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ASSISTANCE TO THE PALESTINIAN PEOPLE
(Conference resolution 146(vi))

Recent economic developments in the occupied Palestinian territories, with special reference to the financial sector

Report by the UNCTAD secretariat

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PREFACE

Review of the work of the Special Economic Unit (Palestinian people), 1986-1987

(a) The Palestinian financial sector under Israeli occupation (UNCTAD/ST/SEU/3). This constitutes an in-depth study prepared by the Special Economic Unit of UNCTAD in collaboration with ESCWA. It investigates the structural and operational aspects of the Palestinian financial sector as it has evolved under 20 years of occupation. In particular, it examines the contribution of the financial sector to the economy and its potential to meet growing development needs. Accordingly, the role of banking and other financial institutions in mobilizing and allocating resources in the economy is evaluated. This is followed by an analysis of the Israeli Government budget for the occupied territories and its contribution to domestic capital formation and government services. Particular emphasis is given to the role of the tax system and the changes effected in its structure since 1967 and their relevance to the economy of the territories. This is followed by a detailed analysis of the role of external resources, i.e. factor income and transfers, in sustaining the economy of the territories. The study draws on the findings and examines measures aimed at improving the overall performance of the financial sector and its contribution to the development of the Palestinian economy.

(b) Recent developments in the Palestinian economy with particular reference to the financial sector. This constitutes the subject of the 1987 issue of the Unit's annual report to the Trade and Development Board on the economy of the occupied Palestinian territories and is based mainly on UNCTAD/ST/SEU/3. Part one briefly reflects on the effects of recent Israeli policies and practices on the overall performance of the Palestinian economy and developments in major areas. It tackles areas which were not dealt with in the 1986 report of the Unit, thus broadening the coverage of the economy. Part two of the report provides a concise account of the structure and performance of the financial sector in relation to the financial resource needs of the Palestinian economy. For a thorough coverage of the various aspects of the financial system, reference is made to the respective issues covered in UNCTAD/ST/SEU/3.

(c) Data base facts on the economy of the occupied Palestinian territories. In view of the paucity of qualitative and quantitative information on the economy of the occupied territories, work continued on the development of the three-tiered data base system of the Unit. The system covers essential statistical series, a detailed chronological index of research material, and bibliographical information (English and Arabic languages) on the economy of the occupied territories. While the information from the data base is primarily intended for the immediate use of UNCTAD in its work on the economy of the territories, the following documents are being issued separately for the benefit of others concerned with the subject: (1) Selected statistical tables on the economy of the occupied Palestinian territories (UNCTAD/ST/SEU/4); (2) Select chronology of economic issues and related developments in the occupied Palestinian territories (UNCTAD/ST/SEU/6); and (3) Selected English language bibliography of research references on the economy of the occupied Palestinian territories (UNCTAD/ST/SEU/5).

(ii) During the period under review, the Unit continued its efforts to strengthen co-operation with other United Nations departments and agencies involved in work on the economy of the occupied territories, notably ESCWA, United Nations Centre for Human Settlements (Habitat), ILO, UNIDO and United Nations Centre for Social Development and Humantarian Affairs. Co-operation has taken the form of exchange of information, substantive consultation on issues of mutual interest, participation in meetings, and substantive contributions to work carried out under other programmes. These included close collaboration with ESCWA concerning the preparation of the financial sector study, UNCTAD's participation in the HABITAT Seminar on the "Identification of priority development projects aimed at improving the living conditions of the Palestinian people in the occupied territories" (called for in General Assembly resolution 40/201), and contribution to the "Programme of economic and social assistance to the Palestinian people" (called for in General Assembly Resolution 41/181).

(iii) The staff of the Unit undertook missions to Jordan and Iraq in connection with its work programme. These entailed discussions with officials of Governments as well as regional and national organizations on the status of on-going activities of the Unit and consultations on the scope and orientation of activities envisaged in the forthcoming work programme of UNCTAD, in line with Conference resolution 146 (VI) and Trade and Development Board resolution 239 (XXIII). The Unit has simultaneously developed its co-operative arrangements with academic and research institutions in the occupied Palestinian territories.

(iv) As for the future activities set out in the 1988-1989 work programme of UNCTAD, which was brought to the attention of the Trade and Development Board at the first part of its thirty-third session, the Unit will embark, in 1987, on a study of the trade and services sector and its role in the economic development of the occupied territories. Parallel with this study and based on an assessment of work completed on various aspects of the territories' economy, a second study will be initiated in 1988 to examine alternative development strategies for the territories. Simultaneously, the Unit will also initiate work on the preparation of the 1988 issue of its annual report to the Board at the first part of its thirty-fifth session in September 1988.

(v) Work on the Unit's data base, encompassing the development of statistical series, compilation and referencing of research material, and establishing bibliographical references on the economy of the territories, will continue as part of the substantive work of the Unit. Output for dissemination to a wider audience will comprise periodic data base reports on the territories' economy.

(vi) Within the scope of the United Nations Programme of Economic and Social Assistance to the Palestinian People, called for by General Assembly resolution 41/181, it is considered necessary to improve the reliability of quantitative and qualitative information on various aspects of the Palestinian economy and to develop indigenous capabilities in development programming and management. One way of effectively dealing with both issues is to develop existing facilities in these areas. Accordingly, the Special Economic Unit of UNCTAD will concentrate on the preparation of two technical assistance projects in the occupied territories aimed at strenghtening local institutional capabilities in: (a) collection, analysis and dissemination of trade and related services' data and statistics; and (b) development and application of appropriate criteria, methodologies and procedures involved in the selection, preparation, evaluation and implementation of investment projects in the territories.

(vii) The Unit will intensify efforts to enhance co-operation with the United Nations organizations concerned and to strengthen working relations with regional and national institutions involved in work on the Palestinian economy, including Palestinian research institutions in the occupied territories. Furthermore, every effort will be made to enhance the Unit's access to data and information sources, including direct access to field data from the territories.

Part I

AGGREGATE ECONOMIC PERFORMANCE - HIGHLIGHTS OF MAJOR ISSUES

A. Trends in output

1. The Israeli occupation of the West Bank and Gaza Strip since 1967 has brought about radical changes in the structure of their economy. With respect to agriculture, Israeli policy has proceeded along a number of axes involving the expropriation of land, the increasing subjugation of Palestinian agriculture to the requirements of the Israeli market and the control of water resources. In the area of industry, small-scale industries have been increasingly transformed into ancillary industries catering to the needs of Israeli industries through sub-contracting arrangements. The closure of all the banks and financial institutions that existed prior to occupation and the Israeli banks' policies on loans and deposits deprived the territories' economy of a dependable indigenous mechanism for financial intermediation. Israeli commercial policy has gradually transformed the territories into the largest importers of Israeli products, with a growing adverse effect on their balance of trade. Parallel to these developments, a rapidly growing percentage of the Palestinian labour force has been obliged to seek employment in Israel and/or to leave the territories in search of work opportunities elsewhere.

