United Nations TD/B/65(2)/3

United Nations Conference on Trade and Development

Distr.: General
23 July 2018

Original: English

Trade and Development Board
Sixty-fifth session, part II
Geneva, 1–4 October 2018
Item 6 of the provisional agenda
Report on UNCTAD assistance to the Palestinian people

Report on UNCTAD assistance to the Palestinian people: Developments in the economy of the Occupied Palestinian Territory*

Note by the UNCTAD secretariat**

Executive summary

Economic prospects are bleak due to risky political horizons and unfavourable trends in aid, Gaza's reconstruction and credit-financed expansion in consumption. Real per capita income in the Occupied Palestinian Territory declined in 2017. The customs union of the Paris Protocol is a major obstacle for Palestinian development. Eliminating the budget deficit altogether would not restore the trade balance and could be self-defeating on fiscal grounds. The Occupied Palestinian Territory has the highest unemployment rate in the world, and women and youth are disproportionately impacted by the joblessness crisis. Construction of illegal Israeli settlements and annexation of Palestinian land accelerated. Gaza continues to slide on a path of de-development as a grave humanitarian crisis deepens. A severe electricity crisis restricts the supply to households sometimes to as little as two hours per day and cripples delivery of basic services. Despite the call by UNCTAD to promote development in the Occupied Palestinian Territory, donor support declined as occupation entrenches itself further. UNCTAD continues to respond to the complex needs of the Palestinian economy. However, securing resources is critically important for UNCTAD to enhance its assistance to the Palestinian people and implement paragraph 55 (dd) of the Nairobi Maafikiano and General Assembly resolutions that request UNCTAD to assess and report on the economic cost of the Israeli occupation for the Palestinian people.

* The designations employed, maps and the presentation of the material in this document do not imply the expression of any opinion whatsoever on the part of the United Nations Secretariat concerning the legal status of any country, territory, city or area, or of its authorities, or concerning the delineation of its frontiers or boundaries. In accordance with the relevant resolutions and decisions of the General Assembly and Security Council, references to the Occupied Palestinian Territory or territories pertain to the Gaza Strip and the West Bank, including East Jerusalem. Use of the term "Palestine" refers to the Palestine Liberation Organization, which established the Palestinian National Authority (PNA). References to the "State of Palestine" are consistent with the vision expressed in Security Council resolution 1397 (2002) and General Assembly resolution 67/19 (2012).

** This report should not be quoted by the press before 12 September 2018, 5 p.m. GMT.

I. Anaemic growth and the highest unemployment in the world

1. The constrained economy of the Occupied Palestinian Territory continued to underperform in 2017. From a low baseline, gross domestic product (GDP) grew by 3 per cent, implying further decline in per capita income. GDP grew by 4 per cent in the West Bank but contracted in Gaza by 0.3 per cent, implying a 4 per cent drop in GDP per capita in the ravaged Strip. The economy has been driven by construction, wholesale and retail trade, and services. Agriculture contracted by 11 per cent.

2. Poor economic performance is caused by restrictive measures imposed by the occupying Power. World Bank (2017) conservative estimates indicate that removing Israeli restrictions could increase annual GDP growth up to 10 per cent. In Gaza, lifting the economic siege could generate additional cumulative growth in the range of 32 per cent by 2025. Some relaxation of the dual-use list alone could generate additional growth of 6 per cent in the West Bank and 11 per cent in Gaza by 2025. On the other hand, persistence of the status quo means that growth will not significantly exceed 3 per cent, combined with a steady decline in per capita income and extremely high unemployment rates.

3. Investment is not only forestalled by existing restrictions, but also by the possibility of tightening them or introducing new ones. In such a volatile, high-risk environment, few investors will commit large amounts of capital to manufacturing or other sectors that are sensitive to Israeli restrictions. Investment that survive is thus channelled towards small, service-oriented microenterprises and small enterprises characterized by weak capacity for employment-generation, low productivity, lack of technological dynamism and little scope for expansion. These dynamics mean that 90 per cent of total establishments in the Occupied Palestinian Territory are small firms, with less than four employees, while only 1 per cent of establishments employ more than 20 workers.

4. Economic prospects are bleak due to negative political horizons and unfavourable trends in the three main factors that supported economic growth in recent years: donor support; reconstruction in Gaza; and credit expansion for public and private consumption. Prospects are further clouded by the acceleration of confiscation of land and productive resources and unfavourable regional dynamics in the Middle East.

A. Expanding occupation and declining donor support

5. The Government of the State of Palestine continued its fiscal reforms under extremely unfavourable politico-economic conditions. Longstanding efforts for controlling expenditure and enhancing revenues were maintained, and the Government succeeded in bringing down its deficit from 27 per cent of GDP in 2006, to 8 per cent in 2016 and 2017 (table 1).

6. In 2017, net revenue declined, though this reflects only a high 2016 baseline created by one-off receipts.[1] If one-off payments are excluded, 2017 revenue would have increased by 8 per cent, while total expenditure (including development) would have declined to 33 per cent of GDP, down from 35 per cent in 2016.

7. The administrative separation of Gaza from the West Bank compounded a governance crisis, fragmented the Occupied Palestinian Territory and undermined the delivery of public services. Gaza, under an economic siege since 2007, continues to be a source of fiscal pressure. It has been contributing less than 10 per cent of public revenue while absorbing 30–40 per cent of total expenditure. As an illustration, in 2016 public revenue raised in Gaza was around $300 million while its spending reached $1.5 billion. In the same year, the West Bank budget registered a small surplus and, in 2017, was nearly

[1] Telecommunications licensing fees of $145 million and two payments, totalling $300 million made by Israel to partially compensate for leaked fiscal resources related to health stamps, equalization levies, border exit fees and value added tax (UNCTAD (2017b)).

