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The Palestinian economy: Macroeconomic and trade policymaking under occupation*

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Executive summary

The occupied Palestinian territory of the West Bank and Gaza Strip has been under Israeli occupation since June 1967. In May 1994, following the signing of the Oslo Accords of September 1993 between the Palestine Liberation Organization (PLO) and the Government of Israel, the Palestinian Authority assumed limited self-rule over parts of the occupied Palestinian territory. After 1967, the occupied Palestinian territory was cut off from previous trade relationships and forced into asymmetrical economic ties with Israel. The occupied Palestinian territory became a "partner" with Israel in a de facto, one-sided customs union – Israeli products had free access to the Palestinian markets, while Palestinian exports to Israel were subject to a wide range of restrictions. As result, the Palestinian economy has experienced a major structural deformation and has turned into an economy characterized by two growing disequilibria: a resource gap and labour market imbalance, and an unhealthy dependence on external sources of income. It also features a sectoral disarticulation and an underdeveloped infrastructural basis.

This study identifies the distortions inflicted on the economy of the occupied Palestinian territory over the last four decades. It illustrates the economic changes brought about by the establishment of limited self-rule in 1994 and analyses the economic relationship established by the Paris Protocol on Economic Relations, hereafter referred to as the Paris Protocol, which was signed by the PLO and the Government of Israel in April 1994. The study argues that the implementation of the Paris Protocol, which mainly served the interests of Israel, has undermined the emergence of new mutually beneficial relationships between the two sides, and instead reinforced the skewed economic relation cemented by the occupation.

The analysis of the relationship between trade, growth, employment and poverty in the occupied Palestinian territory suggests that there is no systematic relationship between trade and growth. First, gross domestic product (GDP) per capita has been declining over the last two decades and the trade ratio exhibits no trend with unstable or erratic behaviour. Second, the bulk of Palestinian unemployment is of a long-term nature, and intermittent periods of growth did not reduce the severity of unemployment. The two conclusions emphasize the need for a new strategy to overcome the vicious circle of unemployment and poverty and to position the economy on the path of employment-intensive growth. The first dimension of the strategy stresses the need to link all relief, emergency and financial aid measures to Palestinian development priorities and to improve the efficiency of donor aid so as to expand the capacity of the economy. The second dimension deals with improving the investment climate and attracting foreign direct investment (FDI) through the implementation of reform measures to reduce the risk and costs associated with investment in a war-torn economy. The third dimension calls for a pro-growth strategy that empowers the poor by improving their access to education, health services infrastructure, credit and social safety nets.

The study stresses that the Palestinian economy would not be able to implement such a strategy in its present situation, characterized by severe Israeli control over Palestinian territorial, regulatory and trade policy affairs. Thus, the strategy has to set as its objective the sovereignty of the Palestinian trade sector and policy space. In trade terms, this includes the diversification of trading partners – away from Israel – and efforts at expanding Palestinian trade policy capacity and space. Guided by this consideration, the study treats regional integration, which has so far been denied to the Palestinian economy, as an avenue through which the Palestinians can explore this strategy of reducing dependence on trade with Israel, in line with the broader goal of achieving economic independence as a prerequisite for sovereignty and independence. The study highlights the need for regional coordination and harmonization in the key areas of infrastructure, trade, and monetary and fiscal policies. Such regional integration can provide Palestine with the much-needed policy space and recognition as a separate customs territory, rather than a subset of Israel's customs envelope.

Abbreviations

AfT	Aid for Trade
FDI	foreign direct investment
GAFTA	Greater Arab Free Trade Area
GDP	gross domestic product
NAFTA	North American Free Trade Agreement
OCHA	Office for the Coordination of Humanitarian Affairs
PCBS	Palestinian Central Bureau of Statistics
PLO	Palestine Liberation Organization
RCA	revealed comparative advantage
VAT	value added tax
WTO	World Trade Organization

Introduction

Within the mandate of the United Nations Development Account project on promoting subregional growth-oriented economic and trade policies towards achieving the Millennium Development Goals in selected Arab countries, this publication intends to examine the relationship between growth, trade, employment, unemployment and poverty in the Palestinian economy in the occupied West Bank and Gaza Strip. Guided by the findings of the study and inquiring into the potential gains from Arab regional integration, the publication will provide policy recommendations on the role of the Palestinian Authority in adopting a pro-poor growth strategy and a development-driven trade policy that aims at reducing unemployment and poverty in the occupied Palestinian territory.

Following this introduction, the second section of this study presents a brief account of the Palestinian economy under occupation, with a particular emphasis on the trade sector, as well as the role played by the Palestinian Authority in shaping the nature and direction of trade policy in the occupied Palestinian territory. Given the role of donors in the process of trade policymaking, the third section is devoted to an analysis of donors' approach to trade and the extent to which this has influenced Palestinian trade policymaking. This is followed by an examination of the relationship between growth, trade, employment and unemployment, and poverty in the occupied Palestinian territory. The paper ends by recommending elements of a poverty-reducing and employment-enhancing growth and trade strategy for the Palestinian economy.

I. The Palestinian economy – a brief review

A. Occupation-related distortions of the Palestinian economy

Since its occupation of the West Bank, including East Jerusalem, and Gaza Strip in 1967, Israel has imposed numerous military and economic measures that have affected all sectors of the Palestinian economy, resulting in long-term economic disequilibria and, in some cases, irreversible de-development. The following discussion highlights discuss some aspects of the recent developments in sectors of the Palestinian economy most relevant to this study.

Denial of access to natural resources

It is estimated that over the last four decades, Israel has confiscated more than half of the land in the West Bank, with the number of Israeli settlements reaching 134 (West Bank, including East Jerusalem), and the number of settlers, 500,000 (Office for the Coordination of Humanitarian Affairs (OCHA), 2009). This has substantially reduced the area available for Palestinian rain-fed and cereal farming. Furthermore, Palestinians in the West Bank use only about 15–20 per cent of the water available annually in the area; the rest is used by the Israeli settlements and within Israel itself. In 2002, Israel started building the separation barrier in the West Bank creating numerous, isolated bantustans, disintegrating the West Bank even further. More Palestinian farmland and water resources were confiscated for the construction of new settlements, military outposts and bypass roads; further, agricultural production infrastructure, including water wells, irrigation networks, agricultural roads, greenhouses and farms, was destroyed. This has dealt a further blow to the geography and economy of the West Bank.

The latest figures from 2009 show that land confiscation has resulted in 40 per cent of Palestinian land in the West Bank lost to settlements and related infrastructure. The construction of the 709-km separation barrier reinforced this, as around 85 per cent of its projected path cuts deep into the West Bank, limiting farmers' access to their land (OCHA, 2009). The need for "difficult-to-obtain permits" to pass through gates to access their lands, has discouraged many farmers from even applying, in some cases forcing them to abandon their land to the west of the barrier (UNCTAD, 2010). The construction of the barrier implies a permanent loss of 8 per cent of Palestinian agriculture products. In Gaza, farmers are denied access to agricultural lands within the 300–1,000 meter-wide "buffer" zone along the 45 km of Gaza's borders with Israel. After June 2009, 46 per cent of the farmland in Gaza was inaccessible or out of production. Similarly, Palestinian fishermen are not allowed to fish beyond three nautical miles from the Gaza shore instead of the internationally recognized 20 miles (UNCTAD, 2010).

Closure and blockade: inhibiting transaction costs

Palestinian livelihood and development have been curtailed in the face of Israeli settlement activities, land confiscations, recurrent border closures and, since 2002, the construction of the separation barrier. These have not only produced immediate effects on the development of the occupied Palestinian territory, but have also diminished the prospects for a territorially contiguous, viable Palestinian State.

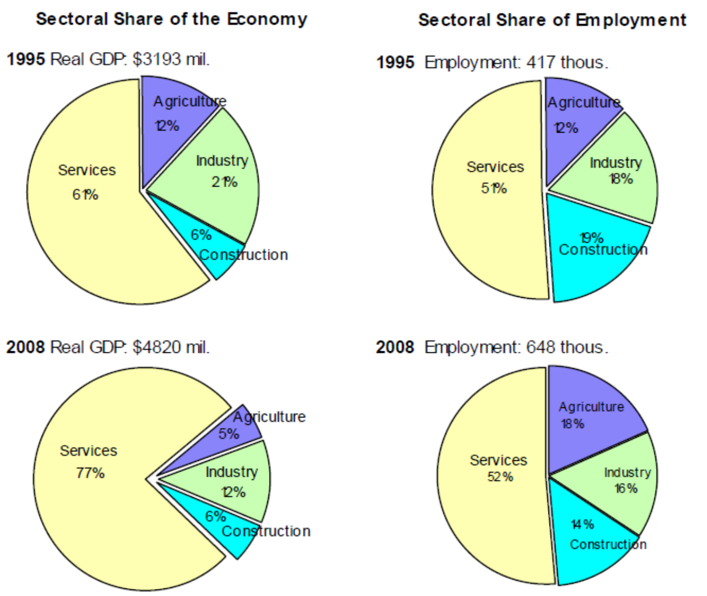
The closures, which have intensified since 2009, have seriously weakened the Palestinian export sector and pushed many firms out of business. Closures have also deepened Palestinian economic dependence on Israel, with the share of Israel in Palestinian trade rising from 63 per cent in 1999 to 79 per cent in 2008. The subsequent trade deficit with Israel as a percentage of GDP is estimated to have increased from 38 per cent in 1999 to 56 per cent 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 (UNCTAD, 2009a). The prohibitive transaction costs at major commercial crossing points in the form of damaged goods and long waiting times have severely affected trading activities. The Israeli closure measures have been further aggravated by the almost complete blockade of Gaza since June 2007, which has brought to a halt most forms of economic activity and trade.

The direct physical damage and indirect cost to the occupied Palestinian territory of the December 2008 war on Gaza adds up to $3.1 billion; it was estimated that it would increase to $3.9 billion by 2011 if Israel continued to impose the blockade and closures (UNCTAD, 2010). This is more than 80 per cent of GDP generated by the occupied Palestinian territory in 2008. Lifting the closure policies is a prerequisite for any improvements in the Palestinian economy, widespread unemployment and deepening poverty.

Eroded productive base

The above trends have resulted in the erosion of the Palestinian productive base, particularly sine the second Intifada and the tightening of the closures and extensive restrictions on Palestinian access to their land and natural resources. According to conservative estimates, the occupied Palestinian territory is now operating with much less than two thirds of its 1998 capital stock (productive base) (UNCTAD, 2008). Figure 1 demonstrates the erosion of the economy's productive capacity: between 1995 and 2008. The share of agriculture in GDP declined from 12 per cent to a mere 5 per cent, while the share of industry fell from 21 per cent to 12 per cent. At the same time, the combined share of the non-tradable goods sector, services and construction rose from 67–83 per cent, with services accounting for all the increase (UNCTAD, 2010). In addition to the impact of the above-mentioned measures, the destruction of physical infrastructure and private and public property is estimated to have cost the economy around $3.5 billion, equivalent to 30 per cent of pre-2000 capital stock (UNCTAD, 2006a). In addition to capital stock losses, it is estimated that the cumulative economic opportunity cost of potential income (GDP) over the period 2000–2004 alone was about $6.4 billion in 1997 dollars (UNCTAD, 2006). This is equivalent to 140 per cent of Palestinian pre-crisis GDP.

Figure 1. Economic and employment structural changes in the Palestinian economy



Source: UNCTAD, 2010.

In such circumstances, there has been no space for private investment recovery to revitalize the eroded productive base. At the same time, government investment in 2008 stood at only around $250 million, a mere 5 per cent of GDP, while industry continued to shrink and construction stagnated (UNCTAD, 2009a). The devastation of Gaza has strongly reinforced the already existing de-development momentum through a further marginalization of agriculture and industry. The systematic erosion of the Palestinian productive base, particularly in Gaza, 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 chiefly by donors.

Leakage of financial resources

The Israeli occupation of the Palestinian territory has also been associated with a continuous transfer of financial resources to Israel. Prior to the establishment of the Palestinian Authority in 1994, this happened in the form of "income transfers" through three main channels: Palestinian payment of value added tax (VAT) and custom duties on goods imported from or through Israel, the income tax and social security contributions paid by Palestinians working in Israel and the seigniorage revenue that Israel received because its currency is legal tender in the occupied Palestinian territory. This fiscal leakage has constituted between 15–25 per cent of Palestinian GNP over the years (Luski and Weinblatt, 1994).

This resource leakage to Israel was further institutionalized in the post-Oslo era and under the terms of the Paris Protocol, whereby the Palestinian trade taxes are supposed to be collected by Israel and transferred to the Palestinian Authority – see box 1 for details. Since then, taxes have been withheld intermittently by Israel as an instrument of political pressure. This trend became even more frequent after the second Intifada. Several holes remain in the arrangements of the Protocol for refunding to the Palestinian Authority the VAT, and customs and purchase taxes paid on the commodities consumed in the occupied Palestinian territory. Various estimates of this leakage put the figure at around 2.6–4.2 per cent of the occupied Palestinian territory's GDP (Kanafani, 1996, 2001).

Box 1. Refunding of indirect taxes between Israel and the Palestinian Authority

There are several forms of trade taxes that are due to the Palestinian Authority but are collected by the Israeli authorities, forming the basis of a large fiscal leakage of Palestinian resources to Israel. These include (a) customs, (b) levies, (c) excises, (d) purchase taxes and (e) VAT.

