



General Assembly

Distr.: General
2 August 2019

Original: English

Seventy-fourth session

Item (36) of the provisional agenda*

Question of Palestine

Economic costs of the Israeli occupation for the Palestinian people: fiscal aspects

Note by the Secretary-General

The Secretary-General has the honour to transmit to the General Assembly the report prepared by the secretariat of the United Nations Conference on Trade and Development.

* [A/74/150](#).



**Report prepared by the secretariat of the United Nations
Conference on Trade and Development on the economic
costs of the Israeli occupation for the Palestinian people:
fiscal aspects**

Summary

The present report is submitted pursuant to General Assembly resolutions [69/20](#), [70/12](#), [71/20](#), [72/13](#) and [73/18](#), in which the Assembly requested the United Nations Conference on Trade and Development to assess and report on the economic costs of the Israeli occupation for the Palestinian people.

I. Introduction

1. Since 1967, the West Bank, including East Jerusalem, and the Gaza Strip have been under Israeli military occupation and the Palestinian people have endured adverse policies that have affected their economy and all aspects of life. The signing of the Protocol on Economic Relations between the Government of the State of Israel and the Palestine Liberation Organization in Paris in 1994, was expected to improve the Palestinian economic situation. However, Palestinian economic development remains elusive and characterized by poor growth performance, chronic fiscal and trade deficits and high dependency on the economy of the occupying Power. Following decades of denying the Palestinian people the right to freely access their natural resources or to make optimal use of their financial resources, the issue of economic losses incurred due to the occupation has been drawing increased attention. Since 2014, various Palestinian and other studies have addressed Palestinian fiscal losses resulting from current trade and economic relations with the occupying Power. The first of those studies was published by the United Nations Conference on Trade and Development (UNCTAD) in 2014 and addressed the leakage of Palestinian revenue under the Protocol.¹

2. In the present report, UNCTAD builds on findings made in previous studies and reports as well as on new quantitative analysis, and examines the fiscal costs of the occupation for the Palestinian people. Those costs severely constrain the capacity of the State of Palestine to achieve the Sustainable Development Goals. The fiscal costs of the occupation are a part of the overall economic losses caused by the occupation and consist of two components: Palestinian fiscal leakage to Israel under the Protocol, and other fiscal losses resulting from policies and measures imposed under the prolonged occupation. In the present report, light is shed on both parts by estimating the value of the fiscal leakage through some significant channels and by taking a new look at other significant fiscal losses related to the occupation.

A. Objectives

3. Accordingly, the objectives pursued in the report are:

(a) To map channels of fiscal leakage that had not been not identified in previous studies, such as leakage from direct taxes; tax evasion through undervaluation of goods imported from Israel and the rest of the world in the declaration of their actual value; and losses resulting from withholding Palestinian clearance revenue;

(b) Based on a consistent estimation methodology, on reviews of studies by international organizations and on agreements concluded, to update the estimate of the fiscal leakage to Israel and of other fiscal losses incurred by the State of Palestine as a result of restrictions imposed by the occupying Power, and documenting the sources of that fiscal leakage and those fiscal losses;

(c) To estimate the fiscal leakage to Israel, which is part of the overall Palestinian fiscal losses caused by the Israeli military occupation. As indicated previously, those overall fiscal losses are a part of the overall economic costs of the occupation borne by the Palestinian people.

¹ United Nations Conference on Trade and Development (UNCTAD) *Palestinian Fiscal Revenue Leakage to Israel under the Paris Protocol on Economic Relations* (Geneva, 2014).

B. Concepts and limitations of the analysis

4. The report focuses on one element of the economic costs of the occupation, namely the Palestinian fiscal losses, or what could be termed the fiscal costs of the occupation. One of the components of those fiscal costs is fiscal leakage to the Israeli treasury. That includes all Palestinian public revenues, as identified in the Protocol, that leak to the Israeli treasury because of the Protocol's inadequate implementation or because of measures imposed by Israel. Therefore, as stipulated in the Protocol, those leaked resources should be reimbursed to the Palestinian treasury. In 2016, the Palestinian Authority received two payments from Israel totalling \$300 million to compensate for previously leaked public revenues related to health stamps, equalization levies, border exit fees and value added tax.²

5. On the other hand, the fiscal costs of the occupation represent all Palestinian public revenues lost as a result of the protracted occupation, regardless of whether they leak to Israel. In other words, they represent the additional fiscal revenue that the Palestinian Authority could have raised if the occupation had not existed and the Palestinian people had had full control over their economic affairs.

6. Therefore, the fiscal costs of the occupation include both the fiscal resources leaked to the Israeli treasury and fiscal revenues foregone because they have been collected neither by Israel nor by the Palestinian Authority. However, there may well be other sources of Palestinian fiscal losses that are not covered in the present report and need further investigation. Those may include:

(a) Fiscal leakage resulting from the flow of Palestinian service imports from Israel;

(b) Fiscal losses resulting from the lack of control over natural resources and the inability of the Palestinian people to adopt economic, trade and industrial policies of their own;

(c) Fiscal losses resulting from the delay in transferring deductibles from the wages and compensations of Palestinians working in Israel and its settlements (such as health stamps and pensions);

(d) Updated estimates of fiscal losses resulting from severely restricted access to the parts of the West Bank designated by the Oslo Accords as Area C, which make up more than 60 per cent of the West Bank,³ and the untapped investment potential relating to natural resources such as oil, natural gas, minerals and resources in the Dead Sea;

(e) Other economic losses caused by occupation measures and policies such as military operations, siege, closure, demolition of buildings and uprooting of productive trees.

II. The Protocol on Economic Relations and estimates of Palestinian fiscal losses

7. As part of the Oslo Accords, the Palestinian economic, trade and taxation policy framework was incorporated in the Protocol on Economic Relations of 1994. Under the Protocol, the West Bank and Gaza Strip came under the jurisdiction of the

² See the report on UNCTAD assistance to the Palestinian people – developments in the economy of the Occupied Palestinian Territory (TD/B/64/4).

³ See Office for the Coordination of Humanitarian Affairs, "Occupied Palestinian Territory: Area C", available at www.ochaopt.org.