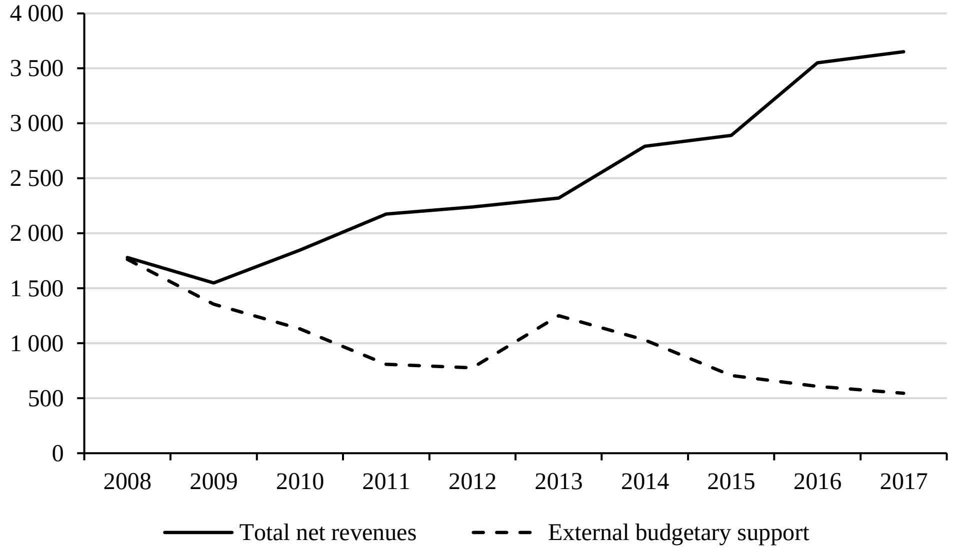
balanced. In other words, the overall State of Palestine budget would have been balanced if it were not for the situation in Gaza and the prolonged economic siege.

B. The international community should promote development in the Occupied Palestinian Territory

8. UNCTAD (2018) elaborates on how half a century of occupation and appropriation of land and resources has impoverished the Palestinian people and denied them the right to development. It maintains that both Israel and the international community have responsibility under international law to avoid actions that impede development and to take affirmative steps to foster development in the Occupied Palestinian Territory.

9. There has been a longstanding consensus that sustainable development in the Occupied Palestinian Territory requires three pillars: (a) Israel needs to ease restrictions on the Palestinian economy; (b) donors need to remain engaged and enhance the scope and quality of aid; and (c) the Government of the State of Palestine needs to implement reforms to facilitate growth. However, regarding these three prerequisites for development, Israel has failed to ease restrictions and the record of donors has been spotty. The State of Palestine has made significant efforts to facilitate growth.

Figure 1
Palestinian public revenues and budget support
(Millions of dollars)



Source: Palestinian Central Bureau of Statistics (PCBS).

10. Despite the call by UNCTAD on the international community to shoulder its responsibility to promote development in the Occupied Palestinian Territory, the downward trend in donor support continued; successful bold fiscal reform efforts of the State of Palestine were not matched by positive donor engagement (figure 1). In 2017, budget support from donors dropped by 10.5 per cent from the 2016 level. Total international support was $720 million, only one third of the $2 billion in 2008. For the same period, budget support shrank from $1.8 billion to $544 million, a 70 per cent decrease. The worsening weight of occupation, cuts in foreign aid and collapsing fiscal space hinder the ability of the State of Palestine to carry on with State-building efforts and the essential tasks of governance, including provision of vital public services.

11. Echoing UNCTAD reports and studies, the United Nations (2018) indicates Palestinian fiscal resources, in the range of $300 million per year, continue to be leaked to Israel because of the arrangement whereby the Government of Israel collect taxes on Palestinian international trade on behalf of the Palestinian Government and then transfers the revenue from such taxes. Even within the imbalanced framework of the Paris Protocol,

the Government of the State of Palestine outlined a number measures that could reduce ongoing leakage of Palestinian revenues to the Israeli treasury.

Table 1
Economy of the Occupied Palestinian Territory: Key indicators

	1995	*1999*	*2002*	*2006*	*2010*	*2015*	*2016*	*2017**
Macroeconomic performance								
Real gross domestic product growth (percentage)	7.1	8.3	-12.5	-3.9	8.1	3.4	4.7	3.1
Gross domestic product, nominal (millions of dollars)	3 283	4 271	3 556	4 910	8 913	12 673	13 426	14 498
Gross national income (millions of dollars)	3 723	5 025	3 775	5 333	9 512	14 385	15 322	16 490
Gross national disposable income (millions of dollars)	4 122	5 398	4 826	6 624	11 503	15 807	16 731	18 309
Gross domestic product per capita, nominal (dollars)	1 427	1 553	1 182	1 449	2 339	2 864	2 957	3 097
Gross national income per capita, nominal (dollars)	1 618	1 827	1 255	1 573	2 496	3 251	3 375	3 522
Real gross domestic product per capita growth (percentage)	-0.2	4.8	-15.0	-6.8	5.0	0.4	2.1	0.0
Real gross national income per capita growth (percentage)	0.7	4.6	-16.4	-5.0	2.2	2.0	1.4	-1.0
Population and labour								
Population (millions)[a]	2.34	2.96	3.23	3.61	4.05	4.68	4.82	4.78
Unemployment (percentage)	18.2	12.0	31.2	23.7	23.7	25.9	26.9	27.4
Total employment (thousands)	417	588	452	636	743	959	978	997
In public sector	51	103	105	147	178	211	211	184
In Israel and settlements	68	135	42	55	78	112	116	131
Fiscal balance (percentage of gross domestic product)								
Revenue net of arrears/clearance withheld	13.0	23.4	8.2	25.0	21.6	22.2	26.6	25.2
Current expenditure	15.0	22.1	28.0	46.4	34.5	31.7	32.2	30.6
Total expenditure	25.1	29.3	34.2	52.1	39.6	33.5	34.7	33.1
Overall balance (commitment basis)	-12.1	-5.9	-26.0	-27.1	-17.9	-11.3	-8.1	-7.9
Public debt[b]	---	20.0	21.1	22.2	21.1	20.0	18.5	17.5
External trade								
Net current transfers (millions of dollars)	400	373	1 051	1 291	1 991	1 421	1 409	1 819
Exports of goods and services (millions of dollars)	562	752	478	736	1 367	2 338	2 381	2 693
Imports of goods and services (millions of dollars)	2 441	3 364	2 234	3 683	5 264	7 538	7 627	8 067
Trade balance (millions of dollars)	-1 879	-2 612	-1 756	-2 947	-3 897	-5 200	-5 246	-5 374
Trade balance (percentage of GDP)	-57.2	-61.2	-49.4	-60.0	-43.7	-41.0	-39.1	-37.1
Trade balance with Israel (millions of dollars)	-922	-1 598	-886	-1 887	-2 737	-2 916	-2 622	-2 887
Trade balance with Israel (percentage of gross domestic product)	-28.1	-37.4	-24.9	-38.4	-30.7	-23.0	-19.5	-19.9
PNA trade with Israel/total PNA trade (percentage)[c]	83.5	67.5	56.9	64.4	66.6	62.1	60.0	59.8
PNA trade with Israel/total Israeli trade (percentage)[c]	4.2	3.8	1.9	2.2	2.7	3.6	3.4	3.4

Sources: PCBS, Palestinian Ministry of Finance and Palestinian Monetary Authority. Israeli trade data are obtained from the Israel Central Bureau of Statistics.