Case I: Direct Palestinian imports, through Rafah, Damia and Allenby crossing points, of goods from the three lists or of other goods.
Clearance: The Palestinian Authority collects directly (a), (b), (c), (d) and (e).
Case II: Imports via Israel of clearly identified goods that are destined to a company registered in the West Bank and Gaza Strip (either by Palestinian or Israeli importers).
Clearance: The Palestinian Authority receives (a), (b), (c), (d) and (e), minus 3 per cent administration charge kept by Israel.
Case III*:* Palestinian documents (by invoices and bills) re-imports of foreign goods already imported into Israel.
Clearance: The Palestinian Authority receives (e) only, except for fuel, where (d) are also refunded.
Case IV*:* Palestinian documents (by invoices and bills) imports of Israeli manufactured products that have high imported content or on which purchase taxes and other levies and excises are imposed.
Clearance: The Palestinian Authority receives (e) only (the relatively high purchase taxes imposed on Israeli manufactured products are not refunded).
Case V: Palestinian direct purchases of imported or Israeli manufactured products that are not officially documented by bills and invoices delivered to the money clearance subcommittee.
Clearance: The Palestinian Authority receives none.

In practice, refunding of import taxes and VAT between Israel and the Palestinian Authority is based on the place of business registration rather than on where the goods are actually consumed, as clearly stated in the Paris Protocol.

Source: Kanafani, 1998.

Regulatory constraints

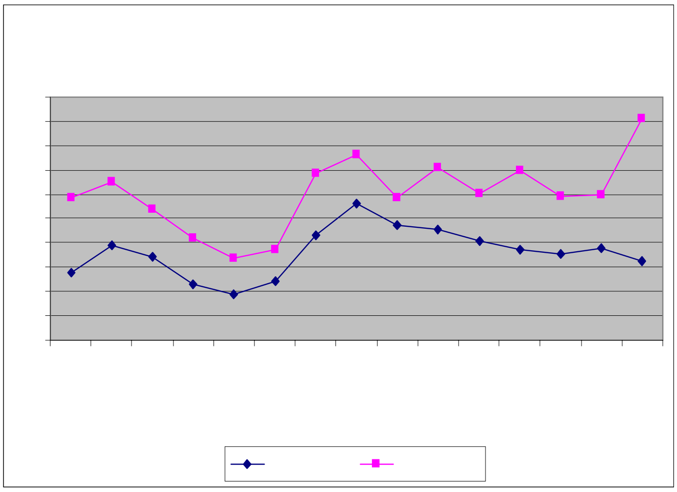
Prior to the Oslo Accords, the Israeli Administration controlled the affairs of the occupied Palestinian territory through its direct military rule. Following the Oslo Accords, this was institutionalized under the terms of the Paris Protocol. Plans by Palestinian businessmen to start new ventures, or to expand old ones, have been often frustrated by delays in granting permits, which are required for all activities related to the acquisition of land, the construction of buildings, the transportation of goods, all financial transactions, and export and import. Investment has been further discouraged by the underdevelopment of effective Palestinian financial intermediation. This reflects the closure of all Arab banks at the beginning of the occupation in 1967 and their reopening on a small scale in the mid-1980s. Other regulations affected the state and pace of technological change and modernization in various economic sectors, with the Israeli authorities regulating imports of advanced machinery and technology to the occupied Palestinian territory, while imposing strict regulations on the type of agricultural products and exports.

Labour market distortions

In 1992, one third of all employed Palestinians – around 120,000 – worked inside Israel. They were often employed in low-skilled jobs, mainly in construction, agriculture and services, at relatively higher wages than in the occupied Palestinian territory. This not only reduced the competitiveness of local Palestinian employers by distorting the wage structure of the local Palestinian economy; it also increased dependence on the Israeli economy as a major source of employment and made the Palestinian labour market and economy vulnerable to the fluctuations in the Israeli economy. As a result, the Israeli demand for Palestinian labour fluctuated with the business cycles, especially in construction, and was further weakened by the substitution of Palestinian workers by foreign workers from Eastern Europe and East Asia in the 1990s (Angrist, 1995). Following the eruption of the second Intifada in 2000, the strict enforcement of the Israeli Permit policy concerning Palestinian workers, and the commencement of the construction of the separation barrier in the West Bank in 2002, the number of Palestinians working in Israel plummeted from some 135,000 in 1999 to 75,000 in 2008. This not only led to a drop in the remittance transfers to the occupied Palestinian territory, but also to higher unemployment and poverty rates, especially in the absence of a viable Palestinian private sector as an alternative source of employment.

According to the Palestinian Central Bureau of Statistics (PCBS), Palestinian unemployment reached a high of more than 31 per cent in 2002. By 2008, this had declined to 26 per cent. As shown in figure 2, these trends have been far more pronounced in the Gaza Strip, with unemployment standing at 38 per cent in 2002 and 40.6 per cent and in 2008 (PCBS, 2009a).

Figure 2. Unemployment rates in the occupied Palestinian territory, 1995-2008 (second quarter)



Source: PCBS, 2008.
Note**:** The above data are based on a relaxed definition of unemployment, which shows the percentage of persons who do not work regardless of whether they are seeking employment.
Abbreviations: Q – quarter**.**

Structural changes in the Palestinian economy

As indicated in table 1, agriculture has traditionally been a leading economic sector and source of employment in the occupied Palestinian territory, with food and agricultural products often constituting at least around 17 per cent of all Palestinian exports (Bouzergan, 2007). However, since 1967 and more so after the signing of the Oslo Accords, the Palestinian agricultural sector's contribution to the economy has declined sharply. This is due to a host of factors, including the confiscation of land and water resources, labour movement restrictions leading to a general shift to the service sector as an alternative source of employment, the unavailability of inputs, restrictions on agricultural exports due to closures, increased production costs and donors' treatment of the agricultural sector as a vulnerable, and therefore weaker, candidate for donor funding – something which has also been reflected in the policies of the Palestinian Authority. This policy bias against the agricultural sector has persisted, despite its emergence as a critical sector in cushioning the high levels of unemployment in the territories following the second Intifada and the massive Palestinian job losses inside Israel.

Production and exports from the agricultural sector are not only vital for providing a strong input base for Palestinian industrial expansion, but they would also reduce Palestinian dependence on the Israeli economy for various agricultural and food products, while generating employment. Agriculture's contribution to Palestinian GDP has almost halved since the early 1990s, constituting only around 4–6 per cent of GDP in recent years.

Table 1. Sectoral share of gross domestic product: Remaining West Bank and Gaza

Sectors	***1999***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Agriculture and fishing	10.4	9.9	7.9	7.1	5.2	5.6	5.6	4.6
Mining, manufacturing, electricity and water	14.5	15.2	17.0	17.1	17.0	15.0	13.8	13.6
Construction	13.7	2.3	5.0	5.7	6.8	7.2	6.2	4.9
Wholesale and retail trade	11.0	10.9	9.8	9.8	9.4	9.6	9.2	10.8
Transport	5.9	9.9	4.6	6.1	5.8	6.6	7.5	8.9
Other services	19.5	22.8	22.8	22.8	23	19.6	22.2	25.2
Public administration and defence	11.0	13.6	16.9	14.3	14.1	15.7	13.9	13.9

Source: Palestine Economic Policy Research Institute (2007, 2009).
Notes: West Bank excludes East Jerusalem in this table.
Figures for 2008 are estimates.

Table 2. Percentage distributions of employed persons in the occupied Palestinian territory by economic activity, 1995–2008

Sectors	***1995***	***1999***	***2002***	***2003***	***2004***	***2005***	***2006***	***2007***	***2008***
Agriculture, hunting and fishing	12.7	12.6	14.9	15.7	15.9	14.6	16.1	15.6	13.4
Mining, quarrying and manufacturing	18.0	15.5	12.9	12.5	12.7	13.0	12.4	12.5	12.1
Construction	19.2	22.1	10.9	13.1	11.7	12.9	11.1	11.0	10.9
Commerce, hotels and restaurants	19.6	17.0	20.0	20.1	19.4	19.4	19.2	19.5	20.2
Transport, storage and communication	4.9	4.7	5.6	5.8	5.4	5.7	5.7	5.6	5.0
Services and other	25.6	28.1	35.7	32.8	34.9	34.4	35.5	35.8	38.4
Total	100	100	100	100	100	100	100	100	100

Source: PCBS, 2009a:80.

The second Intifada, which began in late 2000, and the massive number of Palestinian job losses in Israel, were followed by the 2006 elections of the Palestinian Legislative Council, which put Hamas at the helm of the Palestinian Authority and led to the subsequent withdrawal of donor funding and the Israeli blockade of the Gaza Strip. This was in addition to the continued strict closure policy in the West Bank. The direct consequence was the shutting down of many agricultural and industrial businesses, with unemployment rising to unprecedented levels. It reached nearly 30 per cent in 2007 and more than 40 per cent in 2008 (PCBS, 2009a). According to OCHA (2007), more than 75,000 workers out of approximately 110,000 employed by the private sector were temporarily laid off because of the impact of the closures, and the majority of private businesses have shut down.

The industrial sector did not fare better than agriculture. In 2007, manufacturing constituted only around 9.4 per cent of Palestinian GDP (PCBS, 2009b). This small and declining share was associated with a deteriorating pattern in capital intensity that has prevailed since the early 1990s.[1] In addition, the lack of access to inputs and markets brought about by the Israeli closure policy, as well as the destruction of numerous plants and the productive base, led to a further decline in Palestinian industrial activity. The Israeli measures have also subjected Palestinian exports and imports to

[1] Capital–output and capital–labour ratios in the Palestinian economy have increased steadily since the 1970s (Arnon et al., 1997).

complicated certification procedures, while limiting the development of industry by specifying the types and quantities of raw materials that can enter the territories for use in the manufacturing industries. The dumping of low-priced, poor-quality Israeli industrial goods in Palestinian markets has prevented the establishment of any Palestinian industry that could compete with similar Israeli enterprises. In the meantime, most donor support was focused on emergency and relief assistance with very little attention paid to infrastructure and the industrial and agricultural sectors (UNCTAD, 2006a).

Trade

The decline in Palestinian trade has been a result of the uncertainties and restrictions facing exporters, in terms of timely delivery of their inputs as well as their products. Already flagging, Palestinian trade received a further blow following the second Intifada, when the growth of exports declined from 2.3 per cent in 1999 to -34.8 per cent in 2002, with imports dropping from 5.4 per cent to -17.3 per cent during the same period (Missaglia and de Boer, 2004). The sudden intensification of movement restrictions, Israel's withholding of tax revenues due to the Palestinian Authority, the lack of imported inputs and the closure of borders with the outside world, led to a sudden decline in trade activities inside the territories. With exports declining much faster than imports, the Palestinian trade deficit has grown substantially.

The main problem with Palestinian trade is that Israel is by far its largest trading partner. From 1967 until the signing of the Oslo Accords, 80–85 per cent of Palestinian exports and 80–90 per cent of its imports were to and from Israel. This pattern persisted well after the Oslo Accords and the signing of the Paris Protocol, which reaffirmed Israel's control over Palestinian borders and trade regulations. From 1999 to 2004, Palestinian trade with Israel represented around 64 per cent of total Palestinian trade, reaching 79 per cent in 2008. This implies that the trade deficit with Israel as a percentage of Palestinian GDP rose sharply from 38 per cent in 1999 to 56 per cent in 2008, equivalent to more than 140 per cent of total donor support received by the Palestinian Authority in 2008 (UNCTAD, 2009a).

Table 3. Total value of imports, exports, net balance and transaction trade for remaining West Bank and Gaza Strip, 1995–2005
(Millions of dollars)

	Imports	*Exports*	*Trade balance*
1995	1,658	394	-2,052
1996	2,016	339	-2,356
1997	2,239	382	-2,621
1998	2,375	395	-2,770
1999	3,007	372	-3,379
2000	2,383	401	-2,784
2001	2,034	290	-2,324
2002	1,516	241	-1,756
2003	1,800	280	-2,080
2004	2,373	313	-2,686
2005	2,668	335	-3,003
2006	2,759	367	-3,125

Source: Adapted from PCBS (2008).

Weakened Palestinian institutions

After the establishment of the Palestinian Authority in 1994, the new Palestinian institutions had limited capacity to cope with the restrictions and the conditions placed upon them by the Israeli policies. During the period of limited self-rule (1994–2000), the Palestinian Authority was not able to articulate a comprehensive national programme of reconstruction and development. This was due in part to Israeli policies that did not live up to the commitments made under the Oslo Accords and to the Palestinian Authority's structural weaknesses and lack of coherent vision, reflecting, to a large extent, the inherent shortcomings of the Oslo Accords. Furthermore, the vision, agenda and conditionalities of the donor community overburdened the already weakened Palestinian institutional and economic capacity and, hence, limited the scope for development of a national development strategy and policy. Furthermore, the Palestinian Authority's rent management strategies on sensitive imports such as cement, iron and petroleum products, led to higher production costs. The absence of a clear development-driven objective, wide-ranging donor demands and conditions, and the pressure of Israeli repressive policies and measures have led to a curious mix of Palestinian Authority policies, which often lack sustainability and coherence.

In addition, donors' involvement in Palestinian reform and in the institution-building process, together with their aid conditionality and the existing policy framework of the Paris Protocol, have resulted in a shrinking Palestinian policy space, whereby Palestinian Authority policies are on the one hand made within a framework offered and approved by donors, and on the other hand, are mere responses to the numerous and sometimes contradictory donor aid conditionalities. These limitations have not only reduced the capacity of Palestinian institutions to respond to the needs of the Palestinian economy, but have also created fragmentations within Palestinian institutions and ministries.

