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REPORT ON UNCTAD'S ASSISTANCE TO THE PALESTINIAN PEOPLE*

Prepared by the UNCTAD secretariat

Executive summary

While United Nations Security Council resolution 1397 (2002) reaffirmed the international vision of a region where two States – Israel and Palestine – live side by side within secure and recognized borders, the imperatives created by the unilateral Israeli disengagement from Gaza in mid-2005 have directed attention to the need to rapidly address new realities on the ground. Meanwhile, the economic governance tasks that the international community and the Palestinian Authority (PA) have set for the immediate future are ambitious, to say the least. The Palestinian people are expected to form and reform institutions in preparation for statehood, while the non-sovereign PA attempts to implement a coherent economic policy framework in an environment of systemic disruptions, impoverishment, insecurity and denial of rights. In such an uncertain situation, the challenge to PA economic policymakers of preparing for statehood could not be greater.

Five years of economic retrenchment have deeply scarred the Palestinian economy. After a year of respite, economic contraction continued in 2004, with dire consequences for poverty, production capacity and the Palestinian people's basic needs. This highlights the multiple challenges facing Palestinian development: recovery and reconstruction have to proceed against a background of attrition of the economic base, a war-torn economy distorted by years of occupation and dependence on the Israeli economy. Further complicating the task is the very limited economic policy space available to the PA and the increasing need for donor support. A Palestinian "reform-for-statehood agenda" should be grounded in a development-driven approach to trade rather than a trade-driven approach to development within a framework of national consensus that clearly identifies pro-poor development and reform priorities.

Now in its tenth year, UNCTAD's technical cooperation with the Palestinian people continues to provide concrete support with a view to building capacities for effective economic policymaking and management, and strengthening the enabling environment for the private sector. Under difficult field conditions, the secretariat has achieved notable progress in project implementation and UNCTAD's technical assistance has become increasingly relevant to the governance of the occupied territory after the disengagement from Gaza. However, inadequate extrabudgetary resource availability, especially for central support functions of this programme, undermines its ability to implement the Bangkok and São Paulo mandates and impairs delivery of effective assistance.

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Introduction

PALESTINIAN ECONOMIC PROSPECTS AND PREPARING FOR STATEHOOD

1. Amidst the deep crisis and hostilities that prevailed in the occupied Palestinian territory in mid-2002, the United Nations Security Council demonstrated an act of faith and peace in adopting by consensus its resolution 1397 (2002).¹ In that resolution, which has provided a strategic basis for subsequent efforts to resume an Israeli–Palestinian peace process, the international community affirmed a vision of a region where two States – Israel and Palestine – live side by side within secure and recognized borders. Since then, while the armed conflict entered a period of relative calm in 2005, the humanitarian, economic and political crises which have emerged since 2000 have yet to be resolved, thereby undermining the operational capacities of the Palestinian Authority (PA) and threatening the preparedness of the Palestinian people to assume the responsibilities of statehood.

2. While the international community's "Performance-based road map to a permanent two-state solution to the Israeli-Palestinian conflict" was endorsed in 2002 by both Israel and Palestine as the frame of reference for the coming period, three years later it remained mired in its first phase, from which there seemed to be no way out. Meanwhile, the imperatives created by the unilateral Israeli disengagement from Gaza in mid-2005 have directed attention to the need to rapidly address new realities on the ground. At the same time, the time horizon for achieving the principal purpose of the road map, namely the ending of Israeli occupation of the Gaza Strip and the West Bank, including Jerusalem, and the establishment of an independent, contiguous and viable State of Palestine, appears to have been displaced yet again. This could undermine the terms of the peace process as accepted by all parties since the Oslo accords in 1993, including its economic underpinnings.

3. This highly uncertain state of affairs, after almost four decades of occupation and on top of five years of conflict and economic decline, poses formidable, seemingly insurmountable obstacles to PA policymakers in most spheres, including economic and development policy. The list of tasks that both the international community and the PA itself have set for the immediate future is highly ambitious, if not unrealistic. While economic pressures increase amongst an impoverished population, with insecurity exacerbated by the breakdown since 2001 of the PA security apparatus in the context of continuing occupation, the Palestinian people are expected to forge democratic institutions and transparent processes in preparing for statehood. In the economic sphere, a number of targets are considered immediate priorities, of which the most pressing are to:

- Halt the public wage bill and workforce inflation;
- Avoid overdependence on donor aid to provide social protection and budget support;
- Manage a transparent balanced budget without incurring unsustainable external debt, while divesting the PA of its remaining commercial and market assets;
- Pursue an open and liberalizing trade policy compatible with multilateral trade rules as well as the economy's least developed, war-torn status;
- Establish accountable public sector institutions according to global best practices;
- Promote absorption within a distorted labour market of some 80,000 workers formerly employed in Israel, and more than twice the number again of chronically unemployed;

- Design and manage a coherent economic policy and development programme for a fragmented, landlocked territory surrounded by land and sea barriers with Israel and intersected by the built-up areas, access routes and buffer zones of Israeli settlements;
- Reinforce and develop the rule of law after years of deterioration and centralization of powers.

4. While addressing these challenges in a sustained manner may help create the conditions for the successful emergence of a viable State, the question arises as to whether they should be considered sufficient conditions, much less preconditions, for statehood as they are currently framed by the donor community, and so far adhered to by the PA. Put another way, the challenges that the above list entails in the economic governance sphere alone call for authorities and capacities that only sovereign States are usually able to deploy, even if not many of them can successfully address a comprehensive development agenda. So the question then arises as to whether the non-sovereign PA can fulfil such an agenda under occupation, or implement any coherent economic policy framework and programme.

5. UNCTAD's mandate in this area of its work (in the Bangkok Plan of Action of 2000 and in the São Paulo Consensus adopted in 2004) recognizes the need to intensify its programme of assistance to the Palestinian people, strengthened with adequate resources. Over 20 years, this programme has witnessed and adapted to the vicissitudes of the conflict and the inherent risks, much as the Palestinian economy and people have somehow survived their worst years (e.g. 1988–1993 and since 2000) while seizing opportunities presented by the better years (e.g. 1994–1999). The programme has contributed to Palestinian institution and human capacity building, predicated on the eventual establishment of sovereign Palestinian government. While not losing sight of the core challenge of contributing to long-term development, UNCTAD is working closely with the PA and international partners to establish the irreversible institutional "facts on the ground" of the future Palestinian State.

