United Nations TD/B/56/3*

United Nations Conference on Trade and Development

Distr.: General
7 August 2009

Original: English

Trade and Development Board
Fifty-sixth session
Geneva, 14–25 September 2009
Item 10 (b) of the provisional agenda
Report on UNCTAD assistance to the Palestinian people

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

Of the twenty-five years that UNCTAD monitored and investigated the performance of the economy of the occupied Palestinian territory and the policy environment affecting it, 2009 represents without a doubt an all-time low. In all aspects – the level of its activity, the structural weaknesses it exhibits and the hostile policy environment in which it survives against all odds – the Palestinian economy today faces a real challenge to its integrity, solvency and indeed the very viability that it must enjoy for the two-state solution to become a reality. In particular, the devastation visited upon the occupied Gaza Strip and its economy has plunged its 1.5 million inhabitants into depths of poverty and disintegration unknown for generations. The blockade it has endured has isolated it from the rest of the occupied Palestinian territory and the world. The sustained programme of UNCTAD assistance to the Palestinian people not only addresses the realities of stunted development under occupation, but also supports building the economic institutions required for a sovereign and viable Palestinian State as called for by the international community.

* Reissued for technical reasons.

[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).

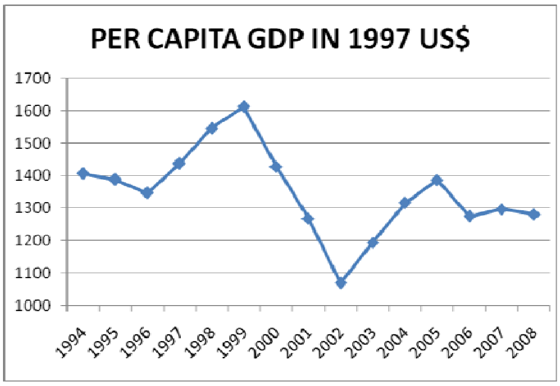
[2] The information in this document should not be quoted by the press before 8 September 2009.

I. Eroded economic, productive and natural resource base

A. Restrained economy

1. Yet another lost year for Palestinian development was chalked up in 2008 as the economy not only failed to recover but continued to lose ground for the ninth year in a row (figure 1). Gross domestic product (GDP) growth was well below potential despite substantial foreign aid and institutional reforms carried out in an unfavourable environment by the Palestinian Authority within the framework of the Palestinian Reform and Development Plan (PRDP). The continued isolation of the occupied Palestinian territory under a tight Israeli closure policy and blockade of Gaza has further fragmented the economy. As a result, real GDP is estimated to have grown by only 2 per cent in 2008 (table 1); leading to a 1.2 per cent decline in per capita GDP. The cumulative effect is a 34 per cent drop in real per capita GDP between 2000 and 2008.

Figure 1



2. Economic recovery will not emerge spontaneously and needs concerted action by the Palestinian Authority, the international community and Israel. Despite the volatile political conditions, the Palestinian Authority implemented a number of reform measures under the PRDP in 2008. They focused on enhancing the efficiency and transparency of government institutions, curbing the fiscal deficit and improving security in the West Bank. These reforms were supported by substantial donor aid, with total external support to the Palestinian Authority reaching $1.9 billion in 2008, including $1.8 billion for budgetary support (up from $1 billion in 2007). However, Israeli policy persistently pulled the economy along an adverse path, with heightened internal and external barriers to the movement of Palestinian people and goods within/from/to the West Bank and Gaza. Such restrictions are the main mechanisms undermining the recovery of the Palestinian economy by pre-empting the intended benefits of foreign aid and reform.

3. The private sector’s inability to cope with mobility restrictions and other Israeli measures and the resulting inability to create jobs, combined with the Palestinian Authority’s pursuit of fiscal sustainability and the exhaustion of its ability to act as an “employer of last resort”, resulted in the rise of the unemployment rate from 28 per cent in 2007 to 32 per cent in 2008. Gaza’s unemployment is 13 per cent above the national average. This comes at a time when agricultural is no longer capable of providing displaced workers with low productivity underemployment – as it has been doing since 2000 – due to internal and external closures, the loss of fertile land in both the West Bank and Gaza and inadequate access to the remaining agricultural land.

4. Poverty continues to widen and deepen. The percentage of households living in the occupied Palestinian territory in relative poverty jumped from 20 per cent in 1998 to 57 per cent in 2007. The latter figure includes 48 per cent living in extreme poverty.[3] In Gaza relative poverty touched 79 per cent of the population in 2007, of which 69 per cent were living in extreme poverty. Food insecurity has also become an acute problem, affecting 38 per cent of the Palestinian people in 2008.[4]

B. Closure, settlements and separation: erosion of the productive and natural resource base

5. The Palestinian economic decline is rooted in the relentless Israeli internal and external closure policy, the attrition of the Palestinian productive base and the loss of Palestinian land and natural resources to the "Separation Barrier" and Israeli settlements, which continued to expand in 2008 both in size and population. In such a hostile environment there are no signs of private investment recovery to revitalize the eroded productive base. Government investment, at $250 million, was around 5 per cent of GDP in 2008, while industry continued to shrink and construction stagnated.

6. Restrictions on Palestinian access to natural and economic resources have stunted Palestinian development through multiple channels. Thirty per cent of Gaza's arable land is rendered inaccessible to Palestinian farmers, while the latest massive Israeli military campaign in Gaza has taken a toll on the quality of the remaining arable land. Fishing is allowed only within a narrow distance from the coast resulting in resource depletion and declining returns from fishing activities.

