (US\$200 million). As of 31 December 2016, however, disbursement ratios for these four countries, respectively, were estimated by the World Bank at 22%, 18%, 25%, and 30% of their Cairo conference pledges.⁶⁹ (See Figure 7)

⁶⁸ According to the World Bank latest update of 4 May 2017, the remaining \$1.126 billion of the disbursed funds were allocated outside the DNA framework as follows: \$336 million for budget support; \$280 million for humanitarian and emergency aid; \$293 million for UNRWA General Fund; \$86 million for fuel, and \$131 million for other purposes.

⁶⁹ World Bank, Economic Monitoring Report to the Ad Hoc Liaison Committee (19 September 2016), p. 33.

Figure (7)

GAZA RECONSTRUCTION:
Pledges vs. Disbursements by Big Donors
(in millions of \$US; as of December 31, 2016)



Source: World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (May 4, 2017), Annex 2, pp. 30-33

(2) The entry of essential goods and building materials from Israel, through GRM, has not been sufficient to meet reconstruction needs as identified by the DNA.⁷⁰ Moreover, construction materials that fall under the “dual-use” list system require the approval of Israel to be allowed entry into Gaza; a process that takes time causing significant delays. In this regard, the World Bank reported that, two years after the war, only two-thirds of the reconstruction materials required for repair of the houses damaged during the war has been imported through GRM.^{71,72} Furthermore, construction materials needed to rebuild the houses that were totally destroyed during the war, construction of additional new housing units to meet the natural population-growth-driven increase in demand,⁷³ and rebuilding and repairing war-fuelled destruction and damage in other sectors, mainly infrastructure projects, are all still more difficult to import through GRM.⁷⁴

A third reason, often not mentioned, but highly significant in the case of Gaza, is the presence of other areas outside the DNA framework that strongly compete for a share of the pledges made at the Cairo conference.⁷⁵ To a large extent, this is a reflection of the continued deepening of Gaza’s socioeconomic and humanitarian crises and the desperate need for donor funds to mitigate their harsh impact on the population.

⁷⁰ Israel has total control over the operation of GRM – and hence, over each and every project related to the reconstruction of Gaza, whether managed by the private sector or by international organizations – in four major areas: what projects could be built and where; the quantities of building materials needed for each project (by deciding “the ratio of cement, steel and gravel needed to build each square meter of the project”); who is authorized to purchase them; and the surveillance standards in warehouses storing construction materials. See, Gisha, *Two years later: The long road to reconstruction and recovery* (August 21, 2016), p. 2.

⁷¹ World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee* (19 September 2016), p. 27. In a news conference held in Gaza city on October 17, 2016, the director of operations for UNRWA in the Gaza Strip, Bo Schack, mentioned that “Israel hasn’t yet approved a list of names of Gaza citizens submitted in May 2015 whose houses have been damaged during Israeli military offensives and need construction.” See Ma’an News Agency, UNRWA official warns of ‘increasing frustration’ in Gaza Strip (OCT. 17, 2016).

⁷² According to OCHA, “The amount of construction materials imported via the Gaza Reconstruction Mechanism (GRM) in April-September 2016 was nearly half the amount in the previous six months.” See OCHA, *The Gaza Strip: The Humanitarian Impact of the Blockade* (November 2016), p. 1.

⁷³ Construction materials not only are needed for new housing units, but also to meet the increase in demand for other social infrastructure facilities. Gaza, for instance, needs at least 20 new schools each year just to keep pace with the population growth, yet only 20 schools have been built since 2008. As a result, 67% of government schools and 75% of UNRWA-run schools have been operating in double shifts during the 2015/2016 year. See OCHA, *The Monthly Humanitarian Bulletin* (September 2016), p. 7.

⁷⁴ As of July 2016, out of the 969 projects that were submitted through GRM, projects completed represented 7% of the residential projects, 23% of the infrastructure projects, 13% of the commercial projects, and 5% of industrial projects. See Shelter Cluster Palestine, *Construction Material Tracking for Gaza July 2016* (August 8, 2016), p. 5.

⁷⁵ See footnote no. 66.

D. UNDP 2016 SURVEY OF GAZA PRIVATE SECTOR

During summer 2016, UNDP conducted a new survey of the non-agricultural private sector establishments in the Gaza Strip. The main goals of the survey were (1) to update the information obtained from a similar survey that was conducted in the immediate aftermath of the 2014 war concerning a damage assessment;⁷⁶ (2) to track progress, or lack thereof, in addressing the sector's reconstruction and recovery needs, including the international financial assistance provided to Gaza's private businesses; (3) to conduct a "before-and-after-the-war" comparison to assess the changes that took place in a number of business-related indicators (namely, employment, production/sales, capital investment, and exports); and (4) to procure a new assessment of the current state of business establishments two years after the war.

This section provides a quick description of the survey data, the sectors and sub-sectors covered, and the various indicators assessed in the survey. This will be followed by a summary of the survey main findings, and ends with a brief analysis and implications of the survey results. A number of illustrative charts and figures of the survey findings are presented in the report Annex.

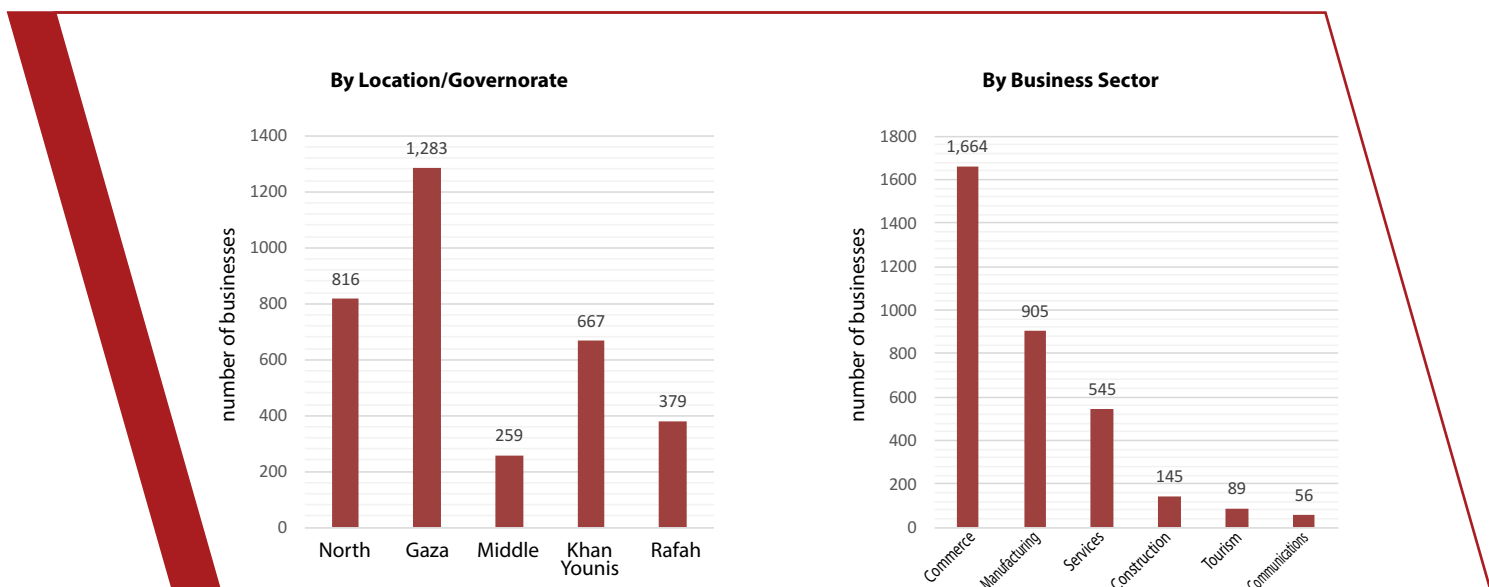
1: DATA, SECTORS, AND INDICATORS

The survey was conducted between 31 July and 10 September 2016, and covered a total of 3,404 war-affected businesses in five governorates across the Gaza Strip as follows (see Figure 8): Gaza (1,283 establishments), North area (816), Khan Younis (667), Rafah (379), and the Middle area (259). The surveyed businesses covered six sectors: commerce (1,664 establishments), manufacturing (905), services (545), construction (145), tourism (89), and communications (56). The first three sectors represented 91% of all surveyed businesses, with the commerce sector, at 49% of the total, ranking the highest, followed by manufacturing sector (27%) and services sector (16%).

Figure (8)

GAZA PRIVATE SECTOR BUSINESS SURVEYED:

Sectors Affected by the 2014 War
(total number = 3,404 enterprises)



Of the surveyed businesses:

49% were in commerce
27% were in manufacturing

16% were in service
4% were in construction

3% were in tourism, and
2% were in communication

⁷⁶ See the last paragraph of Section B in this Chapter



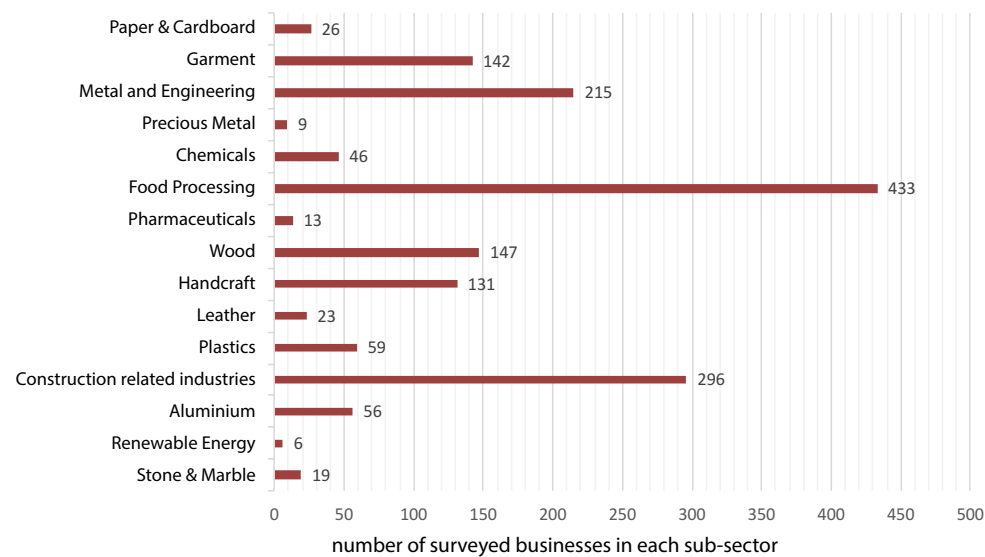
The survey also covered 15 industrial sub-sectors, with a total of 1,636 enterprises, representing 48% of the 3,404 total surveyed businesses (See Figure 9). Three sub-sectors dominated the survey: food processing (434 firms), construction-related industries (297), and metal and engineering enterprises (216), representing respectively, 26.5%, 18.2%, and 13.2% of the total sub-sector establishments.

The new survey focused on a number of business-related indicators in order to assess the change in their status and how this has affected the state of Gaza's private sector two years after the war. These indicators included (1) new assessment of the monetary value of war-caused inflicted damage and losses, (2) the type of damage/physical destruction incurred (total, heavy, or partial), (3) the level of international financial assistance received, and the amount of bank financing obtained by damaged businesses (4) the changes in the size of production/sales of the surveyed firms, (5) changes in the values of business firms' capital assets of the damaged private establishments, (6) changes in private sector employment, both by number of employees hired and by gender, and (7) changes in the volume of exports and in the number of exporting firms.



Figure (9)

GAZA PRIVATE SECTOR BUSINESSES SURVEYED:
Industry's Sub-sectors Affected by the 2014 War
(Number of establishments = 1,621)





2: SUMMARY OF THE MAIN FINDINGS

Below is a summary of the survey's main findings, organized by the type of the indicators used in the assessment. These findings, however, need to be viewed with caution due to problems related to the presence of few data gaps, errors and inconsistencies in the conducted survey. As such, the survey findings should be treated as indicative of the size and scope of the existing post-war damage and losses sustained by the Gaza private sector, and of where operational decisions concerning priorities for reconstruction and recovery should be focusing.

(a) Findings concerning damaged sectors and damage type:

Out of the 3,404 non-agricultural private sector establishments surveyed, 1,778 (52.2%) businesses were totally damaged, 1,172 (34.4%) sustained heavy damage, and 454 (13.4%) were partially damaged (Chart 3 in the Annex). Furthermore, of the 1,178 totally damaged businesses, 914 (51%) and 446 (25%) enterprises, respectively, were from the commerce and manufacturing sectors. These same two sectors accounted for 551 (47%) and 325 (28%), respectively, of heavily damaged businesses. Tourism and communications sectors were the least affected by war damage, both totally and partially. Service sector war-inflicted damage was somewhere in between these four sectors (Chart 3 in the Annex).

In addition to the damage sustained by private sector establishments during the 2014 hostilities, a number of surveyed businesses also reported incurred physical damage in the previous wars of 2008/2009 and 2012 (Chart 4 in Annex). Survey results show that out of 3,404 firms, 923 (27%) had incurred damage in both 2008/2009 and 2012 wars; 561 (16%) were exposed to damage during the 2008/2009 war; and 808 (24%) had been damaged in 2012 war. The rest of the surveyed businesses, 1,112 (33%) reported no damage in previous wars. Moreover, in the aftermath of the 2014 hostilities, 1,563 (46%) of the damaged enterprises surveyed were able to resume operation even before receiving any financial compensation, while the rest of the damaged businesses, 1,841 (54%) were not able to operate before getting financial assistance (Chart 4 in the Annex).