2. Since 1968, after a period of relatively high levels of growth, the contribution of domestic output to gross national product (GNP) fell steadily during 1978-1984, reflecting a pattern of structural change which has brought about a rapid decline in the relative share of the traditional sector. 1/ However, structural change has not brought about an increased capacity within the modern commodity producing sectors to establish a more durable base for the sustained growth and development of the economy. The share of the industrial sector in domestic output has stagnated over a period of seven years. The gradual deterioration of the economy reflects, *inter alia*, the absence of a sound and coherent economic policy for the territories. Indigenous efforts aimed at enhancing economic activities and contributing to development have been stifled on security, political and economic grounds. 2/

3. In 1984, over one third of national product was generated outside the territories, mostly as factor income from wages of the territories' workers in Israel and the rest of the world, and partly as transfers from various private and official sources. The net effect of these has been a sizeable increase in private income and consumption in addition to transfers (as taxes, social security payments and others) to Israel. Since 1978, private consumption has exceeded GDP with its adverse effect on prices and the balance of trade. 3/ Lack of appropriate financial institutions and investment opportunities has prevented the mobilization and allocation of residual income into productive areas.

B. Savings and investment

4. Total disposable private income from all sources has increased at a rate much higher than the rise in gross national product. This rising trend does not seem to have been equally reflected in the level of personal savings. Private savings have amounted to around one fifth of gross disposable income for much of the period. 4/ Higher propensities to consume, deterioration in

the balance of trade, lack of indigenous financial institutions, anomalies in the structure of interest rates, and increasing inflationary pressure coupled with frequent depreciation of the Israeli currency are partly responsible for such a trend. To a large extent, the level of total savings has been influenced by the strong impact of external forces and the structural changes in the economy of the territories. More importantly, it can be attributed to the initiative of the private sector and to its savings effort in very difficult circumstances.

5. The government sector, despite the revenue it derives through taxation, is virtually non-existent in the territories as a potential source of savings. Similarly, the corporate sector is an insignificant source of finance owing to the undeveloped state of most business institutions. It is largely the household sector which the economy of the territories has relied on as a source of savings during the 20 years of occupation.

6. The private sector has played an equally important role in investments despite the various constraints resulting from occupation, especially the absence of an adequate financial system. However, total private investments have lagged behind private savings since the late 1970s, reflecting poor financial intermediation and a high degree of political and economic uncertainty. 5/ For the most part, private investment has been in building and construction. Expenditure on residential buildings has absorbed more than four fifths of private investment. This has been primarily intended to meet the growing need for housing, and to provide a hedge against inflation. In addition, discouragements and obstacles against investment in productive projects in agriculture and industry have led potential investors to move into speculative dealings involving movable and immovable properties and a range of other commercial activities.

C. Prices and the impact of inflation.

7. Increasingly close economic links with Israel rendered the territories highly susceptible to Israeli price movements and high rates of inflation. 6/ Inflationary pressure in the territories has arisen primarily from the increased prices of imported goods from Israel, which have amounted to almost 90 per cent of all goods imported, and through circulation of Israeli currency which serves as legal tender in the territories. It is equally due to the declining capacity of the domestic economy and its inability to meet the rising level of demand generated through increased factor income, remittances and other transfers from abroad. The impact of inflation on the life of ordinary citizens, civic institutions, and business enterprises in the occupied territories has been overwhelming, particularly since 1974 and the devaluation of the Israeli currency in that year. The most important visible subsequent outcome of this phenomenon had been the sharp and often erratic depreciation in the Israeli currency, especially when measured against the Jordanian dinar, which is the second legal tender in the West Bank. 7/

8. The deterioration in the exchange value of Israeli currency has made economic planning and business activity in the territories difficult and unusually risky. An overriding objective for all businessmen has been the preservation of the real value of their sales and goods in stock. One immediate measure they took for this purpose was to curtail their credit facilities to customers almost to zero, or else to convert the unpaid value of goods to Jordanian dinars at the prevailing exchange rate - a measure which

often proved unfair to buyers. The rapidly rising level of prices, during the period 1975-1984, subjected consumers to severe hardships. On the supply side, it equally resulted in increasing the risk margin for sellers and eventually drove some out of business.

9. A pronounced and increasing differential in the consumer price indices between the territories and Israel has led to a fall in the value of sales to Israeli buyers of output from local markets in the territories. Meanwhile, an increasing number of residents in the territories now buy some of their consumer and durable goods from neighbouring Israeli towns, where prices are not as high. This dual impact on demand in local markets has been an important factor in precipitating the current recession in economic activity in the territories.

10. The rising rate of inflation gradually resulted in a marked decline in the real disposable income of most income groups and was accompanied by a widening gap between monetary income of families and the cost of maintaining their standards of living at levels prevailing during the mid-1970s. The impact of this situation has been particularly hard on the purchasing power of workers paid in Israeli currency. High rates of inflation have also affected the economic status of the middle and low-income groups and caused a sharp drop in the standard of living for the professionally privileged income group. The standard of living for most income groups would have dropped to very low levels had it not been for the effective role played by remittances earned abroad.

D. Developments in some major areas

11. Agriculture remains the backbone of the territories' economy despite its declining contribution to gross domestic product. For an initial period of over a decade, the sector was marked by high rates of growth, due largely to a marked rise in the productivity of certain high-priced products rather than a corresponding rise in aggregate output. 8/ Since the early 1980s, however, agricultural output has followed a steady decline.

12. Until the 1980s, measures such as improvement in the use of implements, and introduction of new equipment, including drip irrigation, fertilizers, improved seeds and other inputs requiring relatively small amounts of capital, were instrumental in increasing output per labour and land inputs. Most of these measures were financed from the farmer's own resources, through business savings and by short-term borrowings from the informal financial market, involving merchants, money-lenders, and commission agents. The total size of Israeli government loans, which continued only until 1970, was insignificant.

13. Growing limitations on the availability of private and public finance, coupled with changing output, cropping patterns and markets, as well as growing dependence on Israeli trade policies and administrative restrictions on water and land use, have imposed severe constraints on agricultural producers. By contrast, as part of settling an increasing number of Israelis in the territories, a plan for the agricultural activities of these settlers provides them with sizeable areas for cultivation and for pasturage, 9/ much of it in the fertile lands of the Jordan Valley of the West Bank. A similar pattern has been in force in the Gaza Strip. 10/

14. Consequently, total cultivated area has decreased in the territories with no new measures for the inhabitants to replace losses through land reclamation and irrigation programmes. Cultivated land has declined from around 36 per cent of total land area in the West Bank in 1966 to about 27 per cent in 1984, and in the Gaza Strip from 55 per cent of total area in 1966 to 28 per cent in 1985. 11/ The adverse effect of these factors on agricultural output, employment and income cannot be overstated. Agricultural output and income in the West Bank show a steady decline during the period 1981-1985, though the decline in the level of employment in agriculture has been less drastic over the period. 12/

15. The industrial sector has stagnated during much of the occupation period. In the early years of occupation, the authorities had focused attention on developing industry, even though the support was limited. In later years, this emphasis was shifted to the enforcement of routine industrial regulations. 13/ As such, the industrial sector has been operating in increasingly difficult circumstances, deprived of guidelines to help in determine the most appropriate strategies and measures to ensure its growth. On the whole, the sector has been forced to operate within limits imposed by three rival forces acting simultaneously, namely domestic, Israeli and Jordanian markets.

