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Report on UNCTAD assistance to the Palestinian people: Developments in the economy of the occupied Palestinian territory[1]

Note by the UNCTAD secretariat[2]

Executive summary

The economy of the occupied Palestinian territory (oPt) continued to perform well below potential in 2009. There were signs of improvement in GDP growth and other indicators, but these need to be interpreted cautiously in view of the wider context. Territorial fragmentation, inequalities and welfare divergence continued to grow, aid dependence deepened, and access to natural and economic resources shrank. Private investment continued to be hampered by mobility restrictions and the risk of introducing new restrictions at any moment. While the direct damage incurred by the 2008–2009 Israeli military operation in Gaza is estimated at one third of the economy's output in 2006, before Gaza's blockade, the indirect cost of the war has been greater. The economic and humanitarian situation in Gaza continued to worsen. Despite funds allocated for economic reconstruction, the blockade and closures imposed on the oPt ensures that these funds do not have a tangible economic impact. At the heart of the Palestinian economic development bottleneck is a weakened tradable goods sector suffocated by the use of inappropriate currency, closure, and atrophy of the productive base. Palestinian development stands to benefit by resuscitating the tradable goods sector and building the Palestinian trade and productive capacity within the framework of the United Nations "delivering as one".

[1] The designations employed and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delimitation of its frontiers or boundaries. In accordance with the relevant resolutions and decisions of the United Nations General Assembly and Security Council, references in this report to the occupied Palestinian territory (or territories) pertain to the Gaza Strip and the West Bank, including East Jerusalem. Use of the term "Palestine" refers to the Palestine Liberation Organization (PLO), which established the Palestinian Authority following its 1993/94 accords with Israel. References to the "State of Palestine" are consistent with the vision expressed in Security Council resolution 1397 (2002).

[2] The information in this document should not be quoted by the press before 31 August 2010.

I. Repressed economy

A. Economic performance well below potential

1. The economy of the occupied Palestinian territory (oPt) continued to perform well below potential in 2009, per capita gross domestic product (GDP) remains more than 30 per cent lower than its level 10 years ago, and the long-term prospects for establishing a viable, contiguous Palestinian State appear bleak in light of the diminishing access to natural and economic resources as well as the separation and fragmentation of the Gaza Strip, West Bank and East Jerusalem. The estimated 6.8 per cent GDP growth – 1 per cent in Gaza and 8.5 per cent in the West Bank – and the smaller improvement in the West Bank per capita income should be cautiously viewed in the context of the low base of 2008 GDP, the continuing isolation of the Palestinian economy from regional and global markets, the 34 per cent decline in per capita GDP during the preceding eight years, eroded productive base, and shrinking access to land, and natural and economic resources.

2. With Gaza under an almost complete blockade, growth in the West Bank was driven mainly by unprecedented aid inflows. However, the restrictions on the movement of Palestinian goods and labour, and the destruction of much of the productive base, substantially reduced the economic benefits of this massive aid and limited it to the short term. The stifling of Palestinian productive activities implies that the potential multiplier and second round effects of the large aid and government expenditure could not materialize, especially with resources leaking into the Israeli economy as reflected by the fact that the $2.9 billion trade deficit with Israel was more than 80 per cent of net current transfers in 2008.

3. The performance of the economy also reflects a very modest relaxation in the Israeli mobility restrictions within/to/from the West Bank. However, not only does the relative improvement largely exclude Gaza and most parts of the West Bank, it remains reversible. The well-below-potential growth in 2009 should be combined with concerns over its sustainability, deepening aid dependence, diminishing access to natural and economic resources and worsening regional welfare divergence and fragmentation of the West Bank, Gaza and East Jerusalem.

B. No signs of private sector resurgence

4. Another sobering peculiarity of the growth of the West Bank local economy in 2009 is that it was driven largely by the aid-dependent public sector, with no signs of private sector recovery in the horizon. The revival of the private sector is unlikely to occur unless mobility restrictions on labour and goods are lifted and productive base rebuilt. It is crucial to note that the confidence of existing and potential Palestinian and foreign investors is not hampered only by the actual restrictions on access and movement in place, but also by the unpredictability of closure policies and the risk of introducing new restrictions unexpectedly. Therefore, sustained private sector revival requires not only secure access to internal and external markets, but also elimination of the risk of reintroducing restrictions.

5. The prohibitive transaction costs resulting from restrictions on Palestinian access to domestic and global markets, combined with settlement activities and confiscation of lands, has been undermining the viability of businesses and forces many investment activities away from agriculture and manufacturing in favour of the non-tradable goods sector. As shown in chapter III, the ensuing structural deformation entrenches dependence on foreign aid and remittances as the main sources of foreign exchange and pre-empts the gains that other countries achieve from participation in global trade.

C. High and widespread unemployment and poverty

6. As shown in table 1, unemployment has declined by 1.6 per cent. However, it is still higher than the 30 per cent mark and more than 9 percentage points above the 1999 level. The situation is worse in Gaza, where unemployment was 14 per cent above the national average.

7. Therefore, the latest Palestinian jobless growth episode cannot lead to significant reduction in poverty as it has so far had little impact on employment, a key channel through which economic growth reduces poverty. Recent poverty estimates indicate that 80 per cent of Gaza's households lived below the poverty line in 2007, with the situation worsening ever since (World Bank, 2010). In the West Bank, the poverty rate is estimated at 45 per cent. Food insecurity also remains widespread. With a drop of more than 60 per cent in agricultural output over the last 10 years and the depletion of households' coping strategies, food insecurity currently affects 61 per cent of the population in Gaza and 25 per cent in the West Bank (FAO–WFP, 2009).