6. The concrete results achieved to date in technical cooperation with Palestine and donors, and the growing relevance of UNCTAD's policy recommendations in this very special situation, serve as incentives to sustaining and intensifying its contribution to peace through the promotion of a comprehensive, participatory and pro-poor approach to development policy. This year's report provides some suggestions about the type of attention and action that would serve the goals of Palestinian development under any scenario, bearing in mind the overarching need to link relief to reconstruction and development.

Chapter I

THE WAR-TORN PALESTINIAN ECONOMY

A. Aggregate economic developments

7. After a year of respite, the Palestinian economy resumed in 2004 the sharp decline begun in 2000, in the wake of tightened Israeli mobility restrictions on people and goods and a systematic internal and external closure policy imposed on the West Bank and Gaza.² The year 2002 had witnessed the third consecutive economic regression, leading to a gross domestic product (GDP) 15.2 per cent smaller than that of 1999.³ Recently released official Palestinian data, shown in table 1, indicate some recovery in 2003 with 4.5 per cent GDP growth. However, 2004 confirmed the unsustainability of this rebound with a renewed 1 per cent decline.⁴ This reflects a shattered, war-torn economy with a sustained contraction in its supply capacity as a result of prolonged occupation and four years of destruction and deterioration of private and public infrastructure.

8. In terms of per capita income, the picture is bleak, with the Palestinian people's welfare falling by more than one third between 1999 and 2004. Real per capita gross national income (GNI), in 1997 dollars, dropped by 33.4 per cent from \$1,860 to \$1,237. As a result, the impact on poverty was substantial: it is estimated that 61 per cent of Palestinian households were living under the poverty line of \$350 per household (comprising 2 adults and 4 children) per month by the end of 2004. Households' median monthly income had fallen by about 45 per cent from \$610 in 2000 to \$330 by the end of 2004.⁵ This drop was more severe in Gaza, where the median monthly income fell from \$415 to \$220.⁶ Consequently, 32 per cent and 20 per cent of Gaza and West Bank households, respectively, are living in extreme poverty, unable to meet their basic needs.⁷ Meanwhile, households appear to have exhausted their coping strategies, and by the end of 2004 only 17 per cent of the West Bank households were found to be capable of withstanding the adverse conditions for more than one year, compared with around 33 per cent in Gaza.⁸

9. The economic and physical capital costs to the Palestinian economy of the past five years of hostilities continue to mount. According to recent UNCTAD estimates, the cumulative economic opportunity cost in terms of loss of potential income over the period 2000–2004 is estimated to be \$6.4 billion (1997 dollars), or 140 per cent the size of the Palestinian GDP before 2000. In addition, the physical capital loss is estimated to be around \$3.5 billion, as a result of destruction of private and public infrastructure and capital stock and overuse of surviving physical capital. This estimated loss is equivalent to 30 per cent of pre-2000 Palestinian capital stock.⁹ According to UNRWA, in the four years ending in August 2004, 2,370 housing units were destroyed in the Gaza Strip, with approximately 22,800 people left homeless. In 2004 alone, 1,399 houses in both Gaza and the West Bank were destroyed, with 10,683 people left homeless.¹⁰ In other words, the Palestinian economy in 2005 will have to operate with a much smaller base compared with that of 1999.¹¹

10. The overall impact of this economic attrition is erosion of the Palestinian production capacity and degradation of people's ability to feed themselves, and therefore increased dependence on imports, especially from Israel. This ramification is highlighted by the consistently high domestic absorption (private and public consumption and investment expenditures to GDP ratio) and the allocation switch from investment to consumption.

Following a decline from 163 per cent of GDP in 1999 to 143 per cent in 2001, the absorption–GDP ratio climbed to 164 per cent in 2004. Meanwhile, an increasing portion of this expenditure was allocated to satisfy urgent consumption needs. While the share of private and public consumption in GDP increased from 117 per cent in 1999 to 134 per cent in 2004, the share of total investment dropped from 43 per cent to 27 per cent. Put simply, in the wake of the past four years of Israeli occupation and war, the Palestinian economy invests and produces less and therefore consumes more imports, especially those from Israel.

Table 1
Palestinian economy (West Bank and Gaza Strip): Key indicators – Selected years^a

	1995	1999	2000	2001	2002 ^{Rev.}	2003 ^{Est.}	2004 ^{Est.}
Macroeconomic performance							
Real GDP growth (%)	6.1	8.6	-5.6	-6.6	-3.8	4.5	-1.0
GDP (million US\$)	3225	4201	4108	3816	3484	3921	4011
GNI (million US\$)	3699	4932	4793	4143	3700	4204	4373
GDP per capita (US\$)	1380	1478	1386	1229	1073	1158	1146
GNI per capita (US\$)	1583	1736	1617	1335	1140	1242	1249
Real GNI per capita growth (%)	7.9	4.1	-10.7	-16.1	-9.8	2.8	-4.2
Domestic expenditure (% of GDP)	151.8	163.6	155.4	143.3	161.0	153.0	164.4
CPI inflation (%)	10.8	5.5	2.8	1.2	5.7	4.4	3.0
Population and labour							
Population (million)	2.34	2.84	2.96	3.10	3.25	3.39	3.50
Unemployment (% of labour force) ^b	26.6	21.7	24.6	36.2	41.2	33.4	32.6
Total employment (thousand)	417	588	597	508	486	591	607
In public sector	51	103	115	122	125	128	131
In Israel and settlements	50	127	110	66	47	53	48
Fiscal balance (% of GDP)							
Government revenue	13.2	23.8	23.1	7.1	8.3	19.5	23.3
Current expenditure	15.3	22.5	29.1	28.7	28.5	27.2	31.1
Total expenditure	25.5	29.8	34.9	34.3	34.9	34.7	31.9
Recurrent balance	-2.1	1.3	-5.9	-21.5	-20.2	-7.8	-7.9
Overall balance	-12.3	-6.0	-11.8	-27.1	-26.6	-15.2	-8.6
External balance							
Exports of goods and services (million US\$)	499	684	657	534	529	378	467
Imports of goods and services (million US\$)	2176	3353	2926	2336	2654	2456	3049
Trade balance (% of GDP)	-51.8	-63.6	-55.4	-43.3	-61.0	-53.0	-64.4
Current account balance (% of GNI)	-21.7	-31.7	-20.9	-13.0	-13.6	-8.9	-16.5
Trade balance with Israel (million US\$)	-1388	-1644	-1506	-1541	-1123	-1524	-1621
Trade balance with Israel (% of GDP)	-43.0	-39.1	-36.7	-40.4	-32.2	-38.9	-40.4
Current account balance with Israel (% of GNI)	-24.7	-18.5	-17.1	-29.3	-24.5	-29.5	-28.8
Imports from Israel /PA private consumption (%)	56.5	52.4	50.7	53.8	36.8	45.7	46.3
Total PA trade with Israel/total Israeli trade (%) ^c	3.7	3.6	2.8	2.7	2.0	2.4	2.3
PA trade with Israel/total PA trade (%) ^c	78.8	67.1	71.2	78.6	53.4	75.1	66.8