16. Domestically, industry has managed to sell more than twice as many products as it has sold to Israel. However, the sector is increasingly assailed by competition from Israeli industries which enjoy generous government support. In addition, Israeli output is not subject to customs duties in the territories. The imposition of value added tax (VAT) has further reduced the comparative advantage enjoyed by Palestinian industry before 1976. Local industry is also being confronted with competition from Israeli plants built in close proximity of the Israeli settlements in the territories. 14/ As against the "non-development" position of the Israeli Government towards Palestinian industry, Israeli settlement policy is complemented by an industrial plan for the West Bank which is designed to attract Israeli industry and labour to this "hinderland". This includes the establishment of industrial zones, involving large-scale Israeli public and private investments, and various concessional tax and credit facilities. 15/ By contrast, policy towards Palestinian industry is aimed at dispersing it outside urban centres and developing workshop areas in villages. While Palestinian industries will be allowed to establish within Israeli industrial parks in the occupied territories, they will not be eligible for Israeli incentives. 16/

17. Regarding the Israeli market, there is minimal penetration of industrial goods from the territories, except for some leather and textile products, wood products, building materials and certain processed foods. Much of this has been through subcontracting arrangements between Israelis and Palestinian local producers. Subcontracting has appealed to Israeli producers because of the availability of cheap labour and lower overheads in the territories. These factors lower the cost for the Israeli manufacturing sector and increase the competitiveness of the commodities concerned, especially as no duties are paid by the Israeli manufacturers on imports of goods from the territories produced through subcontracting. Although subcontracting in the territories may also lead to some degree of specialization in the industral branch concerned, it does not reflect the actual needs of the Palestinian economy.

18. As for the Jordanian market, large-scale expansion of industrial exports is limited for two reasons: the policies of promoting similar domestic industries and of maintaining the Arab boycott of products for which the equipment and raw materials were not imported from and/or through Jordan. The Jordanian and Arab authorities have recently begun to relax some of the restrictions on the entry of industral goods from the territories. However, economic recession in the once prosperous countries of the Gulf may not allow a more rapid absorption of industrial goods from the territories.

19. Despite the growing need for increased numbers and better standards of housing, the housing sector remains one of the most neglected areas of the territories' economy. Almost half of the territories' population live in conditions of seven or more persons per dwelling. 17/ One third of the population lives in one-room units and almost half in two room dwellings, giving an average housing density of three persons per room for the territories as a whole, 18/ The supply of housing over the years has not kept pace with population increase. Most new residential units have been constructed by the private sector, mainly prompted by the rising demand of an expanding population for dwellings, increases in income, lack of alternative investment opportunities and the determination to assert rights to the land in the face of continuous threats of confiscation and the execution of Israeli road and settlement construction plans. 19/

20. There has been no construction of residential buildings for the Palestinians by the public sector in the West Bank since 1968 and in the Gaza Strip since 1978, except for some housing projects for the resettlement of refugees in the Gaza Strip. 20/ Restrictive practices by the authorities, especially in terms of administrative obstacles to issuing building permits, stifled local private efforts and effectively barred a potentially large number of families from procuring decent housing. 21/

21. By contrast, the establishment of Israeli settlements in the occupied territories has gone on unabated since 1967 in violation of international law. 22/ It has moved in parallel with Israeli land acquisition policies which have assured a virtually unlimited reserve of land for Israeli settlements. 23/ Currently, there are over 150 non-military highly subsidized Israeli settlements in the West Bank (excluding East Jerusalem) and Gaza Strip. These have a total population of more than 52,000 settlers, equal to the projected figure of 52,500 Israelis planned to be settled in the occupied territories by 1985. 24/ In 1979, the Government also allowed private Israeli citizens to buy Palestinian land; three years later, land developers obtained the approval to build private settlements. By the end of 1985, the Higher Planning Committee had processed 191 plans for Jewish built-up areas. 25/

22. The concentration of Israeli settlements in the metropolitan areas near the so-called "green line" (i.e., the pre-1967 borders of Israel), a trend which first appeared in 1981, has become more pronounced. Israeli settlers wanting to move to such areas were provided with a range of incentives and concessionary terms of credit. Businesses and enterprises wishing to relocate just across the "green line" receive similar preferential treatment. 26/ Most of the Palestinian villages and towns have been prevented from cultivating land near these settlements or building on it. In fact, many roads and other infrastructural facilities connecting these settlements are extended through such parcels of land 27/ connecting them with Israeli cities beyond the "green line".

23. Efforts are under way to extend Israeli settlements into remote areas, while work on the expansion of the existing ones continues. The strategy is to achieve "maximal distribution of a large Israeli population in areas of high settlement importance ...". 28/ The infrastructure of the existing settlements is sufficient to double or even triple the present number of settlers. In addition to the building over 2,800 homes in existing settlements in recent years, 29/ work also began in 1986 on the 13 new Israeli settlements planned in the West Bank and Gaza Strip. 30/

24. As part of the overall financial and other incentives aimed at inducing Israelis to settle in the occupied territories, the Government of Israel invested a sum of almost $2 billion on settlements in the West Bank between 1968 and the end of 1985. This does not include investment in military installations. In recent years, the level of annual capital outlay had been $200-250 million. This is in addition to expenditures incurred by the World Zionist Organization (WZO) on settlements. In 1985, WZO's expenditure on settlers per unit (family) came to $165,000 in the Jordan Valley and to about $80,000 in the highlands. 31/

25. By comparison, total public capital formation (including municipalities) for the benefit of Palestinians in the West Bank amounted to a sum of $300 million during a period of 17 years, i.e., 1968-1984, or an average of only $17.6 million per annum. On a *per capita* basis, public investment outlays in 1983 on settlements in the West Bank amounted to $8,000 per Israeli settler as against public capital formation of $52 per Palestinian inhabitant of the West Bank. 32/

Part II

THE PALESTINIAN FINANCIAL SECTOR UNDER OCCUPATION

A. Money and banking

26. There were eight commercial banks operating in the West Bank and three in the Gaza Strip prior to June 1967. The total number of branches by then had reached 26 in the West Bank and four in the Gaza Strip. The banks, especially those in the West Bank, rendered services of a relatively high standard and played an important role in developing such sectors as trade, tourism, small-scale industries and certain forms of agricultural ventures. In 1967, the total assets of these branches in the West Bank alone are estimated to have been more than 15 million Jordanian dinars (JD), accounting for over one fifth of total assets of Jordan's commercial banking system, with deposits of about JD 14 million and credit of around JD 10 million. 33/

1. Israeli Military Government policy

27. Following the occupation of the territories, all indigenous banks and their branches along with other financial institutions were closed down. 34/ Their accounts were frozen, documents removed and cash transferred to the Central Bank of Israel as deposit accounts in the banks' names. "Examiners of Banks" were appointed and entrusted with the power to issue bank licenses, inspect and freeze accounts, determine maximum permissible levels of interest rates and methods of accumulation of funds, establish the minimum liquidity ratio and perform a number of other functions. 35/ Major Israeli banks were authorized to open branches in the territories.

28. As for the medium of exchange, Israeli currency was declared legal tender in the territories. Subsequently, the Jordanian dinar was also allowed to continue to serve as legal tender and circulate in the West Bank. The Egyptian pound, however, was declared illegal and gradually withdrawn from circulation, thus leaving the Israeli pound as the only legal tender in the Gaza Strip. 36/ Nevertheless, both the Jordanian dinar and the Egyptian pound continued to circulate unofficially in the Gaza Strip. 37/ The rapidly declining value of the Israeli currency also attracted holdings in the United States dollar in the territories mainly as a unit of account and store of value. 38/ As a result, there is no specific currency system belonging to the territories themselves, as was the case during the Mandate and until 1967. 39/ All transactions in foreign exchange, gold, and bonds were allowed with licensed dealers designated to operate as individuals and/or institutions (i.e., banks). 40/

29. By the beginning of 1983, over 122 Military orders had been issued governing banking and monetary activities in the territories. These and other related provisions have either cancelled or amended Jordanian and Egyptian financial laws and regulations in force in the territories up to June 1967. East Jerusalem, on the other hand, was subjected totally to Israeli financial legislation following its annexation.