B. Pre-Oslo trade regime: 1967–1994

Following the 1967 occupation, the occupied Palestinian territory was cut off from previous trade relationships and forced into new and asymmetrical economic ties with Israel. Within a year of occupation, Palestinian trade with the rest of the world came to a halt. The "open bridges" policy adopted by Israel in the 1970s was a one-way system allowing only some Palestinian exports to Arab markets with severe restrictions on imports from those markets. Under direct Israeli military rule, the Palestinian areas became a "partner" with Israel in a de facto, one-sided customs union – Israeli products had free access to the markets of the occupied Palestinian territory, while Palestinian products were subject to a wide range of quantity and regulatory restrictions. Palestinian agricultural exports to Israel were practically prohibited, except as a buffer to meet any shortages in supply from Israeli sources, and manufactured exports were subject to multiple administrative controls and non-tariff barriers. Israel's trade policy, well known for its high degree of protectionism, was applied automatically to the occupied Palestinian territory without any allowance for the particular needs and potentials of the Palestinian economy (Kanafani, 1996). Strict administrative controls on water and land use, licensing requirements for the cultivation of certain crops and regulatory restrictions on the establishment of investment projects effectively held back production in the occupied Palestinian territory. There was no financial or banking system, and Palestinian farmers and manufacturers were effectively excluded from the various forms of public subsidies extended so openhandedly to their Israeli counterparts (Hamed, 1996). In effect, all direct external relationships were transformed into indirect relationships operating through Israeli entry points and via Israeli import and export agents (Cobham and Kanafani, 2004).

At the same time, almost all direct and indirect taxes imposed on the Palestinians in the occupied Palestinian territory, including VAT and taxes on imports, were transferred to the Israeli treasury. They were collected on the basis of origin or place of payment, rather than on the basis of destination and residency. Palestinian workers in Israel were obliged to pay national insurance contributions without being entitled to most of the corresponding benefits.

C. Post-Oslo trade regime – Paris Protocol on Economic Relations and its implementation

The Paris Protocol is the annex to the Oslo Accords that regulates economic relations between the two parties. Its main distinguishing components are as follows: (a) it implicitly recognized the need to rectify the Palestinian economy's skewed relationship with Israel; (b) it was intended to equip the Palestinian Authority with the legal, institutional and procedural means to manage and develop Palestinian external trade within a Palestinian development vision; and (c) the Preamble included a mutual recognition of each party's distinct economic interest. Emphasis on "economic ties with other markets" was of special significance, particularly for the occupied Palestinian territory, where over 90 per cent of external trade is conducted with or through Israel.

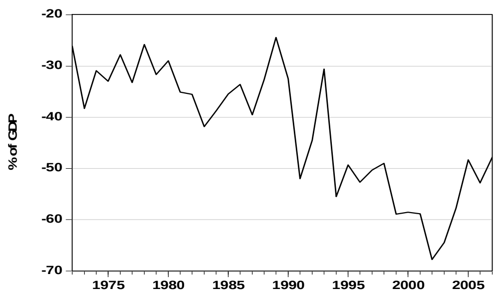
The Protocol advocated free trade between Israel and the areas under the Palestinian Authority's control, with the exception of quantitative restrictions on six agricultural products to be phased out based on an agreed timetable. Israel's import policies were to continue to apply, with the provision that the Palestinian Authority would be allowed some flexibility in import policies on two lists of goods with specified quantities (A1 and A2 as identified in the Protocol), as well as on unlimited quantities of a long list of tools and light machineries (List B as set out in the Protocol), provided that the goods meet Israeli specifications. Each side would administer its own domestic tax policies, but the VAT rate in the occupied Palestinian territory could not be 2 percentage points lower than the 17 per cent applied in Israel at the time (Paris Protocol, article III-15). The new Israeli shekel would remain in circulation in the occupied Palestinian territory as means of exchange while the possibility of a Palestinian currency was postponed for future discussion. Although both sides were to maintain normal labour movements with the other, they were granted the right to determine the extent and conditions of this labour movement into their own areas of jurisdiction.

Under the Paris Protocol, the Palestinian Authority was made dependent on Israeli rebates of customs and import taxes. Israel interpreted "imports from the rest of the world" into Palestine in a peculiarly restrictive manner: Imports were only those goods directly imported by Palestinian companies via Israel and clearly labelled as destined for clearance by the Palestinian Authority. This does not include those imports from a third country via Israeli intermediaries for onward shipment to the occupied Palestinian territory. These imports, which could be called “indirect imports” from Israel, are treated as if they where produced in Israel. The latter represented no less than 30–40 per cent of Palestinian imports (Kanafani, 1996), although recent estimates put the actual amount at up to 80 per cent of Palestinian imports (Khalidi, 2010). The fiscal leakage, as well as the adversities of depending on one source and route of imports, imply that the bulk of Palestinian imports in fact do not originate in Israel. Therefore, the potential benefits of this trade have been elusive and the dependence on the Israeli economy has been reinforced throughout the years.

After a steady decline in both commodity exports and imports in the early 1990s, both witnessed some increase in 1995. Exports involved mainly subcontracting in labour-intensive sectors such as shoes and clothing, and a few agricultural products. Labour income from Israel and substantial donor assistance paid for the expanding trade deficit. However, with the deterioration of the political situation and the intensification of the Israeli closures policies, Palestinian exports and imports in 1996 declined by 15 per cent and 10 per cent, respectively (Zavadjil, 1997). The Intifada had a major impact, particularly on Palestinian exports, which were now further undermined by tightened Israeli movement and access restrictions, the lack of access to inputs and markets, and strict licensing and regulatory requirements.

By 2005, the Palestinian trade deficit had reached 54 per cent of GDP, of which the deficit with Israel accounted for 39.4 per cent (UNCTAD, 2006b). This meant that for every dollar produced domestically, 55 cents constituted an outstanding liability to the rest of the world, including 40 cents to the Israeli economy. By 2006, imports had surged to 86 per cent of GDP, compared with 75 per cent in 2005, pushing the trade deficit to $2 billion, an extraordinary 73 per cent of GDP, which was 30 per cent over its 30-year average (UNCTAD, 2007). According to UNCTAD, the Palestinian trade deficit had reached an estimated 78.5 per cent of GDP by 2008, while the trade deficit with Israel had risen to an all-time high of 56 per cent, double the 1995 levels. Figure 3 illustrates the dramatic deteriorations in the Palestinian trade balance in recent years.

Figure 3. Trade balance as a percentage of gross domestic product, 1972–2007



Source: Database of UNCTAD-Palestine macroeconomic model

Although the formalization of the Israeli-Palestinian trade relationship was expected to stimulate “fairer” trade – that is, less Palestinian imports from, and more Palestinian exports to, Israel – various factors contradicted such outcomes. Once relations were formalized in the context of the Paris Protocol, strict standards and sanitary and phytosanitary requirements became a serious hindrance to trade flows, themselves acting as non-trade barriers to Palestinian exports. Hopes for better terms of trade were further dashed following the gradual expansion and intensification of the closure system, which restricted the movements of goods and people not only between the occupied Palestinian territory and Israel, but also with the outside world and within the occupied Palestinian territory.

The Paris Protocol and its uneven implementation failed to change the overall framework which had created the unbalanced relationship between Israel and the occupied Palestinian territory in the first place. If anything, the dependent state of the Palestinian economy has worsened, while the only difference with the pre-Oslo era remains the change in the source of financing of the large and growing trade deficit with Israel. Given the decline in the number of Palestinian workers in Israel, the Palestinian trade deficit with Israel has been increasingly financed by foreign aid rather than by workers' remittances or exports.

D. Donor influence on Palestinian trade policy

Donor and international agencies have played an influential role in shaping the post-Oslo Palestinian economic development policy framework. Therefore, the donors' agenda has affected Palestinian trade and trade policy since the Oslo Accords and influenced the Palestinian trade-employment-poverty nexus. The period of donor involvement in the occupied Palestinian territory coincided with the rise of the Aid for Trade (AfT) agenda. AfT was the response to the failed "aid and trade" liberalization efforts, which aimed at unlocking the potential benefits of both trade and foreign assistance. However, as it later transpired, AfT differed only slightly from the old recipe of trade liberalization. It was argued that trade can "create effective market access by removing internal barriers to trade" through creation of more trade-friendly structures in developing countries (Stiglitz and Charlton, 2006).

Furthermore, the AfT framework argued that the growth outcome of trade-related assistance would lead to poverty reduction through the trickle-down effect. Poverty seems to be seen here as a mere technical problem that can be fixed through aid. However, de-linking poverty from its origins in deep-rooted external causes (armed conflict) and in specific internal causes (total dependency on Israel for employment and imports, land confiscation and other military orders restricting the free movement of people and goods) has drastically limited the horizon of success of this approach.

Nevertheless, this approach was enthusiastically applied in the occupied Palestinian territory, although it had limited applicability since the main obstacles to trade activities are external to the economy and lie in restrictions imposed by the Israeli authorities. The attempts to invent novelty approaches that both comply with the Israeli security claims and allow for the smooth and free flow of goods and people proved to be illusory. In other words, this approach fails to incorporate an analysis of the specific factors linking trade, poverty or economic development in the specific war-torn context of the Palestinian economy.

Recently, a further shift in donor attention from development aid to reform and institution-building assistance has been observed. An increasing proportion of foreign aid has been directed towards the trade policy and regulation category, particularly as the intensifying conflict has deterred donors from investing in developmental, productive and infrastructural activities (Taghdisi-Rad, 2011). These have been aimed at streamlining the Palestinian trade sector and institutions in accordance with international standards, rather than targeting the specific needs of the Palestinian trade sector, most importantly the diversification of Palestinian trade range and market which, by reducing its dependence on Israel, could contribute to the rebuilding of the eroded productive base and the creation of an autonomous trade structure.

E. Structure of Palestinian trade

The environment in which Palestinian trade has been taking place has deteriorated further since the Paris Protocol. The Palestinian economy continued with the same characteristics as those that persisted during the years 1967–1994, but with an increased dependency on the Israeli economy, and intensified Israeli-imposed closures and movement restrictions since 1994. The outbreak of the second Intifada in late 2000 dramatically increased the Israeli closures and the restrictions placed on the Palestinian economic activity, including trade. The developments in the Gaza Strip since 2006 led to its further isolation. Together with the 2007 Israeli blockade on the Gaza Strip and the Israeli military operation in December 2008–January 2009, exports from Gaza came to a complete halt, leading to sharp rises in unemployment, worsening the already high levels of poverty in the Gaza Strip.

The occupied Palestinian territory continues as an unequal partner in a one-sided customs union with Israel, obliged to apply the trade policies of an advanced economy without benefiting from free trade or any of the compensatory advantages often contained in standard customs unions. As a result, the large Palestinian trade deficit continues to be around 70 per cent of GDP, the trade deficit with Israel constituting the bulk thereof. As shown in table 4, Israel is the dominant trading partner of the occupied Palestinian territory. Although the occupied Palestinian territory is in dire need of trade diversification and market expansion, Palestinian efforts to establish trade links with Arab regional and international partners have been often, directly and indirectly, undermined by the dominance of Israel and the elements of occupation.

Table 4. Shares of main trading partners, 2002–2006
(Percentage**)**

Country	*Year*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*
Israel	Imports	85.0	84.6	84.6	84.0	85.8	85.7
	Exports	89.8	91.8	90.9	77.4	88.7	86.0
European Union	Imports	12.3	10.0	9.9	10.8	9.7	9.2
	Exports	3.7	2.5	2.3	3.0	0.7	3.4
United States	Imports	0.0	2.0	1.9	1.4	0.9	0.9
	Exports	0.1	0.2	0.5	1.1	0.7	0.6
Switzerland	Imports	0.4	0.4	0.4	0.7	0.7	1.3
	Exports	0.1	0.1	0.0	0.1	0.7	3.4
Arab counties	Imports	2.4	3.0	3.2	3.1	2.9	2.9
	Exports	6.3	5.4	6.3	18.4	9.2	6.6

Sources: PCBS, foreign trade statistics, several years.

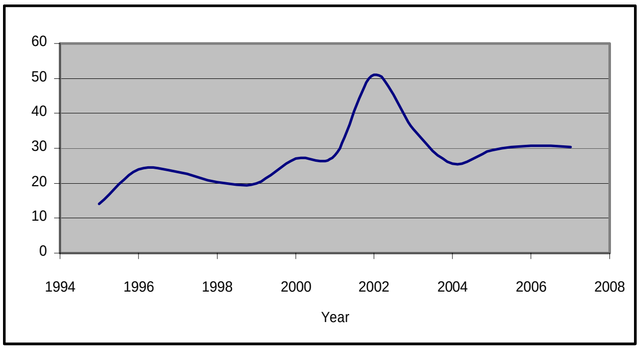
F. Poverty in the occupied Palestinian territory

Poverty levels in the occupied Palestinian territory have remained high and on the increase for many years. This has been a result of the erratic and declining rate of economic activity, low wages, loss of employment opportunities due to the Israeli closure policy, reduced employment generation capacities of the public and private sectors, and restricted access to natural resources, as well as declining and unstable employment opportunities in Israel. The rate and intensity of poverty have also varied between the West Bank and the Gaza Strip. The harsh reality of livelihoods in the occupied Palestinian territory implies that income levels are not a sufficient indicator of poverty. Consumption levels should be taken into account as further indicators of poverty rates.

Despite expectations of economic prosperity and generous donor support following the signing of the Oslo Accords, consumption-based poverty rates in the occupied Palestinian territory rose from 14 per cent in 1995 to 24 per cent in 1996. This was due to the sluggish economic recovery, the increase in the number of closures in the occupied Palestinian territory and the slow disbursement of donor funds. Furthermore, fluctuating Israeli demand for Palestinian labour affected the earnings and livelihoods of a large number of Palestinian households (Shaban and Al-Botmeh, 1995). With a significant drop in unemployment rates and a relatively stable employment in Israel, poverty rates improved towards the late 1990s to reach a low of 12.1 per cent in 1998. However, following the outbreak of the second Intifada and the sudden decline in economic activity, poverty rates jumped to 51 per cent in 2002 (PCBS, 2009a).

