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**ASSESSMENT OF  
LEGAL AND REGULATORY POLICIES  
CONSTRAINING BUSINESS ACTIVITY  
IN GAZA AND THE WEST BANK**

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## EXECUTIVE SUMMARY

This assessment identifies major policy, legal/regulatory and administrative constraints to private-sector business activity in the West Bank and Gaza; reviews other donor activities in support of legal and regulatory reforms; recommends policy interventions for which USAID has clear comparative advantages over other sources of assistance; and, determines which Palestinian counterpart agencies would be most supportive of USAID efforts in this sector. The assessment team, composed of an economist, a business lawyer and a part time specialist on performance monitoring and evaluation, conducted the field work and drafted the report between 17 July and 7 September, 1996.

From the universe of constraints examined in the body of the report, and using the filters of economic impact, USAID/Tel Aviv program priorities, and budgetary constraints, the team recommends the following areas for policy intervention:

1. Strengthening and enforcing legal mechanisms to create and enforce **security interests**. Currently, business activities are constrained because of the inability of investors to provide guarantees for loans and other type of transactions. Within this area, two recommended priority actions are:
  - **Commercial Registration:** currently, commercial registers are weak and inefficient. They do not provide a modern system of public information about individual enterprises to key actors in the market, nor do they constitute a reliable mechanism for the registration of a company's security interests, which ultimately constrains a company's access to credit. In addition, the lack of a functioning commercial register limits the ability of companies to protect valuable commercial rights such as money judgements, sales of businesses, intellectual property rights (IPR) --when there is no IPR register. It is recommended that USAID support an effort to unify, modernize and complete the commercial register. The Ministry of Trade and Economy in Ramallah is already active in this area, but may need support to expand its operations to Gaza and other cities in the West Bank.
  - **Land Registration:** land cannot be given as collateral because of lack of clear title from not being registered in the land registration department. Land registration is manual and follows an outmoded system. There is limited and outdated information from cadastral surveys as maps are almost non-existent. An appropriate intervention would be to develop a modern system of land titling and registration which would provide, at a minimum, a modern system for perfecting non-possessory security interests. However, the team was advised that major reforms in the land titling and registration systems should only be undertaken once final status negotiations with Israel take place.

2. Developing a program to protect **intellectual property rights (IPR)**: there is a weak to nonexistent legal system protecting IPR in Gaza and the West Bank, and there is no enforcement. Not only does weak IPR protection discourage "high tech" foreign investors and undermine innovation by local entrepreneurs, but it also limits the ability of companies to protect valuable assets and to use IPR as collateral. To overcome this obstacle, it is recommended that USAID develop a program to protect IPR through the design of a comprehensive legal framework, a working patent and trademark registration office, and a strategy for implementing and enforcing IPR mechanisms.
3. Supporting a technical assistance unit within the Ministry of Finance that would develop the following areas:
  - **Trust Law**: there is no Trust Law in Gaza or the West Bank. Financial institutions operate without a clear legal sense of their "fiduciary" duty to place the interest of the investors above their own or their firm's. Developing a Palestinian Trust Law is reportedly a top priority area of the Minister of Finance, because of its implications in providing an initial legal base for developing term credit and equity markets. It is recommended that USAID support the Ministry of Finance in drafting and implementing a Trust Law that would protect the interests of investors using different financial vehicles.
  - **Accounting and Auditing Standards**. There are no legal accounting and auditing standards; this has led to inconsistent practices in financial reporting. In turn, this constrains companies' access to credit because banks lack confidence in their financial information. As a consequence, future efforts to develop a stock market could be curtailed because of problems of adequate disclosure. It is recommended that USAID support a program which legally establishes internationally accepted standards in accounting and auditing, and provides technical assistance for their compliance.
  - **Negotiable Instruments**: currently, the legal framework for negotiable instruments is weak and limited in scope. This creates uncertainty and raises transaction costs as payment mechanisms for business transactions become unreliable, technically inefficient, and risky. It is recommended that USAID support a program to update the law and generate new financial instruments as needed.
4. **Advocacy**: the private sector has a weak voice in promoting legal, regulatory and administrative reforms affecting the business climate. Business persons are generally aware of constraints related to private sector activities, but are not adequately organized to provide collective pressure for reform. It is recommended that USAID support rewriting the current law on business associations so that it is less influenced by the government and thus less

sensitive to political pressures. In addition, there is a need to strengthen private sector trade and business associations and private sector controlled "think tanks" that could be the focal point for government and private sector dialogue on business reforms.

5. **Commercial Legal and Judicial Reform:** currently, there is weak enforcement of contracts through the court system, leading to more reliance on informal enforcement mechanisms that increase transaction costs, raise uncertainty and discourage new investments. To alleviate this key constraint, it is recommended that USAID support a program to streamline the commercial justice system, by automating manual procedures, training judges and other court personnel, and modernizing caseload management and court administration procedures. This recommendation complements USAID's Democracy and Governance project to support the Ministry of Justice in its efforts to improve the judicial system.

Additional areas analyzed in this report include: Civil Code provisions as applicable to commercial transactions; insurance and contract savings; companies regulations; antitrust; labor issues; and, governance, public administration and the rule of law.

An appropriate legal framework, including an effective judiciary, is imperative for an efficient market system in the West Bank and Gaza. Such a framework should be based on clear rules and procedures, applied and enforced fairly by well functioning institutions. In a situation where the laws are inadequate, the processes arbitrary or too intricate, and the institutions poorly staffed, ineffective or dishonest, Palestinian businesses will not find the conditions necessary to prosper or to compete in global markets.

## **I. Introduction**

To attract investment and business expansion, the Palestinian Authority recognizes that it must accord high priority to the modernization of the legal and regulatory framework governing business activities and property rights. While legal protection and user-friendly commercial laws alone may not be sufficient to induce foreign companies and individuals to invest, they are, nonetheless, important elements in any investment decision.

### **A. Scope of work**

The consultant team was tasked with assessing the legal and regulatory policies constraining business activities in Gaza and the West Bank with a view to provide USAID with recommendations to develop a program of activities.

The **original terms of reference** (Annex 1) called for the team to (1) identify the universe of policy/ regulatory/administrative constraints to business activity in the West Bank and Gaza; (2) review other donor activities in support of legal or regulatory reform; (3) determine which policy constraints would be most amenable to change through a program of technical assistance and advocacy; (4) determine which Palestinian counterpart agencies would be most supportive of USAID efforts in this sector; (5) recommend policy interventions for which USAID has clear comparative advantages over other sources of assistance; and (6) assess/recommend appropriate levels of effort, sequence, timing, conditionalities, milestones, and expected impacts for a program of USAID initiatives in this sector.

After a few weeks in the field, it became clear to the team that the original scope of work was too ambitious for the time allocated for the assignment. In subsequent discussions with USAID officials, a verbal agreement was reached that the team's efforts should concentrate on the first five tasks of the above list. Furthermore, it was agreed that the team would omit from its analysis constraints that were macroeconomic, too political, or security related.

### **B. Personnel**

This study was carried out by a three-person team: Richard Sines, team leader and economist; Jim Fremming, specialist on performance monitoring and evaluation; and Ana Maria Linares, business lawyer. The field work was conducted between 17 July and 7 September, 1996, under the supervision of the Private Enterprise Office of USAID/WB&G.

## C. Methodology

The team conducted this study on the basis of:

- Interviews in Gaza and the West Bank with a wide range of businessmen/women, lawyers, think tanks, locally-based NGOs, representatives of Palestinian Ministries and other Palestinian authorities currently involved in legal and regulatory initiatives, donor agencies, and officers of the U.S. Embassy in Tel Aviv and the Consulate General in Jerusalem.
- Analysis of existing laws, regulations, statutes and other legal documents, both in English and Arabic. Given the time and language constraints, the analysis contained in this report presents an overview of the legal situation in Gaza and the West Bank. It is not intended to provide legal advice on any of the issues discussed.

The team studied the information gathered from these sources to establish **findings** or facts related to key issues, on the basis of which, an in-depth **analysis** was made to identify the problems and constraints related to business activities. Finally, **conclusions** were drawn to indicate the scope of actions required to address the problems identified. From the set of constraints studied in Chapter III, the team selected four major areas for possible USAID intervention, discussed in Chapter V, which contains the team's recommendations.

## D. Organization of the report

This report is organized as follows. Chapter I is an introduction, followed by economic and legal background discussions in Chapter II. Legal and regulatory constraints to business activities are presented in Chapter III. A summary analysis of donor support in the area of commercial legal, administrative and regulatory reform is presented in Chapter IV. The final Chapter contains specific recommendations for USAID intervention and identifies potential counterpart agencies.

## E. Acknowledgments

The team would like to thank Ms. Asma Abu Gazaleh from Gaza and Mr. Ra'ed Abdul Hamid from Ramallah, for their excellent work in translating difficult laws into English. The team would also like to acknowledge the continuous support and collaboration of Mr. Sharhabeel Al' Zaeem and his law firm in Gaza. Finally, the team extends its appreciation to all Palestinians who graciously accepted to devote their time to the interviews without which, this report would not have been possible.

## II. Economic and Legal Background

### A. Recent Economic Overview of the West Bank and Gaza

The peace initiative's substantial political gains, as symbolized by the first-ever January 1996 elections of the "Ra'ees"<sup>1</sup> of the Palestinian Authority and the Legislature, have not been matched to date by comparable economic gains. The subsequent February and March bombings in Jerusalem and Tel Aviv resulted in tight Israeli closure of labor, commodity and service markets in Gaza and the West Bank, that led to an economic situation that was worse than autarchy. The situation is particularly bleak in Gaza where the six-month closure has been particularly effective in devastating the economy and undermining almost any non-Palestinian private investment. Factors of production, including labor, machinery, and intermediate inputs, were immobile. Commodity and service trade was practically halted between Israel, Gaza and the West Bank, and redirected at great expense within the West Bank.

Despite a recent easing up, the continued magnitude and uncertainty of the Israeli closure of the Palestinian economy, as evidenced by last September events, has essentially ruled out the placement of the West Bank and Gaza on any "short list" location by a serious foreign investor, with the exception of Palestinians motivated by factors other than short-run profitability. However, even if closure were not a key factor, the Palestinian economy would be hampered by policy, regulatory and institutional constraints, as described in detail in the next chapters.

The economic situation in the West Bank and Gaza is further exacerbated by continued failure of both the Israeli Government and the Palestinian Authority to provide a stable social, political and institutional framework within which individuals can interact with less fear of physical or economic harm from one another, fewer and less costly precautions, and be more willing to undertake joint actions with future mutual benefits. For example, economic closure is put into effect as a result of random events instigated some times by Palestinians and other times by Israelis, making it extremely difficult for a business person who must operate under the resulting unstable business climate. Much of the negative ramifications on the Palestinian economy derive from an instability of the overall business climate rather than the inherent negative impacts of specific constraints at a particular time.

In contrast to these problems, the economy of the West Bank and Gaza has substantial positive features conducive to development: many small, active, and resilient enterprises with output accounting for approximately 85 percent of GDP; little inefficient parastatal activity; no major national debt burden; substantial entrepreneurial and managerial skills; a relatively low-waged, high-skilled work force; a wealthy and influential expatriate community, primarily living in neighboring

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<sup>1</sup> The term "Ra'ees" is the agreed-upon term found in the English version of the Interim Agreement. In Arabic, "Ra'ees" (reportedly) means both the English word "chairman," proposed by the Israeli side, and "president," proposed by the Palestinian side.

states and ready to involve itself in Palestinian commercial affairs; potential trade linkages particularly through expatriates ties; and a strategic geographical location. Moreover, improving the Palestinian economy and raising the well being of Palestinians has the support of regional neighbors and global powers because of the substantial political and economic benefits associated with peace and stability in the oil-rich Middle East.

## **B. The Legal Context in Gaza and the West Bank**

It has been repeatedly claimed that the system of commercial laws and regulations in force in the West Bank and Gaza, creates an incoherent framework for business to flourish. The roots of the problem are typically associated with the multiplicity of sources of law that compose the current legal and regulatory structure. While the complexity of the legal system is undeniable, especially when considering that different laws apply to the West Bank and Gaza, the confusion created by the various sources of law is not as great as originally perceived.

Determining the applicable law to a particular situation is not difficult. Indexes exist and even collections of applicable laws have been compiled. Some are fairly old, but others date back to only 1994. For example, in Gaza, a group of judges has prepared a comprehensive collection of applicable laws and regulations organized into approximately 30 to 35 volumes. Working from the original Ottoman or Mandate law, these judges incorporated all subsequent modifications into a single user-friendly collection of legal documents. Unfortunately, these documents are available only in Arabic.

The legal system's complexity appears to be due to the lack of legislative evolution over the past 29 years of Israeli rule. Current business laws are the same as those in force in the late sixties. Since then, only Israeli military orders have been issued which have negatively affected key business activities, such as land registration and insurance. As a result, the problems identified in this report relate more to the difficulties of clearly outdated laws, such as those dealing with basic business transactions and negotiable instruments, and to the lack of laws in key areas that have not been enacted since the Israeli occupation in 1967, such as intellectual property rights, trust law, and antitrust.

The sense of complexity of the legal system in the West Bank and Gaza is exacerbated by the minimal understanding of how the various sources of law have come into play historically so as to create the current legal framework. To correct this, a brief historical review of the evolution of the law from the Ottoman times to the present is presented.

### **Evolution of the Legal System in Gaza and the West Bank**

The Ottoman period extended from 1517 to 1917, when laws were issued by the parliament in Constantinople. By the nineteenth century the codification of certain laws began to take place. In 1857 laws pertaining to land were unified into one code which still continues to be largely in force. Similarly, the Civil Code was also codified during this period, and large parts of it still apply.

Three categories of law can be identified from the Ottoman period: (1) Moslem and non-Moslem religious law; (2) Civil and customary law; and (3) Capitulatory law.

Moslem and non-Moslem religious law dealt with aspects of personal status such as marriage, divorce, succession and inheritance. Different religious communities were allowed to exercise jurisdiction over their own members and judgements rendered by the tribunals of these communities were enforced by Ottoman authorities. Civil and customary laws were drawn from the principles of civil law contained in French codes as long as they did not contradict Moslem doctrine. Capitulatory law comprised all rules applicable to foreigners in the Ottoman Empire; it was abolished with the establishment of the British Mandate.

The British Mandate covered the period from 1922 to 1948. The government of the Mandate preserved the laws in force when the Mandate began. Most important among these was the Ottoman Land Code of 1858, which was amended several times over the years. Other codes such as the criminal law and procedures code, and the civil procedures code were repealed and replaced by laws modeled on Egyptian legislation, also inspired by the French legal system. The effect of British Mandate legislation is still evident in laws currently in force, particularly in Gaza.

After 1948, the West Bank was administered by Jordan, and the Gaza Strip by Egypt. Initially, Jordan did not try to influence the West Bank legal system. The Jordanian military governor of the West Bank ordered all laws and regulations in force on 15 May 1948, to remain if they did not contradict the Jordanian Defense Law of 1935.<sup>2</sup> In 1950, the West Bank and Jordan were united. Although Jordanian and Palestinian legal systems differed in several areas, they shared common roots. Thus, a legal commission was set up to consider the merger of the two legal systems. Between 1952 and 1967, the Jordanian Parliament enacted comprehensive new legislation which permitted the unification of the two legal systems in almost all legal areas.<sup>3</sup>

In contrast, the Government of Egypt did not incorporate the Gaza Strip into Egypt and did not try to apply Egyptian laws directly in Gaza. Gaza remained an autonomous unit, described as an area subject to the supervision of the Egyptian forces in Palestine. As such, Gaza had its own independent legislative, executive and judicial functions.

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<sup>2</sup> Proclamation No. 2 in "Three, Compilation of Laws and Regulations Issued and in Force in the Hashemite Kingdom of Jordan until 1960," as cited by The International Commission of Jurists/Center for the Independence of Judges and Lawyers in The Civilian Judicial System in the West Bank and Gaza: Present and Future, June 1994.

<sup>3</sup> Shehadeh, Raja, "The Declaration of Principles and the Legal System in the West Bank," Palestinian Academic Society for the Study of International Affairs, 1994.

After occupation in 1967, Israel promulgated a number of military orders: approximately 1,400 for the West Bank and over 1,100 for Gaza. Most extended military jurisdiction over diverse aspects of life in the occupied territories. The military was given full control over all transactions on immovable property, use of water and other natural resources, power to expropriate land, and authority to operate banks. Import and export of agricultural products to and from Gaza and the West Bank all required Israeli permission.<sup>4</sup>

### **Agreements between the PLO and Israel**

The 1993 signing in Washington D.C. by the PLO and Israel of the **Declaration of Principles on Interim Self-Government Authority** (Declaration of Principles) marked the beginning of a progressive transfer of authority to Palestinians, which includes the power to legislate over a limited number of areas. Subsequently, the **Agreement on the Gaza Strip and the Jericho Area** was signed in May 1994, providing for the redeployment of Israeli forces. Following the signing of the Gaza/Jericho Agreement, the powers that had been vested in the Israeli Military Government in Gaza and Jericho were transferred to the Palestinian representatives<sup>5</sup> pending the election of a Council, which occurred in January 1996. In 1994, the economic relations between the Palestinians and Israel were set out in the **Protocol on Economic Relations** signed in Paris. This is also referred to as the **Paris Agreement**.