2. Israeli banks

30. Shortly after the occupation, branches of Israeli banks were allowed to open and operate in the territories. According to the Bank of Israel, 30 branches of Israeli banks were operating in the West Bank (excluding East Jerusalem) and Gaza Strip by the end of 1984. 41/ If branches in East Jerusalem are also included, the number rises to 36. However, available information indicates that only 22 branches of Israeli banks in the territories were serving Palestinian towns, in May 1986. Fourteen branches were located in major Israeli settlements and serve mainly Israeli settlers.

31. Branches of Israeli banks in the occupied territories derive their resources from funds deposited by the Government of Israel and by the general public in the territories. Operationally, they do not really engage in financial intermediation in the territories. Despite an increase in deposits, total credit extended by these branches to the public declined from a level of 1.27 per cent of the territories' GDP in 1977 to 0.48 per cent in 1981, rising to 1.1 per cent in 1984. In 1984, credit to the public amounted to only 8 per cent of total assets and 10.7 per cent of deposits. The percentages have steadily declined from their levels of 18.1 and 23.8 per cent, respectively, in 1977. 42/

32. The inhabitants of the territories can maintain deposit accounts in both Israeli and foreign currencies. In 1984, total deposits accounted for 74.5 per cent of all liabilities. While total deposits show a cumulative annual average increase of 5 per cent in constant prices during the period 1980-1984, they continue to figure low in terms of gross national product and/or gross disposable private income. 43/ In 1984, total deposits amounted to only 7.5 per cent of GNP as against 29 per cent in 1966. 44/

33. The rapid decline and the present low level of deposits in Israeli currency shows the continuing and substantial depreciation of its value vis-à-vis relatively stable currencies, especially the Jordanian dinar. Despite a fee on dinar deposits and the deep political uncertainty surrounding the future of the territories, a number of residents have resorted to these banks for safe keeping of their surplus dinars. Around 80 per cent of all bank deposits of the general public in 1984 was in foreign currencies including dinars, as against 12 per cent in 1977. In addition to the holding of Jordanian dinars, various types of commercial transactions, payment of salaries and other obligations are calculated and paid in dinars. 45/

34. Credit to the public from government earmarked deposits has almost come to an end. Its share in total credit has declined from 43.4 per cent in 1977 to only 1.8 per cent in 1984. On the other hand, balances with branches in Israel have maintained their high level in proportion to total deposits and assets. In 1984, these balances amounted to over 80 per cent of deposits and 60 per cent of assets. Branches of banks generally follow the traditional banking practice of safety and liquidity and extend short-term loans of up to one year for commercial purposes and partly as operating capital for agriculture and industry. It can therefore be inferred that these branches channel funds out of the territories for investment in Israel itself. There are no specialized financial institutions geared to meet the medium and/or long-term financial needs in agriculture, industry and housing. Scarcity of

equity and working capital has been a limiting factor especially in agriculture and industry. Loans to agriculture and industry, extended by Israeli banks into the 1970s, are no longer available to Palestinian producers.

35. A common form of credit comprises overdraft facilities. Under this arrangement, which does not involve the use of government earmarked funds, banks are free to exercise their own discretion without having to consult with the military authorities. The rate of interest charged on overdrafts ranged between 39 and 50 per cent per annum in early 1986. Branches of Israeli banks also issue letters of credit to Palestinian importers. Since the volume of imports to the territories from the rest of the world, other than Israel, is noticeably small, the role of Israeli banks in facilitating international trade on behalf of Palestinian businessmen is correspondingly marginal. Opening of letters of credit is hampered more by constraints arising from government regulations on licenses and other requisites than by the banks themselves.

36. Israeli banks issue several forms of guarantees on behalf of Palestinian businessmen and in favour of third parties. Israeli banks also offer other services which may facilitate business transactions, without necessarily bearing on their role as intermediaries between depositors and borrowers. They act as payment conduits between tax payers and the Government. Furthermore, the Government resorts to these branches for paying salaries and pension dues to most of its employees in the territories and to Palestinians working in Israel.

37. On the whole, the branches of Israeli banks have not succeeded in restoring the pre-1967 level of banking operations both in terms of scope and volume. In particular, they have been unable to play the conventional and fundamental role of intermediating between depositors and borrowers which is essential for mobilizing local financial resources and channelling them to investment opportunities in the territories. Their role as a source of credit to the Palestinian borrowers remains insignificant. Apart from some of the common banking services offered, their role in promoting economic growth and development in the territories has indeed remained minimal.

3. Arab financial institutions and practices

38. In 1967, the Jordanian authorities decided to retain in the West Bank the physical presence of all branches of the Amman-based commercial banks. The purpose was not only to protect their legal status but also to facilitate some post-occupation contacts between the inhabitants of the territories and the East Bank with respect to withdrawal of deposits, and maintaining trade and other traditional links. The Jordanian authorities have also allowed some main Jordanian commercial and specialized credit institutions (namely, The Arab Bank, Housing Bank, the Industrial Development Bank, Towns and Villages Development Bank) to extend their services to the inhabitants of the West Bank to the extent possible.

39. Since 1967, the Arab Bank branch in Nablus, the West Bank, has performed certain types of banking services, such as opening new accounts in its sister branches in Amman. It is claimed that there has been a steady flow of deposits from the occupied territories to commercial banks in Amman on a sizeable scale of about \$3-\$6 million per month, much of it through the Arab Bank. The Nablus branch of the Arab Bank still refrains from advancing

any form of loans or credit facilities to inhabitants in the West Bank, in compliance with Israeli orders. Therefore, the one-way flow of funds seems to have further exacerbated the tight financial situation of the business community in the territories.

40. Commercial banks in Jordan generally do not provide any form of credit to Palestinians residing in the West Bank and Gaza, except if the businesses involved are located outside the territories. However, should any loan be considered, commercial banks demand fully-fledged guarantees traceable in Jordan (e.g. mortgage of real estate located in Jordan or signatures from 2-3 accredited guarantors). Only a few residents in the West Bank and Gaza can raise the needed collateral. The Arab Bank in Amman, has been involved in extending long-term loans to municipalities in the West Bank since 1971. 46/

41. The Towns and Villages Development Bank has been providing long-term loans to municipal councils for completion of development project since 1967. As a government bank, its loans, carrying a low interest of 5.5 per cent, have been guaranteed by the Government. 47/ The Housing Bank has equally been engaged in extending loans to West Bank residents for housing construction and repair. 48/ The Industrial Bank does not grant loans to West Bank residents owing to the difficulty of appraising loans, monitoring their use and recovering them. However, it has administered loans for West Bank projects using funds made available by the Jordanian authorities. 49/

42. In the Gaza Strip, prior to 1967, branches of Arab banks were operating with limited services, mainly focused on the financing of trade. There was little willingness to take risks and engage in the financing of agricultural and industrial development projects. 50/ The Bank of Palestine, established in 1960 with a small capital, was able to provide credit facilities for foreign trade activities in the Gaza Strip, particularly the export of citrus fruits, until it was closed down in 1967. 51/ After 14 years of closure, and in view of the mounting need for normal banking services, an agreement was reached with the Bank of Israel in 1981 allowing the re-opening of the Bank of Palestine. While the permission granted has been independent of Israeli banking legislation, in practice the Bank has been subjected to full supervision and control by the Bank of Israel and the Military administration through the "Examiner of Banks". The agreement permitted the Bank of Palestine to render "normal banking services" from its headquarters in Gaza City, with a commitment to consider subsequently the re-opening of its branches in the future in Khan Yunis and Rafah. Despite repeated requests, none of the branches have been re-opened. Although the Israeli authorities did "in principle" finally agree, in June 1986, on the reopening of the Bank's branch in Khan Yunis, the final approval of the Bank of Israel is still pending. 52/