7. Agricultural development has been thwarted by the loss since 1967 of 40 per cent of West Bank land to settlements and related infrastructure.[5] The Separation Barrier resulted in the confiscation of about one fifth of the West Bank's most fertile cultivable land,[6] the destruction of physical infrastructures and limited access to water resources.[7] Farmers have restricted access to their land. The barrier has forced 3,551 enterprises out of business and disrupted the road and water networks of 171 villages. Once the barrier is completed, 10 per cent of the West Bank will be in the seam zone between it and the 1949 Armistice Lines.[8]

8. The barriers to the movement of goods and people within the occupied Palestinian territory have fragmented what is left of the economy and given rise to price differentials and limited factor mobility. Goods are damaged at checkpoints and transportation costs have doubled in some areas.[9] The situation is even worse for exporting sectors, which have to pay an additional cost at external borders. These factors, and the uncertainty they create,

---

[3] Palestinian Central Bureau of Statistics (PCBS) (2008). Press release: poverty and living conditions in the Palestinian territory – 2007. August.

[4] WFP et al. (2008). Joint rapid food security survey in the occupied Palestinian territory.

[5] United Nations Office for the Coordination of Humanitarian Affairs (OCHA) (2007). The humanitarian impact on Palestinians of Israeli settlements and other infrastructures in the West Bank.

[6] UNCTAD (2008). Report on UNCTAD's assistance to the Palestinian people. UNCTAD/TD/B/55/2.

[7] PCBS (2008). *Survey on the Impact of the Expansion and Annexation Wall on the Palestinian Localities that the Wall Passed Through.* Ramallah, PCBS.

[8] OCHA (2005). Preliminary analysis: the humanitarian implications of the February 2005 projected West Bank barrier route; OCHA and the United Nations Relief and Works Agency for Palestine Refugees (UNRWA) (2004). The humanitarian impact of the West Bank barrier on Palestinian communities.

[9] World Bank (2008). Economics of "policy-induced" fragmentation: the costs of closures regime to the West Bank and Gaza. Middle East and North Africa working paper series 50. World Bank. Washington DC.

not only make business planning impossible and undermine the viability of existing businesses but also discourage potential domestic and foreign investment.

9. The net result is the atavistic atomization of domestic production enclaves and a Palestinian economy edged towards autarkic isolation from global markets – except for more dependence on the already sizable imports from Israel. As the deformed Palestinian productive structure continues to morph in adaptation to the constraints imposed by Israeli measures, there is a serious risk of path-dependence ensuring long-lasting damage.[10] As a result, Palestinian firms' choice of goods to produce for internal and external markets is not dictated by comparative advantage and economic considerations, but rather by the cost of Israeli security measures that has to be factored in. The upshot of producers' adaptation to these measures is devastating for the small Palestinian economy with an output mix altered towards lower value added products; loss of scale economies; pervasive inefficiency; impaired competitiveness; constrained government ability to gear production towards strategic and employment-intensive sectors; and a smaller tradable goods sector, all of which pre-empts effective participation in international trade.

Table 1
The Palestinian economy (West Bank and Gaza Strip): key indicators[a]

	1995	1999	2002	2004	2005[rev.]	2006[rev.]	2007[prl.]	2008[est.]
Macroeconomic performance								
Real GDP growth (%)	6.0	8.8	-13.3	12.0	8.6	-5.2	4.9	2.4
Gross domestic product – GDP ($ million)	3 220	4 179	3 433	4 198	4 634	4 619	4 672	4 784
Gross national income – GNI ($ million)	3 699	4 932	3 656	4 430	4 992	5 047	5 220	5 507
Gross disposable income – GDI ($ million)	4 099	5 306	4 708	5 151	6 120	6 323	7 314	7 747
GDP per capita ($)	1 400	1 493	1 125	1 317	1 410	1 363	1 337	1 331
GNI per capita ($)	1 608	1 763	1 199	1 390	1 519	1 489	1 494	1 532
Real GNI per capita growth (%)	0.7	4.1	-16.7	8.7	7.2	-6.5	3.7	1.0
Population and labour								
Population (millions)	2.34	2.96	3.23	3.41	3.51	3.61	3.72	3.83
Unemployment (% of labour force)[b]	32.6	21.7	41.3	32.5	28.9	29.6	27.9	31.7
Total employment (in thousands)	417	588	477	578	633	666	666	648
In the public sector	51	103	125	131	145	152	146	151
In Israel and settlements	68	135	49	50	63	64	63	75
Fiscal balance (% of GDP)								
Revenue net of arrears and clearance withheld	13.2	23.9	8.5	25.0	29.5	33.8	34.1	26.8
Current expenditure	15.3	22.6	29.0	36.4	43.0	49.3	54.4	54.8
Total expenditure	25.6	29.9	35.4	37.1	49.2	55.4	61.1	61.3
Overall balance – cash basis	-12.3	-6.1	-27.0	-12.1	-19.7	-21.5	-27.0	-34.4

./…

[10] UNCTAD (2006). Integrated simulation framework for Palestinian macroeconomic, trade and labour policy. UNCTAD/GDS/APP/2006/2.

	1995	1999	2002	2004	2005[rev.]	2006[rev.]	2007[prl.]	2008[est.]
External trade								
Net current transfers ($ million)	400	399	1 090	730	1 171	1 479	2 361	2 750
Exports of goods and services ($ million)	499	1 039	522	644	746	710	926	885
Imports of goods and services ($ million)	2 176	3 567	2 876	3 479	3 320	3 795	4 432	4 640
Trade balance (% of GDP)	-52.1	-60.5	-68.6	-67.5	-55.5	-66.8	-75.0	-78.5
Trade balance with Israel ($ million)	-922	-1 598	-886	-1 500	-1 945	-1 887	-2 260	-2 678
Trade balance with Israel (% of GDP)	-28.6	-38.2	-25.8	-35.7	-42.0	-40.9	-48.4	-56.0
Palestinian Authority trade with Israel/total Palestinian Authority trade (%)[c]	92.3	62.6	48.4	60.4	73.0	64.9	71.5	80.8
Palestinian Authority trade with Israel/total Israeli trade (per cent)[c]	4.3	3.9	2.0	2.4	2.7	2.3	2.6	2.8

Source: Data from PCBS, the World Bank, the International Monetary Fund (IMF), the International Labour Organization (ILO) and the Israeli Central Bureau of Statistics.