* Preliminary estimates.

[a] Except for the population figures, all data exclude East Jerusalem, due to the fact that PCBS has no access to the city.

[b] Public debt includes domestic and external debt but not arrears and Palestinian National Authority (PNA) debt to the pension fund.

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

C. A flawed, unequal, harmful to development customs union

12. The Palestinian economic policy framework is shaped by the customs union established in 1967 and later formalized by the Paris Protocol in 1994 whereby free trade prevails between Israel and the Occupied Palestinian Territory and the two economies share the same external tariffs on trade with the rest of the world. The negative consequence of the customs union for the Palestinian economy cannot be overstated. Its problems are four-fold:

(a) A well-functioning customs union requires members to be at comparable levels of development. A customs union between two entities at vastly different levels of economic development does not bode well for the weaker side. An occupied, underdeveloped economy has much to lose from a customs union with an economy at the level of the Organization for Economic Cooperation and Development, even under conditions of cooperation and goodwill.

(b) A beneficial customs union requires high level of cooperation that guarantees the interest of all members in border management, terms of trade with the rest of the world, negotiation of trade agreements, tariffs policy and revenue sharing. In the Occupied Palestinian Territory, the terms of the customs union are set unilaterally by Israel without regard to the vastly different needs of the Palestinian economy.

(c) The application by Israel of the terms of the customs union is selective.

(d) The restrictions Israel imposes on the movement of Palestinian people and goods pre-empt investment and inflate costs, and thus remove the international competitiveness of the Palestinian economy, rendering the Occupied Palestinian Territory an import-dependent, captive market, mainly for Israeli products.

13. Under the rubric of the customs union, the Occupied Palestinian Territory developed a large, persistent trade deficit rooted in an underdeveloped export sector and weak capacity of domestic producers of exportable and importable goods to compete in domestic and global markets. In 2017, Palestinian exports were 19 per cent of GDP, while imports were 56 per cent; the trade deficit was 37 per cent of GDP, among the highest in the world. Israel accounted for 54 per cent of the Palestinian trade deficit, as trade with Israel accounted for 60 per cent of total Palestinian trade (table 1). This massive deficit was financed by incomes of Palestinians workers in Israel and settlements, remittances of expatriate workers and foreign aid.

D. Mobility restrictions foster poverty and political instability

14. Over the years, Israel established a complex matrix of controls over the Palestinian economy featuring a permit system, roadblocks, earth mounds, trenches, road checkpoints, road gates and the Separation Barrier. These restrictions choke trade and investment by inflating costs and undermining competitiveness. For the same transaction, Palestinian importers pay three times the cost paid by Israeli importers, while Palestinian exporters pay twice the cost paid by Israeli exporters (World Bank, 2017). Furthermore, Arnon and Bamya (2015) find that restrictions and trade barriers resulted in a 34–45 per cent productivity decline in the agricultural sector.

15. Another major constraint on productive activities is the dual-use list of civilian goods, which Israel does not allow Palestinians to import because they have potential military application. The list includes civilian machinery, spare parts, fertilizers, chemicals, medical equipment, appliances, telecommunication equipment, metal, chemicals, steel pipes, milling machines, optical equipment and navigation aids. This list is far larger than internationally recognized dual-use material (World Bank, 2018). The effects of this ban ripple through all sectors of the economy.

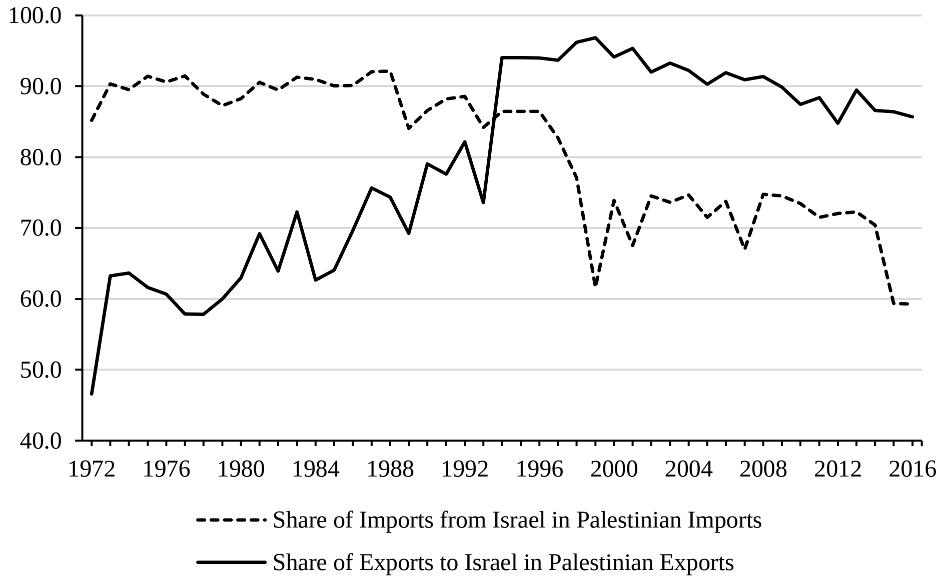
16. The ban forces producers to either quit or use costly inputs and technologies that are outdated and less efficient; with obvious consequences for competitiveness and profitability. The firms that could continue operation are pressured to reduce wages to compensate for the ensuing higher cost and lower productivity. Amodio et al. (2017)

quantify the impact of the dual-use list and conclude that it costs the West Bank 5 per cent of its GDP. They also find that local labour market conditions worsen exceptionally in areas where production and employment are more reliant on inputs banned by dual-use list restrictions. The resulting deterioration in wage and employment reduces the cost of engaging in conflict and therefore heightens political instability.

E. Diversion of Palestinian trade towards unfavourable Israeli markets

17. The restrictions on Palestinian trade establish substantial non-tariff barriers and divert Palestinian trade from competitive world markets to the less favourable Israeli markets at significant cost to Palestinian producers and consumers. Imports of the Occupied Palestinian Territory from Israel are dominated by goods for which Israel does not have a particular comparative advantage in exporting; this means they can be procured at lesser cost from other markets. Even when trading with third countries, Palestinian traders are often forced to access foreign markets through Israeli intermediaries, an arrangement that drains away Palestinian economic resources. The degree of trade diversion is reflected in that, between 1972 and 2017, Israel absorbed 79 per cent of total Palestinian exports and 81 per cent of imports. Trade concentration with Israel, as depicted in figure 2, mirrors the isolation of the Occupied Palestinian Territory from global markets.