With the relative calm that prevailed after 2003, poverty did not worsen, but remained high. This was mainly due to the negative effect of the expanding separation barrier and to the continued restrictions on economic activity and labour movement. As a result of the international boycott of the Palestinian Authority following the 2006 parliamentary elections and the subsequent suspension of aid to the occupied Palestinian territory, the number of people living in deep poverty, that is, living on less than 50 cents a day, doubled from 500,000 to over 1 million (Palestine Monitor, 2009). According to PCBS, by 2008 over half of all Palestinians were living in poverty: 46 per cent in the West Bank and 79 per cent in the Gaza Strip.

Figure 4. Poverty rates in the occupied Palestinian territory, 1995–2007
(Percentage)



Sources: Shaban and Al-Botmeh (1995) estimates for the year 1995; World Bank, data relating to 1996–1998, 2000, and 2002; PCBS, other years.

The risks and uncertainties associated with conflict and occupation have debilitated the Palestinian economy and, therefore, dampened private sector activity and reduced its employment generation capacity. As a result, the public sector became the largest employer with a relatively large wage bill, mainly financed by donor budget support. This implies that the donor assistance and Palestinian Authority revenues have a direct bearing on poverty, as occurred following the 2006 elections. This experience reminds the donor community of its international obligations in the poverty reduction and development efforts in the occupied Palestinian territory.

II. Economic growth, trade, employment and poverty

The relationship between growth, trade, employment, and poverty in the occupied Palestinian territory should be assessed within the context of occupation, economic dependency on Israel and the influence of donors on its economy trade policy framework. Therefore, establishing the links between economic and trade policy and a strategy to promote employment generation and poverty reduction is an elusive task in the context of the Palestinian economy. Poverty and employment in the occupied Palestinian territory are determined by a host of exogenous factors that do not correspond to those available in orthodox economic theory. Palestinian trade, for example, is determined mainly by the nature of political relations and regulations, legacies of past economic agreements and direct conflict-related impediments of trading activity. Poverty, however, is an outcome of limited access to resources –which has direct and indirect roots in the conflict. Finally, economic growth is determined not by the level of economic activity and policy, but by the elements and intensity of the political conflict, as well as the levels of financial aid that the occupied Palestinian territory receives from donor organizations.

Within this context, the following section will attempt to examine whatever is left of the relationship between trade and growth, growth and employment, and, finally, unemployment and poverty. The aim of this analysis is to highlight in which areas policy could have an impact on enhancing these linkages.

A. Relationship between trade and growth

Economic theory asserts that trade entails the efficient allocation of resources as it rationalizes production according to comparative advantage in sectors that enjoy increasing returns to scale. It is also based on the assumption that trade allows the dissemination of knowledge and technological progress through spillover effects. However, these outcomes will not materialize unless the country in question has a flexible economic structure capable of responding to potential trade opportunities. This requires mobile labour and capital that can move quickly and at little cost between sectors, and wages and interest rates that respond to shifts in supply and demand.

The literature on the causality between trade expansion and economic growth has been inconclusive at best. The development record of successful developing and developed countries suggests that during the early stages of development, trade liberalization is often an outcome of, and not a prerequisite to, a successful growth strategy. However, at later stages of development, trade and growth may interact and reinforce each other: A high growth rate of domestic output may serve to boost trade and a high rate of growth of world trade may stimulate more expansion of domestic production.

A glance at Palestinian data during the 1980–2005 period in table 5 is sufficient to ascertain the absence of any systematic relationship between trade and growth. Whereas GDP per capita has been declining over this period (aggregate annual growth was about 2.5 per cent on average annually), the trade ratio exhibits no particular trend and shows very unstable and erratic behaviour.[2] Both of these anomalous performances are the inevitable outcome of the various distortions, described above, which have markedly increased the risks associated with trade and investment as the conflict has intensified over the years. Trade activities have been particularly impeded by the occupation-induced misallocation of factors among sectors or firms, affecting the normal patterns of trade and accumulation. It is no longer the comparative advantage, but the limitations imposed by occupation that determine the patterns of Palestinian trade.

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[2] Trade ratio, (exports + imports)/GDP, is an indicator of openness. It tells us little about the type of trade regime. While large economies tend to have low trade ratios, small economies tend to have large ones.

Table 5. Growth rates of output, trade, employment and productivity in the occupied Palestinian territory
(Annual average in percentage)

	1980–84	*1985–89*	*1990–94*	*1995–99*	*2000–04*	*2005–08*
Workers in Israel (percentage of total employment)	36.1	37.7	30.1	19.2	9.44	7.75
(X+M/GDP)	78	62.7	69.9	89.8	92.9	66.0
Productivity change	-4.5	5.6	6.8	5	-1.8	0.7
Unemployment rate	1.50	3.00	5.60	20.00	24.90	23.65
Change in number of unemployed	33.5	13.2	35.5	1.7	20.4	2.45
Change in number of employees	0.75	0.62	1.96	1.38	0.26	3.0
Imports (M)	0.56	-0.04	NA	2	-0.8	1.85
Exports (X)	-0.5	-1.4	3.9	2.2	-1.2	9.71
GDP growth rate	-0.45	1.8	0.2	1.7	-0.2	3.65

Sources: Palestine Economic Policy Research Institute database collected from the Israeli Central Bureau of Statistics for the years 1980–1994 and from PCBS for the years 1995–2005 and 2005–2008.
Note: Productivity change (row 3) is defined as GDP/number of employees.

Trade is hampered by the inefficiency caused by factors of production being used below their capacity. This occurs because of the barriers to, and high costs of, factor mobility, tight institutional and regulatory limitations, unfair and skewed integration to and competition from the Israeli market, and the fiscal leakage from Palestinian trade sector to the Israeli economy. The dumping of cheap, and often low-tech, Israeli products (as well as indirect imports via-Israel) in Palestinian markets not only marginalizes the Palestinian producers and exporters, who are already working under harsh and restrictive conditions, but also reduces the capacity of any technological transfers from these imports. Furthermore, labour mobility between sectors is not easy because of Israeli measures and the high risk accompanying movement from one location to another.

The prolonged occupation has also resulted in production increasingly taking place in smaller size farms and industrial firms, often run and operated by family members who do not receive formal wages according to their marginal productivity. Instead, they receive payments according to their average productivity, hence breaking the link between labour marginal productivity and wages. This will further reduce labour's incentive to move between sectors. Restrictions on labour mobility, combined with the high risk of capital investment, have deformed the economic structures and flexibility required to take advantage of opportunities in trade.

Another factor that affects the growth–trade link in the Palestinian context is the negative effect resulting from having a quasi-customs union with an advanced economy which has extensive free trade agreements with other countries and adopts a tariff regime that suits its own needs and requirements. Furthermore, as mentioned in the previous section, practically all the Palestinian Authority's import revenues are collected by the Israeli customs authorities. The flow of these taxes to the Palestinian Authority has been very erratic in recent years, with the taxes often withheld on political grounds. Therefore, instead of supporting Palestinian economic growth and development or providing a source of revenues for investment, these import taxes have been used as a political control mechanism by the government of Israel at various points. This breaks another traditional mechanism through which trade revenues could contribute to domestic investment and growth.

B. Economic growth and unemployment

The Palestinian economy has been suffering from very high rates of unemployment for a long time. In addition to the occupation-related factors that have retarded Palestinian trade, the labour market suffers particularly from the Israeli closure policy, the long legacy of dependence on the Israeli labour market, the labour-related elements in the Paris Protocol and the lack of viable productive employment opportunities. These have led to a distorted and segregated labour market in the occupied Palestinian territory. Labour movement restrictions have not only created direct unemployment for a large number of the Palestinian labourers by blocking their access to their work, but also have further reduced employment opportunities by hampering economic activity.

Furthermore, the Palestinian Authority and donor attention to the legitimate emergency and relief needs have taken the focus away from employment-intensive and productive sectors such as agriculture and industry. This, along with international pressure on the Palestinian Authority’s public sector wage bill and a weak private sector unable to provide an alternative source of employment, has led to high levels of unemployment and underemployment in the Palestinian labour market.

Agricultural employment and productivity have particularly suffered because production and exports of this sector have been severely affected by a lack of access to inputs and the costly back-to-back system of exports.[3] These have led to high transaction costs and the destruction of large quantities of agricultural exports. In the meantime, unemployed agricultural workers find no alternative source of employment, since all other sectors are also affected by the closures.

These trends have been at their worst in the Gaza Strip, where large numbers of workers have lost their employment in the agricultural sector, further threatening the livelihoods of many Palestinians. As a result of the Israeli-imposed blockade on the Gaza Strip since June 2007, employment conditions in Gaza are much worse than in the rest of the occupied Palestinian territory. Nearly 90 per cent of the 3,900 industrial establishments in Gaza have shut down since mid-June 2007, either temporarily or permanently. The industrial sector used to employ approximately 35,000 workers up until the blockade in mid-June 2007. Since then, no goods from that sector have been exported, leading to industrial sector employment of fewer than 3,000 workers – a mere 9 per cent – in November 2007 (OCHA, 2007). This trend has appeared in other labour-intensive sectors such as construction.

The Israeli military operation in Gaza between 27 December 2008 and 18 January 2009 was another major blow to the Palestinian economy, its productive base and employment generation ability. The Palestinian economy’s direct and indirect losses as a result of the military attacks are estimated at around $1.9 billion, 135 per cent more than Gaza’s 2006 GDP (UNCTAD, 2009a). Infrastructure and productive capacity of the various sectors have been severely damaged, leading to further deterioration of the livelihoods of the Palestinian population in Gaza. The link between trade, employment and poverty in the Palestinian territories is deeply affected, and even determined, by the forces of conflict. This implies that any efforts aimed at the effective reduction of poverty through trade policy formulation need to take into account the various conflict factors that overshadow this relationship. Any viable future strategy for Gaza needs to focus on rebuilding this productive capacity, while ensuring long-term employment and reduced dependence on international aid.

Finally, one of the implications of the prominent role played by donors in Palestinian economic policymaking is the subsequent change in the nature of economic relationships and structures. The realities of conflict and closures have on the one hand dampened Palestinian trading activities, and on

[3] This requires that freight must be off-loaded from one truck, carried across the border and loaded onto another truck. This has also allowed Israeli transport providers on the other side of the border to charge high prices, putting Palestinian goods at a further competitive disadvantage (UNCTAD, 2003).

the other hand, increased the levels of foreign aid poured into the economy. The subsequent dependence on aid as a main source of government revenue means that employment levels no longer reflect the productive capacity of the economy, but rather the extent of donor attention to employment-generating schemes.

III. Palestinian regional trade agreements

A. Extraregional trade agreements concluded by the occupied Palestinian territory

The road to Palestinian integration with regional and international markets has been tortuous and often obstructed by Israel’s interventions and policies. Nonetheless, the Palestinian Authority has concluded a number of international trade agreements since the early 1990s, the most important one being signed with the European Union – the occupied Palestinian territory’s largest trading partner after Israel. The following is an overview of Palestine’s bilateral trade relationships.

The relationship between the European Commission and the occupied Palestinian territory started in 1986, when the former granted preferential treatment to Palestinian products to enter the community with zero tariffs. After this agreement, the European Union became very significant for Palestinian trade. However, after the signing of the Paris Protocol, Israel considered this agreement to be a violation of the Oslo Accords, as it treats Israeli and Palestinian markets as two separate entities and implies a de facto end to Israel’s dominant status, especially since goods jointly produced in Israel and in the occupied Palestinian territory no longer qualify for duty-free entry into the European Union. However, the provision of the Paris Protocol that allowed the Palestinian Authority to sign economic agreements with third parties *as long as they are in compliance with the Paris Protocol*, which effectively means compliance with the Israeli trade regime or Israel’s own agreements with third parties, limited the potential benefits from this association between the occupied Palestinian territory and the European Union.

In 1997, Palestine signed a trade agreement with the European Union. This is a standard, if provisional, interim association agreement established within the Barcelona Process (EuroMed initiative), which envisages the gradual establishment of a free trade area between the occupied Palestinian territory and the European Union with respect to manufacturing products and provides for limited and reciprocal preferential arrangements for trade in agricultural commodities. In addition, this agreement includes provisions on programmes and technical assistance to support the Palestinian Authority’s institution-building and investment in Palestinian socio-economic affairs, in line with the European Union’s policies and conditions regarding trade and institutional reform.

The Palestinian trade agreement with the European Free Trade Association, signed in 1998, was a mirror of the interim agreement between the European Union and PLO/Palestinian Authority, providing duty-free treatment to most industrial products. Duty-free access is granted to some Palestinian and processed agricultural, fish and marine products of the occupied Palestinian territory and the European Free Trade Association, while the majority of processed agricultural products are granted a reduced tariff.

The United States has indirect historical trade relations and agreements with the Palestinian Authority. Under the 1985 United States-Israel free trade agreement, a step-by-step decrease in custom taxes was to be applied on imports, culminating in their complete removal in 1995. Afterwards, the agreement was extended to incorporate the occupied Palestinian territory as a customs envelope, granting duty-free treatment to all Palestinian exports to the United States and vice versa, as long as the products satisfy the rule of origin criteria, namely that the product must be wholly obtained (grown, produced or manufactured) in the occupied Palestinian territory.

B. Free trade agreement with Jordan

This was the earliest trade agreement between the then newly created Palestinian Authority and an Arab country. Signed in 1995, it aimed at the exemption of customs duties on a specified list of products, with the eventual objective of establishing a free trade area between them. The agreement is constrained by the limited policy space left to the Palestinian Authority within the Paris Protocol.

Aiming to improve joint-venture opportunities between the two parties, the Palestinian Authority and Jordan signed an agreement on the encouragement and protection of investment between the two countries.