43. While the Bank of Palestine is allowed to maintain its pre-1967 accounts in Egyptian-pounds and to present its statements of accounts in this currency, all its dealings are, however, conducted in Israeli shekels. Customers' loan repayments are indexed to the United States dollar. An appeal to allow it to deal in foreign exchange has not been acted upon by the Israeli authorities. The inability of the Bank to engage as an "authorized dealer" in foreign exchange, including Jordanian dinars, had been a major constraint on the direction and size of its operations, on its ability to promote foreign trade and compete with branches of Israeli banks, on its contribution to the growth

and development of the local economy, and on its active trade links with Jordan and other countries. Lending operations and overdraft facilities, covering trade, agriculture and industry, have remained limited. The Bank grants modest loans of short duration, rarely exceeding 10 months. The long-term needs of these sectors are not met. The capital of the Bank remains small despite repeated attempts to increase it three-fold which have not received approval of the Israeli authorities.

44. As a result, the Bank of Palestine has not been able to carry out effectively financial intermediation in the Gaza Strip. It has not yet succeeded in mobilizing available resources and allocating them to priority areas. While the ratio of its credit to deposits is generally higher than those of Israeli bank branches, it is still low for a commercial bank. 53/ The Bank's role as an intermediary between depositors and borrowers will continue to be insignificant as long as its ability to mobilize savings and external loans is limited. Serious efforts are needed to examine the Bank's role in financial intermediation, bearing in mind the pressing financial resource requirements of the Gaza economy.

45. A variety of formal and informal facilities have attempted to partly fill the gap created by the absence of appropriate financial institutions and an inadequate and undeveloped banking system. The Arab Development and Credit Company, for example, was established in 1985 with financial intermediation intended to constitute a major part of its business. Although established in Jerusalem under Israeli laws, the company is allowed to operate within the occupied territories under the supervision of the Israeli military authorities. 54/

46. Rural credit was transformed in the wake of Israeli occupation. The Government of Jordan closed all West Bank branches of the Agricultural Credit Corporation and ordered a freeze on the lending operation of the branches of the Jordan Co-operative Union in view of conditions imposed by the Israeli authorities. 55/ Sources of rural credit, during the first decade of occupation, consisted primarily of suppliers of production requisites and, to a much lesser extent, marketing middlemen. By the late 1970s, rural credit witnessed three major transformations. Firstly, farmers displayed a growing trend towards scaling down their long-term investments to the bare minimum, because of erratic fluctuations in profitability and the insecure political environment. Secondly, the second part of the 1970s witnessed the emergence of a large number of private voluntary organizations, many of which were involved in providing financial aid to rural and agricultural projects. Thirdly, the establishment, in 1978, of the Jordanian-Palestinian Joint Committee as the main conduit for Arab aid to the occupied territories presented new possibilities. Notwithstanding these developments, credit facilities in rural areas have remained deficient in that the costs and conditions of finance, even seasonal credit, are beyond the means of most of the inhabitants. Co-operatives, moneylenders, farm supply dealers and marketing middlemen have only partially met the needs.

47. Dealers in farm supplies have played a major role in meeting the needs of most commercial farm owners for seasonal credit facilities. This source of credit is characterized by relatively simple transactions and effectiveness in meeting desired needs. It has continued to function even after occupation, when its credit role became more important. By the mid-1970s, the unpredictable decline in the value of the Israeli currency forced dealers to

minimize the duration of credit facilities and to insist on cash payment. The relative stability of the Israeli currency since mid-1985 has again encouraged dealers to resume their credit services. While not yet operating at the pre-1967 level, dealers remain, by far, the most important source of seasonal and short-term finance in the territories. 56/ Lenders are able to earn noticeably high rates of return by charging higher prices on inputs sold to farmers and through the commission they earn on the sale of their clients' produce.

48. A key component of existing financial arrangements in the occupied territories is constituted by licensed moneychangers who had operated prior to 1967 in the West Bank and the Gaza Strip. Since occupation, however, the number of moneychangers operating in the West Bank rose sharply, from 42 to almost 200 in 1986. The growth in this sector was in response to the absence of adequate and appropriate monetary institutions, the existence of a two-currency system in the territories, and the need for some informal channels for the transfer of funds between the territories and Jordan and the rest of the world.

49. In most cases, moneychangers perform a wide range of activities including currency exchange, money transfers, clearing of accounts, accepting deposits, extending loans, and managing investment portfolios. 57/ The exchange of Jordanian dinars and Israeli shekels is routinely requested by practically all categories of inhabitants. In addition to the dinar-shekel exchange transactions, moneychangers are also involved in unofficially handling Arab currencies in the form of remittances from relatives working abroad. The United States dollar is equally handled on a considerable scale, often involving Israeli citizens. Israeli military and monetary authorities display a degree of tolerance of this activity, especially in view of its net positive effect on the Israeli economy.

50. The transfer of money to and from the occupied territories is another major function which moneychangers perform efficiently on an extensive scale. Moneychangers also extend some loans to borrowers whom they know well through the course of their business, mostly for short periods and at annual interest rates which reach 40 per cent. Cashing of bank cheques drawn on accounts in Jordanian banks is another service which moneychangers extend to their trusted clients. In some cases, large moneychangers have performed other functions on a selective basis, such as investment on behalf of others in shares in Amman Financial Market.

51. Moneychangers have managed to provide a number of vital services to residents and institutions in the territories. However, their role in financial intermediation remains limited in scope, with credit facilities confined to "first aid" lending in the services sector. Their role in financing industry has been virtually nil, while in agriculture and housing they play no role at all. The operation of the informal monetary sector has acquired an institutional character such that moneychangers are obliged to act as banks. This, however, has taken place in the absence of requisite laws and regulations and of an indigenous central authority responsible for protecting the parties concerned and regulating monetary policy in the interest of economic objectives. In the area of foreign exchange, the multiple currency system has provided a lucrative source of income, despite Israeli prohibitions, risk of confiscation of money being illegally transferred across the bridges and the chronic conflict with tax authorities. 58/

4. Attempts at re-opening of local banks

52. Following the occupation, attempts were made to re-open the local banks both in the West Bank and Gaza Strip. However, the Israeli authorities demanded that the banks concerned should operate under the supervision of the Central Bank of Israel - a demand considered to be contrary to the laws and regulations prevailing in the territories when occupied. In 1973, the negotiations, which also involved the International Monetary Fund, came to an end without any agreement.

53. By the mid-1970s, a new round of negotiations was launched, this time involving only the Arab Bank. Several obstacles eventually emerged, preventing agreement. These included: the refusal of the Israeli authorities to permit the opening of East Jerusalem branches, which carried serious political implications unacceptable to the Arab Bank; legal reserves of over 70 per cent were to be kept at the Bank of Israel (in Jordanian dinars) and at no interest, deposits which were held in banks outside the country should be transferred back to local branches; re-opened banks would be asked to generate more equity capital so as to maintain their finances independent of their main offices in Amman. The third round of re-opening negotiations took place between 1982 and 1985, again involving only the Arab Bank. A tentative agreement was reached in late 1985 to re-open the Arab Bank in Nablus, and a compromise was reached on all other differences. However, the Israeli authorities have still not responded to the proposal.

