



Palestine Economic Policy Research Institute (MAS)

MSMEs in Palestine; Challenges and Potential

Editor

Nidal Rashid Sabri

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The Palestine Economic Policy Research Institute (MAS)

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Palestine Economic Policy Research Institute (MAS)
Jerusalem and Ramallah

Preface

Between October 2008 and October 2010, the Palestine Economic Policy Research Institute (MAS), with the generous support of the International Development Research Centre (IDRC), engaged in a research program entitled “*Poverty Reduction through Private-Sector Development: Policy Research for MSMEs*”. It was the primary objective of the project to conduct a comprehensive analysis of the current status of Micro, Small and Medium Sized Enterprises (MSMEs) in Palestine, the challenges that the proprietors of such operations face and the potential contribution of Palestinian MSMEs to the achievement of the national development vision.

The program involved the production of fourteen separate research studies (ten policy-papers and four critical law reviews). These aimed to examine the legal and regulatory environment in the West Bank and the Gaza Strip, as well as particular opportunities and challenges facing MSMEs, such as the challenges associated with successfully marketing products, access to financial services, the current degree and character of female entrepreneurship and labor force participation, and the availability and quality of relevant vocational education.

This report is an overview of the primary findings of the research program. It summarizes the results of the various studies that were conducted and provides a general introduction to the issue of MSMEs, both in general and within the unique context of the Occupied Palestinian Territories.

Finally, I would like to express my thanks for the MAS research staff for their reviews and comments on the various chapters presented in this book. This includes Andrew Hunter, Rami Totari, Abdelwahab Abdelaziz, Salim Al Husari, Shahrazad El Far, Sana Kamal, Qusai Al Saifi and Mai Jodeh. Also I would like to extend gratitude and appreciation to our partners the International Development Research Center- IDRC for their generous and continuous support.

Samir Abdullah
Director General

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Introduction

The MSMEs play a significant role in boosting GDP and living standards, encouraging domestic investment, recycling national income and decreasing unemployment rates. Moreover, from the perspective of the individual consumer, MSMEs are particularly well suited to providing products and services that are relevant to the domestic context at reasonable prices. The MSMEs allow for a fast turnover cycle lowering inventory costs, thus creating savings that can be passed on to the customer. It is also regularly argued that MSMEs are a viable mechanism of increasing national exports. Thus, to enhance and support such sector, and to explore the foundation for the establishment and development of such firms within the Palestinian context, it is necessary to explore the various issues and aspects. Thus the Palestine Economic Policy Research Institute implemented this project, which produced fifteen various studies.

Out of these studies, eleven papers have been selected and incorporated in one volume entitled “MSMEs in Palestine; Challenges and Potential”. The first chapter of this volume is devoted to the framework of the Palestinian economy. The second chapter explores various current challenges and problems facing the MSMEs in Palestine. The third chapter included in this book presents various international experiences in supporting MSMEs, while the fourth and fifth chapters present the legal environment in the Palestinian economy and the related draft law of MSMEs in particular. The sixth chapter is related to improving the Palestinian investment legislation to the advantage of SMEs. The seventh and eight chapters are in regard to the Palestinian MSMEs and international product standards and WTO requirements. The eighth chapter covers irrigated agriculture MSMEs sector in the Palestinian economy. The ninth and tenth chapters are related to marketing and financing aspects respectively.

Chapter I: MSMEs and the Palestinian Economy

Nidal Rashid Sabri

1.1 Introduction

In emerging economies, Micro Small and Medium sized Enterprises (MSMEs) contribute greatly to growth and development. Compared to larger commercial enterprises, MSMEs have a number of unique attributes. MSMEs are smaller and consequently more flexible. This makes MSMEs able to adapt their operations to market changes and to respond to new demands with greater ease and innovation. Due to the importance of MSMEs to domestic economies and to the global economy in general, interest in the various dimensions of small-scale commercial activity is increasing in both academic and policy-making circles alike. Comparing MSMEs and large-scale enterprises is a regular subject of debate amongst scholars of economic development. The most common debates are in regards to the advantages and disadvantages of small-scale entrepreneurship, including business size, number of employees, invested capital and the value and frequency of transactions. The benefits of small-scale entrepreneurial ventures are determined by a number of macro and micro level factors that include the size of the national economy, the prevailing legislative framework, employment opportunities for skilled and unskilled labor, production costs, potential economies of scale, legislation regarding ownership, rates of return on investments, the culture of corporate social responsibility.

1.2 MSMEs and Palestine

In many ways, Palestinian MSMEs constitute the Palestinian economy. According to the Palestinian Central Bureau of Statistics PCBS, MSMEs comprised 99% of all businesses in 1998. In the past, studies have been conducted in order to assess the advantages of MSMEs compared to larger-scale corporate ventures within the Palestinian context. In general, these studies have indicated that MSMEs have a number of specific advantages and, for this reason, should be encouraged through policy initiatives (Sabri, 1998). Previous studies have found that smaller firms have higher average rates of labor productivity and a higher ratio of assets and

inventory turnover than large-scale industries, despite the fact that larger firms have greater access to external financing.

Within the documents that detail the national development strategy, including those issued by the Palestinian Ministry of Planning (MoP) between 2005 and 2008, there are numerous references to policy options designed to support medium sized-enterprises. In reality, however, the current role of the Palestinian government in terms of enhancing MSMEs is limited. In the various development strategies of the PNA, only some of the statements supporting MSMEs were translated into policies. MSMEs are not, for example, provided with tax exemptions, or regulations tailored to their specific needs nor do they have special financing programs made available for them.

It is not, however, just a lack of government support that restricts the development potential of MSMEs within the Palestinian context. A substantial number of Palestinian MSMEs operate in the informal sector. These are often managed by individuals with only limited levels of education and are frequently financed by family savings, thus generally allowing them to only achieve low rates of worker productivity (Malki et al., 2004). Moreover, with the exception of small enterprises producing crafts and some others operating in the tourism sector, few Palestinian MSMEs have developed in a way that allows them to trade internationally.

In the following sections, the corporate, legal and cultural environments within which Palestinian MSMEs are required to operate are discussed.

1.3 Entrepreneurship in the Palestinian Economy

In general, the majority of Palestinian entrepreneurship ventures are funded - initially at least - by individual or family savings, with little support from governmental bodies. However, motivations for establishing a new business vary considerably from venture to venture. A survey conducted to examine new Palestinian business ventures found that 53% of ventures were based on the savings and experience of the entrepreneurs involved. A quarter of the new ventures reviewed by the survey were established by entrepreneurs without previous experience in the field. In such cases the motivation of the entrepreneurs was to invest their available savings and achieve self-employment. Other ventures were established as small projects and later developed into larger ones (Sabri, 1999).

Table No. 1: New Palestinian Ventures by Type

Initiation of the present manufacturing Ventures	Ratio
1. Investor "Entrepreneur" invested money without previous experience	26%
2. Investor "Entrepreneur" invested money with previous experience	28%
3. Working in trade and expanded to industry "Backward integration"	17%
4. Expansion of workshops to a factory	16%
5. Employee Entrepreneurship	9%
6. Other forms of ventures	4%
Total	100%

Source: Sabri, 1999

1.4 Taxation in the Palestinian Economy:

A critical issue for the growth and development of MSMEs in Palestine is the parameters of the taxation system that they are required to operate within. The present tax system is complicated and has remained largely unchanged for the last two decades, with the exception of the amendments that were made to the income tax law in 2005. The present tax system regulates personal and corporate income taxes, property taxes, direct taxes, Value Added Tax (VAT), customs, duties and fees as indirect taxes. Moreover, there are various local taxes that have an impact upon business operations in Palestine. Today, three types of local taxes exist in the West Bank; they include property taxes, license fees, and educational taxes (imposed on residents of municipalities). In addition, there are three other types of taxes imposed on those who fall under the jurisdiction of village counsels (Sabri, 2004). The following table summarizes the tax types in 2010. Clearly, there is a pressing need to simplify the tax framework, especially in regards to indirect and local taxes.

Table No. 2: Summary of taxes prevailing in Palestine as of 2010

Taxes	Rates
Income Tax	
1. Self-employed income	5% to 15%
2. Payroll income	5% to 15%
3. Corporate income	15%
Indirect Tax	
1. VAT on all goods and services	14 %
2. Customs duties (based on goods and source)	0% -200%
3. Excise on some produced goods	30% in average of sale value

Taxes	Rates
4. Fees in Petroleum products	20% to 60% plus 14%
5. Excise on tobacco, wine	Average rate 50% of value
Local taxes (property and	17%
Local taxes- Education tax	7% of rent
Local taxes- Craft licenses	\$ 10 -\$ 250 a year
Local taxes - Business licenses	\$ 18 -\$3500 a year
Local Villages Taxes; Poll tax (head tax)	\$ 4
Local Villages Taxes; rural property	\$ 6 per dunum land

Source: Compiled by the author

1.5 Doing business in Palestinian

The Palestinian economy is complex. In certain respects, it represents a positive business environment for investors and entrepreneurs. In others, however, it is extremely problematic. Relevant points concerning MSMEs and the Palestinian economy are discussed below.

First: the Palestinian economy is dominated by the service sector; the contribution of the service sector generates more than 67% of Palestinian GDP, compared to 8% for agriculture and 13% for the industrial sector (PCBS, 2008). The service sector includes the public sector, tourism, storage, financial services, communications, transportation, education and health amongst others.

Second: Palestine does not have a national currency. Three different currencies are used for different purposes including exchange transactions and savings. It is possible that this multi-currency system reduces the efficiency of the Palestinian payment system. It is certain, however, that the system denies policy makers the use of the tools of monetary policy of the sort that can help promote economic growth, combat inflation or reduce unemployment. In addition, having three currencies does not provide the stability that a national currency provides against exchange rate fluctuations.

Third: Research demonstrates that starting a business, closing a business or generally doing business in Palestine is often problematic. The World Bank's "Ease of Doing Business Survey 2010" ranked Palestine 139, 176, and 167 among the 183 states regarding ease of doing business, starting a new business and getting credit respectively. Importantly, according to the World Bank, it is harder to close a business in Palestine than in any other country in the world.

Table No. 3: Rank of Palestine in ‘Ease of Doing Business’ Measurements, Compared to World States in 2009-2010

Ease of...	2010 rank	2009 rank
Doing Business	139	137
Starting a Business	176	167
Dealing with Construction Permits	157	149
Employing Workers	135	132
Registering Property	73	80
Getting Credit	167	165
Protecting Investors	41	38
Paying Taxes	28	26
Trading Across Borders	92	92
Enforcing Contracts	111	123
Closing a Business	183	183
Rank one is the best state among the 183 World states		

Source: World Bank (2010) **Doing Business 2010**, available online: www.doingbusiness.org

Fourth: Palestine’s rank in the Human Development Index (HDI), which measures levels of education and health as well as certain economic indicators, is moderate. This is true despite of the prevailing political context. According to the UNDP, Palestinian HDI is 0.736, ranking 100 out of 170 states; lower than the median HDI and close to the average. Life expectancy at birth for a Palestinian is about 72.9 years, ranking at 64 among the 170 states that are included in the index. The adult literacy rate is 92.4% - ranking 48 out of 170 states (UNDP, 2006, UNDP, 2008 and PCBS, 2008a).

Fifth: Palestinian banks have considerable liquidity available to them. In addition, remittance flows from Palestinians working abroad are of a high value, as are the aid inflows from the international community to the PNA and to local and international NGOs (Sabri, 2003).

1.6 MSMEs and Palestinian Business Culture

As it is often the case in emerging economies, Palestinian MSMEs are usually family-based businesses. This raises a number of issues; significant among them is the effect it has on business continuity. When the responsibility of management is passed on to different generations, firms

may be divided between family members or even liquidated. This is an issue that transcends cultures and affects enterprises of all sizes.

In the context of Palestine, it is often family-run firms that prove to be the most successful. This is especially true in the food and beverage industry as well as the textile, lumber, furniture, hotel, retail and wholesale sectors. In some cases, the market share of some family firms has reached 95%. Certain family firms employ between 200 and 350 employees, while the average size of a Palestinian enterprise is only 5 employees. However, evidence illustrates that approximately one third of family run-enterprises are affected by conflict between family members. In such cases, it is not unusual for businesses to be liquidated, divided or transferred to other owners. Internal disputes are particularly common when an enterprise reaches its second or third generation of management. That said, even though internal conflicts seem to be relatively uncommon among the first generation of management, it is still a risk to family-run enterprises from establishment onwards. Inter-family dynamics are an important determinant of the life-cycle of Palestinian businesses and should not be understated.

Table No. 4: Examples of Management Disputes and the Succession Issue in Palestinian Family-based Firms

Business	Level of Generations	Main Dispute reason	The End
Clothes	First generation	Relationship to contractors	Partners left the business to one owner
A chocolate company	first and second generation	Marketing and management strategies	Sold to outsiders
A food company	Second generations	To rehabilitate the factory	Transfer the business to another country
A hotel	Second generation	Distribution of work among partners	Sold to other owners
A furniture company	Second generation	Marketing and management strategies	Sold to other owners
Wholesaling	Second generation	Over withdrawals of profits	Close the business

Source: Sabri, 2008b

The primary sources of internal conflict within family-run operations appear to be distributions of profits, withdrawal of profits without prior agreement, variations in management style and family disputes. It is the

disputes that most commonly result in liquidation or the division of the enterprise between the different family members (Sabri, 2008 and 2009). However, it should be noted that survey data suggests that by the third generation of management, the majority of Palestinian enterprises that are not family-run cease operations for one reason or another. Among surveyed enterprises it was only family-run operations that continued through the third generation of management and beyond.