While this agreement is designed to achieve free trade in all goods, it remains confined to specific lists of goods that can be exchanged duty-free between the two parties. The Palestinian Authority grants customs duty exemptions to 45 products originating in Jordan on List 1 and to 32 products on List 2. Jordan grants customs duties exemption (List 3) and exemption from customs duties and other taxes (List 4) to a total of 60 Palestinian products. This agreement has not been working properly for a number of reasons. Serious administrative obstacles and logistic difficulties on both sides of the border are frequently cited by business people. Israeli control of the crossing points multiplies these difficulties.

C. Trade agreement with Egypt

Signed in February 1997, this agreement is aimed at activating the economic and technical cooperation agreement that was approved by the two parties on 25 January 1994, particularly with regard to trade. The two parties agreed to develop bilateral trade relations by exempting a specified list of products of national origin of the customs duties. In addition, the agreement called for cooperation in various economic sectors by giving the Palestinians access to Egyptian airports, seaports and land routes for exports and imports of Palestinian goods from and to the rest of the world. However, it is argued by some that the overall terms of the arrangement were more favourable to Egypt than to the Palestinian economy (Abdel Raziq, 2002). Egypt’s reluctance to implement tariff cuts based on World Trade Organization (WTO) regulations and the Palestinian Authority’s unilateral implementation of these cuts substantially reduced the competitiveness of Palestinian products in Egypt.

D. Free trade agreement with Turkey

The agreement, signed in 2004, aimed at exempting customs duties on all industrial products entering the two countries. Given Turkey’s obligations arising from its customs union with the European Commission and in line with the Euro-Mediterranean Interim Association Agreement on trade and cooperation between the European Union and the Palestinian Authority, the agreement aims to gradually establish a free trade area between the two countries. An important element of this agreement is the removal of all customs duties on imports and charges on products originating in Turkey or the West Bank and the Gaza Strip. Within the provisions of abolishing customs duties, the Palestinian Authority is given the space for limited occasional increases in customs duties aimed at protecting infant industries and sectors undergoing restructuring or experiencing serious difficulties.

E. Greater Arab Free Trade Agreement

The most important regional initiative in the Arab region is the Greater Arab Free Trade Area (GAFTA), which was signed in 1997 by 17 members of the Arab League, with the aim of establishing a fully fledged free trade area by 2008 – which was subsequently brought forward to January 2005. The agreement calls for duty-free exports and imports of all agricultural and industrial goods across the region t by gradually lowering duties and taxes by an average 10 per cent per year, as well as the elimination of all non-tariff customs and other barriers that impede free trade among the members.

However, GAFTA does not cover trade and investment in services; this has been launched recently. Another limitation is the strict rules of origin requiring that over 40 per cent of the value added of the product be contributed in another GAFTA member country if the imported product is to qualify for tariff relief. In addition, the approval procedures for certificates of origin in the importing country have often proven lengthy and cumbersome, thus acting as a strong non-tariff barrier. Other elements that have prevented a smooth application of the agreement are the exclusion of sanitary and phytosanitary standards and technical barriers to trade and the absence of dispute-settlement mechanisms. Further harmonization in the areas of competition policy, intellectual property rights and government reforms have been hardly achieved. This is partly due to the different structures of the economies and institutional capacities, as well as the degree of their involvement in the multilateral trade system (WTO).

Despite these limitations, the agreement seems to have produced important results. Since the late 1990s, non-oil intraregional Arab trade increased from 20–24 per cent in terms of exports and from 4.5 per cent in 1998 to 9 per cent in 2006 in terms of imports. Between 2004 and 2005, regional Arab trade grew by about 30 per cent, from $75 billion to $98 billion (Hoeckman and Zarrouk, 2009). This increase is also partly a result of the heightened attention to trade during the 1990s, as levels of remittances and Arab aid started to decline, leading to a rise in the number of bilateral trade agreements between the economies of the region, such as the trade agreement between Egypt and Jordan and the export development agreement between the Syrian Arab Republic and Yemen. The signing of the Aghadir agreement also encouraged further regional integration.

The Palestinian Authority joined GAFTA with the hope of providing market access for the industrial and agricultural products of the Palestinian economy and reducing its dependence on Israel’s market and on trade via Israel. Furthermore, the Palestinian Authority hopes to obtain technical assistance to help improve Palestinian competitiveness. In 2000, Arab Summit resolution No. 200 also exempted 100 per cent of all Palestinian exports to the Arab world from all duties and customs. Although these initiatives are important steps in providing a larger market for Palestinian products and cheaper sources of material and technical inputs for Palestinian production, the continuous absence of an autonomous Palestinian trade policy that determines import duties on borders and other areas of trade reduced their potential impact on the revival of Palestinian trade. In addition, the quantity of trade with Arab countries was not substantial and the agreement was overshadowed by the items or products still restricted by lists included in the Paris Protocol. In addition, the implementation of the agreement was subject to severe restrictions at the Israeli-Jordanian border.

IV. The dynamics of Arab regional integration

Poor competitiveness, the absence of trade routes and a host of non-tariff barriers applied by Israel forced the Palestinian Authority to turn away from trading directly either with neighbouring Arab countries or the outside world. Practically almost all Palestinian external trade was conducted with or via Israel. By raising the cost of capital goods and intermediate goods to Palestinian producers, the higher tariffs imposed to protect local Israeli industries have destroyed the competitive edge of Palestinian traditional products in foreign markets. According to Kubursi (2012), the cost of garment production in the West Bank is higher than that of Jordan by a factor of 2.17, mainly because Palestinian producers pay twice as much for their imported textiles, compared with equal quality textiles imported from the East Asian market by Jordanian producers. The occupied Palestinian territory cannot import Asian textiles because of the prohibitive tariff imposed by Israel to protect its own industry and trade with its strategic trade partners.

In an attempt to measure the competitiveness of Palestinian products in foreign markets, Kubursi (2012) estimates the coefficient of revealed comparative advantages (RCAs) for the occupied Palestinian territory's exports in 1998 and 2008. The total number of commodities taken into account was 260, and 6 regions were selected for which the RCAs of the 260 commodities are calculated. The results are presented in table 6.

Table 6. Summary of Palestinian RCA indicators, 1998 and 2008

	1998		*2008*	
	RCA > 1	*Percentage of total*	*RCA > 1*	*Percentage of total*
World	56	21.5	62	23.8
Arab	35	13.5	36	13.8
European Union	13	5.0	12	4.6
NAFTA	4	1.5	9	3.5
Japan	0	0.0	4	1.5
China	0	0.0	1	0.4

Source: Kubursi (2012).

As all quantitative indicators, the RCA is neither perfect nor reflects the full picture and all the dimensions of competitiveness. This is especially true in the Palestinian case, where access to foreign markets is severely curtailed and the quality of external trade data leaves much to be desired. Nevertheless, the exercise reveals interesting trends. First, very little changed in the decade between 1998 and 2008 with regard to the number of commodities with an RCA greater than 1. Second, out of 260 exported commodities, only about 35 commodities exported from the occupied Palestinian territory have an RCA greater than 1 in the markets of the Arab countries. The number is about 10 commodities solely in the European Union and the NAFTA markets. However, the RCAs are usually refined to eliminate all the values that are less than a certain minimum threshold. As shown in table 7, if a minimum critical value of 20 is considered, then a mere 5 commodities exported from the occupied Palestinian territory to the Arab countries would pass the threshold.

Table 7. Palestinian commodities exported to other Arab countries with relatively high RCAs, 2008

Commodities	*RCA*
Meat, meat and edible offal, prepared, preserved, n.e.s.	387.8
Fruits, preserved and fruit preparations (no juice)	42.5
Drugs and pharmaceuticals, including veterinary products	26.3
Fruit and vegetables juices, unfermented, no spirit	24.0
Fixed vegetable fats and oils, crude, refined, fractions	20.8
Milk, cream and dairy products (excluding butter and cheese)	16.4
Animal or vegetable oils and fats, processed n.e.s.	15.5
Soap, cosmetics, cleaning and polishing	13.6
Stones, sand and gravel	12.0
Ferrous waste, scrap, remelted alloys, iron and steel	11.1

Source: Kubursi (2012).

Third, although concentrated mainly on foodstuffs, the range of commodities with relatively large RCA values for Palestinian trade with the Arab region has experienced a change over the period 1998–2008: the items of basic manufacturing that had relatively large RCA values in 1998 dropped off the list during the 2000s and were replaced by more basic products such as fruits and vegetables. The analysis shows that the Arab countries receive the bulk of Palestinian exports of agricultural and other resources-based exports as well as textiles. The low-technology exports and the almost non-existent medium-technology Palestinian exports are also destined mainly for the Arab market, but the quantity and the stability of such exports are highly limited.

Another important index is called the concordance index, which gives an idea about the potential of trade between two partners. The index compares the share of certain commodities in total Palestinian exports with the share of the same commodity in the total imports of the trade partner. If the two shares are equal, there is perfect concordance and the index has a value of 1 (100 per cent). In case of perfect discordance, where what one country exports the trade partner does not import at all, the value of the index would be zero. Kubursi (2012) concludes that "In both 1998 and 2008, the concordance indices for Palestine show low values across the regions". The concordance between Palestinian exports and the imports of the Arab countries is quite low (10–14 per cent), and even lower with the European Union (4–5 per cent). The comparable figures for Jordan in 2008 are significantly better – 30 per cent and 23 per cent, respectively.

Therefore, the effect of Palestinian trade policy on employment and poverty has been restrained, as it is to a large extent determined by these occupation-related elements that have controlled the quantity and quality of Palestinian trade. Under such circumstances, it is of utmost significance for the future Palestinian trade strategy to set as its foremost objective the sovereignty of the trade sector and of policy space. In trade terms, this includes the diversification of trading partners and efforts to expand the volume of exports and to enhance specialization in high value added products. In view of these priorities, strengthening Palestinian-Arab regional integration can be an avenue through which some of these objectives could materialize.

Regional integration can strengthen the independence of Palestinian trade by diversifying Palestinian trading partners and activities. It can also pave the way for greater Palestinian integration into the global trading system through a transfer of technologies and investment flows as well as an improvement of the terms of trade and of bargaining power. Being an active part of Arab and other regional trade agreements and activities provides the Palestinian economy with a relative measure of autonomy, control and credibility so far denied to it under its special economic arrangement with

Israel. However, the very nature of occupation is in large part accountable for the limited history of Palestinian regional integration.

Arab regional integration is also of particular importance in preparing for and reinforcing the final political settlement towards the establishment of a Palestinian State. Given the weak basis of the Palestinian economy and its dependence on the Israeli economy and donor assistance, the economy could experience an initial crisis once the structures of the occupation are lifted and the economy is left to its own devices. In such circumstances, having access to wider regional trade and labour markets and regional economic and trade infrastructure will make this transitional phase smoother by providing the much-needed economic resources, infrastructure and markets. This will also prepare the Palestinian economy for its eventual integration into the world economy and trading with a wider range of economies around the world. Emerging from many decades of forced activity with a single economy and trading partner, the Palestinian economy's involvement in regional trade can serve as a stepping stone towards strengthening its technical and technological capabilities, trade infrastructure and regulations, and market access and practices. In other words, Arab regional integration can help achieve the ultimate objective of creating a well-functioning, stable and vibrant economic environment conducive to Palestinian statehood and sovereignty.

Since the beginning of the Israeli occupation, the patterns of trade between the occupied Palestinian territory and neighbouring Arab countries have undergone a massive change. The peculiarities involved in trading through Israel have since then undermined economic and trade relations of the occupied Palestinian territory with its Arab neighbours. The most prominent economic relations during this time have been in the form of Palestinian labour movement to other countries, especially in the Gulf, the subsequent inflow of remittances and the flows of aid.

The customs union with Israel, which was enforced since 1967, did not only make Palestinian products unattractive to its regional and international partners, but also increased the cost of production for domestic Palestinian producers, or wiped them off the market altogether. At the same time, the boycott by the League of Arab States of Israeli products and inputs meant that Palestinian products with Israeli inputs were not allowed into the Arab markets. Therefore, labour became the main Palestinian export to Israel and the regional Arab economies. However, the demand for this type of export started to diminish in the early 1990s after post-Gulf War political divisions among the Arab countries and Israel's policy of replacing Palestinian workers with new immigrant workers from Asia.

Hopes were raised that the previous decades of isolation of the Palestinian economy from that of the Arab region and the world would come to an end when the Palestinian Authority was finally granted, under the Paris Protocol, the "right of economic decision-making in accordance with its own development plan and priorities". However, as indicated earlier, the Protocol failed to bring about a new era of Palestinian economic development. The fading prospects of peace also reduced the possibilities of regional integration directly: Countries such as Egypt, Jordan and Morocco, which had signed economic agreements with Israel during the optimistic, immediate post-Oslo period, were soon faced with serious political issues, as Israeli military and economic policies imposed harsh restrictions on the Palestinian economy.

Although the occupied Palestinian territory is ideally located, with Jordan and Egypt as potential gateways to the Arab Mashreq and the Gulf States, and the Arab Maghreb and Europe, respectively, it has been unable to exploit the potential benefits of establishing fruitful economic relations with two of its closest neighbours. The involvement of the Israeli military, administrative and regulatory bodies in all aspects of Palestinian economic policymaking, the widely different development experiences of the occupied Palestinian territory from that of its neighbouring countries and the lack of infrastructure and minimum certainty required for trade transactions have made Palestinian regional economic relations and integration a very difficult task.

The 1990s was also an era of trade promotion and large-scale reforms, including trade-related institutional reforms across the region. The Palestinian Authority was also given higher levels of trade-related assistance that incorporated reform conditionalities. In this context, regional cooperation was once again viewed as a viable avenue through which the costs of such reforms could be reduced by sharing the risks, coordinating the reforms and creating a more investment-friendly environment by means of an enhanced regional infrastructure and an enlarged regional market.