54. In view of the unsuccessful efforts to reopen local banks, and the continued need for regular banking services in the territories, attempts were made in recent years to open new banking institutions in the West Bank. In 1984, a group of West Bank businessmen began a dialogue with Israeli authorities, in an effort to secure a license for a new bank to be based in Nablus, with more branches to be opened later in other cities. However, the Government of Jordan insisted on the re-opening of the closed local banks which were more advantageously placed compared to any new bank in terms of capital, experience in the territories, know-how, and ability to mobilize external resources.

55. In yet another attempt, the Israeli and the Jordanian authorities simultaneously agreed to a request to re-open the branch of the Cairo-Amman Bank in Nablus. 59/ The branch, which resumed operations late in 1986, will function in accordance with the Jordanian law in force in the territories and amended by Israel. The Bank is expected to serve businessmen in both the West Bank and Gaza Strip and has obtained approval to open branches in other West Bank cities. One source estimated that there is up to $250 million in uninvested Palestinian savings which could be deposited in the Bank and used to launch industries in the West Bank. 60/

56. The re-opening of the branch of the Cairo-Amman Bank is no doubt a positive development giving rise to expectations for the re-opening of other banks which were operating in the territories before 1967. However, the unique nature of the Bank, where both Jordan and Israel will be involved in supervising its operations, poses a number of questions. These pertain to the adverse effects of the Bank on small financial businesses, the unwillingness of individuals to disclose all financial operations to the occupation authorities, and the role of Israeli authorities in the direction and size of loans. 61/ The success of the Bank would obviously depend on a number of

vital factors, namely the volume of its capital, its ability to conduct financial intermediation by attracting local savings and effectively allocating them to needy sectors of the economy, its area of coverage, its policy on accommodating credit needs of various sectors of the economy, and above all, on Israeli policy governing the nature and scope of its activities and the frame of the legal system within which the Bank expects to operate.

B. The fiscal determinants

57. From 1950, the West Bank was subject to Jordanian fiscal legislation, including measures based on the pre-1948 Palestinian fiscal system. In the Gaza Strip both Palestinian and Egyptian legislations provided the basis for the operation of the fiscal system. 62/ While it is claimed that the fiscal laws and regulations prevailing in the West Bank and Gaza Strip prior to their occupation by Israel in 1967 are still in force, a wide range of Israeli military orders and proclamations have created a different situation. The tax system alone has been subjected to more than 177 military orders and proclamations (including amendments), all aimed at increasing government revenues intended to meet some basic government services.

1. Government budget

58. Total expenditures of the Israeli military Government in the territories fall short of providing the minimum level of basic government services to a growing population, meeting investment requirements, and creating an adequate infrastructural basis for sustained growth and development of the economy. Government expenditures have declined in real terms during the inflationary period. Natural increases in population and return to migration have further reduced the per capita benefit of these services. Military Government expenditures in 1984 amounted to only 12.8 per cent of GNP of the territories or $218 per capita, representing one of the lowest levels of government outlays among developing economies. 63/

59. Current expenditures amounted to almost 69 per cent of total government outlays in 1984. Only a few items under this category are of direct relevance to the Palestinian population. These include education, health, welfare, public works, postal services and telecommunications. However, much of the allocations in these areas cover salaries and other expenses. The remaining items largely cover the operations of the military Government and Civil Administration. Modest increases shown in the level of Government current expenditures during the subsequent period (1985 and 1986) should be viewed against the eroding effect of inflationary pressures of past years.

60. Capital or development expenditures, involving water resources, electricity grids, telephones, roads, Civil Administration and archeology, are partly aimed at contributing to the construction and/or improvement of Israeli settlements and meeting the needs of the military administration. Loans and grants to local Palestinian authorities are aimed at supporting the limited resources of these authorities. On the whole, actual development expenditures amounted to as little as 1.9 per cent of GNP of the territories in 1984. Coupled with restrictions on private investment, lack of a fully-ledged indigenous banking system, and Israeli settlement policies, the contribution of this small share of national income to capital formation and growth in employment, output, and income in the Palestinian economy has been nil. The

assistance of the international community, covering a wide range of activities and carried out independently of the Israeli Government, has increasingly supplemented total Israeli budgetary outlays in the territories.

61. The national income accounts of the territories reveal two major sources of Israeli Government revenues, namely "income tax and transfers to the Government" and "net indirect taxes on domestic production". A number of sources of government revenues are omitted altogether from these categories. Despite these limitations, revenues from these two sources amounted to 12 per cent of GNP in 1984 which, is comparable with performance in a number of developing low-income economies. 64/ The Israeli Government budget for the occupied territories realized a relatively small surplus in the West Bank and a deficit in the Gaza Strip, in 1984. 65/

62. The final picture will be different if revenues from other sources, as indicated above, are also included. These cover revenues from taxes and social security deductions from the wages of Palestinians working in Israel, customs duties collected by Israeli authorities on the territories' imports through Israel and Jordan, the hidden value added tax charged on all Israeli exports to the territories in lieu of customs duties chargeable by the territories, fees on permits for crossing the bridges into Jordan, and a number of other levies. Including these sums will result in an overall surplus in the Israeli Government budget for the territories. Furthermore, these calculations do not cover the direct and indirect benefits that accrue to the economy of Israel from the activities of Israeli settlers in the occupied territores. It is, therefore, argued that the inhabitants of the territories, in fact, pay a net "occupation tax" that can be estimated after 18 years at a conservative total cumulative figure of $700 million for the West Bank alone. 66/ This refutes claims that the low level of public expenditures and investment derives from budgetary revenue limitations. If net fiscal transfers had been invested in the territories, rather than added to Israeli expenditures, it would have been possible to improve local services significantly and, in particular, to contribute to the development of local economic infrastructures.

63. In the absence of a national authority in the occupied territories, municipalities of Palestinian cities and towns become the most important local institutions to provide public services. Were it not for the constraints of occupation, they could have been instrumental in creating job opportunities and undertaking capital projects through community and rural development programmes. Prior to 1967, municipalities played an important role in their localities with the help of the central Government. Since 1967, a situation has emerged whereby municipalities have been subjected to the legislative, executive and judicial authority of the military commander in the territories. 67/ Municipalities are not allowed to embark on new projects without advance approval of the occupation authorities. In many cases, the approval is either not granted or only after a long delay. This has led, at times, to a situation where some municipalities could not spend available revenues for badly needed projects and services. As municipalities cannot exercise legislative power, they are not allowed to introduce new taxes and fees, change their prevailing rates, coverage or collection procedures without the prior approval of Israeli authorities. This is crucial as many taxes and fees are not income and prices elastic and are levied either at flat rates and/or imputed in an arbitrary manner.

64. Revenues and expenditures of municipalities need to be viewed in the light of the above-mentioned constraints. 68/ Revenues, which are divided between "ordinary" and "extraordinary" have amounted to as low as 4.6 per cent of GNP in 1984/85. 69/ Ordinary revenues accounted for about 75 per cent of total revenues in the West Bank in the last five years and for 71.6 per cent in the Gaza Strip. Extraordinary revenues comprise grants and loans from Arab and non-Arab sources, including that of the Israeli Military Government budget in the occupied territories. In addition, they include income from municipalities' projects. Owing to the unreliable nature of internal and external contributions to the budget of the municipalities, it has not been possible to depend on extraordinary revenues on a regular basis. Ordinary revenues seem to be more reliable, though not reliable enough to meet the mounting development requirements of municipalities.