(b) Findings concerning the value of the damage sustained:

Survey results show that the total value of damage reported by 3,109 enterprises amounted to US\$164.4 million (Chart 5 in the Annex). Chart 5 also shows that 1,672 (54%) of the surveyed businesses reported damage of less than US\$10,000 each; 637 (21%) enterprises reported damage between US\$10,000 and US\$20,000 each. A smaller number of firms, 81 (3%), reported damage between US\$100,000 and US\$200,000 each, while 52 (2%) establishments reported damage between US\$200,000 and US\$500,000 each. The rest of enterprises, 5 in total, reported a much higher value of sustained damage; 3 of them estimated the inflicted damage between US\$0.5-1 million each, and 2 firms reported damage between US\$10-20 million each.

As would be expected, the largest losses were incurred by larger businesses, who presumably had more specialist equipment or large-scale premises vulnerable to war damage than smaller scale businesses. More specifically, Chart 6 shows that there are huge differences between private sector firms concerning war damage. While, for instance, only 20 establishments (0.6% of total number of surveyed businesses) accounted for close to 50% of the total damage to Gaza private sector [the last three columns in Chart 6], 92% of reporting establishments (2,848 businesses) accounted for only 20% of total damage [the first 4 columns of the Chart].



(c) Findings concerning financial compensation/support:

Survey results show that out of the 3,404 private sector businesses that have sustained damage during the 2014 war, only one-third, 1,157 units, have received some sort of financial compensation, while 2,248 (66%) damaged enterprises reported receiving no financial assistance (Chart 7 in the Annex). Furthermore, the total amount of financial aid/compensation received by the 1,157 firms was estimated at US\$5.67 million: less than a quarter (or 24%) of the US\$23.18 million total value of damage sustained by them. Only 789 (68%) of the establishments that received compensation were able to resume operations after that.

Survey results also showed that while 25% of the businesses (864 units) received financial compensation of less than US\$5,000 each, two businesses received a relatively large amount of financial support: one received US\$170,000 and the other US\$879,000. Most firms, as shown in Chart (8) in the Annex, spent the financial assistance they received in five areas: damage repair (28%), equipment maintenance (16%) raw material purchase (12%), and operating expenses (12%), with 20% of the assistance obtained spent on a combination of all these expenses. Critically, the total paid compensation reported by businesses was equivalent to just 3.4% of the estimated damages reported by the 3,404 surveyed businesses, which was estimated at US\$164.4 million.

(d) Findings concerning damaged firms' resort to bank financing:

According to the survey findings, only 7% (238 businesses) out of the 3,404 total firms have used domestic banks' financing in the aftermath of the 2014 war, while the remaining 93% (3,166 damaged establishments) did not utilise such a facility (Chart 9 in the Annex). Total bank credit obtained by damaged firms amounted to US\$13.8 million, representing 8.4% of the estimated \$164.4 million total damage for the whole non-agricultural private sector businesses. Survey results also showed that 46% of the damaged businesses that accessed bank financing have obtained loans ranging from \$5,000-\$10,000 each, with other 22% receiving credit ranging from \$10,000-\$50,000.⁷⁷ Four damaged enterprises obtained bank loans exceeding \$1 million each. Finally, most firms, as shown in Chart (10) in the Annex, spent the bank loans they obtained in five areas: purchase of raw material (23%), damage repair (16%), equipment maintenance (11%), and operating expenses (10%), with 33% of bank credit spent on a combination of all these expenses.

A quick comparison between financial compensation and bank financing reveals that most damaged firms that received some sort of compensation have spent it on damage repair and equipment maintenance, while those firms that obtained bank loans have spent them to buy raw material and to repair damage so as to enable them to resume operation.

⁷⁷The calculation here excluded bank loans below \$5,000; hence total number of business establishments that is reported to have obtained bank loans (117 firms) is about half of those businesses that actually applied and got loans (238 firms) according to the survey data.

***(e) Findings concerning changes in sales and stock of capital assets:***

The survey findings also showed a hefty drop in damaged businesses' sales and in the value of their capital assets. This is done by comparing these two variables over two periods of time, before and after the 2014 war (Chart 11 in the Annex). As for sales, the findings of the survey showed that business sales revenues in the first quarter (Q1) of 2016 were 43% of the sales figure recorded in Q1/2014, a sizable drop of 57% (from US\$236 million to US\$101 million), and a loss in sales of US\$135 million. As for the changes in damaged establishments' stock of capital assets, the survey results showed that between 2014 and 2016, the value of businesses' capital assets plummeted by almost half, from US\$655 million to US\$334 million, a drop of 49%, or US\$320 million.

(f) Findings concerning the total changes in, and gender composition of, employment in affected businesses:

The same "before-and-after-the-war" comparison was conducted to gauge the impact of the 2014 hostilities on total employment and on the gender composition of employment in the damaged businesses (Chart 12 in the Annex). As for the first variable, survey findings showed that two years after the war, total employment (males and females combined) in surveyed businesses dropped by 62.3%, from 66,796 employed workers before the 2014 war to 25,286 workers two years after the war. As for the changes in gender composition of hired workers, the survey results revealed that female *share* in total employment has *increased*, from 21.3% in 2014 to 43.5% in 2016, while male share dropped, from 78.7% to 56.5% over the same period. This finding, however, needs to be viewed with a caveat, since the *absolute* number of females in total employment in the surveyed businesses had dropped by 23%, from 14,235 workers before the war to 10,951 workers two years after the war.

(g) Findings concerning changes in export values and in number of exporting businesses:

A similar "before-and-after-the-war" comparison concerning the change in total exports sales and in the number of exporting businesses revealed a sharp decline in the damaged businesses exports potential as a result of the 2014 hostilities (Chart 13 in the Annex). The survey findings concerning the first indicator showed that the value of total exports of firms covered in the survey dropped from US\$48.21 million before the war to US\$20.45 million two years after the war, a drop of 57.6%. A larger decline in the number of Gaza exporting businesses was also shown by the survey findings, where this number dropped from 385 firms before the war to 133 firms two years after the war, a drop of 65.5%.



3: BRIEF ANALYSIS AND IMPLICATION OF THE SURVEY FINDINGS

The findings of the UNDP survey as summarized above vividly show that Gaza private sector capabilities have been severely degraded by the 2014 hostilities, and that financial compensation received by damaged business was only a tiny fraction of the total damage sustained, and hence, was grossly inadequate to help usher in the much needed recovery.

This continued downgrading of Gaza business capabilities has reflected itself in a number of ways: a sharp reduction in post-war stock of capital assets and in business sales; a persistent fall in private sector employment, both in number and in gender; and a large drop in private sector export potential, both in export volume and in the number of exporting firms. These ruins wrought by the 2014 hostilities came on top of an already failing private sector in Gaza, battered by years of continued stringent restrictions on movement, access and trade, and by a stifling economic blockade that has been in place since mid-2007.

The results of the survey thus provide a strong reminder of the urgent need for donors to accelerate short-term financial assistance, bring meaningful and sustained change to Gaza's highly stressed business climate, and to break away with past ineffective policies, in order to save Gaza's private sector. These three broadly-stated implications of the recent UNDP survey findings will be further elaborated on in the remaining two chapters of this report. The next chapter will present an extended analysis of the problems and bottlenecks that are crippling private sector operations in Gaza, while the concluding chapter proposes a different approach to Gaza's continued economic calamity.



CHAPTER





Gaza's Private Sector: **Analysis of Major Problems and Bottlenecks**



The future of the Gaza Strip economy depends on building a vibrant private sector, fully integrated with the rest of the Palestinian areas (West Bank, including East Jerusalem), and efficiently operating in a highly enabling business environment. For that to happen, Gaza freedom of movement of people and trade, in and out of coastal strip, need to be secured, its use of national economic resources unrestricted, and its access to domestic, regional, and world markets unhindered. It will also depend on having close and mutually rewarding business connections with the much stronger, well-developed, and technically advanced Israeli economy.

In light of today's bleak reality, and what has become of the Gaza economy and its private sector over the past decade, the above statement seems to be a very tall order. The current catastrophic conditions in Gaza desperately require sustained action in order to slow, stop, and eventually reverse the decline in real-terms of Gaza's economy. The continuation of *ever-deteriorating* economic conditions will only take Gaza closer to the abyss. Without a political resolution and a new approach to rebuilding and recovering Gaza's private sector, it seems inevitable that socioeconomic conditions in Gaza will only get worse.



Gaza's population is very young (43.7% are under the age of 14),⁷⁸ and is growing annually at 3.3% (one of the highest growth rates in the world). Its labour force is growing even more rapidly, increasing at 4.5% a year, and adding close to 35,000 new entrants annually to the job market, a figure that is expected to grow higher and higher each year due to the youth bulge in Gaza's population. A 2012 IMF analysis of Palestinian labour market trends showed a one-to-one direct correlation between economic growth and employment opportunities, i.e. a 1% increase in economic growth will lead to a 1% increase in employment.⁷⁹ Based on this finding, Gaza's economy has to grow by at least 4.5% a year just to absorb the annual additions to its workforce. More output growth will be needed in order to reduce the already dangerous unemployment rate, currently standing at 40.6% (close to 56% among the youth, aged 15-29).⁸⁰ Gaza's economy, however, has been virtually stagnant over the past decade, with average annual GDP growth during the period 2006-2016 not exceeding 1.44% (see Figure 1 in Chapter 2). During the same period, Gaza population grew by 38.4%, adding an estimated 350,000 new workers to the labor force. These hard statistics explain the reasons behind the continued rise in Gaza's unemployment since 2006, especially among the youth, along with the continued deterioration in living standards of the population. The current conditions are unsustainable. Something must change, and fast, in order to avoid an impending collapse.

Reconstruction and recovery alone, even if both are carried out successfully (a far-fetched assumption, given the current pace of rebuilding, the grossly underfunded DNA programme, and the continued internal and external constraints under which reconstruction is taking place), will, at best, bring Gaza back to where it was on the eve of the summer 2014 hostilities, itself already a highly unsustainable situation as mentioned above.

The challenge now facing the international community and its Palestinian counterparts is to initiate a significant strategic shift in the current thinking about the economic future of the Gaza Strip. Focusing on the private sector holds potential for preparing Gaza to go beyond reconstruction and short-term recovery, into medium- and long-term growth and development. This strategic shift is consistent with the "Building Back Better" principle; one of many guiding principles in the implementation of the DNA programme. The analysis in this chapter, therefore, intends to complement the work that has been done in the DNA framework, and to take it a step further towards the eventual development of a strong, vibrant, private sector-led economy in Gaza.

To that end, this chapter, and the next, take the discussion about Gaza's economy and its private sector from the standard questions of "what happened three years after the 2014 hostilities?" and "what has been accomplished so far?" to the more central and substantive question of "what could, should, and needs be done in order for short-term recovery to be attained, and for medium- and long-term growth and development to be at all possible?" In an attempt to answer this complex question, and as a first step in building a deeper understanding of what must be done to enhance the quality of Gaza's business environment, this chapter provides a preliminary analysis of the binding constraints and bottlenecks facing the current business climate in Gaza.

The analysis is based on data and information made available to the author from workshops, interviews, and surveys conducted by UNDP between March and July 2016. These meetings and data-gathering activities included representatives from five key sectors: agriculture and fishing; industry; information technology; tourism; and contracting. Within the industrial sector, representatives from the following 10 sub-sectors were consulted: food processing, metal and engineering, aluminium, renewable energy, leather, construction, wood and furniture, plastic, pharmaceutical, and paper and cardboard.⁸¹ The paper also benefited, among other relevant sources, from the latest World Bank report on "Investment Climate Assessment" in Palestine.⁸²

78 PCBS, *On the Eve of the International Population Day 11/07/2012*, p. 1.

79 IMF, *West Bank and Gaza: Labor Market Trends, Growth and Unemployment* (December 2012).

80 PCBS, *Labor Force Survey (October-December, 2016), Round (Q4/2016)*, February 13, 2017.

81 The proceedings of March 2016 workshop is summarized in two UNDP reports: (1) *Managing risks: Towards employment and economic development in Gaza* (Gaza, 30 April 2016), and (2) *Economic Recovery and Development in the Gaza Strip* (July 26, 2016).

82 World Bank, *West Bank and Gaza Investment Climate Assessment: Fragmentation and Uncertainty* (Washington, D.C., September 2014).



A. GAZA PRIVATE SECTOR: A QUICK SNAPSHOT

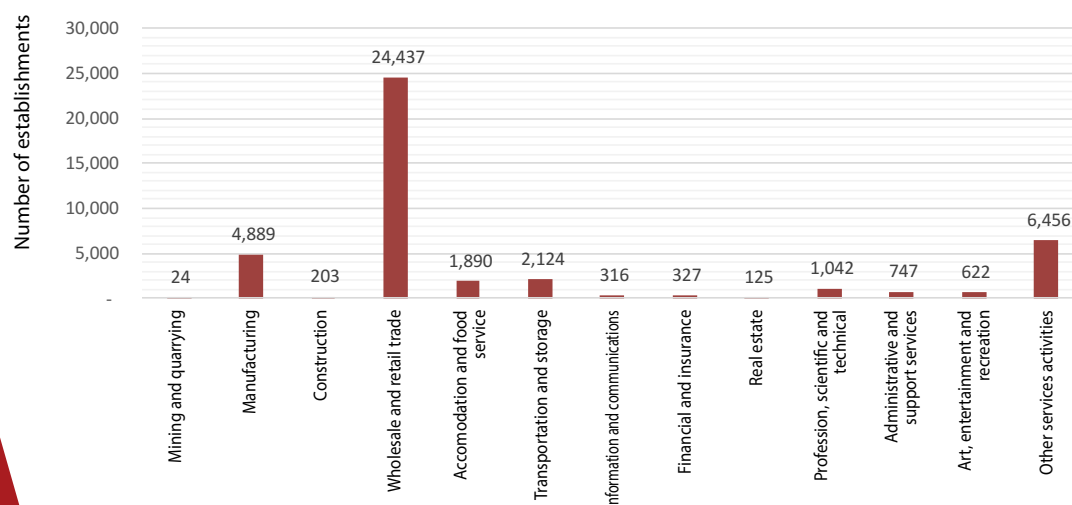


By tradition most firms in Gaza are family owned and family operated, and largely engaged in trade and services oriented activities. In 2012, the latest year where a survey about Gazan businesses was conducted by the Palestinian Central Bureau of Statistics (PCBS),⁸³ the survey found that over half (56.6%) of all business establishments were operating in wholesale and retail trade, 11.3% were operating in manufacturing sector, and the rest, 32.1%, were engaged in the service sector (see Figure 10).