The difficult political environment, together with lack of adequate physical and institutional infrastructure, has repeatedly undermined efforts to establish economic relations with other neighbours. In order to avoid the uncertainties attached with the high levels of dependence to the Israeli economy, the Palestinian trade policy should be part of an overall strategy aimed at addressing the fundamental needs of the war-torn Palestinian economy. In doing so, trade policy and any form of integration should ensure optimal allocation of the natural and human resources of the occupied Palestinian territory, encourage the continuation of institutional reform – and most importantly in the case of trade – promote the expansion and diversification of production and trade. Many of these elements can be approached by means of regional integration, whereby markets are expanded and more factors of production are employed to meet the demands of this larger market.

V. Impediments to Palestinian regional integration

Although vital for the future of the Palestinian economy and the prospects for trading internationally, any attempts at regional economic integration in the occupied Palestinian territory should follow a careful, gradual approach. This is all the more important given the many decades of skewed economic integration with Israel and the long legacy of de-development that the Palestinian economy has experienced as detailed above. In addition to the Paris Protocol and the Palestinian dependence to the Israeli economy, impediments to Palestinian regional integration include the limited policy space available to policymakers, the influence of non-regional trade agreements and the lax implementation of previous and existing regional trade agreements.

A. Limited policy space

The autonomous policy space required for successful Arab integration has been denied to Palestinian policymakers, both under the period of direct occupation and even after the signing of the Paris Protocol. This has limited the Palestinian Authority’s capacity in designing and implementing the economic and trade policies that are suited to the war-torn state of the Palestinian economy. It has also imposed severe limits on the availability of policy instruments required for addressing the fundamental distortions and structural weaknesses in the economy and pacing its own reform priorities and development agendas. Given the small size of public finance, and the long-term budgetary and trade deficits, the Palestinian Authority’s policy space has been further minimized by its dependency on international donor assistance provided for the budget, development and humanitarian concerns. However, the persistent conditions of emergency crisis management have limited the Palestinian Authority’s capacity to concentrate its efforts on developing the indigenous sectoral and institutional priorities and reforms required for its successful integration with Arab and international markets.

In a 2008 study, UNCTAD analysed the economic benefit of expanding the policy space available to the Palestinian Authority or, alternatively, the opportunity cost of the continuation of the Paris Protocol (i.e. the absence of an expanded policy space). According to UNCTAD 2009b, some political stability and the expansion of policy space from the existing one-sided fiscal policy to include the full set of instruments of fiscal, monetary and industrial policies would enable the Palestinian economy not only to improve labour productivity, but to move towards full employment in less than 10 years.

In addition to the Paris Protocol, donors have also influenced Palestinian policymaking processes. This is reflected in the gradual shift over time in the tones, objectives and components of Palestinian development plans – increasingly becoming aligned to donor priorities. This can be made clear by comparing the objectives of the 2005–2007 Medium-term Development Plan and the 2008–2010 Reform and Development Plan. The former plan accorded priority treatment to poverty reduction and advocated a developmental approach to relief and reconstruction operations. It called for the allocation of aid according to national priorities, focusing mainly on coordinating development efforts at the project level. Priorities were divided into “short-run priorities”, which include a focus on agriculture and other sectors catering for domestic consumption, job creation and export promotion, and “long-term priorities”, such as regional integration and the implementation of an independent Palestinian trade policy, including the enhancement of regional trade beyond the limits imposed by the Paris Protocol and shift of production and exports towards higher value added products.

In contrast, the 2008–2010 Palestinian Reform and Development Plan adopted a more conventional view on reform in the area of trade, addressing Palestinian trade as if the economy of the occupied Palestinian territory suffered mainly from excessive government intervention and market distortions. Trade liberalization is emphasized as an engine of growth, where a WTO-compatible trade regime is considered to be the paramount element in emphasizing the economy’s export capacity and competitiveness. The major emphasis here is placed on the adoption of low tariff rates and the thrust revolves around institutional building and institutional reform.

B. Impact of non-Arab regional and international trade agreements

International trade and international trade agreements provide a beneficial spillover for the enhancement of regional trade relations. This occurs by harmonizing international trade regulations and institutions, limiting the discriminatory aspects of regional trade agreements, strengthening a country's terms of trade and trade policy autonomy, protecting vulnerable countries' territorial integrity and expanded market shares required for a successful trade promotion strategy. These are of special importance since they can benefit the rich human capital and the strong knowledge-based assets with which the Palestinian economy is already endowed. In such circumstances, and in view of the new protectionist policies in place in most of the world's largest markets, the promotion of the private sector in trade could act as a viable instrument through which export activities could take place without many of the constraints and regulations often involved in public-sector trade-related activities. In other words, the private sector could gain many benefits of trade in international markets, which could also help Palestinian trade expand regionally. Furthermore, the correlation is also in the opposite direction: stronger regional ties, more collaborative regional infrastructural projects and an enhanced pool of regional skills and science will, in turn, enhance the standing of the occupied Palestinian territory in international markets.

In its agreements with other international partners, such as the European Union, the Palestinian economy has faced similar non-tariff barriers, as many developing countries do in their trade relations with the more advanced nations. These acted also as barriers to Palestinian trade with its regional partners. This era of new protectionism, reflected in restrictive technical, health and environmental standards and in the arbitrary use of anti-dumping tariffs and duties, acts against the expansion of Palestinian export activities in general. For example, although the European Union and the United States have been involved in promoting the Palestinian agricultural products since the 1980s, providing them with preferential treatment in their markets, the levels of Palestinian agricultural exports to these markets have been very low to date. The European Union's declared policy of enhancing regional trade and in deploying its association agreements with individual countries in the Middle East to encourage the establishment of regional free trade blocks is a welcome initiative. However, very little is being achieved on this front, partly due to the enduring Palestinian-Israeli conflict.

An initiative put forth by the United States, the qualified industrial zone, or QIZ, has been in operation in Jordan since 1996 and in Egypt since 2004. The initiative, which aims particularly at encouraging the integration of Israel in the regional economy, has negatively affected the Palestinian economy, particularly the textile industry. Before the onset of the qualified industrial zone in Jordan and Egypt, around 85 per cent of the Palestinian textiles industry subcontracted for the Israeli textile sector. However, the Palestinian economy started to lose this source of revenue, as the qualified industrial zone provided not only cheaper sources of labour in Jordan and Egypt, but also allowed the Egyptian and Jordanian textile industries to receive preferential treatment in the United States market.

C. Failure of previous regional trade agreements

The terms and conditions of Palestinian bilateral (Arab) trade agreements signed to date have not been particularly conducive to further Palestinian development or its further integration with the regional markets. They have often involved institutional and policy drawbacks. For example, the trade agreements with Egypt and Jordan limited the application of preferential treatment accorded to Palestinian exports to specific products within limited quantities. It has been only over time, and with the gradual adoption of the Arab Summit's decision in 2000 to grant Palestinian exports duty- and quota-free access to Arab markets, that Palestinians have been allowed greater potential access to the regional markets.

The varying developmental experiences and the different political alliances and positions have led to the absence of a cohesive regional development strategy and vision required for guiding Arab regional integration efforts. Divergent political positions in relation to Israel and long-standing territorial and border and legitimacy conflicts have been prominent characteristics of the region. At the same time, the high employment and social costs that may result from involvement in trade openness can be too high for many of the governments of the region to accept. As a result, patterns of specialization and sectoral complementarities have not been formulated within the region, creating few incentives to regional export competition (UNCTAD, 2004).

The weak state of the region’s physical, financial and transportation infrastructures, complicated and time-consuming customs procedures, complex and diverse exchange rate controls and the virtual absence of regional clearing and payments arrangements are among many other factors limiting the region’s potential for effective regional integration and viable entry points for Palestinian engagement with regional partners.

VI. Towards deeper Arab integration

What emerges from the above discussions is that regional integration is an avenue by which the Palestinian economy could regain some of its trade competitiveness and power. However, it is important to emphasize that although beneficial in the medium- to long-term, integrating into a larger market includes short- to medium-term costs. The previous sections set out some of the main benefits of such regional integration in terms of lower transaction costs, economies of scale and specialization, institutional harmonization and trade diversification. The short-term costs of such an integration policy include unemployment in some of the import-competing industries, sectoral shifts and possible dislocation, and reduced autonomy in policymaking. However, in the Palestinian case, the economic and political benefits of such regional trade integration are far greater than its immediate costs. After all, the immediate costs are an inevitable step towards Palestinian trade development, paving the way for its integration in international trade.

In the context of the Arab countries, regional integration is not only important in view of the trade benefits that it entails but, perhaps more importantly, in view of its ability to act as a leverage to achieve Millennium Development Goal 1 by creating new employment opportunities. Therefore, this calls for a more deliberate, development-driven approach to regional partnerships. In line with this, generating employment, attracting higher productive FDI, diversifying trade and industrial bases, raising living standards and reducing poverty should be among the top priorities of all regional integration efforts. In other words, the "regional union should change the economic conditions in member countries, so that the test should not be one of trade creation and diversion, but rather of development creation and diversion" (Edwards, 1985).

A. Trade redirection

That the Palestinian trade sector has been dominated by Israel as the main trading partner has practically diverted Palestinian trade away from the Arab economies and the rest of the world. In turn, lifting the long-standing restrictions on the Palestinian economy could create much trade with the Arab countries and the rest of the world. This would not only benefit Palestinian production, export diversification and competitiveness, but also would enhance its terms of trade.

Assessing the impact of the removal of non-tariff barriers and restrictions on Palestinian exports and imports on the flow of trade between the occupied Palestinian territory, its Arab neighbours, Israel and the rest of the world, UNCTAD (1998) found that 70 per cent of Palestinian exports would have been directed towards neighbouring Arab countries, the Gulf States and Islamic countries, and 74 per cent of Palestinian imports would have come from neighbouring Arab countries, the United States, Japan, Korea, the European Union and Turkey.[4] However, the study highlights that the removal of these trade restrictions would not eliminate the large Palestinian trade deficit, but instead would redirect it towards Arab countries, the United States, Japan and the European Union.

B. Infrastructural enhancement

Development of infrastructure is often cited as both a pre-condition for and a major benefit of regional integration. Regional cooperation, cost and service sharing of infrastructures related to water, environmental management, energy, communications and transportation cannot only enhance regional trade, but can benefit a country's own economic activities.

[4] In 2006, 72 per cent and 89 per cent of Palestinian imports and exports, respectively, were with Israel (PCBS, 2008).

Given the debilitated state of Palestinian infrastructure, the ability of the occupied Palestinian territory to join regional integration agreements will to a large extent depend on improved regional infrastructures. Limited access to water, energy, electricity networks, waste water facilities, and the non-existent and poor transportation structures, road networks and checkpoints, all raise the trade transaction costs, which in turn increase the cost of production and exports, thus reducing Palestinian export competitiveness.

Donor support in these areas declined dramatically after the increase in the frequency and depth of physical destruction, the continued expansion of settlements and the intensification of the closure policies. Therefore, the Palestinian economy sorely needs to rely on regional infrastructures in order to facilitate its access to inputs, production and exports. In addition, regional finance could facilitate the development of Palestinian infrastructure, especially in the absence of donor financing in this sector, particularly in the post-Intifada period. Challenges of environmental degradation and water safety also require regional efforts and investment opportunities to achieve adequate solutions.

In the area of transportation, a number of key improvements need to take place without which the high transportation costs through the Palestinian territories will continue to act as a major obstacle not only to international trade, but also to domestic trade. Suffice it to recall that the main bridge connecting the West Bank with Jordan cannot support the weight of a loaded truck. A number of vital changes are necessary: rehabilitating and improving the road network, establishing and enhancing a rural network that provides access to rural and agricultural land, and overcoming the obstacles posed on the Palestinian transportation system as a result of the expansion of settlement-related road networks, which in some cases have blocked vital Palestinian routes.

Given the scarce and political nature of water in the region, the distribution, conservation and expansion of water resources are of utmost importance, not only for the stability of a regional trade agreement, but also for providing an essential input for agricultural and industrial production in the region. A political settlement within the “final status of negotiations” is therefore vital for granting the Palestinians an equitable share of this central resource. In addition, Palestinian electricity has long been supplied by Israeli firms, which is not only provided at high cost, but is used as a political instrument, as it is regularly cut off. A unified and independent Palestinian power system operating as part of a regional network that promotes interconnection with its neighbouring countries is essential for the growth and development of the Palestinian economy.

The state of the Palestinian border crossings, the long and cumbersome procedures spanning from hours to days at a time, the back-to-back system of transportation, and the ad hoc closure of crossings have severely undermined Palestinian trade since the late 1990s and especially after the Intifada. Tons of agricultural exports have rotted behind the closed borders, unable to reach their destination; the costs to traders of renting refrigerators at the crossings have led many to abandon their perishable exports altogether, or have substantially added to their trade costs. International attempts at overcoming these difficulties have been futile, since much of the current restrictions are imposed by Israel on security grounds. There is still a need, particularly at the border crossings with Egypt and Jordan, to expand traffic capacity and build terminal facilities on the Jordanian and Egyptian sides of the border so as to eliminate – or best accommodate – the costly delays arising from the present procedure. According to UNCTAD (2003), under certain conditions, such as improvements in the region’s infrastructure and the facilities at border crossings, re-routing Palestinian trade, which is currently transiting Israeli ports via port facilities in Egypt and Jordan, could generate savings and other gains for the Palestinian trading community and economy.