Figure 2
Share of Israel in Palestinian international trade
(Percentage)



Source: PCBS and UNCTAD.

18. The depth of captivity can be gauged by the fact that Israel exports as much to the Occupied Palestinian Territory as it does to Cyprus, Egypt, Greece, Jordan and Turkey combined, even though the combined GDP of these countries is more than 100 times the GDP of the Occupied Palestinian Territory (World Bank, 2017). Under normal trading conditions, Israeli exports to the Occupied Palestinian Territory would be a tiny fraction of ongoing levels, and Palestinians would earn more from exports and pay less for imports. There is an urgent need to replace the customs union enshrined in the Paris Protocol with a new framework that endows the State of Palestine with control over its customs territory, borders and trade and industrial policies as a first step for breaking the cycle of de-development.

F. Women and youth disproportionately dispossessed by occupation

19. The Palestinian people suffer from persistent unemployment and poverty crises rooted in their inability to utilize their human and natural productive assets. Reflecting weak GDP growth, unemployment edged up from 26.9 per cent in 2016 to 27.4 per cent in 2017; 18 and 44 per cent in the West Bank and Gaza, respectively. Even though the Occupied Palestinian Territory suffered the highest unemployment rate in the world (International Labour Organization, 2018), the situation would have been much worse, were it not for employment in Israel and settlements, which is problematic, and the low labour force participation rate of 44 per cent, among the lowest in the world.

20. A dearth of jobs in the Occupied Palestinian Territory forces thousands of Palestinian workers to seek employment in Israel and settlements. Dependency on Israel is underscored by the fact that the labour market in Israel and settlements accounts for 20 per cent of employed Palestinians in the West Bank; in 2017, the Palestinian workforce employed there grew by 11.5 per cent. While the expansion of Palestinian employment in Israel and settlements is a windfall for Israeli producers in labour-intensive sectors, it undermines the competitiveness of the Palestinian economy and its export capacity (Bank of Israel, 2014). Furthermore, according to the International Labour Organization (2018), employment in Israel and settlements is beset with hardship, abuse, vulnerability, exploitation and discrimination. Occupational injuries and fatalities at construction sites are among the highest observed in Organization for Economic Cooperation and Development countries.

21. Adverse labour market conditions disproportionately impact women and youth. Half the Palestinian under age 30 are unemployed, and one third of those in the 15–24 age group is considered “not in education, employment or training”. The disenfranchisement of women is highlighted by the fact that their labour force participation rate is a meagre 19 per cent compared to 71 per cent for men, even though Palestinian women are well educated by international and regional standards. As indicated by the International Labour Organization (2017; 2018), women are more vulnerable to humiliating security measures enforced at Israeli checkpoints, settler violence and prolonged commutes to work. Moreover, the link between education and employment is weakening as women with bachelor’s degrees or higher levels of education, unlike males, suffer higher unemployment rates.

G. Settlement expansion as incremental annexation in the West Bank

22. Security Council resolution 2334 of 23 December 2016 states that the establishment of settlements by Israel in Palestinian land has “no legal validity” and represents a “flagrant violation” under international law and, and recalls the obligation of Israel to stop settlement activity and live up to its obligations under the Fourth Geneva Convention. Furthermore, at its tenth emergency special session on the illegal Israeli actions in Occupied East Jerusalem and the rest of the Occupied Palestinian Territory, the United Nations General Assembly adopted, on 21 December 2017, resolution A/ES-10/19 on the status of Jerusalem. In the resolution, the General Assembly “affirms that any decisions and actions which purport to have altered the character, status or demographic composition of the Holy City of Jerusalem have no legal effect, are null and void and must be rescinded in compliance with relevant resolutions of the Security Council, and in this regard calls upon all States to refrain from the establishment of diplomatic missions in the Holy City of Jerusalem, pursuant to Council resolution 478 (1980)”.

23. Despite several United Nations resolutions, construction of illegal settlements accelerated in 2017 and 2018. During the first three quarters of 2017, approval for construction of new housing units reached 10,000, more than double the total for 2016. In early 2018, plans were approved for 5,000 housing units in existing settlements and for the establishment of new settlements (United Nations, 2017a and 2018). Settlement expansion is combined with relentless destruction of Palestinian assets, including electrification projects, schools and residential property. Between 2009 and mid-2017, Israel demolished over 4,000 Palestinian-owned structures and 236 European Union-funded structures in

Area C (Office for the Coordination of Humanitarian Affairs (OCHA), 2017; Dajani and Lovatt, 2017).

24. Concerns about annexation were expressed by United Nations organs such as the International Court of Justice. In 2004, the Court issued an advisory opinion on the legal consequences of the construction of the 712 km-long Separation Barrier. Despite "assurance given by Israel that the construction of the wall does not amount to annexation and that the wall is of a temporary nature", the court expressed concern that "the route of the wall will prejudge the future frontier between Israel and Palestine" and that "Israel may integrate the settlements and their means of access". As such, the Court "considers that the construction of the wall and its associated regime create a 'fait accompli' on the ground that could well become permanent, in which case, and notwithstanding the formal characterization of the wall by Israel, it would be tantamount to de facto annexation". International Court of Justice warnings notwithstanding, annexation continues unabated. Evidence for incremental annexation of large portions of Area C in the West Bank includes that the occupying Power has:

(a) Continuously transferred Israeli population into settlements and forced the Palestinian population out of the area. By 2018, 611,000 Israelis live in 250 settlements in the occupied West Bank, including East Jerusalem, in contravention of international law. Settlers in Area C are the fastest rising demographic group, with a 5 per cent annual population growth, compared with 1.9 per cent in Israel and 2.6 per cent in the West Bank (Office for the Coordination of Humanitarian Affairs, 2017).

(b) Invested more than $19 billion in the construction of settlements and related infrastructure (Dajani and Lovatt, 2017).

(c) Extended its domestic legal jurisdiction to settlers, while Palestinians are subject to different military laws, with narrower rights and safeguards.

(d) Continuously imposed economic, social, political and administrative measures that deepen the integration of settlements into the Israeli State system.