2. The tax system: Israeli policies and practices

(a) Changes in tax laws

65. A detailed system of taxes, duties and fees was in force in the West Bank and Gaza Strip at the time of their occupation in 1967. As in most developing economies, the emphasis in the design and structure of the system reflected revenue considerations of the Government. In view of the limited scope of the tax system as a whole, its potential role in the allocation, stabilization, and distribution objectives of public policy was being promoted through a combination of monetary and other fiscal instruments.

66. Following the Israeli occupation, numerous military orders were issued aimed at amending the prevailing tax system of the territories. Subsequently, the Civil Administration was authorized to increase maximum income tax rates through by-laws in order to facilitate the amendment process. In addition to changing the scope and rates of taxes, new taxes were imposed with a view to increasing government revenues and gradually aligning the tax system to that prevailing in Israel itself.

67. Nowhere in the tax system of the territories are changes more pronounced and continuous than in the area of income tax. They pertain to rates, income brackets, methods of assessment, collection, and appeal procedures, 70/ all aimed at maximizing government revenues. From June 1967 to February 1985, 34 military orders have been issued to amend income tax rates, income brackets and exemptions. The minimum level of taxable income was reduced, tax rates were increased, and the amounts of income in taxable brackets were reduced. While the top rate has increased by 5 per cent, the amounts in taxable income brackets have been lowered in most cases by more than 50 per cent. It is obvious that by lowering taxable income brackets, a higher tax rate is now levied on amounts which generally represent less than half of the taxable bracket under the pre-1967 system. For example, a taxable income of JD 1,600 which used to fall within the 15 per cent tax bracket under the 1964 Income Tax Law has now moved up to the 33 per cent bracket, signifying more than a 100 per cent increase in tax payment. 71/

68. A comparison with income tax liability in Jordan under the new 1982 Income Tax Law puts the taxpayer in the territories at a great disadvantage. The net impact of changes in the 1982 Income Tax Law of Jordan on a married couple with four children having an annual taxable income of JD 2,000, is that income tax due has dropped from JD 165 under the 1964 Income Tax Law to JD 33

under the 1982 Law. 72/ But, as a result of the major amendments introduced by Israeli authorities in the 1964 Income Tax Law, the actual amount of tax due for the same size family in the territories is currently assessed at JD 299, which is 9 times higher than in Jordan. Israeli military orders have also lowered personal allowances for income tax purposes. 73/ The ceiling of allowance in the West Bank stands at JD 314, which is only 22 per cent and 13 per cent of that prevailing in Jordan and Israel, respectively. With respect to business income tax, the Israeli authorities have also amended the Egyptian tax laws whereby Gaza businesses, including the Bank of Palestine, have to pay 37.5 per cent tax on their income.

69. The most striking change pertains to tax collection procedures whereby taxpayers are now obliged to make advance payments on a monthly basis throughout the fiscal year and not after it, as had been the case. In a way, the pay-as-you-earn (PAYE) method of tax collection was enforced on various categories of income without giving due consideration to the periodicity of earnings. The monthly installment is based on an annual estimate which is equivalent to the total tax paid for the previous year. The practice is objectionable not only on legal grounds but also from an economic point of view as it impinges on the limited resources available to businesses for investment and/or as working capital. The advance payment of the tax is also practised in Israel itself, where the balance of the tax due is indexed to the cost of living. In the West Bank, however, the balance is indexed to the average exchange rate of the Israeli shekel to the Jordanian dinar. Israeli military orders have cancelled income tax appeal courts dealing with tax matters, thus revoking judicial consideration of appeals, and confined appeals to an administrative/military committee without juridical competence. 74/ A similar practice is followed in respect of the appointment of "assessment officers". 75/

70. Another serious Israeli practice involving the tax system of the territories is the treatment of Israeli settlers and their juridical entities based in the occupied territories. In principle, under the generally accepted norms of tax laws, the income of aliens, including Israelis residing in the territories, is considered taxable under the law of the territories, because such income is "derived, received or obtained" in these territories' and not in Israel. 76/ In practice, however, no taxes based on the territories laws were collected from Israeli citizens living in these territories. Companies and associations that were registered in Israel but operated in the territories paid their taxes directly in Israel while those registered in the territories paid no income tax at all. In 1978, the Israeli Knesset changed the Israeli Income Tax Ordinance, stating that the income of an Israeli citizen which was produced, obtained or received in the territories will be regarded as income produced, obtained or received in Israel. The objective of this amendment was to prevent the territories from becoming a tax haven for Israeli citizens by not paying any taxes. 77/

71. While the move has not ended the legal application of the territories' tax law, in practice it has prevented the territories from collecting the taxes due to them, notwithstanding the illegality of the presence of Israeli citizens and juridical entities in these territories. The changes introduced stipulate that if an Israeli citizen living in the territories paid taxes to the taxation authorities in the territories, this would entitle exemption from the Israeli tax up to the amount of tax that had already been paid, in order

to avoid double taxation. 78/ However, no separate tax is paid to the territories to begin with which would justify such treatment under the Israeli tax system.

72. Customs duties imposed on Palestinian imports from abroad are the same as those applied to imports of Israel. The actual range of tariffs is difficult to identify as they are contained in the final prices of imported goods. Constant changes in these duties, not only due to inflation but also to economic policy, add to the difficulty of assessing the exact amount of duty imposed and to the uncertainty that confronts importers. An accepted approach relies on the fact that customs duties were levied at 100-150 per cent on consumer goods and around 40 per cent on non-consumer goods in 1981. 79/ In addition, the purchaser has to pay the 15 per cent value added tax on transactions with the importers. While there may be an economic justification for such duties to be applied on imports into Israel, the same cannot hold for the occupied territories. Israeli customs duties may be aimed at protecting some domestic Israeli industries in which the occupied territories may have no interest. As such, the payment of these duties by importers in the territories is not only a participation in protecting Israeli economic interests but is also a contribution to Israeli Government revenues.

73. A range of other taxes and sources of government revenue are in force in the territories, many of which have been either newly introduced or their rates increased since 1967. These include items such as property tax, excises imposed on local industrial products, education tax, land tax, social services' tax, fees for notary and for power of attorney, special taxes on pharmacies and private medical practioners, fees on permits for crossing the bridges on the Jordan River, "fines" or "penalities" for security and other offences, pension contributions, and social security deductions.

74. The Israeli authorities instituted, in August 1976, a tax on all goods and services in Israel. The tax, referred to as Value Added Tax (VAT), was imposed at a flat rate of 8 per cent. The authorities subsequently provided that the tax should also apply to transactions carried out in the territories by Israeli citizens. 80/ The purpose was three-fold: not to create a tax haven for Israelis in the territories; to raise Israeli Government revenues; and to further integrate into the Israeli economy the economic activities of Israelis living in the territories. In Israel, the imposition of VAT was aimed, *inter alia*, at balancing the loss of government revenue due to the reduction of other taxes, notably income tax.