[a] With the exception of population figure, data reported in this table excludes East Jerusalem.

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

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

10. Israeli restrictions on the shipment of cash from West Bank financial institutions to Gaza have effectively paralyzed Gaza’s banking system. Cash shortage has inflicted serious damage on the economy by complicating the day-to-day exchange of goods and services, increasing transaction costs and undermining confidence in banks. Not only has the closure policy strangled Gaza’s external trade, cash shortage has further impaired its internal trade. It has led to a shift of financial activities towards unregulated informal channels that are not amenable to the supervision of the Palestinian Monetary Authority. There are concerns that this may eventually spill to West Bank financial institutions. This episode of financial “de-development” is a serious setback to Palestinian efforts to lay the institutional foundations of a future viable state.

11. Certainly, foreign aid has prevented the Palestinian economy from a complete collapse in the last few years. Aid not only enables Palestinian institutions to function and provide critical services, it also has a favourable impact on aggregate demand and supply constraints. Assessment of foreign aid should always weigh its upside against the backdrop of the adverse occupation conditions in the occupied Palestinian territory. This invites efforts from the Palestinian Authority, national and international institutions to identify optimal aid allocation that maximizes benefits and minimizes distortions. Aid should not be a de facto substitute for Israel shouldering its international obligations towards the occupied Palestinian territory. Nor should Palestinian Authority reliance on aid postpone developing sound governance and productive and institutional capacities to lay the foundations for a sovereign Palestinian State trading with all its neighbours.

C. Continued fiscal and external fragility, and increased dependence on Israel

12. In spite of the challenges posed by feeble GDP growth, high inflation and the appreciation of the new Israeli sheqel (NIS), the Palestinian Authority has implemented serious fiscal austerity measures. The level of net public revenue has been increased and public expenditure has been reduced by curbing public employment, freezing wages, improving tax collection and enforcing strict rules for utility bills payment. This austerity, implemented in an environment of high poverty and unemployment, led to an 11 per cent

drop in the real wage bill[11] and a 7.6 per cent reduction in the recurrent budget deficit ratio (table 1). However, the Palestinian Authority's fiscal position continues to be vulnerable as reflected by the low capital expenditure levels, continued dependence on aid for budget support, bleak economic outlook and the substantial resources needed for the reconstruction of Gaza.

13. On the revenue side, while improved tax collection resulted in a 6 per cent rise in revenue, there is scope for higher revenue once closure is lifted. However, public revenue is negatively affected by the Gaza blockade and the closure policy, which eliminates some customs revenue and encourages the smuggling of goods from Israel.

14. Approaching the Palestinian Authority's stated goal of a single digit ratio of public wage bill to GDP is extremely difficult in light of the absence of robust GDP growth and employment-generating private sector recovery, and is highly risky from a social point of view. For example, the planned 27 per cent reduction in net lending – a kind of electricity and utility subsidy – threatens to deprive the most vulnerable households of their energy needs. Fiscal reforms should be carried out in a manner that does not add pressure on the poor and should be imbued with built-in protection of poor households' right to access an energy minimum.

15. The prospects of Palestinian Authority public finances are dimmed by the aftermath of the recent Israeli military campaign in Gaza. A sizable $2 billion in domestic and foreign aid resources have to be earmarked for Gaza reconstruction just to bring the economy back to the debilitated state it was in before the offensive. With or without the reconstruction efforts, the Palestinian Authority's ability to sustain its fiscal discipline and reforms depends on whether Israel lifts movement restrictions.

16. Nine years of intensified closures have seriously weakened the Palestinian export sector and many of the firms driven out of business are unlikely to come back when relative normalcy returns. Table 1 shows that Palestinian exports fell in 2008 from their 2007 level and continued to be below their 1999 level, implying a steeper decline in real terms. On the imports side, the rise in the cost of imported goods in Palestinian markets associated with closures erodes households' purchasing power and inflates production costs. Weak exports performance and growing imports increased the trade deficit to an unprecedented 79 per cent of GDP, up from 75 per cent in 2007 and 61 per cent in 1999.

17. Closures have also deepened Palestinian economic dependence on Israel, with the share of Israel in Palestinian trade rising from 63 per cent in 1999 to 79 per cent in 2008. The trade deficit with Israel as a percentage of GDP is estimated to have increased from 38 per cent in 1999 to 56 in 2008. The latter is equivalent to more than 140 per cent of the total donor support received by the Palestinian Authority in 2008, and to 71 per cent of the overall Palestinian trade deficit.

II. Devastation of Gaza: another blow to the war-torn economy

18. At the time of writing this report, six months have lapsed since the launching of the Israeli military campaign in Gaza, but Gaza's local economy is still waiting for reconstruction to commence as it remains under an almost complete blockade since June 2007. This constitutes the latest episode in a series of Israeli measures since the occupation of the West Bank and Gaza in 1967. As documented by United Nations agencies and human rights organizations, these measures have driven larger segments of the population

[11] IMF (2009). Macroeconomic and fiscal framework for the West Bank and Gaza: third review of progress. Staff report. IMF. Washington DC.

into the ever-widening and -deepening pool of destitution, while effectively setting limits to Palestinian development prospects. It is against this background that the consequences of the recent military offensive should be assessed.