Sources: Historical data from the Palestinian Central Bureau of Statistics; data for 2003–2004 are estimated by the UNCTAD secretariat on the basis of recently released PCBS data,¹² and IMF fiscal estimates (2004).¹³ Israeli trade data are obtained from the Monthly Bulletin of Statistics of the Israeli Central Bureau of Statistics.

^a All data exclude East Jerusalem.

^b Unemployment rates include discouraged workers following the ILO relaxed definition.

^c Total Palestinian and Israeli trade data refer to goods, and non-factor and factor services.

11. The opposite side of the high absorption–GDP ratio is an equally high trade deficit. The latter continues to climb at a rate much faster than that of domestic production. The deficit widened from \$1.8 billion in 2001 to an estimated \$2.6 billion in 2004, with exports each year either declining faster or increasing more slowly than imports. When this pattern is combined with the depreciation of the new Israeli shekel (NIS) in 2003 and then its appreciation in 2004, it is clear that while the Palestinian trade balance does not benefit from the depreciation of the Israeli currency, it suffers the full negative impact of currency appreciation. This negative–negative mechanism is reinforced by three factors: (i) attrition of production base and prohibitively high factors of production and transaction costs; (ii) the PA cannot implement a national exchange rate policy that takes the domestic production structure into consideration; and (iii) a national trade policy in the context of the Israeli–Palestinian Economic Protocol of 1994 that does not give the PA flexibility to change trading partners in response to changes in major currencies.

12. Palestinian net imports from Israel represent two thirds of the total trade deficit. In the last five years, the Palestinian trade deficit with Israel as a percentage of GDP ranged between 32 per cent in 2002 and 40 per cent in 2004. This reflects *inter alia* the dependence of the Palestinian economy on a single market (Israel), which is also observed in the importance of each partner in the total trade of the other. As shown in table 1, while trade with Israel represented 67 per cent of total Palestinian exports and imports, the latter represented only 2.3 per cent of total Israeli trade.

13. The cost of this deficit is substantial, especially in the light of the recent Palestinian economic retrenchment and the lack of sustainable external resources. In the last four years, while net Palestinian imports from Israel averaged about \$1,450 million annually, net current transfers to the PA, which mainly represent donor support to relieve the humanitarian emergency, averaged \$1,300 million per year. These figures indicate that all the donor relief support received by the PA in the last four years was not enough to pay for the trade deficit with Israel. It paid only 90 per cent of the gap, while the remaining 10 per cent (about \$140 million annually) is covered by net factor income, which is mainly the income of Palestinian workers in Israel. In other words, an amount equivalent to all donor support to the PA plus half of workers' remittances is channelled to the Israeli economy to pay for Palestinian net imports from Israel. It is important to emphasize that these figures should not be taken as a reason for the international community not to meet its commitments to the Palestinian people. On the contrary, the Palestinian economy needs additional support to withstand and recover from the ongoing crisis. However, the PA and the international community should work together within a framework led by a Palestinian socio-economic development vision capable of protecting the poorest from the dire impact of economic retrenchment, while at the same time reducing dependence on imports from Israel and expanding markets for Palestinian exports.

14. At the economic policy level, the 1994 Protocol on Economic Relations between the Government of Israel and the Palestine Liberation Organization (Paris Protocol) leaves little space for Palestinian policymakers. Under the quasi-customs union between Israel and the PA, the latter has adopted the tariff structure of the more sophisticated Israeli economy, with minor exceptions; the PA applies the Israeli VAT rate with the option to increase or decrease it by 2 per cent on a limited number of goods; Israel collects tariffs and VAT on Palestinian imports on behalf of the PA; and the PA does not have the option to issue a national currency. Accordingly, the Palestinian policymaker does not have any instruments for monetary,

exchange rate and trade policies, or even the complete set of fiscal policy instruments. The PA retains only limited control over tax and budgetary management, since the largest part of public revenue is determined by Israeli rates that do not suit the war-torn structure of the Palestinian economy. Furthermore, such revenue is subject to clearance by the Israeli authorities. In a sense, the economic policy space available to the PA is reduced to a one-sided fiscal policy (expenditure allocation), which is less than the space available to local or regional governments in many countries.

15. This framework has imposed itself on PA fiscal operations. The PA continues to have a large public deficit and is incapable of financing capital expenditure, which represented a mere 2.5 per cent of total public expenditure in 2004. The public sector wage bill continues to be the largest expenditure item, consuming around 68 per cent of total 2004 expenditure. The PA budget deficit is estimated to have declined from 15.2 per cent of GDP to 8.6 per cent to reach \$345 million, about 80 per cent of which is financed by external budget support and the remaining 20 per cent through accumulation of arrears.

Table 2
Structural changes in the Palestinian economy: 1995–2004

Economic sector	Employment structure				Economic structure			
	% of total employment				% of GDP			
	1995	1999	2002	2004	1995	1999	2002	2004 <i>Est.</i>
Agriculture and fishing	12.7	12.6	14.9	15.9	11.9	11.0	10.7	12.4
Mining, manufacturing, electricity and water	18.0	15.5	12.9	12.7	21.3	16.1	16.5	15.7
Construction	19.2	22.1	10.9	11.7	9.2	11.8	2.5	3.3
Commerce, hotels & restaurants	19.6	17.0	21.1	19.9	18.2	14.5	14.6	15.2
Transportation, storage & communications	4.9	4.7	5.5	4.9	4.6	5.1	10.7	11.0
Services & others (including public admin.)	25.6	28.1	35.7	34.9	34.9	41.6	45.0	42.4
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Palestinian Central Bureau of Statistics (PCBS):

- Time Series for Quarterly National Accounts at Constant Prices (2000–2004), July 2004.
- Labour Force Survey (January–March 2005) Round (Q1/2005), 28/04/2005.