C. Economies of scale and intra-industry trade

As a stepping stone towards multilateral cooperation and international trade, regional integration can expand the economy’s supply and demand markets gradually, without the sudden shock that many domestic industries could experience if the economy had gone through a phase of rapid trade liberalization. The larger market allows for a healthy level of competition through which a more efficient and specialized use of the economy's resources takes place. The simultaneous development of the infrastructure would allow the economies to reap the benefits of this larger-scale production.

A major difficultly of intra-Arab trade has been the similar export structure of most Arab economies and the limited range of traded products, often being confined to agriculture and basic manufacturing products. However, through a more efficient division of labour, firms can move towards product differentiation and intra-industry trade. This is of particular importance to those countries of the region that have a relatively limited industrial sector and those that would not be able to develop this industry without access to a wider pool of labour and technology.

UNCTAD (1998) calculated intra-industry trade indices for seven product groups in Egypt, Jordan, the Syrian Arab Republic and Tunisia. One of the findings of the study was that in all these countries, manufacturing and chemical products generated more intra-industry trade than the other five groups, namely, food items, fuels, ore and metals, machinery and transport equipment. The study indicates the potential of Arab intra-industry trade, which can benefit the industrial trade of these economies internationally. This is particularly important, as it supports the industrialization drive in many of these economies, while moving away from traditional export sectors such as agriculture and basic manufacturing.

D. Enhancing international competitiveness and attracting foreign direct investment

Lower production costs resulting from better infrastructure, easier access to inputs, a more efficient division of labour and the removal of tariff and non-tariff barriers to trade among member countries reduce the cost of production and in turn increase the country's regional competitiveness. The latter can then grow when the country expands its production and exports to an international level. This, combined with the earlier suggestion that international trade can enhance the chances of successful regional integration, implies that development and progress in expanding trade at one level, regional or international, can reinforce the expansion of trade at the other.

Furthermore, regional integration could strengthen the country's bargaining power in its trade relations. This aspect is of utmost importance to the Palestinian economy, given its history of skewed and forced integration with the Israeli economy. The larger market and institutional arrangements of an agreement will empower the country's trading stance in other bilateral, regional or international trade relations and also reduces the risks of discriminatory and illegal trade practices of other trade partners.

Attracting FDI could be an important spillover effect of regional integration for the Palestinian economy. The occupied Palestinian territory has been deprived of private and foreign direct investment for many decades, mainly due to the uncertainties and unstable environment of the territories that do not provide the minimum stability required to ensure investors' confidence. The risk of physical destruction, the frequent and arbitrary closures and movement restrictions, the unstable and complicated institutional and regulatory environment and the crumbling prospects of peace have often prevented investors from initiating activity in the occupied Palestinian territory. Therefore, participation in regional trade integration and the existence of international rules and regulations could signal a certain degree of stability and stimulate investment. In addition, access to regional markets could balance the relatively small size of the domestic Palestinian market and, hence, act as an incentive to foreign investors to undertake large-scale manufacturing projects.

VII. Elements of a strategy to reduce unemployment and poverty

An unemployment- and poverty-reduction strategy should take into consideration that the impact of unemployment on the standard of living and poverty has been all the more pertinent in the Palestinian case, given the absence of mechanisms and welfare provisions to protect the poor and the unemployed. This has been particularly the case, given the limited government resources, the lack of a coherent strategy targeting the poor, the destruction and erosion of an agricultural and industrial productive base, and insufficient domestic and international programmes addressing the poorest segments of the population. The fluctuations in the economy and the segregated and rigid labour market have also made it difficult for the unemployed to find their way back to employment, thus pushing more people below the poverty line.[5]

A. Efficient use of aid

Since the Oslo Accords, donor funding has been the major source of Palestinian revenue aimed at promoting the development of an independent Palestinian economy. However, especially since the second Intifada in 2000, larger proportions of aid are being increasingly channelled towards relief and emergency assistance, as shown in table 8. This is partly a response to the worsening humanitarian disaster in the occupied Palestinian territory and partly an indication of donors' inability to carry out developmental projects in the face of an intensifying conflict. Although humanitarian relief provides a type of safety net for the local population, it also relieves the Israeli Government of its responsibilities as the occupying power (under the Fourth Geneva Convention) towards the Palestinian population. It is argued that donors, by financing the costs of the Israeli military occupation, have absolved Israel of its obligations towards the Palestinians and in doing so, have contributed to normalizing the occupation (Keating et al., 2005).

Table 8. Total external aid to the occupied Palestinian territory
(Millions of dollars)

	Before 2002	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009*	*Total*
Commitment	1,689	946	813	837	1353	1958	1599	3253	1,151	13,600
Disbursement	983	862	768	839	1,087	1,241	1,639	3,052	1,193	11,664
Budget support	5	410	151	242	224	309	554	1,684	944	4,524
Humanitarian	255	276	219	257	368	466	477	670	160	3,149
Other	2,658	176	398	340	495	465	607	698	89	5,926

Source: Ministry of Planning. Available from http://db.mop.gov.ps/amc/sectorprofile.asp .

Therefore, given the cycle of de-development perpetuated mainly by the measures imposed by the Israeli authorities and the structural weaknesses of the Palestinian economy, there is a vital need to increase the levels of development funding to be channelled towards rebuilding and expanding the productive economic base that would enhance long-term job creation and poverty reduction, and

[5] These trends have been more pronounced in the Gaza Strip, because of the severe blows that it has received from the blockade since June 2007 and the 23-day war in December 2008. As a result, poverty now affects 87 per cent of the population in Gaza.

would eventually lead to a reduction in Palestinian dependency on foreign aid.[6] In the meantime, donor programmes should strive to reflect the realities on the ground as well as Palestinian development priorities, rather than those of the donors themselves.

B. Improving the investment climate

As demonstrated in table 9, domestic and foreign investment in the occupied Palestinian territory have been consistently undermined by the uncertainties associated with the intensifying conflict, such as threats of physical destruction, changing trade and economic regulations and the lack of effective demand, to name just a few. Within this unstable environment, the Palestinian Authority should aim to improve the services and capabilities of the key institutions that are of significance to the private sector.

Table 9. Percentage changes in net foreign direct investment in the occupied Palestinian territory, 2000–2006

	2000	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
Net foreign direct investment	(887.5)	136.9	(2.2)	(91.3)	(426.9)	(62.1)	(406.9)
Inflow	(67.1)	(69.0)	(51.0)	91.5	171.7	(4.8)	(60.0)
Outflow	25.9	77.0	(4.7)	(86.5)	4.7	(82.7)	1431.9

Source: PCBS, balance of payments, several years.
Note: Numbers in parenthesis are negative.

In order to improve FDI in the occupied Palestinian, territory a number of measures can be considered. Unlisted companies should be encouraged to list themselves on the Palestinian Securities Exchange, which would expand the market and enhance confidence. Palestinian shares should be promoted for external trade in a number of countries, particularly in countries that host large Palestinian communities. Given the current challenging environment, an online trading system for foreign investors that allows direct online payment can ease foreign investors’ access to Palestinian markets. Furthermore, the role and productivity of the Palestinian Securities Exchange should be constantly monitored and evaluated in order to enhance its role in attracting FDI.

UNCTAD (2009c) outlined an aftercare strategy to retain existing investors and attract new ones in the occupied Palestinian territory. There are many components of this strategy: investor aftercare services, information dissemination, partnerships with specialized training and research institutions, the promotion of cooperation and networking among enterprises, sectoral-geographical clustering, the integration of existing investors into regional and global value chains, policy advocacy, comprehensive legal frameworks for investment, a conducive tax system, skills development, increased financial intermediation, the expansion of eligible collateral and the creation of credit and insurance schemes. Areas that require immediate and special attention, even under occupation, are as follows:

Land registration: Most land in the West Bank remains unregistered, making it difficult for businesses to purchase land and expand operations. Funding a full-scale project to improve land policy and officially register all land would give a major boost to private-sector activity.

[6] The occupied Palestinian territory is becoming more dependent on foreign aid due to its increased relief projects. This is a sign that the original goal of fostering an independent Palestinian economy is not being reached.

Legislative reforms: Many existing laws affecting private-sector activity are contradictory; those governing the occupied Palestinian territory are not fully harmonized. Among the most pressing laws that are required for the establishment of a stable legal environment are the Commercial Law, the Companies Law and the Competition Law. The procedures for drafting, passing, and enforcing legislation should be improved to allow for easier entry of private businesses into contracts and an expansion of their operations.

Competition policy: It is widely acknowledged that the Palestinian economy is becoming less competitive and that monopolies and large businesses are using the current crisis to expand their market power. Given the importance of maintaining confidence in the economic system and the trust of the population, the Palestinian Authority should renew efforts to develop a competition policy and establish regulatory bodies in areas such as telecommunications.

C. Promotion of employment-intensive sectors

According to UNCTAD (2006a), a national Palestinian development strategy needs to set specific sectoral priorities aimed at promoting sectors or subsectors that are capable of achieving time-bound developmental objectives, particularly in terms of employment and income. This also implies a stronger role for the Palestinian Authority in leading and determining the allocation of donor support to priority sectors. For this to be achieved, it is essential to modify the sectoral pattern of development assistance observed in 1999–2004 and allocate more funds to relatively employment-intensive industries. Specifically, agriculture and other sectors with higher employment generation capability should receive a higher proportion of donor development assistance, be it technical, financial or other support. However, the proposed switch should be associated with specific programmes to raise the productivity of labour-intensive sectors, while at the same time increasing their employment absorption.

The decline of cultivated and arable land area resulting from the Israeli settlement construction, expansion of the separation barrier and bypass roads, and the lack of access to the required agricultural inputs have resulted in high rates of rural-urban population shift as people in the occupied Palestinian territory seek employment. This has resulted in the movement of labour to urban areas, increasing the supply of unskilled and semi-skilled labour in urban centres, and in turn, leading to a further segmentation of the labour market. To stimulate the employment of labour, especially in rural areas, efforts should concentrate on the following measures:

(a) Restructuring, reactivating and institutionalizing the coordination frameworks and channels between stakeholders in the agricultural sectors, including the Ministry of Agriculture, non-governmental organizations and the private sector, under the auspices of a higher agricultural council;

(b) Promoting Palestinian priorities in donor projects and activities. In this regard, the agricultural sector should be a priority, with special attention given to resolving the problem of agricultural property fragmentation and small land holdings.

The Palestinian Authority should issue regulations and measures to protect Palestinian agricultural workers and products, particularly in the context of Israeli movement and regulatory restrictions and in the face of competition from the highly subsidized Israeli agricultural products. Calling for the establishment of a national centre for rural and agricultural research and planning by the relevant stakeholders will also be a valuable contribution to this traditional source of Palestinian employment.

In urban areas, subsidies should be considered to improve education and health sectors; attention should also be given to infrastructural enhancement.

It is well understood that the easing of the Israeli restrictions remains the key to free movement and the efficient allocation of labour between the various sectors of the economy. However, the Palestinian Authority could begin implementing a selective set of policies, such as those suggested above, even under the ongoing circumstances.

D. Enhancement of human capital

High levels of demand for higher education, combined with the inability of the market to produce enough jobs for graduates, have led to staggering levels of unemployment. This has, in turn, led to a vicious cycle in which demand for both graduates and higher education is being dampened and undermined by the negative dynamics of the segregated labour market. Yet, it is important for the labour market and the future enrichment of labour capacities to enhance the human capital of the poor by providing better access to education and job opportunities. This involves improvements in (a) careers education, (b) access to careers information, (c) careers advice and guidance and (d) professional development.

In addition, there is a need to improve health services. In its current structure and functioning, the Palestinian health care system does not guarantee full access to all patients. Tertiary health care provision continues to be suboptimal, with many gaps in service provision, forcing the demands for health care to be increasingly geared towards countries abroad. In order to improve health services, the following measures are necessary: (a) launching a comprehensive health care needs assessment study, (b) reconstructing the health insurance structure and schemes to guarantee universal health care coverage, (c) developing clear quality guidelines for all health care services and (d) acquiring expert advice on the economic implications of public health care policies as part of the formulation process. Tertiary health care development is a continuous process and must be integrated as an important component in all health care strategies and plans of the Ministry of Health and the Ministry of Education and Higher Education. Reaching this end would empower the poor and help them move above the poverty line.

E. Improved physical infrastructures and access to credit and social safety nets to empower the poor

The debilitated Palestinian infrastructure is a major challenge for a new Palestinian State. It is also essential to prevent unregulated urban development that might otherwise result from a rapidly growing population and an increasing rural-urban migration. To counterbalance the underdeveloped status constantly imposed on the Palestinian infrastructure, increased international attention should be placed on developing the quality and lowering the cost of infrastructure services, particularly transportation, electricity and water. The importance of infrastructure in empowering the poor should be accompanied by their access to credit. This could be done by granting microcredits or microloans to the poor, thus enhancing their employment opportunities at a low rate of interest. More viable employment opportunities also need to be generated by employment or labour-intensive programmes to provide a long-term solution to the employment and poverty trends in the occupied Palestinian territory. Moreover, protecting the poor may involve training them in new skills and equipping them with knowledge about the necessities of the market and labour opportunities. All this will eventually create a social safety network that will protect the poor.

F. Reducing dependence on Israel and enhancing regional integration

At this stage of reversed development under occupation, it might be premature to stress that the liberalization of trade, particularly of imports, should be the chief objectives of the Palestinian economy. At the present state, enterprises are too weak to withstand increased competition in global or even domestic markets. This is likely to persist as long as they do not benefit from an independent national economy and supportive government institutions. It is essential to bear in mind that the prime objective of trade or any trade-related reform should not be to liberalize the Palestinian economy per se, but to provide a vent for productive surpluses, as well to diversify the trade range in order to increase Palestinian income security. This calls for a trade policy that takes into account the realities of the occupation, the needs of Palestinian enterprises and national development priorities. Policy should focus on increasing employment and reducing poverty, while nurturing supply capacity, eliminating occupation-related distortions and laying the groundwork for sustained economic recovery, with trade only an integral component of this process.