A. Destruction and economic losses[12]

19. Since the Israeli unilateral withdrawal from the Gaza Strip in 2005, the territory witnessed alternate periods of relative calm and of military operations. In an unprecedented escalation, the Gaza Strip endured a massive Israeli military campaign from 27 December 2008 to 18 January 2009. The human toll was grave with 1,326 direct deaths, 5,450 injuries and over 100,000 internally displaced persons, and long-lasting adverse consequences on Gaza's human capital. The Gaza Strip, where 40 per cent of the occupied Palestinian territory's population lives, has seen widespread destruction of infrastructure, productive capacity and livelihoods. Initial estimates put the economy's direct and indirect losses at around $4 billion, including the costs associated with cushioning the humanitarian impact of the military campaign of around $1 billion.

20. The first PCBS assessment in January 2009 put direct losses at around $1.9 billion; 135 per cent more than Gaza's 2006 GDP. This takes into consideration the massive damage to basic infrastructures; complete or partial destruction of more than 21,000 public and private buildings (14 per cent of Gaza's structures); spoilage of raw material stocks; and damage to Gaza's electricity grid and its water and sewage networks. In-depth sectoral estimates indicate that total direct losses could reach $2.5 billion. As a result of the complete halt in economic activity during the offensive, Gaza also suffered an estimated $88 million in GDP losses.

B. Fragile ceasefire and economic insecurity

21. In response to the escalation of the conflict, the United Nations Security Council on 8 January 2009 issued resolution 1860, which calls for an immediate ceasefire and the unimpeded provision and distribution throughout Gaza of humanitarian assistance by creating and opening transit corridors for the sustained delivery of humanitarian aid. Ten days after the resolution, the ceasefire was established, but the blockade was not lifted. Presently, travel in or out of Gaza remains restricted, except for a limited number of humanitarian cases, and the main commercial crossing points with Israel and Egypt have been closed for most of the scheduled working days. The restrictions on imports of materials and spare parts needed for reconstruction and on the entry of cash and fuel have

---

[12] This and the following two sections draw on data and information from the following reports: B'Tselem. www.btselem.org/English/Gaza_Strip/; OCHA (2009). Field update on Gaza from the Humanitarian Coordinator: January–May; OCHA (2008). Electricity shortages in the Gaza Strip: situation report; OCHA (2007). The humanitarian impact on Palestinians of Israeli settlements and other infrastructures in the West Bank; OCHA (2005). Preliminary analysis: the humanitarian implications of the February 2005 projected West Bank barrier route; PCBS (2009). *Preliminary Estimates for the Economic Losses in Gaza Strip Caused by Israeli Aggression*. Ramallah, PCBS; PCBS (2008). Press release: poverty and living conditions in the Palestinian Territory – 2007; PCBS (2008a). *Survey on the Impact of the Expansion and Annexation Wall on the Palestinian Localities that the Wall Passed Through*. Ramallah, PCBS; UNDP (2009). Inside Gaza: attitudes and perceptions of the Gaza Strip Residents in the aftermath of the Israeli military operations; UNDP (2008). Unemployment in the occupied Palestinian territory. *Development Times*. 2; WFP et al. (2008). Joint rapid food security survey in the occupied Palestinian territory.

been maintained. Restrictions on the entry of aid packages are eased erratically, rendering the delivery of emergency relief a difficult task.

22. Economic security, access to sources of livelihoods and living conditions in the Gaza Strip are at their worst since 1967. Palestinian farmers remain unable to access agricultural lands located along the borders with Israel and fishermen's access to fishing areas has been reduced to a narrow zone within three nautical miles off the Gaza shores – 15 per cent of the area established under the Oslo Accords. More than half of the population experiences intermittent electricity supply and 90 per cent have limited access to drinking water. Poverty has affected 90 per cent of the population, of whom 65 per cent are living in extreme poverty. Food availability is volatile, depending on the opening of border crossings and farmers' ability to resume production.

23. In view of the eroded productive base, it is likely that the coming few years will witness the destitution of even larger segments of the population, with initial estimates suggesting that Gaza will accumulate additional income losses of more than $700 million in 2009, half the size of Gaza's GDP in 2006. The devastation of Gaza has strongly reinforced the already existing de-development momentum. Agriculture and industry have been marginalized, together accounting for only 21 per cent of GDP and 28 per cent of employment. On the other hand, public administration and services sectors have become the main employer. They absorbed 54 per cent of Gaza's labour force in 2008 up from 37 per cent in 1999. The ultimate impact of this momentum is the systematic erosion of the Palestinian productive base, particularly in Gaza, which deprives the Palestinian people of their ability to produce and feed themselves, and turns them into poor consumers of essential goods imported mainly from Israel and financed mainly by donors.

C. Reconstruction plans yet to be implemented

24. The reconstruction of Gaza is guided by the 2009–2010 Palestinian National Early Recovery and Reconstruction Plan (PNERRP), with an estimated reconstruction cost of $2.8 billion. This includes $1.3 billion for early recovery and $1.5 billion for budget support and supplementary emergency budget support for 2009. Donors responded positively at the international conference held in Sharm El-Sheikh on 2 March 2009, with $4.5 billion in pledges for the PNERRP and other activities in 2009–2010.