Figure (10)

NUMBER OF NON-AGRICULTURAL ESTABLISHMENTS IN THE GAZA STRIP BY MAIN ECONOMIC ACTIVITY, 2012:

(Total number = 43,202 establishments)



Source: Palestinian Central Bureau of Statistics, Establishments Census Atlas of Palestine 2012 (November 2013)

⁸³ See Palestinian Central Bureau of Statistics, Establishments Census Atlas of Palestine 2012 (November 2013).

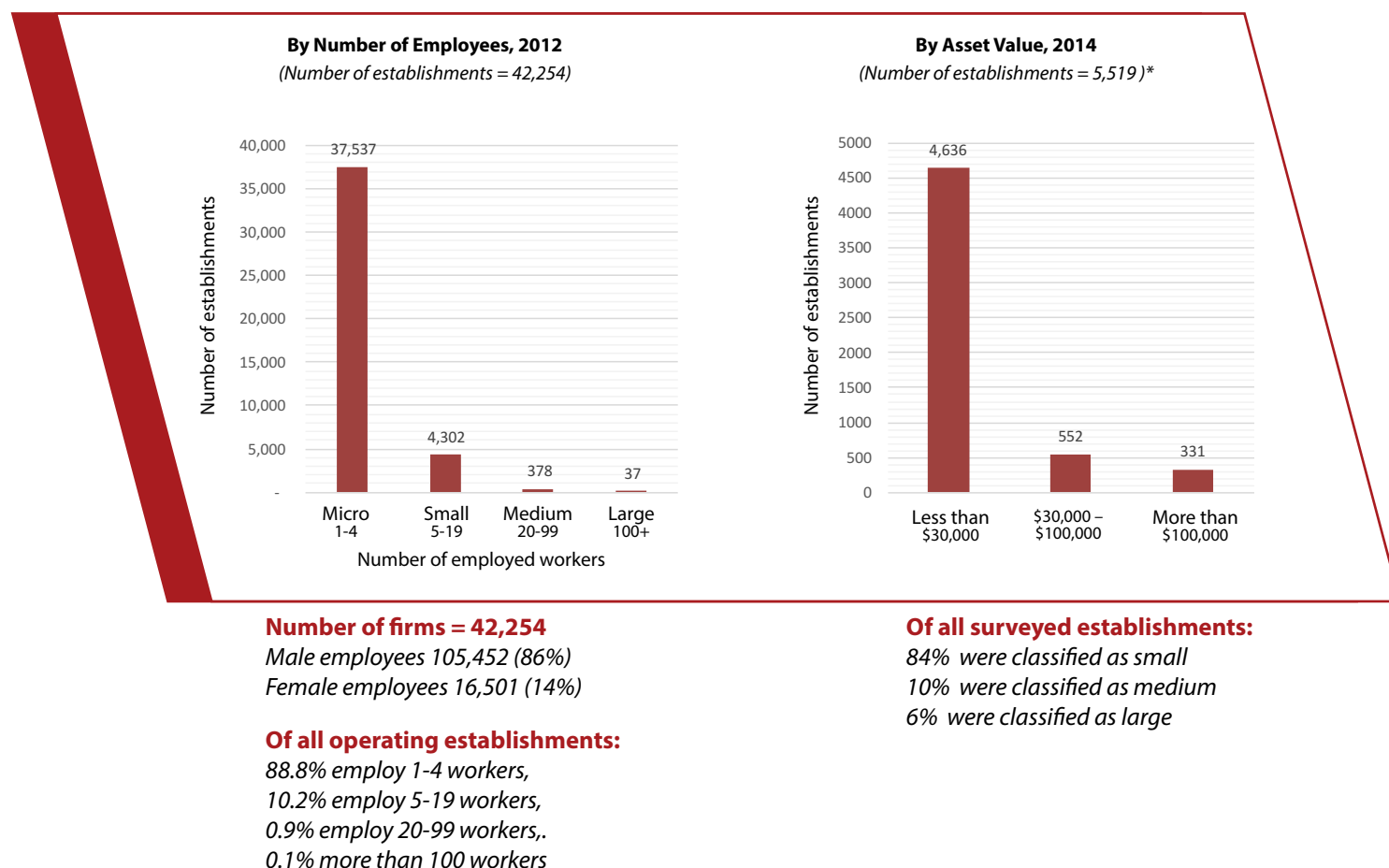
Furthermore, Gaza's business establishments are mostly small in size, both in terms of the number of workers they employ and the value of their assets. The same 2012 PCBS survey, for example, found that the overwhelming majority (88.8%) of all operating business establishments in Gaza were employing between 1-4 workers, with 8.1% having between 5-19 employees. Only 0.1% (37 establishments) employed over 100 workers (See Figure 11). As for assets value, a recent survey supported by the UNDP in the context of damage assessment after the 2014 hostilities revealed that 84% of the surveyed establishments were small businesses with asset value under US\$30,000, 10% had asset value between US\$30,000 and US\$100,000, and only 6% had asset value above US\$100,000⁸⁴ (See Figure 11).

Another defining characteristic of Gaza's private sector businesses is their low level of labour productivity (i.e., value-added per worker), low capital intensity (capital units per worker), and low total factor productivity (a measure of firms' technical efficiency). In all three indicators, as the World Bank 2014 report on assessing investment climate in Palestine showed, Gaza firms compare far less favourably than their counterparts in East Jerusalem and West Bank.⁸⁵

Figure (11)

NON-AGRICULTURAL ESTABLISHMENTS IN THE GAZA STRIP :

by Number of Employees and Asset Value



⁸⁴See UNDP/PAPP, Strategic Programme for Livelihoods and inclusive economic growth through Employment Creation, Micro Enterprise Recovery & Private Sector Development for Gaza (no date).

⁸⁵World Bank, West Bank and Gaza, Investment Climate Assessment: Fragmentation and Uncertainty (Washington, D.C., September 2014), pp. 10-14.

B. ASSESSING GAZA BUSINESS ENVIRONMENT: METHODOLOGY AND ITS RATIONALE

The methodology used in the analysis of Gaza's business environment is adapted from the "Diamond Model" developed in 1990 by Harvard Business School professor Michael E. Porter in his landmark study on the determinants influencing the competitiveness of nations and companies.⁸⁶ The purpose of the analysis in this chapter, however, is *not* to examine how competitive Gaza's business environment is; rather, the model is utilized here to study the quality of this environment, identify existing constraints and key impediments, and ultimately pinpoint possible policy intervention measures that could improve overall business setting.

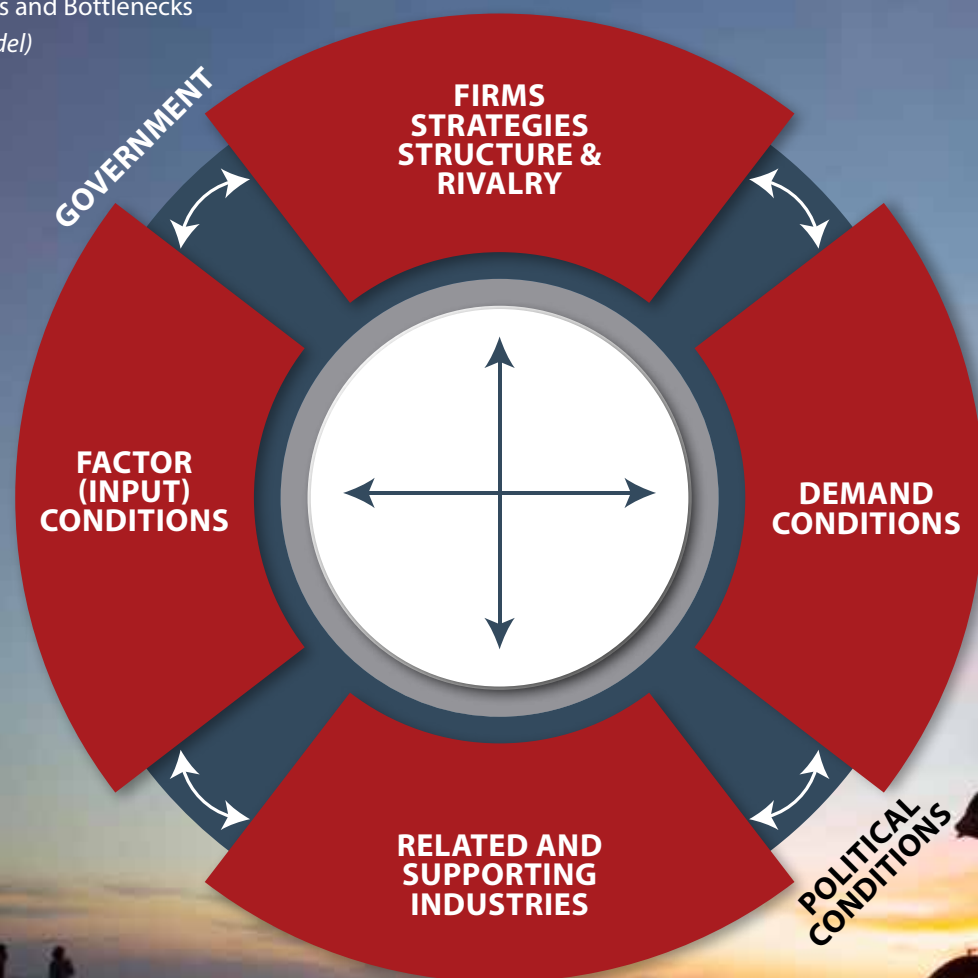
In the "Diamond model", Prof. Porter identified five main determinants that have the greatest influence on, and ultimately define and shape the quality of, the business environment in any country or firm (see Figure 12). These determinants are: (1) factor (or input) conditions, (2) the presence of related and supporting industries, or the cluster, (3) demand conditions, (4) firms' strategies, structure, and rivalry, and (5) the government role. Each determinant in the Diamond model affects, and is affected by, other determinants in the system, as represented by the direction of the arrows in the Figure (12) below.

Figure (12)

GAZA'S BUSINESS ENVIRONMENT:

Analysis of Problems and Bottlenecks

(The "Diamond" Model)



Note: To keep the Diamond figure simple, arrows pertaining to "Government" and "Political Conditions" determinants are not shown, but can be imagined going to other determinants.

⁸⁶ Michael E. Porter, "The Competitive Advantage of Nations," Harvard Business Review, March-April 1990.



All five determinants in the Diamond model will be examined in assessing Gaza's business environment. Given Gaza's unique situation, its battered economy, and the complex set of political constraints under which it has long been operating, a sixth "special" determinant is added to Porter's model. This extra determinant is related to Gaza's highly unstable "political conditions," and will be used to capture what the overwhelming majority of private sector agents in Gaza have cited as *the* key constraint on their ability to conduct business.

The use of the Diamond model as a tool of analysis in this chapter is justified on four grounds. **First**, the model has long been recognized as pioneering in its field, and has been used across the world as a powerful analytical tool to explain the degree of competitiveness of the private sector enterprises. **Second**, in the context of this report, the model represents a clear tool to layout the numerous challenges that delay short term recovery and hinder long-term growth and development, as diagnosed by Gaza's private sector leaders themselves in workshops and surveys conducted by UNDP. **Third**, the Diamond model's analysis and its related determinants can neatly reveal one or more areas of possible intervention measures by policymakers, national or international, independently or jointly in partnership with Gaza's private sector, in order to address weak aspects of the business climate. **Fourth**, if one is to look beyond short-term reconstruction and recovery, with an eye on Gaza's needs and requirements for strategic long-term growth and development, the Diamond model can be easily used to conduct an in-depth analysis of each one of Gaza's business sectors/sub-sectors in order to assess their existing conditions, gauge their future potential, and weigh their possible contribution to Gaza's long term prosperity. This is one of the study's key recommendations which will be further explained in the next chapter.

Before we move to the analysis, however, four things are important to keep in mind. **First**; the six determinants in the "Gaza's Diamond" do not all have the same degree of importance, or exert the same level of influence over private sector operations. This is so because in the context of the present-day Gaza Strip, the "political conditions" determinant seems to constitute the overwhelming constraint facing domestic entrepreneurs, followed by "factor conditions," "government role," and, to a lesser degree, "demand conditions". The remaining two components of Gaza's Diamond, namely the "strategies and structures" and the "related and supporting industries" determinants, do not play much of a crucial role, positive or negative, in influencing the business climate in Gaza, given the largely underdeveloped state of its private economy.

Second; in the case of Gaza, there seems to be a strong and direct link between "political" and "government" conditions on one hand, and the "factor" and "demand" conditions on the other, with the direction of influence running from the former to the latter. Such relationship between the two sets of determinants has implications for policy intervention in Gaza's business climate, as will be explained in different parts of this chapter. **Third**; the main goal of using the Diamond model in this study is to *highlight* the main constraints and bottlenecks facing Gaza's private sector, not to conduct an *in-depth* analysis of the Diamond's determinant conditions. As such, the discussion of the Gaza Diamond in this chapter will be brief, and mostly descriptive in nature, not a quantitative one, i.e., data pertaining to the Diamond's determinant conditions will be kept to a minimum. Furthermore, since Diamond analysis is intended to complement the DNA framework, the latter has already provided a detailed set of data on the pre- and post- war conditions of both infrastructure and productive sectors.

