Written evidence submitted by The Portland Trust

Summary

1. The Portland Trust has long been an advocate of the private sector as an engine of growth in the Palestinian economy. With limited options for further expansion of the public sector we believe the need to support Palestinian private sector development to help generate sustainable economic growth and create jobs is greater than ever.

2. In this context, The Portland Trust, with assistance from McKinsey & Company, spent 2013 conducting extensive research in consultation with hundreds of stakeholders in the Palestinian economy to determine a practical, long-term private sector action plan for sustainable growth and job creation. The resulting plan and its supporting analysis were published in November 2013 in ‘Beyond Aid: A Private Sector Initiative for Investment, Growth and Employment’. The Palestinian private sector and its stakeholders continue to express their enthusiasm and support for the initiative, which is described by many as ‘the first of its kind’. Beyond Aid has also received extensive support from the Palestinian Government and is aligned to their medium term development strategy. Internationally, the initiative supports the renewed peacemaking efforts of the US administration and international parties. It is, at the same time, complementary to the work done by the Office of the Quartet Representative to develop a ‘Palestinian Economic Plan’.

3. Implementation is already underway with working groups of business leaders and experts leading the development of an extensive number of projects across five high-potential sectors: agriculture, construction, IT, tourism and energy.

4. If fully implemented the plan could result in an additional $8bn in incremental GDP (+80% growth from 2012) and 370,000 jobs created by 2030. This would help to meet the need to produce 1 million jobs to reduce unemployment to 10% in the long-term.1

5. As a private sector-led plan the majority of the effort is placed with businesses, entrepreneurs and investors. However, it will require extensive collaboration between the private and public sectors, especially to create a positive enabling business environment and ensure that access to capital is available to foster large-scale private investment.

6. The Portland Trust believes that DFID could play a vital role in this initiative and ask the Committee to consider a number of specific roles and projects for DFID. These include:

   a. Becoming the lead donor in the Private Sector Grant Facility (PSGF) to support large private investment projects. £75m of aid used to finance 15% of the cost of a project could generate £500m of private investment. Such a scheme can be particularly relevant to the development of infrastructure.

   b. Ensuring that DFID’s broader work on Development Impact Bonds (DIBs) is incorporated into its Palestinian Programme. DIBs to lower the incidence of type 2 diabetes among the Palestinian population are currently being explored.

   c. Leading a coordinated HMG effort to provide the necessary technical expertise for the development of Public-Private-Partnerships (PPPs) in a number of areas.

   d. Easing the visa granting process for Palestinian executives to participate in short-term training and capacity building programmes in the UK.

7. Overall we would recommend more DFID involvement in this important private sector initiative, and for DFID to consider building their private sector programme around it.

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1 All facts and analysis cited in this document including economic data and estimates are extracted from ‘Beyond Aid: A Palestinian Private Sector Initiative for Investment, Growth and Employment’ (The Portland Trust, November 2013)
Overview

Further information and background on The Portland Trust’s ‘Beyond Aid’ initiative is set out in the following sections of this report, which is structured as follows:

- Introduction to The Portland Trust
- Context for activities in 2014
- Critical role for the private sector
- The ‘Beyond Aid’ strategy
- Support needed
- Recommended interventions

The Portland Trust stands ready to respond to any follow-up questions the Committee may have.

Introduction to The Portland Trust

8. The Portland Trust is a British non-profit ‘action tank’ with offices in London, Ramallah and Tel Aviv. It was established in 2003 with the mission of promoting peace and stability between Palestinians and Israelis through economic development. We focus on identifying and launching initiatives to assist in the development of the Palestinian private sector and to reduce poverty in Israel through social investment and social entrepreneurship. Activities to help develop the Palestinian private sector have included programmes to promote affordable housing, establish private sector pension funds, and enhance credit to small and medium-sized enterprises through the creation of loan guarantee schemes.

9. The Portland Trust has continually highlighted the need for a ‘triple helix’ approach to conflict resolution – involving politics, economics and security. To support this argument periodic research has been undertaken. This includes case studies on Northern Ireland (2007), Bosnia and Herzegovina (2009), and a publication examining the important peacemaking role of business in Cyprus, Northern Ireland, South Africa and the South Caucasus (2013).

10. The Portland Trust has also been a long-term advocate of the need to support the private sector as the engine of growth in the Palestinian economy. Evidence to support this approach, and a number of initiatives that could help to unlock private sector potential, were first set out in a report titled ‘Beyond Conflict: The Economic Impact of Peace on Palestinians and Israelis’ in 2004.

11. More recently, in 2013, the Palestinian private sector asked The Portland Trust, with the assistance of McKinsey & Company, to help develop a practical plan of action for sustainable growth and employment. In November 2013, following extensive consultation and research with hundreds of Palestinian and international stakeholders, The Portland Trust published ‘Beyond Aid: A Private Sector Initiative for Investment, Growth and Employment’.