16. Disruptions of internal economic activities and external trade have led to loss of job opportunities for Palestinians within the occupied territory and in Israel. Unemployment rose from 21.7 per cent in 1999 to reach a peak of 41.2 per cent in 2002 and then declined to an average of 32.6 per cent in 2004, leaving more than 290,000 Palestinians jobless.¹⁴ Although unemployment rates reflect the bleak picture, employment figures reveal the resilience of the economy and the social cohesiveness of the Palestinian people that prevented a complete collapse in the face of devastating conditions. During 1999–2004, total employment increased from 588,000 to 607,000, while Palestinian employment in Israel dropped from 127,000 to 48,000. The domestic economy was able to absorb this shock and increase its employment by almost 100,000 jobs through employing an additional 20,000 workers on top of the 80,000 who no longer work in Israel. This is a clear positive adjustment to redistribute the reduced income available under the conditions of the last five years, at the cost, however, of a major reduction in labour productivity. It is therefore of paramount importance for the PA not only to target employment generation schemes to the sectors that are able to absorb the shock of the labour released from the Israeli market, but also to design appropriate programmes to increase productivity in these sectors.

17. These falls in income were accompanied by profound economic structural changes (see table 2). Both the manufacturing and construction sectors lost their importance as major sources of employment and income. These accounted for 12.7 per cent and 11.7 per cent of 2004 employment, respectively, as compared with 15.5 per cent and 22.1 per cent in 1999. In contrast, the agricultural and services sectors, and to a lesser extent commerce, became major sources of employment.¹⁵ Services, agriculture and commerce and hotels all registered increases in their contribution to GDP over the same period. As shown in a previous study by the secretariat, these changes are underscored by a shift in the industrial base towards low-productivity, low-pay activities.¹⁶ However, these three sectors functioned as the economy's shock absorber and managed to provide employment at the time of crisis. The challenge is to support these surviving sectors' capacity to generate jobs, while at the same time increasing their productivity and wages.

18. Notwithstanding the Advisory Opinion of the International Court of Justice of 9 July 2004 and UN General Assembly resolution A/RES/ES-10/15 of 20 July 2004, Israel proceeded with the construction of the Separation Barrier, after making certain adjustments. In addition to the Barrier, Israeli settlements continue to expand on Palestinian land in the West Bank, including Jerusalem, a process fully documented elsewhere in United Nations reports and resolutions. Of concern here is the direct economic impact of the Barrier and settlements and the further contraction they cause to an already fragmented and vulnerable Palestinian production base and resources, especially land and water. The Barrier's final route has created a zone between the 1949 United Nations Armistice line and the Barrier itself, which covers an estimated 578 sq. km, representing around 10 per cent of the West Bank, including Jerusalem. According to the most recent information available, when completed, the Barrier will be 670 kilometres in length, of which only 20 per cent will run along the 1949 borders.¹⁷ Its effective length will be twice the length of the 1949 contours of the West Bank, since a major part intrudes into the West Bank to a depth of 22 kilometres in some areas.

19. The United Nations estimates that about 50,000 Palestinians living in 38 villages and towns will be confined behind the Barrier, of whom 10 per cent will live in "closed areas" or "enclaves". The rest will live in "semi-enclaves", surrounded by the Barrier and connected to the rest of the West Bank by only one route, or in "closed areas", between the barrier and the 1949 Armistice Line. Palestinians living outside the enclaves and closed areas as well as those living outside the Barrier should apply for permits to reach their jobs and farms, while those living in closed areas should obtain special permits to maintain their residence rights.¹⁸ By February 2004, the construction of the Barrier had already entailed the confiscation of around 270 sq. km of Palestinian land, including the most fertile areas in the West Bank, and 49 wells. Palestinian households living behind the Barrier have depleted their coping strategies. Moreover, 551 enterprises and 85 residential units had been destroyed or rendered inaccessible by the end of March 2004.¹⁹

20. The continued confiscation of Palestinian lands by Israel has substantially undermined the agricultural sector's absorptive capacity. Owing to the construction of the Barrier, the West Bank has lost some of its most fertile areas, with agricultural lands accounting for 86 per cent of the confiscated 270 sq. km by July 2004. The situation in the Gaza Strip was no better, with over 15 per cent of Gaza's 172 sq. km agricultural land levelled by Israeli military action, in addition to substantial losses of water resources.²⁰ By mid-2004, the total amount agricultural land losses in both the West Bank and Gaza was around 260 sq. km, representing at least 14.5 per cent of the total cultivated land in 2003.²¹

21. The previous analysis highlights the multiple challenges facing Palestinian development efforts. Recovery and reconstruction have to proceed under adverse conditions of conflict, economic attrition, mobility restrictions and lack of sovereignty, against a background of a war-torn economy distorted by years of occupation and dependence on a much stronger economy. Further complicating the task ahead is the very limited policy space available to the PA to manage the economy and the increasing need for donor support. The following section proposes some elements of a pro-poor development policy framework to help guide the PA in forming a viable economy for a viable State.

B. Palestinian reform, trade policy and development prospects

22. The above examination further illustrates UNCTAD's assessment since 2001 of the occupied territory as a war-torn economy experiencing a complex humanitarian emergency, where vulnerability is intensified by the depletion of supply capacity, thus setting in motion a cycle of de-development.²² While humanitarian assistance remains critical for cushioning the adverse environment, it risks setting limits on the economy's future development prospects through reinforcing dependence on Israel and creating long-term reliance on foreign aid. These concerns were explicitly recognized by the PA in its Medium Term Development Plan (MTDP) of 2005,²³ which reflects a growing consensus among Palestinian policymakers on the pressing need for renewed development efforts.

