History of the Economies of the West Bank and Gaza Strip

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Introduction

The economies of the West Bank and Gaza Strip (WBGS) face a severe crisis. When the Oslo peace process was first launched, everyone stood ready, anxious to capitalize on "peace dividends." There was reason to be. The 1993 Declaration of Principles (DOP) and 1994 Paris Protocol fueled joint Palestinian and Israeli optimism for a prosperous economic future. Both saw in economic cooperation mutual benefit. The Paris Protocol seemed to support a prevailing notion that "mutual respect for each other's economic interests, reciprocity, equity and fairness" would result in economic "spill-over effects" that could also strengthen the peace process. Unfortunately, while both Parties placed substantial emphasis on improving Palestinian economic conditions at the signing of the DOP, as a key to peace, the Israeli economy reaped large peace dividends as the Palestinian economy was allowed to collapse. In reality, the WBGS economies have struggled in spite of the peace process, rather than being assisted by it.

Today it has become clear, without taking account of Israel's all-out economic war on the Palestinians following the second intifada, that the WBGS economies are a casualty of the peace process. A consistent decline in Palestinian economic performance preceded Al-Aqsa intifada, despite the internationally community's financial support. This was not because Palestinians do not have rich human and financial resources inside and outside the WBGS areas. It was not because the Palestinian Authority failed to formulate macroeconomic policies, especially with regards to trade, and to create the regulatory framework necessary to improve investment. It was also not because Israel insisted that structural bilateral relations remain largely unaltered, maintaining the de facto customs union pending final status talks. The reason for the economic decline was Israel's perception and treatment of the Palestinian people as an enemy rather than a partner, thus choosing not to cooperate and coordinate on economic policies as the Paris Protocol had assumed would happen. Israel maintained an antagonistic approach that paved the way for frequent WBGS closures under the pretext of security. It also increased settlement building to further diminish the prospect of a Palestinian economy that grows and is self-reliant. By far these were the greatest contributors to Palestinian economic decline and set the stage for the second intifada which begain in September 2000.

Since Al-Aqsa intifada Israel has continued to make the Palestinian economy pay a price it cannot afford. Israel's "permanent" closures have suffocated the WBGS economies, continuing to produce staggering poverty and unemployment rates. Palestinian gross national income per capita has fallen to nearly half of what it was two years ago. More than fifty-percent of the Palestinian workforce is unemployed. Physical damage resulting from the conflict, up until August 2002, has amounted to $728 million. Between June 2000 and June 2002, Palestinian exports declined by almost a half, and imports by a third. Investment contracted from an estimated $1.1 billion in late 2000 to $19 million to date. Overall, Palestinian national income losses during the intifida have exceeded $5.4 billion, the equivalent of one full year of national income prior to the violence. Still, amidst this grim economic outlook and Israel's counterproductive behavior, hope must persist. An alternative scenario not predicated on hope is disaster, i.e. total Palestinian economic collapse and denied existence.

With hope, this paper begins by offering a background summary of Palestinian economic performance, past and present, to lay a foundation to probe the requirements of Palestinian economic growth and sustainable economic development. Specifically, this paper identifies imperatives for Palestinian economic growth and threats to Palestinian economic viability. It also provides an itemization and assessment of future challenges. Finally, this paper offers possible short and medium-term solutions that pave the way for Palestinian economic rebound. In the end, this paper demonstrates that the WBGS's economic growth and development cannot be achieved so long as Palestinians lack jurisdiction, border control, territorial integrity and contiguity, and unhindered access to outside markets. Put another way, what is required now to achieve Palestinian economic development and growth is a viable Palestinian economy.

I A 1967-2000 Synopsis of Palestinian Economic Realities and Performance

Israeli policies and actions following Al-Aqsa intifada did not generate the current Palestinian economic crisis; thirty-some years of occupation and interim arrangements, which continue to breed Palestinian economic dependency, did. Efforts continue to make right what Israeli policies (1967-1993) have made certain: total economic integration that precludes industrial development and restricts formulating independent policies to promote private sector growth. A brief overview of past Palestinian growth patterns follows to serve as an analytical backdrop for this paper.