D. Fiscal sustainability remains elusive

8. The Palestinian Authority (PA) deficit on cash basis has improved from 31 per cent of GDP ($1.9 billion) in 2008 to 27 per cent ($1.8 billion) in 2009. However, the recurrent deficit on commitment basis has actually deteriorated by about 2.6 per cent of GDP. The latter increased from $1.3 billion in 2008 to $1.6 in 2009 as result of an increase in emergency spending to cover expenditures related to the 2008–2009 Israeli military campaign in Gaza, and the resulting deterioration of the economic and humanitarian situation. As shown in table 1, recurrent expenditure increased by 1.1 per cent to account for 48.3 per cent of GDP. The rise in non-wage expenditure, spending on Gaza and a shortfall in donors' support forced the PA to resort to short-term borrowing from domestic banks and accumulate arrears, which will burden future budgets.

9. The attack on Gaza and continuation of the siege led to serious decline in tax and customs revenues. In 2009, total revenue declined by 1.5 per cent to 24.2 per cent of GDP. Budget and aid resources were also drained by the need to respond to the deteriorating health and humanitarian situation. PA spending in Gaza in 2009, at more than $1.4 billion, was higher than the entire budget support it received from donors at a time when tax revenue from Gaza dried up. Gaza is expected to consume half of the $3.9 billion budget expenditure planned for 2010 (UNSCO, 2010).

10. The Separation Barrier, expansion of settlements in the West Bank and evictions of Palestinians in East Jerusalem have laid additional claims on PA institutional and budgetary resources. The PA has announced the allocation of some $63 million to support villages and communities affected by the construction of settlements and the Separation Barrier to help them cope with the disruption to their livelihood and productive activities (PA, 2010).

Table 1
Economy of the occupied Palestinian territory: key indicators[a]

	1995	*1999*	*2002*	*2004*	*2006[rev.]*	*2007[rev.]*	*2008[prl.]*	*2009[est.]*
Macroeconomic performance								
Real GDP growth (%)	6.0	8.8	-13.3	12.0	-5.2	5.4	5.9	*6.8*
GDP ($ mil.)	3,220	4,179	3,433	4,198	4,594	5,147	6,108	*6,600*
Gross national income (GNI) ($ mil.)	3,699	4,932	3,656	4,430	5,286	5,913	7,019	*7,326*
Gross national disp. income (GNDI) ($ mil.)	4,099	5,306	4,708	5,151	6,777	8,281	10,437	10,527
GDP per capita ($)	1,400	1,493	1,125	1,317	1,363	1,337	1,698	*1,782*
GNI per capita ($)	1,608	1,763	1,199	1,390	1,489	1,494	1,952	*1,978*
Real GNI per capita growth (%)	0.7	4.1	-16.7	9.1	-5.9	2.0	2.9	*0.2*
Population and labour								
Population (mil.)a	2.34	2.96	3.23	3.41	3.61	3.72	3.83	*3.94*
Unemployment (%)b	32.6	21.7	41.3	32.5	29.6	27.9	31.7	*30.1*
Total employment (thousands)	417	588	477	578	665	667	648	*717*
In public sector	51	103	125	131	152	146	160	*181*
In Israel and settlements	68	135	49	50	64	63	75	*73*
Fiscal balance (% of GDP)								
Revenue net of arrears/clearance withheld	13.2	23.9	8.5	25.0	25.0	24.7	25.7	*24.2*
Current expenditure	15.3	22.6	29.0	36.4	49.6	48.6	47.2	*48.3*
Total expenditure	25.6	29.9	35.4	37.1	55.3	50.5	56.8	*51.0*
Overall balance – cash basis	-12.3	-6.1	-27.0	-12.1	-30.3	-25.8	-31.2	*-26.8*
External trade								
Net current transfers ($ mil.)	400	399	1,096	734	1,491	2,368	3,418	3,201
Exports of goods and services ($ mil.)	499	1,039	522	644	533	535	599	*620*
Imports of goods and services ($ mil.)	2,176	3,567	2,876	3,479	3,478	3,541	4,105	*4,541*
Trade balance (% of GDP)	-52.1	-60.5	-68.6	-67.5	-64.1	-58.4	-57.4	*-59.4*
Trade balance with Israel ($ mil.)	-922	-1,598	-886	-1,500	-1,887	-2,259	-2,888	*-2,558*
Trade balance with Israel (% of GDP)	-28.6	-38.2	-25.8	-35.7	-41.1	-43.9	-47.3	*-38.8*
PA trade with Israel/total PA trade (%)[c]	92.3	62.6	48.9	60.6	72.0	91.7	95.7	*76.3*
PA trade with Israel/total Israeli trade (%)[c]	4.3	3.9	2.1	2.4	2.4	2.7	2.9	*3.1*

Sources: Palestinian Central Bureau of Statistics (PCBS), World Bank, International Monetary Fund (IMF), ILO and Israel Central Bureau of Statistics.

[a] Due to PCBS inability to access East Jerusalem, data exclude East Jerusalem, with the exception of population figures.

[b] According to the ILO “relaxed definition”, unemployment rates include “discouraged workers”.

[c] Palestinian and Israeli trade data refer to goods, and non-factor and factor services.

E. Fiscal reforms in a difficult environment

11. In 2009, the PA continued to pursue fiscal sustainability as a central policy goal despite the unfavourable humanitarian conditions and the private sector’s inability to generate additional employment and tax revenue. The ongoing fiscal reforms aim at achieving transparency, accountability, improving budget preparation and control

processes, integrating and rolling out a computerized accounting system to all line ministries, raising the capacity and efficiency of tax collection and improving overall PA public financial management. As a result, domestic tax revenue rose from 4.5 per cent of GDP in 2008 to 4.9 per cent in 2009 (IMF, 2010).

12. The PA has introduced serious measures to ensure that consumers pay utility bills. These measures include the privatization of electricity distribution, introduction of prepaid electricity meters, linking access to certain government services to payment of utility bills, and direct deduction of due amounts from the salary of public sector employees. However, while better targeting of subsidies is desirable, the privatization of electricity distribution in any situation, especially one of occupation and conflict, needs to be accompanied by safeguards to ensure that poor households have adequate access to electrical power. Moreover, alternative sources of funds have to be specified to compensate local governments and councils for the revenue loss that resulted from the privatization of electricity distribution. In other words, while narrowing the fiscal deficit is important, PA fiscal reforms should not be pursued in ways that aggravate the already serious poverty levels, nor should they undermine the ability of local governments to deliver services and respond to the needs of their constituencies.