Palestinian Authority for a five-year transitional period. As the overarching policy framework for the management by Palestinians of their economic affairs, the Protocol constituted a precedent that legitimized previously unacknowledged Palestinian economic rights, such as the right and power to levy direct taxes, to reconstitute direct trade relations with Arab countries, to formulate policies related to importing, banking, insurance, water, energy and other domains, and to establish the autonomous Palestinian Monetary Authority to assume, to a limited extent, the supervisory tasks of a central bank without issuing a national currency.

8. Originally the Protocol was intended to shape the Palestinian economic policy framework during a five-year interim period ending in 1999. However, it continues to shape the Palestinian economic policy framework to this day.⁴ According to some studies, a number of provisions of the Protocol have not been implemented by Israel.⁵

9. As has been argued in several reports and studies, the policy framework, along with measures imposed by Israel, are the main reason for the fiscal fragility of the State of Palestine, and fiscal losses, including leakages to Israel. In its pioneering 2014 study,⁶ UNCTAD showed that the annual fiscal leakage resulting from imports from Israel and customs evasion represented 3.6 per cent of the Palestinian gross domestic product (GDP) or 18 per cent of tax revenues. In another study, UNCTAD estimated that goods smuggled from Israel accounted for 26 per cent of Palestinian imports from Israel (\$890 million) in 2013. In other words, customs duties and value added tax on those goods leak to Israel.⁷

10. The World Bank has estimated the Palestinian fiscal losses resulting from the lack of access to Area C (over 60 per cent of the West Bank) at \$800 million in 2012.⁸ In its report to the Ad Hoc Liaison Committee in 2016,⁹ the World Bank estimated the fiscal leakage resulting from the following sources: undervaluation or misdeclaration of imported goods; compensation for Palestinian workers withheld by Israel; excessive administrative fees levied by Israeli customs to process Palestinian imports transiting through ports in Israel; and Palestinian indirect imports from Israel. In another study, the World Bank estimated that between 2013 and 2015 the Palestinian Authority lost value added tax in the range of \$70 million to \$184 million due to losses in the Palestinian wired and wireless telecommunications sector.¹⁰

11. In three reports to the Ad Hoc Liaison Committee, the State of Palestine pointed out that the implementation of certain articles of the Protocol on Economic Relations would increase Palestinian public revenue by about \$300 million per year (2 per cent

⁴ In its resolution 73/256, the General Assembly stressed the need for the continued implementation of the Paris Protocol on Economic Relations, including with regard to the full, prompt and regular transfer of Palestinian indirect tax revenues.

⁵ UNCTAD, *Palestinian Fiscal Revenue Leakage*, p. III and pp. 9–15; report on UNCTAD assistance to the Palestinian people – developments in the economy of the Occupied Palestinian Territory (TD/B/63/3), para.16; World Bank, “Economic monitoring report to the Ad Hoc Liaison Committee” (Washington, D.C., 19 April 2016), paras. 38–49; International Monetary Fund (IMF), “West Bank and Gaza: report to the Ad Hoc Liaison Committee” (Washington, D.C., 5 April 2016), p. 10, box 1. Available at www.imf.org/~media/Files/Countries/ResRep/WBG/WBG040516.ashx.

⁶ UNCTAD, *Palestinian Fiscal Revenue Leakage*.

⁷ Ibid.

⁸ Orhan Niksic, Nur Nassser Eddin and Missimiliano Cali, *Area C and the Future of the Palestinian Economy* (Washington, D.C., World Bank, 2014).

⁹ World Bank, “Economic monitoring report”.

¹⁰ World Bank, *Telecommunications Sector Note in the Palestinian Territories: Missed Opportunity for Economic Development – Note for the Palestinian Ministry of Telecommunications and Information Technology* (Washington, D.C., 2016).

of GDP in 2017).¹¹ The sources of fiscal leakage mentioned in these reports were: the outdated mechanism of clearance of Palestinian imports through Israel; the excessive administrative fees levied to clear those imports; the unfair distribution of revenue from exit fees paid by Palestinian passengers exiting the Occupied Palestinian Territory; the withholding, by Israel, of deductions from wages of Palestinians working in Israel and the settlements, in particular the equalization levy, the health stamp, social security and the pension funds; indirect imports, and public revenue from Area C.

12. In a recent study, the Economic and Social Commission for Western Asia used a computable general equilibrium model to measure the cost and impact of the restrictive measures imposed on the Palestinian economy by the occupying Power. The study showed that those measures were the main reason for the weak economic performance and restricted access to scarce Palestinian resources. The study suggested that reducing the restrictions in Area C would increase Palestinian GDP by 12 per cent and reduce unemployment by 27 per cent.¹²

III. Estimating a part of the fiscal costs of the occupation for the Palestinian people

13. As discussed in subsection I.B above, the fiscal costs of the occupation arise from the current trade regime and current economic relations with Israel, from the constraints created by the Israeli military occupation and from the lack of Palestinian control in the economic sphere. The present section contains estimates of the fiscal leakage and other fiscal losses based on data from 2015 and on previous studies. It further includes an assessment of non-recurring sources of fiscal leakage and losses resulting from the withholding by Israel of Palestinian clearance revenue. Those three elements together result in an estimate for the fiscal costs of the Israeli occupation borne by the Palestinian people over the period 2000–2017.

A. Estimated cost of fiscal leakage

14. In the present subsection, only those sources of Palestinian fiscal leakage to Israel are examined for which data were currently available. However, it is important to keep in mind that there are other potential sources of fiscal leakage; those should be assessed once data become available.

1. Estimated fiscal leakage from indirect imports

15. Indirect imports are Palestinian imports that are registered as if they originate from Israel, but that actually originate from a third country. As stipulated in the Protocol on Economic Relations, Palestinian imports from Israel that satisfy rules of origin are exempt from Palestinian import tax. Therefore, revenues from taxes on indirect imports (i.e., imports originating in a third country) should be transferred to

¹¹ State of Palestine, “Government of the State of Palestine AHLC report” (n.p., May 2017); State of Palestine, “Government of Palestine’s report to the Ad Hoc Liaison Committee”, (Brussels, 20 March 2018); State of Palestine, “Stopping fiscal leakages: the Government of Palestine’s report to the Ad Hoc Liaison Committee Meeting” (Ramallah, 2018). Available at http://www.lacs.ps/documentsShow.aspx?ATT_ID=36702.