Fourth; the policy interventions suggested in the course of this chapter are by no means exclusive or exhaustive, and need to be viewed in the context of the DNA short- and long-term recommended policy interventions in the productive sector.⁸⁷

⁸⁷See DNA document, pp. 167-168 and pp. 170-171.





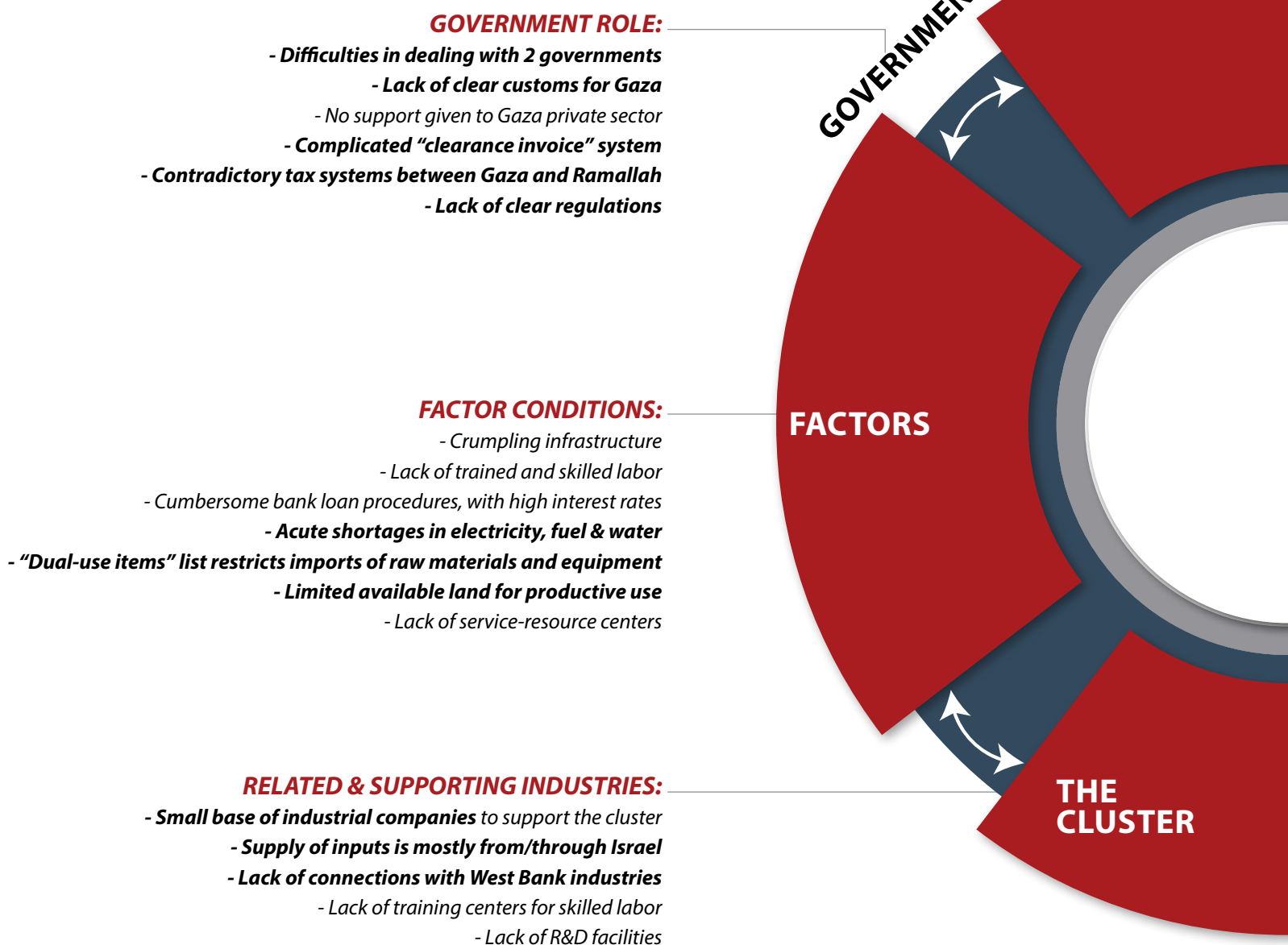
C. GAZA BUSINESS ENVIRONMENT: PROBLEMS AND BOTTLENECKS TO PRIVATE SECTOR GROWTH

Figure (13) below presents a bird's-eye view of Gaza's business Diamond, with the current state of conditions for each one of its six determinants briefly summarized based on the diagnosis made by a representative sample of private sector agents in Gaza during July 2016. The remainder of this chapter will take a closer look at the Diamond's determinants, one determinant at a time. In each case, we will explain what the determinant means, what its main components are, and how they affect the current business environment as indicated in recent local business surveys and workshops.

Figure (13)

GAZA'S BUSINESS ENVIRONMENT:

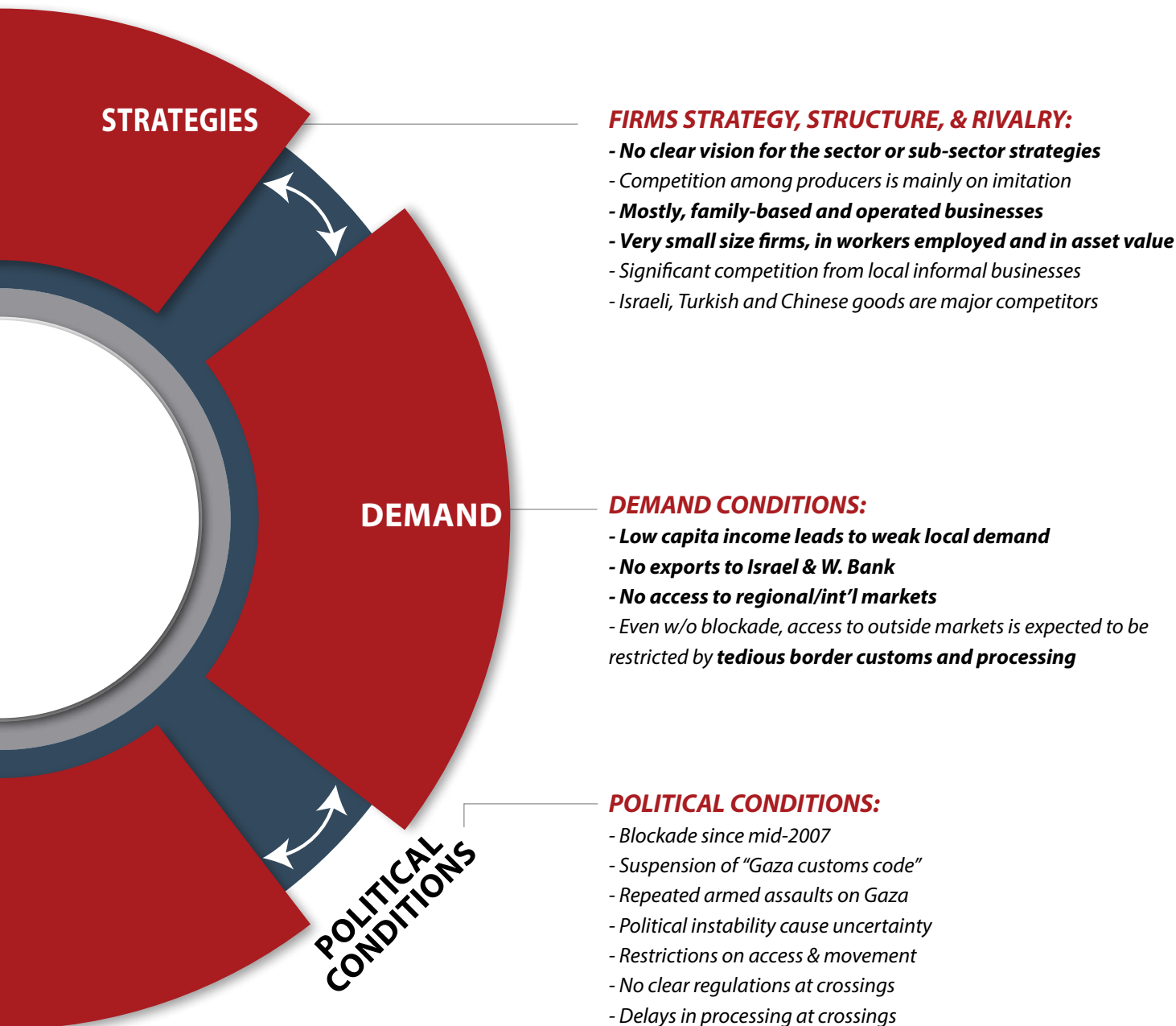
An Analysis of Problems and Bottlenecks*



* Items in bold letters indicate "caused by adverse political conditions"



Before proceeding, however, two things are worth noting. **First**; the discussion below will be very broad; determinant-related, rather than sector-specific, i.e., the focus will be on the state of determinant conditions, not on the type of the enterprises affected by them. **Second**; Gaza's private sector is not a monolithic block, and thus, operating enterprises are not affected to the same degree by the highly strained business climate.⁸⁸ Yet, in the grand scheme of things, the existing differences between businesses and how they are individually impacted by restrictions are *less significant* when compared to the overwhelming negative weight the various constraints have on the whole economy, regardless of the size, location, or type of business activity. Nonetheless, despite the current bleak business climate in Gaza there are some positive signs, one of which is the ascent Information and Communications Technology (ICT).⁸⁹ However, the overall picture is still one loaded with formidable constraints that result in very weak and poor business conditions as will be explained in some details in the rest of this chapter.



⁸⁸ The author is grateful to an anonymous reviewer for bringing up this point.

⁸⁹ Despite these positive developments, it is important to remember here that Israel continues to have total control over every aspect of the ICT sector in Gaza; from the supply of infrastructure, to the severe restrictions imposed on the entry of essential equipment and spare parts (defined by Israel as "dual-use" items), to access to 3G technology, to the control over communications networks. Frequent and lengthy outages in electricity delivery present an added serious complication for the ICT sector. For more details on this and other Israeli restrictions, see Gisha, *Hand on the Switch: Who's responsible for Gaza's infrastructure crisis?* (January 2017), pp. 17-19

1 Factor Conditions



Factor conditions refer to the availability and quality of the factors needed by firms in the production of certain goods and services, as well as the time and cost at which these factors (inputs) can be obtained, either at home or from abroad. Four categories are included in the Gaza Diamond's "factor conditions" determinant: physical (natural resources and infrastructure), financial (finance and banking), human (skills and expertise), and know-how (knowledge and technology). In all four categories, Gaza current business environment suffers a great disadvantage.

Gaza private sector leaders, in the sectors and sub-sectors recently covered in UNDP-supported business surveys and in workshops,⁹⁰ have constantly identified the poor state of factor conditions as one of the main binding constraints on their business operations. Chief among these factor-related impediments are the chronic and persistent shortages in electricity supply and the high cost of securing alternative power sources like diesel generators. Gaza's power deficit is currently estimated at 55%,⁹¹ resulting in daily power outages of up to 18 hours,⁹² and average related losses in businesses' sales estimated at 22% each month.⁹³ Critical shortages in water supplies, both in quality and quantity, that have already reached a crisis level,⁹⁴ which could quickly turn into a major humanitarian disaster if not immediately addressed.⁹⁵ Further constraints include: recurring acute shortages of imported fuel supplies; the imposition of a vaguely-defined, "dual-use items" list that restricts or prohibits imports of crucial raw materials and machinery; limitations on the banking sector's ability to transfer money in and out of Gaza; a lack of skilled workers and firms' inability to cover their cost; and the poor state of infrastructure facilities at the border crossings with Israel.

Each one of these factor-related constraints constitutes an area in need of urgent and immediate intervention by the international community to help Gaza's private sector. The DNA framework (volume II) has a long list of recommendations pertaining to short-term recovery needs in the infrastructure sector.⁹⁶ However, moving "beyond survival," requires that these short-term measures must be part of a broader strategic approach that deals with the very poor state of Gaza's factor conditions. This must address their root political causes, and introduce a set of sustainable solutions that can ultimately pave the road from short-term reconstruction and recovery to long-term growth and development (note: this caveat applies to all short-term intervention measures suggested in various places in the rest of this chapter. The DNA framework also emphasizes the importance of such a necessary link). Until now, such a strategic long-term view by the international community towards Gaza's multi-faceted economic crisis, as will be explained in more details in the next chapter, has not yet been fully developed.

⁹⁰ See UNDP, *Economic Recovery and Development in the Gaza Strip* (July 26, 2016).

⁹¹ Daily demand for electricity in the Gaza Strip in 2016 is currently estimated at 470 megawatts (MW), while supply, at peak, is only limited to 210 MW. Electricity supplies in Gaza come from three main sources: Gaza Power Plant (60 MW); which is only half of its operational capacity at 120 MW/day capacity due to the damage caused by Israeli airstrikes and to persistent fuel shortages), Egypt (28-30 MW), and Israel (120 MW) paid by the PA. Any supply disruption in one or more of these three sources could result in rolling power cuts of 20 hours a day; severely hampering the delivery of basic services. For more on this, see OCHA, *The Monthly Humanitarian Bulletin* (April 2017), pp. 3-5. Daily demand of electricity in 2020 is estimated at 550 MW, and is projected to double by 2030. See United Nations, *Gaza in 2020: A Liveable Place?* (August 2012), p. 10.

⁹² United Nations, *Gaza: Two Years After*, p. 4. Also see OCHA, *The Humanitarian Impact of Gaza's Electricity and Fuel Crisis* (July 2015).

⁹³ World Bank, *West Bank and Gaza, Investment Climate Assessment: Fragmentation and Uncertainty* (Washington, D.C., September 2014), p. xvi. The report cited 88.5% of Gaza firms consider long daily power cuts as a major impediment to their businesses.