In 1967 Israel integrated the poor and small Palestinian economy. By 1972 Israel's economy had completely absorbed the Palestinian economy, and Israeli economic, trade, and labor policies came to shape Palestinian trade activity. Initially, this convergence had a mixed impact. On the positive side, the Palestinian economy experienced rapid growth from 1968 to the mid-seventies. This was a result of two phenomena: economic gains from sudden opening of opportunities in Israel, especially labor employment, and also trade in many (but not all) goods, and the growing employment opportunities for Palestinians in the booming Gulf countries.

Economic integration with Israel led to an increase in income and economic activity because of the "spread effect" from employment and trade. Israeli markets opened to manual Palestinian labor. New trade technological opportunities and reallocation of factors assisted in generating almost equally rapid growth in domestic production. A reduction in low productive agricultural employment, including cycle unemployment, and more intensive marketization, particularly in rural areas, further provided for fast growth rates.[1]

On the negative side, integration had a polarizing affect. Integration, along with increased Gulf employment, contributed to rapidly rising money incomes, strong

[1] In the 1970s, the WBGS were among the top ten fastest growing economies in the world when GNP growth was measured. The GDP expansion was also large by international standards. However, this growth was a productive of another important factor: skilled Palestinians were increasingly finding employment in the Gulf. Boosted remittances from Palestinian workers and transfers from oil-rich countries acted to counter-balance weaker economic opportunities in Israel in the late-seventies and early-eighties. Therefore, although Israel's growth slowed following the 1979 oil shock, and the process of labor substitution away from low productivity toward employment in Israel decreased, the Palestinian economy's rapid growth continued, albeit at a lesser rate.

demand-led growth, and high savings, with a large portion of savings financing investment in housing. Unfortunately, Israeli policies and practices restricted Palestinians from using natural resources, engaging in productive economic activity, and having / creating a Palestinian public sector. Fearing that Palestinians would compete with Israeli manufacturers, Israel did not invest or industrialize in West Bank and Gaza Strip. It also restricted what Palestinians could do. Israel made the free movement of Palestinian workers into Israel, coupled with free export of Israeli goods to the West Bank and Gaza Strip, the most important features of Israeli-Palestinian economic relations. As for Palestinian goods into Israel, those experienced significant trade barriers, especially agricultural goods. As a result, not only was the Palestinian economy denied developing an economic infrastructure to become self-reliant, but also it was diverted from other Arab and foreign markets to rely solely on Israeli goods.

Economic stagnation prevailed from early-1980s until 1987. After the collapse of the regional oil boom, and while employment in Israel remained flat, declining employment opportunities and decreasing Gulf work remittances replaced economic growth. An economic decline shortly followed after the first Palestinian intifida erupted. Until 1993, the intifada's related strikes and economic activity repression, along with the effects of the first Gulf War, continued this output decline. Further political and economic uncertainty plagued the West Bank and Gaza Strip. A recovery in 1992, prompted by drawdowns of savings and expectations of peace, was followed by a renewed decline in 1993. Despite elements of improvement, the Palestinian economy has been unable to rebound since.

By the time the Palestinian Authority was created to inherit some territory from Israel pursuant to the peace process, many public services were in disarray: power outages were frequent, drinking water was often below WHO standards, etc. Public investment in economic and social infrastructure had been unusually low at less than 3% of GDP. The WBGS economies had, aside from the uneven pace of growth, displayed an unusual, skewed pattern of development. Investment had been high, but this investment did not create new jobs until the late 80s, because an unusual high portion of investments went in housing. In turn, private investment in directly productive activities had been low, and industrialization at 7% GDP in the West Bank and 10% in Gaza were way below economies of the same level income at the time.