13. There is no evidence that the wage gap between the public and private sectors reflects unrealistically high public sector wages. The gap, at least in part, is the inevitable outcome of the strangulation of the private sector that wiped out its ability to generate employment. In addition, reducing public sector wages risks deteriorating the quality of public services as well as contracting domestic demand and consequently increasing the already high unemployment and poverty rates.

14. Lifting the siege on Gaza, so that reconstruction may take off in earnest and normal economic activities can resume, is essential for narrowing the high and unsustainable fiscal deficit. Ending the siege on Gaza would ease the fiscal pressure on both the expenditure side and the revenue side. Indeed, the PA goal of narrowing the fiscal deficit will be hard to achieve without dismantling movement restrictions from/to/within the oPt.

F. Fragmentation undermines governance and provision of public goods

15. Fragmentation and lack of contiguity within the West Bank – including East Jerusalem – and between the West Bank and Gaza Strip not only undermine the efficiency and competitiveness of the Palestinian private sector, they also undermine the authority of the PA and its ability to establish the rule of law, and weaken its ability to efficiently provide public services and goods at normal costs. Territorial fragmentation and lack of economic and institutional contiguity, therefore, undermine the prospects of a two-State resolution of the conflict by breeding not only economic disparities but also social and political polarization.

16. Within areas under its control, the PA has demonstrated competence at running the public sector and delivering public services in spite of unprecedented challenges. However, in the realm of State-building, there are limits to what technocratic competence can achieve without a political settlement that results in Palestinian sovereignty and removing the multiple structural constraints on Palestinian development elaborated in numerous UNCTAD reports and studies.

G. Persistently large trade deficit and dependence

17. The Palestinian trade deficit deteriorated from 57 per cent of GDP in 2008 to 59 per cent in 2009. A salient feature of Palestinian trade is the dependence on Israel as a source of

import and an outlet for exports. As can be seen in table 1, more than three quarters of Palestinian trade is with Israel. While the trade deficit with Israel improved, retracting from 82 per cent of the overall deficit in 2008 to 65 per cent in 2009, it was still high and larger than the $2.4 billion of donors' support transferred to the oPt in 2009. This dependence can be traced back to complex, mutually reinforcing economic, political and logistical factors arising from prolonged occupation. The lack of a seaport and airports, and the constraints on trade with and through neighbouring Egypt and Jordan despite the competitive cost have practically concentrated Palestinian trade with and through Israel. Part, but not all, of the trade between the oPt and Israel could be mutually beneficial but its involuntary and unequal nature has rendered Palestinian economic development subservient to Israeli economic and political imperatives, often masked under "security requirements".

18. Trade dependency on Israel remains substantial, despite strong potentials for trade with other countries and bilateral trade arrangements with the European Union (EU), Jordan, Turkey, Arab States, Canada and the United States. Furthermore, the easing of movement restrictions in the West Bank does little to solve the fundamental reality of stifled Palestinian trade, especially in the context of the blockade on Gaza, the construction of the Separation Barrier and other *ad hoc* movement restrictions that could be introduced unexpectedly.

II. Closures, blockade and economic rehabilitation

19. The economy of the oPt continues to suffer from a prolonged Israeli closure policy, which has become tighter since 2000. The devastating economic impact of such a policy was intensified by the construction of the Separation Barrier in the West Bank in 2002. It was further aggravated by the almost complete blockade of Gaza since June 2007. According to UNCTAD (2008) conservative estimates, the oPt is now operating with much less than two thirds of its 1998 capital stock (productive base). Under this institutionalized restrictive and distorting mechanism, economic recovery and poverty reduction will remain elusive.

A. West Bank: Closures and Separation Barrier

20. The West Bank witnessed minor easing of Israeli movement restrictions with the reduction of the number of closure obstacles form 630 to 550 in 2009 (UNSCO, 2010). Otherwise, most of the security measures set in place since 2000 remain almost unchanged. These include a system of restrictions on the mobility of Palestinian labour and goods within and between the West Bank, Gaza and the rest of the world. Land confiscation continued unabated, with 40 per cent of Palestinian land in the West Bank lost to settlements and related infrastructure.

21. The construction of the 709 km Separation Barrier has deprived the Palestinians of more of their land and natural resources. Around 85 per cent of the Barrier's projected path cuts deep into the West Bank to impose new borders away from the internationally recognized Green Line (OCHA, 2009b). It has compounded the problem of agricultural decline by limiting the access of farmers who live in the "seam zone" (the area east of the Barrier and west of the 1967 Green Line). Farmers trapped in that zone need to have difficult-to-obtain permits to pass through gates to access their fields. Repeated failure to obtain permits has discouraged many Palestinian workers from even applying for these permits (UNDP, 2010b). Difficulties in accessing agricultural land not only changes the output mix and compromise productivity and quality of produce, it also poses a serious risk that in the long run many Palestinian farmers will be forced to abandon their land west of

the Barrier (FAO, 2010). According to the World Bank (2008), the construction of the Barrier implies a permanent loss of 8 per cent of Palestinian agriculture product.

22. Furthermore, any potential benefit from trade in the West Bank is undermined by prohibitive transaction costs at major commercial crossing points in the form of damaged goods and long waiting time. As a result of repeated and lengthy Israeli security checks, Palestinian traders are faced with long queues with inadequate facilities and limited working hours at the crossing points. The number of outbound and inbound trucks is erratic, dictated by Israel's security concerns. Furthermore, the number of outbound trucks is at least 50 per cent less than that of inbound trucks, reflecting tighter Israeli measures on Palestinian exports (PalTrade, 2010).