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Chapter: II

Problems of MSMEs in Palestine

Nasr Atyani and Sara Al-Haj Ali

2.1 Introduction:

This study investigates the conditions of Micro, Small and Medium Enterprises (MSMEs) in the West Bank and the Gaza Strip (WBGS). It aims to shed light on their importance in the Palestinian economy, illustrate their main features and distribution in the different economic sectors and geographic locations. The study also investigates current challenges and obstacles facing MSMEs, as well as the effects of the Israeli occupation. The final section proposes a series of recommendations with the aim of assisting policy makers to alleviate the obstacles faced by Palestinian MSMEs and support MSMEs' development and growth. As the relevant literature demonstrates, there is no universal definition of an MSME. Definitions may vary according to the purpose of a discussion/study or as a result of the diversity of the environments in which they operate (by country, region, or economic sector or status). However, the number of employees, the sales value, the capital and legal aspects may be factors to be considered in determining this type of business entity. Regardless of the factors used to depict them, MSMEs are generally flexible. They have the ability to adapt quickly, they are easy to establish, and they are generally family owned and have simple and straightforward management. However, they are also generally conventional in nature and market their products or services locally.

2.2 Governmental Institutions Supporting Palestinian MSMEs

Palestinian MSMEs receive support from various governmental and non-governmental organizations, agencies and firms. The following section will present a summary of these organizations and their main role in this regard:

- ✧ **The Palestinian Ministry of National Economy:** The ministry shapes the economic environment to encourage the private sector to grow. For this end, it synchronizes policies and national economic plans with other ministries. For MSMEs in particular, the Ministry of National Economy signed two agreements worth 25 million Euros with the

Italian government and the Palestinian Industrial Union. These agreements will offer low interest loans to MSMEs, therefore enhancing this economic sector.

- ✧ **The Palestinian Investment Promotion Institution PIPA:** The Palestinian investment promotion law No.1 of 1998 (PNA, 1999) stipulated the establishment of an institution to encourage and facilitate new investments in all business sectors and to issue a yearly investment manual. In addition, the Palestinian law of investment promotion No.1 of 1998 (PNA, 1999) grants tax exemptions in three areas; these include: customs tax exemption, income tax exemption for five years for newly established firms, and customs exemption on furniture and electronic equipment. PIPA contributed to establishing institutes related to investment promotion. However, the major disadvantage of the law is its emphasis on firms with a capital of US \$100,000 minimum. Thus, the majority of MSMEs do not benefit from the facilities offered under the Palestinian investment promotion law.
- ✧ **The Palestinian Standards and Measurement Institution:** Since its establishment, the Palestinian Standards and Measurement Institution has approved 622 specifications in manufacturing and construction sectors, and certified 19 laboratories in West Bank and 6 in Gaza Strip for products in the construction and food industries. In addition, it has issued quality assurance certificates to approximately 120 factories and businesses. Accordingly, this institute helped certain businesses export to international markets enhancing their competitiveness, especially in the stone, quarrying and agriculture sectors. This was possible through quality improvement and the adoption of the required specifications.
- ✧ **The Palestinian Industrial Union:** This union was established by the Palestinian Ministries Council in 1999 in order to enhance the Palestinian industrial sector and to help in the implementation of regional and international industrial agreements. Moreover, the union offers programs to facilitate the integration of some industries into new international markets such as the industry improvement program, as well as programs to improve the product quality and competitiveness.
- ✧ **The Palestinian Specialized Industrial Union:** There are 21 specialized unions of industries namely pharmaceuticals, quarrying, IT, leather and plastics, which were established following 1996.

However, these specialized unions include only 4,000 businesses out of the 14,000 that qualify for membership. The primary role of the unions is the provision of technical and professional support.

- ✧ **PAL-Trade Commercial Center:** This was established by Palestinian businessmen to work as an NGO in order to help exporting Palestinian products. This center organizes and takes part in regional exhibitions to help promote Palestinian products and to support their competitiveness. It offers consultations and other technical and managerial services to Palestinian businesses, including MSMEs.
- ✧ **The Palestinian Union of Chambers of Commerce, Industry, and Agriculture:** Established in 1989 in Jerusalem, this union includes 14 chambers in the West Bank and 5 in the Gaza Strip. MSMEs represent approximately 99% of Palestinian businesses, according to the database of the Union. The Union of Chambers implemented various programs, including a few in collaboration with the International Labor Organization-ILO. The programs aim to increase job opportunities in addition to holding workshops and courses for the owners of the MSME's.
- ✧ **The Chambers of Commerce, Industry, and Agriculture:** The Palestinian chambers were established in 1940-50s. Their major function is to issue original certificates for Palestinian exports to the Arab states and ensures compliance with Arab boycott procedures imposed on Israeli products.
- ✧ **Small Business Enterprise Center:** This was established in 2003 as a non-governmental organization. Funded by the German Technical Assistance Agency (GTZ), it works under the supervision of the Palestinian Ministry of National Economy, the Union of Palestinian Chambers, and the GTZ. The center offers approximately 800 consultations and services in financial and managerial aspects. Every year, the Palestinian industry exhibition is held. This contributes to the development of new marketing strategies for Palestinian producers.

The objectives of the Small Business Enterprise Center are:

1. Contribute to the development of the Palestinian private sector by increasing the productivity of MSME's.
2. Develop entrepreneurship within MSME's and establish new MSMEs with promising potential.

3. Improve the quality and increase the quantity of financial and non financial services such as training, information, and consultation.
 4. Provide logistical assistance to MSMEs.
- ✧ **Palestine Development Fund:** This fund was established in 1996 through an EU funding as a result of the merging of multiple NGO credit firms. This fund offers microfinance services to MSMEs. It is considered as a semi-governmental institute and offers financial assistance to small, large and newly established firms. The fund had offered around \$98 million to approximately 3,000 Palestinians by the end of 2008; mostly to medium sized firms (PBC, 2009). The loans offered by the fund created approximately 3,000 new jobs in both the West Bank and the Gaza Strip and about 700 new jobs in the Jerusalem district.
 - ✧ **Non-Governmental Organizations:** Many of these organizations offer funds targeting small business firms, especially firms owned and operated by women. Examples of such firms are the Palestinian Businesswomen's Association, Palestine for Credit and Development (FATEN), Palestinian Agriculture Relief Committee (PARC), Arab Centre for Agricultural Development (ACAD), American Near East Refugees Aid (ANERA), Corporative Housing Foundation (CHF), Young Men Christian Association (YMCA) and, Caritas – Jerusalem (Associate member).
 - ✧ **Welfare Bank for Microfinance:** This is a commercial bank established in 2006 targeting Palestinian MSME's. This bank aims to help in the development of the infrastructural, legal and institutional for MSME's.
 - ✧ **Palestine Network for Small and Micro Finance (PNSMF):** This network was established in 2002. It includes the major NGOs working in microfinance. There are nine members and four associated members in PNSMF. This network aims to coordinate between the different NGOs working in financing small scale firms and conducting training workshops, especially for small businesses. This leads to the creation of new jobs in the Palestinian economy, especially for women. The network includes about 95% of the small and micro lending institutions in Palestine.

- ✧ **Community Center of Bethlehem University:** This center was established in 1989, under the name of the Business Development Center in order to develop the Palestinian private sector. It was later renamed the Joint Community Center. It aims to strengthen the connection between the university community and the business community as well as to conduct relevant research and publications.

2.3 Summary of the Problems Facing MSMEs

Palestinian MSMEs face numerous obstacles to their development, including:

- ✧ Limited benefits offered by PNA policies to promote investments and support businesses as well as a lack of information regarding MSMEs.
- ✧ Limited availability of financing opportunities for Palestinian MSMEs from both formal credit systems and informal credit systems, which has led to an inefficient allocation of financing opportunities.
- ✧ Limited resources to enlarge enterprises coupled with poor marketing abilities and limited access to international markets.
- ✧ One of the most pressing issues facing the majority of MSMEs, which negatively affects their productivity, is the lack of expertise among workers – thus reducing their competitiveness. Despite the fact that MSMEs constitute the majority of Palestinian enterprises and employ a large number of workers, data shows that MSMEs do not contribute much to the value-added of the Palestinian economy, especially in the case of micro-enterprises.
- ✧ With lower levels of productivity compared to other enterprises, MSMEs do not contribute much to production.
- ✧ The Israeli occupation in the WBGS has been devastating for both small and large businesses, impeding development and severely weakening infrastructure, capital, labor movements and productivity.
- ✧ Low competitiveness, the closure of thousands of businesses, and downscaling have resulted in the deterioration of the economic situation for a large proportion of the population. The average number of workers per enterprise in the industrial sector decreased from 4.84 in 1999, to 4.22 in 2004. About 3,650 registered enterprises closed down in 2007 (77% in the West Bank and 23% in the Gaza Strip).
- ✧ The Israeli occupation severely impedes Palestinian trade with international markets, particularly through export restrictions and the Israeli control of borders. Both involve time-consuming inspections at Israeli customs posts.

- ✧ The absence of legal and legislative structures governing the operations of MSMEs, and the absence of a law that recognizes their economic and social importance. This has restricted the capacity of MSMEs to plan for the future.
- ✧ The absence of law specific to MSMEs has prevented clearly defining MSMEs and results in an absence of a statistical system for tracking them down and monitoring them.
- ✧ The lack of infrastructure services such as water, electricity and roads etc.
- ✧ The absence of comprehensive plans and strategies to support the development of MSME's. This may have contributed to poor performance on the part of MSMEs.
- ✧ The lack of a general policy to regulate MSMEs commercial activities such as imports, exports and other related issues.
- ✧ A lack of coordination between the proponents of MSMEs and the absence of an official spokesperson for MSMEs.

2.4 Recommendations to Support and Promote MSMEs

1. To create and provide the necessary legal framework within which MSMEs should operate. This will involve reaching a clear and agreed upon definition for MSMEs that is appropriate for the Palestinian context. This study recommends that the public sector contributes to developing and up-scaling MSMEs through capacity building programs and increasing market accessibility.
2. To create a business incubator, providing suitable conditions that enable MSMEs to increase and develop their operations.
3. To increase the quality of their products. In order to enhance the capabilities of MSMEs, it is also important to establish and maintain strong links with research institutes and universities.
4. To improve labor productivity and managerial skills.
5. To establish ties with foreign enterprises, to establish technical cooperation, to seek licensing from international enterprises and to participate in local, regional and international trade fairs.
6. Encourage MSMEs to export and to import, and provide them with access to domestic and foreign markets.
7. To establish special industrial zones for MSMEs.
8. Initiate registration and licensing procedures as well as providing tax breaks.
9. Strengthening the legal and regulatory environment to ensure that the laws that relate to MSMEs are upheld.

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Chapter III: International Experiences in Supporting MSMEs: Lessons for Palestine

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3.1 Introduction

Due to the importance of MSMEs in the global economy, there is an increasing interest in various aspects of such firms around the world. MSMEs contribute significantly to gross domestic product (GDP) and also create many employment opportunities. Moreover, MSMEs help to increase the exports of developing countries. This chapter will present and analyze the experience of MSMEs in other countries. This includes experiences with legal environments designed to stimulate MSMEs' growth and development, experiences in the expansion of access to finance for MSMEs and experiences in the provision of services to support MSMEs.

3.2 Types of Support for MSMEs in other Economies

3.2.1 The Legal Environment for MSMEs

The experience of other countries has indicated the importance of legislation in terms of identifying and standardizing MSMEs. These experiences have shown that the inclusion of a clear and comprehensive legal definition of MSMEs is the first step to developing a healthy environment for MSMEs. In the Palestinian economy, MSMEs face many obstacles and their development has been negatively affected by the absence of a national definition.

In various countries, including Egypt and Tunisia, MSME laws have emphasized the need to simplify and shorten the procedures for MSME registration as well as to group the official institutions involved in the process of the registration of MSMEs into a single office capable of facilitating all registration procedures. Other countries, such as India and Japan, have opted to establish a ministry or institution specifically catering for MSMEs. These ministries or institutions are responsible for the

registration of MSMEs, in addition to providing financial and supportive services. In the Palestinian context (at least in the short-term), trade and business laws ought to be updated to include articles that emphasize the need to follow the consolidated bureaucracy model described above, as an appropriate mechanism to facilitate the completion of all MSME registration procedures. In the long-run, an MSME law should be adopted. This law should stipulate the establishment of an independent body or Ministry specifically catering for MSME needs and development in Palestine. MSME laws in certain states, such as Tunisia, Japan, Italy and India, have set a number of incentives and benefits for MSMEs in order to encourage the development and improvement of working conditions within MSME. These laws include the provision of direct and indirect tax exemptions, as well as the implementation of policies to protect MSMEs against bankruptcy. Moreover, there are some laws that oblige the government to purchase a portion of the goods they require from MSMEs, sometimes at higher prices.

3.2.2 Supporting the Access of MSMEs to Finance

Sources of financing are a major factor influencing the establishment of MSMEs. To this end, countries such as Egypt and Japan have taken practical measures to facilitate the access of MSMEs to funding. They have established funds in lending institutions to support MSMEs, supervised and monitored by the government. In other cases, countries such as the Philippines and Indonesia have obliged, through law, lending institutions to expand their funds to MSMEs. Palestinian MSMEs could greatly benefit from these practices if a unified lending institution were created. This unified lending institution would contribute a large part of MSMEs' operational costs, while helping to compile the scattered efforts of lending institutions and distribute their resources more efficiently. It is predicted that this would reduce interest rates on loans offered by lending institutions and give a longer grace period to borrowers. The success of this approach depends upon the establishment of a loan guarantee fund that aims to overcome obstacles stemming from the high number of guarantees required of applicants for loans, while also providing assurances to the lenders.

It is worth mentioning that other amendments can be introduced to the Palestinian Banking Law (2) of 2002 (PNA, 2002), including requiring banks to provide a minimum level of credit facilities to MSME owners as a proportion of their deposits. At the same time, it is useful to promote

initiatives from MSME owners themselves that aim to establish societies and lending institutions that specifically consider their needs.

3.3 Supportive services provided to MSMEs

MSMEs require more support and complementary services than do large enterprises. This is due to the fact that they suffer from limited financial resources and the technical capacity necessary for their development and expansion is also limited. In reviewing the experiences of other countries, it was found that countries such as Japan have dealt with this challenge through the creation of specialized technical support centers and logistics facilities for MSMEs. Other countries, such as India, have provided a range of support services through their official institutions. They have also focused on the introduction of new technologies and have supported the marketing of MSMEs both locally and internationally as well as helping develop the capacities of workers. Germany focused on the human resources in MSMEs, promoting the uses of technology, research, innovation, and the diversification of marketing outlets for their products.