25. However, the disbursement of the international commitment to Gaza's reconstruction has yet to begin in earnest, with most donors conditioning the release of funds upon Palestinian political developments. Only 39 per cent of the United Nations Emergency Appeal has been financed. A closer examination of the aid effort shows that there remains much room for improving aid effectiveness:

(a) It is difficult to establish the additionality of pledged aid. The $4.5 billion pledged came after $7.7 billion was pledged at the December 2007 Paris Conference in support of the PRDP. Given historical trends and donor attitudes, it is not reasonable to assume that the total pledged amounts to $12 billion. Rather, this suggests double pledging by some donors and overlap of medium- with short-term programming. This could reflect inadequate attention to the lessons of aid effectiveness, as regards predictability, national ownership of aid and the complexities of such a serious humanitarian crisis;

(b) It is difficult to delineate the resources allocated for Gaza's reconstruction, as the 2007 and 2009 conferences featured a special emphasis on supporting the PRDP, while the implementation of both is increasingly contingent on political conditionalities;

(c) The bulk of pledges for the PNERRP and the PRDP are earmarked for budget support. According to the Palestinian Authority, 64 per cent ($5.7 billion) of the two plans' combined resource requirements are for budget support. This reflects a continuation of previous trends where the share of private and productive sectors has been consistently modest. For all the virtues of boosting aggregate demand through public sector wage stimulus, such an approach will have very little impact on the critical need to revitalize the eroded and destructed productive base.

26. The simple lesson to draw from the recent past is that the scope and quality of donor response should perceive the recent damage inflicted on the Palestinian economy in general, and Gaza in particular, as unfolding against a background of prolonged occupation and protracted conflict and isolation. The aid effort should be based on a coherent development strategy for the envisioned State of Palestine that goes beyond budgetary allocations and generic statements of objectives. The strategy should aim at supporting, rebuilding and expanding the eroded productive base to allow the Palestinians produce domestically, feed themselves, employ their growing labour force and reduce their reliance on international aid and the forced dependence on imports that mainly come from Israel. Otherwise, linking relief efforts to strategic development objectives and hence ensuring the viability of the envisioned Palestinian State will be an elusive task.

27. Needless to say, improving aid effectiveness is insufficient to steer Gaza out of destitution, unless paralleled by immediate measures to break the tight siege of Gaza. If no action is taken beyond securing safe passage to Gaza for humanitarian aid and restoring the status quo ante at the borders, the population will become completely dependent on international aid and Israeli good will at the borders. Targeted efforts should also seek to re-establish the severed commercial and production networks between Gaza and the West Bank. Otherwise, the two regions will remain economically separated, thereby aggravating regional disparity and further reducing the potential of the Palestinian economy. Finally there is a critical need to empower Palestinian policymakers with the full range of economic policy instruments required for the management of the war-torn economy and placing it on the path of recovery and sustained growth. Some of these broader prerequisites are examined below.

III. Continuity and change in Israeli policy towards the economy of the occupied Palestinian territory[13]

28. The Accra Accord[14] agreed that sustained assistance to the Palestinian people was needed not only to reduce the negative impact of economic and social adversity in the occupied Palestinian territory, but “with a view to creating the conditions conducive to building a sovereign and viable Palestinian State”. This commitment, reflecting an unprecedented global consensus on the need for a two-state solution, comes at a moment when the prospects for such a solution have been diminished by the dynamics of conflict and the economic, territorial and institutional policies that prolong occupation.

A. Occupation, sovereignty and development

29. Successive Israeli Governments’ policies towards the Palestinian economy have been the overriding determinants of Palestinian economic performance and developmental prospects. Since 1967 these have evolved from aiming to integrate Palestinian economic resources into Israel’s “mainland” economy, to acting to marginalize and isolate the economy and markets of the occupied Palestinian territory from that of Israel and the world.

[13] This section of the report is extracted from a longer review with the same title (forthcoming).
[14] UNCTAD (2008). *Accra Accord.* UNCTAD/IAOS/2008/2.

Over the years, through unilateral action or economic and political agreements with Palestinian partners, this has contributed to a diminishing Palestinian economic and productive base and reduced prospects for the emergence of the economy required for a sovereign Palestinian State.

30. In 2009, when the call for a viable Palestinian State is back on the international agenda, economic policymakers can benefit from a candid assessment of how prolonged occupation and the economic policy framework that sustains it has undermined the prospects of the envisioned state. Whatever form a new phase of Israeli policies towards the Palestinian economy might take, if it is not compatible with the establishment of sovereign economic institutions and adequate national economic policy space, its impact will ultimately only prolong and deepen the occupation.

31. It is in this context that the early 2009 announcement of "economic peace" initiatives by the new Israeli Government should be understood. In particular, it is important to examine the extent to which these "new" Israeli initiatives differ from, or are a component of, long-standing Israeli policy towards the Palestinian economy. Through a review of 25 years of reporting by UNCTAD, a coherent argument emerges for a bold departure from the conventional international economic policy approach, which has left unchallenged the context, frameworks and policies of occupation. An alternative model recognizing the realities of the Palestinian economy and the evident incompatibility between occupation and development becomes imperative.

B. Israeli policies towards the Palestinian economy before and after 1994: from "skewed economic integration" to "physical separation"

32. For four decades, Israel's relations with the occupied Palestinian territory have been managed by the Israel Defence Forces. Its "Civil Administration" (currently the Coordinator of Government Affairs in the Territories) assumed authority for Palestinian social, economic, political and institutional affairs in 1967. The regulations devised to manage the economy were intended to ensure harmony with Israeli regional and international policy concerns, as summed up in the 1980s by the official stance that in the territories "there will be no development initiated by the Israeli Government, and no permits will be given for expanding agriculture or industry (there), which may compete with the State of Israel".[15]

33. Israeli policy towards the economy of the occupied Palestinian territory until the 1990s featured a careful integrationist strategy that extracted labour, land and other resources from the territory while depriving Palestinians of requirements for independent economic development. The result of this deliberate yet selective "integrationism" was the increased vulnerability of the Palestinian economy to Israeli economic, political and security prerequisites. This overall strategy was enacted through various power-sharing arrangements under elaborate schemes announced such as "condominium" and "devolution", in which economic development and territorial planning remained the prerogative of the occupying power. The distorted vision of "development under occupation" ensured a cost-free, skewed integration of Palestinian infrastructure and economic resources to Israel.