12. This and other publications are available to download from our website: www.portlandtrust.org.

Palestinian Economic Context

13. From 2006 to 2011, the Palestinian economy grew at an annual average rate of 8.2% reaching over 12% at its peak in 2011. However, growth was partly fuelled by high levels of aid from the international donor community and proved to be unsustainable. The Palestinian National Authority (PNA) received at least $1bn a year in aid between 2006 and 2010, and nearly $2bn in 2008 (more than 30% of that year’s GDP).
14. This led to a rapid expansion of the public sector. In 2008, the number of public sector employees increased to 146,000 (30% more than in 2004) and by 2012, as many as 177,000 workers were on the public sector’s payroll. In the short term this helped boost economic growth, mainly through government expenditure but also through high levels of consumption by public sector employees.

15. By 2011, as the international financial crisis affected donors’ budgets, aid dropped to less than $700m. As a consequence the Palestinian National Authority (PNA) increasingly struggled to meet its financial obligations. This resulted in a deep fiscal crisis, during which delays in the payment of civil servants’ salaries were not uncommon.

16. Given the nature of public sector driven growth the fiscal crisis had an immediate and direct impact on the economy. Although private sector output grew at 10% in 2012 this did not fully offset the contraction in the public sector and thus overall GDP growth fell to 5.9%, half the rate from the previous year, continued to slow down in 2013 and is predicted to be below 4% in 2014.

17. At the same time unemployment remained structurally high. Even during the five year period of high growth unemployment never fell below 20% and subsequently rose to 23% in 2012.

Critical Role for the Private Sector

18. With limited options for further public sector growth it is clear that the private sector needs to lead the way in rebalancing the economy and promoting sustainable growth. The IMF’s Representative in the West Bank and Gaza, Dr. Udo Kock, has said that the “private sector must play a central role in strengthening the resilience of the Palestinian economy, reducing its aid dependence and generating jobs.” The critical role of the private sector as an engine for growth has also been recognised by the PNA in their mid-term development strategies.

19. There is also strong international support for private sector development and investment. Secretary of State John Kerry and the Office of the Quartet Representative are committed to attracting large-scale investment, instigating iconic economic development projects, and improving the Palestinian business and investment environment.

20. Strong performance by the private sector in recent years suggests there is potential for it to lead the way towards sustainable long-term growth. Since 2006, private companies and entrepreneurs have been responsible for more than 65% of net jobs created. More recently, even in a difficult context, the private sector achieved impressive double-digit growth of 13.5% and 10% in 2011 and 2012 respectively.

21. However the scale of the challenge facing the private sector is daunting. With high population growth (2.9%), and young people already comprising 58% of the population, there is an urgent need for new and sustainable job creation. Estimates indicate that 750,000 jobs must be created simply to maintain the current unemployment rate of 23% through to 2030. To reduce unemployment to 10% by 2030 1 million new jobs will be needed. This is equivalent to more than doubling the number of workers currently employed and would require the overall economy to grow at an annual average rate of 8.2% over 17 years. In this context, the private sector would have to achieve and sustain at least 9% growth a year.

The ‘Beyond Aid’ Strategy

22. Much of the existing research on the Palestinian economy attempts to estimate the potential for growth under assumptions of a final political settlement. Such a solution, including the
formation of a Palestinian State, is unquestionably necessary to enable sustainable economic development. However, it is our belief that there are several actions that the Palestinian private sector can undertake to create jobs and stimulate growth despite existing constraints (such as restrictions on movement and access and lack of control over natural resources). It is these such actions that are set out in the tangible private sector-led plan presented in Beyond Aid.

23. Building on contributions from international experts and over 250 Palestinian stakeholders, a number of investment opportunities and private sector-led projects have been identified across five high-potential economic sectors: agriculture, information technology & digital entrepreneurship, tourism, construction, and energy. These were chosen following assessment of over 20 economic sectors for their potential contribution to GDP growth and job creation, as well as capacity to maximise immediate opportunities in the current context.

24. Analysis estimates that the more than 60 projects defined for these five high-potential sectors could contribute over $8bn to Palestinian GDP by 2030. They could create more than 150,000 direct and around 220,000 indirect new jobs (around 40% of the number needed to reduce unemployment to 10% in the long term) and call for approximately $600m in investment in the short term.

25. Specifically:

a. The **agriculture** sector could become a leading exporter of select high-value crops and, as a result, contribute nearly $1.4bn to GDP (up from $502m in 2012) and create around 36,000 new jobs by 2030.

b. Palestinian **IT businesses** and digital entrepreneurs could drive the nascent information technology industry to increase its direct annual contribution to GDP as much as eight-fold to $960m (from around $105m in 2012) and generate more than 18,000 additional high-quality jobs by 2030.

c. The Palestinian **tourism** sector has the potential to grow substantially by 2030, increasing its contribution to GDP from around $250m in 2012 to an estimated $750m and the number of workers it employs from around 17,000 to 38,000 by 2030.

d. **Construction**, already an important economic sector, has the potential to nearly double its annual contribution to GDP to $2.8bn and create up to 64,000 new jobs through to 2030.

e. Finally, reduced reliance on **energy** imports and greater utilisation of renewables could add up to 17,000 new jobs and up to $2.2bn to GDP by 2030. Additionally, implementing projects in the energy sector has the potential to reduce the cost of electricity for households and industries, freeing up income and capital, which could have a significant indirect impact on GDP.