The Declaration of Principles of 1993 included an interim period of five years to take place immediately after Israeli withdrawal from Gaza and Jericho. The agreement negotiated to govern this period was signed in Washington D.C. in September 1995, and is commonly referred as **Oslo II Agreement**. During the interim period, a gradual transfer to the PA of some powers and responsibilities is to take place with a view to promote economic development in the West Bank and Gaza.<sup>6</sup> Initially, five responsibilities were transferred to the PA: (1) education and culture, (2) health, (3) social welfare, (4) direct taxation and (5) tourism.<sup>7</sup>

The Oslo II Agreement sets forth the scope and limits of legislative power of the Council as the representative of the Palestinian Interim Self-Government Authority. The Council has the power to adopt legislation within the territorial and functional jurisdiction, as granted by the Oslo I and Oslo II Agreements. This jurisdiction does not include issues to be negotiated in the permanent status negotiations, such as Jerusalem, settlements, specified military locations, Palestinian refugees, borders, and foreign and Israeli relations.

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<sup>4</sup> Ibid.

<sup>5</sup> Article 3 (a) of Annex II, Declaration of Principles, 1993.

<sup>6</sup> Article VI (2), Declaration of Principles, 1993.

<sup>7</sup> Article VI (2), Declaration of Principles, 1993.

While the Council has the power to issue primary legislation, the Chairman (Ra'ees) of the Executive Authority of the Council has the power (1) to initiate or present proposed legislation to the Council, (2) to promulgate legislation adopted by the Council, and (3) to issue secondary legislation including regulations to any primary legislation adopted by the Council.

According to the Oslo II Agreement, certain legislation will be declared void *ab initio*:

Legislation which amends or abrogates existing laws or military orders, which exceeds the jurisdiction of the Council, or is inconsistent with the provisions of the Declaration of Principles of 1993, the Oslo II Agreement, or any other agreement that may be reached between the two sides during the interim period. The Chairman of the Executive Authority of the Council shall not promulgate any legislation adopted by the Council that falls within the above categories.<sup>8</sup>

All legislation passed by the Council must be communicated to the Israeli side of the Joint Israeli/Palestinian Legal Committee established by the Declaration of Principles of 1993. Israel may refer to this Committee any legislation that it views as exceeding the jurisdiction of the Palestinian Council.<sup>9</sup>

In sum, the PA's legislative powers are severely restricted both in scope and procedure by the Oslo II Agreement:

- (1) in **procedure**, because of the complexity of the system devised for approval of new legislation based on a three-step process, where the Israeli side of the Joint Legal Committee has almost a veto power; and,
- (2) in **scope**, because key areas which would require substantial legal reform for improving the business climate in Gaza and the West Bank are beyond the authority of the PA, such as the military orders put in place during Israeli rule which deal with civilian or business issues.

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<sup>8</sup> Article XVIII, Palestinian-Israeli Interim Agreement on the West Bank and Gaza Strip, Washington, D.C., 28 September 1995.

<sup>9</sup> Ibid.

The implications of these legislative restrictions for the analysis presented in this report cannot be overstated, given that most reforms directed at improving the business environment in Gaza and the West Bank will eventually require passage of new legislation.

### **C. Palestinian Authority's Role in a Market Economy**

If a modern market economy is to be developed in the West Bank and Gaza, the markets and not the government will make most of the economic decisions automatically. The Palestinian Authority's (PA) role would remain minimal after establishing an environment that facilitates market transactions. The PA's primary role would be to determine the "rules of the game" for the economy and provide for their modification, arbitration and enforcement. This responsibility mandates three fundamental roles for the PA:

1. Preserving law and order, which the PA essentially does;
2. Enforcing contracts, which the PA can improve; and
3. Defining and protecting property rights, which the PA can also improve.

With the exception of trade restrictions associated with closure, which are outside the scope of this report because of their political nature, basic weaknesses in "enforcing contracts" and "defining and protecting property rights" represent possibly the most fundamental constraints to the Palestinian economic development effort. These weaknesses are also basic obstacles in the development of a modern Palestinian financial sector.<sup>10</sup>

Protection of property and enforcement of contracts allow those with little property and without political influence to invest. They promote the accumulation of physical and human capital. They lower transaction costs. They help generate a better distribution of income and wealth. Very importantly, they give investors and consumers a sense of security and confidence in the system that is badly needed especially for the commitment of long term capital.

Limiting government action to just the above three roles is described as a "laissez faire" economic approach. It minimizes the role of government and maximizes the role of individuals.

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<sup>10</sup> Palestine Economic Policy Research Institute (MAS), Palestinian Banking Sector Statistical Review, Issue 1, June 1995.

However, a laissez faire economy would not maximize Palestinian social welfare. The Palestinian economy has many situations characterized as market failures, such as monopoly<sup>11</sup>, lack of information, and provision of public goods -- essentially those goods and services that benefit more than a single individual or family. Palestinian market failures can be traced to absent or outmoded laws, or their lack of enforcement. When the self-interest of individual Palestinians differs from the interests of society, government intervention is economically justified.

An appropriate legal framework, including an effective judiciary is critical for an efficient market system. Market mechanisms require a competitive playing field and assume a great measure of certainty and predictability in the applicable rules. Without an appropriate and properly enforced legal framework, market mechanisms are replaced by personal relationships and corrupting practices.

Legislative policy is meshed with economic and social policies. Through legislative and regulatory action, economic and social policies are translated into rules and procedures, the effective application of which enables societies to achieve their objectives. Experience shows that successful legislative policies are those which are based on the assumption of permissibility -- those which assume that prohibitions, limitations and approvals are the exception rather than the general rule. This assumption is one of the basic principles of Islamic jurisprudence (*usul-ul-fiqh*) which recognizes permissibility as the general rule.

Allowing economic agents to work with minimum state intervention has long been advocated in the Arab culture, such as in the fifteenth century writings of Ibn Khaldun. Experience shows that minimum state intervention is good economics, good law and it respects human dignity. It assumes goodness in people and relies more on after-the-fact enforceable sanctions in case violations of established rules than on the prior approval of every possible act. By keeping the limits to a minimum dictated by the demands of public interest, the state also insures the effectiveness of the limits introduced. Such effectiveness is often lost in systems based on the presumption of prohibition and burdened with excessive constraints. Drawing the right boundaries between state and market forces is one of the fundamentals of successful legislative policies. It is also the underlying issue in any discussion on private sector development.

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<sup>11</sup> Palestinian monopolies have been established, or transferred as monopolies to Palestinians by Israelis, and benefit powerful vested interests in a number of Palestinian sectors including gasoline and construction. These unregulated monopolies are well known by Palestinians and they generally lead to higher prices than would be the case under competition. Thus, this market structure leads to a misallocation of scarce Palestinian resources. In modern market economies, such uneconomic market activity would be curtailed by antitrust laws and their enforcement, which do not now exist in the West Bank and Gaza.

### **III. Legal and Regulatory Constraints to Business Activity in Gaza and the West Bank**

This chapter looks at the legal and regulatory processes associated with business transactions, that in the West Bank and Gaza often act as fundamental constraints to business. A comprehensive matrix containing a summary of this chapter is presented in Annex 2. This report does not include a discussion on constraints considered either macroeconomic, dealing with import/export restrictions, or closure and security related, as they were outside the team's scope of work. However, given their importance to the business environment in Gaza and the West Bank, a brief summary of them is presented in Annex 3.

As indicated in Chapter I, the most fundamental conditions needed in establishing modern markets is enforcing commercial contracts and, defining and enforcing property rights. As the West Bank and Gaza move toward integrating the economy into global markets, top priority must be given to developing systems for timely and efficient adjudication of commercial disputes. Defining and enforcing property rights is also critical in establishing collateral for financial investment, particularly for efficient small and medium-size firms.

#### **A. Civil Code as Applicable to Commercial Transactions**

### **Findings**

#### **1. Creation of Valid and Enforceable Commercial Contracts**

The creation of valid and enforceable commercial contracts is governed by the Civil Code known as Al Majallah, which dates back to the Ottoman period. This Code has been extended by parts of British Mandate Law. The Jordanian Commercial Code and Civil Procedure Law No. 42 of 1952 are also applicable in the West Bank.

To create a valid contract, the parties must be legally capable, must have the intention to enter into a contract, and the contract must have a legal purpose. Parties can agree to any type of contract as long as its purpose is not against public order or the law.

The sales contract is regulated in the *West Bank* under the terms of offers and acceptances. The Jordanian Commercial Code provides that both the offer and the acceptance must take place in the same location in order to be valid. They do not need to be in writing. Acceptance of an offer is considered valid unless it was induced by violence, bad faith or false representations. If any dispute arises between the parties, any obligations not specifically provided for in a contract are resolved by the interpretation of the court.

## 2. Remedies Available for Breach of Contract

In the *West Bank*, two types of remedies are available to a party in case of a breach of contract. If a party acting in good faith fails to comply with his/her obligation, the aggrieved party has an action to recover the contract price. If there was bad faith, the aggravated party can recover the contract price plus lost profits. Punitive damages are not contemplated by the law.

Enforcement of contractual remedies varies in the West Bank and Gaza. While in *Gaza*, the courts would enforce contractual remedies irrespective of the amount, in the *West Bank*, the court may reduce them if considered too onerous.

### Analysis

The *formation of contracts* is made easy by the lack of formalities, since not even a written document is necessary under the law. However, as real opportunities for investment are expanded, written contracts will be necessary, especially for important transactions or transactions involving a foreign party.

The regulation of the *sales contract*, one of the most important contract types in business, is limited. Although based on offer and acceptance, key aspects of what constitutes an offer, when an offer can be modified or when it is considered a firm offer, are not treated in the law. Neither are the fundamental elements of the acceptance. This gap makes it necessary to require that both offers and acceptances take place in the same location. If enforced, this legal requirement would create an undue burden on business and would definitely restrict transactions.

As to the *contract terms* in cases of dispute, courts are given the authority to interpret the will of the parties at the time the contract was entered into; however, no guidelines or principles are provided for such interpretation. There is no indication as to what should be the outer boundaries of freedom of contract, what types of mandatory terms, if any, should be part of a sales contract, or what happens when parties do not expressly agree on key terms of a contract -such as price or quantity. This creates uncertainty in the business environment and delays the resolution of commercial disputes since judges may use means of evidence to decipher the will of the parties which are not consistent with commercial practices.

The legislation analyzed provides only for limited *remedies/compensation* in case of breach of contract. Remedies seek to put the aggrieved party in as good a position as if the contract had been fully performed. If a party is unable to comply with the terms of a contract, the breaching party will be liable to pay the contract price. No additional remedies, besides lost profits in cases of bad faith are considered in the law.

## **Conclusion**

The Civil Code provisions analyzed contain basic rules of contract formation as well as procedures and rules of fairness. However, they do not adequately provide standard provisions governing modern business transactions, such as distributorship and technology licensing, which are not addressed in the law. In addition, the parties determine in the contract most of the law applicable to their transactions, but it is difficult to draft complex transactions from nothing. Up-to-date provisions of commercial law are necessary as they would provide a common vocabulary, structure, and basic protection for certain types of transactions.

The state can be an efficient provider of basic contractual rules, given such factors as its economies of scales, its ability to gather expertise and its enforcement mechanisms. But the PA and the Palestinian Legislature lack expertise in this area. The development of commercial contract rules and procedures should be based on the best local and international experience. It should also build bridges between the legal system and the business community, and between local and international business interests.

### **B. Enforcement of Commercial Contracts through the Court System**

#### **1. Execution of Court Judgements**

## **Findings**

The civilian justice systems in the West Bank and Gaza are derived from the legal systems enforced in the two areas before the advent of the 1967 Israeli occupation. In *Gaza*, the court system follows the structure established during the British Mandate. It is composed of magistrate courts, district courts, a criminal court, land courts and a High Court. There is also a parallel system of religious courts.

In the *West Bank*, the courts are organized in accordance with the Jordanian Forming Courts Law of 1952. There are three types of courts: regular, religious and special courts. The regular courts are granted jurisdiction over all civil and criminal matters. The religious courts deal with all issues of personal status. The special courts were created to deal with issues such as land and water disputes, and municipal matters. An example of special courts were the tribunals for the Settlement of Disputes over Land and Water which were set up in 1952. Their work was suspended after the Israeli occupation by Military Order No. 291 of 1968.

In both the West Bank and Gaza, judgements issued by civil, criminal and even religious courts are implemented by the Execution Office which is part of the judiciary but separate from the courts. Creditors or creators of a security mortgage, including security mortgages on cars and other security interests, need to obtain an order from a civil court to make effective a security interest and then present it to the Execution Office for implementation.

In the past, courts played a weak role in the enforcement of commercial contracts and the final resolution of commercial disputes. This was not necessarily the result of problems dealing with the substantive law, as adequate guarantees for fair trial are found in civil and criminal procedure rules (although procedures are often too formalistic and cumbersome). The real explanation for the lack of enforceability of court judgements appears to be threefold<sup>12</sup>:

- First, during the Intifada years (from 1987 to 1993), the public was discouraged from resolving their conflicts in the courts. The Intifada leadership called upon Palestinians to settle their disputes amicably, which lowered the number of cases brought to the courts. Palestinians turned to other methods of resolving disputes, such as informal arbitration and mediation. These methods were not always effective or fair, as they were not essentially based on law.
- Second, judgements passed by the Palestinian courts were executed through the police. The police force in the West Bank and Gaza, although Israeli, contained some Palestinian officers, who were responsible for investigating offenses with no Israeli interest. After 1987, however, these Palestinians in the Israeli police were asked by the Intifada leadership to resign. Almost all did. In practice, their resignation denied the courts the power to execute their judgements. The police stations and functions were taken over by the military. Execution of civilian court judgements suffered because a Palestinian would not ask the Israeli military to execute any judgement against another Palestinian. As a result, the Ramallah Execution Department had a backlog of approximately 2,000 judgements pending execution as of 1995.
- Third, people lost confidence in the judicial system because of Israeli interference with the operation of civilian justice. This lack of confidence eventually led to the paralysis of the courts.

Under the latest accord between Israel and the PLO, the "Palestinian-Israeli Interim Agreement on the West Bank and Gaza Strip or Oslo II Agreement," the Palestinian Council was given judicial powers. As head of the judiciary, the Council is to exercise its powers within the boundaries of the jurisdiction established by Oslo II, through an "independent judicial system composed of independent Palestinian courts and tribunals."

The Council's jurisdiction is limited to matters falling into its territorial, functional and personal jurisdiction, which are defined by the Oslo II Agreement as follows:<sup>13</sup>

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<sup>12</sup> The International Commission of Jurists/The Centre for the Independence of Judges and Lawyers, The Civilian Judicial System in the West Bank and Gaza: Present and Future, June 1994.

<sup>13</sup> Article XVII, "Palestinian-Israeli Interim Agreement on the West Bank and Gaza Strip Oslo II," September 1995.

- **Territorial jurisdiction** covers the Gaza Strip, except for settlements and the specified military installation, and West Bank territory, except for areas classified as "C" which, except for the issues that will be negotiated in the permanent status negotiations, will be gradually transferred to Palestinian jurisdiction in three phases. The Council will not have full jurisdiction even upon completion of the schedule of transfer because issues that are to be negotiated in the permanent status negotiations will remain outside its control. The territorial jurisdiction includes land, subsoil, and territorial waters.
- **Functional jurisdiction** extends to the specific powers and responsibilities expressly transferred to the Council by the Oslo II Agreement;
- **Personal jurisdiction**, refers to the application of the territorial and functional jurisdiction to all persons except Israelis.

### **Analysis**

The Palestinian Authority's judicial powers are limited by the authority retained by Israel. Matters left under the jurisdiction of Israel include settlements, military installation areas, Israelis, external security, internal security and public order of the settlements, and those agreed powers and responsibilities specified in the Agreements. Israel is to exercise such authority through its military government which has all the necessary legislative, judicial and executive powers and responsibilities in accordance with international law.

As explained above, the problems of execution of judgements reside more in the history of occupation than in the law itself. Local courts in Gaza and the West Bank required the use of Israeli police to enforce court judgements and in most cases refrained from doing so. The result has been the absence of sound enforcement of judgements. Introduction of the Palestinian police is expected to change this situation. Under the current peace agreements, the Palestinian police can enforce judgements in area A; as for Areas B and C, enforcement is done by the Joint District Coordination Offices. However, it is important to remember that under the current Peace Agreements, two parallel systems of justice with jurisdiction over the West Bank and Gaza exist: one deals with Palestinians, and the other with Israelis.

In addition, after three decades of Israeli rule, the courts in the West Bank and Gaza suffer from the problems facing the judiciary in most developing countries. These problems are usually of four types: (1) problems resulting from lack of independence and interference by other branches of government; (2) physical problems related to the shortage of buildings, facilities, supplies and financial resources; (3) human resource development related to the numbers and qualities of the judges and other court officers, their training and work methods as well as their salaries and benefits; and, (4) problems related to the judicial process, including the system of case management and applicable procedures.