23. The crisis has also generated growing attention to the need to reform public institutions and to reconsider the existing trade regime. However, much of the "conventional wisdom" on Palestinian reform, especially in the area of trade, development and poverty reduction, implies or insists on rapid liberalization and integration into the world market. Often, economic policy prescriptions by Palestinian and international sources have followed standardized solutions that address a textbook reality,²⁴ as if the economy of the West Bank and Gaza were a normal developing economy that suffers from mere government intervention and market distortion. Trade liberalization is emphasized as an engine of growth, where a WTO-compatible trade regime is considered to be *the* paramount element in enhancing the economy's export capacity and competitiveness. However, it should be recognized that the Palestinian economy suffers from distortions created by decades of occupation, years of destruction and a path of unbalanced development that mainly supplies cheap manpower and low-value-added processes to the economy of the occupying power. These distortions have to be addressed first for any trade regime to have an impact.

1. The PA reform agenda

24. The PA has perceived since 2000 the need to strengthen and improve the performance of public institutions as a key element in achieving sustainable development. It has launched a number of reform agendas since then: the Economic Policy Framework (2000); the 100-Day Plan of the Palestinian Government (June 2002); the One-Year Reform Action Plan (September 2004); and the 100-day Work Plan of the most recent PA Cabinet (March 2005). The announced aims of these initiatives were to establish participatory, consensus-oriented, accountable and transparent policy-making processes; improve efficiency and effectiveness at the implementation level; and ensure responsiveness to the economy's development interests. Despite the fact that these goals are laudable, many observers contend that not enough has been done to translate them into visible and durable policy measures, except in the sector of

public finances. While the PA did initiate sustained efforts in these and other areas that were geared to State-formation goals, its current policy is based on the premise that it must reform and renew public institutions and policies intended for a transitional, self-government phase and achieve "good governance" *before* the State of Palestine can enter the community of nations.²⁵

25. A number of independent Palestinian reform decisions and efforts have been under way for many years now, and have translated into concrete projects. Four projects that the PA requested from just one of many agencies (UNCTAD) are clear examples of an emerging Palestinian governance vision: (i) *the Integrated Framework for Palestinian Macroeconomic, Trade and Labour Policy*; (ii) *the Automated System for Customs Data Analysis (ASYCUDA++)*; (iii) *Debt Monitoring and Financial Analysis (DMFAS)*; and (iv) *Establishment of the Palestinian Shippers Council*.²⁶ Furthermore, the PA is implementing these and other economic and social policy initiatives and projects as interrelated components of its MTDP, which calls for linking short-term relief and reconstruction efforts to long-term development objectives; enhancing the PA's capacity in the area of aid management; guiding donor interventions; and building public sector capacity in the area of economic policy.

26. Successful pursuit of a Palestinian "reform-for-statehood agenda" remains a key challenge. One of the first steps in this regard is to establish a wide participatory approach to design, follow and monitor the implementation of a development vision and strategy to meet the aspirations of the Palestinian people, reduce dependence on Israel, prepare Palestinian enterprises for assuming their role in the economic revival process, and most importantly, to guide the priorities of reform and State formation. The PA needs to continue along the steps of State formation around the priorities associated with Palestinian development objectives, including improved governance. Furthermore, the PA needs to expand and deepen its public-private sector partnership by involving grassroots representatives of civil society in order to ensure proper targeting of the poor. Most critically, the PA needs to focus on advancing a Palestinian-designed-owned vision appropriate for *forming* the institutions of national governance instead of only *reforming* those of transitional self-government. Since the right of the Palestinian people to independence and statehood is no longer disputed, and its imminence cannot be much longer denied, it seems incumbent on economic policymakers to now plan accordingly.

2. Poverty, trade and development prospects

27. While the importance of export promotion is acknowledged, it might be premature to overemphasize it as *the* top priority at this stage of the Palestinian economy's development. Rather, the focus of policy should be on reducing poverty, while nurturing productive capacity, eliminating occupation-related distortions and laying the ground for the economy's sustained recovery. The question should then be what are the policies required for reducing poverty and how trade can play a supportive role therein.

28. An exclusive focus on trade liberalization, which assumes that poverty can be reduced through the trickle-down effects of trade integration, could be counterproductive because enterprises are too weak to compete in global markets or Israeli markets. Furthermore, as

UNCTAD's reports on the least developed countries have shown, the relationships between trade openness, trade integration, growth and poverty reduction are far from mechanical or linear; it is not the case that liberalization always reduces poverty.²⁷

29. Moreover, trade policy is but one element of trade development that also depends on fiscal, monetary, exchange rate and industrial policies (most of which are not available to the PA), and an enabling environment to ensure a positive response to incentives. Particularly important in this regard are non-trade policies, which promote the development of productive capabilities through capital investment, skills acquisition, organization change and technological modernization. At the same time, reducing poverty requires going beyond the necessary but not sufficient condition of accelerating economic growth. Empirical evidence shows that there is no invariant relationship between the rate of growth and the rate of poverty reduction, and that even in a context of faster growth, complementary policies specifically targeting poverty are required.²⁸

30. This means that to facilitate a powerful role for trade in reducing poverty, Palestinian efforts should be rooted in *a development-driven approach to trade rather than a trade-driven approach to development*. In the short term, links between trade expansion and poverty reduction work through prices, returns to factors of production, availability of public goods and food security. In the long run, trade's positive influence comes through the utilization and upgrading of productive capacities, innovation and accumulation of physical, human and organizational capital. It is these processes that should form the focus of the Palestinian development approach to trade policy. Furthermore, comparative experience shows that the more diversified an economy's structure, the greater the role of trade in achieving growth and in reducing poverty. In other words, trade can best serve as a vehicle for poverty alleviation when the economy matures.²⁹ The implication for Palestine is to restructure the economy, but within the context of a sector-focused strategy that seeks to strike a balance between immediate and long-term objectives through linking relief and reconstruction to development efforts. As indicated in previous reports, this requires setting sectoral priorities to achieve time-bound, quantitative development objectives, and supporting sectors that meet certain criteria for survival and show greater potential for job creation to reduce poverty.³⁰

31. The PA could build on the experience of the East Asian and other countries that have succeeded in achieving rapid economic growth against a background of economic and political crisis or conflict. Such countries adopted development strategies that promoted specific sectors within a given period, while aiming at higher growth and restructuring. The goal of policy intervention was to establish a "rent creation plus discipline" that would marshal the most efficient elements of the corporate sector to serve long-term development objectives.³¹ Other elements of a pro-poor trade policy include creating dynamic synergies between trade and industrial policy, a gradual and sequenced approach towards economic liberalization and a two-track trade strategy with competitive export-oriented industries operating on laissez-faire principles, functioning side by side with protected infant or strategic industries.³² Such an approach does not contradict multilateral trading system rules, which provide ample scope for industrial policy. In this regard, Palestinian international trade

policy should stress the special and differential treatment intended for LDCs. This could be a useful starting point and provide the context for policymaking and trade negotiations. Much depends on Palestine's ability to use existing windows of opportunity built into WTO principles and rules. These opportunities also include some specific export subsidies, non-actionable subsidies and certain tariff increases.³³