34. Israel's earliest "physical separation" strategies in response to the first intifada gave rise to Palestinian popular economic development initiatives aimed at "self-reliance". Given

[15] UNCTAD (1986). Recent economic developments in the occupied Palestinian territories. UNCTAD/TD/B/1102.

the severity of the Israeli response to such initiatives, these had varying degrees of success. Israeli strategies in this last phase of direct military administration of the occupied Palestinian territory were aimed at leaving some room for economic incentives while applying security and related measures that limited the scope of Palestinian productive and income generation activities by effect, if not by design.

35. The Oslo Accords and the self-governing arrangements that it conferred upon the PLO, to be managed by the Palestinian Authority, were heralded by their signatories as a break with the past. Much of that confidence was based on the provision that the Accords, including the Protocol on Economic Relations (PER), would serve for an interim period, with permanent status issues to be negotiated and agreed upon by 1999. However, far from promoting Palestinian economic and territorial integrity, the extended interim period arrangements actually entrenched a skewed integration of the Palestinian economy with the more advanced and higher-income Israeli economy. Physical separation measures meanwhile gained pace as Israeli settlement and closure measures in the territory expanded and violence erupted.

36. The economic institutions that the PER enabled the Palestinian Authority to build did entail a withdrawal of the Israeli Civil Administration from those areas where the Palestinian Authority was granted jurisdiction – an unprecedented ceding to Palestinian hands a range of economic and local management functions that hitherto had been under direct Israeli control. While the Palestinian Authority strove to portray institutions as “national” in their purpose, the actual limits to their regulatory or enforcement authorities soon became apparent. Hence while some policy management space was granted, the more pertinent question is how much the economy gained. Did the PER result in a less adverse impact of occupation on prospects for development (more policy space)? Did long-term benefit accrue from the prolonged proximity to, and under the PER enhanced intimacy with, the Israeli economy? Indeed the limited policymaking space might have been tolerable and, in retrospect, justifiable, had the latter criterion alone been satisfied.

37. Had economic relations between the two economies been confined to the dynamics of free market forces, over time the gap between per capita incomes should have narrowed. What happened in fact was the opposite. The pattern was one of a slow convergence during the first two decades of occupation followed by divergence. Palestinian GDP per capita grew from 11 per cent of that of Israel to 14 per cent until the end of the 1970s, but then the ratio declined continuously, except for a brief improvement during the 1990s. By 2000 it was still below its pre-Oslo level and since then has plunged further, to half its peak of 30 years ago.

38. The architects of the PER framed the interim period as one of reconstruction and growth. The Palestinian Authority adhered to the protocol, just as it tolerated its weaknesses, on the assumption that it would ensure a new, hospitable economic environment featuring open borders, lifting of economic restrictions, an end to settlement expansion and an international commitment to finance reconstruction and development. It seemed plausible to many at the time that such factors would enable the Palestinian Authority to adopt an autonomous economic policy emphasizing growth and development. But as evident from the actual record of the past 15 years, these did not materialize, and any institutional gains of the pre-2000 period have since dissipated.

39. Within the “security first” logic underlying the Oslo Accords and the subsequent agreements, the collection by Israel of Palestinian customs duties and value added tax on imports effectively gave the latter control over significant parts of Palestinian public revenues. These and related aspects of the PER were justified on the ground of short-term expediency and the need to ensure compliance by the Palestinian side before greater sovereignty was transferred. However, the interim period showed that the institutionalization of these measures inflicted a heavy toll on the Palestinian economy in

the context of what may be termed a policy of “asymmetric containment”.[16] By design, these measures are serious enough in their potential ability to harm Palestinian interests through the threat of asymmetric pressure, where Israel justifies the withholding of transfers and other similar acts as a response to a lack of security compliance by the Palestinians.

C. Israeli “economic peace” or a Palestinian economic strategy for peace?

40. By 2009, 15 years after the PER came into existence as an interim economic agreement valid only for a five-year period that was never formally renewed, it remains the de facto economic law of the land. Whatever life it had in it has been lost to the impact of protracted conflict and the failure of the political negotiation process between the parties to yield results. Evolving Israeli strategies towards the Palestinian economy have shrunk Palestinian policy space and eroded Palestinian institutional capacity and the productive base. This contravenes one of the expressed purposes of the PER: “strengthening the economic base of the Palestinian side and … exercising its right of economic decision-making in accordance with its own development plan and priorities”.

41. Whatever strategy might have been pursued in the four decades of Israeli occupation of the Palestinian territory, there has been one constant in the equation: expanding Israeli settlement and occupation controls as against diminishing Palestinian economic policy space, territory and economic structure and scale. Such structural asymmetry cannot provide for an equitable economic relation, nor would it pass the test of compliance with multilateral trade laws and the standards of international economic relations that must be factored into any future political settlement. This asymmetry has deepened Palestinian structural economic dependence on Israel with very little benefits to the Palestinian economy or its impoverished population.

42. Economic indicators clearly show that the economic policy status quo is neither optimal nor even second best. The Palestinian economy has become locked into the PER framework and its development prospects are no better than during direct military occupation. But recent international developments suggest that this could be a historical moment when viable statehood and sovereignty should be the order of business and recognition of the need to address Palestinian national economic security should be forthcoming. The time is opportune for a new phase in Palestinian economic self-determination to support efforts for national self-determination in the broader sense, in line with relevant United Nations resolutions.