## 2. Ability to Attach Assets in Aid of Enforcement of Court Judgements

From a business point of view, one of the key issues when enforcement of a commercial contract is sought through the judicial system is whether or not the law provides for mechanisms to obtain payment of the amount due with the assets of the debtor. This area of the law is covered in *Gaza* by the Pledges Law and by the Jordanian Execution Law No. 31 of 1952 in the *West Bank*.

### Findings

In *Gaza*, all assets of the debtor are available to satisfy claims of unsecured creditors unless specifically excluded by the law or by agreement of the parties. Assets which cannot be attached include "shelter", which legally includes the debtor's family's main residence, food, clothing and one third of the debtor's salary. In the *West Bank*, the law provides for attachment, garnishment, seizure, execution sale, imprisonment, and "use of necessary force" in order to enforce a judgement. Both movable and immovable property can be attached by order of the Chief Execution Officer, including property of the debtor which is in the hands of a third party, as well as the garnishment of rental payments, wages (up to one-third), and rights arising from debts payable to the judgement debtor. Basic personal items or items for personal use cannot be attached. Books, tools, instruments, animals and animal foodstuffs, seeds and anything without which the debtor cannot carry on the profession, trade or occupation which is the source of his livelihood cannot be attached unless the debtor provided his dwelling-house or land as security for a loan. Assets belonging to the government or to local authorities are also out of reach for attachment purposes.

Before attaching real property, the Chief Execution Officer must notify the Land Registration Department who must insert a note to that effect in the register. In the *West Bank*, unregistered land may be attached after a few procedural requirements have been complied with. The creditor requests that the Land Registry register the property in the name of the debtor on the basis of the judgement. Once registered, the Chief Execution Officer proceeds to sell the land, deducting the registration fees paid in advance by the creditor.

In both *Gaza* and the *West Bank*, attached property may be sold upon request of the judgement creditor. In addition, a temporary attachment of assets is possible as a pre-judgement remedy to the creditor. In *Gaza*, temporary attachments are only available for lawsuits for a fixed amount of money or suits for specific performance. They are normally canceled by the judgement, but can become permanent until the winning party obtains payment. Enforcement of the court decision becomes then the responsibility of the Execution Office.

### Analysis

The laws of *Gaza* and the *West Bank* dealing with the ability to attach assets of the debtor in order to enforce a court decision are comprehensive and fairly similar. However, they do not seem to have been widely used in the past. The reasons for this are more related with the enforcement of court decisions than with the substance of the law itself.

In addition, because of the history of the West Bank and Gaza, there is a strong social taboo against evicting an owner from his or her land, especially when the land is used for residential or agricultural purposes. This social attitude can operate to deter courts from ordering the remedy of foreclosure and instead, other remedies may be considered. However, foreigners may not be the subject of such treatment.

### 3. Creditor's Order of Priority in the Execution of Judgements

#### Findings

In both Gaza and the West Bank, the general rule of creditor's rights gives priority to secured creditors and among those, to the creditor who first registered his/her pledge in accordance with the law. Sums received from a judgement debtor or from an execution sale of assets of a judgement debtor are distributed among creditors who presented their claims through the Execution Office. If the total amount received does not satisfy all debts, secured creditors are paid first in accordance with the order of registration of their pledge.

In *Gaza*, exceptions to the above rule may apply on the basis of "good faith." A creditor who did not register a pledge first can still take priority over a later creditor if the later creditor knew or "should have known" of the existence of the earlier pledge. In the *West Bank*, a judgement debtor may be imprisoned if it is proven that he/she had sufficient means to satisfy his/her debts but refused or refrained from doing so, by, for example, transferring or assigning assets to a third party.

Maintenance payments (e.g., family expenses), taxes, fees and charges levied by the government, with the exception of payments owed to the government as ordinary creditor, always take priority over all other creditors, both secured and unsecured.

#### Analysis

The written laws applicable in Gaza and the West Bank explained above provide a sufficient legal framework for creditors' rights. However, their implementation presents major problems. Pledges only become perfected once they are registered in accordance with the law. However, registration is often difficult to complete because of the lack of clear titles to prove ownership of the asset, high registration fees, and outmoded or non-existent registration systems. As a result, creditors may lose the full benefits of the protection granted by the law, i.e., priority of their claims over other creditors' because of the inability to register a valid pledge.

#### 4. Ability to Enforce Foreign Judgements

##### Findings

Foreign judgements may be recognized in the *West Bank* under the Jordanian Law for Enforcement of Foreign Judgements No. 8 of 1952, as amended in 1965. In *Gaza*, the enforcement of foreign judgements is governed by the British Mandate Rules of the Court of 1928, 1929, and 1930.

In both Gaza and the West Bank, a foreign judgement is enforceable when: 1) it was given by a court having jurisdiction; (2) the judgement can no longer be appealed; (3) the obligation imposed by the judgement is not contrary to law or public order; (4) the judgement was not obtained by fraud; and (5) there is reciprocity between the state that issued the decision and Gaza or the West Bank. In addition, in the *West Bank*, the judgement debtor must either reside in, or have property in the West Bank with which to satisfy the judgement. In *Gaza*, the reciprocity requirement can be waived when the Attorney General expressly requests the court to enforce the foreign judgement.

Regarding enforcement of foreign arbitral awards, the Palestinian Territories are not a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. However, *Gaza* has laws governing the enforcement of foreign arbitration awards which derived from the Convention on the Execution of Arbitral Awards of 1927. In addition, the British Mandate Arbitration Foreign Awards Order No. 2 of 1931, also applies. Pursuant to these laws, foreign arbitral awards can be enforced under the same conditions a foreign judgement is enforced, as long as the arbitral award is not contrary to public order or to the law.

##### Analysis

The laws in the Gaza and the West Bank regarding enforcement of foreign judgements seem adequate in principle, although there has been very little experience with their application. However, the general inability to enforce judgements explained above could hamper the efficiency with which foreign judgements are executed, even if recognized by local courts. Such inability can be particularly onerous for foreign investors relying upon local courts for repossessing local assets or enforcing security interests.

##### Conclusions

Substantive and procedural laws in Gaza and the West Bank for the enforcement of commercial contracts through the courts seem in principle adequate. There is, however, room for improvement and updating. Key bottlenecks are found in: (1) the weakness and unreliability of the judiciary; (2) the absence of an effective registration system; and (3) the limited scope of the Palestinian police activities related to the enforcement of court judgements. USAID resources would be helpful in strengthening the courts and improving registration systems.

**Courts** in Gaza and the West Bank need to reduce case delays by streamlining court administrative procedures. This could be accomplished through such means as the use of a modern and effective system of case managing and scheduling and a more efficient means of serving court processes. In addition, judges, Execution Officers, and administrative personnel should receive on-the-job training in areas of commercial and business law which were restricted or neglected during 29 years of Israeli rule. Better trained judges and more efficient court procedures should strengthen the execution capabilities of the courts and should lead to a more effective enforcement of commercial contracts. This should also improve the ability of creditors to obtain payment from a defaulting debtor by means of the attachment of the debtor's assets.

The absence of an effective **registration system** is particularly damaging to creditors who are limited in their ability to secure transactions by means of pledges, charges or mortgages. A modern system of commercial registration should be developed to provide, at a minimum, a mechanism for perfecting non-possessory security interests in all forms of real, personal and intangible property by simple registration in the Land Register, Commercial Register, or other types of registries.

Even after registration systems are put in place and the efficiency of the courts is improved, enforcement of judgements will be confronted with the issue of their execution by the police. Now that the Palestinian police is replacing Israeli military in areas under Palestinian control, prospects for enforcement of judgements have certainly increased. However, the new Palestinian police faces many other priorities, such as maintaining security and peace in the Palestinian Territories. Therefore, it is unclear whether the police will be in a position to devote in the short-term enough time and resources to issues of enforcement of court judgements.

### **C. Enforcement of Commercial Contracts through Arbitration and Other Alternative Dispute Resolution (ADR) Mechanisms**

#### **Findings**

As in other countries with weak commercial administration of justice, a by-product of the weak enforcement capacity of the courts is the development of alternative dispute resolution mechanisms. Because of the poor quality of the court system, these have been preferred ways for resolving commercial disputes in Gaza and the West Bank.

In the *West Bank*, arbitration is governed by Law No. 18 of 1953. If a contract does not provide for arbitration, parties may still submit the case to arbitration before pursuing formal avenues. Arbitration can take place outside of the court, but arbitral awards are enforceable only when recognized by the courts and executed by the Execution Office. Even when parties have provided for arbitration in a contract, they can decide to submit the case to the court system if both agree to do so and the court accepts to hear the case. In addition, a party may ask a court to stop an arbitration process which is underway on the basis that arbitrators are not following the terms and conditions established in the contractual provision.

The court's review of the arbitral award is intended to determine whether there are disputed issues which were left unresolved. If so, the court will send the case back to arbitration. The court can vacate the arbitration award in the following cases:

- if the arbitration agreement between the parties was invalid or if the arbitration took longer than the term specified by the parties or by law (3 months), or if the arbitrators did not follow the arbitration agreement so that the award was improperly procured;
- if any of the parties or arbitrators has no legal capacity;
- if the decision came from an arbitrator who is not allowed by law to act as arbitrator.

### **Analysis**

Lawyers interviewed in both Gaza and the West Bank indicated that arbitrators are required to follow all judicial procedures in the arbitration process, although no express legal provision was found on this regard. The need to follow all judicial procedures would defeat the very purpose for using arbitration, i.e., expedite the resolution of commercial conflicts by submitting claims to a group of experts working within a flexible set of procedural rules.

In addition to this major drawback, other problems identified in this area are: (1) the lack of appropriate basic arbitration guidelines and principles for arbitrators to follow; (2) the lack of a forum for arbitration proceedings; and (3) the lack of a pool of trained arbitrators renowned in their own areas of expertise.

In practice, disputes in both Gaza and the West Bank are often resolved through more informal mechanisms including mediation and the traditional method of *sulha*. These methods lack official enforcement mechanisms. Their strength stems from the considerable force of cultural tradition behind them. Yet, although informal dispute resolution mechanisms may be effective and respected in Gaza and the West Bank when dealing with local parties, they may prove to be less than adequate when foreign parties are involved.

### **Conclusion**

Development of a strong, professional and reliable system for commercial arbitration would not only decongest court rooms, but more importantly, it would substantially improve the business environment in Gaza and the West Bank. Indeed, having a sound mechanism for resolving commercial disputes through any ADR method is one of the key factors a careful investor wants to analyze in any country, given the general inefficiencies of most court systems around the world.

Support in this area involves: (1) establishment of a flexible, effective and practical mechanism of dispute resolution for all commercial transactions --including financial market matters-- pursuant to arbitration allowed under the law; (2) selection of a good pool of professional arbitrators; (3) training courses in arbitration and other ADR methods; and (4) development of a certified ADR center. USIS has financed several arbitration workshops in Gaza and the West Bank. However, no additional funding is contemplated beyond 1996. This area represents a clear possibility for USAID's intervention, particularly given the work already performed by USIS.

#### **D. Secured Transactions**

##### **1. Creation and Enforcement of Security Interests**

Commercial loans for business activities typically require some form of collateral to guarantee repayment of the loan. This guarantee may take the form of a perfected first lien, charge or security interest in tangible or intangible property, real or personal property, all of a company's assets, its equipment, inventory, accounts, or even the company's stock.

#### **Findings**

In the *West Bank*, secured transactions are governed by the Jordanian Collateral Lending Law No. 46 of 1953 and the Jordanian Company Law. In *Gaza*, the creation of security interests is regulated by the Pledges Law and by the Companies Ordinance of 1929. Other specific laws, such as the Land Law and the Mortgage Law also apply in Gaza when the asset given as collateral is land or intellectual property.

In general, a security interest is created or "perfected" in two ways: by deposition of the charged property in the hands of the creditor or by registration of the charge. Charges or pledges on real property must be registered in the Land Registration Department. Charges on a company's stock must be registered in the Commercial Register and charges on intellectual property at the Register of Patents and Trademarks. Security interests which are not perfected in accordance with the law are not enforceable. Fees for the perfection of a security interest on land are one percent of the value of the land. Realization of a security interest requires a court order or an order by the Chief Execution Officer.

A company may pledge its movable property or mortgage any of its property, including unsubscribed shares, as security for business transactions. In practice, however, movable property is rarely used as collateral. Typically, real property is the preferred asset given as collateral to secure business transactions.

Immovable property may be provided as security for a loan if the debtor owns the whole property or a part of it. The debtor can secure the debt using his or her rightful share of the property. All buildings affixed to the land at the time the security was given, and everything that was affixed to the land subsequently will be regarded as part of the property given as security.

In the *West Bank*, giving real property as security or collateral for a debt requires a certificate approved by a "specialist" providing information on whether or not the property is leased, and if it is, the duration of the lease must be indicated. In addition, a certificate must be obtained from the Land Registration Department to demonstrate clear title. The lender has the right to transfer his interest in the property to another party. Such transfer requires registration with the Land Registration Department. The borrower may sell the property provided the buyer accepts the terms of the collateral agreement with respect to the property to be purchased.

If a loan remains unsatisfied after expiration of the loan term in the *West Bank*, the lender is entitled to request the Land Registration Department to sell the property without a judicial proceeding. The Land Registration Department must request the borrower to pay off the loan within one week or else the property will be sold. The borrower can request an extension of up to two months if s/he can demonstrate that it is likely that s/he will pay off the debt within the additional term, or that the sale will cause her/him unreasonable difficulties and will deprive her/him of reasonable personal needs.

If the borrower's application is rejected, or if having been accepted the borrower does not pay off the loan after the extension, the land will be sold in an auction for the highest price offered. The person who obtained the land through an auction is not entitled to sell or mortgage the property for one year because the original debtor has the right to recover the property during that one year if s/he pays the loan amount plus interest and all expenditures and fees paid by the creditor.

In *Gaza*, security interests can be created on any type of property which can be owned, be it real or personal, tangible or intangible. Creation of floating charges is possible only when the debtor is a company. Machinery can in principle be given as guarantee in a business transaction, but this is not often done because of the difficulties to foreclose on it.

## **Analysis**

The legislation for the creation, perfection and enforcement of security interests is fairly detailed in both the West Bank and Gaza. It is nonetheless somewhat outdated and in need of reform. By far the main problem in this area is the inability to perfect security interests through appropriate registration. Security interests which cannot be perfected are not valid. In the West Bank and Gaza, registration departments in charge of perfecting the different types of security interests either do not work properly or simply do not exist. A case in point is the trademarks and patents register which is contemplated by the law but which has yet to be established.

In addition, cases involving foreclosure of real property have been very limited in Gaza and the West Bank, mostly because of the reticence to enforce this type of court decision, as explained above. Because of the limited perfection and enforcement of security interests, other types of guarantees became fairly common, such as co-signature of loan agreements by family members as guarantors.

Several provisions need to be reviewed to conform them to a modern market economy. For instance, rules requiring a certificate by a "specialist" on whether property to be given as collateral is leased, seem obsolete in a modern market economy where other more accurate means of information should be put in place to provide updated information.

Other provisions, such as those allowing a borrower to sell mortgaged property without the lender's consent, on the sole condition that the buyer "accepts" the collateral agreement, eventually become a constraint to term credit. If the original loan is to be maintained with its terms and conditions, banks will want to thoroughly examine the new buyer's credit record before any transfer of property is done. Otherwise, banks will seek to protect themselves by increasing lending rates, therefore limiting access to credit. Even if this legal gap can be filled by contractual provisions, it would still be useful to modify the law to conform it to the needs of the marketplace.

Additional problems are found in the procedure for executing or enforcing security interests. Such procedure is plagued with "judgement calls," which allow a defaulting borrower to postpone execution of a security interest on purely subjective grounds. A defaulting borrower can request that foreclosure on a mortgage be delayed for two additional months by stating that s/he is "likely" to be able to pay if given the extension, or that the foreclosure would cause him/her "unreasonable" harm. In a market economy, this type of provision becomes a serious constraint to lending and to business transactions because the essence of a security interest -- i.e., the ability to foreclose on a defaulting debtor to obtain payment of the amount due, is restricted by subjective considerations.

## **Conclusion**

The ability to create, perfect and execute security interests is key to the development of an active private sector in the West Bank and Gaza given its importance for providing businesses with access to credit. The major bottleneck in this area is again the lack of working commercial and land registries allowing the inscription of security interests, as required by law. Therefore, undertaking the creation and/or modernization of these types of registries is a high priority. In addition, some fairly substantial modifications of the laws on security interests is required in both Gaza and the West Bank. USAID support could play a key role in modernizing registries and updating this type of legislation.

## 2. Real Property Given as Collateral

### Findings

Real property rights are mostly governed by Ottoman Land Code and “Al-Majallah” or Civil Code. Both are applicable in Gaza and the West Bank. Important amendments were also introduced by Jordanian laws and Israeli military orders. A brief account of the origins and evolution of land tenure in the West Bank and Gaza is useful to explain the current situation regarding the ability to use real property as collateral in business transactions.