25. Area C continues to be nearly entirely off limits for the Palestinian Government, producers and investors, even though it represents more than 60 per cent of West Bank area and contains the most valuable natural resources. Under the discriminatory planning regime, only 1 per cent of Area C remain available for Palestinians to apply for building permits, with an approval rate of less than 4 per cent (United Nations, 2018). These restrictions force Palestinians to build without permits and suffer the real risk of demolition, eviction, loss of property and displacement.

H. De-development of Gaza accelerates

26. Gaza has remained under Israeli occupation for the past 51 years. Occupation did not end with the unilateral disengagement of Israel in 2005 as, except for a 12 km border with Egypt, Israel retained control over Gaza's land, sea and air borders. Over 2 million people now live under full blockade, confined to a Strip with a surface area of 365 km² and the third-highest population density in the world.

27. The blockade, now in its eleventh year, eviscerated Gaza's economy and productive base and reduced the Strip to a humanitarian case of profound aid-dependency. The past quarter of a century was not only lost but has been one of ongoing de-development. Six years ago, the United Nations (2012) warned that unless ongoing trends were reversed, Gaza would be unfit for human inhabitancy by 2020. Since then, all socioeconomic indicators have worsened. Efforts at revival have been feeble and all interventions necessarily focused on reconstruction and humanitarian relief, leaving few resources for development or resuscitating the productive base.

28. Gaza's productive capacity has been entirely erased by three major military strikes and a crippling air, sea and land blockade. According to the International Monetary Fund (2017) the 2008/09 Israeli military strike wiped out over 60 per cent of Gaza's total capital stock, while the 2014 strike destroyed 85 per cent of what was left of capital stock.

High political uncertainty and restrictions on trade and productive activities continue to forestall new and compensatory investment.

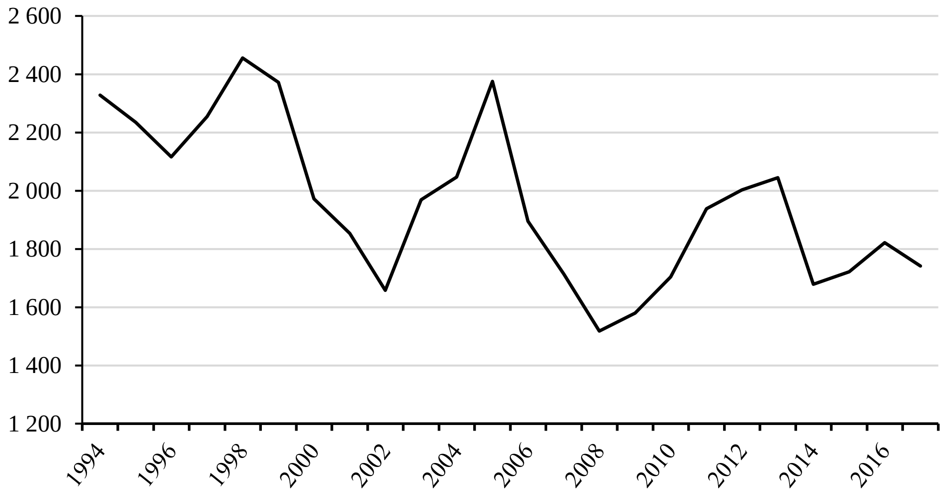
29. The restrictions on economic activities force remaining investment into the construction and services sectors, which have low productivity and low employment and are less dynamic. Construction accounts for a large share of investment, while humanitarian relief and the rebuilding of assets destroyed by Israeli military operations dominate Gaza's economy. On the other hand, since 1994, the contribution of manufacturing and agriculture to Gaza's GDP halved to 8 per cent and 5 per cent, respectively. Growth became increasingly reliant on private and public consumption financed by aid. Since then, consumption accounted for 80 per cent of GDP growth, while net exports contributed only 2 per cent, whereas the contribution of investment was negative, at -6 per cent (World Bank, 2018).

30. The agricultural sector has been constrained by restrictions on importation of essential inputs, fertilizers, chemicals and pesticides. Designated access restricted areas on land near the Israeli border, and at Gaza's sea, deprive producers of up to 35 per cent of agricultural land and 85 per cent of fishing waters. The fishing zone permitted for Gazans varied between 3 and 6 nautical miles instead of the 20 nautical miles stipulated in the Oslo Accords. These restrictions undermine the employment and livelihood of Gaza's 35,000 fishermen and denies the rest of the population a much-needed source of nutrition.

I. Severe energy, water and sewage crises and grave humanitarian conditions

31. Gaza has the third highest population density in the world and may fare worse if the ranking considers the 300- to 1,000-metre restrictions on building along the border with Israel. Since 2012, Gaza's population increased by 300,000, while real GDP per capita declined by 13 per cent to $1,742 in 2017.[2] Today the real income of an average Gazan is about 30 per cent less than in 1999. Furthermore, in 1994 and 2005 Gaza and the West Bank had equal real GDP per capita, today Gaza has 60 per cent of the West Bank's. In other words, the blockade exacts an additional 40 per cent income tax on Gaza's population.

Figure 3
Gaza: real gross domestic product per capita (1994–2017)
(Constant 2015 United States dollars)



Source: PCBS.

[2] At constant 2015 United States dollars.

32. The destruction of the productive base relegated Gaza to poverty and leaves half the population food-insecure, even though 80 per cent of the populace receive social assistance. The enduring pressure and deprivation of basic human, social and economic rights inflict heavy toll on Gaza’s psychological, social and cultural fabric as manifested by widespread psychological trauma, post-traumatic stress disorder, desperation, high suicide rates and drug addiction. In 2017, 225,000 children (more than 10 per cent of the population) required psychosocial support (Office for the Coordination of Humanitarian Affairs, 2017).

33. Shortage of electricity is another key economic constraint. Supply covers less than one third of the daily demand of 450–500 megawatts. Despite increasing demand, fuelled by the need for reconstruction, in early 2018, the Gaza power plant covered just 6 per cent of demand as it operated at less than one fifth of its 140-megawatt capacity, given the fuel shortage and lack of imported parts. The need for investing in power generation is underscored by the growing demand for electricity, which could double by 2030 or much earlier, if suppressed productive activities are freed and the economy is allowed normal operation.

34. In early 2018, households received, on average, two hours of electricity per day and shortages continue to seriously impact everyday life by crippling productive activities and impeding delivery of basic services. The shortage endangers the functioning and maintenance of sensitive medical equipment, including heart monitors, incubators and magnetic resonance imaging (Al-Haq, 2017). Producers, health care and other service providers suffer a great deal either by lack of electricity or by being forced to rely on generators at high cost.