B. Gaza: Economic blockade and devastation

23. The Gaza Strip has continued to suffer from an Israeli blockade since June 2007. As a result, 40 per cent of the oPt population is isolated from the rest of the world. During the first four months of 2010, imports were much less than the minimum required to have a tangible impact on reducing poverty. The number of inbound trucks of imports did not exceed 720 trucks per week, only 23 per cent of the pre-blockade level. The Israeli authorities restrict imports into Gaza to limited amounts of only 76 items compared to 4,000 items before the blockade (WFP, 2010). Most of the items are staple foods which, together with hygiene items, comprised 60–70 per cent of imports. Entry of commercial petrol and diesel was banned, while imports of industrial fuel were barely sufficient for 33–46 per cent of the requirements of Gaza's only power plant, causing power cuts of 8–12 hours per day. Imports of cooking gas met only 66 per cent of the weekly needs (OCHA, 2010a).

24. Gaza's economy is undermined not only by the tight restrictions on imports of goods, but also the restrictions on the transfers of dollars and Jordanian dinars. Cash shortages impede the execution of transactions in these currencies, aggravate the risk banks face and undermine their efficiency and profitability (IMF, 2010). The blockade on Gaza has led to a serious decline in the banking sector and diverted economic and financial activities to the unregulated informal sector, thus posing serious difficulties to the PA efforts to build institutional capacity, improve economic governance, and establish the rule of law.

25. Despite the devastation of the 2008–2009 Israeli military operation in Gaza, real reconstruction has not yet started. Around 75 per cent of the damaged infrastructures, public and private buildings, private businesses, and agricultural land and premises remain in dire need of rehabilitation. The Strip requires 55,000 truckloads of raw materials for reconstruction, but the Israeli authorities allowed only about 30 trucks per week in the first four months of 2010. Consequently, reconstruction effort involves only basic repair, using recycled rubble and construction materials brought through the tunnels between Egypt and Gaza (UNDP, 2010a).

26. The energy shortage, resulting from the blockade, costs manufacturers and service providers up to 50 per cent of their already meager income. Exports are limited to a narrow range of products, mainly cut flowers (Oxfam, 2010; OCHA, 2010a). Agricultural activities have become fraught with danger. Farmers are denied access to agriculture lands within the 300–1,000 meters wide "buffer" zone along the 45 km of Gaza's borders with Israel. It is estimated that after June 2009, 46 per cent of Gaza's agricultural land was inaccessible or out of production. Palestinian fishermen did not escape the Israeli restrictions, as they are not allowed to fish beyond three nautical miles from Gaza's shore instead of the internationally recognized 20 miles (OCHA, 2010b; UNSCO, 2010).

27. The continued blockade, coupled with the devastation of the war, prevents any meaningful improvement in livelihoods, beyond humanitarian relief. While around 90 per cent of Gaza's water supplies are "unfit for drinking", war devastation resulted in the contamination of the groundwater with nitrates up to six times higher than the World Health Organization standard. Moreover, carbon monoxide poisoning is becoming common, as more households are forced to use generators to cope with power shortages (OCHA-WASH, 2009; Oxfam, 2010).

C. Cost of closures, blockade and war

28. The Israeli occupation has institutionalized a territorial fragmentation, thereby disarticulating production and commercial networks, with major consequences for the development prospects of the Palestinian economy. The previous summary highlights a mechanism that systematically drains the already eroded productive base of the whole oPt. This seriously deepens poverty by depriving the Palestinian people of all means of production.

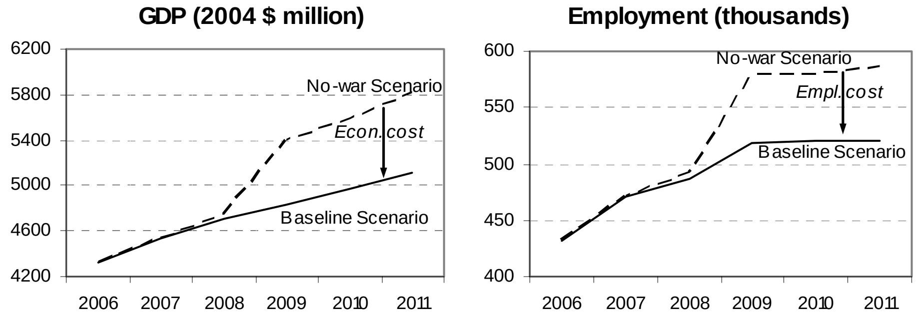
29. The cost of the 2008–2009 war on Gaza was and continues to be substantial to the oPt economy. The direct cost is estimated to be around $1.3 billion: $1.1 billion in damages to private and public structures and infrastructure (PCBS, 2009), plus $180 million in damages to the agriculture sector (FAO, 2009). This is equivalent to 90 per cent the size of Gaza's GDP or about one third the size of the whole oPt economy in 2006 (before the blockade).

30. What could be of more serious and long-lasting effect is the indirect cost of the war, Gaza blockade and West Bank closures. To assess this, an updated version of UNCTAD's macroeconometric simulation model of the Palestinian economy is simulated under two alternative scenarios (UNCTAD, 2006). The "baseline" scenario simulates the performance of the oPt economy from 2008–2011 under the assumption that the 2008–2009 war has occurred and that the tight blockade and closures in the oPt are maintained after the war. The alternative "no-war" scenario assumes that the war did not occur and that Gaza's blockade is lifted and the West Bank closures are relaxed to their pre-2000 levels. The differences between the two scenarios highlight the extent of the indirect cost in terms of forgone GDP and employment.

31. Figure 1 depicts the difference between the two scenarios. The analysis indicates that the continued blockade and closure after the war are costing the oPt economy between $600 million and $800 million a year,[3] or about 13 per cent of its GDP. If the Israeli blockade and closure on the oPt continued until the end of 2011, the 2008–2011 cumulative impact would be $2.6 billion, or 54 per cent of the size of 2008 oPt GDP. As for the employment cost, it is between 60,000 and 80,000 jobs per year, or about 13 per cent of the employment that would have been generated had the blockade been lifted and closures been relaxed. Over the 2008–2011 period, the cumulative loss in Palestinian employment is estimated to be 260,000 jobs or about 40 per cent of the number the economy was able to generate in 2008.