Under Ottoman rule, a land code was compiled in 1858. The purpose of this legislation was to develop a basis for taxing real property by establishing clear title to the land and registering the legal owner. Land registers were created, which to this day are commonly called *tapu*. The right of possession was granted directly by the state upon the payment of a sum in advance called the *tapu* fee. In return, the possessor was granted a title deed.<sup>14</sup>

According to the Land Code and Al Majallah, land is divided into three main categories:

- The first category comprises “*waqf*” land, or lands dedicated to religious purposes. Ultimate proprietary right over these lands is the “All Mighty.” The fruits of *waqf* land accrue to the grantor, but the land itself is in principle inalienable and non-inheritable in perpetuity. Land dedicated to a family *waqf* insures for the owner and his descendants all the benefits. At the same time, the property was protected by the strongest legal and religious sanctions in Muslim law from seizure by the state or its officers. Several classes of *waqf* land exist.<sup>15</sup>
- The second category of land is the “*mulk*” land. This is land which originally was given to Muslim and non-Muslim inhabitants of conquered areas. Different kinds of *mulk* land are considered in the Land Code such as “land for houses within towns and villages, land of an extent not exceeding half a *dumum* situated on the confines of towns and villages which can be considered as appurtenant to dwelling houses, and land separated from *miri* land and made *mulk* in a valid way.”<sup>16</sup>

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<sup>14</sup> Tute, “Ottoman Land Laws,” as cited by Raja Shehadeh in The Land Law of Palestine, 1993.

<sup>15</sup> Ibid.

<sup>16</sup> Ottoman Land Code, Article 2.

- The third category of land comprises "*miri*", "*matrouk*" and "*mawat*" lands. These are lands whose ultimate ownership lies with the state. *Miri* lands were originally all the lands owned by the Sultan comprising arable fields, meadows, summer and winter pasturing grounds, woodland and the like, which were close to the villages.<sup>17</sup> *Matrouk* lands were lands used for public purposes and lands falling between villages and used by all as common pastures.<sup>18</sup> Finally, *mawat* land was "vacant land such as mountains, rocky places, stony fields ... and grazing ground which is not in possession of anyone by title deed, nor assigned ... to the use of inhabitants of a town or village, and lies at such a distance from towns and villages from which a human voice cannot be heard at the nearest inhabited place. Anyone in need of such land could, with "the leave of the official," cultivate it on the condition that ultimate ownership remained with the Sultan.<sup>19</sup>

In summary, under the Ottoman legal framework all lands belonged to the Sultan by right of conquest, with the exception of *waqf* and *mulk* lands. The Land Code dealt specifically with the third category of lands, while the Al Majallah treated both *mulk* and *waqf* lands. Of all these types of lands, *mulk* land is the only one that can be considered land possessed in full ownership.

The British Mandate maintained the legal categories of land described above and created a new category of land, the so-called "state or public land," different from any of the above. Public lands were defined by the 1922 Order-in-Council as "all lands in Palestine which are subject to the control of the government of Palestine by virtue of Treaty, Convention, Agreement or Succession and all lands which are or shall be acquired for the public services or otherwise."<sup>20</sup> In addition to this new category, the British Mandate worked in the preparation of land surveys and in the settlement of disputes over land. A Land Transfer Ordinance also was passed which required a permit to be obtained before land could be transferred.

During Jordanian rule over the West Bank, the Mandate policy to settle land disputes and to issue final indisputable certificates of title continued. However, this process was very slow because of limited resources. Land registration began in 1952 with Jordanian Law No. 40, the so-called law for "Tassuia". Under this law, all lands in the West and East Bank were to be registered. When Israel stopped the registration process in 1967, some cities and villages had begun registering properties, but generally, especially in cities and villages in the North, no registration was completed.

The registration process was halted by Israeli Military Order No. 291 of 1968 which suspended all operations of the Settlement of Disputes over Land Law. After a land survey was

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<sup>17</sup> Ottoman Land Code, Article 3.

<sup>18</sup> Ottoman Land Code, Article 5.

<sup>19</sup> Ottoman Land Code, Article 103.

<sup>20</sup> Shehadeh, Op. Cit.

completed by the Israelis in the areas of the West Bank and Gaza in the early seventies, the Land Departments were instructed to restrict access of the public to land records.<sup>21</sup> This restriction continued in place until the Land Registration Departments were transferred to the PA.

Besides the issuance of more than 2,000 Military Orders, Israel formed Military Objection Committees to rule on appeals against administrative decisions on issues including land, registration of companies, taxation and pensions. In addition, other military appeal committees were established through Military Orders to deal with land registration and town planning.<sup>22</sup> Military orders extended the term for registering purchase contracts from five to fifteen years. As a result, many land deals have not been registered in the Land Registration Department.

### **Analysis**

Land registration in Area A was transferred to the Palestinian Authority in December 1995. Several constraints were identified for giving real property as collateral in business transactions. The most critical deals with the inability to produce clear and reliable title over property to be given as collateral. Title to real property is established only by registration of a purchase contract or court decision transferring the property. However, restrictions imposed on land transfers and registration by Israeli rule, together with high registration fees required by law (five percent of the real value), have resulted in a situation where titles remain unregistered for generations. This not only creates unnecessary disputes, it also deprives the "owner" of the ability to use the property as collateral for bank credit.

In addition, fees, proportional to current value (1%) rather than reasonable flat rate fees, are also imposed on the mortgaging of real estate. Such fees for the registration of titles and mortgages can lead to the practice of understating the real value of the property to be registered. Also, time-consuming procedures applied by inefficient offices further exacerbate the problem.

Three different systems of land registration co-exist in the West Bank and Gaza. *The Land Registration Department*, now part of the *Ministry of Justice*, covers the areas within major cities that were registered before 1967. All other areas, even within city limits, are supposed to be registered in the *Property Department* of the *Ministry of Finance*. In addition, *municipalities* also have a different land register for land zoning and planning. The land register of the Ministry of Finance is used for the imposition of taxes. The Land Registration Department of the Ministry of Justice uses its own register for recording land sales and mortgages.

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<sup>21</sup> Shehadeh, Op. Cit.

<sup>22</sup> Military Order 1060.

None of the registers are updated or complete, and none are linked to each other. Cadastral systems are based on maps dating back to 1967 or before. It is often difficult to determine the precise boundaries of properties. Furthermore, all different categories of land are inscribed in the register, thereby creating a very complex system where ownership refers to categories that are outdated and obsolete.

As there was no access to the land registration department after 1967, the vast majority of transactions involving property transfers occurred outside any recorded system. Today, ownership of unregistered land is more or less ascertained on the basis of evidence provided by family members, the community, or even by old titles issued by Turkish authorities during the Ottoman period.

## **Conclusion**

Uncertainties in land tenure, land registration, and zoning constitute a major limitation to investment in the West Bank and Gaza as they impose significant constraints on pricing, collateral requirements, and increase transaction costs. High priority should therefore be given to improvements in land laws and registration procedures that will support development of credit markets -- particularly the small and medium businesspeople that make up the bulk of the Palestinian private sector. In addition, cadastral surveys should be conducted to update the geographical information which provides the basis for a good system of property rights. Finally, consideration should be given to replacing the high percentage rate now required for title registration with reasonable flat fees.

A word of caution should be mentioned when dealing with cadastral surveys and land registration. Given the historical role that land has played in Gaza and the West Bank, land property rights constitute a highly sensitive area which many interviewees indicated should not be the subject of any major reform effort until final status negotiations with Israel take place. However, it is widely recognized that as they exist now, property rights not only act as a major constraint to business activity, but also allow Israel to take advantage of the complex regime developed by Ottoman, British, and Jordanian legislation for security and settlement-building purposes.

## **E. Banking and Finance**

Financial intermediation is an economic problem of primary importance in the West Bank and Gaza. Lack of equity capital for small and medium-size firms constitutes one of the major constraints to business expansion.

## 1. Lack of a Trust Law

### Findings and Analysis

There is no Trust Law for the West Bank and Gaza. Typically, a trust law provides the legal infrastructure for ensuring that investments are handled with integrity. It gives a sound initial base for developing term credit and capital markets.

A Trust Law is based on the concept of the "fiduciary." Fiduciaries are the individuals charged with the responsibility of overseeing the management of a fund for the interest of the beneficiaries of trust assets. They act under the duty called the "fiduciary duty," to place the interests of investors first.

### Conclusion

It would be important to develop a Trust Law in Gaza and the West Bank before any specific structural changes in the marketplace occur with a view to better protect the interests of investors. This immediate need could be addressed by USAID not only in terms of assisting in the drafting a Trust Law, but also in devising a strategy for its implementation.

The basic tenets of a sound Trust Law are:

- *Independence*: the administrative body of the fund must be independent of any governmental agency or operating company. This independence is key to ensuring that assets will be invested in vehicles that will offer the best rate of return at a predetermined level of risk.
- *Conflicts of Interest*: the managers of Trusts ("trustees") must not take any action other than what would be in the best interest of the Trust.
- *Standard of Care*: the Trustees must be both qualified to make investment decisions and follow a high level of diligence when setting investment policy and making investment decisions.

## 2. Insurance and Contract Savings

Contract savings institutions -- such as the funds paid by Palestinians working in Israel to the Israeli Social Insurance System, or to private pension funds or insurance companies-- often provide much of the investment funding in successfully developing countries. These funding sources would be expected to rise sharply as social insurance systems become more developed in both the public and private sectors. The savings pool of capital created by contract savings institutions should provide a significant amount of capital to fund Palestinian economic growth through the private sector.

## **Findings**

During Jordanian rule, there was no detailed law governing insurance. In 1976, Israeli Military Order No. 676 was issued which revolutionized the insurance industry. Military Order No. 676 is the basic law governing the Palestinian insurance industry today. The Order provided the basis for calculating damages and compensation. It is built on three foundations: (1) pain and suffering; (2) loss of current and future income, appropriately discounted; and (3) actual expenses. Together, they form the technical basis for insurance in the West Bank and Gaza.

Car insurance is now the major insurance subsector. Each type of insurance is controlled by the contract itself. Employee insurance is controlled by Israeli Military Orders No. 62 and No. 663, which provide the basic calculations. Life insurance continues to be limited in the Palestinian Territories for social and religious reasons.

There is no social insurance system or associated supervisory authority mandated by the government to protect the integrity of the social insurance system, despite the fact that substantial funds are directed to the PA from social security payments by Israeli employers to Palestinian workers. Furthermore, there is no law governing private pension funds.

## **Analysis**

The problem appears to be how to invest funds generated by insurance mechanisms. As described above, there is no Trust Law which governs the investment of funds. Failure to establish an appropriate legal foundation for these investments could continue to limit participation in the insurance system, thus curtailing available funding sources for Palestinian investment. This could be a major deterrent to the expansion of the industry in the future, as the business climate improves under the peace initiatives.

Life insurance and pension plans are essentially substitutes. Both should be important sources of capital to the public markets and both should provide retirement security for individual workers. If designed properly, the pension plan can provide the same type of disability and death benefits characteristic of life insurance. Life insurance is important in the long term, but the structural changes necessary to establish a meaningful program are more significant than for the pension plan.

## **Conclusion**

With regard to social insurance paid to Palestinians who work in Israel, there is a need to develop contract savings institutions to deal with these funds. It is also advisable to prepare for new sources of contract savings. In addition, the laws governing social security, medical insurance and pension funds for Palestinians working in Israel should be reviewed with a view on ensuring that the appropriate workers are covered and the investment of funds achieves the highest possible returns given an acceptable level of risk. Life insurance should be separated from non-life insurance

business, and strategies should be developed in order to invest more efficiently the existing pool of capital held by life insurance companies.

### 3. Negotiable Instruments

The ability to use and rely on negotiable instruments, such as checks and notes, is fundamental for the development of business activities in a modern economy. A negotiable instrument is a special document because of the unique legal liabilities associated with it. A special set of rules is therefore necessary to provide for the specific liabilities and obligations that arise with these documents.

#### Findings

In the *West Bank*, Law No. 12 of 1966 from the Commercial Code covers the area of commercial papers and includes a section on checks. Other regulations dealing with checks are found in Jordanian Law No. 16 of 1960, or criminal code.

According to the law, there are three types of commercial papers:

- The first type of commercial paper is a document where A orders B to pay an amount of money on a specific date and place to C. The requirements of this document are the title on the paper, the instruction to pay a definite amount of money, the name of the drawee, the due date, the place, the name of holder, the date of creation, and signature. B in this case is not a bank or any financial institution.
- The second type of commercial paper is a document where A gives instructions to B to pay C a definite amount of money upon receipt by A of the goods which were the object of the transaction. As in the case above, B is not a bank or any financial institution.
- The third type of document mentioned in the law is the check. According to the law, a check must contain an unconditional promise to pay a sum of money and no other promise, order or obligation. The check must indicate whether it is payable to order or to bearer. The types of checks mentioned in the law include checks whose negotiability has been restricted, such as for deposit only check,; postal savings checks, and travelers checks.

According to Law No. 12 of 1966, a check can be presented for payment within five years of issuance. This term is limited to six months if the check was endorsed. The law regulates two types of endorsements. Blank endorsements, which specify no particular endorsee, and special endorsements which specify the person to whom or to whose order the instrument is payable.

The procedure for executing a dishonored check allows the holder to pursue his or her claim in a civil or a criminal action. In the West Bank and Gaza, the criminal action is always preferred because of the possibility of imprisoning the debtor. Once a civil action is commenced, the criminal

action is lost. The civil action is carried through by the Execution Office. The process may be lengthy because the Chief Execution Officer needs to first request the debtor to comply with his or her obligation to pay, and payment by installments is considered sufficient to suspend the execution of the claim.

Any person who tampers with a check or writes a check with insufficient funds is liable to a fine of 50 Jordanian Dinars (JD). Anyone responsible for a bounced check may be subject to imprisonment for one to two years and a fine ranging between JD50 and JD200. For forged checks, the sanction is imprisonment for one to three years. Companies that bounce checks are subject to a fine or to the attachment of the company's assets, unless it is proven that a company's director acted in bad faith. In this case, the director becomes personally liable.

### **Analysis**

The laws regulating negotiable instruments are outdated and very limited in scope. First, there are no clear regulations as to what constitutes a negotiable instrument. Not all commercial papers can be negotiable. Negotiability must follow a narrow definition so that instruments used in business transactions are easily recognizable and distinguishable by anybody. If not, business persons would not be able to rely on them for facilitating payment of transactions.

Only issuance of checks with insufficient funds, forgery and tampering are mentioned in the Criminal Law. There is a legal vacuum regarding the contractual liabilities of the different parties to a negotiable instrument. Nothing is mentioned about important questions such as the relationship between drawer or maker of the instrument, the bank, the endorser if any, and the holder of the document. Issues regarding the liability of each party need to be clearly spelled-out in the law.

Endorsements are also contemplated in the law but with very little detail. Aside from the indication that there are two main types of endorsements, nothing is said about the legal effect of multiple endorsements, what procedures should be followed when a negotiable instrument is dishonored after subsequent endorsements, e.g., presentment and protest, and what is the penalty for noncompliance with such procedures, including discharge of the obligation.

Many other areas typically covered in laws regulating negotiable instruments are missing in the legislation analyzed in the *West Bank*. Some have been mentioned only to illustrate the type of norms that create a legal framework for negotiable instruments which conforms to international standards.

### **Conclusion**

A major updating of the laws on negotiable instruments should be carried out to provide for areas such as specific contractual liabilities and basic regulations on holders in due course. In addition, any legal modifications should study the possibility of developing new instruments to respond more adequately to the needs of a modern market economy. USAID could play an

important role in supporting a revision of the body of law and devising a strategy for its implementation.

#### 4. Additional Related Constraints

Numerous additional constraints emerge in the field of financial and capital markets. Among them, it is worth mentioning the following:

- **Inefficiency of Financial Markets:** Despite renewed Arab banking activities, the Palestinian banking structure remains relatively uncompetitive with three Jordanian banks controlling the great majority of deposits. As in Jordan, the Arab Bank appears to hold a dominant position. The non-competitive structure appears to have led to low deposit interest rates and conservative lending procedures, which appear to be reflected in a single or very limited range of interest rate differentials for investment loans. This is particularly restrictive to smaller riskier firms attempting to obtain loans.

A larger share of bank lending in the West Bank and Gaza is conducted by Palestinian banks and other relatively unregulated forms of equity capital, such as insurance companies. These companies obtain their funds in part by new regulations on buildings which require the purchase of insurance.<sup>23</sup> Most lending continues to be in the form of overdraft facilities which at the end of September 1995, accounted for 72 percent of all loans extended by banks in the West Bank and Gaza, and these represent funds transferred to finance loans outside these areas.

- **Term Loans and Equity Investment:** private equity sources are the main source of equity capital in the West Bank and Gaza. They include equity investment funded from private domestic savings, from retained earnings of private companies, and from foreign sources. Private equity is essential for the establishment of new companies and for the expansion of existing ones. However, as firms become larger and expansion opportunities demand increasingly larger amounts of capital, businesses may look to raise funds from the yet-to-be developed stock markets.

A Jordanian-financed Palestinian capital market project, Palestine Securities Exchange, is currently being formed to meet the vacuum for long term finance. The conditions for forming a stock market are not now ideal, given the limited number of firms for which market shares could be issued. However, if a stock market is created, it should be regulated. Although it may be premature, this area represents one of the major areas for new financial policy and institutional reform.

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<sup>23</sup> MAS, Op. Cit.