¹² Economic and Social Commission for Western Asia, “Measuring the costs of Israeli restrictions on the Palestinian economy: A Computable General Equilibrium (CGE) approach” (Beirut, 2015).

the Palestinian Authority but are leaked to the treasury of Israel instead. The methodology used to estimate fiscal leakage from this source was the following:

(a) Palestinian imports from Israel were assessed at the eight-digit level of the Harmonized System Nomenclature and Classification of Goods of the World Customs Organization. Each commodity was grouped by type of effective import tax (customs duties and purchase tax);

(b) The calculations excluded all imported goods on which import taxes had already been paid, as well as goods that may be imported from Israel only (such as public sector purchases, fuel, gas, energy, vehicles, engines, fresh agricultural products made in Israel, cigarettes and tobacco), because the Palestinian Authority collects the majority of taxes on those commodities directly through the clearance system. Since no value added tax is levied on agricultural products, those were also excluded from the calculations;

(c) All goods imported from Israel but not subject to import taxes were excluded;

(d) The Bank of Israel indicates that 38.3 per cent of Palestinian imports from Israel are indirect imports.¹³ This percentage is used to calculate the tax revenues from indirect imports based on the current Israeli tariff schedule for goods, based on the following:

(i) The value of goods imported from Israel subject to customs duties multiplied by the applicable tariff rate;

(ii) The value of goods imported from Israel subject to purchase tax multiplied by the purchase tax rate;

(iii) Value added tax was calculated on import taxes, then the value added tax collected through the clearance system was deducted to obtain the net or value added tax difference;

(iv) Applying the 38.3 per cent indicated by the Bank of Israel on the values calculated for the above three items.

16. Based on this methodology and on data for 2015, fiscal leakage from all indirect import taxes, whether customs duties, purchase tax or value added tax, was estimated at \$129 million, representing 1 per cent of Palestinian GDP and around 4.9 per cent of total tax revenue.

2. Estimated fiscal leakage resulting from the evasion of customs duties and taxes

17. Although the evasion of customs duties and taxes is widespread, there are no precise estimates owing to a lack of hard data, which in turn results from a lack of control over borders and over Area C, which, as will be remembered, covers more than 60 per cent of the West Bank. Therefore, estimates are based on the opinion of experts and findings made in previous studies.

18. According to previous studies, it is estimated that 25 to 35 per cent of total Palestinian goods imported from Israel enter the Palestinian market without any documentation.¹⁴ However, in an interview with UNCTAD conducted on 15 July 2018, the Head of the Tobacco Department of the Palestinian Customs Authority estimated that, in addition to the officially registered imports from Israel, another 40 per cent of that volume was being smuggled to the Palestinian market. The methodology used for the present report is based on the conservative estimate that

¹³ Bank of Israel, "Recent economic developments", No. 128 (Jerusalem, 2010), table 2.2, p. 23.

¹⁴ UNCTAD, *Palestinian Fiscal Revenue Leakage*.

30 per cent on average of the goods that enter the Palestinian market do not have documentation. However, that estimate is not applied to electricity imports, which accounted for 16 per cent of Palestinian imports from Israel in 2015. To estimate fiscal leakage from tax and customs evasion, the following calculations were made:

- Palestinian imports from Israel in 2015 – excluding electricity – were valued at \$2,565 million. Applying the 30 per cent estimate results in a value of smuggled goods from Israel to the Palestinian market of some \$770 million
- Not all smuggled imports from Israel were subject to import taxes, thus some smuggled imports did not result in revenue losses. Records of actual imports show that 69 per cent of goods imported from Israel were subject to import taxes. Accordingly, the value of smuggled goods subject to import taxes amounts to approximately \$531 million
- The average rates of customs and purchase tax on all imports are 13 per cent and 6 per cent, respectively
- The average customs rate on a basket of Palestinian imports from Israel was 13 per cent, while the average customs rate on a basket of Israeli imports from the rest of the world was 6.5 per cent
- The rates of customs and purchase tax were calculated based on actual imports from Israel in 2015 by classifying each commodity separately at the eight-digit level of the Harmonized System and the Israeli tariff schedule in that year
- The customs rate of 13 per cent and the purchase tax rate of 6 per cent are applied to the estimated \$531 million of smuggled goods subject to customs and purchase taxes in 2015
- A value added tax rate of 16 per cent is applied to the estimated value of smuggled goods, as well as to the value of import taxes that were supposed to have been paid on those goods

19. Based on those calculations, the leakage of Palestinian public revenues to the Israeli treasury resulting from the evasion of customs duties and taxes is estimated to have been no less than \$202 million in 2015, equivalent to 1.6 per cent of Palestinian GDP and 7.6 per cent of total Palestinian tax revenues that year.

3. Estimated fiscal leakage from administrative fees on clearance revenue

20. According to the Protocol on Economic Relations, Israel charges a 3 per cent fee for collecting clearance revenue on behalf of the Palestinian Authority; this is referred to as handling fees or administrative fees. When the Protocol was being negotiated, in 1994, Palestinian clearance revenue amounted to only around \$624 million, resulting in handling fees of only \$18 million in that year. Since then, the revenues of the Palestinian Authority have tripled, leading to a significant increase in the administrative fees paid to Israel. In 2017, Israel collected over \$2.3 billion in import taxes and deducted handling fees of around \$70 million.¹⁵ The World Bank concludes that, based on the share of Palestinian imports within the total volume handled by the Israeli customs service (i.e., Palestinian and Israeli imports put together), the fee should be reduced from 3 per cent to 0.6 per cent, which would increase Palestinian revenues by \$40 million to \$50 million, money that is currently being deducted by Israeli customs.¹⁶

21. In addition, in 1996, Israel started collecting a 3 per cent handling fee on Palestinian imports of fuels and petroleum derivatives such as gasoline, diesel and

¹⁵ State of Palestine, “Stopping fiscal leakage”.