26. For each of the five sectors the report presents a detailed strategy, including a set of short, medium and long term investment opportunities which can be undertaken by the private sector. A snapshot of these ‘catalytic projects’ is shown in the table below.
27. Implementation is already underway and is being driven by a Coordinating Committee formed of prominent Palestinian private sector figures, including members of the Palestinian diaspora. The Portland Trust is acting as a secretariat by working with the Committee and focused sector working groups involving business leaders and experts from across the West Bank and East Jerusalem. During 2014 The Portland Trust will also be directly engaged in the implementation of a number of selected projects across the five prioritised sectors. As implementation progresses, further engagement by the local business community is expected.

28. The initiative has been well received by the Palestinian Government. Mohammad Mustafa, Deputy Prime Minister for Economic Affairs and a member of the Coordinating Committee (acting as Chairman of the sovereign Palestine Investment Fund), considered that “what is new about the ‘Beyond Aid’ initiative is that the private sector is not coming together just to advocate general policy or regulation change. They are going beyond that by proposing a specific way to translate their efforts into opportunities for investment. The government is also moving away from being passive and waiting for the private sector to take their own action. We are studying their proposals and analysing what specific issues need to be addressed to enable their investment programme. This is also a very positive signal for international investors and donors, and could set a new working model for the future.” The Beyond Aid initiative is also aligned with the ‘Palestinian Economic Initiative’, led by the Office of the Quartet Representative.

### Public Sector Support Needed

29. While ‘Beyond Aid’ is a private sector led initiative it will require support from the public sector. In particular the initiative will require the private and public sectors to work together to improve the enabling environment for investment in the economy. Achieving the growth and
job creation opportunities identified for the prioritised sectors will be greatly supported by expanding, enhancing, and/or reforming five enablers:

a. human capital development;
b. infrastructure;
c. regulation and land registration;
d. access to capital;
e. and branding.

30. With the PNA suffering ongoing fiscal issues and a lack of capacity in some areas The Portland Trust believes there is an important role for international governments and their development agencies (including DFID) to play.

Recommended interventions

31. As implementation by the private sector progresses there are number of areas where international public support would help the development of key projects and unblock a number of the cross-cutting enablers listed above. In some cases international support is essential for progress.

32. Private Sector Grant Facility (PSGF). Access to capital remains a key issue for the Palestinian private sector in many sectors. The establishment of a PSGF has been proposed by The Portland Trust. The facility would pool together aid money to be used as grants, which would in turn enable critical large scale private sector investment projects to proceed. The PSGF would finance up to 15% of private sector investment in projects that would otherwise not be able to materialise, including in much needed infrastructure, housing and energy generation (including solar) projects. With DFID’s extensive experience around the world in developing and operating similar funds (including Challenge Funds) they seem well placed to be the lead donor to a PSGF. If £75 million of aid was used in this way it could attract over £500 million in private sector investment.

33. Development Impact Bonds (DIBs). Based on the model of a Social Impact Bond, DIBs aim to provide upfront funding for development programmes by private investors. Investors will then be remunerated by donors or host-country governments - with a return - if evidence shows that programmes achieve their pre-agreed outcomes. The UK’s Social Finance and the US Center for Global Development are leading the development of DIBs, with DFID having been a key member of the Working Group. Work is currently underway to consider where DIBs could be used in the Palestinian context. A number of areas are being explored including lowering the incidence of type 2 diabetes. The Committee are asked to highlight these proposals to DFID and ensure that their broader work in this area is incorporated into its Palestinian Programme.

34. Public-Private-Partnerships (PPP). Many private sector projects in the Beyond Aid initiative are likely to require PPPs (especially in infrastructure and energy). However there is currently little local experience of such structures and mechanisms. The British Government, with its own extensive experience of PPPs would be well placed to provide such assistance, for example through the training and capacity building programme in PPPs under development by Infrastructure UK. We would urge the Committee to consider whether DFID could coordinate a cross-HMG effort to assist in this area. Further down the line the actual construction of many infrastructure and energy projects (including waste-water treatment plants), will be largely dependent on donor and government support. We believe this would be an excellent use of DFID’s resources.
35. **Training / Human Capital Development**: The Portland Trust launched a project in 2012 to address the skills gap in different economic sectors in Palestine. We partnered with Palestinian business leaders and international companies to place mid-level executives from the most established companies in Palestine with world class companies in the UK for fellowship positions lasting between two weeks and two months. The participants developed specific skills relevant to the management of their own companies in the West Bank. As of March 2013, The Portland Trust had placed ten fellows in the UK, but the programme had to stop because of difficulties in obtaining visas for participants. A specific intervention by the UK authorities to ease the visa process and allow this and other similar programmes to continue could create real impact.