In the Palestinian context, support services are crucial for MSMEs. They face great difficulties including: limited access to finance, limitations in the number of outlets for their products, and low levels of interest in training and developing human capital within MSMEs. It is therefore necessary to learn from the successes of leading countries in providing support services to MSMEs. In the Palestinian context, a technical support center could be set up at the national level bringing together the efforts and experience of public and private institutions. To maximize the benefit of this center, support services should be provided in all stages of MSME development – from inception to production to entry into the market place. To ensure the access of all MSMEs to the center, subsidiary offices and branches should be established in all provinces and smaller towns.

Services provided through such a center may include courses and training workshops for MSME staff relating to: raising awareness on administrative and financial matters, how to start a project, production plans, market analysis, and how to improve the quality of products. Other services may involve the provision of programs for MSMEs to enhance their export operations and facilitate their membership of industry and trade unions, at both the local and international level.

3.4 Country Experiences

Various experiences regarding the support of MSMEs are examined including both emerging and developed economies. The following section is devoted to summarizing those experiences:

3.4.1 Japanese Experience

The Japanese government implemented various programs and services offered to enhance MSMEs. These services include (ICFSD, 2002):

1. Exporting their products outside of Japanese markets through exhibitions, and through 80 trading offices located all over the world.
2. Offering consultation services including management and financial services.
3. Offering training programs and special seminars in nine different locations to explain how to start a new business and how to examine market opportunities.
4. Giving priority to MSMEs in case of government purchases and contracts and to offer necessary information in this regard.
5. Facilitating the recruitment of workers and employees needed for MSMEs.
6. Helping in negotiations with external organizations, especially in cases of export agreements and the import of raw materials.
7. Helping share relevant information among related stakeholders.

3.4.2 Indian Experience

The Indian experience includes various services offered to MSMEs, including the following (ICFSD, 2002):

1. Various services of technical support including legal and administrative services offered by governmental agencies and ministries.
2. Assisting Indian MSMEs when attempting to enroll in relevant unions.
3. Government agencies help Indian MSMEs by leasing them equipment to improve the quality of products.
4. Implementing supportive fiscal policies: by increasing the number of specialized banks in order to facilitate access to credit and to provide the necessary assistance and facilities. This is especially offered for private financial MSME's that are operated by women or which are engaged in export activities.

5. Government agencies help Indian MSMEs through training and rehabilitation programs.
6. Government agencies work to introduce e-commerce, IT and other new technology into Indian MSMEs in order to increase their competitiveness in international markets.

3.4.3 German Experience

German government agencies and ministries implement 100 programs and about 1,000 economic organizations exist to support German MSMEs, which may be summarized as follows (Führmann, 2002):

1. Implementing training and rehabilitation programs which are offered by Chambers of Commerce.
2. Implementing technology and research programs to enhance German MSMEs.
3. Providing German MSMEs with supportive and innovative ideas.
4. Supporting research and development projects, including research in industrial development to enhance and support the capabilities of German MSMEs.
5. The government provides up to 50% of the cost of developing new products, and may recover such grants in the event that the product proves a commercial success.
6. Government bodies conduct marketing research in order to help German MSMEs market their products in a more effective way.
7. Cooperation between MSMEs, schools and universities is encouraged especially in which regards to starting new businesses and other related organizational issues.
8. Investment grants from the government are considered to be the main policy for enhancing the capabilities of MSME's. Grants are provided to entrepreneurs who aim to update or expand the productivity of their enterprise and, as a consequence, help to create new job opportunities.

3.4.4 The Singaporean Experience

The government of Singapore implements various programs to support Singaporean MSMEs, through the establishment of the office of Small Enterprise Bureau known as SEB and through the provision of various services. Specifically (CCI, 2003):

1. It provides financial and credit facilities to Singaporean MSMEs.
2. It provides technical and consultation services.

3. The SEB office works to introduce new technologies into Singaporean MSMEs.
4. It offers services regarding developing needed software programs.
5. It offers services regarding training and the development of human resources for employees working in Singaporean MSMEs.
6. It helps MSMEs market their produce in local and foreign markets in order to enhance the sales of their products.

3.5 Recommendations

Considering the experience of other countries in supporting their MSMEs, the following recommendations are offered:

1. A technical support center could be set up at the national level that brings together the efforts and experience of public and private institutions.
2. To maximize the benefit from this center, support services should be provided for all the states of MSMEs development – from inception to production to entry into the market place.
3. Services that could be provided by such a center may include courses and training workshops for MSME staff.
4. Raising awareness of administrative and financial matters such as: how to start a project, production plans, market analysis, and how to improve the quality of products.
5. Other services may involve providing services for MSMEs to enhance their export operations and facilitate their access to industry and trade unions, at both the local and international levels.
6. The use of modern technology to improve the quality of production.
7. Providing services such as shipping, export, membership of industry associations, and the provision of raw materials, equipment and machinery etc.

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Chapter IV: Review of Draft Law on MSMEs in Palestine

Mohammad Khalifa

4.1 Introduction

This chapter aims to evaluate the draft proposed law on Small and Medium Enterprises, prepared by the Palestinian Ministry of National Economy, in order to identify its strengths and weaknesses and to put forward recommendations to improve the draft and develop it into a comprehensive law covering all required articles for the cost-effective, smooth regulation of Micro, Small and Medium Enterprises (MSMEs). The evaluation of the draft law from an economic perspective is carried out on the basis of the following six criteria; ‘the scope for the application of the law and the definition of MSMEs’, ‘the MSMEs supervising body’, ‘the financing of MSMEs’, ‘the incentives and concessions awarded to MSMEs’, and ‘the MSME support services’.

With regard to the legal standpoint, the recent law does not include special provisions for the organization of MSMEs, and many of the relevant laws are old, coming from the British or Ottoman period. Also the laws differ in the West Bank from those in the Gaza Strip. In the West Bank, Jordanian laws are applied, while the Egyptian Laws are applied in Gaza.

The study concludes that the enactment of a law to regulate the work of MSMEs in the Palestinian Territories is crucial for encouraging them and enhancing their role in increasing production and employment. However, amendments to some basic articles in the draft law are necessary to ensure the effectiveness of the proposed law. The required amendments are detailed below.

4.2 Methodology:

To achieve this goal, various research instruments were used. These are as follows:

- ✧ A review of the theoretical framework looking at the effects of laws upon MSMEs was conducted. A comparison was also made between the articles of the draft law and articles related to laws. A further comparison made with similar laws in other countries.

- ✧ A number of interviews with MSME experts were conducted, alongside a specialized workshop attended by researchers, law makers, and representatives of parties involved with MSMEs.
- ✧ A comparison was conducted between the proposed law and other relevant economic laws including the ‘Palestinian Banking Law’, ‘Industrial Estates and Industrial Free Zones Law’, ‘the Standards and Measurements Law’, ‘Labor Law’, ‘Corporation Law’, ‘Commercial Laws’, ‘Formation of Regular Court Law’, ‘Tax Laws’, and the ‘Investment Promotion Law’. This was aimed to ensure the compatibility and complementarities of the proposed law with these existing laws, and examines the potential contribution of the proposed law to regulate MSMEs.
- ✧ The articles of the draft law on MSMEs has been analyzed with respect to similar laws in Egypt, Algeria, India, Japan, the Philippines and other countries in order to identify the most suitable and effective formulation for MSMEs operating in Palestine.

4.3 The Proposed Law

The proposed law for small and medium businesses includes 3 chapters and 23 articles. The law can be summarized as follows:

- ✧ Definition of the firm: An economic unit that aims to make profit while producing goods or services.
- ✧ Framework for the MSMEs: Small firms have maximum 5 employees and a capital of at least US \$20,000 medium firms employ between 5 and 19 people and possess capital of a value between US \$20,001 to 100,000.
- ✧ MSME Authority: The proposed law suggests an authority affiliated with the Council of Ministries. This authority is to be financed by the government in order to accomplish the following objectives:
 - To facilitate the work of MSMEs and to enhance their operations
 - To encourage the establishment of MSMEs
 - To coordinate the work of stakeholders to enhance the working environment of MSMEs
 - To encourage investments in Palestinian MSMEs
 - To contribute to fighting unemployment and poverty in the Palestinian economy
 - To design policies and strategies related to MSMEs.
 - To have a formal database for the sector

- To enhance ways of financing MSMEs and to supply relevant collateral instruments
 - To offer the needed economic and technical consultations to MSMEs
 - To provide marketing support for MSME products
- ✧ Management of the Authority for MSMEs: The Authority regulating MSMEs will be directed by a council of 13 members, chaired by the Minister of National Economy besides members from the Ministry of Finance, Agriculture, Tourism, Planning, and Monterey Fund Authority and an executive general manager. The general manager will conduct the daily operations and implement policies and plans as articulated by the council board of the Authority.

4.4 Comparison with Other Related Palestinian Laws

A comparison has been undertaken between the articles of the proposed law and other relevant economic laws. This aims to ensure both the compatibility of the proposed law with existing ones and examines the potential contribution of the proposed law to regulate MSMEs. The comparison includes the following Palestinian laws:

- ✧ Palestinian Banking Law No.2 of 2002: This law organizes the works of banks and financial institutions; whereby nothing is mentioned about MSMEs. In addition, the law did not state any requirements to allocate a proportion of granted loans to MSMEs. About 90% of MSMEs suffer from the inability to obtain loans, in addition to the inability of about 60% of MSMEs to provide guarantees for the financial institution to get loans. The main reason that makes the MSMEs unable to benefit from the financial institution is that the MSMEs are not legally registered at the relevant authorities, and most of them work within the informal sector.
- ✧ Industrial Estates and Industrial Free Zones Law No.10 of 1998: This law is related to independent industrial zones associated with large industries. Thus, the law does not relate to MSMEs located inside municipalities and village councils. In addition, the law does not refer to the industrial regions or to the incentives and privileges that could benefit MSMEs. Nevertheless, the proposed law refers more than once to the importance of encouraging investment in the MSMEs.

- ✧ The Standards and Measurements Law No.6 of 2000: This law organizes the issue of specifications and standards applied to national and exported products. This law imposes its regulations and fees on all business firms regardless of the size of labor or the value of capital. It also applies to any business including MSMEs.
- ✧ Labor Law No.7 of 2000: This law did not discriminate between small and large businesses, which may mean that the application of this law will increase the cost of labor for small firms, thus leading to less competitive advantages for such small businesses. The application of the law is inconsistent with the economic and social conditions. This is reflected in the increase of unemployment, by the inability of MSMEs to work at full capacity and by the increasing cost of labor in relation to total cost.
- ✧ Corporate Law No.12 of 1964 which applies in the West Bank and 18 of 1929, and No. 19 of 1930 which applies in the Gaza Strip: These laws define businesses by their form of partnerships, including public and private corporations and partnerships. However, the majority of MSMEs are organized as single entity firms, thus they do not all fall under such laws. While MSMEs that are organized in partnership or private corporations are obliged to organize management, financial and legal aspects, the Corporate Law is not applicable for 94% of the MSMEs, so the Corporate Law is not applicable for all of the MSMEs (Nasr and others).
- ✧ Commercial Laws No.12 of 1966 (West Bank), Ottoman Law of 1923, Law of Checks of 1929, and the Bankruptcy Law No.3 of 1936: These laws apply to all businesses including MSMEs. However, exceptions from registration are granted to small traders for the first time.
- ✧ Formation of Regular Court Law No.5 of 2001: This law regulates Palestinian courts on matters which deal with all legal issues, including commercial disputes. However, there are no specialized commercial courts to deal with business disputes, for either MSMEs or large corporations.

4.5 Conclusions and Recommendations

Considering the findings reported in the study, the following is a summary of the conclusions and recommendations that are offered:

- ✧ It is important to re-visit the Law to clarify the goals of the MSME Regulatory Authority and its duties, as well as to specify all the administrative rules which regulate its work and the work of its Board of Directors.
- ✧ Some extra essential duties for the Board of Directors and the MSME Authority should also be added to the articles of the law:
 1. To help create the necessary infrastructure to aid MSMEs in their work and provide a supportive environment that allows the development of MSMEs.
 2. To provide legal consultancy and assistance to micro and small enterprises. It is crucial for MSMEs to avoid legal complications and to benefit from available legal concessions.
 3. To assist civil society institutions that sponsor the interests of MSMEs such as the Chambers of Commerce and research centers.
 4. With regard to funding and financial support, the article of the law must show that funding and financial support is conducted through coordination between the small and medium enterprises and the Monetary Authority as the body supervising the banks and lending institutions, the implementation of any programs or proposals is conducted by the Monetary Authority.
- ✧ The draft law should clarify where and how company registration and other administrative matters relate to the establishment and work of MSMEs should take place. All complications and bureaucratic procedures should be simplified and should take place, as much as possible, in a single office.
- ✧ The Board of Directors should aim to establish an all encompassing office in every governorate in the Palestinian Territories in order to minimize paperwork and make it easy for entrepreneurs to progress as fast as possible.
- ✧ Tax holiday incentives for MSMEs ought to not be less than those provided for larger companies in the “Investment Promotion Law.”
- ✧ There are a number of incentives that can be provided to MSMEs similar to those provided to the MSMEs in other countries and which the current draft law does not address in a sufficient manner. These include the following:

1. Encouraging the government to develop research into technologies related to innovative services and products.
 2. The need for the government to play a more active role in “business incubating,” especially with regard to project start-ups as well as the role of public institutions in R&D and the dissemination of an entrepreneurial culture.
 3. The need for the government to encourage cooperatives and close cooperation among MSMEs as well as value-chains between MSMEs and larger industrial and commercial companies.
 4. The need to develop industrial clusters in areas with special social and/or economic importance.
- ✧ Attention should also be paid to a number of matters after the law is accepted and ratified. The most important of which is the need to swiftly formulate and adopt the rules and regulations (explanatory documents) of the law which are necessary for the actual application and enforcement of the law.
- ✧ The law must refer to the establishment of a supporting center that offers the services for MSMEs, similar to those in Egypt and Algeria as well as local offices of this centre in all governorates.