- **No Leasing or Complementary Tax Law:** there is a lack of important financing devices for the acquisition of high-value durable goods such as motor vehicles, ships, aircraft, construction equipment and computers. One example is financial leasing. Current work in this area by the World Bank would require the concurrent development of taxing laws for the Palestinian Territories. A financial leasing market can remove tax distortions by enabling lessors (owners) to take the tax benefits that lessees (users) cannot use. In other words, financial leasing can lead to a more efficient allocation of economic resources in countries where corporate taxation rates are not negligible.

In sum, there is a need for financial and banking reforms to provide a better business environment in an effort to encourage private sector investment and to reduce capital flight from the West Bank and Gaza. A more competitive banking structure would lead to banking loan portfolios with a broader range of risk, which may provide additional funding for projects more appropriate to Palestinian investment conditions. However, there is little capacity within the PA to regulate the rapid-developments currently taking place in the areas of banking and financial markets. Moreover, the success of financial law and regulations is often dependent upon and involves adopting well defined laws on property rights, reorganizing the court system in ways that accelerate commercial dispute settlements, and developing an appropriate enforcement mechanism for loan collection.

## **F. Regulation of Companies**

Company regulations in the *West Bank* are covered by the Jordanian Companies Law No. 12 of 1964. The laws applicable in *Gaza* are the Companies Law of 1929, and the Companies Ordinance of 1930. Overall, companies laws in Gaza and the West Bank are fairly similar, although Gazan laws have been cited by various lawyers as providing a more comprehensive and flexible framework for companies to operate.

### **1. Companies Registration**

#### **Findings and Analysis**

To date, the Palestinian Authority has not issued regulations that significantly alter the pre-existing legal corporate frameworks prevailing in the West Bank and Gaza. As a result, two separate Palestinian ministries are responsible for registering companies: the Ministry of Justice through its Commercial Register, and the Ministry of Trade and Economy, through the Controller of Companies.

Dual registration for companies doing business in both Gaza and the West Bank is no longer necessary after a 1995 Resolution of Chairman Arafat. In *Gaza*, formalities required for the registration of a new company are minimal and the process takes a few days. In the *West Bank*, requirements are more demanding and the process can take weeks to be completed.

In *Gaza*, real estate companies require a special approval from the PA. It is unclear whether companies whose main purpose is not real estate but who, in their commercial dealings need to buy and sell land, would also be subject to this restriction.

## **2. Fees**

### **Findings and Analysis**

Corporate registration fees differ between the West Bank and Gaza. Moreover, in the *West Bank*, the Ministry of Justice applies a percentage fee on the company's capital while the Ministry of Trade and Economy has set a single flat fee. This situation creates uncertainty in the business environment and increases the cost of transactions as new companies try to register in both institutions to be on the safe side of things.

## **3. Types of Organizations**

### **Findings and Analysis**

In the *West Bank*, five types of organizations exist: ordinary general companies, ordinary limited companies, private stock companies, public stock companies and foreign companies. In *Gaza*, business entities are either companies or partnerships. Companies can be limited or unlimited, either by shares or by guarantee. They can also be private or public.

Neither the Gaza nor the West Bank law contemplates the creation of international joint ventures. Currently, parties willing to operate under a joint venture agreement need to open a corporate presence in Gaza or the West Bank using one of the types of organizations mentioned above. This may act as a deterrent to investment and may increase the cost of transactions.

## **4. Corporate Governance and Minority Protection**

### **Findings and Analysis**

In *Gaza*, the board of directors of a company may adopt decisions by ordinary or extraordinary resolution. Ordinary resolutions require a single majority vote while extraordinary resolutions require the affirmative vote of three quarters of the members entitled to vote. The law does not expressly state the decisions that require a qualifying majority before becoming binding for the company and its shareholders. As a consequence, it is not clear whether minority shareholders are adequately protected when major decisions of the company are considered and taken, such as winding up and mergers.

## 5. Accounting and Auditing Standards

### Findings and Analysis

Accounting and auditing procedures among companies in both Gaza and the West Bank are not standard. They are, in addition, inconsistently applied and enforced. Thus, financial statements are often suspect. As a consequence, companies may find it difficult to obtain financial credit because a bank's credit judgement is a function, in part, of the quality and reliability of the financial information presented by a prospective borrower. If a bank lacks confidence in the financial information provided, it is unlikely to extend credit. Banks can address this problem partially by requiring that financial statements of prospective borrowers be audited by a respectable firm according to generally accepted international accounting and auditing standards. However, smaller companies, which represent the bulk of the Palestinian private sector, may find it difficult or expensive to comply with an audit according to international standards.

## 6. Commercial Register

### Findings and Analysis

Commercial registers existing in Gaza and the West Bank are extremely weak and inefficient institutions. Their activities are limited in scope as they almost exclusively deal with the incorporation of new companies and do not keep records of a company's evolution over time. In *Gaza*, the commercial register is manual and its information is only available to parties in a dispute or to partners or shareholders. In the *West Bank*, the Ministry of Trade and Economy is in the process of computerizing the register but so far, only limited information can be obtained.

The commercial register is a vitally important institution for promoting investment and developing the private sector. It performs a crucial role in providing essential information about individual enterprises to key actors in the market such as suppliers, customers, and banks. For the effective development of the private sector, both businesses and the public need a reliable and efficient means of obtaining as much information as possible about the legal status and condition of entities with whom they are dealing. Thus, a well organized, modern commercial register should enable the public to find out basic essential information about any enterprise in the market.

In addition, the commercial register provides market actors with a means of preserving valuable commercial rights with respect to individual enterprises such as money judgements, sales of businesses and mortgages. This is done by putting the public on notice as to those rights through registration. Similarly, the commercial register provides the means for enterprises to protect their trade names and intellectual property by registration if there is no separate IPR register. However, as explained before, commercial registers do not work properly in Gaza or the West Bank. They do not provide a reliable system for the registration of a company's pledges and therefore restrict the creation and enforcement of security interests, thereby constraining a company's access to credit.

## General Conclusion

An analysis of laws applicable in Gaza and the West Bank shows they require updating. The lack of a well functioning *commercial register* is a serious problem for business transactions because it fails to provide current information about companies, and, more important of all, it constrains the creation and enforcement of security interests (i.e., pledges of a company's stock). Therefore, high priority should be given to the companies register so that it can play the role it should have in a healthy business environment. The companies register needs to be unified under a single institution and needs urgent modernization. Efforts currently undertaken by the Ministry of Trade and Economy for the register in the Ramallah should be supported and extended to Gaza and other cities in the West Bank. In addition, the register's scope of activities should be expanded and completed, and its information should be made readily available to the public. USAID support in training courses could play an important role in bringing up to speed the commercial register in both Gaza and the West Bank.

Development of *accounting and auditing standards* for the private sector is another priority for the PA. Such standards should be consistent with international practices and should be accompanied by a compliance program. This represents an area for USAID's intervention given its solid expertise on issues of public accounting and auditing.

Unification of all *registration fees* into on single flat fee would eliminate the need for double registration and would reduce transaction costs. As to the *types of companies* available, laws should be modified to incorporate the possibility of creating joint ventures. The same holds true for provisions on *corporate governance* which should provide for better protection of minority shareholders. Regarding the *registration of companies* it would be useful to have a single authority in charge of company registration for both Gaza and the West Bank. In addition, procedures should be streamlined to reduce the time required for starting operations.

### G. Protection of Intellectual Property Rights

#### Findings

Intellectual property rights (IPR) protection for industrial patents is covered by Jordanian and British Mandate law. "Copyrights" for cultural and artistic property are covered by Ottoman law in Gaza and by Jordanian law in the West Bank. Specifically, patents are covered by Jordanian Patent Law No. 52 of 1953, in the West Bank, and by British Law No. 33 of 1942, in Gaza. The law also provides for a Patent Register, but it does not exist because it was attached to the Ministry of Economy before 1967.

After 1967, intellectual property was covered by Israeli Military Orders. The authority for registering patents was transferred to the Israeli military, thus discouraging the registration of patents. Today, the commercial register works as a patent register as well.

## Analysis

The laws covering IPR are dated, limited in coverage, inappropriate for adapting Western technology to local conditions. Most importantly, they are not enforced in the West Bank and Gaza. Weak IPR leads to a vote of no confidence by foreign investors in developed countries, including those who would invest in environmentally sound technologies. To meet the conditions for participating more fully in international markets, appropriate IPR systems would be expected to stimulate innovation and adaptation of new environmentally sound technologies to conditions found in developing countries.

In addition, technology transfer to Palestinians has not reached its full potential, in part because of the lack of a functioning system of intellectual property rights protection. The Oslo II Agreement calls for the adoption and implementation of intellectual property legislation compatible with GATT -- now WTO. Work in the area of licensing transactions could be carried forward into a broad-based project for the development and implementation of new intellectual property laws.

The "petty" patent or utility model type of intellectual property is an appropriate model for West Bank and Gaza. In the West Bank and Gaza, this type of protection is called an "amendment" to the main product. This type of IPR is usually applied for a shorter period of time, possibly five years, for less than "seminal" innovations. The petty patent form would encourage innovation by protecting Palestinian innovators who adapt overseas software packages into the Arabic language and in a manner customized to Middle East business organizations and firms.

The critical role of innovation in international competition is more and more obvious. In a globalized trading system with an expansion of cross-border trade, innovators are keen to obtain legally enforceable IPRs over their intellectual property and to defend them over as wide a geographical territory as possible. Substantial differences exist among countries concerning the level of IPRs and their enforcement. A system of incentives to boost the innovative process brings benefits to society at large. Society derives compensation for the rights it temporarily confers on certain individuals since the exclusivity generates economic benefits, especially in the long run, which offset any economic disadvantages or risks which "exclusive rights" might entail.

In sum, lack of IPR protection will likely become increasingly important as the Israeli closure diminishes because IPR is possibly the most important new item that surfaced with the conclusion of the Uruguay Round. Emphasis on stronger IPR protection, generated by the Uruguay Round, and the desire to develop national IPR systems to encourage innovation has led to increased demand by developing countries for support of national systems to strengthen IPRs. The 1994 Paris Agreement between the PLO and Israel deals with foreign trade issues, which include intellectual property transfers and internal Israeli-Palestinian trade. Therefore, any program aimed at strengthening IPR would need to be worked out in collaboration with the Israelis.

## **Conclusion**

With regard to IPR protection, it is necessary to develop a completely new legal basis for an appropriate system which is compatible with the World Trade Organization and other international trade agreements. This is needed to encourage foreign direct investment by new investors in "high tech" industries that would provide new Palestinian high-wage jobs and exports. The widely used "petty patent" or "utility model" version of IPR protection should be adopted because it would encourage Palestinian-based businesses to adapt foreign technologies to local and regional conditions. Finally, strong technical support should be put in place for implementation and enforcement of the new IPR system. IPR is a key area where USAID's support could have a major impact in the business environment in Gaza and the West Bank.

### **H. Antitrust**

#### **Findings and Analysis**

No antitrust laws exist, thus monopolies and non-competitive market behavior is legal in Gaza and the West Bank. A market economy leads to an optimal allocation of society's resources under the assumption that each market is competitive. This means that there are so many buyers and sellers that no individual can control the market price. This assumption is violated when there is a monopoly, a single or dominant seller of a good or service. There are many monopolies in the West Bank and Gaza. As a result, consumer welfare of Palestinians is reduced as the higher price forces consumers to reduce their consumption of this good and switch to less attractive substitutes. This is the case of former Israeli monopolies that have been passed on to special Palestinian vested interests in such areas as gasoline and building materials. By exploiting the unique position, the monopolist maximizes profits, but not society's welfare.

#### **Conclusion**

In modern market economies, "antitrust" laws aim to prevent non-competitive behavior and reduce poor resource allocation. Put another way, they aim to improve market performance by preserving and enhancing the natural competitive forces of the market place. It is recommended that a Palestinian antitrust law be developed. It is also recommended that the PA create more competitive and efficient market structure, particularly for the monopolies taken over from Israelis by Palestinian vested interests.

### **I. Labor Issues**

Given the time constraints of the study, only the labor laws of *Gaza* were analyzed. Volume 18 (1) of the collection of Palestinian laws contains Labor Law of 1964, and other laws on workers unions and management.

## Findings

All labor contracts have to be in writing. For individual non-written contracts, the burden of proof lies with the employee. Contracts that violate the general labor law are null and void unless the terms agreed to by the parties are more beneficial to the worker.

Non-Palestinians require permits to work permanently in Gaza. These permits are issued by the Ministry of Labor. In addition, residency permits are required; these are issued by the Ministry of Interior with the approval of Israel. Currently, residency permits are given for three months at a time.

Upon termination of a contract, the employer has 24 hours to pay benefits to the employee. After one year of work, the employee has the right to compensation equivalent to 14 working days. After five years, the compensation must be equal to 21 working days.

A party can unilaterally terminate a contract for an indefinite period of time with 30 days prior notice, and 15 days for other types of contracts. In contracts terminated with proper notice, the terminating party shall compensate the other in an amount equal to the salary to be paid for the remaining term of the contract. In the event of termination of a labor contract because the period is completed or because of the employer, the employee has the right to full benefits plus half a month of salary for each year worked during the first five years or one month salary for every year after the first five years. If termination was done without justification, the employee has the right to be compensated in an amount to be decided by the Court, which will consider the type of work, possible damages, length of service and cause for termination, in addition to the compensation mentioned in the above paragraph.

Savings funds may be created with contributions from both the employer and the employees. The by-laws of the fund shall state whether or not the employer's contributions are for the benefit of the employee. If such a provision is included in the by-laws and the contributions to the fund were equal or higher to the legal benefits for the employee at the end of the contract, the employee only receives the accrued amount in the savings fund. If no such provision is incorporated in the fund's by-laws, the employee has the right to receive the legal benefits plus whatever amount accrued in his/her favor in the savings fund.

If there is a retirement plan, the employee can choose between retirement benefits or legal benefits. If the contract terminates before the employee is eligible for retirement, the employee has the right to receive whichever is higher, the legal benefits or the retirement plan.

Employers wishing to establish a savings fund and a retirement plan require authorization from the Ministry of Labor. A request should be submitted with a copy of the by-laws of the fund or the plan. If no response is given within 30 days, the authorization is deemed to have been granted.

The obligations assumed by the employer under these plans remain valid except in cases of the company's closing down, or declared bankruptcy. In cases of acquisitions or mergers, new employers will still be liable under the terms of the original by-laws.

The procedure contemplated in the law for the resolution of labor disputes is the following. Both parties are first required to try to solve the conflict amicably. If no agreement is reached, the case can be brought to the Ministry of Labor which will attempt conciliation. If conciliation by the Labor Ministry succeeds, the decision is put in writing, signed by both parties and the representative of the Ministry of Labor. If the conciliation fails, the representative from the Ministry of Labor will inform both parties in writing of his or her conclusions, with a detailed account of the causes and reasons of the conflict. This document serves as a basis for any party wishing to pursue a court action.

### **Analysis**

The current labor laws applicable in **Gaza** do not create the conditions for an enabling environment for business activity, although they have not been cited by business persons as a major constraint to their activities. Labor laws are overly protective of the employee, following an outmoded approach that has proven to be less beneficial to workers in other parts of the world. For example, the employer's obligation to compensate the employee in cases of termination of contract seem particularly onerous. Not only does the employer have to compensate the employee in cases of termination of contract without just cause; the employer is also required to pay compensation when there is proper justification.

Another area that constitutes a major bottleneck is the need to obtain a residence and a work permit for foreigners to work in Gaza and the West Bank. These permits must be approved by Israel, and are granted only for three-month intervals. People carrying foreign passports and of Palestinian origin, have to follow the same procedures and therefore cannot come back to the West Bank or Gaza on a permanent basis.

### **Conclusion**

A major review of the current labor laws is necessary in order to conform them to the practices of a modern market economy. The Ministry of Labor is currently working on a new draft law trying to correct some of the drawbacks mentioned above. The new draft is said to include provisions for minimum wage, work hours, labor associations and worker's compensation, among other things.

In addition, pension plans, insurance and workman's compensation mechanisms are not mandatory. It is basically the employer who decides whether or not to have such plans. It would seem appropriate to create a basic insurance and pension system which would provide the employees with better protection, at the same time that it provides the government with a pool of funds that can be geared toward economic development.

## **J. Associations and Advocacy Groups**

The weak legal basis for business associations, think tanks, and other non-profit advocacy groups for business reform represents one of the major constraints to private-sector development in the West Bank and Gaza. Different laws, although similar, apply to the West Bank and Gaza: Law No. 33 of 1966, applies to the West Bank, and the Ottoman law holds in Gaza.

### **Findings**

Currently, a draft law for "The Social Body Associations and Private Institutions" is being used during the transition period before the development and implementation of a permanent law regulating associations. A major problem is its failure to separate business associations from other non-governmental organizations focussed on social problems. This tends to limit the effectiveness of business associations to develop organizations that could later become important economic institutions. For example, a business association may develop a financial program to support small businesses. If successful, this program would naturally evolve into a financial institution specialized to support micro-enterprises. Under the transition law, which will be the basis for the future permanent law if not changed, business associations are under the control of the Ministry of Social Affairs, and the transition of such a program into a financial institution would be very difficult.