[3] GDP is measured in real 2004 dollars.

Figure 1
Economic and employment cost of war, blockade and closures



32. Summing up the direct physical damage and indirect cost of the war to the oPt between 2008-2010 adds up to $3.1 billion, which would increase to $3.9 billion if Israel continues to impose the blockade and closures in 2011. This is more than 80 per cent of the GDP generated by the oPt in 2008. If the "no-war" scenario assumes a complete lifting of the closure policy, the difference between the "baseline" and "no-war" scenarios would have been larger and therefore the indirect cost of war would have been significantly higher. The point is that the Israeli measures (closures, blockade and war) have a substantial economic penalty not only for Gaza but for the whole oPt economy. Any remedy to the Palestinian economic crisis, widespread unemployment and deepening poverty will not have any meaningful results without disposing of these measures.

D. Informal and tunnel economy

33. Under such an adverse environment, the informal economy has been expanding at an unprecedented rate in the oPt, especially in Gaza, by the establishment of the informal "tunnel economy". Evolved in response to the Israeli blockade, the latter features a network of hundreds of tunnels along the borders between Gaza and Egypt. Around two thirds of economic activity is devoted to informally importing goods into Gaza, with the consequence of crowding out the formal economy. Most of the imported goods are expensive and inaccessible to the poor (PCHR, 2009). In addition, the tunnel economy carries life-threatening risks. Several Palestinians have lost their lives or incurred serious injuries in various incidents, including air strikes and tunnel collapse.

34. Yet, the tunnel economy is a "vital lifeline" for the isolated Gaza, even before the Israeli military campaign (OCHA, 2009b; UNDP, 2010a). For example, it is estimated that 200,000 litres of petroleum products enter Gaza each day through the tunnels. These are critical for reducing the shortages in energy supply (OCHA, 2010a). Around 56 per cent of traders participating in a 2009 survey by the World Food Programme reported increase in their sales volume as a result of tunnel trade (WFP, 2010). Moreover, almost 50 per cent reported increased profit margin, and another 31 per cent emphasized increasing their stock level. The survey also shows that the tunnel economy has had a stabilizing effect on consumer prices. However, most prices remain above those of the West Bank, reflecting the higher transaction costs and risk levels.

E. Ineffective economic rehabilitation under closure

35. Following the Israeli military campaign in Gaza in December 2008, the international community pledged $4.5 billion at the March 2009 Sharm El-Sheikh conference to support the Palestinian National Early Recovery and Reconstruction Plan for Gaza for the period

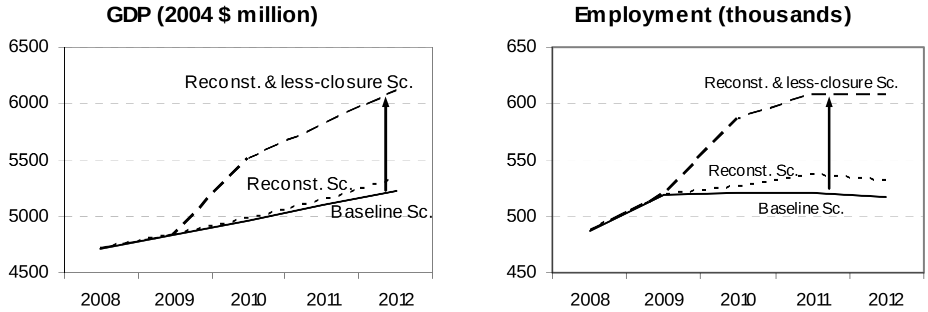
2009–2010. However, during 2009, the sum of donors' funding channelled to the PA was in the range of $2.4 billion. Of this, almost nothing was allocated to serious rehabilitation of the local economy in Gaza or even the West Bank. Donors disbursed $1.36 billion in budget support, covering 94 per cent of the PA's 2009 recurrent budgetary requirements. In contrast, development financing stood at only $390 million (World Bank, 2010). As for emergency needs, only 78 per cent was covered by $625 million of donor funding to finance relief interventions by United Nations agencies. Of this, 75 per cent was for food assistance, compensation for households with destroyed and damaged houses and work programmes in Gaza. The remaining 25 per cent was allocated to interventions in the West Bank social sector (OCHA, 2009a).

36. While donor assistance is critical for cushioning the impact of the Israeli measures, the focus on budget support and emergency interventions risks further aggravating the structural distortion of the economy. However, in the case of oPt, where the economy is under prolonged closure, which sustains the systematic erosion of the productive base, any injection of funds to finance an increase in domestic demand will be fulfilled by an increase in imports rather than an increase in the much-neglected domestic production. Even when funds are allocated for reconstruction and economic rehabilitation, the blockade and closures will continue to undermine the economic impact of these funds. Again, most of the impact will be reflected in higher imports, which mainly come from Israel.

37. To demonstrate this point, UNCTAD's model of the Palestinian economy is simulated under three alternative scenarios to assess the impact of an increase in donor funds to support the oPt economic rehabilitation over the period 2010–2012: (a) the "baseline" scenario assumes that donor support will follow its recent levels and be maintained at $2 billion per year, and that the blockade in Gaza and closures in the West Bank are not relaxed; (b) the "reconstruction" scenario assumes that over the simulation period, donor support and public investment will increase by $1.3 billion and $330 million, respectively, but the oPt blockade and closures will be as firm as it is in the "baseline" scenario; and (c) the "reconstruction and less closure" scenario assumes an increase in donor support and public investment similar to the "reconstruction" scenario, and also assumes that the oPt blockade and closures are relaxed (not lifted) to the pre-2000 level.