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Chapter V

Evaluation of Legal Environment in Palestine

Mohammed Khalifa and Ibrahim Hantash

5.1 Introduction

A major factor in the operations of micro, small and medium enterprises (MSMEs) is the legal system in which they exist. As extensive literature shows, the legal system can benefit or harm MSMEs. On the one hand, the legal system can facilitate MSME operations and prove beneficial in gaining access to financing opportunities, a wider exposure to markets and through benefits from laws that promote investment. On the other hand, the legal system can be burdensome to certain economic activities, especially those operating on a smaller scale, since it is often difficult to meet the added expenses of abiding by the governing laws. There is, therefore, some incentive for MSMEs to remain in the informal sector in order to avoid the financial burdens of abiding by the laws. In this case, MSMEs incur less procedures and expenses in opening and developing businesses, can evade taxes and have more employment flexibility. The decision by MSMEs to abide by the laws in the legal system is mainly determined by the capability of the law-enforcing agencies, as well as by the extent to which the laws meet the needs of these MSMEs and the potential benefits from adhering to the law.

5.2 Methodology

The motivation for conducting this study is the critical role that MSMEs play in the Palestinian economy, making up 99% of the operating enterprises in the Palestinian economy and employing 82% of all workers. This study aims to review the legal environment in which MSMEs operate and the extent to which their needs are incorporated into Palestinian laws, especially the investment promotion law. It also suggests a series of recommendations to improve the legal environment.

5.3 The Legal Environment and Palestinian MSMEs

The major merits of the legal environment regarding MSMEs are described as follows:

Banking Regulation: Small enterprise financing institutions are regulated by the Palestine Monetary Authority (PMA). The draft of the new Banking Law explicitly states that the PMA has supervision and control over small enterprise financing institutions. They are currently set under PMA control and supervised by the PMA law. This diverges from the current Banking Law, which excludes small enterprise financing institutions from its coverage. The current laws do not set lending limits for MSMEs.

Industrial Estates and Industrial Free Zones Law: This law is applied in cities and industrial zones where large enterprises exist. MSMEs have not benefited from the incentives and facilities given by this law, since it is not applicable in the vast majority of areas where MSMEs operate (internal industrial areas and municipal industrial societies).

The Palestinian Standards and Measurement Law: All enterprises in the formal sector must, under this law, adhere to certain technical regulations. The law does not distinguish between enterprises according to size or activity, nor does it give a coherent method in determining the specifications and standards to which MSMEs should abide.

Palestinian labor Law: This law imposes additional burdens on employers which negatively affect the competitive ability of MSMEs. The law expanded the benefits and rights of employees, not based on economic necessity or requirement, but rather due to social considerations. All enterprises are required to abide by this law, no matter what the business' size, activity or ability to finance the employee's benefits. MSMEs are therefore faced with added expenses which they might not be able to bear.

Companies Law: It appears that the draft Companies Law is more developed, applicable and favorable for MSME activities than the current law which is both inefficient and inadequate.

Trade Laws: The current trade laws are considered inadequate for regulating and organizing trade and trade issues in Palestine. A large number of individually owned enterprises that are active in small trade or simple handicrafts are not incorporated within these laws. Moreover, these laws fail to incorporate consensual agreements for settling enterprise bankruptcies outside courts. This creates injustice for MSMEs in protecting the property rights of their products.

Formation of Regular Courts Law: This law does not decree that there be specialized courts, such as commercial courts, and does not require that

there are judges with a specialism in economic or financial issues. This weakens the legal environment in which MSMEs operate since the law is inadequate for regulating their activities and settling disputes arising from trading or from financial transactions.

Trademark Laws: These laws disregard the need to protect the property and trading rights of MSMEs and to regulate enterprise operations in regard to registering their trademarks, or to any other matter of MSMEs.

Tax Laws; Regarding income tax, the MSMEs are subject to 15% income tax, as are large enterprises. All companies, regardless of size or financial situation are subject to 14.5% value-added tax. Furthermore, the value-added tax law does not provide MSMEs with preferred handling or incentives.

Investment Promotion Law: All enterprises and companies that operate with a capital equal to or above USD \$100,000 can, when licensed, receive the incentives and benefits provided by this law.

5.4 Legal Aspects of Commercial Chambers

The role of commercial chambers covers various issues including: collecting related data and publishing it for relevant stakeholders, approving the original certificates of national products, holding conferences to promote national products and services, and keeping the records of its members. There are about 14 Chambers of Commerce in Palestine, besides the General Union of Commercial Chambers. The Chamber of Commerce includes members of traders, partners, agents or managers of Palestinian corporations. In addition business firms such as MSMEs may be affiliated to the Chamber of Commerce, but may not have a dominant role in such institutions. Finally, it has been recommended to reduce the minimum number of members to establish the Chamber of Commerce from the present situation of 300 members, as some Arab countries requires only 30 (Makhool et. al., 2004).

5.5 Conclusions

It is important to mention that this study primarily based its assessment of laws according to their relevance to the needs and working conditions of MSMEs, from their own perspectives. A focus was also given to the potential benefit of MSMEs needs being better represented in these laws. If the study had taken a perspective from a different vantage-point, (such

as for public interest, senior investors or a concern for the financial burdens of laws on the government), the results of this study may have been slightly different.

Given how many laws already exist in the legal system and the number of stakeholders involved, it is expected that many obstacles would face Palestinian policy and law makers in bringing the aforementioned recommendations into effect. In light of this, this study suggests establishing a body, involving all MSME stakeholders, to prepare a law exclusively for MSMEs that incorporates the issues highlighted in this study. While bearing in mind consumer safety, a gradualist method should be applied when requiring specifications and standards of MSMEs' products and services. It is important to encourage enterprises to abide by specifications and standards. This can be achieved by providing incentives that alleviate some of the burdens of applying this law, such as fees or procedures.

5.6 Recommendations

Finally, it may be stated that the existing legal environment which the Palestinian MSMEs operate in is seen to be inadequate and unsupportive, and in the large part fails to support MSMEs' existence, activities and expansion. Accordingly, the following recommendations are offered:

- ✧ To amend the current banking law to incorporate micro lending institutions and require banks to expand their lending services to MSMEs. In such a revision, it would be essential to create a guarantee fund to help alleviate the risk to banks and depositors' rights.
- ✧ To expand the applicability of the Industrial Estates and Industrial Free Zones Law to incorporate internal industrial areas and municipal industrial societies, thus enabling MSMEs to benefit from this law.
- ✧ To amend the Labor Law with the objective of alleviating some of its burdens on MSMEs. Give MSMEs privileged treatment and, considering the size of the enterprises and owners' abilities to afford applying the law, some exceptions within the law. Such preferential treatment should aim to alleviate the burdens keeping MSMEs from expanding their business. With this in mind, preferential treatment should have a temporary timeframe.
- ✧ To amend the draft of the Companies law by expanding its applicability to incorporate the particular partnership companies which make up about 6% of operating enterprises.

- ✧ To amend the draft Trade Law by incorporating definitions and categories for enterprises based on number of workers. Incorporate consensual agreement decrees prior to requiring settlements by courts and finally, adopt the law.
- ✧ To amend the Regular Courts Law as to establish commercial courts and dictate that there are special judges to deal with economic and financial cases, thus promoting efficiency and effectiveness in rulings.
- ✧ 7. To enact a new law to protect property rights and encourage MSMEs to register their products by making registration costs more bearable. Creative discrimination must be applied between the MSMEs in the application side of the labor law, according to the size of the project, the inability of the stakeholders to bear the costs of the application of the law, and the nature of the economic activity that is conducted by these MSMEs. In addition, MSMEs must be given special treatment in terms of labor rights such as: hours worked, social insurance, terms of the contract, minimum wage etc, in order to promote the competitiveness of these MSMEs and to decrease the cost of applying the current law.
- ✧ To amend the current income tax law so as to discriminate between different enterprises based on size and financial situation, in regard to the level of taxation. Also, it is necessary to enact a Palestinian value-added tax law with preferential treatment to MSMEs.
- ✧ To amend the current Investment Promotion Law in order to provide MSMEs with preferential treatment and special incentives and privileges. This should be dictated by the value-added of these MSME's and not the amount of capital (which is exclusive to large enterprises).
- ✧ There should be a law in the Commercial Chambers, in order to enable MSME's to get memberships in the Commercial Chambers, in order to benefit from their services.
- ✧ It is important to form a committee that involves all parties and members who are related to MSMEs, in order to form an MSME law which includes a clear definition of MSME's, legal registration and licensing, the mechanisms for obtaining the necessary funding, legal references, the exemptions and the facilities that must be provided to them.

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Chapter VI

Enabling Palestinian MSMEs to Meet International Product Standards

Ahmad Jalad

6.1 Introduction

The Palestinian Authority adopted the Law of Standardization No.6 of 2000 (PNA, 2000) and amended it in 2004, which issues instructions for Palestinian accreditation of products (PNA, 2000, 2003, 2004). This paper is working within this context of the application of such regulations to Micro, Small and Medium Enterprises (MSMEs). MSMEs are attracting growing interest since they constitute 99% of the enterprises operating in Palestine, as well as for their significant role in the local economy. However, MSMEs face challenges and difficulties, such as their limited capacity to meet the requirements of the standards imposed by the governmental licensing and inspection agencies, as well as those favored by the consumer to enhance confidence in the products of these enterprises. In addition, MSMEs need to enhance their competitive capacity in local and international markets by decreasing production costs and improving the quality of the product, whether it is a commodity, a service or a process. Accordingly, this study aims to identify and clarify the important role of standards in the development of MSMEs and in increasing their productivity, thus increasing their competitiveness and attracting new markets locally and abroad. This study also examines the validity of the hypothesis that the application of standards by MSMEs helps to raise the productive and competitive capacity as well as the ability to attract and open new markets locally and internationally.

To achieve the goals of this study, a review of the existing literature related to the subject matter has been conducted. The review covers the theoretical definition of standards, the reasons behind their inception, the mechanisms and stages of identifying the specifications as well as their subdivisions and importance to various parties. International trade agreements and the Paris Economic Protocol are also reviewed to explore how they affect standards and mandatory technical regulations in the Palestinian Territories. The study also reviews the structure and role of the Palestine Standards Institution in regulating and supporting Palestinian MSMEs. In addition, and in order to gain a better understanding of the role

of standards and the perception of the Palestinian business community of standards, a detailed survey was conducted. The survey provides information regarding the awareness of Palestinian enterprises to the importance of standards, the impact of standard application on the costs of production and in enhancing the competitiveness of these enterprises as well as exploring the obstacles that impede the application of standards.

Previous studies indicate that the application of internationally accepted standards by enterprises facilitate the entry of their products to numerous world markets. The studies also point out that the application of standards contributes to the competitive capacity of MSMEs and eliminates technical obstacles. The application of standards positively reflects on the quality of products and considerably decreases the costs of production. As for the effect of standards on the economy in general, one of the studies concluded that the application of standards contributed to raising the productivity of the British worker by 13% during the period 1948-2002. According to another study prepared in Germany, the application of standards contributed to an increase in GDP of 1%. The results of a study that evaluated the Palestinian food industry demonstrated that development of a quality control system that is consistent with the relevant standards leads to a decrease in the costs of production by 19%.

Some owners of MSMEs say that their commitment to standards is costly, and the size of financial returns is less than the cost of meeting the standards, therefore, committing to meeting standards is unfeasible for these MSMEs.

That by itself is considered a challenge to the MSMEs; it forces them to carefully think about applying standards, taking into consideration the demands for entering the markets and remaining part of these markets, especially in the era of globalization and free trade, which renders all the markets into a single global market in which all the WTO member countries are committed to giving imported products the same advantages as local products, in addition to removing all of the barriers and the technical barriers that are referred to in the Technical Barriers to Trade agreement that is related to product standards. Member countries, according to this agreement, are obliged to adopt standards in accordance with the standards of the International Standards Organization. The agreement states that any changes in the adopted standards from its international counterpart have to be justified (WTO, 1994).

6.2 Standards and Mandatory Regulations

Product standards are determined by a document composed by general agreement and endorsed by a recognized entity such as the Palestine Standards Institution, the International Organization for Standardization (ISO) or other bodies of corporate capacity. This document specifies the rules and guidelines or characteristics for the activities and their outcomes with the purpose of achieving optimal levels of quality, environmental conservation, and health and safety. A standard must therefore be based on scientific and technical results and established expertise in various fields. Standards usually emerge from human needs and a desire to maintain a balance between increases in production and quality assurance. The development of standards is associated with the growth of these needs and the change in the patterns of production. Standards are devised by specialized experts and vary in terms of their classification with regard to the level of their acceptance, subject matter, and the participants involved in their preparation. Standards differ from mandatory regulations in many ways, mainly that regulations have mandatory characteristic while standards are more of a guide. In addition, mandatory regulations aim to ensure environmental and health protection while standards are related to quality control and performance improvements.

6.3 International Trade Agreements and the Paris Economic Protocol

According to the World Trade Organization (WTO), standards are considered one of the prominent non-tariff obstacles. International trade agreements highlight that member countries are obliged to remove tariff and non-tariff technical barriers that prevent the mobility and flow of products among WTO member countries. Member countries should prepare and adopt standards and mandatory technical regulations that are consistent with international standards issued by the International Organization for Standardization (ISO). Those countries are also obliged to grant the same preferences to imported products as those granted to local products in terms of standards and mandatory technical regulations. In its pursuit to join the WTO and benefit from the advantages membership provides, the Palestinian Authority must abide by the provisions and implications of the WTO agreements in all subjects and mainly those related to standards and technical regulations. However, The Paris Protocol provides the Palestinian Authority with the opportunity to devise import conditions and determine the technical standards for imported goods for A1 and A2 lists of goods. Goods in list A1 represent

manufactured goods in Jordan & Egypt especially, and in the Arab countries in general; these lists set the names and quantities of the imported goods by agreement between the Palestinian and Israeli sides, and fit the needs of the local market. Goods in list A2 represent the manufactured goods in the Arab and Islamic countries as well as other countries; these lists also specify the imported quantities in agreement between both sides, taking into consideration the needs of the local Palestinian market. The Protocol also allows the Palestinians to determine the conditions for good importation and their technical specifications within the quota agreed upon. On the other hand, Palestinian imports beyond the quota are subjected to Israeli technical standards. The Palestinian Authority is facing practical difficulties in the application of Palestinian standards on imported goods as a result of its weak technical and financial capabilities and the capacity necessary for testing imported goods.