32. Within this broad policy framework, the approach to trade development needs to be reconciled with the MTDP, which calls for linking relief to development, emphasizes poverty reduction as the overarching goal, advances employment generation as “the vehicle par excellence” for reducing poverty and supports the promotion of sectors with strong backward and forward linkages. Accordingly, as PA economic policymakers review different trade policy options, this can be most usefully done in the context of a nationally conducted consensus-building exercise, which identifies clear reform development priorities, and sectoral goals consistent with current realities and strategic needs to integrate into the rules-based multilateral trading system. The PA will need to draw up its own economic policy road map to statehood to ensure cohesion between immediate and strategic objectives, sectoral and economy-wide targets, and national and global processes.

Chapter II

UNCTAD'S ASSISTANCE TO THE PALESTINIAN PEOPLE

A. Framework, objectives and resource mobilization

33. In accordance with the provisions of the United Nations Medium-Term Plan for 2002–2005, UNCTAD has continued to provide assistance to the Palestinian people, in close consultation with Palestine. Emanating from research and policy analysis, the secretariat's technical cooperation programme, now in its tenth year, is coordinated by the Assistance to the Palestinian People Unit (APPU) and provides concrete support with a view to building capacities for effective economic policymaking and management and strengthening the enabling environment for the private sector. Technical cooperation focuses on four clusters: (i) development strategies and trade policy; (ii) trade facilitation and logistics; (iii) public finance modernization and reform; and (iv) enterprise, investment and competition policy. UNCTAD's assistance to the Palestinian people seeks to respond to the PA's goal of building the institutional capacity and infrastructure required for a viable, market-based economy, in the context of a strategic framework linking relief to development.

34. UNCTAD devotes a significant portion of regular budget resources allocated to this area in support of technical cooperation, as mandated in the United Nations Medium-Term Plan. These resources effectively serve as the core of an inter-divisional programme of technical assistance activities that relies mainly upon extrabudgetary resources, provided by bilateral, multilateral and United Nations system funding agencies. The catalytic and support role of APPU, combined with the technical expertise of other Divisions, act together to ensure that the Palestinian people receive the best possible assistance that can be offered by an international organization such as UNCTAD.

35. As noted in secretariat reports in recent years, the impact of occupation, and hence the uncertainty and humanitarian crisis in this area, directly affect the implementation of this programme. It has also been stressed that additional improvement of effectiveness requires mobilization of more predictable extrabudgetary resources to further enhance the selective and flexible mode of operation which UNCTAD has applied to circumvent insecure field conditions and to sustain progress. Such resources will also be required in order to pursue technical assistance according to the mandates conferred upon the secretariat and in a manner that promotes dynamic synergies between relief, rehabilitation and strategic development needs.

36. While progress may be noted in resource mobilization and project implementation since 2004, UNCTAD continues to operate under tight constraints, which adversely affect its ability to implement the Bangkok and São Paulo mandates as expected. The prevailing conditions on the ground and Israeli restrictions on mobility and field access of UNCTAD staff members, project personnel and consultants continue to limit the scope and pace of technical assistance activities. Nonetheless, UNCTAD implemented externally funded technical cooperation activities in 2004–2005 and has secured new resources for some others.

The progress in this respect attests to the growing relevance and credibility of UNCTAD assistance to the Palestinian people.

37. In the eight-year period from 1997 to 2004, a total of \$3,055,000 of extrabudgetary resources was pledged to UNCTAD technical activities, of which \$2,620,000 had been disbursed by mid-2005. Most of these resources were provided to UNCTAD projects in the 2001–2004 period: \$2,395,000, of which 83 per cent had been disbursed by mid-2005, a satisfactory high rate considering the war-torn conditions of the economy and reduced absorptive capacity of Palestinian institutions. Of no less significance is that by the end of 2005, the secretariat expects to have concluded three new agreements with donors for project implementation in 2005–2007 totalling over \$3 million. An additional \$1 million is required for three other projects that are still unfunded and will be the subject of consultations with the PA and prospective donors to enable implementation in 2006–2007.

38. While the increased availability of project-dedicated extrabudgetary resources is a welcome development, the continued inadequate resource availability for central support functions for APPU threatens smooth implementation and satisfactory results. The secretariat has only been able to maintain in 2004–2005 on a temporary, irregular basis the core professional staff resources that have enabled it to respond effectively to its mandate to provide intensified assistance to the Palestinian people. By mid-2005, no further regular budget resources could be temporarily allocated to retain the third professional staff member attached to APPU since 2000, nor are there extrabudgetary resources available to satisfy the requirement of "adequate resources" referred to in paragraph 35 of the São Paulo Consensus. Although the secretariat addressed itself to a large number of donor and other concerned members of UNCTAD in November 2004 regarding these requirements, no positive responses were forthcoming. Further achievements by the secretariat in this area of work will certainly be impaired unless this pending problem is resolved rapidly.

B. Operational activities under way and new projects in 2005

1. Development strategies and trade policy

39. *Integrated framework for Palestinian macroeconomic, trade and labour policy.* This project will provide the PA with the analytical tools and build capacity to assess the economic impact and developmental outcome of alternative policy options. The project is being implemented by UNCTAD, the International Labour Office (ILO) and the Palestine Economic Policy Research Institute (MAS) for the benefit of six PA ministries. With regular budget resources from UNCTAD and ILO and extrabudgetary contributions from international research foundations, the first phase of the project will be completed in mid-2005, including an operational econometric simulation framework, policy analysis papers and capacity building in this area for staff of several PA ministries.