38. As presented in figure 2, the positive impact of injecting $1.6 billion of donor and public investment funds in the economy without relaxing the blockade and closures is marginal as compared to the impact of this injection, along with relaxing the blockade and closures. Comparison between the "baseline" scenario and the "reconstruction"-only scenario suggests that injecting donor fund while maintaining the blockade and closure might increase GDP on average by less than $50 million (less than 1 per cent) per year in the 2010–2012 period. The impact on employment is slightly higher but still marginal. Average annual employment could increase by 12,000 jobs or 2.4 per cent above the "baseline" level. The "reconstruction and less closure" scenario clearly shows that injecting funds in the economy could have a substantial impact only when the blockade and closure are relaxed, and ultimately lifted. This scenario shows that, in the three-year period, average annual GDP could increase by $710 million or about 14 per cent above the "baseline" level. Similarly, employment could increase by more than 80,000 jobs per year or 15.5 per cent above the "baseline" level.

Figure 2
Economic and employment impact of economic rehabilitation



39. This analysis clearly shows that the tunnel and informal economy cannot and should not be an alternative for lifting the oPt blockade and closures. As noted by the United Nations Emergency Relief Coordinator, "the blockade of Gaza by Israel has been unacceptable, unnecessary and counterproductive from its beginning in 2007; it has worsened conditions of life for Palestinians, deepened poverty and food insecurity, prevented reconstruction, and increased aid dependence by destroying livelihoods and economic activity" (Holmes, 2010). Similarly, the EU High Representative for Foreign Affairs reiterated that the continued policy of closure is unacceptable and politically counterproductive. She called for an immediate, sustained and unconditional opening of the crossing for the flow of humanitarian aid, commercial goods and persons to and from Gaza (Ashton, 2010).

40. The following section will shed more light on how the destruction, blockade and closure manifest themselves in deforming the structure of the economy and reducing the ability of the tradable goods sector to produce and compete even domestically.

41. In June 2010, the Israeli authorities marginally eased Gaza's blockade by expanding the list of goods allowed into Gaza, and by permitting the entry and exit of international personnel as well as Palestinian citizens for medical reasons. In addition, the opening of the Rafah crossing point has improved. While these steps may slightly reduce the misery of the population in Gaza, they will have very little impact, if any, on the economy. The complete lifting of the blockade in Gaza and closure policy in the West Bank are essential for the commencement of the much-delayed reconstruction and the rebuilding of the productive base.

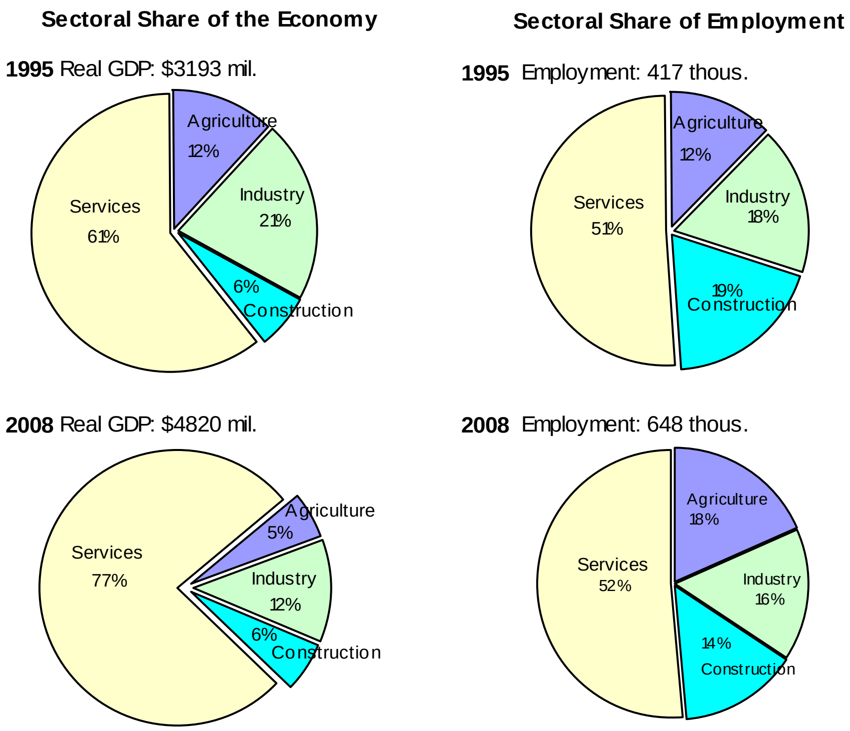
III. The Palestinian tradable goods sector

A. Structural deformation and repressed tradable goods sector

42. Development of the Palestinian tradable goods sector has been stunted by the destruction of the productive base, high transaction costs as a result of closure policy, and an uncompetitive exchange rate, as a result of using the Israeli currency. The combined effects of these factors have put Palestinian producers at marked disadvantage in domestic as well as external markets vis-à-vis their foreign competitors. This has weakened overall development by forestalling the cumulative effects of growth and the long-term learning effects that result from sustained production activities. It has also deepened the dependency on aid and remittances, which together exceed 60 per cent of GDP, as the main sources of foreign exchange, investment and aggregate demand.

43. The suppression of the tradable goods sector deformed the structure of the economy by increasing the share of the non-tradable goods sector, mainly services and to lesser extent construction, in GDP at the expense of the industrial and agricultural sectors. Figure 3 highlights the structural transformation of the Palestinian economy as a result of the choking of productive activities in the tradable goods sector. Between 1995 and 2008, the share of agriculture in GDP declined from 12 per cent to a minuscule 5 per cent, while the share of industry fell to 12 per cent. At the same time, the combined share of the non-tradable goods sector, services and construction rose from 67 per cent to 83 per cent, with services accounting for all the increase. This structural transformation reflects that the services sector could be relatively less vulnerable to the Israeli closure policy.