⁹⁴ EWASH, *Let it flow: How the Israeli blockade has brought Gaza to the brink of a water and sanitation disaster* (21 March 2016).

⁹⁵ Office of the Quartet, *Report for the Meeting of the Ad-Hoc Liaison Committee* (New York, 19 September 2016), p. 5. According to the World Bank, over-pumping and seawater seepage had already caused irreversible damage to parts of Gaza's Coastal Aquifer, the only available source of fresh water in the Gaza Strip. As a result, "only 10% of Gaza's population has access to safe drinking water, compared to 90% in the West Bank or about 85% in MENA in general." See World Bank, *Water Situation Alarming in Gaza* (November 22, 2016) Worse still, almost 40% of the network water is lost due to leakages and network inefficiencies; further compounding the water problem in Gaza. See EWASH, *ibid*.

⁹⁶ The Office of the Quartet report to the AHLC meeting (September 19, 2016) has a very detailed list of recommendations in the energy (pp. 8-15) and water (pp. 18-22) sectors, based on the work the Office has been involved in for several years now.

2 Demand Conditions



This determinant refers to the size, composition, and character of demand, both at home and abroad, which prompt companies to respond in an attempt to meet buyer needs, and to secure their share of the market. Companies sometimes influence demand by responding to an existing market need, or by anticipating an emerging one, through the introduction of either a new product or by improving an existing one.

Under normal conditions, Gaza's enterprises were able to enjoy direct and largely unfettered access to two nearby markets, West Bank and Israel, with demand in each market reflecting the diversity of consumer tastes and their purchasing power. However, the imposition of the Israeli economic blockade on Gaza in mid 2007, and the intensification of restrictions on movement of people and trade have blocked access to these crucial markets. With the continued decline in Gaza's real per capita income, rising unemployment and poverty rates, and the weakening of the buying power of most of its people, demand for Gaza firms' products has plummeted on all fronts. Worse still, under current political conditions, Gaza's regional and international trade is largely a one-way transaction, with exports virtually non-existent or meagre at best. Meanwhile, the import of foreign goods, either legally or smuggled through cross-borders tunnels (which were in operation until mid 2013), has further reduced demand for Gaza's businesses.

Under the current circumstances, the state of Gaza's "demand conditions" determinant, thus is too weak to provide the needed impetus to boost the struggling local businesses. This is another area where intervention by the international community could make a difference in the short-term, through the implementation of policies that could stimulate domestic demand. Once again, the DNA programme has a whole host of such intervention measures,⁹⁷ either through the provision of direct financial support to operating enterprises, or through the introduction of financial subsidies to encourage short-term temporary employment in the private sector (e.g. "cash-for-work" and other emergency employment programmes). It should be noted, however, that the "demand conditions" determinant in the Gaza business Diamond, to a large extent, is a *derived* determinant, not an independent one; as such, the effectiveness of short term intervention measures intended to improve domestic demand will largely depend on how changes in other determinants in the Diamond system can enhance / or hinder demand policy interventions.

⁹⁷ See Detailed Needs Assessment (DNA) and Recovery Framework, p. 53.



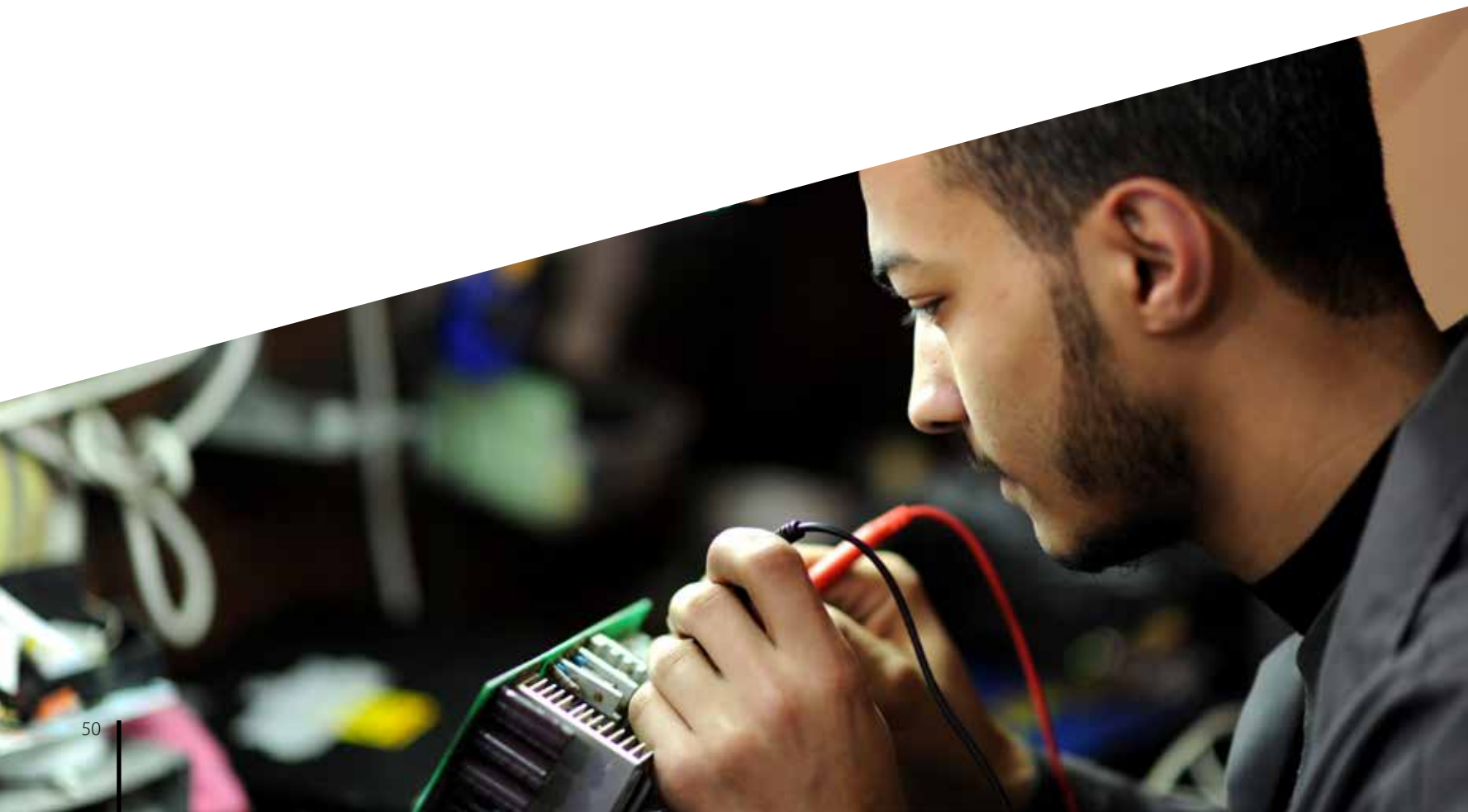
3 **Related** and Supporting Industries

This determinant refers to groups of interconnected companies, of both suppliers and end-users, within a certain business sector producing certain lines of product/products, which all constitute a “cluster” of supporting activities in their area of work. The existence of strong backward and forward linkages among industries, in constant touch with each other to exchange information and innovative ideas, form an indispensable aspect of modern business activities, and its ability to successfully compete at home and abroad.

Gaza’s private sector has long been known not only for its resilience (i.e., its ability to adapt to and withstand pressure), but also for its entrepreneurial capabilities, creativity, and dynamism. In this regard, past interconnectivity with the more advanced and sophisticated Israeli business sector, mainly through sub-contracting activities in sectors like furniture and garment manufacturing, added much to Gaza’s private sector entrepreneurial talent.

Isolated and subjected to repeated destructive wars since 2006, Gaza’s business sector at the present time is too weak and too small to have such a dynamic aspect of vibrant economic activities, for a number of reasons. The continued decline in the share of manufacturing and agriculture sectors in Gaza’s GDP, for example, makes it difficult to have a cluster tailored to provide the two sectors with the needed input, domestically produced or obtained from outside sources. Even with the present low level of related services that are provided domestically, they are still too dependent on Israel and West Bank resources, which are very difficult to access freely for over a decade now. Furthermore, continued restrictions on Gaza’s private sector, and the prevailing high degree of uncertainty and political instability, makes it difficult to have efficient and profitable backward and forward linkages, or to have an innovative R&D industry through local universities and technical colleges geared to the development of new and improved products.

Consequently, short-term intervention measures in this area may not be a top priority under current conditions, or an efficient way to spend donors’ time and financial resources in an attempt to improve this aspect of Gaza’s business Diamond. However, moving beyond reconstruction, any strategic approach to long-term growth and development in Gaza –as part of an integrated Palestinian business sector that combines West Bank and Gaza– should have such an aspect of the “Gaza Diamond” on its future agenda.



4 Strategy, Structure and Rivalry Conditions

This determinant is related to the organization, management, and strategies of business enterprises, and how they strive to achieve their goals. To a large extent, this is a function of business tradition, country setting, and the degree of sophistication and dynamism of entrepreneurship.

In Gaza, as mentioned earlier, most firms are family owned and family operated by tradition, and mostly small in size, both in terms of the value of assets and the number of workers they employ. Only a few firms are considered medium or large companies, with production for sales domestically and for export. Financing for small enterprise is mostly secured through families' own savings, with big businesses having lines of credit with domestic banks, despite the high risk and high rates that bank borrowing entails under current conditions.

Competition among Gaza businesses is largely based on price and product imitation, not on quality or the introduction of new or upgraded products, with very low use of modern marketing techniques to maximize sales and revenues. Given Gaza's current strained business conditions, firms' strategies at present are mostly focusing on pure survival, not on investing in future growth.

Under these extremely tight conditions, "individual firms" as the World Bank puts it, "have sized and shaped their businesses within these existing constraints."⁹⁸ The World Bank further added that: "Engagement in innovative and business-upgrading activities has dropped among Palestinian firms in recent years, *driven primarily by diminished levels of activity among Gaza firms*. The percentage of firms providing formal training, investing in product and process development, and maintaining International Organization for Standardization (ISO) quality system certifications have all dropped. *The most significant drop has been among Gaza firms, which can be interpreted as a response to the effects of the economic blockade on firms*"⁹⁹ [emphasis added].

As such, this determinant of Gaza's business Diamond is very weak. Short-term policy intervention by the international community on this front should continue to include measures previously taken, such as providing risk guarantees to local businesses, along with other recommended interventions outlined in the DNA recovery programme. To be effective, however, such measures, as stressed before, have to be part of an overall long-term strategy intended to develop Gaza's private sector to become the engine for future economic growth and development. Incremental and stopgap policy measures, however badly needed, will only help to provide short-term respite, with dubious long-term impact.

⁹⁸World Bank, *West Bank and Gaza, Investment Climate Assessment: Fragmentation and Uncertainty* (Washington, D.C., September 2014), p. xiv.
⁹⁹ *Ibid*, pp. xvii-xviii

5 Government Role

This determinant examines the role of governments in shaping the overall business environment within which the private sector operates. In the State of Palestine, the government role took a highly disruptive turn in mid- 2007 that adversely affected Gaza's business climate and economic activities for a decade now.

Hamas' armed takeover of Gaza in June 2007 caused the existence of two Palestinian governments, one based in Ramallah and one based in Gaza, with increasingly separate institutional, regulatory, and administrative structures. This further complicated the Gazan business environment, already dealing with the economic blockade and the Israeli-imposed restrictions on access and movement. "Nearly all facets of business regulation are affected by this split," noted the World Bank in its 2014 assessment of the investment climate in the West Bank and Gaza, "including business registration, licensing and permits, banking, taxation, investment incentives, courts, enforcement of contracts, and competition with only a small number of Palestinian firms attempting to navigate business in both territories as regulated by the PA and the de facto Hamas government in Gaza".¹⁰⁰

Addressing this daunting problem requires the re-integration of public institutions in the Gaza Strip and the West Bank. Little progress on this issue has been made thus far, hampering the function of the Government of National Consensus (formed in June 2014). This, obviously, is not an area of direct policy intervention on the part of the international community, although technical proposals to mitigate its increasingly adverse impact on economic activities and on the provision of basic services in Gaza can still be introduced concerning a number of sticking issues (e.g. the salaries of tens of thousands of Hamas-appointed public servants in Gaza, the acute power outages and power rationing,¹⁰¹ the problematic clearance invoice system, among others), along with technical support to assist Gaza business sector on how to navigate their way through the maze of divergent regulations between Gaza and the West Bank. Ultimately, however, not much progress can be expected on this front without the restoration of a reunified single Palestinian government accepted and supported by the international community.



¹⁰⁰ Ibid, p. xvii

¹⁰¹ Although since 2013, donor-funded programs have been delivering emergency diesel fuel supplies in order to maintain the Gaza Power Plant operating at half capacity. A more sustainable solution to Gaza's continued chronic electricity problem, however, is still desperately needed. See OCHA, The Monthly Humanitarian Bulletin (September 2016), p. 10. Israel has already approved to provide Gaza with at least 100 MW of imported electricity. The plan, however, has not yet been implemented. See Office of the Quartet, Report for the Meeting of the Ad-Hoc Liaison Committee (19 September 2016, New York/Brussels, May 3-4, 2017), p. 12.



6 Political Conditions

Out of all six determinants in Gaza's business Diamond, this one is the most disruptive and most destructive. To a large extent, one can attribute the poor state of all other determinants to the extremely unfavourable political conditions that prevailed in Gaza since the beginning of the Oslo process in 1993, but especially since the implementation of Israel's blockade.