Even though the peace process created new political and economic forces that impacted the Palestinian economy fundamentally, the occupation's negative affects were left structurally untreated. So was the policy framework that created weak domestic productive activities. The asymmetrical market relations with Israel and other countries (codified in the Paris Protocol) that caused a bias towards labor export (and raised domestic wages); the regulatory restrictions that held back the expansion of the private productive sector; the fiscal compression and institutional under-development that led to under-provision of public goods; and the restricted access to natural resources continued, frustrating positive Palestinian economic performance. The WBGS's economic condition worsened throughout the peace process. Real GNP per capita income dropped by more than 17% between 1994-1996. Unemployment soared in 1996 to over 28%. In 1996-1997, GDP showed negative growth. Out of the WBGS population, in 1998, 37% of Gaza Strip population and 15.4% of the West Bank were living under poverty, earning less than $2.1 a day. Although in 1999 and early 2000, before the Al-Aqsa intifada, the WBGS economies' registered a 6.1% positive growth, this pleasing anomaly was whipped-out by Israel with the imposition of closures and restricting travel, following Al-Aqsa intifida's start. These patterns demonstrate to things: the economies of WBGS have the potential to grow. Israel actions, however, have been an insurmountable obstacle.

II Growth and Development Imperatives: Palestinian Economic Viability

A. What does "economic viability" mean?

"Viability" essentially entails, from an economic viewpoint, the concrete possibility of continued production. An economy is viable when human, financial, and physical resources are available and can be used to self-sustain, grow, and increase the welfare of inhabitants living within its area. Such economic advancement constitutes development.

B. What is meant by a "Palestinian economy"?

A general agreement prevails among the Parties to the conflict, and the international community as a whole, that the West Bank and the Gaza Strip will comprise the territory of a future Palestine. It follows that these two entities' economies form what is often referred to as the "Palestinian economy." However, this only clarifies geographical scope, and only in general terms. Stating that the Palestinian economy includes the West Bank and Gaza fails to clarify specific territory and borders.

C. Growth and Development Imperatives

Palestinian growth and development necessitate an economically viable Palestinian entity that covers the West Bank and Gaza Strip. The Oslo Accords reflected Israel's conviction that Palestinian economic growth and prosperity can be achieved without defining border and territorial sovereignty. After ten years since the process was first launched we know this is not the case.

Clear territorial sovereignty is important for Palestinian economic growth. It defines state's jurisdiction and scope of intervention. It also permits actors, whether individuals, firms, or governments, to evaluate the countable resources and where they can invest and with whom they can trade. Although many discount the importance of borders in an increasingly globalized world, where freedom of trade and flows of finances and information erode clear territorial jurisdiction, it remains necessary when one does not have it.

Palestine is a case on point. Palestinian economic viability hinges on having geographical contiguity, territorial sovereignty over land and resources, defined borders, and uninterrupted access between the West Bank and Gaza Strip, and between the West Bank and Gaza Strip and the outside world. These viability requirements provide desperately needed economic stability. Without these viability fundamentals the Palestinian economy cannot display sustained growth.

The difficulty begins when one attempts to speak of a Palestinian economy while more than 140 settlements divide the WBGS and encircle its cities, preventing any territorial or economic integration of parts of the WBGS. The difficulty continues when speaking of growth while Jerusalem, a vital physical and economic link between the West Bank's north and south, is not part of the Palestinian economy. Not much can be done about furthering trade, an important vehicle of Palestinian growth, before borders are clearly defined with Israel, Jordan, and Egypt. Finally, regional integration cannot become the motor of growth it is capable of being while Palestinian territorial sovereignty remains unclear and out of Palestinians' control. Nevertheless, Palestinians could post some growth, despite these obstacles that have not changed from when Israel formally occupied the WBGS.