35. A dearth of safe drinking water poses serious economic and health challenges. Gaza’s coastal aquifer, its sole water source, has been virtually depleted by overextraction and the intrusion of seawater. This leaves only 4 per cent of the groundwater in Gaza fit for human consumption. In 2000, 98 per cent of the people had access to safe drinking water through the public water network, but this dropped to less than 10 per cent by 2014, and the situation has been getting worse since. This forced the population to rely on costlier alternatives such as water containers and bottled water, which now account for 90 per cent of consumption of potable water (United Nations, 2017b). For instance, trucked water is uncontrolled, less safe and is up to 20 times more expensive than water through the network.

J. Recurrent military operations on Gaza, more destruction, no reconstruction

36. After three major military operations since December 2008, Gaza’s reconstruction efforts remain far too slow due to the continued blockade and a lack of funding. Restrictions on movement in and out of Gaza worsened in 2017. More than half of the permits granted to business people were cancelled, while the United Nations and other international organizations found it increasingly difficult to deliver material and obtain visas for international staff (United Nations, 2017a).

37. Disbursement of pledges made at the 2014 Cairo International Conference on Palestine: Reconstructing Gaza plateaued at around 53 per cent, and disbursements for reconstruction dropped from $400 million in 2016 to only $55 million in 2017 (World Bank, 2018). The United Nations Relief and Works Agency for Palestine Refugees in the Near East, the second biggest employer in Gaza, faces funding cuts that could significantly worsen the humanitarian situation. The Agency provides social assistance to 80 per cent of the population and operates 267 schools and 21 health facilities. Dwindling donor support, reduction in PNA wage expenditure in Gaza and the funding shortage affecting the United Nations Relief and Works Agency for Palestine Refugees together represent a significant aggregate-demand shock that will deal another blow to an economy already operating under daunting supply constraints.

38. Sustainable economic recovery requires:

(a) Complete lifting of the blockade to allow Gaza's economy full access to freely trade with East Jerusalem, the West Bank and global markets and to restore the human right to free movement for business, medical care, education, recreation and family bonds.

(b) The political, administrative, fiscal, and economic reunification of Gaza with the West Bank. The international community should play a key role and provide sustained political and financial support for the reunification to proceed in ways that help the State of Palestine cope with the fiscal implications of bringing the two regions under a unified governance framework.

(c) Overcoming the electricity crisis, as a matter of priority, by rehabilitant and upgrading Gaza's power plant, securing funds for importing spare parts and fuel and for importing electricity to cover excess demand.

(d) Enabling the State of Palestine to develop the offshore natural gas fields in the Mediterranean discovered since the 1990s.

II. A resource gap imposed by occupation, not twin deficits

39. Occupation distorted the structure of the economy and fostered a huge resource gap, where domestic production is much less than the sum of domestic public and private consumption and investment (domestic absorption), and a huge trade deficit, saving deficit and budget deficit persist. Between 2010 and 2017, these three deficits as a percentage of GDP were -46, -39 and -17, respectively.

40. Despite the importance of all three deficits, analytical and policy attention focused entirely on the smallest of the three, the fiscal deficit, and portrayed it, without evidence, as the main cause of macroeconomic imbalance. Emphasis on the budget deficit is typically based, explicitly or implicitly, on the twin-deficits hypothesis.

41. This hypothesis, derived from the accounting framework of national income accounts,[3] posits that a budget imbalance causes a trade (current account) imbalance, whereby an increase in the budget deficit implies any combination of increase in private savings, a decrease in national investment or a decrease in the current account balance. However, for economies functioning below full employment, such as the economy of the Occupied Palestinian Territory, adjustment to fiscal change may take a different course and the twin-deficits hypothesis does not necessarily hold. It is possible for causality to run in either direction. For instance, a drop in exports, for any reason, adds to a current account deficit, and this may trigger an internal imbalance by affecting tax receipts.

42. The theoretical literature, therefore, does not suggest uniform causality as implied by the two-deficits hypothesis. Therefore, whether or not the budget deficit drives the trade deficit is an empirical question. For instance, for a group of Middle Eastern economies, Hashemzadeh and Wilson (2006) find no uniform empirical relationship between the two deficits, as the relationship is contingent on external and domestic factors such as the tax system, patterns of trade, exchange rate regimes and monetary policy.

43. UNCTAD (2017a) empirically evaluates the twin-deficits hypothesis in the Occupied Palestinian Territory and shows that, during 1968–2018, there is no statistical evidence to support the view that the trade deficit was driven by changes in the budget deficit. The study argues that the two deficits have been cultivated by the economic structure imposed by occupation and the two are both symptoms of a resource gap fostered by an occupation that cultivates dependence on transfers from abroad (donor support and remittances) and forces Palestinian workers to seek employment in Israel and settlements.

[3] For details of mathematical logic, see UNCTAD (2017a).

A. The historical evolution of the Palestinian twin deficits

44. Between 1967 and May 1994, the Palestinian economy was controlled by the Israeli military's Civil Administration. Through this period, tight fiscal policy prevailed, expenditure was not allowed to exceed tax revenue, the budget was always in surplus and public expenditure was low compared with neighbouring countries. For instance, during 1987–1991, the average total expenditure, excluding defence, was 24 per cent of GDP, compared with 37, 31 and 37 per cent in Egypt, Jordan and Israel, respectively.

45. Israel used (and continues) to collect value added tax, fuel tax, purchase tax and customs duties on Palestinian imports, whether they are from Israel or from other countries. However, part of the taxes paid by Palestinians accrued to the Israeli treasury and were not part of the Civil Administration's budget (World Bank, 1993). The prevalence of balanced budgets through this period, combined with the leakage of Palestinian tax revenue to Israel indicates that, during 1967–1994, the Occupied Palestinian Territory operated under a regime of fiscal compression, contractionary fiscal policy and underinvestment in infrastructure.

46. Table 2 depicts the evolution of the deficits and highlights important points. Although the budget was always balanced or in surplus, the trade deficit was large, at around 50 per cent of GDP, and substantial inflows of external income financed the trade deficit. It is important to note that the small budget deficit in 1987–1988 would have been a surplus, had all the tax revenue collected by Israel been handed to the Civil Administration. For the same reason, the surpluses in subsequent periods should have been higher than what is stated in table 2.

Table 2
Two deficits: 1987–1991
(Percentage of gross domestic product)

	1987/88	1988/89	1989/90	1990/91
Budget deficit	-1.0	0.1	0.9	0.0
Trade deficit	-51	-43	-40	-47
External income (factor income plus current transfers)	48	43	40	38
Current account balance	-3.0	0.0	0.0	-9.0
Private savings deficit	-52	-43	-44	-47

Source: UNCTAD secretariat calculations and data in World Bank (1993).