Restrictions on access and movement of people and trade in and out of Gaza, the imposition of a crippling blockade and the launching of three deadly military campaigns in a decade against Gaza have resulted in extensive damage to Gaza's productive assets, caused great financial losses to business owners, and introduced an unprecedented degree of uncertainty and risks to the business environment. Any attempt to lend support to Gaza's private sector must as a point of departure seek to reduce the political constraints that are overwhelming the cause of Gaza's weak private sector. Without that, short-term reconstruction and sustained recovery will be unattainable, and long-term development will remain a pipe dream.

To have an impact, policy interventions by the international community must go beyond the mere provision of financial or technical support, to play a more assertive role in the Palestinian/Israeli political domain. We will discuss this point further in the next chapter.





CHAPTER





Concluding Thoughts and the Way Forward

This report reflected on the harsh economic conditions in Gaza three years after the 2014 hostilities. It started with a review of Gaza economy during the period 2006-2016 (chapter 2), then moved to measure the progress made in reconstructing and recovering Gaza after the extensive damage and losses caused by the 2014 war (chapter 3), and presented an analysis of the current state of Gaza's private sector and the quality of its business environment (chapter 4). The report's goal is to assess the private sector's post-war capacity to lead donor-funded short-term recovery and pave the road for long-term economic growth and development.

What emerged from the analysis is a picture of an incapacitated and small-scale private sector that has been operating under considerable amount of internal and external stress, particularly since the implementation of Israel's economic blockade. The emerging picture also reveals a very poor and largely repressed business environment that constricts all aspects of firms' operations: from investment, to production, to the delivery of final output. In such a highly constrained business climate, the degree of risk and uncertainty is extremely high, the cost of doing business is prohibitive, and the level of confidence among private sector agents is correspondingly low.





In this highly strained business setting, investment and production decisions do not take a long-term view, or aim for future growth and development; rather, the main goal of business owners becomes one of “pure survival,” by managing (i.e., attempting to reduce) the risks they encounter, sometimes on a daily basis. Those who managed to adapt and survive, as one UNDP report observed, “found their capacity to resist and recover from external shocks has gradually eroded, as their assets have dwindled, their markets have contracted or disappeared, their business operations have been interrupted by war, their access to quality water and energy supply have reduced; and their access to credit and investment funds have dwindled.”¹⁰²

And yet, despite all this, the private sector in Gaza remains the one and only means available to resolve Gaza’s ever-deepening crisis under occupation: from the staggering rates of poverty and unemployment, to the crumbling state of basic services and physical infrastructure, to the need to reduce, and ultimately end, Gaza’s chronic dependence on foreign aid. This is the crux of the matter.

With this in mind, the most challenging question becomes: How, and what need, could, and should be done to create an environment that enables Gaza’s private sector to recover and be transformed into an engine for future economic growth and development?

In its latest assessment of the Palestinian investment climate, the World Bank suggested that until the current conflict conditions are resolved, *working within the status-quo setting is the only available option policy makers have*. “In the short-term,” the Bank argued, “policy makers must recognize that the overwhelming constraint to investment and business in the Palestinian territories is political instability. Short-term recommendations (therefore), should be formulated to mitigate the effects of political instability or to work to improve aspects of the investment and business climate that can be improved, even if marginally, under the current constraints.”¹⁰³

This logic of “working within the status-quo setting” seems to underline the incremental, *ad hoc* approach the international community has been following in dealing with the worsening business environment in Gaza. Over the past decade, precious donor money has been spent, and technical assistance programmes have been designed and implemented both unilaterally and multilaterally to that end. And yet, as crucial as foreign aid has been for the survival of Gaza and its economy, it has failed to reverse Gaza’s economic fortunes. The grave socioeconomic conditions in today’s Gaza are clear evidence of this unfortunate, yet largely inevitable, outcome.

The implication is clear: saving Gaza’s private sector will take more than the current ad hoc approach that provides grant funds to disconnected programmes that attempt to mitigate short-term humanitarian needs. Saving Gaza’s private sector takes much more

¹⁰² UNDP, *Managing risks: Towards employment and economic development in Gaza* (Gaza, 30 April 2016), p. 13.

¹⁰³ World Bank, *West Bank and Gaza Investment Climate Assessment: Fragmentation and Uncertainty* (Washington, D.C., September 2014), p. xxi.



than a mere “relaxation” of restrictions on movement of people and trade across border crossings with Israel by issuing more travel permits to business people or allowing more truckloads to enter or exit Gaza; measures that could be revoked by Israel at any time.¹⁰⁴

What is needed is a long-term strategic policy shift; a new approach where short-term incremental measures represent only one component as part of a coherent, long-term and sustainable strategy. In this alternative approach, Gaza needs to be viewed for its strategic development potential, rather than as a humanitarian burden.

The proposed new approach in this report is anchored around three key pillars/components; all are equally vital; all integrated in one package; and all should be pursued concurrently and with vigor and far-sighted vision. These pillars/components are:

(1) In addition to the critical need for continued delivery of emergency humanitarian assistance to ensure Gaza’s population bare survival, the first component calls for an enhanced and accelerated short-term support to Gaza’s private sector in order to address the urgent priority needs - so far underfunded - as identified by the DNA framework and as suggested by private sector representatives in meetings and workshops sponsored by the UNDP. (See Box 1 below)

Box 1: Recommendations for Gaza’s private sector short-term recovery*

The recommendations below are based on deliberations in a workshop organized by UNDP/PAPP and held in Gaza City on 15 March 2016. The workshop had two objectives: (1) to diagnose the challenges facing post-war economic recovery and development, and (2) to propose short- and long-term feasible solutions to Gaza’s worn-torn private sector. Participants included 60 private sector business owners, 12 stakeholders of different economic and industrial sectors and sub-sectors, local private sector development institutions, professional experts, and representatives from the Ministry of National Economy, donors, the Office of the Quartet, and UNDP.

The outcome of the workshop discussion concerning the first objective was briefly presented in Chapter Four in the context of the analysis of major challenges and bottlenecks stifling the Gazan business environment. This box provides a summary of recommendations proposed by the workshop participants concerning the second objective: short-term solutions to the overwhelming difficulties facing the private sector in Gaza.

To be successful, however, these short-term intervention measures should not be stand-alone steps, but part of a strategic developmental approach to Gaza’s economic future led by a revived private sector.

¹⁰⁴ Since March 2016, Israel had revoked more than half of the exit/travel permits issued to Gaza businessmen.

These recommendations are:

- 1. Provide** urgent financial support/grants to compensate for the extensive damage and losses sustained by private sector businesses as a result of continued Israeli blockade and the multiple Gaza military operations, especially the 2014 conflict.
- 2. Accelerate** post-war donor-funded reconstruction, including granting financial support to sectors and sub-sectors badly affected by the 2014 conflict, which are still in desperate need of financial assistance to maintain and replace damaged equipment, and to purchase raw materials so as to enable them resume operations. [As the main findings of the subsequent UNDP's private sector survey have shown, only a fraction of the total value of the inflicted damage to the productive sector has been covered].
- 3. Coordinate** the rapid entry of the raw materials, equipment, machinery, and spare parts from/through Israel, especially those that are restricted from entering Gaza due to continued Israeli application of the "dual-use items" list.
- 4. Remove** Israeli restrictions on access to Gaza's Oslo-agreed, 20-nautical miles territorial Mediterranean waters, by progressively expanding fishing areas so as to revive Gaza's struggling fishing sector crippled by the imposition of the Israeli naval blockade.
- 5. Simplify** the currently vague and confusing tax system, made complicated by the mid-2007 Palestinian political divide between the *de facto* Hamas-controlled Gaza and Ramallah-based Palestinian government in the West Bank. Also, provide tax exemption for war-damaged businesses until they are able to recover.
- 6. Establish** specialised training programmes needed to support Gazan businesses with professionally skilled workers. Also, expand the application of "cash for work" programmes that contribute a to short-term solution for chronic youth unemployment problem in Gaza.
- 7. Assist** in linking Gazan private sector leaders, and Gazan professionals, with their counterparts in the West Bank, the region, and internationally. This should include facilitating participation in trade fairs and exhibitions, attending high level workshops and conferences, as well as visits to regional and global businesses and business-related councils and chambers.
- 8. Agree** on a set of rules and principles that govern the daily movement of people and goods across border crossings with Israel in order to minimize/eliminate current uncertainties and high costs associated with present import and export and movement conditions.
- 9. Address**, urgently, Gaza's chronic electricity problem, with its very costly power outages and its highly inefficient rationing system. Immediate solutions should include securing adequate funds to purchase fuel supplies for Gaza Power Plant to enable operation at its 120 MW full capacity, and to work closely with Israel to expedite the establishment of a new electricity line to Gaza in order to increase current 120 MW supply from Israel.
- 10. Start** the preparation for the design of sub-sectoral, sectoral, and comprehensive plans needed to develop Gaza's private sector. A thorough study of the problems and bottleneck currently crippling the Strip's business environment -- along the same lines introduced in Chapter 4 -- should constitute the first step in his direction.

* Source: UNDP, *Economic Recovery and Development in the Gaza Strip* (26 July 2016)



(2) The design of a strategic plan for medium- and long-term growth and development of Gaza economy. The plan should be based on an in-depth analysis of Gaza's business climate and Gaza's various productive and service sectors, conducted along the same lines and methodology introduced in Chapter Four. The outcome of this analysis should be a number of sector strategies, all integrated in one strategic plan to ensure that policy actions are consistent with the overall strategic vision. Once completed, the plan can serve as a basic guide for effective future national and international interventions in Gaza's private sector. The current donor-funded work led by the Office of the Quartet (in close cooperation with the Palestinian Government and Israel) to find long-term viable solution to Gaza's chronic shortages in energy and water supplies is a step in the that direction and should, in principle, complement the strategic approach proposed in this report aimed to lay the foundation of a private sector-led development strategy for Gaza.¹⁰⁵

(3) A persistent drive by the international community to stabilize the political and security conditions related to the Gaza question, which should eventually lead to a complete lifting of the economic blockade, including freedom of movement and access to resources and markets. This is a sine qua non component of the proposed approach, which should also entail an end to the decade-long Palestinian internal political division and the reintegration of the Gaza Strip into the Palestinian governing structure. Resolving the political crisis is crucial; for short-term intervention measures (pillar 1) to be effective, and for a medium- and long-term strategic plan (pillar 2) to be successfully implemented, a political component must be part of the proposed approach. Post-recovery economic growth and development in Gaza cannot possibly be realized or sustained without "right conditions" in place. The idea here is to have all parties with high stakes in Gaza's future on board to ensure the long term stability of political and security conditions.

This last component of the alternative approach is the most challenging of all. This is so because it requires all immediate parties to the Gaza question to have a genuine interest in pursuing it. Given the current stalemate in the peace process, and the continues deepening of the Palestinian political division, a consensus on how to bring about a real change in Gaza may not be easy to secure.

Yet, there is no other way out. If the root cause of the crisis in Gaza's private sector is political, then this is where the solution lies, and where it needs to be found. Unfortunately, very little has been done so far on this front.

Under unchanging political conditions, the future of Gaza and its inhabitants is bleak. When the UN is already predicting Gaza to be unliveable by 2020, then those with vested interest in the future of a fragmented State of Palestine should take a moment for serious pause. While these crippling political conditions persevere, it is clear that a unified and long-term strategy for investing in Gaza's private sector offers the greatest potential for growth and development to reduce the impact of Gaza's humanitarian crisis on its people.

¹⁰⁵ For a detailed discussion of this point, see Office of the Quartet, *Report for the Meeting of the Ad-Hoc Liaison Committee* (Brussels, May 3-4, 2017).



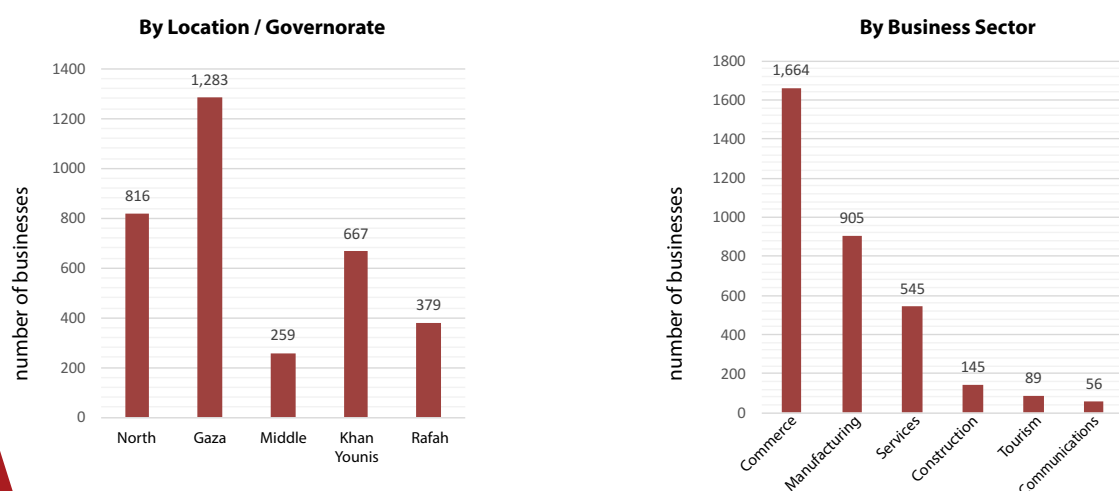
Annex: Charts and Figures

Chart (1)

GAZA PRIVATE SECTOR SURVEY:

Businesses Affected by the 2014 War

(total number = 3,404 enterprises)



Of the surveyed businesses:

49% were in commerce

27% were in manufacturing

16% were in service

4% were in construction

3% were in tourism, and

2% were in communication

Chart (2)

GAZA PRIVATE SECTOR SURVEY:

Industry's Sub-sectors Affected by the 2014 War

(Number of establishments = 1,621)