Palestinian growth and development have been cursed, not necessarily by the Paris Protocol, but by Israel's conscious anti-viability behavior towards Palestinians, continuing its use of economic tools for political purposes, as pressure points to gain political compromises. To a large extent, lack of Palestinian control over territory is the cause for the economic crisis Palestinians face today. In light of the experience of the past ten years, certain Palestinian requirements for growth can be deduced.

1. Adverse Palestinian Path Dependency

The Palestinian economy's viability is challenged by both structural, long-term pressures, and its steep vulnerability to the immediate shocks of war and drastic falls in income, stemming from its prolonged dependence on the Israeli economy and the lack of clear alternatives for economic partners in times of strife. As such, the Palestinian economy must disengage and re-orient away from Israel's economy to avoid an adverse path dependency and instituting a development strategy that is vulnerable to Israeli closures and its favored policy of Palestinian economy under siege.

Colonial institutions and practices continue to play an important role in shaping economic and social trends in a country well after it gains political independence. These institutions created in the past tend to lock-in a certain evolutionary path. Patterns of production and trade and power relations inherited from the past, if left unaltered, tend to exert an influence that shapes future economic trends in a path dependent fashion. Accordingly, the impact of prolonged occupation, and the interim self-government period, must be carefully understood in order to comprehend the nature of the adverse path dependence confronting the Palestinian economy, and what challenges it faces in embarking upon the task of moving toward instituting a new and positive path dependence.

Palestinian dependency manifests itself in the types of production, services, export and marketing processes, as well as the basic procurement of production necessities. Even before the recent developments, the dependency of the Palestinian economy on the Israeli economy, both in trade and in the infrastructure, thereof constituted a major constraint to the strategic viability of the Palestinian national economy. These steps should go in the direction of alternative regional and international markets in order to diversify both export market potentials, as well as inputs for production and imports for daily consumption.

2. Geographical Scope and Contiguity

The geographical scope of the West Bank and the Gaza Strip (based on UNSCR 242 & 338) is the physical area, which the State of Palestine will cover. In this assumption, Internal and External Access and Geographical contiguity are of paramount importance. The physical continuity between the West Bank and the Gaza Strip (uninterrupted movement of goods and people), manifested in a passage from the West Bank to Gaza under full Palestinian sovereignty, with no external interference relating to the movement of people and goods is fundamental. This initially entails access to the Gaza Port[2] and Airport[3] from the West Bank as well as access to both the Jordan and Egypt border crossings from areas in both regions. The state of Palestine must have complete and sovereign access to external border points with Jordan and Egypt. This control must be without any third party interference, in order to ensure the movement of goods to these countries as well as access to their ports and airports and other transport facilities for goods in transit.

3. Economic Stability

If the economy is to be stable, it must maintain a certain level of domestic employment and to keep unemployment to a minimum. The Palestinian economy must, therefore, have built in mechanisms in order to ensure employment alternatives and to work on creating jobs and/or job opportunities in the domestic labor market as well as in different external markets. In order to have economic stability, individual earnings must reflect the cost of living. Per capita GNP, therefore, must meet the basic needs of the individual and/or the family unit in the economy. Otherwise, declining living standards, poverty and dissatisfaction will result in political instability.

4. Potential for Development

The Potential for Development is a basic pillar in the search for viability of an economy. If the Palestinian economy is to have any potential for development, it will need a developed economic infrastructure, including physical infrastructure, legal and institutional infrastructure, as well as trade and economic services. The physical infrastructure required would cover road and highway networks, the Gaza Sea Port, cargo facilities in the Gaza airport, as well as the Rafah and Al-Karamah crossing points into Egypt and Jordan, an airport in the West Bank as well as basic utilities (Water, Electricity, Solid and Liquid waste management and telecommunications). Such infrastructure should be under Palestine's full control and therefore free from external interference. The legal structure to be developed would include the finalization of the draft laws, as well as the creation of the necessary institutions for the implementation and enforcement of these laws through operational regulations. The private sector also needs to further develop its institutions and enterprises, to serve its needs in the areas of marketing and promotion, management, financial services, as well as many other areas of technical capacity and expertise.