Practically every article of this transition law contains an important constraint to private sector business support activities and undermines the ability of business associations and other business related groups to become effective advocates for legal and regulatory business reforms or institutional development. Specific onerous provisions by article in the current transition law include:

- Under Article 1, a foreign association is defined as any association outside the border of the PA or with a majority of its members being foreigners. This definition would include a business association located in East Jerusalem or a group of Palestinian businessmen located in the U.S. or Jordan. This definition highly limits the organized support of business persons, including Palestinians, who live outside the Palestinian territories.
- Under Articles 7 and 50, which deal with licensing and registration of business associations, the Ministry of Interior must approve within 15 days the creation of an association. This can create unnecessary uncertainties for the business community.

There is unwarranted government interference and uncertainty with regard to jurisdiction between the Ministry of Social Affairs and the Ministry of Interior. Under Article 50, to license a sectoral business association dealing in a sector such as tourism, would require additional approvals of related ministries. For example, a business dealing with tourism

would require an additional approval from the Ministry of Tourism. If an association dealt with different areas such as tourism, investment, cultural affairs, or trade, it may need to obtain many additional approvals, which unduly restrict its ability to support its private sector members.

- Under Article 11, which deals with obligations of the association, it is forbidden for the association to own the land or buildings unless it gets the approval of the Minister of Social Affairs. This is another restriction curtailing the efficiency of the association in providing important services to its private sector members.
- Under Article 13, each association is required to keep all mail, faxes, and E-mails in a separate file for government inspection. In addition, the by-law and the members' names, the directors' names and their identity card numbers, ages, and dates when membership was obtained, and records of all meetings, financial statements and expenses must be kept on file for inspection by the Ministry of Social Affairs. These onerous provisions greatly undermine the effectiveness and independence of business associations in supporting private sector member services.
- Under Article 14, any amendment or change to an organization's by-law must have a written approval of the Minister of Social Affairs, after getting the approval of the Ministry of Interior. Again, this leads to more costly government bureaucracy.
- Under Article 15, any association should submit an annual report to the Minister of Social Affairs. The report should describe the associations' total activities, total expenses, sources of funding, and other information. This additional red-tape undermines the effectiveness of smaller business support organizations.
- Under Article 16, each association should have a legal accountant to make its annual budget, unless its expenses are less than JD500.
- Under Article 17, the association should deposit its money in a bank account and should inform the Ministry about this account. No association can keep capital in this account which would be greater than one month's operating expenditures unless they have a separate approval of the Minister. This greatly undermines the efficiency of private-sector support groups.
- Under Article 19, no association can join another association outside the Palestinian Territories, unless it obtains the approval of the Minister. This represents more government red tape.
- Under Article 20, business associations cannot obtain foreign funding or transfer its money abroad without approval of the Minister, except for equipment imports.

- Under Article 22, business associations must be controlled by the Ministry of Social Affairs, including checking accounts.
- Under Article 42, the license of a business association may be revoked by the Ra'ees.
- Under Article 55, the Minister of Social Affairs has the right to appoint a temporary director or board of directors.
- Under Article 56, the Minister of Social Affairs can revoke the license of any association if convinced if it is not doing its work as outlined in the by-laws.

### **Analysis**

Many other provisions of this law allow similar government interference with the efficient operations of business associations. This weakens their operations and ability to serve their private sector members. Strong private-sector trade and business associations are needed in the West Bank and Gaza because of their support for inducing the PA to institute policy and regulatory reforms to strengthen its private sector and to increase international linkages.

Policy and institutional reforms change the status quo associated with powerful vested interests who may prefer no change. Policy reforms and institutional development will be implemented faster by developing collective domestic political support for commercial reforms that enhance investment and trade. Substantially more effort is needed in creating, organizing and strengthening the potentially powerful private sector interests, and their workers, who stand to gain most directly from strengthening markets and linking domestic economies to world markets.

### **Conclusion**

These groups, with USAID support, could work with the government and others within the country to develop an approach that will enhance international linkages and integrate their domestic economies into global markets. Associations representing small and medium-size enterprises, particularly those with export potential, should be strongly supported. Counterpart trade and business associations in the U.S. should be actively engaged in this initiative.

With regard to advocacy groups and business associations, the following would be necessary:

- Enact a new law for not-for-profit associations that would make their creation possible by a simple, streamlined registration according to clear rules regarding the allowable purposes. The new law should not include any government review or approval. The law should be written to depoliticize business associations.

- Establish a formal primary mechanism for constructive dialogue between the government and the private sector to exchange views and develop strategies for developing the private sector. Special attention should be given to include representatives of small- and medium-size firms capable of producing for export. Continue organizing a private sector collective voice for reform and institutional development. This could be carried out through standing committees or commissions that continually seek out necessary conceptual and specific changes in the legal and regulatory field to take steps at the highest level possible to suggest changes.
- Help strengthen the management, organization and efficiency of these advocacy groups, that would be organized along industry lines, with possibly the help of counterpart business associations in the developed countries.

### **K. Governance, Public Administration and Rule of Law**

The notion of the rule of law has important economic benefits as it is intended in particular, to oblige the administration to set clear "rules of the game" and abide by them. The rule of law guarantees freedom, equality and security to the individual. By imposing respect for stable norms on state bodies, the law reduces the risk of arbitrary behavior. The measures that are taken by public authorities become predictable and acquire permanent character, the consequences of which can be calculated by the individual in advance.<sup>24</sup> The combination of these elements is fundamental to the creation of a confident and reliable environment where business and investment can prosper.

There are certain basic principles of governance and public administration without which the rule of law cannot be sustained. Governments must represent the will of their people. The legislative, executive and judicial authorities must be separate, independent and given equal status and importance. The three powers must be able to exercise effective checks and balances against each other. Administrative actions must be legal and controlled by independent judges. Moreover, any power emerging from the collective authority, in particular the legislative and the executive, must respect the individual's fundamental rights and freedoms.<sup>25</sup>

### **Findings**

One of the main problems in the West Bank and Gaza is the lack of a transparent and reliable system of public administration where the rule of law can be instituted through accountable government entities performing clearly stated responsibilities. Currently, the distinction between executive, legislative and judicial functions is not well defined or understood, and even within the executive, turf battles between ministries prevent much needed interagency cooperation.

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<sup>24</sup> The International Commission of Jurists/The Centre for the Independence of Judges and Lawyers, Op. Cit.

<sup>25</sup> Ibid.

Part of the difficulties faced by the PA in establishing a sound and accountable system of public administration derives from the foundation of the interim government itself: the Peace Agreements between Israel and the PLO. According to the Palestinian-Israeli Interim Agreement on the West Bank and Gaza Strip signed in Washington on 28 September 1995 ("Oslo II"), the **Palestinian Interim Self-Government Authority** is composed of the Palestinian Council and the Ra'ees or Chairman of the Executive Authority of the Council.

The Palestinian Council has legislative, executive and judicial powers, within the boundaries of the various Peace Agreements.<sup>26</sup> The Council is composed of 88 representatives including the Ra'ees of the Executive Authority, all directly elected by popular vote on 21 January 1996. The Executive or Executive Authority is a committee within the Council, although it is not only composed of Council members, since the Ra'ees can appoint persons outside of the Council, in a number not to exceed twenty percent of the Executive Authority.

## Analysis

The government structure established by the various Peace Agreements attacks the fundamentals of good public administration, namely the separation of powers between the legislative, the executive and the judiciary. By doing so, it hinders efforts to delineate clear responsibilities between PA entities, ministries and agencies. It also fails to establish appropriate checks and balances between them. In business, this situation is translated into a high level of uncertainty about who develops, issues and enforces the rules of the game.

A case in point to illustrate this problem is the recent Investment Law. The Investment Law has been harshly criticized for not providing a good enough framework to attract foreign investment. Some persons interviewed insist that it is only a draft law because Chairman Arafat signed it when the Council was not functioning and therefore, they contend, the draft needs to be ratified by the Council in order to become a "true" law. For others, there is no question about Chairman Arafat's authority to sign such a law under the peace agreements, especially when the Council had not yet been elected when the law was developed. Despite the fact that the law has been published in the "Official Gazette" and that the Ministry of Trade and Economy is working on its implementing regulations, the debate about its enforceability continues to hinder its full implementation. For the business person exploring investment opportunities in the West Bank and Gaza, not knowing with certainty the status of the Investment Law may act as a potent deterrent.

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<sup>26</sup> Article XVII (3), Palestinian-Israeli Interim Agreement on the West Bank and Gaza Strip, Washington, D.C., 28 September 1995.

## **Conclusion**

Efforts to remove constraints to business activity in the West Bank and Gaza will require parallel efforts geared towards restoration of the rule of law and structuring of the government following sound public administration principles. USAID/West Bank and Gaza Private Sector Program would clearly benefit from even closer coordination with the Democracy and Governance Program in those activities supporting improvements in the organization and accountability of the PA and in reestablishing the rule of law in the West Bank and Gaza.

#### IV. Donor Activities Supporting Legal or Regulatory Reform

Current and planned donor activities related to legal and regulatory reform are presented in the matrix found at the end of this chapter. This list includes 19 discrete projects, including two USAID activities and the efforts of various donors through the World Bank Technical Assistance Trust Fund presented as a single entry. No work by other donors appears to constrain the range of options available to USAID for assistance in the area of legal, regulatory or administrative reform.

The activities of highest relevance are current and planned projects sponsored by the World Bank and its partners. The World Bank is planning a **Legal and Judicial Reform Project**, expected to begin implementation in mid-to-late 1997. Working through the Ministry of Justice, the Bank proposes to provide assistance in the areas of legal reform and information, judicial administration and training, judicial infrastructure, and alternative dispute resolution mechanisms. With the exception of judicial infrastructure, all components are relevant to USAID assistance options as viewed in this report. Preliminary estimates indicate that the total cost of the project would be approximately US\$20 million.

The project's legal reform and information component would include establishment of law commissions within the Ministry of Justice to examine existing legislation currently being compiled by Bir Zeit University; assessments of future PA needs in economic, business and financial law; preparation of research materials to support drafting of legislation; workshops to discuss draft laws; establishment of legal libraries in Gaza City and Ramallah; and publication of a gazette of decisions of the High Court.

In the area of judicial administration and training, the project would include review and modernization of case management, provision of information technology, and establishment of judicial training centers in the West Bank and Gaza.

In the ADR area, the project would feature improvement of mediation and arbitration processes within the court system; and establishment of separate ADR centers, specializing in commercial matters, in both the West Bank and Gaza. The centers would be facilities for training of mediators, arbitrators, lawyers and judges in the use of alternative mechanisms of dispute resolution.

The World Bank is also preparing a project in **Financial Sector Reform**, to be supported through the Technical Assistance Trust Fund. Focus of this activity is to be drafting of new laws in leasing and collateral arrangements. Since apparent needs for financial sector reform are numerous, World Bank staff have suggested to members of our team that USAID involvement in this area would be most appropriate and welcome.

Additionally, the TATF is providing resources for Bank efforts in commercial registration and legal compilation. While software for an automated companies register has been installed at the Ministry of Economy and Trade, the system at this point is not fully operational, due at least in part

to a need to clarify in which ministry the system will be housed, either the Ministry of Justice or the Ministry of Trade. The compilation and automation of the existing banking law, the commercial code, and the companies law are being carried out by the Bir Zeit University Law Center, with support from the Bank, Australia and the European Union.

In addition to World Bank contributions, other relevant donor activities include Australian support of legislation drafting, court administration, and judges training; and United Kingdom support to the Ministry of Economy and Trade for reform of the companies law. In addition, the International Monetary Fund has provided technical assistance to the PA in such areas as tax law and banking law. While the Fund plays a lead role in macroeconomic policy assistance, Fund staff have indicated that USAID assistance in such areas as taxation, the stock market, and trust law would be highly complementary with IMF activities.

**CURRENT AND PLANNED DONOR ACTIVITIES  
IN COMMERCIAL LEGAL AND REGULATORY REFORM<sup>1</sup>**

(1) Donor	(2) Project Description	(3) Executing Agency	(4) Start & End Dates	(5) Disbursed (\$ '000)	(6) Committed (\$ '000)
Australia	Assistance in law writing; support for court administration; judges training and education	Australia/Australian International Legal Resources Inc.	1996 -		
Australia (Rule of Law Assistance Project) and the World Bank (Technical Assistance Trust Fund)	Full text database compilation of existing legislation	Australia/Australian International Legal Resources Inc./World Bank	1995 -		
Belgium	Assistance to Bir Zeit Law Center	Council for Higher Education	10/95 - 10/97	50	100
European Union	Automated full text legal data bank for Bir Zeit University Law Center	Bir Zeit University Law Center	1996 - [do we know end date?]	[Disbursement began 7/96?]	1,400
European Union (MEDA LINE)	Private Sector Support Program: establishment of business centers and policy support		1995 -		3,900
France	Support to Bir Zeit Law Center	Bir Zeit Law Center/France	1996 -	438	
Germany	Advisory services to PECDAR	GTZ	4/95 - 3/97	448	976
ILO	Capacity Building of Chambers of Commerce	ILO			173
Norway	Support to Rule of Law	UNCHR	NA	NA	1,500
Qatar	Support to Bir Zeit University Law Center (operational funding and an endowed chair)	Bir Zeit Law Center			

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**CURRENT AND PLANNED DONOR ACTIVITIES  
IN COMMERCIAL LEGAL AND REGULATORY REFORM<sup>1</sup>**

Sweden	Support to MAS for conducting research activities in the field of economic policy	MAS	1/95 - 12/96	480	666
Switzerland	Assistance to the Israel/Palestine Center for Research and Information's Law Development Program	SDC	1995 - 1997		200
United Kingdom	Support to legal infrastructure in the Gaza Strip	(NA)	1995 -	NA	225
United Kingdom	Study on Standards Institute				
United Kingdom	Support to the Ministry of Trade and Economy for review and reform of companies law	UK	1996		
USA	Democratic Understanding and Development (includes ADR training support by USIS)	IFES, NDI, IRI, IRIS, and USIS	1994 - 1999	3,372	10,000
USA	Program Support: technical support in various areas, including public administration	USAID	1994 -	1,954	3,154
World Bank	Legal and Judicial Reform Project (law drafting, administration of contracts, training, ADR, infrastructure)	(Currently at proposal stage)			
World Bank	Technical Assistance Trust Fund (commercial registration, leasing law, collateral law, legal compilation, support for MAS policy studies)	World Bank	1995 -		

1. Information in this table was collected from various donor and consortium documents, supplemented by personal interviews with officials of donor agencies. Inclusion of activities is based on relevance to the subject matter of this report. Therefore, activities relating to such areas as police, human rights, and physical infrastructure are not included, unless they are combined with efforts directly applicable to commercial/legal reform.. In addition, this list includes only those activities which are active or planned. Those with expired completion date or full disbursement of funds, therefore are excluded. Some of these expired or fully disbursed activities may nevertheless still be in implementation.

## **V. Recommendations for Legal and Regulatory Reforms of the Business Climate in the West Bank and Gaza**

Based on the team's analysis of legal and regulatory constraints, current donor activity, and the experience of other countries, the following represent the major economic barriers facing the West Bank and Gaza. Failure to address them, for political, budgetary or other reasons, will have major negative economic ramifications in terms of broad-based economic growth and improved living standards for all Palestinians. Their continued presence will also undermine generally the efficacy of all donor programs aimed at improving the market-determined export-oriented business environment for private-sector trade and investment.

### **A. Secured Transactions**

It is recommended that USAID develop a technical support unit within the Ministry of Trade and Economy to support its legal unit on commercial reform. This unit would provide technical support to facilitate the Ministry's efforts to reform the legal and regulatory structure of the economy. In addition, the program would focus on developing a closer working relationship between the Ministry and the Palestinian private sector, developing a more systematic relationship with a more important private sector advocacy and advisory role to the Ministry. Finally, USAID could provide technical support for disseminating information on new laws and procedures, and provide workshops, training and other services aimed at making the systems function.

As pointed out earlier, secured transactions are important for enforcing commercial contracts and defining and enforcing property rights because they are the most fundamental conditions needed for establishing modern markets. The West Bank and Gaza currently have inefficient methods for enforcing court judgements related to the execution of security interests. The project would be focused on the following specific areas associated with developing a framework for secured transactions.

#### **1. Commercial Register**

As pointed out in Chapter IV, the commercial register is vital for promoting investment and developing the private sector because of its crucial role in providing essential information about individual enterprises to key actors in the market such as suppliers, customers, and banks. The activities that the two existing commercial registers perform are limited in scope as they almost exclusively deal with the incorporation of new companies and do not keep up with the companies' evolution over time. In the West Bank, the Ministry of Trade and Economy is in the process of computerizing the register, but only limited information can be obtained to date. Because the commercial register does not work properly, it does not provide a reliable system for the registration of pledges of a company's stock and therefore restricts the creation and enforcement of security interests, thereby constraining a company's access to credit.

It is recommended that this project first determine where the final register will be located, and then support technical units either in the Ministry of Trade and Economy or Ministry of Justice to help operate the system. The program would simplify and unify the current company formation procedures with a simple one-day registration in the Commercial Register by reducing and streamlining documents, procedures and founders required. The program would also modernize, computerize and complete the Commercial Register of companies, and enforce the legal requirement that all liens on the property of a business be registered. In addition, the information should be made readily available to the public. The program could also support the development of a leasing law to allow equipment leasing to protect lessors' interests fully by registration of equipment leases in the Commercial Register to put third parties on notice. USAID could also work to enforce the legal requirement that all liens on the property of a business be registered.