6.4 The Role of the Palestine Standards Institution (PSI)

Since its inception and assumption of its duties, the PSI has played a significant role. The PSI prepared and adopted 950 standards and 24 mandatory technical regulations. It granted 159 certificates of supervision and 73 quality assurance certifications. The PSI has also accredited 33 testing facilities. The PSI is facing many challenges that limit its effectiveness and its ability to fulfill its goal. One of the main challenges is the prospect for the acceptance of Palestinian standards and their harmonization with international standards. Another challenge is the capability of Palestinian productive enterprises to apply mandatory technical regulations, in addition to the acceptance of PSI certification for supervision, quality assurance, and testing facilities. The most prominent challenge lies in the ability to provide technical capacity for testing and conformation through the provision and operation of testing facilities. One of the most important goals that the PSI has not yet achieved is to raise awareness regarding the culture of standards among Palestinian enterprises.

One of the major challenges facing the Palestinian standards is the duplicity of the standards adopted in the Palestinian market, and the variation between Palestinian standards and Israeli standards, more precisely the imported goods which are examined according to the latter's standards

The discrepancy between jurisdiction and the different government institutions is another challenge. This stems from a number of government parties issuing standards or criteria different than that stated in the standards.

6.5 Product Standards that Exist in Palestinian MSMEs

- ✧ As a response to the survey of 150 participants, about 41 of the participants who work in Palestinian businesses claimed that they apply Palestinian standards, while the other 7 participants claimed that they apply the standards of other countries.
- ✧ About 95 of the participants claimed that they use standards in the process of purchasing, 100 participants in the production processes, 108 in determining the final merits of the product and 96 participants said they used standards in examining the final products and in packaging and storing the final products.
- ✧ Concerning the purposes of applying standards to their business product, about 112 participants do this because they believe that it will improve sales and for marketing reasons, while 50 participants do this to assure the quality of products, and 19 to assure the quality of the input of the production process. In addition, about 109 of the participants believe that it will satisfy the customers' demand, while about 26 of the participants apply standards in order to reduce defects.
- ✧ About 97 participants agreed that using materials according to standards will reduce raw material waste.
- ✧ About 115 participants agreed that applying standards to production processes will reduce the number of defect products.
- ✧ About 115 participants agreed that applying standards in their businesses will increase their sales. On the other hand, 75 participants don't believe that applying standards in their businesses will help in expanding their sales to new markets outside of Palestine. This may be related to the fact that Palestinian standards may not match international standards or for the difficulties involved in exporting products outside Palestine.
- ✧ However, the majority of participants know that applying product standards is costly, but acknowledge the price is worth it.
- ✧ In another part of the survey in which 300 people participated, about 242 participants responded that they don't need to have the ISO certificate to ensure the quality of products. Only 6 participants have the ISO certificate, and only 13 participants said they have the Palestinian quality certificate.

- ✧ Finally, the survey indicated that the reason for not applying product standards to their products mainly relates to the low awareness of management and employees, the low demand of customers, the unavailability of Palestinian standards for many products and the lack of examining and testing facilities respectively, as reported by this survey.

6.6 Conclusions

This study aims to examine the role of international standards in the development of the Palestinian MSMEs. The major conclusions may be summarized as follows:

- ✧ About 57% of MSMEs operating in the Palestinian Territories don't apply standards while 22% of MSMEs attained a quality assurance certification proving the quality of their products and their conformity with relevant standards.
- ✧ MSMEs face difficulties that impede the application of standards, the most important of which are:
 - The lack of MSMEs' awareness regarding the importance of standards and their role in the development of enterprises.
 - The low awareness on the side of the consumer of the importance of standards for health, environmental, and economic protection.
 - The absence of laws and mandatory regulations for the application of technical standards.
 - The lack of technical capacity on the side of the PSI for the application or verification of standards, such as laboratory testing.
- ✧ Palestinian MSMEs do adopt standards when purchasing raw materials, in production processes, qualities of final products as well as in packaging, transport, and storage.
- ✧ Through the application of standards, MSMEs aim to broaden marketing options and ensure quality stability. MSMEs see this as an appropriate method to verify the conformity of the production process with raw materials and to meet the requirements of official bodies and clients.
- ✧ The application of standards by MSMEs contributes to the reduction of production costs by means of abstention from the use of non conforming raw materials. It also contributes to the decrease of costs resulting from the poor management of production and the reduction of non-conforming products. It is realized that the application of standards increases the volume of sales.

- ✧ The study found that the application of standards is relatively costly, adding an average of 6% to overall costs. But on the other hand, the financial returns appear to justify the extra costs, making the application of standards cost effective. This conclusion is supported by reports from the participants.
- ✧ 75 persons objected and strongly objected that applying standards helps when trying to access new global markets, while 39 persons thought that it did, the number of neutral participants was 36. This contradicts what previous studies have found. There are several reasons for this, including: incoherence of the Palestinian standards with international standards, a failure to accept the procedure of evaluating conformity in Palestine with those countries that export to it, and Israeli attempt to limit imports and exports.

6.7 Recommendations

In order to increase the productivity of Palestinian businesses and thus increase competitiveness and attract new markets locally and abroad for their products, the following recommendations are offered:

- ✧ The need to review and re-write some laws and regulations related to the application and activation of standards ensuring their compatibility, specifically those relevant to overlapping authorities and various technical references.
- ✧ The importance of coordinating the efforts of the PSI with other specialized public and private bodies in order to raise the awareness of the importance of the application of standards.
- ✧ Providing the financial and human resource capacity necessary for verification of standards through the increase of PSI allocations in the public budget and supporting the Ministry with the technical staff and expertise necessary to carry out its responsibilities.
- ✧ It is necessary that MSMEs apply standards to raise the confidence of consumers in their products and in order to improve their competitiveness via decreases in costs, improving quality, and accessing new markets.

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Chapter VII: Improving Palestinian Investment Legislation to the advantage of SMEs

Dr. Feras Melhem

Small and Medium Enterprises (SMEs) constitute 99% of the existing economic institutions in Palestine, and are the largest employers. However, the SME's in Palestine face many difficulties related to access to finance, products promotion, weak experience, technology, and unskilled labor. The Palestinian National Authority became aware of the importance of such projects in economic development, and as a result they started various studies on how to support and encourage SMEs. It could be argued that those studies are still in their initial stages and have not been translated into substantial actions or practical steps to find ways to promote SMEs as did neighboring countries such as Egypt, which developed a series of different policies on how to promote SMEs. Some of those policies have been translated into legislation, such as the law facilitating the registration process of SMEs known as (One-Stop-shop).

In order to contribute to finding the means of strengthening SMEs, the Research Institute of Economic Studies took upon the task of analyzing the Palestinian Investment Act of 1998 by assessing its contribution to promoting domestic and foreign investment in SMEs on one hand, and whether its provisions contribute to bringing foreign investment in Palestine through SMEs, on the other. This study did not stop at this, but evaluated the legal framework for investment in Palestine, and showed the strengths and weaknesses regarding its provisions

Defining SMEs was not an objective of the study, but some definitions have been reviewed by comparing and looking into those that depend on the amount of capital invested, the number of employees or both. In the absence of a clearly defined and accredited definition of SMEs in Palestine, economic studies found that the size of the average capital invested is less than 60% of the minimum required to benefit from the incentives of the Investment Promotion Law.

It should be noted that the legislative policy in place internationally for the promotion of SMEs takes two forms:

1. Positively approaching SMEs within the legal framework by having them at the heart of the investment promotion laws through its provisions of tax incentives, customs and public guarantees, as in the Tunisian law.
2. Not specifying a minimum for investment in SMEs, and thus benefiting from the incentives of those projects. With reference to the Investment Promotion Law, it was found that it did not take into consideration either one of the two approaches above, and thus incentives for SMEs were ignored in the law.

Through the analysis of the Investment promotion Act, it became clear that it didn't identify the investor's nationality; meaning that national and foreign investors alike benefit from its provisions. The Act addressed the incentives and privileges granted to investors, but did not indicate the procedures required to benefit from the incentives granted by law, leaving it to the provisions' regulations which have not been issued yet. The study treated laws related to investment such as company law, intellectual property, the taxation system, and the urban and industrial zones' laws. The study concluded that these laws contribute to the promotion of investment, but some are in need of standardization and being kept up to date.

The rationale behind enacting an investment promotion law aims to:

- ✧ Increase the hard currency flow to Palestine to establish projects and develop businesses.
- ✧ Increase employment.
- ✧ Obtain advanced technology which is important to increase production and product quality.
- ✧ Develop certain economic sectors through granting them investment incentives.
- ✧ Strengthen the competitiveness of Palestine in the long run.

7.1 Objectives

The objective of this study is to analyze the investment legislations related to SMEs, especially the Palestinian Investment promotion Act 1998 in order to:

- ✧ Assess its contribution in encouraging domestic investment in small and medium enterprises.
- ✧ Assess whether its provisions contribute in bringing the small and medium foreign enterprises to invest in Palestine.

- ✧ Assess the legal framework for the investment in Palestine, and identify its strengths and weaknesses regarding the provisions.

7.2 Investment promotion Law

The Palestinian Investment promotion Act 1998 organized the investment in the occupied Palestinian territories and established the Palestinian Investment Promotion Agency (PIPA) that consists of 13 members, 5 of them from the private sectors and the remaining are from the Ministries. The PIPA is responsible for many tasks such as licensing, management and supervision of investment projects, evaluating the laws, suggesting policies, and monitoring projects.

The law allows the investment in all sectors except some fields such as distribution of weapons, air industries, electricity production and distribution, re-petroleum processing, recycling waste and solid waste, telecommunications, radio and TV. Investing in those previously mentioned industries needs the approval of the Council of Ministries. The law also conserves the private property and prohibits expropriation unless it was for public benefit return, with fair compensation or under the court ruling.

The Palestinian legal system has allowed the possibility of implementing the provisions and decisions issued by foreign courts. In the cases of countries where the Palestinian law is not applicable, the Palestinian legislators can refuse the arbitration by foreign courts.

Tax and Customs Exemptions

The law treats all the economic projects in all sectors equally except some projects such as business, insurance, real estate (other than development projects), banks, exchange companies, and any financial institution other than mortgage companies only. The minimum capital required from the companies to benefit from the exemptions is \$100,000.

The investment projects are granted many exemptions such as:

- ✧ Grant exemption to the fixed assets of the project from indirect taxes and customs that entered during a certain period determined by the PIPA.
- ✧ Grant tax and customs exemptions for fixed assets in the case of the development, expansion or modernization of existing projects, as long as the owner of the project proves that the development will increase the production.

The investment projects that take the approval from the PIPA acquire exemptions on income tax as follow:

- ✧ Any investment between \$100,000 - \$1m granted full exemption of income tax for 5 years, and partial exemption on the net income at a nominal rate of 10% for 8 additional years.
- ✧ Any investment between \$1m - \$5m granted full exemption of income tax for 5 years, and partial exemption on the net income at a nominal rate of 10% for 12 additional years.
- ✧ Any investment above \$5m granted full exemption of income tax for 5 years, and partial exemption on the net income at a nominal rate of 10% for 16 additional years.

The law grants exemption in many ways:

- ✧ The Council of ministers can offer some projects and businesses full exemption of income tax for 5 years, and partial exemption on the net income at a nominal rate of 10% for additional 20 years.
- ✧ It grants exceptional exemptions for export-oriented projects, as long as the percentage of production for exports is at least 30% of the total production, and the exemption period not exceeding 3 years.
- ✧ It grants the public shareholding companies whose shares are offered for public subscription tax exemption on the profits, and the percentage of this law exemption is 20% of the nominal value of the share of the shareholder in the capital project.
- ✧ It grants exemptions and full customs to some investment projects such as:
 1. Furniture imported by hotels and hospitals.
 2. Electrical and electronic equipment for the tourism projects and private hospitals and projects.
 3. Purchases of furniture and furnishings, tools, electrical and electronics equipment and supplies by hospitals and hotels that require for refurbishing and renewal once every 5 years, providing it must be entered in to Palestine or used in the projects within 2 years from the approval from the investment promotion agency.

7.3 Laws Related to Investment

7.3.1 The Corporate Laws

The corporate laws organize the types of business and define how to establish each of them. It has been applied by the British mandate companies' laws for the years 1929 and 1930 in Gaza strip, and applied the Jordanian Companies Law number 12 for a year 1964 in West Bank. The legal framework for the registration of businesses is similar in both systems.

The two laws recognize three kinds of companies:

1. Normal companies
2. Limited Liability Companies.
3. Public Shareholding Companies.

The responsibility of the Ministry of National Economy is to register companies; the requirements for the establishment and registration are:

- ✧ Document of incorporation (company names, identifying goals, determining the responsibility of members, determining the amount of capital).
- ✧ Preparation of the rules of procedure.

7.3.2 The Intellectual property laws

The Palestinian legal system in the West Bank and Gaza strip regulates protection to trademarks and patents, which encourage the foreign investors to enter the market significantly.

7.3.3 Tax legislation

The most important types of taxes are the:

1. Income tax: Tax collected from population.
2. The purchase tax: Tax paid on the wholesale prices of consumer goods and some raw materials and goods produced. The rate of tax purchase is between 5%-95%.
3. The value added tax: Tax imposed on goods and services produced locally with the exception of goods for export and tourism services, fruits and vegetables. And the proportion of VAT is 14.5% imposed on annual sales of business.
4. Tax on international Trade that includes:

- ✧ Customs duties that reach in general 50%.
- ✧ Purchase tax that reach 5%-240%.
- ✧ The value added tax which amounts to 14.5%

The tax cuts stimulate the domestic and foreign companies to invest in Palestine. However, the parties (Palestine and the country of the investor) have to be ensured that there is no double taxation in the absence of bilateral tax agreements since some of the tax legislation imposes taxes on the basis of nationality.