¹⁶ World Bank, “Economic monitoring report”.

kerosene. There are no administrative costs involved in direct imports from Israel, similar to products purchased according to arrangements between the private sectors in the two countries.¹⁷

22. According to data supplied by the Palestinian Central Bureau of Statistics, between 1996 and 2017, Palestinian purchases of petroleum and its derivatives amounted to about \$11.2 billion (subject to, on average, 65 per cent excise duty and other taxes). The central clearing data of the Palestinian Ministry of Finance show that, during the same period, excise levied on fuels contributed 32 per cent of total clearance revenue. The total value of clearance revenue collected during the same period was \$23 billion. The 3 per cent administrative fees on that amount equals about \$699 million, of which \$224 million was unilaterally deducted in the form of fees imposed on Palestinian tax revenues accruing from direct fuel imports from Israel.

23. According to the State of Palestine, administrative fees deducted by Israel in 2015 amounted to \$64 million. \$24 million was charged for handling Palestinian imports of petroleum products and fuel.¹⁸ As discussed above, that amount should not have been deducted as fees and therefore should be considered as part of the fiscal leakage. The remaining \$40 million should have been reduced to \$8 million by applying a rate for administrative fees reduced from 3 per cent to 0.6 per cent, as recommended by the World Bank, which implies a fiscal leakage of \$32 million. Hence, in 2015, Palestinian fiscal leakage to the Israeli treasury in administrative and handling fees relating to Palestinian clearance revenue are estimated at \$56 million, representing 0.44 per cent of GDP, or more: \$24 million relating to petroleum excise, and \$32 million to other import taxes.

4. Estimated fiscal leakage associated with the Palestinian telecommunications sector

24. The Palestinian telecommunications and information sector is of growing significance to the Palestinian economy. The World Bank, in a report published in 2016, was the first to address the sector's economic and financial losses owing to constraints imposed by the occupying Power, estimated between \$436 million and \$1,150 million during the period 2013–2015. This means that foregone value added tax accounted for \$70 to \$184 million during that period, or an annual loss between 1.2 and 3 per cent of GDP. Assuming that the loss, in 2015, as a ratio to GDP, was the midpoint of the upper and lower range percentages (i.e., 2.1 per cent), the losses in terms of potential output in that sector stand at \$266 million for that year, in addition to the associated fiscal losses in foregone value added tax, estimated at \$42.6 million, equivalent to 0.33 per cent of GDP or 1.6 per cent of total Palestinian tax revenues in 2015.

5. Estimated fiscal leakage from commercial and economic activities in Area C

25. Under the Protocol on Economic Relations, Israel is obliged to apply the Palestinian tax system to levy value added tax and income tax in Area C on behalf of the Palestinian Authority and transfer that revenue to the Palestinian treasury based on the principle of the place of final consumption and geographic location of income generation. Around 2,000 Israeli commercial enterprises or individuals work in Area C performing various activities; services, industry, agriculture, fuel, gas, and retail.¹⁹ Israel collected value added tax, income tax, property tax, and operational fees from those enterprises and transferred those to the Palestinian Authority until 2000. Israel

¹⁷ Government of the State of Palestine (2017). Report to the AHLC meeting, May, 2017.

¹⁸ Government of Palestine's Report to the Ad Hoc Liaison Committee. September, 2018.

¹⁹ Ibid.

has since stopped doing so or has stopped providing any information about the activities of the enterprises.

26. The Palestinian Government estimates that, during the period 2001–2017, Israel collected \$320 million in value added tax, income tax, property tax and other fees in Area C that was not transferred to the Palestinian treasury.²⁰ This figure represents 0.25 per cent of the Palestinian GDP during that period. Hence, Palestinian fiscal leakage resulting from commercial and economic activities in Area C in 2015 may be estimated at \$32 million, or 1.2 per cent of total tax revenues in that year.

6. Estimated fiscal leakage from the passenger exit fees at the Karamah/Allenby bridge

27. In the Protocol concerning Redeployment and Security Arrangements, the two sides agreed that Israel should collect a \$26 fee from each passenger exiting across the Karamah/Allenby bridge, and transfer to the Palestinian Authority its share, calculated as follows:

- Fee revenues from the first 750,000 passengers will be equally divided between the two sides. The Palestinian Authority will pay Israel \$1 per passenger for services. This means that 46.2 per cent of the revenue goes to the Palestinian treasury and 53.8 per cent goes to the Israeli treasury.
- For fee revenues from all passengers thereafter, \$16 per passenger is destined for the Palestinian Authority and \$10 per passenger for Israel, i.e., 61.5 per cent goes to the Palestinian treasury and 38.5 per cent goes to the Israeli treasury.

28. Since 1994, transfers to the Palestinian Authority have been irregular and partial. From time to time, Israel unilaterally raised the exit fees without consultation with the Palestinian side. Based on estimates by the World Bank, in 2015, fiscal leakage from this source amounted to \$12.2 million (0.1 per cent of GDP).²¹ Based on calculations by the Palestinian Authority, accumulated exit fees due to the Palestinian treasury but withheld by Israel are estimated at around \$145 million.²²

B. Estimated annual fiscal leakage from the sources surveyed

29. The total value of fiscal leakage resulting from the six main sources discussed above are estimated at \$473.4 million in 2015, which represents about 3.7 per cent of the Palestinian GDP or 17.8 per cent of total Palestinian tax revenues that year. In other words, had fiscal leakage to Israel been stopped, the budget deficit of the Palestinian Authority in 2015 (on a commitment basis) could have been reduced by 33 per cent, from \$1,431 million to \$ 950 million (from 11.3 per cent to 7.6 per cent of GDP). It is difficult to quantify the impact of the fiscal losses on the achievement, or lack thereof, of the Sustainable Development Goals in the Occupied Palestinian Territory. However, it is clear that severe shortages of public revenue do prevent the Palestinian Authority from making tangible progress towards achieving the Sustainable Development Goals, in particular Goal 1 (End poverty in all its forms everywhere), Goal 3 (Ensure healthy lives and promote well-being for all at all ages), Goal 4 (Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all), Goal 6 (Ensure availability and sustainable management of water and sanitation for all), Goal 8 (Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all), and Goal 16 (Promote peaceful and inclusive societies for sustainable

²⁰ Ibid.

²¹ World Bank, "Economic monitoring report".

²² State of Palestine, "Stopping fiscal leakage".

development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels).