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[2] Although work was started on the Gaza Port, the Israeli government has prevented completion of the port work, and has recently destroyed all the infrastructure that had been put in place to construct the port.

[3] After the start of the Intifada, the Israeli army fully destroyed the runways at the Gaza Airport and rendered it unusable.

III Palestinian Economic Viability Threats: Israeli Antagonistic Conduct

Many issues will be subject to bilateral negotiations between Israel and the Palestinians. The Paris Protocol hinders the emergence of a more diversified development strategy. Even if the Palestinian economy embarks on a growth and development path it is unlikely to be maintainable under the shadow of Israeli closure.

Israeli measures to crush Al-Aqsa intifada and impose a political solution on the Palestinian People have, in devastating the Palestinian economy, proven the vulnerability of a development strategy that relies so heavily on Israel, whether with regard to labor or other exports. Israeli “closures" refer to restrictions for “security purposes” on the free movement of Palestinian goods and labor across borders, as well as, within the West Bank and Gaza Strip. They have taken three forms: (i) internal closure within the West Bank and the Gaza Strip, reinforced by curfews; (ii) external closure of the border between Israel and the West Bank and between Israel and the Gaza Strip, including the limitations placed on the movement into Israel of Palestinian workers; and (iii) the external closing of international crossings between the West Bank and Jordan, and between Gaza and Egypt. One could also consider withholding Palestinian tax revenues as a form of closure.

Since the 29th of September, Israel has carried out the following collective punishment measures against the Palestinian Population:

1. Imposed a comprehensive closure on West Bank and Gaza Strip and prevented civilians, businessmen and products from movement between cities by dividing the Palestinian Territories in tens of zones (separation between cities and their suburbs, and the imposition of a complete siege on each city and village) whereby movement between the zones is not possible;
2. Prevented access of products between West Bank and Gaza Strip;
3. Stopped all Palestinian exports and imports with the partial and exception of food and medicine;
4. Restrained all goods imported to Palestine in its ports and imposed high security inspection fees on Palestinian importers, in order to clear their goods;
5. Prevented the movement of Palestinian trucks between West Bank and Gaza Strip;
6. Imposed a back-to-back system as a means of transportation of goods at most crossing points between Gaza and Israel and has transferred this trade-impeding system to the West Bank crossing points with Israel;
7. Prohibited Palestinian Customs staff from reaching their work at Rafah entry point with Egypt and Al-Karamah entry point with Jordan;
8. Raised insurance for each container from $500 to $2000;
9. Repeatedly delayed or completely stopped the transfer of PNA earnings from customs, VAT and purchase tax; and
10. Prevented more than 130,000 Palestinian laborers from working in Israel.

A. Movement of Goods within WBGS

The internal movement of goods in the West Bank has been seriously interrupted. For example, in the West Bank, since Operation Defensive Shield[4] in May 2002, and the extension of the "back-to-back" system was announced -- according to which all non-humanitarian goods must be off- loaded from incoming trucks and then re- loaded onto local trucks at eight checkpoint locations near major West Bank cities under the supervision of the Israeli Occupation Army – significant difficulties and delays have increased transaction costs and other related costs.[5] This, in turn, increases the prices of goods for Palestinians, at a time when they make less money, and many are unemployed. In addition, the increased costs make Palestinian products less competitive vis-à-vis Israeli products and other country's goods when exported.

B. Movement of Goods between Israel and WBG

Similarly, the closures impact the movement of goods to and from WBG and Israel. Commercial truck movements to and from the West Bank and Israel have fallen by as much as 50 percent when compared to the pre-Defensive Shield period. Generally, trucks bearing humanitarian cargo or raw materials for donor projects and driven by international drivers or residents of East Jerusalem are allowed easier passage. A limited number of permits have been granted for Israeli trucks bearing goods such as milk and medicine without being subject to back-to-back controls, as well as for Israeli trucks to carry stone products from Bethlehem into Israel. At times of heightened security concerns, restrictions are placed on these trucks as well.