47. During 1994–2017, three subperiods can be distinguished. At its inception, PNA inherited weak fiscal capacity. Tax revenue was low and well below potential, at 10.5 per cent of GDP, less than half of the 23.3 per cent for Jordan, one third of the 31.4 per cent for Israel and about half the average for developing countries. On the spending side, PNA faced the need to make up for historical underinvestment in public services and infrastructure.

48. Despite hard beginnings, PNA put the Palestinian fiscal affairs on solid grounds during its first five years. As shown in table 3, the recurrent deficit during 1995–2000 was a low 2.2 per cent of GDP, and it improved to a surplus of 1.3 per cent in 1999. There was also a reduction in the total budget deficit, from 12.1 per cent of GDP in 1996 to 5.9 per cent in 1999. Recurrent expenditure was financed by tax revenue, while donor aid financed development.

Table 3
Three deficits
(Percentage of gross domestic product)

	1995–2000	2001–2003	2004–2006	2007–2014	2015–2017
Budget deficit					
Recurrent	-2.2	-15	-2.3	-7.3	-6.8
Total	-9.3	-19	-19.2	-16.7	-9.1
Trade deficit	-56	-51	-59	-46	-38
External income: factor income plus current transfers	26	30	29	33	24
Current account balance	-30	-21	-30	-14	13.3
Private savings deficit	-53	-36	-56	-39	-24

Source: UNCTAD calculations based on PCBS and Palestinian Ministry of Finance data.

49. However, in the aftermath of the second intifada in 2000, a chronic fiscal crisis evolved. The tighter Israeli restrictions on economic activities hastened the reversal of the recurrent budget surplus and the redirection of donor support from development to budget support. Yet, despite fluctuations in the budget deficit, the trade deficit showed little response and continued to be large, in the range of 50 per cent of GDP before and after the establishment of the PNA. This provides further evidence against the twin-deficits hypothesis in the Palestinian case.

B. Two measures of the resource gap

50. Cursory examination of the data as well as a formal Granger causality test provide no statistical support for the twin-deficits hypothesis. A more realistic understanding of the Palestinian macroeconomic imbalance recognizes its roots in the resource gap cultivated by occupation policies that stifle the economy and force Palestinians to seek employment in Israel and its settlements. Income from abroad generates a substantial increase in aggregate demand, not matched by increase in domestic production. As a result, a gap between income and domestic output developed as a difference between GDP and remittances, aid and net factor income (income of Palestinians working in Israel and settlements).

51. Furthermore, the employment of Palestinian workers in Israel and settlements contributes to a labour gap. The labour gap is the difference between the workforce and domestic employment and is equal to the number of unemployed workers plus those employed in Israel and settlements.

52. Table 4 shows that transfers accounted for a quarter of the income gap in 1972–1991 and increased steadily following the establishment of PNA to over three-quarters of the income gap in recent years. However, the income gap was highest during the era of direct occupation (1972–1991) and not during the last decade, where large budget deficits were financed by donor support.

Table 4
Income and labour measures of the resource gap
(Percentage)

Period	Income gap	Net current transfer/ income gap	Unemployment rate	Workers in Israel	Labour gap	Unemployment/ labour gap
1972–1991	43	26	3.9	33.4	37.3	10
1995–2000	26	44	27.7	13.5	41.2	67
2001–2003	30	77	36.8	6.4	43.2	85
2004–2006	29	76	30.4	6.0	36.4	84
2007–2014	33	70	28.7	7.9	36.6	78
2015-2017	25	44	26.7	12.3	39.0	69

Source: UNCTAD calculations, based on PCBS and World Bank (1993).

Note: The income gap is external income as a percentage of GDP, and net current transfer/income gap refers to net current transfer as a percentage of the income gap.

C. Structural transformation for reversing the resource gap

53. Reduction in the income gap could take place as a result of any combination of a decline in net factor income or in transfers and/or an increase in GDP. However, the correlation between the income gap and the labour gap is negative (-0.47), implying an inverse relationship between the two. This is consistent with the fact that a reduction in the employment of Palestinians in Israel and settlements reduces net factor income and may worsen domestic unemployment further via the fall in aggregate demand. Reduction in transfers has the same impact on demand, unemployment and GDP growth. A smaller income gap may thus lead to a larger labour gap, while a smaller labour gap caused by a decline in employment in Israel and settlements may exacerbate the income gap via its negative impact on GDP.

54. The preceding analysis indicates that reducing the budget deficit, or even eliminating it altogether, would not necessarily close the resource gap and may even exacerbate it by dampening growth and elevating unemployment without impacting the trade deficit. In other words, the mix of austerity and "reform" routinely prescribed to the State of Palestine overemphasizes the role of the budget deficit and glosses over the central problem of the Palestinian economy. Furthermore, the inappropriate prescription adds pressure on the already fragile socioeconomic and political conditions in the Occupied Palestinian Territory.

55. However, legitimate scepticism about further fiscal austerity should also distinguish between pertinent rationalization of public expenditure in the context of institutional reform, on the one hand, and typical austerity programmes, which crimp growth and can be self-defeating even on purely fiscal terms, on the other. Fiscal sustainability cannot be achieved by further austerity, but rather by a strategy that prioritizes economic growth, employment generation and stemming the leakage of Palestinian fiscal resources to Israel.

56. A revival strategy should seek to resuscitate the agricultural and manufacturing sectors while pursuing a reform programme to eliminate waste and maximize the quality of public spending. A starting point can be targeting the production of non-durable manufactured goods that used to be produced domestically prior to occupation, such as garments, footwear, leather products, soft drinks, furniture, construction materials and pharmaceuticals. Some 50 per cent of recent Palestinian imports from Israel were produced domestically.

III. UNCTAD assistance to the Palestinian people

A. Framework and objectives

57. For over three decades, UNCTAD has been supporting the Palestinian people by relevant policy-oriented studies, technical cooperation projects, advisory services and building international consensus on their development needs.

58. In 2017, UNCTAD continued to respond to paragraph 55 (dd) of the Nairobi Maafikiano, which requests UNCTAD to "continue to assess the economic development prospects of the Occupied Palestinian Territory and examine obstacles to trade and development…", and by paragraph 31 (m) of the Doha Mandate and to United Nations General Assembly resolutions 72/13, 71/20, 70/12 and 69/20, which request UNCTAD to report on the economic cost of the Israeli occupation for the Palestinian people.