In accordance with the Paris Protocol, any goods imported by Palestinians should meet the requirements of Israeli standards and specification rules. In general, such standards and specifications are stricter than international norms, thus serving to protect the Israeli market and act as non-tariff barriers to Palestinian exports. These standards represent a barrier to trade whereby the war-torn Palestinian economy is forced to compete with standards that are even higher than international standards.

The Palestinian Authority should consider designing specific policies to improve trade and foster growth. These policies could include measures such as (a) establishing new institutions to promote Palestinian foreign trade, such as special commercial representative offices abroad and dedicated financing organizations and institutions to organize exhibitions and trade affairs; (b) establishing market research centres to provide information about local and international markets; (c) reducing the value added tax for locally produced products to make them more attractive as exports and enable them to compete with foreign import; (d) reviewing the international trade agreements, continuing to push for preferential treatment of Palestinian exports and promoting private sector involvement in trade negotiations; and (e) concentrating on enhancing the quality of Palestinian products at both the production and marketing stages, specifically by encouraging the use of new technologies, reducing customs duties on high-tech machinery and tightening the supervision of local products with respect to conformity with international standards.

VIII. Institutional and policy harmonization

Rigid and bureaucratic institutional structures and an unstable political landscape have undermined the potential of the region’s trading activities. This is partly due to the political uncertainties affecting many of the countries of the region over the course of the twentieth century, and as a consequence, the constantly shifting political alignments in the region. Promoting and taking advantage of Arab regional integration requires a stable, coordinated and well-functioning institutional environment. A number of policies requiring coordination among Arab countries are as follows:

A. Capital market policies

This includes a harmonization of the region’s capital markets to reduce its fragmentations, to mobilize savings and to pool regional savings in order to allow optimal allocation among competing investment projects. This harmonization of capital markets is not only viable for financing regional infrastructural and production ventures, but also for providing an enabling environment for private sector activity. This, however, requires harmonization of exchange rate policies, tax measures and other fiscal and monetary policies. To facilitate this, it is essential to reform and modernize the procedural and logistical links among Arab countries, particularly in terms of the provision of vital information to investors, the modernization of border-crossing procedures and harmonization of quality standards across the member countries.

B. Labour market policies

This issue is of particular importance to the occupied Palestinian territory, given the long history of Palestinian labour exports to the Arab Gulf countries and Israel. The Palestinian economy has suffered severely from the sudden return of a substantial number of Palestinian workers from various Arab countries owing to the political instability in the Gulf region in the early 1990s. More importantly, the Israeli closure policy has made the flow of labour and the livelihoods of thousands of families in the occupied Palestinian territory subject to political will. Movements of unskilled labour to work in Israel and of skilled labour to the Gulf region have led to distortions in the labour market. The effects of the brain drain may be felt in the economy once the pace of investment increases and markets open up.

The issue of labour market integration, that is, labour mobility to and from other Arab countries as part of factor market integration, is of utmost important in the Arab economies. Therefore, a harmonization of labour market policies and agreements to ensure the smooth flow of labour, dignified treatment and equitable distribution of the benefits are an integral part of regional cooperation and integration. This not only requires a better regulation of labour movement, but also an improvement in educational and labour rehabilitation policies to ensure that future regional demand for specific types of labour or skills is meet from within the region.

C. Demand policies

The coordination of demand policies is particularly important, given the widely different levels, types, and origins of domestic demand in the Arab countries. Oil revenues, remittances and international assistance have inflated domestic demand in some countries, while rising inflation and unemployment have hampered demand in others. At the regional level, the coordination and management of demand in areas such as water, energy, oil and electricity use are of utmost importance, not only because of their scarcity, but also because it is necessary to improve efficiency, rationalize trade and conserved resources. At the macro level, harmonizing inflation rates and stabilizing exchange rate fluctuations could be instrumental in reducing the risks of regional investments and facilitating the expansion of trade.

D. Monetary policies

Monetary policy coordination is central to regional trade transactions and capital flows. However, this is one of the most challenging areas of coordination between the Palestinian economy and other Arab countries. Currently, there is no Palestinian national currency. The new Israeli shekel, United States dollar and Jordanian dinar are used as legal tender. This is thought to have created a high degree of inefficiency and fluctuations due to the floating exchange rate between the dollar and the new Israeli shekel. The Palestinian economy is also losing revenues from seigniorage due to the absence of a national currency – or the existence of currency board arrangements as an alternative to a national currency – along with an imposed inability to use exchange rate and money as macroeconomic policy instruments (see UNCTAD, 2009b). Furthermore, recent restrictions imposed by the Israeli authorities on the free flow of the new Israeli shekel have created a great deal of uncertainty and severe liquidity problems, particularly in the Gaza Strip.

E. Fiscal policies

Tax harmonization has a strong, direct bearing on the development of regional investment and trade. As other barriers to product, labour and capital mobility are removed during the course of integration, the expansion of regional trade and investment activities becomes dependent on the abolition of tax and customs obstacles to cross-border activities. Different tax levels result in directing capital to countries with lower taxes, which leads to a suboptimal allocation of investment across the region. Therefore, regional tax harmonization can prevent distortions in intraregional trade flows. As tax harmonization is a long-term objective, other policies such as the harmonization of production subsidies or consultations on investment incentives could lead the way in the medium term.

Another aspect of fiscal policy that poses challenges to the Palestinian economy's Arab regional integration efforts is the lack of control by the Palestinian Authority over its fiscal revenues (UNCTAD, 2009b). Given the operation of the Palestinian economy as a territory within the Israeli customs envelope, the Palestinian tariff regime is designed in accordance with Israeli economic conditions and interests, often implying at least three layers of taxes on imports, and adding to the price of imports used by Palestinian producers.

The balance of the Palestinian Authority's budget is financed by international donor support, further conditioning the policy space available to the Palestinian Authority. A revision of current norms and rules governing Israeli-Palestinian economic relations should incorporate a new set of standards and taxes reflecting Palestinian economic conditions and development priorities. This will revise downwards some of the major tariffs and result in lowering the prices of Palestinian inputs and outputs, hence fostering trade with its neighbouring countries.

IX. Conclusion and policy recommendations

The above analysis indicates that regional Arab integration can provide an opportunity for the development of the Palestinian trade sector by expanding its trading activities with Arab trading partners. In addition, regional integration can provide the much-needed autonomy and recognition of Palestinian trade as that of an independent, sovereign customs territory rather than a territory defined within Israel's customs envelope. However, this is a challenging task, given the insufficient physical and institutional infrastructure of the Palestinian economy, the lack of viable financial and transportation structures, rigid restrictions imposed on trade and economic activity, and the uncertainties associated with a prolonged and often volatile conflict.

In order to facilitate successful regional integration, both the Palestinian Authority and its Arab neighbours need to create, harmonize and reform the necessary institutional, infrastructural and regulatory conditions that are conducive to regional trade. However, the long-term benefits of such efforts and the potential benefits of such involvement for the Palestinian economy remain subject to political developments on the ground. It is important to recognize the central role of the current political and economic arrangements that govern Israeli-Palestinian relations and have long acted as a barrier to Palestinian trading activities and relations. A revision of such political and economic arrangements and a more stable regional environment based on a just and enduring peace remains a key factor– if not the key factor – determining the success of Palestine's future regional integration efforts.

Regional integration can also help put the Palestinian economy on the path of integration in the international multilateral trading system. This can be accomplished by improving infrastructure, institutions and trading standards, as well as the country's terms of trade and bargaining position. Simultaneously, however, participation in a multilateral trading system can enhance a country's regional integration efforts. For example, the potential benefits of WTO membership for the Palestinian economy and the reinforcement of its territorial and trade autonomy would not only provide the required institutional guidelines and standards required for regional integration activities, but would also allow regional integration to be pursued without producing any adverse impacts on trade relations with the rest of the world. Accession to WTO is a policy option that can prepare the economy for the costs and benefits that it would achieve by dealing with economies with vastly different trade and institutional structures.

In times of donor fatigue, reduced development assistance and economic stagnation, regional integration can offer a viable alternative through which Palestinian trade and economy can be enhanced by exploiting opportunities available within the region. This not only provides the Palestinian economy with a much-needed market, but also allows for the transfer of technology, finance and investment flows to the territories, raising Palestinian production, exports and competitiveness regionally, and in turn, globally. Two considerations are important in this context: first, regional integration, although significant in providing a strong regional market for Palestinian trading activities, is also significant in its role as a stepping stone towards Palestine's wider trade integration internationally. Second, given the high levels of poverty, unemployment and sectoral structural deficiencies, trade policy should aim not only to create more trade, but to minimize these social and economic weaknesses. Regional trade agreements should thus be organized, prioritized and conducted with the above two considerations in mind.

In addition to the policy recommendations discussed in the previous sections, a number of areas specifically related to international trade should be the centre of trade and macroeconomic policymaking in the occupied Palestinian territory.

A. Agricultural exports

The agricultural sector should be central to Palestinian regional integration efforts. This is vital, not only because of the critical importance of agriculture to the Palestinian unemployment problem, but because it is necessary for Palestinian agricultural products to regain a share of their lost foreign markets. It is also essential to utilize regional inputs, water and infrastructural resources to revitalize this declining sector. The development of agricultural production and exports will provide the required inputs for, and encourage exports from, the food processing industries, while promoting Palestinian food security and reducing pressure on real wages.

In the Palestinian context, expanding the agricultural sector's opportunities through Arab regional integration requires institutional reforms and enhancing the legal framework for land ownership, tenancy and inheritance rights, and water rights. These have been areas of much controversy and debate over the last decades, especially with the increased expansion of Israeli settlement activities. The latter has also undermined Palestinian agricultural infrastructure and has led to massive reductions in the size of Palestinian arable land, the lack of a viable transportation system and difficulty in accessing rural areas. Rehabilitation and reconstruction are urgently needed for agricultural roads, artesian wells, and a secure supply of electrical power. These are highly contentious issues and their resolution depends on the collaboration of the Israeli authorities and, more importantly, on a revision of the post-Oslo economic frameworks governing Israeli-Palestinian economic activities.

Regional collaboration can help develop the Palestinian agricultural infrastructure and enable the transfer of technology and training. The Palestinian Authority should, in turn, provide an accommodating institutional environment in which these flows can take place, in order to ensure the efficient flow of capital to farmers, to improve workers' technical skills, and to enhance marketing facilities and access to regional and international markets. Another important area is storage, packing and grading facilities, particularly given the threat of border closures, which are often detrimental to perishable agricultural exports.

B. Trade in industry

In the case of industrial exports, the quality and quantity of physical infrastructure and human capital is key. The levels of technology and skills applied in the Palestinian industrial sector have often been kept to a minimum as a result of stiff Israeli controls on the transfer of technology to Palestinian firms. The dominance of Israel as the main trading partner of the Palestinian economy has resulted in a peculiar form of economic dependency that does not lead to a transfer of technologies, at the levels expected, from the more advanced trading partner. Arab integration could fill this gap. However, in order to attract such technological transfers and investments, the Palestinian economy should aim at increasing its market size, which in turn, will raise the profit margin of investors and create an incentive for such technological transfers. Regional integration can therefore be very significant in providing the much-needed market expansion for Palestinian products.

C. Infrastructure

Poor physical and institutional infrastructure is one of the main impediments to Palestinian regional trading activities. Despite the long seacoast of the Gaza Strip, the occupied Palestinian territory is landlocked, enjoying neither the facility of an airport nor that of a seaport. The sea and air spaces of the occupied Palestinian territory are controlled by the Israeli military authority. All exports and imports take place through the land border crossings, which are also controlled by the Israeli authority and are subject to heavy screening and long delays. This adds substantial costs to Palestinian imports and exports, dramatically decreasing the competitiveness and viability of Palestinian trade. In the absence of any efficient alternatives, many Palestinian traders seek to conduct their transactions through Israeli commercial agents, who act as intermediaries and import the goods and clear them. However, the existence of these intermediaries adds to the trading costs by promoting a physical leakage to Israel, while depriving Palestinians traders from having direct contact with overseas markets.

Therefore, the establishment of air- and seaport facilities and of efficient transportation and crossing procedures are essential to conduct viable and efficient trading activity between the Palestinian economy and that of the Arab countries. However, the establishment of such facilities and procedures implies an effective handing over of power and border control to the Palestinians – something which the Israeli authorities are not prepared to give up. Also of importance is a serious and concerted regional effort to modernize procedures at border crossings and to standardize the legal and technical aspects of custom duties, measurements, standards and rules of origin in order to create an adequate and efficient regional transport system at the service of regional trade activities.

D. Trade in services

Given the stiff mobility restrictions on goods and labour across the occupied Palestinian territory, it has long been suggested that trade in services is one of the most viable future channels for expanding Palestinian trade. Like agriculture and manufacturing, this requires major improvements in the physical, legal, institutional and economic policy frameworks both at the national and regional levels.

From the Palestinian point of view, these reforms should take place within the context of Palestinian economic development priorities and a vision of its future trajectory. Therefore, Arab regional integration should be incorporated into Palestinian economic development priorities. This, in turn, would require coordination between sectoral development priorities and the role of regional trade in enhancing the productivity and capacity of those sectors. Finally, all of these reforms rely on the existence of a solid, fair and final political settlement covering the affairs of the occupied Palestinian territory – without such a settlement, it will be difficult for long-term economic planning and regional integration policies to fully achieve their objective. Nonetheless, as discussed previously, the Palestinian Government can take certain steps under the conditions of occupation that could lead the Palestinian economy in a direction that is in line with a viable future independent Palestinian economy and State.

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