30. On 17 February, the Israeli Government began to implement the law adopted by the Knesset in July 2018 that required the Israeli Government to freeze, from the clearance revenue it collects on behalf of and transfers to the Palestinian Authority, an amount equal to the sums paid by the Palestinian Authority “directly or indirectly” to Palestinians, or to the families of Palestinians convicted by Israeli courts of involvement in alleged “terrorist activities” or other security-related offences, as defined by Israeli law, or who were killed while carrying out such activities. The legal view of Israel is that such payments violate the obligation of the parties to the Oslo Accords to take all measures necessary to prevent acts of terrorism, crime and hostilities directed against each other and to prevent incitement. Accordingly, on 17 February, Israel announced that it would freeze approximately \$139 million of the Palestinian Authority’s clearance revenue over the course of 2019, amounting to a little over 6 per cent of the total amount of revenue transfers in 2018.

31. On 21 February, the Palestinian Authority informed the Israeli Government of its rejection of this unilateral decision, stating that, under the Protocol on Economic Relations, no amount may be deducted without the consent of both parties, and that it would not cease its social welfare payments to the families of prisoners. The Palestinian Authority has since refused to accept any clearance revenue transfers from Israel, noting that it will accept the revenue only if the full amount payable is transferred. Clearance revenue from Israel constitutes up to 65 per cent of the total revenue of the Palestinian Government. The decision has prompted the Palestinian Government to take severe austerity measures, including reduced salary payments to Government employees, the cessation of all promotions, appointments, bonus payments, purchases of property and cars and, and a reduction of expenses paid for travel, hospitality and fuel. In addition, the Palestinian Authority has delayed the transfer of welfare payments to some of the poorest families. The Palestinian Authority has not published a budget for 2019. The impact should be addressed in a future analysis.

C. Other fiscal losses related to the occupation

32. Palestinian losses of public resources caused by the protracted occupation represent all public revenue that could have been collected by the Palestinian treasury in the absence of the occupation. There are direct and indirect fiscal losses resulting from the occupation, which includes but is not limited to military operations and actions, the closure imposed on the Gaza Strip, movement and access restrictions in force on the West Bank, the demolition of buildings and the uprooting of trees.

1. Estimated fiscal losses resulting from Israeli control over Area C

33. In a study, the World Bank discussed the huge output, labour and tax revenues that Area C has the potential to contribute to the Palestinian economy.²³ Area C represents 60 per cent of the land area of the West Bank. Since Area C is still under Israeli control, the right of the State of Palestine to benefit from the Area’s economic potential is limited. According to the World Bank, the likely potential benefit from alleviating the restrictions imposed by Israel in Area C is equal to 35 percent of Palestinian GDP, a potential increase in tax revenue of 7.6 per cent of GDP (\$960 million in 2015).²⁴ In its more recent report, the World Bank again emphasized that

²³ Niksic, Nasser Eddin and Cali, *Area C and the Future of the Palestinian Economy*.

²⁴ The \$960 million represents 7.6 per cent of 2015 GDP. The source of the 7.6 per cent estimate is Niksic, Nasser Eddin and Cali, *Area C and the Future of the Palestinian Economy*.

losses resulting from not tapping the economic potential of Area C were estimated at \$3.4 billion per year.²⁵ This situation has weakened the Palestinian economy, stripping it of the ability to benefit from those economic resources in agriculture, tourism, trade and natural resources. The economic resources could have reduced the Palestinian budget deficit.

2. Estimated fiscal losses from undervaluation of imports

34. Manipulation of actual values of imports is common across many countries. Often merchants opt to forge bills to reduce their tax liabilities. However, the prevalence of undervaluation differs from one country to another, depending on how strict or weak law enforcement is. In the Palestinian case, the World Bank indicates that undervaluation is higher for imports from third countries than for imports from Israeli sources.²⁶ This is ascribed to the higher costs entailed and the Israeli restrictions affecting Palestinian direct importation from third countries, which may explain why Palestinian merchants depend heavily on imports from Israel. The following methodology was used to estimate losses from undervaluation of imports from Israel:

- All goods that cannot be undervalued were excluded: public sector purchases of electricity, fuel, gas and some other commodities that are imported into the Palestinian market under agreements with large companies
- The World Bank estimate for undervaluation of imports from Israel of 23 per cent was adopted.²⁷ Thus, the real value of the imports in question is estimated at the declared value divided by 77 per cent
- The value added tax rate of 16 per cent was applied on the difference between the real and declared values in the customs declaration

35. The estimated undervaluation, i.e., the difference between the real and declared values of imports from Israel, was \$210 million in 2015, which implies that the loss in Palestinian value added tax revenues amounted to \$33.7 million.

36. Losses from undervaluation of imports from the rest of the world were estimated using the same methodology, with two facts being taken into consideration: first, the level of undervaluation of third-country imports was estimated at 32 per cent;²⁸ second, those imports were subject to all import taxes (including customs duties and purchase tax). Unlike the World Bank approach, in which the Israeli average tariff rate for the Palestinian import basket was used, the methodology followed in the present report was based on detailed records of imports, at the eight-digit level of the Harmonized System, to estimate the fiscal losses from undervaluation of imports from third countries, specifically:

- All goods that cannot be undervalued, such as cars and cigarettes, were excluded
- Imports exempt from import taxes were excluded on the assumption that they were not being undervalued
- The World Bank estimate of 32 per cent for undervaluation of imports from third countries was adopted.²⁹ Thus, the real value of those imports is estimated at the declared value divided by 68 per cent

²⁵ Niksic, Nasser Eddin and Cali, *Area C and the Future of the Palestinian Economy*.

²⁶ World Bank, "Economic monitoring report".

²⁷ Ibid.

²⁸ Ibid.

²⁹ Ibid.

- All Palestinian imports from third countries were identified at the eight-digit level of the Harmonized System. Based on the World Bank estimate of 32 per cent (in the previous step), the real value – not the declared value – was used and the relevant customs and purchase tax rates were applied to calculate the import taxes that should have been collected
- The World Bank estimate of 32 per cent was applied to calculate tax revenues based on the actual value of that imports, assuming that the collected taxes (for undervalued imports) equalled 68 per cent of the total tax revenue that should have been collected had the actual value of the goods been declared. In other words, total tax revenue that should have been collected based on the estimated real value of imports equalled actual collected taxes divided by 68 per cent
- The difference was calculated between the estimated value of import taxes and the actual amounts collected (for undervalued imports).