59. The UNCTAD programme of assistance to the Palestinian people aims at building and strengthening the institutional capacities of the Palestinian public and the private sectors required for building a robust economy to underpin the future independent Palestinian State and achieve the Sustainable Development Goals. The programme addresses the Palestinian economy's needs through four clusters:

(a) Trade policies and strategies

(b) Trade facilitation and logistics

(c) Finance and development

(d) Enterprise, investment and competition policy.

B. Operational activities under way

60. Recently, UNCTAD successfully wrapped up a project on capacity development for facilitating Palestinian trade. One of the key achievements of the project was the establishment of a professional diploma training programme, entitled "Supply Chain Management", developed jointly by UNCTAD, the Palestinian Ministry of National Economy, the Palestinian Shippers Council and Birzeit University. The programme is designed to serve the needs of Palestinian exporters, importers, customs brokers, government staff, young graduates, lawyers and other professionals. In 2017, the programme was accredited by the Ministry of Education and Higher Education.

61. UNCTAD provided continuous advisory services to the Palestinian Government and various public and private sector institutions, international organizations, researchers and academics.

62. In 2017, UNCTAD continued its efforts to strengthen Palestinian customs capacity by engaging PNA and donors in a new round of cooperation to modernize and update the version of Automated Systems for Customs Data (ASYCUDA) World presently used by Palestinian customs. The proposed new intervention aims, among other things, at strengthening Palestinian capacity for customs valuation, risk analysis and post-clearance controls. It also seeks to establish an interface between ASYCUDA in the Occupied Palestinian Territory and the global gate system used in Israel to facilitate the exchange of trade data between the two systems in real time. This interface is essential for Palestinian fiscal sustainability, since it can be used to ensure timely access by the State of Palestine to accurate, comprehensive Palestinian trade data, which is a prerequisite for stemming the substantial leakage of Palestinian fiscal resources to Israel.

63. Furthermore, given the increasing Palestinian debt, and its growing complexity, UNCTAD continued dialogue with officials at the Palestinian Ministry of Finance and Planning to reintroduce the UNCTAD Debt Management and Financial Analysis System (DMFAS) to enhance the quality and scope of Palestinian public financial management. DMFAS can play a key role in mitigating the evolving risk of debt distress and ensuring that Palestinian public debt remains sustainable.

64. In 2017, UNCTAD benefited from a grant from the Government of Qatar to sustain and enhance UNCTAD capacity to support the Palestinian people’s efforts to achieve sustainable development and lay the foundations of a sound, well-functioning economy to underpin a future sovereign Palestinian State.

C. Coordination, resource mobilization and recommendations

65. In 2017 and early 2018, UNCTAD continued its development support to the Palestinian people in coordination with the government of the State of Palestine, Palestinian civil society, international agencies, donors and the UN Country Team.

66. A shortage of resources limits the ability of UNCTAD to strengthen its assistance to the Palestinian people. Therefore, member States are invited to support UNCTAD capacity to implement paragraph 55 (dd) of the Nairobi Maafikiano by extending adequate resources to strengthen the staff capacity and fund proposed projects in this important area of work. UNCTAD also recommends securing the resources for upgrading Palestinian capacities for customs administration and financial management, and for fulfilling General Assembly resolutions, which request UNCTAD to assess and report on the economic cost of the Israeli occupation for the Palestinian people.

References

Al-Haq (2017). Gaza Closure Enters its Tenth Year. Available at http://www.alhaq.org/publications/papers/GazaClousureJune2017.pdf.

Amodio F, Di Maio M and Baccini L (2017). Security, trade and political violence.

Institute of Labour Economics. Discussion Paper No. 10819.

Arnon A and Bamya S, eds. (2015). *Economics and Politics in the Israeli Palestinian Conflict* (German Agency for International Cooperation).

Bank of Israel (2014). *Trade Links between Israel and the Palestinian Authority*. Available at http://www.boi.org.il/he/NewsAndPublications/PressReleases/Documents/Israel-Palestinian%20trade.pdf.

Dajani O and Lovatt H (2017). Rethinking Oslo: How Europe can promote peace in Israel-Palestine. European Council on Foreign Relations. Policy Brief.

Hashemzadeh N and Wilson L (2006). The dynamics of current account and budget deficits in selected countries in the Middle East and North Africa. *International Research Journal of Finance and Economics*. 5:111–129.

International Labour Office (2017). The situation of workers of the occupied Arab territories: Report of the Director General. Appendix. ILC.106/DG/APP.

International Labour Office (2018). The situation of workers of the occupied Arab territories: Report of the Director General. Appendix. ILC.107/DG/APP.

International Monetary Fund (2017). West Bank and Gaza: Report to the Ad Hoc Liaison Committee. 31 August.

Office for the Coordination of Humanitarian Affairs (2017). Occupied Palestinian Territory: Humanitarian Facts and Figures. Available at https://www.ochaopt.org/sites/default/files/factsheet_booklet_final_21_12_2017.pdf.

United Nations (2012). *Gaza in 2020: A Liveable Place?* (Office of the United Nations Special Coordinator for the Middle East Peace Process, Jerusalem).

United Nations (2017a). Report to the Ad Hoc Liaison Committee. 18 September.

United Nations (2017b). *Gaza: Ten Years Later* (United Nations Country Team in the Occupied Palestinian Territory).

Palestine United Nations (2018). Report to the Ad Hoc Liaison Committee. 20 March.

UNCTAD (2017a). *The Occupied Palestinian Territory: Twin Deficits or an Imposed Resource Gap?* (United Nations publication, New York and Geneva).

UNCTAD (2017b). Report on UNCTAD assistance to the Palestinian people: Developments in the economy of the Occupied Palestinian Territory. TD/B/64/4. 10 July.

UNCTAD (2018). *The Economic Costs of the Israeli Occupation for the Palestinian People and their Human Right to Development: Legal Dimensions*. (United Nations publication, New York and Geneva).

World Bank (2018). Economic monitoring report to the Ad Hoc Liaison Committee. Working Paper. 19 March.

World Bank (2017). *Unlocking the Trade Potential of the Palestinian Economy: Immediate Measures and a Long-Term Vision to Improve Palestinian Trade and Economic Outcomes*. Report No. ACS22471 (Washington, D.C.).

World Bank (1993). *Private Sector Development*. In volume 3, *Developing the Occupied Territories: An Investment in Peace* (Washington, D.C.).