## **2. Intellectual Property Rights (IPR) Law and Register**

Another recommendation pertains to the development of a program to protect intellectual property rights. The goal would be to promote the transfer of "high-tech" products and processes, and encourage the domestic adaptation and development of these technologies. A program to provide an array of specific IPR assistance should be closely tailored to West Bank and Gaza conditions and needs, with special focus on improving the environment. Project results in this area may include:

- Engaging constructively the PA and private sector in program implementation and training for IPR protection.
- Preparing an initial assessment of the level of innovation and technology development activity in developing environmentally-sound technologies.
- Diagnosing Palestinian IPR systems affecting the transfer, adaptation and development of environmentally-sound technologies, including legal regimes, enforcement, institutional capabilities, and human resource capabilities.
- Providing formulas for improving the Palestinian IPR regime, including changes in the legal regimes, IPR register, enforcement systems, institutional capabilities plus appropriate computers and other equipment, and human resource capabilities.
- Developing a timetable of IPR assistance activities, including policy dialogue, training and technical assistance and institutional development.

The training and technical assistance component could consist of:

- Designing and administering short-term, U.S.-based training courses on specific IPR topics.

- Developing short-term "exposure tours" of target Palestinian IPR administration groups to relevant U.S. agencies and private organizations.
- Designing and implementing in-country training courses on IPR system management.
- Providing technical assistance to the West Bank and Gaza. Specialists could be brought in to offer counsel on legal structures and enforcement, economic analysis and monitoring, IPR register administration, Management Information Systems (MIS) design and maintenance, enforcement techniques.

This type of program would be appropriate for development at a regional level. This could involve preparing a coherent regional approach to strengthening IPR systems, and designing a series of sensible, actionable steps, focused on training, that could introduce IPR systems. One subcomponent would be to develop a prototype workshop on IPR.

At a later stage of the program, or for nations in an active phase of establishing IPR protection agencies and programs, a substantive "menu" of services would be made available. For example, a USAID Middle-East assistance unit might be developed that would provide a collaboration among relevant U.S. Government agencies to be established and operational in delivering training, technical assistance and institutional assistance. A jointly funded USAID/private sector program would strengthen IPRs in selected countries. This would include improving their IPR laws and enforcement structures. Officials engaged in IPR registration and administration in a determined number could receive training under the program. If developed as part of a regional program, the basic concept of the proposed program could be to develop a common set of IPR services and capabilities focused on training, and then to extend these services, as appropriate, on an industry-specific, country-specific basis in Middle-Eastern countries.

### **3. Real Property Title and Mortgage Registration System**

Because of its importance to a healthy business environment, it is recommended that a modern system of land titling and registration based on updated cadastral information be developed. However, timing is of the utmost importance given the political sensibilities in this particular area. Therefore, USAID should obtain clear indication from the PA before undertaking any activities related to land titling and registration.

Any land titling and registration project should at least incorporate the following steps:

- Creation of a sound system for classifying and numbering plots of land and their subdivisions to the smallest unit possible;
- Creation of a database associating numbers to both geographical and title information;
- Preparation of cadastral surveys to update maps and other geographical information;

- Surveys and other types of information gathering exercises should be carried out to determine ownership and liens.

This type of project was conducted in Gaza City by United Nations Volunteers for the Gaza municipality. In a period of four and a half months, the first three steps of the project were completed for a city with 300,000 inhabitants in an extension of 33 Km<sup>2</sup>. However, information on precise boundaries and land titling is still missing.

## **B. Finance**

One potential area for USAID collaboration would be to support the efforts of the Ministry of Finance to strengthen the legal basis for financial development, as described in Chapter III. It may be appropriate to work with the Minister of Finance and his staff to develop a program that would provide technical assistance in developing the legal framework, support an organizational capacity to provide private sector advice, and when appropriate, support the dissemination of information through workshops and other appropriate forms of training. Initial areas of support could include negotiable instruments, Trust Law, and accounting and auditing standards.

### **1. Trust Law**

It is recommended that USAID lend support in this high priority area for the Minister of Finance. This law is needed up-front before any other financial regulatory reforms are prepared since its existence will simplify other laws such as the one currently contemplated for the new stock market. The basic elements of a Trust Law are described in Chapter V of this report.

The key element is the “fiduciary” concept, whereby an individual charged with overseeing management of a fund for the interests of the beneficiaries of trust assets. Fiduciaries would be named for plans run by government authorities and for private plans. The named fiduciaries should be legal professionals, who are independent, free of conflicts of interest and qualified to make investment decisions.

With U.S. world-class expertise in financial matters, USAID is in an excellent position to support the Ministry of Finance. Specifically, these efforts would be oriented towards developing a Palestinian Trust Law, that would better protect the interests of investors particularly as efforts are made to channel potential public and private savings pools into productive Palestinian investments. Rather than trying to seek out all the specific entities or activities for which fiduciary duty should apply, it is preferable to establish generally applicable duties in a basic Trust Law.

### **2. Accounting and Auditing Standards**

It is recommended that USAID work in the areas of developing legal minimal standards of acceptable accounting and auditing practices and procedures. Credit judgements depend partly on the quality and reliability of financial information presented by a prospective borrower, since if a

bank lacks confidence in the financial information it is unlikely to extend a credit. Smaller firms that account for as much as 95 percent of the Palestinian private sector's production, may find it difficult or expensive to comply with an audit according to international standards. USAID could work with the Ministry of Finance in developing these legally acceptable standards that are consistent with international practice, and establish a compliance program that could include workshops and on-the-job training.

### **3. Negotiable Instruments**

It is recommended that a legal basis for negotiable instruments as described in Chapter III of this report be prepared. The legal regulations for negotiable instruments are outdated and limited in scope. There are no clear regulations as to what constitutes a negotiable instrument. Negotiability must follow a narrow definition so that instruments used in business transactions are easily recognizable and distinguishable by anybody.

USAID might consider working with the Ministry of Finance to support a major update of the law that would provide for such areas as specific contractual liabilities and basic regulations on holders in due course; the possibility of developing new financial intermediaries to raise private capital and to invest venture capital, by which specialized investors support new risky business ventures with expected high returns.

#### **C. Advocacy**

One of the principal problems for speeding up the above legal and regulatory reforms and institutional development has been the lack of organized collective political support within the private sector for reforms and institutional development. Businessmen are generally aware of the constraints to private sector activities, but are not adequately organized to provide pressure for reforms which are resisted by vested interests associated with the status quo.

There is a need to strengthen private-sector trade and business associations, as well as private sector-controlled think tanks. Indeed, this would be welcome as because donor support for inducing developing country governments to institute policy reforms to strengthen their private sectors and to increase international linkages has generally been unsatisfactory. This is largely due to the fact that policy and institutional reforms change the status quo associated with vested interests who prefer no change. Policy reforms and institutional development will be implemented faster by developing collective domestic political support for reforms that enhance investment and trade. More effort is needed in creating, organizing and strengthening the potentially powerful private sector interests that stand to gain most directly from strengthening markets and linking domestic economies to world markets. These groups could work with the government and others within the country to develop an approach that will strengthen private sector activities. Associations representing small and medium-size enterprises, particularly those with export potential, should be strongly supported.

A "think tank" run by the Palestinian private sector would require important input from key private sector leaders, and a strong Palestinian chief executive. With the right leaders and staff, such an organization could be the focal point for discussing key issues in the area of legal, regulatory and administrative reform.

#### **D. Commercial Legal and Judicial Reform**

USAID could develop a program to strengthen the legal, judiciary and regulatory framework of a country with respect to enforcing commercial contracts and defining and enforcing property rights. Top priority must be given to developing systems for timely and efficient adjudication of commercial disputes. Defining and enforcing property rights is critical in establishing collateral for financing investment, particularly for small and medium-size firms.

There is a need to prepare a program focusing on administration of commercial justice. This program could support regulatory reform, develop pilot projects, streamline and automate manual procedures at pilot courts, train judges on home-based personal computers, strengthen research resources and administrative capacity, and provide workshops and training courses for new and experienced judges.

A project could aim to improve the operation and performance of Palestinian civil courts and the quality of judicial and legal services with respect to commercial and other aspects of modern law. The project would be primarily a supply-side program, focused on strengthening of the legal system,-including policies and regulations.

Twenty nine years of Israeli occupation has led to an increased demand for a large number of needed law initiatives, and an improvement in the administration of justice intervention. This has been stimulated by national and international business communities which fail to undertake major investments in the West Bank and Gaza without a supportive legal environment to protect their interests and resolve their disputes quickly, fairly, and consistently.

The Ministry of Justice will be receiving direct assistance from USAID and a joint World Bank-Australian initiative. These activities are not yet well defined. There is a need to introduce modern technology in the justice sector. This includes information and automation projects; and a need to coordinate legal databases.

Principal components could include: (1) court administration improvement, and (2) the development of an informed judiciary. It could involve audiences, institutions, systems and technologies which are linked. The major overall challenge in project design might be to create a comprehensive framework balancing inputs and activities, so that gains within the components are mutually supportive, and contribute to an overall vision for improving the Palestinian commercial legal and judicial sector.

The improvement of court administration could involve training court personnel in the new systems and procedures, training judges to use automated databases to facilitate research and decision-making, and identifying regulatory reforms needed to reduce delay and improve court operations overall. The success of this component would determine the feasibility and desirability of its expansion.

### **Palestinian Counterparts Most Supportive of USAID Reform Efforts**

The following is a list of government ministries, agencies, associations or other groups that would be most supportive of USAID private sector reform efforts in the commercial legal, administrative and judicial areas:

- **Ministry of Trade and Economy:** It is currently working through its legal department in updating the companies' laws and other legislation related to agency, distributorship and franchises. There is a need to develop ties between the legal department and the private business sector. This could be set up along lines to be worked out between the Ministry and the private sector. This might involve private sector think-tanks and committees with members chosen from various representative business associations or other respected business persons. There is a need to build a body of support in the private sector for advising on the development of legal reforms, and then, supporting their implementation and enforcement. However, donor technical and financial support should play a role in facilitating the reforms chosen by the Palestinians themselves.
- **Ministry of Justice:** This ministry could use a strong pilot project to strengthen administrative justice in commercial courts.
- **Ministry of Finance:** The Ministry of Finance focuses primarily on taxation, Palestinian Monetary Authority (PMA) regulations and banking. Priority issues include modernizing income and corporate taxes, regularizing tax assessment procedures and developing administrative procedures. They are particularly interested in developing a stock market and insurance industry that is appropriately integrated into the financial markets.
- **Bir Zeit University Law Center:** The Law Center has currently undertaken the compilation of Palestinian laws in English and Arabic, and the creation of a legal data base.
- **Palestinian Monetary Authority (PMA):** The PMA focuses on the development of banking regulation and supervision.
- **Palestinian NGO Network,** including such research centers as MAS in Ramallah or the Center for Palestine Research and Studies in Nablus.
- **Private Sector Advisory Councils,** committees or business associations.
- **Municipalities:** they are responsible for cadastral surveys and zoning issues.

**SCOPE OF WORK**

## Scope of Work for an Assessment of Legal and Regulatory Policies Constraining Business Activity in the West Bank and Gaza

### Background:

Business activity in the West Bank and Gaza has been constrained by the absence of an appropriate system of commercial laws and regulations. The current legal and regulatory regimes governing business transactions derive from a number of Ottoman, British, Jordanian, Egyptian and Israeli sources. This incoherent framework is not transparent or reliable, and does not support a modern market economy. It contributes to a perception of commercial risk that dampens the enthusiasm of domestic and foreign investors, alike. Other economic consequences of this situation include: increased costs of private sector activities, skewed resource allocations, and constraints on the adoption of modern technology.

To attract investment and business expansion, the Palestinian Authority recognizes that it must accord high priority to the modernization and harmonization of the legal and regulatory framework governing business activities and property rights. While legal protection and user-friendly commercial laws alone may not be sufficient to induce foreign companies and individuals to invest, they are, nonetheless, important elements in any investment decision.

Support for macroeconomic policy reform and public sector institution building is currently provided by other donors (particularly the IMF and the World Bank). For its part, USAID intends to develop a program of activities to address specific policy or regulatory constraints that impede business activity. However, USAID assistance will be limited to those areas where appropriate counterparts within the Palestinian Authority can be identified and where USAID has a clear comparative advantage vis-a-vis other sources of assistance.

Such areas might include: contract law; commercial arbitration; secured finance; intellectual property; property rights, titling and registry; banking, finance, leasing and insurance regulation; landlord and tenant regulation; import/export provisions; labor regulation; technology licensing; bankruptcy regulation; and securities exchange. While this list is necessarily illustrative, it reflects the broad range of topics that the assessment team should review during the course of their investigations. Based upon the work of the team, USAID will identify those areas where U.S. assistance would have a comparative advantage and progress can be achieved over the strategy period (1996-2000). The specific modalities for USAID interventions will be determined as a function of the type of policy constraints to be addressed.

**Objectives:**

The objectives of this assessment are to: 1) identify the universe of policy/regulatory/administrative constraints to business activity in the West Bank and Gaza; 2) review other donor activities in support of legal or regulatory reform; 3) determine which policy constraints would be most amenable to change through a program of technical assistance and advocacy; 4) determine which Palestinian counterpart agencies would be most supportive of USAID efforts in this sector; 5) recommend policy interventions for which USAID has clear comparative advantages over other sources of assistance; and 6) assess/recommend appropriate levels of effort, sequence, timing, conditionalities, milestones, and expected impacts for a program of USAID initiatives in this sector.

To achieve these objectives, this contracting action will procure up to 120 person/days of specialized technical assistance under contact No. HNE-0159-C-00-3080-00.

**Specific Tasks:**

*Task 1: Familiarization*

The consultants will review relevant documents and background materials relating to legal and regulatory policies in the West Bank and Gaza.

They will meet with U.S. based representatives of the World Bank, FIAS, the IFC and the IMF to assess the current status of those agencies' efforts in support of legal and regulatory reform.

Upon arrival in Tel Aviv, the consultants will meet with the Director of the Private Sector Office of USAID/WB&G for an entry briefing and a review of proposed methodology. Subsequently, the assessment team will arrange to meet with representatives of the Palestinian Ministries of Economy and Justice; with representatives of locally-based NGOs and donor agencies currently involved in legal and regulatory reform initiatives; with Palestinian and Israeli businessmen/women; with relevant officers of the U.S. Embassy in Tel Aviv and the Consulate General in Jerusalem, and with other sources of background information to be determined in collaboration with USAID.

*Task 2: Assessment of the Legal and Regulatory Environment*

The consultants will conduct field investigations and interviews in order to identify the universe of legal, regulatory and administrative constraints to business activities in the West Bank and Gaza.

The consultants will prepare a comprehensive matrix depicting and analyzing these constraints and comparing the current policy

environment in the West Bank and Gaza to that of other countries in the region and elsewhere in the developing world.

### Task 3: *Analysis of Program Options*

The consultants will assess the current and planned activities of other donors, agencies of the Palestinian Authority and NGOs in support of legal and regulatory policy reform and prepare a matrix summarizing these initiatives.

Based upon that analysis, the assessment team will identify areas where USAID assistance would be most beneficial. Synergism with other donor efforts and potential opportunities for donor coordination will be explored.

The consultants will then meet with relevant counterpart officials to discuss potential program options and assess the level of interest/commitment of such agencies to undertake policy advocacy initiatives necessary to achieve constructive reforms.

### Task 4: *Recommendations*

The consultants will recommend a set of initiatives for USAID consideration that will address significant policy or regulatory constraints to business activity in the West Bank and Gaza and reflect the team's assessment of comparative advantage (as per Task 3, above).

The team will prepare a policy matrix that will indicate proposed reform targets, benchmark actions, and expected results.

The team will also describe and analyze Palestinian counterpart agency actions required to achieve desired reforms, assess potential difficulties and provide a qualitative assessment of the probability of significant reform during the strategic planning period. Similarly, the team will recommend appropriate conditionalities for USAID assistance at each policy reform milestone and suggest methodologies for measuring progress toward the achievement of each policy reform target.

The team will recommend appropriate levels of effort for USAID assistance on an issue-specific basis and propose timing and sequence for USAID-funded interventions.

### Task 5: *Debriefings and Final Report*

The consultant Team Leader will organize a comprehensive briefing of USAID staff at an appropriate point, approximately midway during the team's time in-country. That briefing will highlight preliminary findings and provide an opportunity for a fulsome discussion of issues relating to Specific Tasks 2-4.

One week before the team's scheduled departure, the Team Leader will distribute a draft Final Report, conduct a formal debriefing

of the team's findings and recommendations and solicit comments from the audience (to be selected by USAID WB&G). Substantive comments and suggestions arising during the briefing will be incorporated into the final version of the Final Report.

Within ten (10) working days of the conclusion of the field portion of this assignment, the Team Leader will submit to USAID WB&G ten (10) copies of the Final Report containing the team's response to each of the Specific Tasks described above and including all appropriate annexes and addenda. One or more computer diskettes containing all text and tables contained in that Report will also be provided to USAID at that time.

**Period of Performance:**

The U.S.-based component of this assessment will begin on/about July 10, 1996.