C. External Closure: Between the West Bank and Gaza; with the Rest of the World

The "Safe Passage" route, designed to allow Palestinians to move relatively freely between the West Bank and Gaza, was closed by the Israeli authorities on October 6, 2000, after nearly a year of operation and has not reopened. Border closures with neighboring countries meant that both passenger and commercial traffic through international crossings remained heavily restricted. According to data collected by the Israeli Airports Authority, the number of Palestinians crossing Israel's land borders fell by 28.3 percent in the period between January and October 2002.

D. Israeli Unilateral Separation

In parallel with the Palestinian Al-Aqsa Intifada, Israel started to take measures for gradual unilateral separation. This bolsters the Palestinian choice to disengage and re-orient.

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[4] In spring 2002, following an escalation of violence, the Israeli Defense Forces launched Operations "Defensive Shield" (March 29, 2002) and "Determined Path" (June 18, 2002). These military operations transformed many West Bank cities, towns, and villages into restricted military zones, with residents under sustained (often 24-hour) curfew for days at a time. At times, Israel put nearly 900,000 West Bank residents in 74 communities under curfew, and on average during the six-and-a-half month period between June 17 and December 31, 2002, 37 localities and 547,000 persons were directly affected. Jericho alone among major West Bank urban areas that avoided curfew, but like all parts of the West Bank suffered from the intensification of movement restrictions.

[5] These associated difficulties with moving goods between West Bank cities bear much more on manufacturers and traders attempting to move goods *out* of Palestinian cities than on those bringing goods *in* from Israeli suppliers.

E. Settlements

F. Mini conclusion

Israel's unilateral recourse to border separation confirms that the economic prosperity in the WBGS depend on access to Israel and through it to the world, and secondly, that Israel is imposing new criteria for defining and conceding territorial rights. Within this paradigm, Palestinian economic development and growth cannot take place. The most significant step associated with separation was the replacement of Palestinian labor working in Israel with foreign labor.[6] Other measures that have had an adverse impact include: tighter restrictions on the movement of goods with and through Israel and between cities in the West Bank and Gaza, tougher arrangements concerning imports and exports that authorize passage at certain military checkpoints and subject to downloading incoming trucks and then re-loaded into local trucks before proceeding to their final destination, tighter system of permits for controlling the movement of Palestinians within the West Bank and Israel pose an immediate challenge to Palestinian economy and its future recovery. These measures are particularly relevant to development policy-making and implementation at the Palestinian level. The Palestinian economy has experienced decline in employment, trade, and investment and an increase in transactional and transportation costs.[7]

Territorial Control Under the Paris Protocol

Israel's unilateral territorial control has so far hindered economic performance. Contrary to what the Paris Protocol predicted, borders and territorial definitions were not transcended for the mutual benefit of both Parties to the conflict.

[6] The Palestinian labor force working in Israel, which accounted for a quarter of total Palestinian work force, specialized in low-productivity construction and agriculture sector jobs. See, Basim Makhool, "Economic growth and employment in the West Bank and Gaza Strip", Arab Economic Journal, 27:11, Spring 2002.

[7] The continuation of these measures will certainly aggravate the already precarious humanitarian crisis, since the economy's coping strategies have been effectively overwhelmed by poverty. This will render attempts to address development needs particularly difficult, while emergency humanitarian needs will still be evident even after the attainment of stability. The experiences of other war torn economies also show that food aid can result in suppressing food prices and, henceforth, act as a disincentive for local farmers. At the same time, aid may increase the profitability of non-productive activities such as commerce and construction, which are much easier for the private sector to expand into than export activities. Hence, the risk of breeding aid dependency as a coping mechanism at the household level in addition to further aggravation of the economy's structural weaknesses.