43. However, in 2009, far from making a clean break from the “occupation first” logic and the realities that have determined the Palestinian economic trajectory, the idea of further reform of existing Palestinian Authority institutions to better serve a much prolonged interim period continues to take precedence over the need to form the economic policy and institutional framework for statehood. The experience of the past decade of reforming the Palestinian Authority does not support the notion that with enough tinkering with institutional governance and other preconditions being satisfied, the nascent Palestinian State will be significantly better equipped for “policy launch” than it would have been in 2002 when the international community first endorsed its establishment.

44. It is within such a perspective that the new policy orientations of the latest Israeli Government in its relations with the Palestinian Authority, with an emphasis on improving economic conditions, should be understood. The Israeli Prime Minister has argued that the

[16] Khan M (2004). *State Formation in Palestine: Viability and Governance During a Social Transformation*. London, Routledge.

first step to a lasting peace needs to be the fostering of the Palestinians' economic situation. He has called for an "economic peace", without defining its parameters, to boost the moribund Palestinian economy and lay the groundwork for future peace talks. According to initial reports, the Prime Minister intends to form an inter-ministerial committee whose task will be to coordinate the government's activities in this area vis-à-vis the international community and the Palestinian Authority. This committee will work on "developing the Palestinian economy" and "improving the quality of life" in the West Bank. The committee is reported to be seeking to advance some 25 economic initiatives in the West Bank. However, the Palestinian response to these initiatives is best summarized by the PLO senior negotiator, who has commented that "rather than ending the occupation", the Israeli Prime Minister "has proposed an 'economic peace' that would seek to normalize and better manage it. Instead of a viable Palestinian State, his vision extends no further than a series of disconnected cantons with limited self-rule".[17]

45. A renewed Israeli economic strategy to improve the quality of life in the occupied Palestinian territory would testify to a failure to heed the lessons of 40 years of occupation. The PER could not disengage the Palestinian economy from the skewed economic integration-cum-physical separation dynamics with which Israel has administered its economic relations with the occupied Palestinian territory. The expectation that some inducements to improve individual welfare might succeed today where they failed a generation ago is detached from the reality of the past years. That the bold promise of Oslo of development and ultimately independence, may be abandoned for another interim period is tragic – especially in the context of the prolonged occupation and the much deteriorated Palestinian economic, political and social capacities.

46. It is not adequate to simply dismiss this latest economic strategy towards the Palestinian Authority. Instead, it is incumbent on policymakers to carefully examine whether the lessons of prolonged occupation do not instead call for an initiative to define a Palestinian economic strategy for sovereignty and peace – not only predicated on the imminence of statehood, but also cognizant of the imperative of dismantling occupation so that statehood can be viable. The principles of state viability and a peaceful two-state solution would enhance longer-term development prospects. It would also be an incentive towards peace by demonstrating Palestinian readiness to adopt the economic policy and related legal and institutional frameworks necessary for the two-state solution to succeed.

47. A shift is needed in the dynamics of Palestinian economic policy from those driven by the prerequisites of occupation to those that ensure protection through applying the rule of law and the rules governing international economic relations. While the legal framework defined by the PER remains the legal departure point for any repositioning of the Palestinian economy, it should not define the parameters or the policy framework reform needed for a Palestinian State to be viable and peaceful from day one. Rather, a different set of principles should be highlighted in trying to carve out economic policy space for a Palestinian State, which can safeguard its sovereignty in a world of global interdependence and market liberalism, such as:

(a) Restoring the territorial integrity of the West Bank and the Gaza Strip, as affirmed in the PER and as undeniably necessary for viable statehood;

(b) Recognizing the separateness of the Palestinian Authority customs territory, which is implicit in the choice made in 1994 by Palestine to opt for a customs union with the separate customs territory of Israel;

[17] Erakat S (2009). "Israel's step back from peace." *Washington Post*, March 28.

(c) Addressing the special needs of a newly independent, war-torn state as it emerges into the community of nations and ensuring that it has access to all possible tools to manage and gradually enhance its economic policy space as its development needs evolve;

(d) Beginning today to form the institutions for a viable state rather than pursuing the incessant reform of institutions of self-government that function according to a set of promises whose fulfilment remains elusive – a policy process leading nowhere.

48. Although expanded policy space on its own cannot shield the economy from the impact of occupation, empowering national institutions (even under occupation) is essential to enhancing enterprises' and households' resilience in the face of crisis. One multilateral forum where Palestine can translate these principles into a policy platform for a sovereign national economy in the making is the World Trade Organization (WTO). In concrete terms, a new Palestinian economic strategy should entail, among other moves, early consideration of the acceptance of Palestine, in its capacity as representing the separate customs territory administered by the Palestinian Authority, as an observer in the WTO. Such a move would require the support of all WTO members, especially current and future main trading partners who would eventually shepherd an accession process once it begins.

49. While it would take years to shape the economic policy and institutions of the new state, such an initiative would confer immediate economic benefits and a measure of economic policy autonomy, for Palestine. By reanchoring the nominal autonomy of the economy within a cooperative, multilateral recognition framework rather than in the redundant and dysfunctional bilateral framework of the PER, Palestine can define a benchmark and a broad reference platform for market liberalism, transparency and equity. This would in turn help to shape national economic institutions in the area of trade, public finance, monetary and macroeconomic policy, as well as a wide swath of economic regulation to which all members of WTO aspire. By shifting Israeli–Palestinian economic relations away from a bilateral level that actually masks a unilateral policy, such a new status would be an incentive to state-building efforts in a rules-based, multilateral setting.