7.3.4 The Palestinian Investment Promotion Law: Pros & Cons

The Palestinian Investment Promotion law aims to protect investors and to grant them benefits and privileges to invest by:

- ✧ Promoting and encouraging the economic openness.
- ✧ Organizing the expropriation.
- ✧ Providing guarantees which is very important for the investor decisions, such as guarantees against expropriation of the project economic, others related to the free transfer of capital abroad, guarantees related to resolution of disputes that may arise as a result of investment and the role of the local judiciary in settling disputes, guarantees of non-cancellation the management of investment projects, guarantees against nationalization and expropriation.
- ✧ Stimulating the investors to invest in Palestine.
- ✧ Promoting export-oriented investments.
- ✧ Encouraging investors to establish a public shareholding companies.

However, there are a few drawbacks related to the Investment Promotion law, including:

- ✧ The law did not match the international standards such as granting preferential treatment to local investors
- ✧ Did not specify what is meant by the special projects, which opens up the possibility of fraud and manipulation.
- ✧ The Council of Ministers and the Investment Promotion Agency have broad powers to grant tax and customs exemptions, and this may adversely affect the investment situation especially if there was a case of bad use of authority.
- ✧ The Law grants tax and customs exemptions without taking into accounts the development of certain geographical areas or particular economic sectors.

- ✧ The ratio and period of the tax and customs exemptions is high compared to other countries.
- ✧ The guarantees against the cancellation of the project investment in the Investment Promotion Law are not satisfactory.
- ✧ The laws about regulating incentives did not take into account encouraging investment in SMEs.
- ✧ Granting privileges and extra incentives for the use of a certain percentage of local raw material and sources may be contrary to international standards, particularly those contained in the Agreement on Trade-Related Investment Measures (TRIMS). Article 24 (c).
- ✧ The law also does not comply with international standards set by the TRIMS agreement in the text in Article 31 which reads: "The Commission may grant exemptions for exceptional exporting projects ..."
- ✧ The ratio and duration of tax and custom exemptions are considered high.
- ✧ The law did not grant tax and custom exemptions based on institutionalized developmental regulation that takes into account the development of certain geographical areas or the development of a particular economic sector.

7.4 Recommendations

1. The Palestinian Authority has to offer every economic sector the attention, guidance, and specific and distinctive legislative policy.
2. The need to follow the legislative policy based on the selection of projects which is important to the national economy that can benefit from the exemptions and tax benefits.
3. Modernize and update the commercial and economic laws.
4. Redefine the investor's capital, to include cash and in-kind investment and intellectual rights.
5. Review of article 4 of the law concerning the nature of the projects benefiting from the incentives so as to encourage certain sectors while not closing the door to others (i.e. interest in the information and communication technology ITC).
6. Review the article 43 of law, with regard to the exemption of commercial projects, or at least defining the exempted commercial projects in the provisions of the law. It would have been better to use the term business here.
7. Revisit the articles related to the investment promotion body, especially with regard to determining the functions of the Governing Council and Investment Directorate, and also to increase the

representation of the private sector and economists. Some of the tasks need to be entrusted in the board of directors such as: supervising the investment projects, as well as maintaining control over them. And here, we see that these tasks rest with the Directorate of Investment, which provides supervision and monitoring reports to the Governing Council for discussion and decision-making and appropriates recommendations.

8. There is a need to clarify or establish clear criteria for some of the terminology used such as "special quality projects."
9. Review the legislative and economic philosophy behind granting tax exemptions. It is well known that the tax and custom exemptions are not considered decisive factors in the investor's decision since the imposition of high taxes on income may lead to the reluctance of investors to invest their money. However, permanent tax-exemption or low taxation may lead to capital flee to the country of the investor. Such a situation occurs when the country of the investor imposes taxes on the income of the company.
10. Some experts recommended that tax exemption should enter into force once the project starts making profit and not once the project starts operating, while emphasizing the necessity of activating the supervision over projects in order to reduce the manipulation of financial statements for the purpose of obtaining exemptions provided by the law.

Chapter VIII: Compliance of WTO Requirements to Palestinian Standards and measures

Dr. Issam Abdeen

8.1 Introduction

In seeking to join the World Trade Organization (WTO), the Palestinian Authority is attempting to assert in its legislation the importance of complying with the organization's standards. In doing so, the PA is facing the huge challenge of conforming its internal laws and legislation to a list of obligatory international trade agreements and conventions. In addition, the PA is also facing the challenge of solving the predicaments present in the Palestinian Standards and Measurements Law which includes dealing with all aspects of contradiction with other related Palestinian laws; this in turn will pave the way for the PA to join the WTO.

The Palestinian legislator, while drafting the Palestinian Standards and Measurements Law and other related laws, ignored the main goals of the WTO's conventions, specifically in relation to particular Technical Barriers to Trade (TBT) and Sanitary and Phytosanitary Measures (SPS). This in turn will have harsh consequences for the Palestinian side in the process of future negotiations to join the WTO.

This study aims to review the Palestinian Standards and Measurements Law No. 6 (2000) along with its amendments, regulations and instructions. In addition, it aims to analyze the law's strengths and weaknesses, to draft amendment proposals to enhance its legal framework and to deal with its predicaments in a manner that fits within the related Palestinian laws and also conforms to current international standards and trends, while also complying to the general framework of the Palestinian Standards Institution's (PSI) new strategy for the years 2010-2013.

8.2 The Legal and Institutional Framework for Standards and Measurements

The Palestinian Standards and Measurements Law No. 6 (2000) presents the legal framework for standards and measurements in Palestine. The law was amended through Law No. 3 (2004) which explained the required

mechanisms through the process of preparing and approving standards and measurements. The Cabinet issued the national measurements system No. 2 (2003) that affirmed that the Palestine Standards Institution's (PSI) board of directors has the authority to adapt and approve instructions and provisions regarding the measurements system.

On the 28th of January 1994 the head of the P.L.O Executive Committee approved the establishment of the PSI which started operating at the end of 1996 out of Nablus. But the institutional framework remained unclear until the issuance of the Palestinian Standards and Measurements Law No. 6 (2000). The law specified the goals of the institution that includes; approving specific systems for standards and measures, achieving health, economic, and environmental protection for consumers, in addition to supporting the national economy, economic development plans, and developing industry.

According to the Law, the board of directors of the PSI consists of 12 members; 7 representing governmental bodies, and 5 representing NGO's with the Minister of National Economy as the Chairman.

8.3 Evaluating the Standards Law

It's obvious that the Palestinian law was simply a copy of the Jordanian Standards and Measurements Law No.15 (1994). This opens the discussion regarding the policy that the Palestinian legislators follow and the extent to which they have a clear legislative plan that takes into consideration Palestinian legislative priorities and the uniqueness of the Palestinian state. Palestinian legislators failed to notice that the Jordanian Law that they copied has been cancelled and replaced by another Law No. 22 (2000).

The terms and definitions that appear in the Palestinian law must be revised in order to keep up with technological advances taking place in other areas of the world.

The definition of "Palestinian Standards" found in Article No. 1 of the law is very general and applies everywhere. In addition, the definition does not highlight the guiding, non-obligatory purpose of "the standard" as it appears in the annex of the TBT agreement.

There is a need to add more definitions to the Standards and Measurements Law, and to adjust some of the definitions that already exist in the law according to the TBT agreement.

It is clear that the Palestinian legislator is reluctant to grant the PSI administrative, financial, and regulatory independence. This contradicts international practices and trends. A manifestation of this reluctance is found in deleting the phrase “administrative independence” that existed in the Jordanian Law.

8.4 Standards and Measures Compliance with WTO Requirements

There is no doubt that there is a huge burden on the Palestinian legislator in paving the way to start the negotiations to join the WTO. It is necessary to understand that this is a long and complicated task that needs time and effort; one that cannot be reduced through a simple legal text added towards the end of Standards and Measurements Law that states that, preparing and approving standards and obligatory technical instructions must be done according to WTO principles.

Many steps must be taken in order to ease the process of making sure that Palestinian standards and measures comply with WTO requirements, such as; involving the private sector in preparing standards and measures, improving performance in terms of preparing and approving the obligatory technical instructions and achieving the requirements of international standards.

8.5 Conclusions

One of the major findings of this study was that the lack of a clear, coherent legislative plan subject to assessment and review contributed directly to the deficiency in the Palestinian Standards Law as well as to the overlap with other related laws such as: the Consumer Protection Law, the Public Health Law, the Agriculture Law, the Environment Law and the Labeling and Control of Precious Metals Law. This led the Palestinian legislator to overlook the requirements of joining the WTO. In particular, it was overlooked that the TBT stressed in its third Annex regarding “Good Practices Principles” the importance of exerting all efforts to avoid the overlap of authorities and tasks between the standards institution and other relevant bodies.

The Specifications and Measures Law neglected the fact that the obligatory technical instructions must not be set in a way that might create unnecessary barriers to international trade, while taking possible risks into account. The law also failed to stress the importance of complying with “Good Practices Principles” in the process of preparing and implementing the standards. All of this is extremely important in order to join the WTO.

Additionally, the Specifications and Measures Law left the control and inspection mechanisms vague by transferring it to an act that has not yet been issued by the Cabinet. In addition, the law contributed to the shortage of financial resources of the PSI through depriving it of the revenues it generates. Moreover, the law granted the authority of licensing laboratories to the PSI, contrary to international trends.

8.6 Recommendations

The study recommends that a clear and coherent legislative plan be implemented gradually and aim to resolve all aspects of deficiency in the Specifications and Measures Law and to conform it to other related laws, as well as to international trends and practices represented by WTO’s conventions.

The study also recommends the development of the PSI’s administrative, financial, and regulatory independence. This follows the international trends that stem from the fact that the institution needs experts, specialists, and equipment capable of marketing itself locally and internationally, and also capable of designing economic policy, achieving development and encouraging investment.

Furthermore, the study suggests that efforts should be directed towards solving the imperfections caused by the absence of authorized bodies responsible for control and inspection. Further efforts should be directed towards adopting the recommendations of the TBT regarding preparing standards, obligatory technical instructions and compliance assessment procedures.

The study also recommends setting rules to coordinate with international bodies through the establishment of a comprehensive information center within the PSI. This center will be responsible for the exchange of information and providing answers for all inquiries related to specifications, measures, and technical instructions in accordance with the

TBT and SPS. It also recommends establishing a national center for licensing laboratories that is totally separate from the PSI.

The study stresses that ministries and governmental bodies must fully coordinate with the PSI in issues related to the PSI's field of work. In addition they must work with the PSI to remove all legal and technical obstacles that limit the efficiency of the institution, affect economic performance, and harm future efforts to join the WTO.

8.7 References

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Chapter IX: Irrigated Agriculture as Business Enterprise in Palestine

Fathi Srouji

9.1 Introduction

This section aims to describe the small and medium sized enterprises in the irrigated agricultural sector in the West Bank. This sector accounts for a significant share of employment in the Palestinian economy. The agricultural area in the Palestinian Territory (whether cultivated or not) was about 2,559 million dunums in 2006, which forms about 42% of the total area. However, only part of this area is irrigated (PCBS, 2008). The study explores the problems facing this sub-sector and suggests policies that may contribute to solving them, and in turn lead to the growth and development of this sector. The study concentrates on this sub-sector due to its significance in terms of productivity. In fact, the productivity of one irrigated dunum is known to be equal to about 28 times that of a rain-fed dunum. The definition of small, medium, and large firms in agriculture was made according to the area of the holdings: small agricultural enterprise with 10 dunums or less and medium agricultural enterprise with 11-40 dunums. Holdings of more than 40 dunums were classified as large agricultural enterprises. This is due to the fact that employment in agriculture is characterized by family, seasonal, and part-time employment, which makes it difficult to classify agricultural holdings into small and medium according to the number of workers. Therefore, this chapter will be devoted to explore the major merits of MSMEs in irrigated farming businesses as well as other related issues including financial and marketing aspects.

The findings of this section are based on a special survey conducted on Palestinian farmers. The survey includes a sample of farmers from the West Bank governorates who practice irrigated farming. These governorates are Jericho, Jenín, Tubas, Tulkarem, Nablus, Qalqilia and Hebron. The sample has been chosen according to the relative importance of each of the governorates to the total irrigated agricultural land within them.

9.2 Major Merits of the Palestinian Agricultural Sector

The major merits of the Palestinian agricultural sector may be summarized as follows:

First: The area of Palestinian cultivated land is about 1,500.2 million dunums (2007), which forms about 59% of the Palestinian agricultural Area. The Palestinian agricultural area includes fruits, vegetables, seeds, and non-fruitful trees. The irrigated area is only about 12% of the total agricultural area. The majority of land holders are male, leaving only 5% of the total land area to be owned by females. Of the total, about 97% of agricultural holders are heads of households and have an average family size of 7.9. In addition, the majority of land areas are 10 dunums or less, while the average piece of land is 19.8 dunums in the West Bank and 8.5 dunums in Gaza Strip (PCBS; 2008).

Second: This survey found that almost half of Palestinian farmers own their own land, while 23% of them lease from other owners, and 32% of farmers use the land of others on a profit sharing basis. The last two forms of farmers mainly belong to small and medium pieces of lands.

Third: The majority of Palestinian farmers use regular crop rotation cycles (sequencing) and most of them use the biennial cycle that extends for two years. The use of crop rotation cycles increases land fertility and improves biological pest control. In addition, the survey indicated that 56% of Palestinian farmers have a low level of education - below the secondary level, while 44% of farmers hold a general secondary certificate or higher. A higher level of education could lead to rapid acquisition and better utilization of technology, about 70% of the sample fall within the age groups of more than forty years , and 71% of them have more than twenty years agricultural experience.