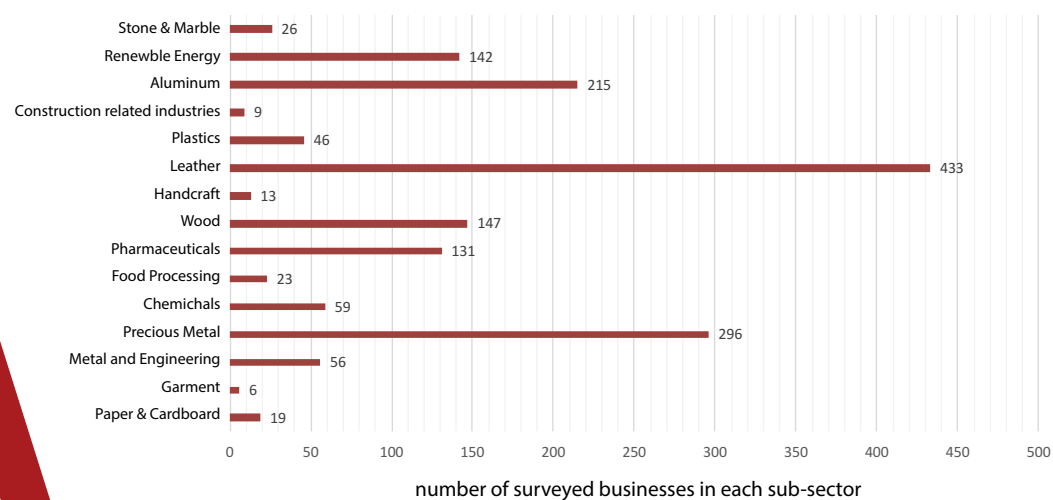


Chart (3)

DAMAGE SUSTAINED BY SURVEYED BUSINESSES :

(Total number = 3,404)

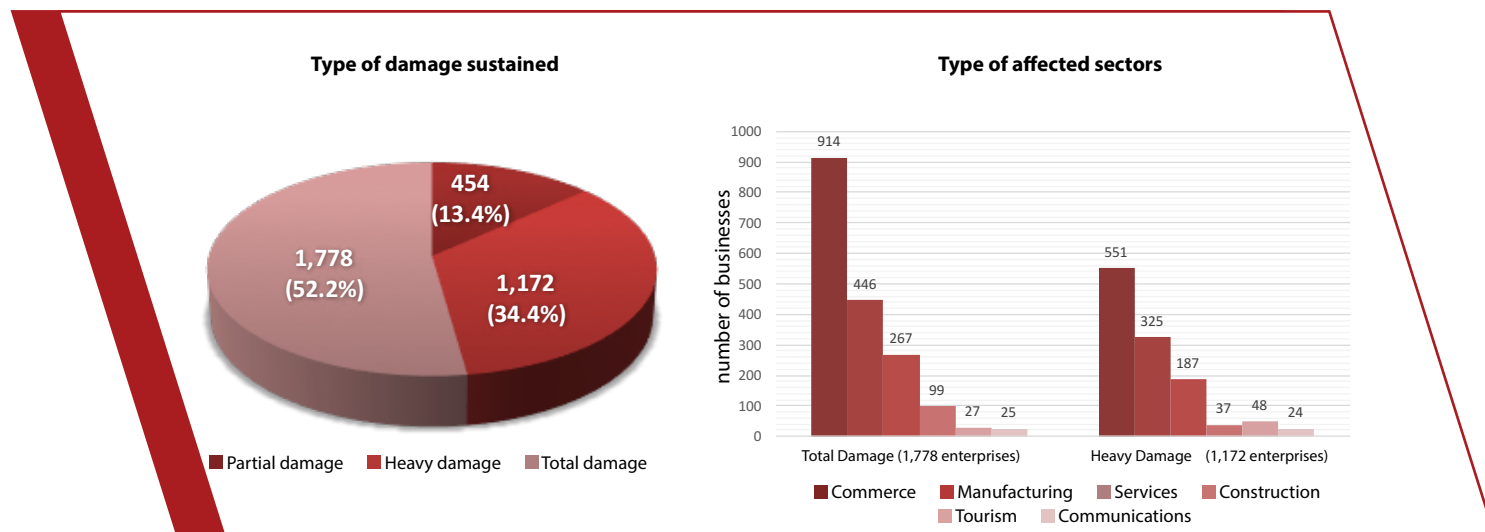


Chart (4)

DAMAGE SUSTAINED IN PREVIOUS WARS:

Operations after 2014 War

(Total number of affected businesses = 3,404)

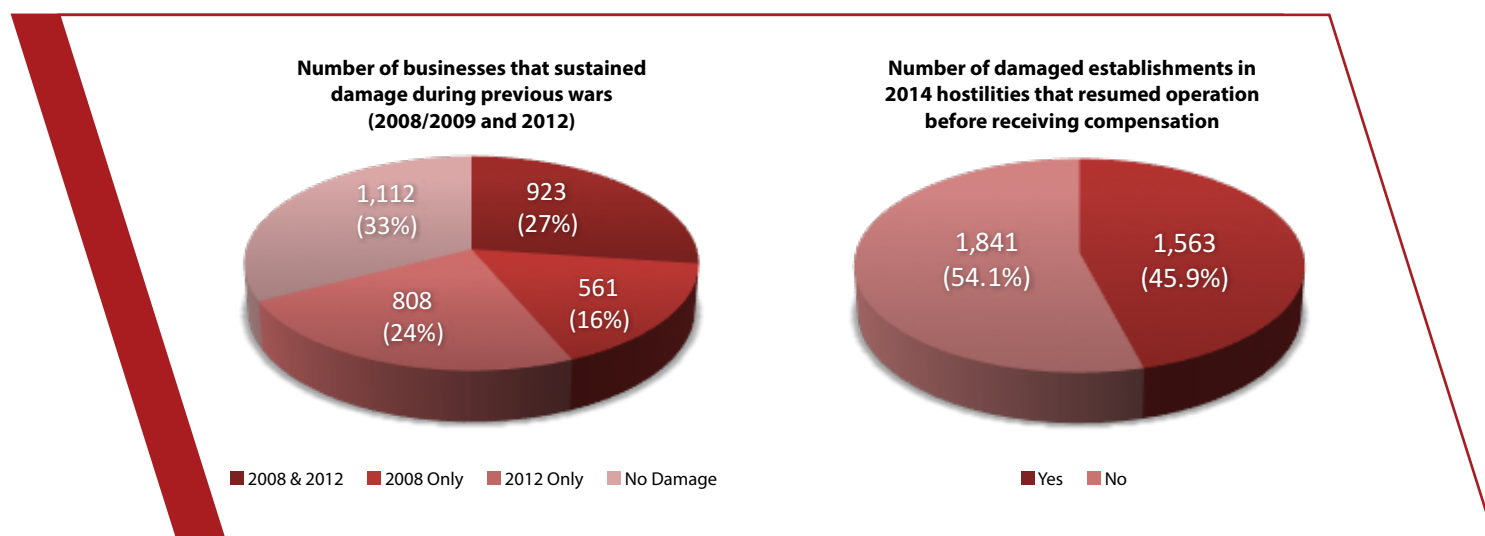




Chart (5)

VALUE OF DAMAGE SUSTAINED BY SURVEYED BUSINESSES:

(Number of reporting businesses = 3109) - (Total damage value = \$164.4 million)*

Estimated by the PA Ministry of Economy

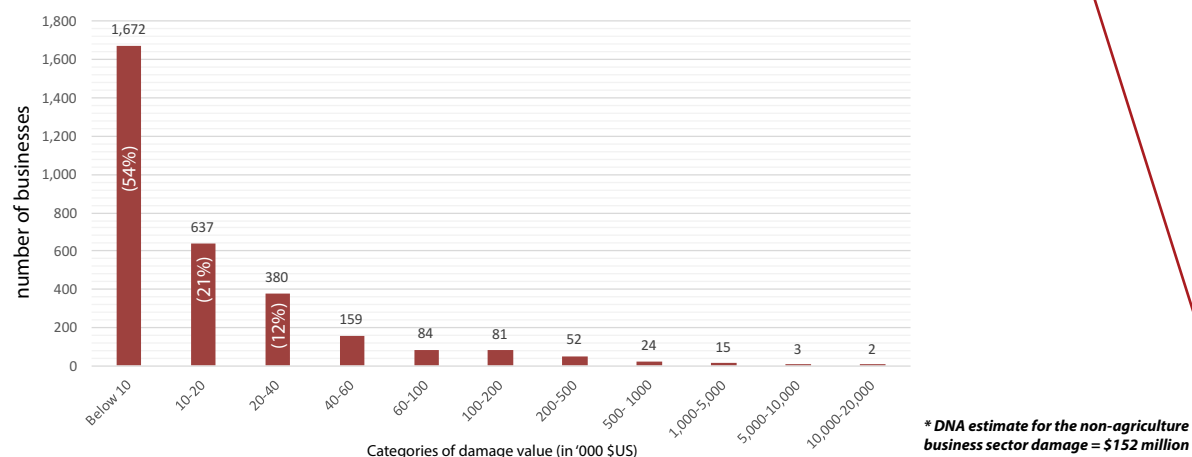


Chart (6)

TOTAL VALUE OF DAMAGE SUSTAINED:

By number of establishments

(Number of businesses = 3109) - (Total damage value = \$164.4 million)

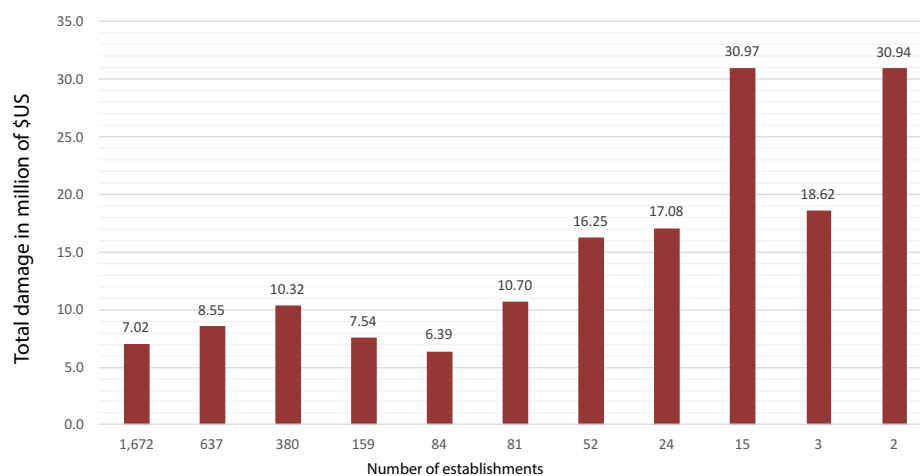


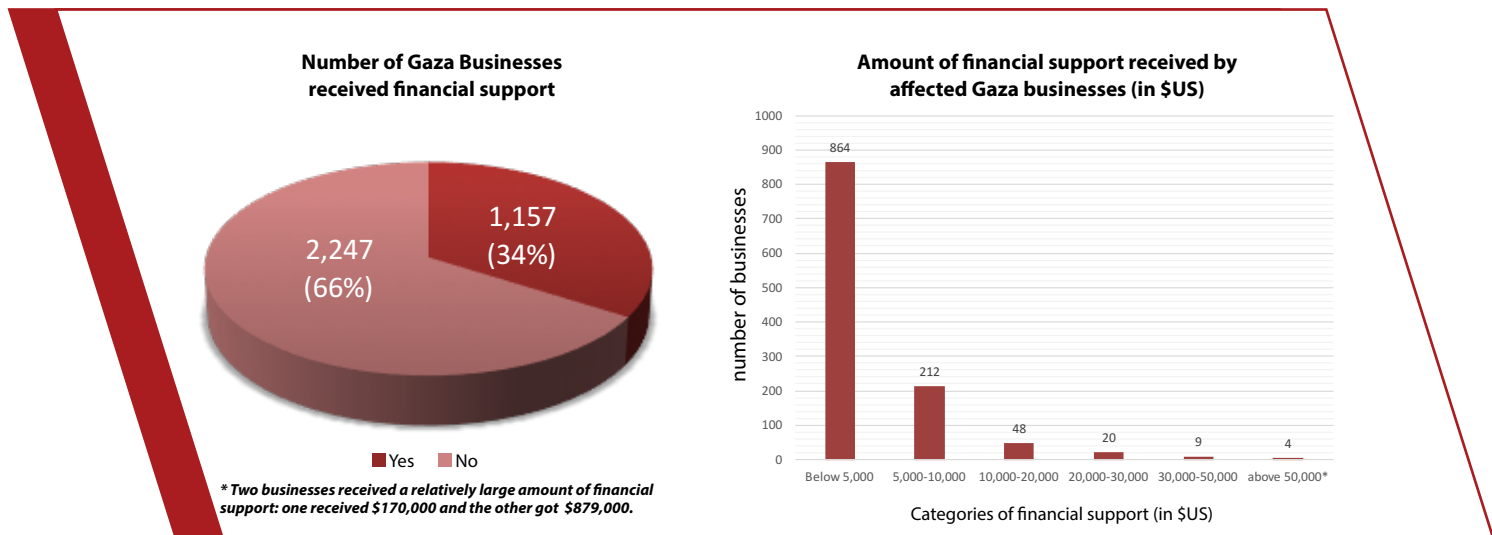
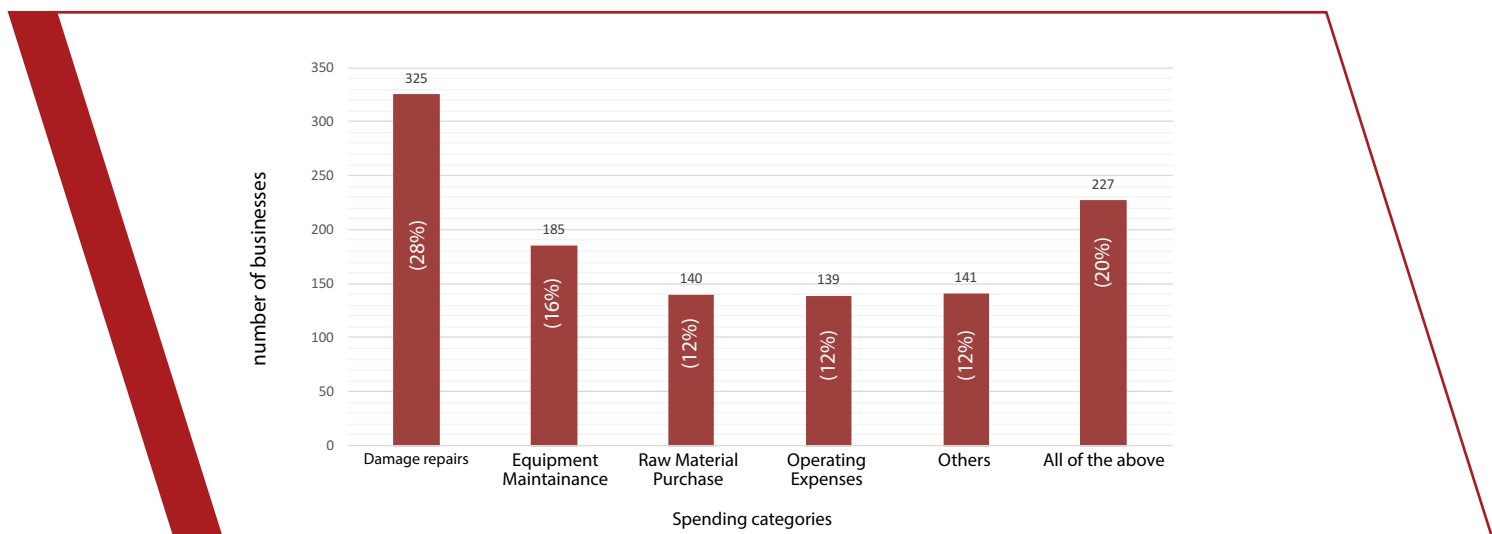
Chart (7)**FINANCIAL SUPPORT RECEIVED BY SURVEYED BUSINESSES:***(Total number of establishment = 3,404)***Chart (8)****HOW THE FINANCIAL COMPENSATION HAS BEEN USED:***Number of Gaza businesses received support = 1,157**Total value of compensation received = \$5.67 million)*