40. *Preparations for observer status for Palestine at the World Trade Organization (WTO).* At the request of the PA, UNDP called upon UNCTAD to participate in the design and implementation of a technical assistance project to support Palestinian capacity to address the

economic crisis, elaborate appropriate strategies to integrate the Palestinian economy with regional and international markets and prepare for Palestine's eventual accession to the WTO. Main outputs would include a core Palestinian expert team trained in substantive issues involved in economic development, trade policymaking and trade negotiations, and the sectoral and intersectoral investigations of the implications of WTO compliance; and a national consensus position and participatory, transparent processes initiated on these matters. While UNDP is seeking the necessary resources for this project, consultations continue with the PA on its scope and design.

2. Trade facilitation and logistics

41. *Establishment of the Palestinian Shippers Council (PSC)*. In response to a PA request in 2004, the UNCTAD secretariat will soon conclude a contract with a multilateral donor for a technical assistance project to establish the PSC to defend and promote the interests of Palestinian shippers (enterprises that are end-users of international and local transport). The project will build the capacity of the PSC secretariat, its members and the shipper community in the area of trade facilitation, in particular as regards shipping rates and transport conditions, customs broker and warehouse operations, port and border crossing regulations and conditions, as well as customs tariff duties and regulations. The PSC will be launched and hosted at the outset by the Palestinian private-sector trade promotion organization *Paltrade* until it is established as an autonomous self-sufficient entity.

42. *Capacity building for port management and institutional development, and border cargo management and export possibilities under a reformed border regime*. In 2000, an UNCTAD secretariat expert mission to the PA proposed follow-up technical assistance to prepare the Sea Port Authority (SpA) for the eventual operation of Gaza Port. While subsequent events brought the project to a halt, UNCTAD proposals will again be relevant once the political prospects for a resumption of the project are clearer. Meanwhile, in order to rapidly prepare for Israeli disengagement in the occupied territory, a World Bank review has recently highlighted the range of facilitation measures, including customs, seaport and transit arrangements that would be required for ensuring concomitant economic revival focused on enhancing export capacity.³⁴ UNCTAD has been consulting closely with the World Bank in this regard in order to ensure that the secretariat's experience and technical capacities in these areas are drawn upon in the context of this international effort.

3. Public finance reform and modernization

43. The UNCTAD secretariat and the PA Ministry of Finance (MoF) resumed in 2005 implementation of the project *Capacities in debt monitoring and financial analysis (DMFAS)*. The second phase of this project, implemented with the MoF since 2001, will be pursued over the period 2004–2005, with bilateral funding already available for project activities. An UNCTAD staff mission in May 2005 made several training, software update and organizational and other recommendations, which are under review by the Ministry.

44. *Customs modernization and automation*. In this most successful experience in UNCTAD's technical cooperation with Palestine, new resources mobilized in 2003 have

permitted the completion of the *ASYCUDA Phase II* project for the PA General Directorate for Customs and Excise. This entailed installation of the prototype system in Customs headquarters and at three pilot PA Customs sites. Implementation outpaced programmed objectives and the ASYCUDA team at PA Customs has become a central component of the PA readiness to assume sovereign responsibilities in Gaza and elsewhere in the occupied Palestinian territories over the coming period. The ability to fully exploit the ASYCUDA++ system to its potential remains dependent on funding to implement the final phase of the project, which involves the system's roll-out and update to *ASYCUDAWorld* in 2006–2007. Consultations with Palestine and a likely donor for Phase III are expected to be concluded by September 2005.

4. Enterprise, investment and competition policy

45. *Support for small and medium-size enterprise (SME) development (Empretec)*. Thanks to the support of the Palestinian Fund for Employment and Social Protection (FFESP), UNCTAD resumed training activities in 2005 in support of the Palestinian enterprise sector, which had been suspended for over a year owing to funding shortfalls. Local counterparts include the PFESP and the Palestinian Federation of Industries (PFI). However, funding is available only until the end of 2005 and new funds are urgently required in order to complete the programme beyond then. A sustainable vision for completing this programme in the West Bank, extending it to Gaza and ensuring full national ownership by 2006 implies significant resource needs; serious donor attention to this project is urgently required.

46. UNCTAD began work in 2004 on a new technical assistance project to assist the Palestinian Investment Promotion Agency (PIPA) in implementing an *Investment Retention Programme*, aimed at providing investment support services to existing enterprises in coping with and surviving the present crisis. The project has completed a survey and a qualitative assessment of Palestinian investors, and efforts are now focused on design of a strategy and creation of a core expert team within PIPA for implementing the programme. Funds are sought for implementing Phase II, which will entail designing sector-based investment promotion programmes in cooperation with PIPA over a period of 18 months.

C. Coordination and harmonization

47. In the design and implementation of its work programme, the secretariat has maintained close contacts with relevant international organizations, especially the United Nations Relief and Works Agency for Palestine Refugees (UNRWA), the United Nations Economic and Social Commission for Western Asia (ESCWA), the Office of the United Nations Special Coordinator for the Occupied Territories (UNSCO) and the International Labour Office (ILO), as well as with international and Palestinian research centres and civil society institutions. As noted above, its work in trade facilitation and public finance reform has attracted the keen interest and growing cooperation of both the World Bank and the IMF. The secretariat has also sought to draw the attention of bilateral, multilateral and regional donors to its resource needs through written communications, missions to capitals and a range of other modalities.

48. UNCTAD technical assistance to the Palestinian people in 2004–2005 benefited from continued extrabudgetary support from Norway, the European Union, the International Development Research Centre (Canada) and the ILO. Meanwhile, the United Nations Development Programme (UNDP) has continued to extend indispensable logistical and liaison field support to UNCTAD. The secretariat is grateful for the foresight, and the support to UNCTAD assistance to the Palestinian people, demonstrated by these and other donors in the past.

Notes

¹ Adopted by the Security Council (SC) at its 4489th meeting, on 12 March 2002. In accordance with the relevant General Assembly resolutions and decisions, use of the term "Palestine" in this report refers to the Palestine Liberation Organization, which established the Palestinian Authority (PA) following the 1993–1994 accords with Israel. References to the "State of Palestine" are consistent with the vision expressed in the said SC resolution and the "Road Map".

² Details of the Israeli closure policy imposed in the occupied Palestinian territory are presented and discussed in United Nations Office for the Coordination of Humanitarian Affairs (OCHA) (February 2005), "Preliminary analysis: The humanitarian implications of the February 2005 projected West Bank Barrier route" (www.ochaopt.org); and World Bank (October 2004), "Four years – Intifada, closure and Palestinian economic crisis: An assessment". Also see the Palestinian Central Bureau of Statistics (PCBS; www.pcbs.gov.ps) (2003–2004), "Impact of Israeli measures on the economic conditions of Palestinian households (11th round – October–December 2004)".