Fourth: Most Palestinian farmers (65%) buy their water for irrigation from owners of water resources - irrespective of the size of land tenure. Only 7% of small farmers own their water resource, in comparison with 9% of medium scale tenants and 30% of large scale tenants. In addition, 49% of the farmers own their own equipment, while another 49% rent equipment from their owners, and only 2% rent equipment through cooperative societies. Finally, 79% of Palestinian farmers work on their lands alongside other workers from their families, both males and females, paid or unpaid, in addition to employing male and female workers from the market. The amount of non-family workers increase in large scale

agriculture compared to small and medium sized, with the average number of workers reaching 3.42 males and 2.67 females.

9.3 Financing of Farming

The financing issue is one of the major issues which influences the growth of this sector. Thus, the following section is devoted to explore the major aspects of financing small farming businesses.

9.3.1 Methods of financing agricultural supplies

Palestinian farmers mainly (55%) finance their purchasing through cash transactions from their savings. On the other hand, about 45% of Palestinian farmers finance their purchasing through a credit instrument, such as accounts payable (credit granted from wholesaling merchants), farming cooperatives or using other Islamic transactions. However, small farmers use credit granted from wholesaling merchants to finance their farming supplies less than medium-sized farmers according to ANOVA analysis. In other words, the farmers who own large farms use more credit financing compared to small land owners. The data shows that 48% of small- sized farmers tended to finance their purchasing by debt entirely or partially, 60% of medium- sized farmers, and 74% of large- sized farmers.

9.3.2 The need for external financing by Palestinian farmers

In order to estimate the need for external finance by Palestinian farmers, the survey indicated that only 19% of small farmers didn't require external finance, while 39% of Palestinian farmers need an external source of financing in most seasons, as presented in Table No. 1.

Table No. 1: The Need of Palestinian Farmers for External Credit Based on Size of Land

	The need for external credit	Ratios
Owners of small size of land (10 Dunums or less)	Always	11.6
	Most of seasons	42.7
	Some seasons	27.0
	No need	18.7
	Total	100%
Owners of medium size of land (11 Dunums to 40)	Always	9.7
	Most of seasons	32.3

	The need for external credit	Ratios
	Some seasons	26.9
	No need	31.2
	Total	100%
Owners of large size of land (More than 40 dunums)	Always	8.2
	Most of seasons	35.1
	Some seasons	29.7
	No need	27.0
	Total	100%

9.3.3 The use of loans by Palestinian farmers

The survey indicated that the majority of the farmers (95%) never received loans from either commercial banks or from microfinance organizations. In addition, large scale farmers showed less inclination to resort to loans. Thus, only 5% of Palestinian farmers got loans to finance their businesses. This applied for all types of farmers including small, medium and large owners. The reason for not getting loans to finance some farming activities were distributed between regional reasons, the difficulty of repaying in time, the high cost of external financing, and the inability to offer collateral against the loan. In addition, there are several methods available to finance agricultural inputs. These methods are: buying in cash through the lease holder, and, on credit from the agricultural materials merchant in return for supplying him with the crop at the time of harvest. The results also reveal that the necessity for loans differs by the size of the land tenure. So while small farmers regularly require loans, the need reduces as the area of the holding becomes larger.

In comparison, other studies reported close results. For example, Sabri (2008) found that the agricultural sector uses the least amount of credit from the Palestinian banking system. In addition, the majority of farmers don't accept the concept of using their lands as collateral for getting loans from banks, while they prefer using agricultural credit cooperatives for getting loans.

Finally, it may be concluded that there are several ways available for financing the purchase of agricultural production inputs. Most tenants finance these purchases in two main methods; the most prominent is to buy on credit from agricultural inputs merchants with 53% of tenants doing so. Also, the cash payment method by landowners can be used, with 45% of

tenants using this method. Other methods are also used to finance the purchase of these inputs, but are less popular than the previous two. These methods are: buying in cash through the lease holder, and, on credit from the agricultural materials merchant in return for supplying him with the crop at the time of harvest. The results also reveal that the necessity for loans differs by the size of the land tenure. While small tenants regularly require loans, the need reduces as the area of the holding becomes larger.

Table No. 2: Reasons that prevent owners from direct borrow

The reason for not going to borrow	The number of iterations	Percentage
Unwillingness to borrow due to religious reasons	298	83
Unwillingness to borrow due to the fear of inability to repay	267	77
An unwillingness to borrow because of the high cost	267	76
unwillingness to provide the required assurance	262	76
Unwillingness to borrow due to long repayment period	246	71

9.4 Applying the concept of insurance on agricultural activities

The survey showed that two-thirds of Palestinian farmers know about the concepts and systems of agricultural insurance. In addition, they are generally willing to participate in such a system if it's initiated in the Palestinian economy. 64% affirmed their willingness to contribute 1% of their sales to the insurance fund. This percentage rises to 86% among those who expressed their desire to participate in the system under the condition that the Palestinian government has to participate in the fund of the insurance system alongside their 1% contribution of income

9.5 Tax awareness

The survey indicated that one-fifth of farmers are not familiar with the possibility of recovering a part of the value added taxes imposed on the purchased input supplies. In addition, farmers generally reported that they know about such a possibility, but they don't participate due to the complicated and time consuming procedures and they may not be able to find the needed invoices and other documents. The Results of the analysis indicated that most farmers (61%) will participate in the system of agricultural insurance in the event of application of the law.

According to group that ensure from recovering part of the value added taxes, but do not require invoices to submit them to the department of Palestinian, the reasons could be summarized as the follow:

- ✧ Trader refused to give them the invoice.
- ✧ Trader try to raise the price if he purchased by bill.
- ✧ The complexity of the recovering tax process.
- ✧ The long period that required to recover tax.

9.6 Marketing Aspects

The major methods of marketing for Palestinian farming products are based mainly on selling from the land to mediators who are either drivers or wholesalers. They take products to vegetable and fruit markets in Palestinian cities, or export it inside green line territories, or process it to export such products outside Palestine. However, some farmers use their own vehicles to distribute their produce, while only a few of the farmers deal directly with final consumers through selling directly from their land. The majority of the small farmers use drivers to distribute their products, compared to medium and large farmers who mostly deal with traders and wholesalers. In addition, the majority of the problems faced by Palestinian farmers in marketing their products are detailed in Table 3.

Table No.3: Ranking of Marketing Problems Facing Palestinian Farmers

Problems of marketing aspects	Frequencies	Rank
High cost of market fees	293	1
High cost of transportation	218	2
Competitions from imported products	190	3
Multiple mediators in marketing process	154	4
Unorganized markets	81	5
Military checkpoints	71	6
Lack of government policy	69	7
Lack of specialized exporting companies	68	8
Bad agricultural roads	59	9
Lack of specialized packaging companies	42	10

The table indicates that the majority of farmers believe that market fees are very high, which reach around 10% of the sales value, distributed between the municipality which gets 4% and contractor with 6%. This is followed by the high cost of transportation as perceived by 63% of participated

farmers; the unfair competition that arises from imported products was considered a major problem by 53% of the farmers, the multiplicity of mediators (43%), the absence of legislation that regulate the work of fruit and vegetable central market (24%), the Israeli military checkpoints (22%) and ,the absence of a clear government agricultural policy.

In addition, problems were reported in the multi-mediators and wholesalers in the marketing process, a lack of exporting and packaging companies, and the unorganized vegetable and fruit markets. Further reported problems are the high fees of the central vegetable markets in the main Palestinian cities, the competition from products within the green line, the high transportation costs, the shortage of chemical fertilizers forbidden for security reasons and the large number of middlemen working as wholesalers, as well as other problems caused by military occupation. These include the temporary and permanent checkpoints, the lack of export or classification and calibration companies in nearby areas, and the high cost of agricultural production inputs, including water sources for irrigation, which are mainly under the control of the occupation.

9.7 Recommendations

Finally, based upon the findings of this study, the following recommendations may be drawn out:

- ✧ To accelerate the introduction of an agricultural insurance system.
- ✧ To encourage and help owners of wells to transfer to electricity pumps from fuel pumps, that will lead to a decrease in the prices of irrigation water.
- ✧ To address the problem of the unavailability of chemical fertilizers with Israel and to provide heavy equipment; this will increase productivity.
- ✧ To promote cooperatives when purchasing agricultural production inputs and in the marketing of crops.
- ✧ To encourage small-credit financing institutions to deal with small farmers, especially in offering loans under Islamic financing, reducing their demands for guarantees, and lowering their rate of interest.
- ✧ To activate extension services, especially technology diffusion to small farmers.
- ✧ To encourage small farmers to use the agricultural crop rotation cycle in order to increase soil fertility and to improve the biological control of agricultural pests.

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Chapter X: Marketing of MSMEs' Products

Anton Sabella

10.1 Introduction

The MSME sector has assumed a more substantive and significant role in developing domestic economies by providing opportunities for employment and boosting the Gross Domestic Product (GDP). Since MSMEs constitute the majority of enterprises in the Palestinian Territories, it has become increasingly important for those managing MSMEs, their supporting organizations, and domestic legislators to put forth all possible efforts and to advance the performance and development of MSMEs in terms of both the quantity and quality of their marketing initiatives. In light of the fact that marketing constitutes an essential function in the performance of any organization, including MSMEs, marketing has become synonymous with opening up new markets and developing products and services that better suit the needs and wants of customers.

10.2 Methodology

This study used a topic-specific questionnaire distributed to 407 businesses. The number of returned questionnaires was 254 from the West Bank and 111 from the Gaza Strip. The questionnaire was aimed to collect data about the current marketing situation in MSMEs within the Palestinian Territories and to measure to what extent different marketing techniques or tools are deployed and used by Palestinian MSMEs. The collected answers of the survey will help in exploring the level of awareness towards marketing concepts and techniques in these enterprises. Moreover, the study aims at exploring the quality and different types of support rendered to MSMEs from supporting organizations, in particular, those related to marketing. Accordingly, this study will be able to suggest recommendations to expand MSMEs' market coverage, and improve their innovation and competitive abilities based on the perceptions of MSME businessmen.

10.3 Findings of the Study

The survey indicated that 96% of the selected sample from Palestinian businesses had no marketing departments, and the majority of MSMEs that

have marketing departments are large firms as expressed by number of workers and managed by educated managers holding university degrees. In addition, the study revealed that marketing instruments were mostly used in the active economic cities in Palestine including Gaza City, Nablus, Ramallah and Hebron. The study found that there is a positive correlation between the size of sales and using marketing instruments in Palestinian MSMEs. However, to understand the marketing situation of Palestinian MSMEs, this study presents the major findings of the survey.

Methods of promotion and advertising are considered to be one of the major functions of the marketing process; thus this study examines the situation that exists in the Palestinian economy in the context of MSMEs. Based on the collected questionnaires, the study found that the majority of Palestinian MSMEs concentrate on self-promotion and their goodwill in promoting their products in the Palestinian economy, as presented in Table No. 1. The table shows that using marketing and advertising means, such as newspapers, the radio and exhibitions by Palestinian MSMEs are limited and ranged only between 4% and 6% of the total participants of the survey.

Table No. 1: Methods of Promotion Palestinian MSMEs

Methods of Selling	*%
Personnel Promotion	87%
Newspapers and radio	4%
Catalogues	6%
Exhibitions	5%
Goodwill	58%
Others	6%

*more than one for some buyers

This limited use of marketing functions applies also to the distribution methods of selling the products of Palestinian MSMEs, since the majority of businesses use only direct selling from their own location, as presented in Table No. 2. In addition, only 4% of total Palestinian MSMEs use agents. It's known that the use of agents to distribute products is mainly associated with large wholesaling firms and factories. The rest of the participants of the study use other methods of selling, such as distributing their products to other wholesalers and retailers, as presented in Table No.2.

Table No.2: Distribution Methods of Selling for Palestinian MSMEs products

Methods of Selling	%
Direct Selling	52%
Thought wholesaling	9%
Retailing	16%
Agent	4%
Others	19
Total	100%

For the importance of the marketing processes in the MSME's, about 47% agree on its importance while about 14% strongly agree.

Another aspect which the study revealed is related to the obstacles facing Palestinian MSMEs in the marketing process. It is shown that the majority of Palestinian MSME owners believe that the political situation is the main obstacle facing the marketing of their products, this situation may refer mainly to check points and cross boarder points. The second important obstacle for marketing in the Palestinian economy is related to the limited sources of finance allocated to marketing functions as perceived by the majority of the participants who agree or strongly agree about this cause. Finally, the unimportance of marketing in a firm's strategy is perceived as one of the obstacles of not using many marketing concepts, since the majority - 89% - either agree or strongly agree about such issues.

Another issue was explored through this study relating to the role of supporting organizations to the marketing function, such as training and exhibitions services. The study found that about 94% of Palestinian MSMEs don't get benefits from such services and they are not satisfied with such services. However, between 50% and 66% of Palestinian MSMEs who actually benefited from such services are satisfied with the services received, about 55% don't know about the existence the supporting organizations.

Approximately 80.5% of the sample of MSME's reported that the supporting organizations do not play a positive role in promoting their products through exhibitions, while about 7.1% praised the positive role they played and 12.3% took a neutral view.

Another related element to the marketing function was examined in this study, which is related to the social and professional networking between managers, competitors and suppliers of Palestinian MSMEs. The study found that the majority (up to 95%) of Palestinian MSMEs seeks a social and personnel relationship with suppliers, but they don't believe such a relationship is that important to running their businesses. However, this type of relationship is much less prevalent when considering relationships with competitors. Finally, Palestinian MSMEs generally believe that business and professional relationships are more important than personal and social relationships.

10.4 Conclusions

Based on the findings of the survey of Palestinian MSMEs, the following conclusions are offered:

First: according to the study, many MSME managers are not aware of the importance of marketing and few consequentially use any marketing tools. Most MSME managers do not develop any marketing plans with clear objectives for their enterprises and the majority do not have a marketing department. This was also indicated from the unwillingness of managers to consider creating a marketing department in the future. Analysis of the respondent's answers identifies that enterprises that deploy marketing are larger in size and inhabit districts that are economically more active, such as Nablus, Hebron, and Ramallah. However, the building of strong relationships through effective interactions with customers was the most prevalent method of marketing being used; strategies that represent no actual outlay of money. The awareness of the importance of establishing a marketing department at the establishment is, to some extent, associated with the level of educational attainment of the manager of the establishment to some extent. In this context, the questionnaire shows that approximately 71% of the MSME's which have marketing departments are run by people with university degrees.