37. Using this methodology, the total losses resulting from the undervaluation of imports from third countries are estimated at \$138.6 million. That is more than the losses caused by the undervaluation of imports from Israel because imports from third countries are subject to customs duties, purchase tax and value added tax. In the case of imports from Israel only the value added tax revenues are lost owing to undervaluation.

38. Hence, total tax revenue lost owing to undervaluation of Palestinian imports in 2015 are estimated at \$172.3 million (1.36 per cent of GDP): \$33.7 million relating to imports from Israel plus \$138.6 million relating to imports from third countries. It should be noted that the Israeli treasury could also incur losses in tax revenue if the Israeli exporter undervalued the same goods.

3. Estimated fiscal losses from shuttle trading at the Karamah/Allenby crossing with Jordan

39. In addition to losses associated with smuggling goods from Israel, there are fiscal losses resulting from the smuggling of goods from the local market and the Jordanian market as well, in particular of cigarettes and tobacco. The smuggling of cigarettes and tobacco is driven by the high taxes imposed on cigarettes of up to 85 per cent of the value. Revenue from the tobacco tax constitute 25 per cent of domestic revenues.

40. The household survey of the Palestinian Central Bureau of Statistics indicates that tobacco imports make up 71 per cent of cigarettes and tobacco consumed.³⁰ Their value is \$450 million. On the other hand, the Head of the Tobacco Department of the Customs Authority of the Palestinian Ministry of Finance stated on 15 July 2018 that tobacco consumption was estimated at \$550 million. The \$100 million difference between the two figures is an indication of the magnitude of the tobacco smuggling.

41. According to the same source, in 2017, tax revenues from tobacco amounted to \$420 million. The illicit trade in tobacco, in which tax and customs duties are evaded, constituted 30 per cent of the Palestinian tobacco market, which resulted in \$110 million in lost revenues per year. Half of the smuggled cigarettes likely came from Jordan across the Karamah/Allenby bridge.

42. Accordingly, if only the tax evasion from the smuggled tobacco from Jordan is considered, and local products are excluded, the estimated fiscal loss is at least at \$55 million in 2015 (0.43 per cent of GDP). These losses are also the result of the fact that Israel prevents Palestinian customs personnel from being present to fulfil their duties at border crossings and at the Karamah/Allenby bridge.

³⁰ Palestinian Bureau of Statistics, "Palestinian Expenditure and Consumption Survey (October 2016–September 2017): Press report on the levels of living in Palestine – expenditure, consumption and poverty" (Ramallah, 15 April 2018).

D. Recurrent fiscal leakage and losses: the fiscal cost of the occupation

43. In sections B and C, estimates were given of the leakage of Palestinian fiscal revenue to Israel and of Palestinian fiscal losses due to the occupation that are not the result of leakage. The sum of these two components represents the fiscal costs of the Israeli occupation to the Palestinian people. However, the assessments and estimates in the present report do not exhaust all sources of probable fiscal leakage or fiscal losses. They cover only those sources about which data are currently available. In other words, the estimates presented in the report could be revised as more data and evidence become available.

44. As concluded above, and summarized in table 1, the estimated total annual recurrent Palestinian fiscal leakage and losses, i.e., fiscal costs, resulting from the occupation that can be quantitatively substantiated are enormous. They are estimated at \$1.66 billion, which is equivalent to 13.1 per cent of GDP or 62.6 per cent of total tax revenue in 2015.

Table 1
Estimates of Palestinian fiscal costs of the occupation: leakage and other losses, 2015

<i>Source or type of leakage or loss</i>	<i>Amount (millions of United States dollars)</i>	<i>Percentage of GDP</i>	<i>Percentage of tax revenues</i>
Fiscal leakage			
Indirect imports	129	1.02	4.86
Smuggling and tax evasion	202	1.59	7.60
Administrative (handling) fees	56	0.44	2.11
Telecommunications sector	43	0.34	1.61
Israeli economic activities in Area C	32	0.25	1.21
Passenger exit fees at the Karamah/Allenby crossing	12	0.10	0.46
Subtotal	474	3.74	17.84
Other fiscal losses			
Fiscal losses from Area C	960	7.58	36.17
Fiscal losses from underinvoicing of imports	172	1.36	6.49
Fiscal losses from smuggling from Jordan	55	0.43	2.07
Subtotal	1 187	9.37	44.37
Total	1 661	13.11	62.57

E. Estimated non-recurring fiscal leakage and losses from withholding clearance revenue by Israel

45. Another measure is the repeated suspensions and delays by Israel in transferring clearance revenue to the Palestinian Ministry of Finance without any prior arrangement or warning. Israel collects Palestinian tax revenues on behalf of the Palestinian Authority that it should transfer to the Palestinian Ministry of Finance on a monthly basis through the clearing system. From 1997 to 2015, Israel froze

Palestinian clearance revenue from time to time for varying periods, sometimes for more than 24 months. The total of the dues withheld during that period amounted to \$2.4 billion.³¹

46. Vulnerability to the withholding of Palestinian clearance revenue not only undermines the ability of the Palestinian Authority to plan and administer its finances and development projects, it also poses a challenge to the Authority's ability to meet its financial obligations, in particular the wage bill and current expenditures from the public budget. To cope with the ensuing crises, the Authority is forced to resort to borrowing from domestic banks, thereby incurring the costs of extremely high interest rates accruing on credit denominated in new Israeli shekels. In addition, the Israeli treasury profits from the interest paid on the dues withheld at interest rates paid on bank deposits in Israel. Interests on withheld revenue is another channel of costs incurred by the Palestinian treasury and a source of leakage to the Israeli treasury. The fiscal costs have been estimated using the interest rates the Palestinian Government pays on the loans it receives from domestic banks, while fiscal leakage to Israel has been estimated using the interest rate on bank deposits in Israel.

47. As shown in table 2, the cumulative Palestinian fiscal leakage and losses arising from this source is estimated at \$150.9 million (for leakage) and \$336 million (for losses).