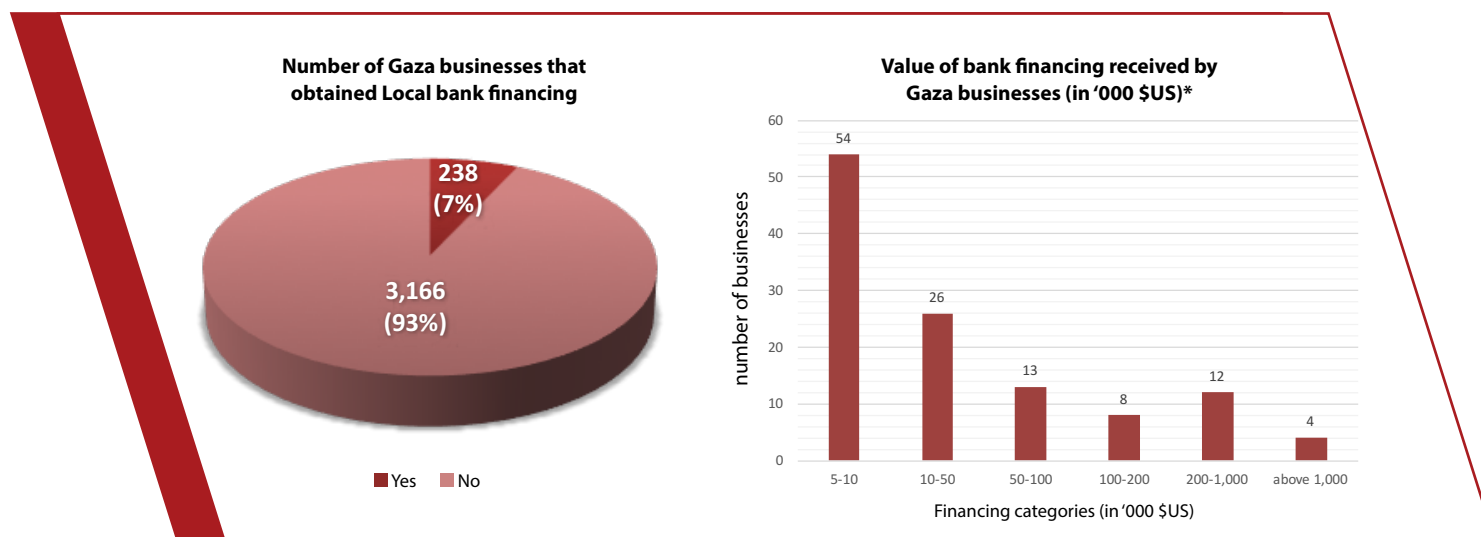
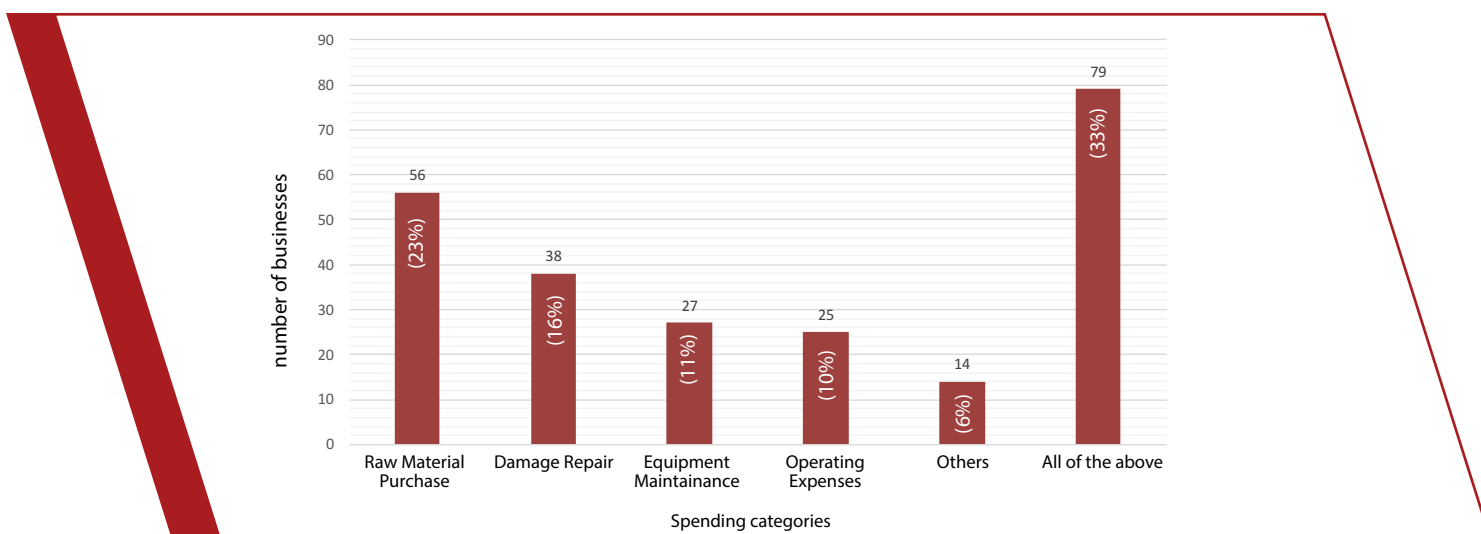
Chart (9)**POST-WAR DOMESTIC BANK FINANCING:***(total number of businesses = 3,404)***Chart (10)****HOW THE BANK FINANCING HAS BEEN USED:***(Number of businesses obtained financing = 238**Total bank financing received = \$13.8 million)*

Chart (11)

BUSINESSES SALES AND CAPITAL ASSETS IN SURVEYED BUSINESSES BEFORE, AND TWO YEARS AFTER, THE WAR: (in million \$US)

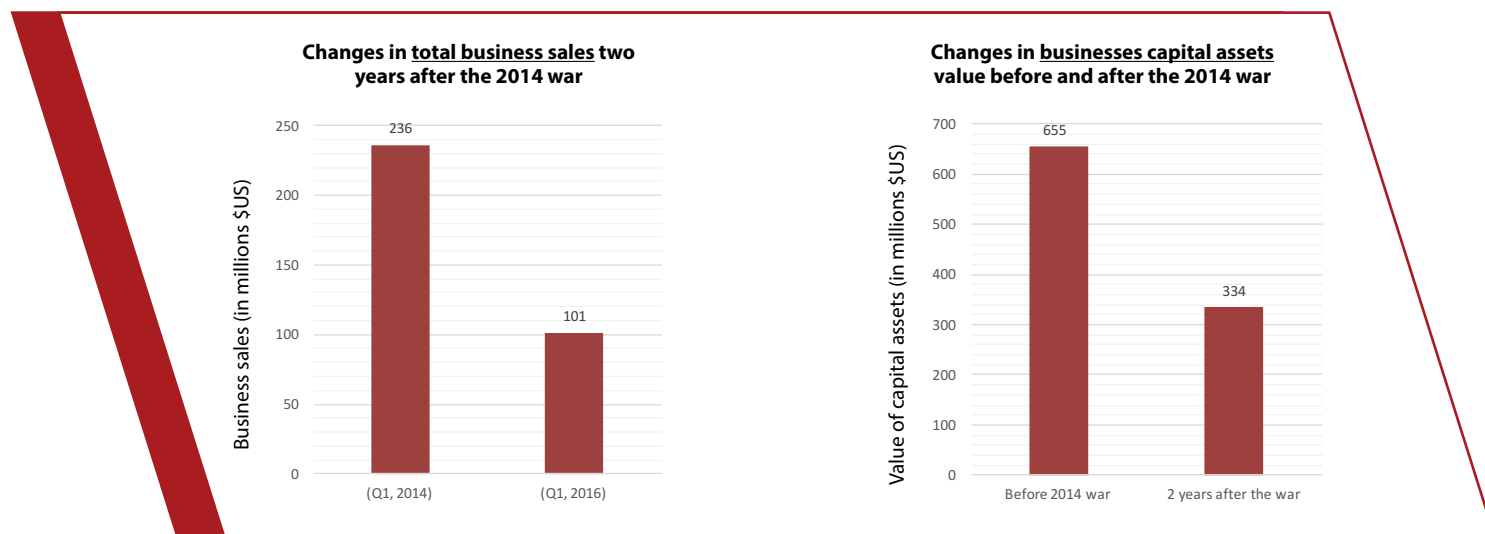


Chart (12)

CHANGES IN TOTAL, AND IN GENDER COMPOSITION OF, EMPLOYMENT BEFORE AND TWO YEARS AFTER THE HOSTILITIES: (in million \$US)

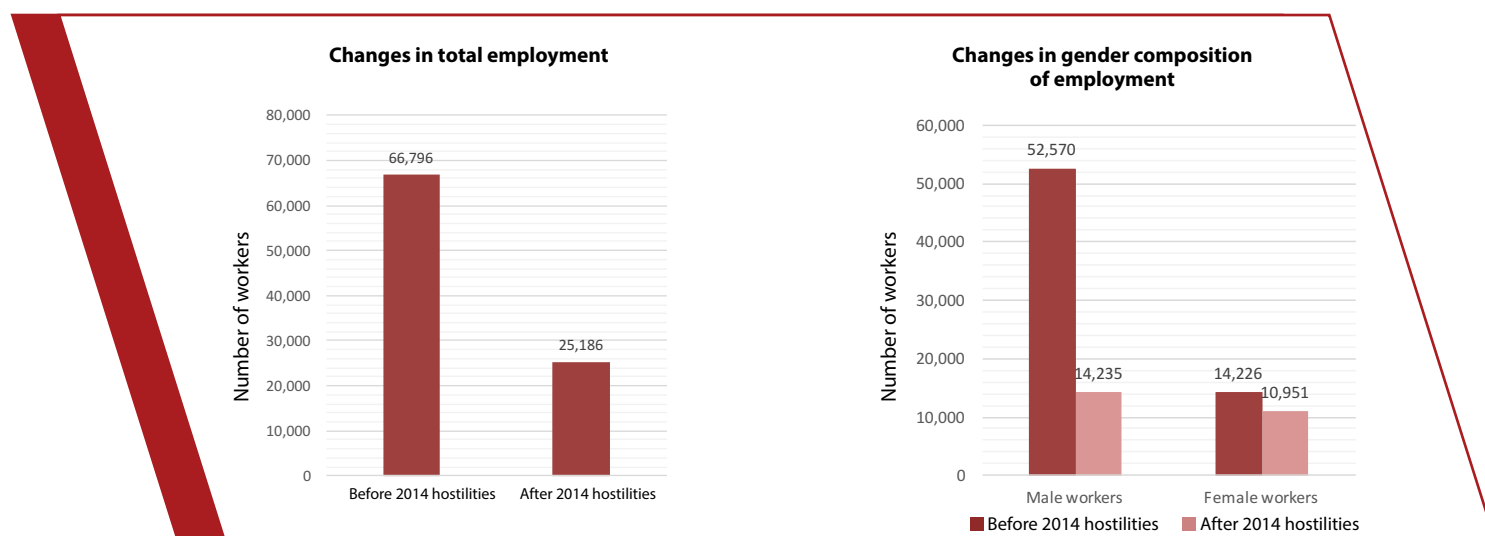


Chart (13)**CHANGES IN EXPORTS VALUES AND IN NUMBER OF EXPORTING BUSINESSES BEFORE, AND TWO YEARS AFTER THE HOSTILITIES:**
(in million \$US)