The field-based component of this assessment will begin on/about July 17, 1996 and conclude on/about September 5, 1996.

**Consultant Qualifications:**

1) Team Leader. This consultant should have significant experience designing and/or implementing project/program activities that contribute to policy reform. He/she should possess, at a minimum:

- a. appropriate academic qualifications;
- b. at least ten years professional experience in policy analysis, from both economic and legal perspectives;
- c. top-flight presentational skills in both written and oral media.
- d. familiarity with the region.

Working knowledge of arabic would be useful, but not essential.

2) Specialist in Business Law. This consultant should have experience as both an analyst of legal regimes impacting business and as a practitioner providing legal advice to business entities, preferably in a developing world context. As with the Team Leader, familiarity with the region and working knowledge of arabic would be beneficial.

3) Performance Monitoring and Evaluation Specialist. This consultant will have the primary responsibility for designing an appropriate set of policy reform milestones and suggesting a methodology for measuring progress toward the achievement of each policy reform target. As such, he/she should have proven experience designing similar performance monitoring plans for policy reform initiatives. He/she should be well-versed in statistical analysis and economic modeling. Experience in gender

disaggregation would also be desirable.

Reporting Arrangements:

The consultants will report directly to the Chief of the Private Enterprise Office of USAID/WB&G. All official communications and requests for USAID clearances should be routed to that Officer.

**Matrix**  
of  
**Legal/Regulatory Constraints and Opportunities**

<b>LEGAL AND REGULATORY REFORM: CONSTRAINTS AND OPPORTUNITIES</b>			
(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<i>A. Civil Code applicable to commercial transactions</i>			
<ul style="list-style-type: none"> <li>• Contract creation</li> </ul>	Current law is limited as often obsolete	Key elements of important contracts are not contemplated in the law. For example, offers and acceptances are required to take place in the same location in order to create a valid sales contract. This imposes a restriction on modern business transactions when parties may be in different locations.	Update laws
<ul style="list-style-type: none"> <li>• Remedies</li> </ul>	Current law provides limited remedies	Two types of remedies exist, depending on whether there was bad faith or not: contract price and lost profits. Courts can modify contractual remedies if considered too high. Punitive damages are not contemplated in the law. Clearer rules about possible remedies would provide less business uncertainty.	Update laws

**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<i>B. Enforcement of contracts through the court system</i>			
<ul style="list-style-type: none"> <li>• Execution of judgements</li> </ul>	Implementation of current laws is weak or nonexistent.	This is an enforcement issue. Now improving with Palestinian police. Formal and informal mechanisms of contract enforcement are used, but sometimes contracts are enforced by illegal means.	Strengthen enforcement mechanisms of courts
<ul style="list-style-type: none"> <li>• Commercial court system</li> </ul>	Weak administration of commercial justice.	Poorly trained judges, lawyers, and court administrators. Weak court operations, supported by outdated management information systems. Weak administration of commercial justice raises transaction costs of private sector activities.	Improve and strengthen operation of the courts.
<ul style="list-style-type: none"> <li>• Attachment of assets in the enforcement of judgements</li> </ul>	Implementation is weak or nonexistent.	Attachment of assets, although possible under the law, is not widely used because of weak and uneven enforcement.	Strengthen court operations and enforcement mechanisms
<ul style="list-style-type: none"> <li>• Creditors' rights: order of priority in the execution of judgements</li> </ul>	Implementation is weak or nonexistent.	In order for a creditor to have priority over other creditors, his/her pledge must be registered first. Registration is difficult since most registry systems are manual, outdated, and incomplete. Therefore there is no effective system of guaranteeing priority rights of creditors.	Computerize, modernize and complete registries, and provide technical support for their use.

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**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<ul style="list-style-type: none"> <li>Ability to enforce foreign judgements</li> </ul>	Limited experience in its use; potential problems in its implementation	Inability to enforce judgements can be particularly onerous for foreign investors relying upon local courts for repossessing local assets, such as real estate.	Strengthen courts and enforcement mechanisms
C. <i>Enforcement through ADR</i>	Laws are too formalistic and cumbersome.	Arbitrators are required to follow all judicial procedures. This imposes an undue burden on arbitration processes as courts have power to vacate an arbitral award for procedural errors. WB/G have no professional ADR center that could train arbitrators, establish basic ADR principles and host arbitration processes.	Modernize law to: (a) limit role of courts to enforcement and not review of awards; and (b) increase flexibility within arbitration procedures. Support development of a certified ADR Center.
D. <i>Secured Transactions</i>			
<ul style="list-style-type: none"> <li>Creation and enforcement of security interests</li> </ul>	Implementation is weak or nonexistent.	While in theory borrowers can pledge any type of property (including land and houses), in practice it is difficult to create an enforceable security interests because commercial and land registries do not work properly. If security interests cannot be registered, they cannot be enforced. Under such circumstances no system is in place for guaranteeing transactions.	Modernize registers (e.g, land, commercial, patents and trademarks, and motor vehicles)

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**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<ul style="list-style-type: none"> <li>• Real Property given as collateral</li> </ul>	Implementa- tion is weak.	Complex system of land titling, originating from Ottoman times, where lands are classified under several categories (12 at least). In area A (controlled by the PA), only a small percentage of land is registered (i.e., land registered before 1967). Restrictions imposed on property transfers and registration during Israeli rule have resulted in general inability to produce clear and reliable title over real property to be given as collateral.	Establish modern system of land titling and registration. Modify registration fees to feature reasonable flat fees. Provide technical support to do cadastral surveys and update geographical information.
<i>E. Banking and Finance</i>			
<ul style="list-style-type: none"> <li>• Trust law</li> </ul>	No law.	Lack of qualified investment and legal professionals, charged with the responsibility of overseeing management of funds for the interests of trust beneficiaries, may lead to unproductive or risky assets. Benefit and investment goals are best met by ensuring that investment advisors and managers conduct business with integrity (fiduciary duty).	Develop a trust law based on the principles of fiduciary duties, independence, no conflicts of interest, and a high standard of care.

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**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<ul style="list-style-type: none"> <li>Insurance companies</li> </ul>	<p>No enforcement of current laws, which are based on Israeli model. No laws on for contract savings.</p>	<p>Insurance companies often work without any tupe of supervision and oversight. Because there is no effective regulation, there remains limited purchases of insurance. This curtail available funding for investment.</p> <p>The Paris Agreement (1994) includes provision that social insurance paid to Palestinians who work in Israel be remitted to the PA. There are no regulations for management of this potential investment portfolio and there is no effective supervisory authority, mandated by the PA to ensure the integrity of the social insurance system. This pool of funds could constitute a substantial source of capital for investment in WB/G.</p>	<p>Develop and strengthen mechanisms for effective supervision of insurance companies.</p> <p>Develop contract savings institutions under a modern legal framework.</p>
<ul style="list-style-type: none"> <li>Negotiable instruments</li> </ul>	<p>Law is limited in scope and outmoded.</p>	<p>Negotiable instruments are limited to checks, promissory notes and loan debentures (WB). No regulations exist regarding contractual liabilities, holders in due course, forged or stolen instruments, etc. This likely discourages financial transactions and increases their cost.</p>	<p>Update laws.</p>

**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<i>F. Companies regulations</i>			
<ul style="list-style-type: none"> <li>• Registration</li> </ul>	Current law is inconsistent.	Different institutions are in charge in WB/G; this creates confusion and uncertainty in the business environment. In Gaza, companies whose main purpose is real estate require authorization from the High Commissioner (Arafat today). The extent to which this requirement applies to foreign companies whose main purpose is not real estate is unclear. Inhibits foreign direct investment.	Modify and unify the commercial registry.
<ul style="list-style-type: none"> <li>• Fees</li> </ul>	Law is inconsistent.	Different fees are applied in different geographical areas of the West Bank, and in WB/G. This increases the cost and uncertainty of transactions.	Establish one single fee applicable in WB/G.
<ul style="list-style-type: none"> <li>• Types of organizations</li> </ul>	Law is limited in scope.	Joint ventures are not contemplated in the law. This may increase cost of transactions and discourage foreign investors, since alternative mechanisms need to be found in the absence of a legal framework.	Update companies law.
<ul style="list-style-type: none"> <li>• Corporate governance</li> </ul>	Law is unclear.	In Gaza, law is not clear on what decisions require a qualifying majority. Minority shareholders may not be adequately protected. In the WB, restrictions may apply to minority shareholders, who may not be elected to boards of directors.	Update companies law.

**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<ul style="list-style-type: none"> <li>Accounting and auditing standards</li> </ul>	<p>There are no legal standards.</p>	<p>Companies produce financial statements which do not follow appropriate accounting and auditing standards and become an obstacle to obtain credit.</p>	<p>Develop appropriate accounting and auditing standards and provide technical support for their use.</p>
<ul style="list-style-type: none"> <li>Commercial register</li> </ul>	<p>Register does not operate well.</p>	<p>Register has under the law very limited functions as it is used only for incorporation of new companies. Up-to-date database of company information is not currently available. Existing system is manual, and information is available only to participants in a dispute or to partners or shareholders of the company. This constrains business activity and enforcement of commercial law. It also may diminish investors' confidence in the business environment.</p>	<p>Computerize, modernize and complete registries, and provide technical support for their use.</p>
<p><i>G. Intellectual Property Rights</i></p>	<p>Law is very limited in scope; enforcement is weak or nonexistent.</p>	<p>Law needs to cover new types of technology, such as computers and biotechnology. New law should incorporate petty patents or utility models, which are weaker forms of IPR that support local applications of modern international technologies. Without an effective law, there is weak encouragement of innovation. Technology-intensive firms are discouraged from locating in WB/G.</p>	<p>Formulate a comprehensive legal system of IPR protection, incorporating the utility model that is compatible with rules of the World Trade Organization.</p>

**LEGAL AND REGULATORY REFORM:  
CONSTRAINTS AND OPPORTUNITIES**

(1) Legal/Economic Area	(2) Constraint <sup>1</sup>	(3) Comments	(4) Opportunities
<i>H. Antitrust</i>	No law.	Numerous monopolies exist, in areas ranging from gasoline to construction. Former Israeli monopolies have been passed on to Palestinian vested interests.	Support development of antitrust laws to encourage good market performance by enhancing natural competitive forces in the marketplace.
<i>I. Labor Issues</i>	Law is outmoded.	Labor laws are often outmoded and overly protective of the employee. However, not cited by businesses as major constraint.	Update laws.
<i>J. Associations and Advocacy Groups</i>	Law provides insufficient protection from government interference. New law in draft.	Business associations currently are weak advocates of commercial, legal and judicial reform. They also play a weak advisory role to the PA on legal and regulatory issues affecting the business climate.	Modify current law with one that reduces government interference. Provide training and technical support to business associations, committees or other private sector advisory groups to facilitate their advisory and advocacy efforts for policy reform.
<i>K. Governance and public administration</i>	Weak public administration	Basic Law has yet to be passed. No clear division of roles and responsibilities among PA ministries and agencies. Unclear checks and balances among executive, legislative and judicial areas of government. This leads to uncertainty relating to "rules of the game."	Provide technical assistance to key ministries in basic public administration, especially on authorities of ministries/agencies, and training in fundamentals of public administration and policymaking processes.

## BARRIERS TO PRIVATE SECTOR DEVELOPMENT OUTSIDE SCOPE OF WORK

There are many constraints to Palestinian business activity that do not fall under the rubric of legal, regulatory or administrative and therefore, have not been analyzed in the main body of this report. However, their removal is also critical for developing the proper business climate. A brief summary of this type of constraints is presented below.

- **Constraints Related to Closure.** One Palestinian businessman described the situation generally as follows:

Closure is a security Catch 22: Israeli "security" actions, that enforce closure, adversely affect economic activity, lowering Palestinian economic security and raising poverty, further encouraging extremism and undermining security. Insecurity is fueled by lack of clear rules concerning personal security and protection of private property. The resulting high risk discourages economically prudent private sector investment in the West Bank and Gaza. This further undermines regional security which adversely affects all the countries in the region. Given the importance of the energy resources of the region, it adversely affects the global economic and political situation.

- **Macroeconomic Constraints.** These are associated with the control of money, public expenditures and taxation, which are being partially addressed by the World Bank and the International Monetary Fund. For example, during the Intifada, Palestinian businessmen were encouraged not to pay taxes to Israelis. Now, in order to generate operating funds, the cash-strapped PA is requiring Palestinian businesses to pay all back taxes not paid to the Israelis. This is being resisted by the hard pressed Palestinian businesses.
- **Constraints Related to Import/Export Mechanisms.** Implementation of Israeli trade policy causes a variety of hardships to business activities in the West Bank and Gaza, even apart from border closures. Israel retains physical control of the Territories' borders, and the most direct route for sea shipments into the Territories lies through Israeli ports.

The problems resulting from this situation are mainly threefold: (1) Israeli commitments under regional trade pacts -- such as the recent agreement with Jordan-- can be satisfied through imports into the territories--imports that never reach Israel itself; (2) trade measures protecting strategic Israeli industries are applied in Gaza and the West Bank thus restricting

Palestinian imports of inputs and other activities in those areas; (3) entry of traded goods through checkpoints into Gaza and the West Bank is made very difficult; Palestinian importers consistently report overzealous searches by Israel border security, resulting in significant loss or damage to merchandise.

Despite the Paris Economic Protocol (1994) which provides for PA jurisdiction over a list of regional goods, actual Palestinian control over trade policy and border access remains minimal.

- **Constraints Related to PA-Israeli Negotiations.** Finally, the impact of current negotiations between the PA and Israel cannot be overstated. Frustration over the slow progress in this area has resulted in acts of violence which dramatically increase the security risk to new investors and to local businesspeople.

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**LIST OF PERSONS INTERVIEWED**

• *Private Sector*

Omar Y. Al Sarraj, Al Wadi Consult, Gaza

Worker in a small manufacturing company, Gaza

Owner of a specialty consumer products retail store, Gaza

Mohamed S. Qudwa, Palestine Chamber of Commerce, Gaza

Mohammed Al Sabawi, Gaza Aheliea Insurance Company, Gaza

Mr. Elredaisi, Elredaisi Polystyrene Foam and Plastic Company, Jabalia

Nadim Khoury, Taybeh Brewing Company, Ramallah

Mazen Sinokrot, Sinokrot Food Company, Ramallah

Gabris Mardirossian, Silvana Chocolate Company, Ramallah

Farid Abu-Gosh, Caterpillar Dealers, Ramallah

Michel Abu-Aita, Comet Company [screw manufacturer], Beit Sahour

Khaled Qutob, agriculture, Jericho

Safwan Bataina, Palestine Securities Exchange, Nablus

Yahya J. Shunnar, Palestine Securities Exchange, Nablus

George Nasser, Towels Manufacturers, Bethlehem

Dr. Samir Abdullah, General Manager, Arab Palestine Investment Bank, Ramallah

Hashem A. Khatib, Cairo Amman Bank, Ramallah

Tewfic I. Habesch, General Manager, Arab Development & Credit Co.

Nebras A. Besiso, Executive Director, Technical Development Corporation

Ibrahim Abdelhadi, Managing Director, The Arab Insurance Co. Ltd.

Bassim Khoury, Asst. General Manager, Pharmacare Ltd., Ramallah.

Micheal Abu-Aita, Comet Ind. Co., Bethlehem.

Hani H. Shawa, Deputy General Manager, Bank of Palestine, Gaza.

Hashem Ata Shawa, Chairman, Bank of Palestine, Gaza.

Ihsan Kamal Shaushaa, Foreign Relations Manager, Bank of Palestine.

Sharhaabeel Y. Al Za'eem, Sharhaabeel Alza'eem & Associates, Gaza.

Ramzi I. Zananiri, Dep. General Manager, National Palace Hotel, Jerusalem.

Haytham Al-Zuabi, Lawyer, Bir Zeit.

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Ra'ed Abdul Hamid, IPCRI.

Gershon Baskin, IPCRI.

Zakaria al Qaq, IPCRI.

Nedal R. Jayousi, Palestinian Coordinator, IPCRI.

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Ali A. Sha'at. Ministry of Planning and International Cooperation.

Samir Hulelieh, Deputy Minister, Ministry of Economy and Trade.

Hiba Hussein, Ministry of Trade and Economy.

Ibrahim M. Aldaghma, General Counsel, Ministry of Justice.

- **Donor Agencies/Programs**

Dushyant Joshi, United Nations Development Program.

Salam K. Fayyad, IMF Resident Representative.

Wafa Dajani, DAI/Small Business Support Project, Jerusalem.

Laurel Druben, ITI/Small Business Support Project, Jerusalem.

Timothy J. Smith, Project Director, Small Business Support Project (DAI), Jerusalem.

Paul Sutphin, U.S. Consulate General, Jerusalem.

Nagi Hanna. The World Bank, Jerusalem.

Leila Calnan. The World Bank.

Gary Creighton, Embassy of Australia, AILR, Tel Aviv.

Bettina Mucheidt, European Commission.

Joe Saba, World Bank, Washington D.C.

Maria Dakolias, World Bank, Washington, D.C.

Dorothy Young, USAID/ANE/ME, Washington, D.C.

John E. Wasielewski, USAID Consultant.

Jose Ceron, Legal consultant for industrial zones, USAID.