Table 2
Estimated non-recurring fiscal leakage and losses from the withholding of Palestinian clearance revenue

		<i>Clearance revenue withheld</i>		<i>Fiscal leakage</i>		<i>Fiscal loss/costs</i>	
<i>From</i>	<i>To</i>	<i>Duration (months)</i>	<i>Amount^a (millions of US dollars)</i>	<i>Interest rate^a (per cent)</i>	<i>(millions of US dollars)</i>	<i>Interest rate^b (per cent)</i>	<i>Amount (millions of US dollars)</i>
July 1997	August 1997	1	87	14.5	1.0	18.7	1.36
December 2000	December 2002	24	500	7.3	72.5	12.9	129.0
March 2006	July 2007	16	1 100	5.2	76.41	13.2	193.6
May 2011	May 2011	0.5	100	3.0	0.13	11.7	0.49
November 2011	November 2011	0.5	100	3.0	0.311	11.7	0.49
November 2012	January 2013	3	100	1.9	0.49	9.2	2.30
January 2015	April 2015	3	450	0.2	0.20	7.8	8.78
Total			2 437		150.9		336.0

Source: International Monetary Fund (IMF), "West Bank and Gaza: report to the Ad Hoc Liaison Committee" (Washington, D.C., 5 April 2016). Available at www.imf.org/~media/Files/Countries/ResRep/WBG/WBG040516.ashx.

^a Interest rates on bank deposits based on the rates of the Bank of Israel.

^b Interest rates on lending in new Israeli shekels based on the PMA rates.

³¹ IMF, "West Bank and Gaza: report to the Ad Hoc Liaison Committee".

IV. Estimated cumulative fiscal leakage and fiscal costs of the occupation during the period 2000–2017

48. The estimates of the fiscal costs of the occupation given above are based on the data and information available at the time of the analysis. That also applies to the amount of Palestinian clearance revenue withheld by Israel. In the present section an estimated monetary valuation is presented of the fiscal leakage and the fiscal costs of the occupation as they accumulated over the period 2000–2017. The year 2000 has been selected as the start because it was the first year after the Palestinian Interim Self-Government Authority was to end its transitional mandate.

49. Fiscal leakage is an ongoing problem; resources had been leaking even before 2000. As shown in table 1, the annual fiscal leakage from the Palestinian treasury to the Israeli treasury is estimated at 3.74 per cent of the Palestinian GDP. The annual leakage for the period 2000–2017 has been estimated on the basis of that rate; the total represents the accumulated leakage of funds that should have gone to the Palestinian treasury during the 18-year period under consideration (see table 3).

50. Since the Israeli treasury retained the funds instead of transferring them to the Palestinian Authority, it is assumed that they were kept as deposits in Israeli banks, collecting interest at the rates applicable at the time. As shown in table 3, the cumulative fiscal leakage that could be substantiated for the period 2000–2017 stands at \$5.6 billion without interest. The accumulated interest has been calculated at \$1 billion for the same period. Adding that amount results in an estimated total fiscal leakage of \$6.6 billion, or about 4.4 per cent of GDP over that period, equivalent to 21 per cent of total Palestinian public revenue.

Table 3
Estimated cumulative fiscal leakages and fiscal costs of the occupation, 2000–2017

Year	Fiscal leakage					Fiscal costs of the occupation				
	Amount ^a (millions of US dollars)	Cumulative amount (millions of US dollars)	Interest rate ^b (per cent)	Cumulative interest (millions of US dollars)	Cumulative amount with interest (millions of US dollars)	Amount ^a (millions of US dollars)	Cumulative amount (millions of US dollars)	Interest rate ^c (per cent)	Cumulative interest (millions of US dollars)	Cumulative amount with interest (millions of US dollars)
2000	161.3	161.3	9.8	15.8	177.1	565.5	565.5	12.9	72.9	638.4
2001	149.7	311.1	7.1	38.9	349.9	524.9	1 090.4	16.4	263.3	1 353.7
2002	205.5	516.6	7.1	78.3	594.9	595.2	1 685.6	15.5	415.9	2 101.4
2003	148.4	665.0	7.8	136.1	801.1	520.2	2 205.8	13.7	774.0	2 979.7
2004	161.9	826.9	4.3	177.7	1 004.6	567.6	2 773.3	13.5	1 251.4	4 024.8
2005	180.7	1 007.6	3.7	221.9	1 229.5	633.4	3 406.8	13.5	1 880.2	5 287.0
2006	183.6	1 191.2	5.3	296.2	1 487.4	643.7	4 050.5	13.2	2 664.7	6 715.2
2007	282.3	1 473.5	4.0	367.4	1 840.9	915.4	4 965.9	12.7	3 416.9	8 382.8
2008	249.6	1 723.1	3.7	445.6	2 168.7	874.9	5 840.8	12.0	4 531.7	10 372.5
2009	271.8	1 995.0	7.7	633.5	2 628.4	952.9	6 793.7	11.0	5 775.9	12 569.6
2010	333.4	2 328.3	1.6	681.5	3 009.8	1 168.5	7 962.2	10.9	7 277.0	15 239.2
2011	391.7	2 720.0	2.9	780.80	3 500.8	1 373.0	9 335.2	11.7	9 222.0	18 557.2
2012	421.9	3 141.8	2.4	874.2	4 016.0	1 478.7	10 813.9	11.3	11 485.0	22 298.9

Year	Fiscal leakage					Fiscal costs of the occupation				
	Amount ^a (millions of US dollars)	Cumulative amount (millions of US dollars)	Interest rate ^b (per cent)	Cumulative interest (millions of US dollars)	Cumulative amount with interest (millions of US dollars)	Amount ^a (millions of US dollars)	Cumulative amount (millions of US dollars)	Interest rate ^c (per cent)	Cumulative interest (millions of US dollars)	Cumulative amount with interest (millions of US dollars)
2013	466.7	3 608.5	1.4	936.9	4 545.4	1 637.9	12 451.8	11.6	14 254.1	26 705.9
2014	475.6	4 048.0	0.6	967.5	5 051.6	1 667.0	14 118.8	11.0	17 362.8	31 481.7
2015	474.2	4 558.2	0.1	974.7	5 532.9	1 670.2	15 789.0	10.2	20 729.2	36 518.2
2016	502.1	5 060.3	0.1	980.8	6 041.1	1 760.1	17 549.1	9.1	24 199.0	41 748.1
2017	542.2	5 602.3	0.1	987.3	6 589.9	1 900.7	19 449.8	9.3	28 241.6	47 691.4

Source: UNCTAD secretariat calculation.