Second: The study highlights the importance of MSMEs focusing on the needs of the customer as opposed to the actual product. This will enable the enterprises to produce better products that match customer demand and be capable of self-promotion. It also suggests that those who are unable to establish a marketing department within their enterprises should try to obtain the services of marketing experts to help them in developing effective marketing plans, including budgets and activities, which correspond to their needs and capabilities. Additionally, branding was

viewed as a key factor in the positioning of the product in the consumers' mind and must be continuously managed and maintained. This can be achieved through effective promotion and advertising using different media vehicles like billboards, newspapers, the radio and television etc.

Third: MSMEs face several obstacles and difficulties in marketing their products. The most commonly stated obstacle was the orientation of the management of the enterprise and their approach towards marketing, which is invariably considered as a peripheral concern. It was also found that the lack of awareness and knowledge about marketing in those enterprises represent another major obstacle in addition to political and financial complications. For some, the financial situation of the enterprise constitutes a major problem for the development of any marketing plan and using any techniques or tools thereof. Competition, on the other hand, was not seen as an obstacle; to the contrary, it is seen as conducive to the development of the enterprise in all aspects.

Fourth: The role played by the supporting organizations is minimal. This was indicated in the respondents' answers in regards to not knowing of the existence of such organizations and acknowledging their ineffective role – most of which did not receive any service or benefit. However, those who received some kind of assistance have expressed their satisfaction with the performance of supporting organizations be it managerial assistance or a training course. The level of satisfaction seemed to decrease when asking the respondents to express their satisfaction with the support of such organizations in the marketing field (increasing the awareness of marketing, identifying available tools, and promoting MSMEs products).

Fifth: Networking is considered a very useful tool at the disposal of MSMEs to build, manage, and maintain relationships with large enterprises, suppliers, and distributors. The study showed that the managers of MSMEs are keen on developing strong personal and professional relationships with individuals in large enterprises, competing firms, and suppliers. The study also showed a discrepancy amongst the different respondents in expressing their reluctance to develop relationships with competitors and large enterprises. Conversely, most of the respondents do not believe in the positive influence of their relationships on their performance. This is also in relation with the respondents' perception of the importance of professional relationships over personal ones.

Sixth: Branding was viewed as a key factor in the positioning of the product in the consumers' mind and must be continuously managed and maintained. This can be achieved through effective promotion and advertising using different media vehicles like bill boards, newspapers, radio and television.

10.5 Recommendations

Considering the marketing situation of the Palestinian MSMEs, the following recommendations may be reported:

- ✧ To consider developing nation-wide marketing awareness programs addressing specific marketing concepts.
- ✧ Enact a new law to protect property rights and encourage MSMEs to register their products by making registration costs more bearable.
- ✧ For these programs to be successful, they have to be tailored according to different sectors or more specifically according to the needs and capabilities of beneficiary groups. Also, to enhance the effectiveness of the programs, they should be spread across various districts and cities, particularly marginal ones.
- ✧ To work with MSMEs in marketing their products in foreign markets
- ✧ To establish contacts with sister organizations in foreign markets.
- ✧ To participate in international and regional trade shows.

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Chapter X: Adequate Financing of Palestinian MSMEs

Naser Abdelkarim

11.1 Introduction

This study seeks to diagnose and analyze the financing structures of small and medium-sized Palestinian MSME's with regard to types, sources and costs. It also aims to define the main problems facing those MSME's in getting the financial resources needed for their continuation and development. The study also presents policy proposals that can improve the financing possibilities and conditions available for small and medium-sized MSME's.

11.2 Methodology

Primary and secondary sources of data and information were used to achieve the study's objectives. A survey was conducted through two means, which were: A questionnaire directed to 75 firms, and financial analysis instruments, covering 56 firms, used to analyze the contents of general balance sheets presenting the financial positions of MSMEs. The primary financial statements were collected to identify presently available sources of financing, as well as problems faced in this connection. In addition, special attention in this regard is paid to materials published by the Palestinian Central Bureau of Statistics regarding economic MSME's operating in the Palestinian territories, and by the Palestine Monetary Authority and other bodies connected to the Palestinian financial sector.

11.3 The Impact of Factors on the Financial Structure of SMEs

There are various factors which may influence the finance structures of the businesses, which may be summarized as follows:

- ✧ The age of the firm: Generally, the firms at the first stage of life depend on financing from internal sources, but with increasing opportunity to get external finance later on. For example, a study examining the structure of businesses in Malaysia indicated that 68% of the sample uses their own source of financing in the startup stage (Rozali, et. al, 2004). Other studies reported similar conclusions, which indicate that firms in the startup stage depend on their own

sources (Rivaud-Danset, et al., 2001; Evers, 2006). This is due to the fact that SMEs in the early stage may work in an environment that is too high risk to borrow from banks (OECD, 2006).

- ✧ Size of the firm: There are positive associations between the size of a firm and the sources of funds (Bhaird and Lucey, 2006); the smaller the business is, the more the firm depends on its own source of funding and not on external loans, and vice versa.
- ✧ Other factors may also have an impact on the structure of the businesses, such as the type of assets, profitability, growth stage, type of business, and the degree of risk.

11.4 Financial Structure of MSMEs

According to the survey regard the need for external finance, the results shows that most of the MSMEs need external finance to develop and to improve their business, about 62% of the MSMEs answered that they did need extra finance.

This study found that the majority of firms who participated in the survey expressed their need for external finance. However, the need for external finance is more urgent in the industrial and service sector than for firms working in the commercial sector, about 76% of the MSMEs that work in services need extra finance, while this percentage decreases to 48% of the MSMEs which work in the commercial sector, moreover, the percentage of MSMEs that say that they don't need any external finance has reached 12%, most of them are in the commercial sector.

Table No. 1: Sources of Finance for Palestinian MSMEs

Source of MSMEs	Ratios
Paid Capital	78.1%
Short loans from banks	8.3%
Finance leasing	1.4%
Retained Earnings	2.7%
Commercial credit from suppliers	2.7%
Loans and continuations from friends and family members	5.3%
Others	1.5%

Regarding the sources of funding for Palestinian MSMEs, this study found that paid capital represents the main source of business financing in MSMEs with a share of 78% of respondents, as shown in Table No.1. This is followed by short term loans, loans from their families and friends, commercial credit and retained earnings respectively.

However, it should be noted that Palestinian businessmen prefer financing from friends and family members compared to dealing with a formal financing system. For example, when asked about the source they used when in need of finance, 23% refer to friends and family members, while only 18% went to banks to get loans. In addition, the survey indicated that about 22% of the total sample applied for loans which they didn't receive, besides about 18% indicated that they required funding, but don't seek it because they feel they can't get, as presented in Table No.2. 33% of the sample acquired loans from either the formal or the informal banking system.

Table No. 2: Ratios of Palestinian MSMEs That Received Loans

	Got Loans	Applied for loans but rejected	Need loans but they did not try
Banking System	18%	8%	4%
Grantees from special programs	4%	6%	10%
NGOs	33%	22%	18%

For the conditions of availability of getting loans for Palestinian MSMEs as perceived by the sample, the study indicated that the economic and political situation is a major factor as perceived by 26%, as presented in Table No.3. This is followed by the size of the firm in sales, and banking credit policy in which 10% perceived them as the major factor for the availability of funds for loans. In addition, other issues such as collateral and the credit history of the firm are also major factors. However, only 1% of the sample gives importance to the personal contacts with banks' managers as shown in Table No.3.

Table No. 3: Conditions of Availability for Getting Loans for Palestinian MSMEs

Conditions	%
Economic and Political Situation	26%
Collateral Issue	8%
Size of the Firm's Sales	10%
Credit History of the Firm	8%
Banking Credit Policy	10%
Personnel Contacts with Banks' Managers	1%
Capital and Total Assets	8%

When the Palestinians who participated in the sample of the study were asked about the reasons for not getting external finance, about 34% referred to religious reasons preventing their application for loans. Other reasons were also mentioned, as shown in Table No.4.

Table No. 4: Reasons of not Getting Bank Loans, as perceived by Palestinian MSMEs

Reasons of not getting loans	%
Lack of management experience	11%
Lack of financial information to offer to the bank	18%
Lack of collateral	26%
To avoid bankruptcy in case of losses	11%
Religion reasons	34%

The results from the survey of the value of required finance by Palestinian MSMEs shows that 18% need finance in the region of US \$15,001 to 20,000, while 15% of the sample need from US \$0 to 5,000, as shown in Table No.5.

Table No. 5: The Value of Loans Required by Palestinian MSMEs in US\$

The needed amount	%
0- 5000	15%
5001- 10,000	14%
10,001- 15,000	11%
15001- 20,000	18%
More than 20,001	15%
No need for loans	27%

In addition, about 47% of the sample did not ask for loans in the last two years, while about 18% of the total sample received loans between US \$5,000 and 10,000, about 11% got more than US \$10,000, and about 10% got less than US \$1,000. Finally, the survey shows that only 5.4% of the loans granted were long term loans for five years or more, 12% of the total loans were from 3 to 5 years, and the majority (58%) of the loans was between one to three years, and about one fourth of the loans were short term loans for less than one year.

11.5 Analysis of the Balance Sheet of Palestinian MSMEs

Based on the analysis of the balance sheet of about 65 Palestinian MSMEs, including industrial, commercial and service firms, the following findings may be reported:

1. The share of paid capital was about 35% of the total liabilities and owner equity for the total selected sample of the firms.
2. The share of commercial credit and the short terms and the accounts payable was about 43% of the total liabilities and owner equity of the selected firms.
3. The share of external finance was about 14% of the total liabilities and owner equity.
4. Finally, the share of the retained earnings was only about 8% of the total liabilities and owner equity.

However, it should be noted that there are some differences between the findings presented in the first section of this chapter, which were based on the perceptions of the businessmen and the findings reported by the analysis of the financial statements.

11.6 Conclusions

The study reached a number of conclusions that can be summarized as follows:

- ✧ Small and medium-size MSME's continue to suffer from the low level of available financing. Most MSME's are in need of external financing to increase and develop their activities. Around 62% of queried MSME's agreed that they need external financing. The percentage of MSME's in the services sector that need external financing was relatively high, reaching 76%; whereas it decreased in the commerce sector to 48%. However, the percentage of MSME's that did not need external financing at all was around 12%. They were centered in the commerce sector.
- ✧ According to the objectives of finance the survey results show that about 21.9% says that the Investment expansion is the main objective of financing, and the repayment of loans is ranked in the second place by a percentage 13.7%.
- ✧ Personal contributions (owned capital) generally constituted the prime source of financing for small and medium-size MSME's. This source composed the highest rate, 78.1%, of the sample's MSME's when asked to define the most presently used source of financing in their

MSME's. Bank loans and banking facilities occupied second place with 8.2%. Both internal financing (realized undistributed profits) and commercial credits came in third place with 2.7% for each.

- ✧ The role of banks is considered important, but did not reach the required level. The achieved average increase in deposits in banks operating in Palestine was not accompanied by a similar increase in available credit facilities, which did not exceed 32% of deposits at the end of the Q1 2009. This is due to a very complicated and cautious policy followed by Palestinian banks in granting credit facilities, because of the high degree of risk in the Palestinian economy. In addition, demand for credit facilities is generally weak, due to the low level of investment opportunities that the semi-closed Palestinian economy provides.
- ✧ The continued existence of programs by small lending institutions is dependent on foreign aid sources, as most of them operate in accordance with agendas of donor states, a fact which reduces their possibilities and abilities to meet increased demand for loans. At the same time, the size of the loans offered by them does not coincide with increased demand for bigger loans to finance the activities of different MSME's.
- ✧ It should be noted that there is a gap between the demand for different sources of financing and the opportunities provided to those MSME's to meet their financing needs. All this underlines the need to bridge the gap through united efforts by the different institutions responsible for financing processes, in addition to the role of the government in formulating laws, setting policies and drawing programs that can provide solutions to the financing problems faced by owners of small and medium-sized institutions. Such institutions have an important role to play in moving forward the process of economic and social development in Palestine.

Based on these conclusions a number of recommendations were formulated, which can improve the opportunities and conditions of financing available to small and medium-size business MSME's operating in the territories of the Palestinian Authority. The recommendations are of different levels; some involve the governmental level, and others are on the level of the MSME's themselves. The third part is about the level of the financing institutions operating in the territories of the Palestinian Authority and the international donor institutions.

11.7 Recommendations

Considering the above conclusions, the following recommendations are offered:

- ✧ The adoption of an appropriate legal and organizational framework that can stimulate this kind of financing, on the condition that it provides the controlling authorities with the ability to set a minimum for credit facilities provided by banks and other institutions extending loans to MSME's.
- ✧ Strive to set up a united national fund specialized in providing loans and financial incentives to small and medium-size MSME's, especially to entrepreneurs.
- ✧ Grant banks financial privileges, such as tax exemptions for profits obtained from activities of financing such MSME's. This is to encourage banks to finance small and medium-size MSME's with low interest rates, in addition to lowering the obligatory reserves required of banks in proportion to the amount of money used to finance small and medium-size MSME's, as well as other incentives.
- ✧ Strive to create coordination mechanisms with international and local institutions and organizations that provide assistance and support to small and medium-size MSME's, in an attempt to reach a systematic approach to develop and raise the level of those MSME's, instead of concentrating on profit competition among MSME's.
- ✧ Look into the possibility of creating a fund for guaranteeing loans provided to small and medium-size MSME's, which can contribute to reducing the obstacles connected to the increase and multitude of guarantees required from loan seekers.
- ✧ Attempt to establish anti-bankruptcy programs or funds that provide an interest-free loan for long periods of time to MSME's facing difficulties for a certain period of time.

11.8 References

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