Figure 3
Economic and employment structural changes in the Palestinian economy



44. The structural deformation has been combined with a precipitous decline in agricultural and industrial productivity evidenced by the rise in the share of the agricultural sector in total employment from 12 per cent in 1995 to 18 per cent in 2008 in spite of the decline in its relative contribution to total output. Figure 3 indicates similar decline in industrial productivity over the same period.

B. Reviving the tradable goods sector

45. Reviving the Palestinian tradable goods sector requires three main elements: (a) replenishing the eroded productive base; (b) reducing transaction costs; and (c) establishing a development strategy that targets promising subsectors in the agriculture and industrial sectors. This section focuses on the third element. It draws on a recent policy research conducted by the Secretariat to assess the prospects and constraints of the Palestinian tradable goods sector (UNCTAD, forthcoming). The following is a summary of key policy implications and recommendations emerging from this work:

(a) Developing the Palestinian export sector is key to sustained improvement in Palestinian standards of living in light of the small size of the domestic market. However, it is unrealistic to expect the export sector to act as an engine of growth in its current state;

(b) The large size of imports indicates that strengthening the export sector should proceed hand in hand with building the capacity to domestically produce some goods that are hitherto imported. PA support to domestic production of importable goods would not be a typical variant of “import substation” strategies since the current structure of Palestinian economy does not reflect the operation of normal market forces, and comparative or competitive advantages: rather, it is nothing but a direct result of over four decades of occupation policies. The proposed strategy may be dubbed “corrective import substation” to underscore that policies, recommendation and even subsidies for this purpose are intended to correct structural distortions and are thus not contrary to the principles of free trade.[4] The argument here is not to give Palestinian producers of tradable goods advantages vis-à-vis foreign competitors, but to help overcome the impact of the disadvantages they have been subjected to for decades;

(c) The choice of import-competing goods for targeted policy support should be based on the magnitude at which a good is imported, its strategic importance and potential employment effects, cost-effectiveness and the size of government purchase;

(d) Real exchange rates are key determinants of merchandise trade flows with Jordan and Israel. Real devaluation of the Israeli and Jordanian currencies increases Palestinian exports to their markets. This finding confirms that of UNCTAD (2008), which shows that the use of the monetary and exchange rate policies of the more advanced Israeli economy undermine Palestinian competitiveness. The evidence that the use of the Israeli currency (NIS) is inimical to Palestinian development should no longer be ignored. At present, the political and institutional prerequisites of introducing a national currency do not exist. However, a plausible corrective intervention to neutralize the effects of using the NIS is a tax/subsidy scheme whereby imports are taxed and the revenue thus raised is used to strengthen not only export-oriented activities, but also import-competing activities. Such a scheme should be interpreted not as a typical case of trade regulation but a corrective action to the impaired competitiveness caused by the use of the NIS and the additional costs borne by Palestinian producers due to the closure policy and internal market fragmentation;

(e) Israel’s non-tariff barriers limit Palestinian exports to Israel and enlarge imports from it. However, under equal trade conditions, Palestinian exports to Israel may increase by 30 per cent while imports from it may fall by up to 50 per cent, as other markets become accessible. The removal of such barriers will increase Palestinian exports and reduce imports. The conclusion is that these barriers are directly and primarily responsible for the large and persistent Palestinian trade deficit and the dependence on Israel, as well as weak and uncompetitive tradable goods sector;

(f) The most plausible goods to be imported from markets other than Israel are electrical energy and natural gas. Policy may pursue the development of joint ventures with Jordan to supply the West Bank with fuel, electricity, and natural gas and with Egypt to supply the Gaza Strip with these products;

(g) A 1 per cent rise in Palestinian capacity relative to its trade partners is associated with a 0.2 per cent decline in Palestinian imports. This suggests that weak productive capacity has an important role in reinforcing the trade deficit. The empirical evidence suggests that many currently imported goods can be produced domestically.

[4] See the discussion on “distortion correction schemes” in UNCTAD (2008).

C. Promoting Palestinian trade and productive capacity

46. The state of the Palestinian economy heightens the urgency of rebuilding the productive base. Over the years, UNCTAD has argued that while meeting immediate relief and emergency needs is vital, it should not overshadow the need for developing Palestinian productive capacity in order to lessen aid dependence in the short run, and dispense with aid altogether in the long run. UNCTAD proposes that enhancing the effectiveness of aid and correcting the economy's structural deformation requires a strategy for developing trade and productive sectors within a framework that links relief to development. As proposed in the following chapter, one way to help pursue this goal is to introduce the United Nations Chief Executives Board (CEB) Cluster on Trade and Productive Capacity in the oPt to design a flexible framework of coordinated interventions capable of fostering dynamic synergies between humanitarian interventions and building sound Palestinian productive base. The Cluster was launched in 2007 as a joint initiative by United Nations agencies. It aims at enhancing the United Nations "delivering as one" initiative to ensure the tangible contribution of the trade and productive sectors towards achieving the Millennium Development Goals (MDGs). The complex problems hampering effective Palestinian participation in international trade suggest that the Cluster can play a key role in rebuilding the Palestinian productive base and placing the economy on a path to sustainable recovery.

IV. UNCTAD assistance to the Palestinian people

A. Framework and objectives

47. Working in close consultation with the Palestinian Authority and civil society, the secretariat has been actively engaged in supporting Palestinian development and institution-building efforts since 1995, guided by a comprehensive mandate agreed by member States[5] and responding to technical assistance requests by the PA and Palestinian civil society. In so doing, UNCTAD has fashioned a multi-faceted programme of technical assistance, which draws on the experience of the secretariat as a whole. The programme emphasizes interrelated treatment of trade, finance and enterprise development, with technical assistance activities grouped within four Clusters: (a) trade policies and strategies; (b) trade facilitation and logistics; (c) finance and development; and (d) enterprise, investment and competition policy.

48. As in previous years, programme implementation continued to be hampered by Israeli mobility restrictions on national trainees and project staff access to the oPt. Nonetheless, UNCTAD maintained steady progress in its programme of work, as it continues to adopt a selective and flexible mode of operations. However, achievements remain insufficient to address the daunting development challenges facing Palestinian policymakers, as the economic crisis continues to drain the economy of its most vital resources.