³ PCBS has recently revised upwards the GDP figures for 2002 and 2003.

⁴ Excluding the economy of occupied East Jerusalem.

⁵ Average exchange rate of the NIS was 4.086 and 4.49 to the dollar in 2000 and 2004, respectively.

⁶ PCBS (February 2005), "Impact of the Israeli measures on the economic conditions of Palestinian households", 11th Round: October–December 2004, Press Release, Ramallah.

⁷ PCBS (December 2004), "Brief statistical indicators of social, economic and geographic conditions in the Palestinian territory by the end of 2004" (in Arabic).

⁸ PCBS (February 2005), "Impact of the Israeli measures on the economic ...", Press Release, Ramallah.

⁹ In addition to the direct destruction, it is assumed that the depreciation rate increased from the historical average of 5 per cent to 8 per cent to reflect the overuse and lack of maintenance. This follows the World Bank depreciation assumption for an estimated capital stock of \$11.21 billion in 1998; World Bank (May 2003), "Twenty-seven months – Intifada, closures and Palestinian economic crisis: An assessment", p. 19.

¹⁰ Israeli Information Center for Human Rights in the Occupied Territories (B'Tselem): www.btselem.org.

¹¹ Following the data revisions by PCBS, some of the figures (especially for 2002–2003) analysed in this report are different from those reported in UNCTAD (2004), "Report on UNCTAD's assistance to the Palestinian people", prepared by the UNCTAD secretariat for the Trade and Development Board, fifty-first session, Geneva, TD/B/51/2, 4–15 October.

¹² PCBS (December 2004), "Press Release for the Palestinian National Account 2003", December 2004; and PCBS (July 2004) "Time Series for Quarterly National Accounts at Constant Prices (2000–2004)".

¹³ International Monetary Fund (IMF) (December 2004), "Macroeconomic and Fiscal Developments, Outlook, and Reform in the West Bank and Gaza", presented at the Ad-Hoc Liaison Committee (AHLIC) Meeting, Oslo, <http://www.imf.org/external/np/dm/2004/120804.htm>.

¹⁴ PCBS (April 2005), "Labor force survey: January–March 2005", Press release. Ramallah.

¹⁵ Ibid.

¹⁶ UNCTAD (2004), "Palestinian small and medium-sized enterprises: Dynamics and contribution to development". New York and Geneva: United Nations.

¹⁷ OCHA (February 2005), "Preliminary analysis: The humanitarian implications of the February 2005 ...".

¹⁸ United Nations Office for the Coordination of Humanitarian Affairs (OCHA) and the United Nations Relief and Works Agency for Palestine Refugees (UNRWA) (1 September 2004), "The Humanitarian Impact of the West Bank Barrier on Palestinian Communities". The occupied Palestinian territory: OCHA.

¹⁹ PCBS (July 2004), "Survey on the impact of the expansion and annexation wall on the Palestinian localities that the wall passed through: March 2004". Ramallah.

²⁰ The Palestinian Center for Human Rights (PCHR) (April 2004), "Uprooting Palestinian trees and levelling of agricultural land: 1 April 2003–30 April 2004".

²¹ Total cultivated land in the West Bank and Gaza in 2003 is 1,815,019 dunum (1,815 sq km), about 89.5 per cent of which is the West Bank: PCBS; www.pcbs.gov.ps/agricul/tab_01.aspx.

²² See UNCTAD, "Report on UNCTAD's assistance to the Palestinian people", prepared by the UNCTAD secretariat for the Trade and Development Board, forty-ninth session, 7–18 October 2002; fiftieth session, etc.

²³ Palestinian National Authority, Ministry of Planning (February 2005), "Medium Term Development Plan: 2005–2007", draft.

²⁴ London School of Economics (LSE) (November 2004), "Presentation of the results of the Economic Policy Programme: Towards an economically viable Palestinian State - executive summaries", London; World Bank (July 2002), "Long-term Policy Options for the Palestinian Economy". Jerusalem, West Bank and Gaza Office.

Some of the PA policy documents have echoed the same line of thought; see PA Ministry of Economy, Industry and Trade (2003), "Creating an economically viable Palestinian State: Strategy for Palestinian compatibility with the multi-lateral trading system"; PA Ministry of National Economy (MNE) (January 2004), "Institutional framework - Palestinian national strategy for economic development: Creating economically viable state of Palestine"; and PA MNE (November 2004), "Export economic recovery through export development".

²⁵ For further discussion see Khan, M.H., Giacaman, G. and Amudsen, I. (eds., 2004), *State Formation in Palestine: Viability and Governance during a Social Transformation*, London: Routledge.

²⁶ A brief description of these projects is in chapter II of this document.

²⁷ Wade, R. (2004), "Is globalization reducing poverty and inequality?", *World Development*, vol. 32, no. 4., pp. 567–589. Also see Dollar, D. and Kraay, A. (2001) "Trade, growth and poverty", World Bank Policy Research Department, Working Paper No. 2615, Washington DC.

²⁸ See for example, Osmani, S.R. (March 2004), "The employment nexus between growth and poverty: An Asian perspective", report prepared for the Swedish International Development Agency (SIDA) and the United Nations Development Programme (UNDP), UK, University of Ulster.

²⁹ UNCTAD (2004), "The Least Developed Countries Report...", chapter 2.

³⁰ For discussion on the linking of relief and reconstruction to development and sectoral criteria, see "Report on UNCTAD's assistance to the Palestinian people", TD/B/51/2, 11 August 2004.

³¹ Akyüz, Y., Chang, H. and Kozul-Wright, R. (1999), "New perspectives on East Asian Development" in Akyüz, Y. (ed.) *East Asian Development: New Perspectives*. London: Frank Cass Publications.

³² UNCTAD, Trade and Development Report (1996 and 1997); and Lall, S. (October 2003), "Reinventing industrial strategy: The role of government policy in building industrial competitiveness", Working Paper No. 111, Oxford: Queen Elizabeth House.

³³ Akyüz, Y. (ed.) (1999), *East Asian Development: New Perspectives*. London: Frank Cass Publications.

³⁴ World Bank (June and December 2004), "Disengagement, the Palestinian economy and the settlements", and Technical Papers.