50. This would reconfirm the Palestinian commitment to peace and at the same time support the efforts for viable statehood and effective sovereignty. By focusing on the real economic needs of statehood, it would also help to save the precious time that remains before realities on the ground have been transformed too drastically. It is high time to shift the paradigm of Israeli–Palestinian economic relations from that of occupation and denial of sovereignty to one of parity between partners within a multilateral framework of peaceful cooperation.

IV. UNCTAD assistance to the Palestinian people

A. Framework and objectives

51. Building on the experience of the secretariat as a whole, and in close cooperation with the Palestinian Authority, the UNCTAD programme of assistance to the Palestinian people seeks to support Palestinian reform and development efforts within four clusters: (a) trade policies and strategies; (b) trade facilitation and logistics; (c) finance and development; and (d) enterprise, investment and competition policy. The programme is constantly evolving in response to the Palestinian economy's emerging needs, featuring multifaceted advisory, training and institution-building activities tailored to balance immediate intervention with strategic national development objectives.

52. Last year saw further consolidation of this programme to ensure prompt response to Gaza's deepening economic crisis and to economy-wide development challenges. This has involved designing an emergency rehabilitation package for Gaza and fine-tuning ongoing activities to maintain focus on creating the necessary conditions for Palestinian economic viability and statehood.

53. However, programme implementation continued to be impeded by Israeli mobility restrictions on national trainees and project staff as well as on UNCTAD experts' access to the occupied Palestinian territory. The secretariat was also unable to forge ahead with planned activities in the Gaza Strip owing to political instability.

54. Nonetheless, UNCTAD has succeeded in circumventing the adverse field conditions and maintaining steady progress in its activities as it further developed its selective and flexible mode of operations. To ensure the full implementation of the secretariat's mandate on assistance to the Palestinian people, UNCTAD will intensify its technical assistance activities to mitigate the adverse socio-economic conditions and support the establishment of a sovereign and viable Palestinian State in accordance with the United Nations Medium-Term Plan for 2009–2010, paragraph 44 of the Accra Accord and Security Council resolution 1397.

B. Emergency rehabilitation package for Gaza

55. Drawing on its intimate knowledge of the Palestinian economy and long-standing expertise as the United Nations focal point for the interrelated treatment of trade and development, the secretariat designed an emergency response package to support the rehabilitation of the war-torn Gaza Strip. The package proposes a programme that aims at creating synergies between emergency needs and strategic development objectives. Activities are designed to be implemented within the context of a multi-year plan to enable proper sequencing and flexibility to address unforeseen developments. The proposed activities, elaborated in consultation with relevant Palestinian Authority departments, include:

(a) Monitoring the economic impact of occupation on poverty and the prospects for establishing a viable and sovereign Palestinian State;

(b) Interventions targeting immediate needs: poverty reduction; food security and commodity trade; trade facilitation; and enterprise rehabilitation and development;

(c) Activities targeting medium- and long-term objectives in the areas of trade policy, industrial estates and business and investment retention and promotion.

56. UNCTAD will cooperate with other United Nations agencies, international and regional institutions to seek financing for the proposed programme.

C. Operational activities underway

57. Progress was achieved in the implementation of the Development Account project on promoting subregional growth-oriented economic and trade policies towards achieving Millennium Development Goals 1 and 8 in the occupied Palestinian territory and five other Arab countries. The project team of experts has been established and six national policy papers were prepared for discussion at the first workshop in Beirut in June 2009.

58. The implementation of the Automated System for Customs Data (ASYCUDA) project to modernize Palestinian customs has seen impressive progress since 2008. It covers customs procedures, information technology, capacity-building, training and system

applications. In preparation for the system’s complete roll-out to all customs offices, the new ASYCUDA World was configured and launched in June 2009. However, the blockade of Gaza has confined the progress to the West Bank. Project staff is ready to extend the system to Gaza once the political situation improves.

59. By October 2008, the secretariat had successfully completed the project on the establishment of the Palestinian Shippers’ Council. As stated in the final project report, its objectives have been achieved. The council is a vibrant private sector institution engaged in facilitating Palestinian trade with a committed board of directors, and the secretariat continues to cooperate with the new institution as needed.

60. Coordination is ongoing with the Ministry of National Economy to support the Palestinian Authority’s efforts to integrate into the multilateral trading system. Activities under consideration include capacity-building, training and advisory services to assess the advantage of, and establish consultation mechanisms for, building a national consensus on the WTO accession process.

61. UNCTAD is in communication with the Ministry of Finance to consider the resumption of activities under the project “Strengthening Capacities in Debt Monitoring and Financial Analysis System (DMFAS)”, which was suspended due to lack of funds.

62. Implementation of the Investment Retention Programme under a follow-up phase II project and the Support for Small and Medium Enterprise Development Programme (EMPRETEC Palestine) continue to be on hold due to a funding shortfall.

D. Resource mobilization, coordination and harmonization

63. Both the design and implementation of the secretariat’s programme of assistance to the Palestinian people proceeded in coordination with the relevant activities of UNRWA, the United Nations Special Coordinator for the Occupied Territories (UNSCO), UNDP, the Economic and Social Commission for Western Asia (ESCWA), ILO, the World Bank and the IMF as well as national civil society institutions. UNDP has continued to extend indispensable logistical and liaison field support to UNCTAD.

64. The programme has benefited from generous extrabudgetary support from the European Commission and the United Nations Development Account. However, capitalizing on previous achievements and the secretariat’s partnerships is undermined by funding shortfalls. It is now more necessary than ever to secure predictable and comprehensive extrabudgetary support for its work in this area.