^a The annual fiscal leakage and the fiscal costs of the occupation have been calculated by multiplying the estimated rates of 3.74 per cent and 13.11 per cent shown in table 1 with the annual Palestinian GDP. The annual figures also include the interest accumulated on the Palestinian clearance revenue withheld, as shown in table 2.

^b Interest rates on bank deposits based on Bank of Israel rates

^c Interest rates on lending in new Israeli shekels based on the rates of the Palestine Monetary Authority.

51. The fiscal costs of the occupation, on the other hand, are a graver problem, as those include both the fiscal leakage and the loss of other public revenue that could have been realized by the Palestinian treasury if the Palestinian Authority had full control over its fiscal affairs and there were no occupation. As indicated in table 1, the annual fiscal costs of the occupation are estimated at 13.1 per cent of GDP. The costs resulting from lost public revenue is exacerbated by the fact that the Authority is forced to bear additional costs because it has to borrow money from local banks at high interest rates to cope with the loss of resources and to meet its financial obligations. Table 3 shows the estimated cumulative monetary value of the fiscal costs of the occupation, including the cost of borrowing. The cumulative fiscal costs during the 18 years under consideration, without interest, are estimated at \$19.5 billion. Adding the interest increases the losses by \$28.2 billion, bringing the total valuation to \$47.7 billion. That amount is more than three times the output of the Palestinian economy in 2017, and some 32 per cent of cumulative GDP during those 18 years.

V. Summary of results

52. Estimates of the fiscal costs of the occupation in 2015, based on those that could be mapped in the present analysis, came to \$1.7 billion, or 13.1 per cent of GDP for that year. Of that amount, fiscal leakage to the Israeli treasury accounted for \$473 million (3.7 per cent of GDP). Other fiscal losses – not leaked to Israel – accounted for the remaining \$1.2 billion (9.4 per cent of GDP).

53. An extrapolation of the analysis to cover the period 2000–2017 results in an estimated cumulative fiscal leakage of more than \$5.6 billion during those 18 years, equivalent to 39 per cent of the 2017 GDP. This amount could have increased the overall Palestinian tax revenues by 17.6 per cent and reduced the current public deficit on a cash basis by 42 per cent. Interest accrued on fiscal revenue captured by the Israeli treasury during the same period adds \$1 billion, increasing the estimated cumulative fiscal loss to the Palestinian Authority from leakage alone to \$6.6 billion, or an annual loss equivalent to 4.4 per cent of GDP.

54. In addition to the leakages to Israel, the cumulative fiscal cost of the occupation for the Palestinian people for the period 2000–2017 is estimated at \$19.4 billion,

equivalent to 134 percent of the GDP in 2017, i.e., the output of the Palestinian economy over one year and four months. When the compound interest of about \$28.2 billion is added, the estimated fiscal costs of the occupation resulting only from the sources surveyed in the present report amounts to \$47.7 billion during the period 2000–2017. That equals more than three times of what the Palestinians produced in 2017.

VI. Conclusions and recommendations

55. The analysis and figures provided in the present report highlight a number of enduring problems that have worsened over the years, namely: the smuggling of goods from Israel and from illegal settlements to the Palestinian market; increased fiscal leakage resulting from indirect imports via Israel; the inability of the Palestinian Authority to enforce the proper invoicing of imports and the transport of imports from Israel or any third country; control by Israel of Area C (more than 60 per cent of the West Bank) and lack of access enabling the Palestinians to operate there. All of these and other measures imposed by the occupying Power have compounded the challenges facing the Palestinian Government in collecting revenue and have resulted in a loss of large parts of that revenue, which has led to a chronic budget deficit and has further shrunk the fiscal and policy space available to Palestinian policymakers.

56. To cover these fiscal costs caused by the occupation and the ensuing financing gaps, the Palestinian Government has increasingly relied on international aid, borrowed from local banks, accumulated arrears with the domestic private sector and rationalized its expenditures. Those measures have slowed down the drivers of economic growth by reducing developmental expenditure to less than 3 per cent of total public expenditure in recent years. These conditions have resulted in an increasingly weak and fragile Palestinian economy characterized by inadequate and deteriorating public services and weak aggregate expenditure, in particular expenditure for investment and development purposes.

57. In conclusion, the fiscal losses, the narrow policy space available to Palestinian decision makers and the lack of control over economic affairs have undermined the capacity of the Palestinian Government to adopt effective financial, tax and development policies. The economic policy framework and its implementation should be consistent with Palestinian development needs and priorities, and should facilitate the achievement of the Sustainable Development Goals in the Occupied Palestinian Territory and the economic security of the State of Palestine as called for in several resolutions adopted by the Security Council and the General Assembly, such as Council resolutions [1850 \(2008\)](#) and [1860 \(2009\)](#), and Assembly resolution [72/13](#).

58. To achieve that, a fundamental change is needed in many working arrangements, including those relating to: border crossing points and access by Palestinian officials to those points, as well as to Area C; import policies and import surveillance mechanisms; and the exchange of information, data and records concerning imports. Furthermore, as was done in 2016, Israel and the Palestinian Authority may consider negotiating some of the topics raised in the present report to address and rectify all outstanding issues, resolve accumulated dues to the Palestinian people and establish a mechanism by means of which the Government of Israel may share with the Palestinians all the information related to Palestinian trade and fiscal resources.

59. Given the heavy fiscal costs of the occupation, the Palestinian people are much farther away from reaching the Sustainable Development Goals, if it can reach them at all, than it would be without the occupation. There is a need to secure additional resources for achieving the Sustainable Development Goals in the Occupied

Palestinian Territory and to strengthen the capacity of UNCTAD to support the Palestinian people in those efforts.

60. Humanitarian and economic support are crucial to creating an environment that favours negotiations to resolve the conflict. However, no amount of humanitarian or economic support will resolve the conflict itself. Humanitarian or economic support can only be complementary to a legitimate political process but will not replace political rights or statehood. The United Nations maintains its long-standing position that lasting and comprehensive peace can only be achieved through a negotiated two-State solution. The Secretary-General will continue to ensure that the United Nations works towards the establishment of an independent, democratic, contiguous and viable Palestinian State, living side by side in peace with a secure Israel, with Jerusalem as the capital of both States consistent with relevant Security Council resolutions and international law.