49. To address these challenges, the secretariat programme of technical assistance capitalizes on UNCTAD's knowledge of the Palestinian economy and the experience of United Nations specialized agencies in the oPt. The programme attempts to involve new mechanisms for intensifying UNCTAD's activities and their effectiveness in the oPt and for

[5] For instance, the 2008 Accra Accord calls for strengthening Palestinian capacity-building efforts and intensifying support to the Palestinian people with a view to creating the conditions conducive to building a sovereign and viable Palestinian State.

striking a balance between immediate emergency needs and the long-term development targets that are essential for the proper functioning of the economy of the future Palestinian State. As such, the programme makes a tangible contribution towards achieving the objectives and mandate of the United Nations Strategic Framework for 2010–2011, paragraph 44 of the Accra Accord, and General Assembly resolutions 56/111 (paragraphs 6 and 7) and 43/178 (para. 9).

B. United Nations Inter-Agency Cluster on Trade and Productive Capacity

50. In the context of the "delivering as one" reform process of the United Nations system, and in close collaboration with the United Nations agencies in the oPt, the secretariat has designed a multi-faceted proposal for a work programme to support PA renewed development efforts. The programme involves joint technical assistance activities in the area of trade and productive capacity development, within the framework of the United Nations Chief Executives Board Inter-agency Cluster on Trade and Productive Capacity.

51. In line with the CEB Cluster's strategic orientation, the development of trade and productive sectors policies and operations will be based on a strategic framework that emphasizes systemic addressing of the linkages between trade, poverty reduction, human development and the MDGs. The focus is to ensure policy coherence, inter-agency coordination and integration of activities in a sequenced manner, based on a context-sensitive pragmatic approach that enables a flexible configuration of operations. In this sense, the programme aims at strengthening the United Nations country team (UNCT) in the oPt, and assist it in linking relief interventions with strategic development objectives.

52. At present, the proposed programme includes five agencies: UNCTAD, the United Nations Development Programme (UNDP), the United Nations Industrial Development Organization (UNIDO), the Food and Agriculture Organization of the United Nations (FAO) and the International Trade Centre (ITC). Progress to date has involved the articulation of the programme's strategic objectives, inter- and intra-agency coordination mechanism and delivery modalities. Following two exploratory missions by UNCTAD and UNIDO, the involved agencies are now in close consultations to finalize a joint proposal. It has also been proposed that all future joint technical assistance should be delivered within the context of a multi-year implementation plan. Such an approach should enhance the impact and effectiveness of the ongoing individual operations, provide tangible contributions to rebuilding and developing Palestinian trade and productive capacity, and allow for addressing the ongoing economic regression in the oPt.

53. Meanwhile, consultations are underway to bring other relevant United Nations agencies on board, in order to further enrich the programme and avoid duplication of efforts. To set the stage for the formal launching of the Cluster as an integral part of the UNCT programme of work and the submission of the interagency proposal to potential donors, a joint mission by Cluster agencies is planned for the near future to present the proposed programme to the UNCT, donors, PA and other stakeholders.

C. Operational activities underway

54. The secretariat achieved significant progress in the area of trade policy under the Development Account project for promoting subregional growth-oriented economic and trade policies towards achieving MDGs 1 and 8 in the oPt and four other Arab countries. Most notable have been the fruitful discussions on the issues of pro-poor trade and growth

strategies, harmonization of trade statistics, infrastructure and institutions to facilitate regional trade integration. The project's three regional workshops resulted in concrete policy recommendations aimed at achieving the above objectives. A final expert meeting will be organised in Geneva towards the end of 2010 to present project findings to UNCTAD members.

55. The secretariat has also registered important achievements in the area of trade facilitation under a project for modernizing Palestinian customs, ASYCUDA III. The year 2010 has seen the strengthening of the national team of experts within the PA with additional skills, the consolidation of a small community of customs experts in the private sector, and a set of tailor-made training manuals for future use by Palestinian Customs. Moreover, the secretariat has supported the Palestinian Shippers' Council (www.psc.ps) efforts to launch new products to address the emerging needs of its members of importers and exporters and those of the Palestinian shipping community at large.

56. UNCTAD has also conducted a needs assessment mission to inform the design of a new technical assistance project in the area of debt management. The project, to be implemented in cooperation with the PA Ministry of Finance (MoF), involves building the capacity of the MoF staff and the introduction of the most recent release of UNCTAD's Debt Monitoring and Financial Analysis System (DMFAS) in the MoF headquarters in Ramallah.

57. However, achievements continue to be hampered by funding shortfalls which prevents UNCTAD from resuming planned activities in the areas of investment promotion, small and medium enterprise development (EMPRETEC–Palestine programme), and support to the continuing Palestinian efforts in obtaining WTO observership status.

D. Resource mobilization, coordination and harmonization

58. Both the design and implementation of the secretariat's programme of assistance to the Palestinian people proceeded in close coordination with the UNCT and relevant international organizations, as well as national and international research centres and civil society institutions. Furthermore, programme implementation has been facilitated by the UNDP's logistical and liaison field support to UNCTAD staff, experts and project personnel.

59. The programme has also benefited from generous extra-budgetary support from the EC and the United Nations Development Account. However, capitalizing on accumulated achievements is undermined by funding shortfalls, and the absence of field presence. The launching of the Chief Executives Board Cluster on Trade and Productive Capacity in the oPt will constitute the first step in establishing the much needed field presence, while enabling greater complementarity and closer coordination with United Nations sister agencies and other international development organizations.

60. Despite the progress made in resource mobilization and project implementation, UNCTAD still faces significant resource shortfalls. Unless adequate and predictable resources are made available, as called for in paragraph 44 of the Accra Accord, UNCTAD's ability to intensify its technical assistance to the Palestinian people will be severely constrained.

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