75. The value added tax was also introduced at the same rate of 8 per cent in the West Bank under Bylaw No. 31 of 1976 without announcing its imposition as a new tax. It was related to Jordanian Law No. 16 of 1963. As such, a new piece of legislation was super-imposed on the existing law. The rate of the tax was subsequently raised to 12 per cent in 1977. By 1982, a further increase of 3 per cent was effected, raising the tax to 15 per cent payable by all businesses and entities except crop farming enterprises. The tax is also applied on transactions that cover imports reaching the territories through Israel. The increase of the tax in 1982, both in Israel and the territories, was aimed at financing the Israeli invasion of Lebanon. 81/

76. The tax burden of Palestinians, both individuals and juridical entities, has thus been continuously increased against a comparatively low and declining level of income. Additionally, many small businesses have been confronted

with penalties allegedly for lack of adequate records and non-payment of this and other taxes. 82/ On the whole, VAT has evolved over the past few years to become one of the most serious fiscal constraints to the development of Palestinian industry and trade.

(b) The tax system and economic activities

77. In the mid-1950s Jordan, along with other developing countries, introduced laws and regulations which provided incentives to the private sector for investment in industrial, tourist and transport projects. Income from agricultural activities was and still is exempt from tax. None of the old or new investment related incentives are applied in the territories, although the relevant laws are theoretically still in force. On the contrary, as noted, a number of tax provisions have been amended and administrative procedures instituted to the disadvantage of entrepreneurs. As a result, new enterprises find it very difficult to float themselves during their initial stages of operations as they are seized with fiscal and monetary obligations.

78. The tax system in the territories is, therefore, used in its traditional role as the supplier of revenues to the Government. As such, its role in influencing entrepreneurial decisions on the allocation of resources leaves much to be desired. The treatment accorded to Israeli settlers in the territories provides a striking contrast. Some of the financial incentives extended to Israeli businesses in some areas of the territories are indicative of the inequality in treatment. Settlers' businesses enjoy, inter alia, the following incentives: (a) an "investment grant" equal to 30 per cent of the enterprises' total investment in fixed assets; (b) a "concessionary loan" equal to 40 per cent of the total investment of fixed assets; (c) exemption from income tax for the first seven years on retained earnings; (d) a ceiling of 30 per cent on corporation taxes; (e) taxes on dividends to foreign investors limited to 10.5 per cent; (f) waiving of "employers' tax" for five years; (g) a number of import and export benefits once the business passes the start-up phase. In addition, aid for research-and-development may amount to as high as 54 per cent of the business's R and D outlays. 83/

C. External financial resources

79. Three distinct but interrelated phenomona are indicative of the territories' growing dependence on external sources of finance: factor income from Palestinians working in Israel; factor income of short-term emigrants working in Jordan and elsewhere; and, private and official unrequited transfers from abroad, including permanent migrants' remittances. Given the nature of interaction of the territories' economy with those of neighbouring countries, whereby the territories do not have the authority to regulate the flows of trade and services, such a dependency is not surprising. In fact, it may be argued that only through maintaining these external linkages have the territories been able to counter restrictions on the economy at the local level and withstand the challenges posed within the context of relations with the Israeli economy and the influences exerted by the Arab economic environment over the past decade.

80. In 1983, when GDP in the occupied territories had reached its highest point, 36 per cent of the territories' net national disposable income originated in factor income and transfers, also equivalent to 57 per cent of GDP. 84/ Not only is the economy increasingly dependent on external sources

of finance, but this appears to be largely in the direction of those originating in Israel. Indeed, were it not for the continued flow of transfers to the territories from Arab and international sources, the degree of dependency on that exclusive source of income would be even greater.

1. Factor income

81. Factor income from work in Israel, which became significant as of 1970, results from the daily movement of Palestinian labour into Israel for employment. Whereas 12 per cent of the territories' labour force was employed in Israel in 1970, the proportion had reached 37 per cent by 1984. 85/ The locally employed labour force in 1984 was still smaller than its 1970 level. 86/ Meanwhile, since the mid-1970s another phenomenon has gained momentum in response to the lack of local job opportunities and the attractions of lucrative employment in the oil-producing Arab States. These two factors pushed an increasing number of West Bank and Gaza Strip residents to emigrate and seek work abroad. In some cases, these migrants remained abroad, so that their remitted income is treated as "transfers", while in other cases, Palestinians have maintained residency in the territories, generating "factor income" from work in Jordan or elsewhere for a certain period each year. In addition to factor income from wages of Palestinians employed (but not resident) in Israel, Jordan, other Arab States, and the rest of the world, there are other factor income payments accruing from abroad (i.e., rent, profits, and interest). 87/

82. Factor income from Israel grew steadily from 1978 to 1984, by more than 110 per cent, or at an average rate of 18 per cent per annum. 88/ It peaked in 1983, an especially prosperous year for the Israeli economy. Factor income from the rest of the world has also grown, but at a smaller rate of 75 per cent during the period 1978-1984, or some 15 per cent per annum. Thus, according to official Israeli statistics, the major component of factor income payments to the territories is that gained through employment in Israel. This component of factor income has accounted for at least 75 per cent of total factor income payments to the territories in every year since 1978. 89/

83. Factor income payments by the territories exhibit a relative stability, growing only slowly and maintaining a generally low level until 1984. This underscores the fact that, despite dependence on external financial sources, the territories provide less attraction to external financial interests or labour for productive or profitable deployment. The level of net factor income payments to the territories has, as a result, doubled between 1978 and 1984. 90/ In 1983, the significant expansion experienced in the Israeli economy helped to generate a record high of $550 million net factor income.

84. In 1968, when a relationship had not yet been clearly defined between the Palestinian economy and those of Israel and Arab countries, factor income from abroad represented less than 3 per cent of GNP. 91/ Factor income accounted for 25 per cent of GNP in 1978, peaked at 33 per cent in 1983, and fell to 30 per cent in 1984. This trend helps to illustrate the interplay of weak domestic economic growth and external financial dependence. While the economy has been unable to develop domestic sources of finance and domestic economic growth witnessed annual fluctuations, factor income has steadily grown, thus acquiring an increasingly significant role in the overall financing of the Palestinian economy.

2. Financial transfers

(a) Net transfers to the occupied territories

85. The other major component of external financial resources available to the territories, represented by unrequited transfers, has become increasingly prominent over recent years. There are three major sources for transfers to the territories. The first involves flows from Israeli and Jordanian government institutions to individuals or institutions in the territories, including Israeli military government transfers to local authorities or to individuals. The second major source of transfers to the territories is from Palestinians who have emigrated from the territories since 1967, but who still support family members in the territories, also referred to as remittances. The third component of transfers to the territories, namely official aid, can be broken down according to its two main sources, Arab and non-Arab international aid. The bulk of transfers from the territories has increasingly been destined for Israel, in the form of taxes and transfers to central Government. There is no evidence of significant other transfers out of the territories to Jordan or elsewere.

86. Net transfers to the territories increased until 1981, after which they began to fall, reaching in 1984 a level below that of 1979. 92/ One component, namely transfers to private persons in the territories 93/ grew gradually from 1978 to 1982, only to decline in following years. Transfers to private persons have accounted for well over half of all transfer payments credited to the territories since 1979. They remain the largest component of transfer payments to the territories.

(b) Components of transfers

(i) Transfers between the occupied territories and Government

87. While the benefits accruing to the territories through their relation with the Israeli economy may be apparent in terms of job and income opportunities the costs are not so easily perceived. One way to measure costs is through looking at the scale of financial resources transferred by the territories to Government in the form of indirect production, value added and income taxes and other such transfers. Transfers and subsidies from Government almost doubled between 1978 and 1984, while the share of Government transfers in total transfer payments to the territories also increased, from 7 per cent in 1978 to some 11 per cent in 1984. 94/

88. Transfers from the territories in the form of income, production and value added taxes, and other transfers (duties, fees, fines, etc), trebled between 1978 and 1984. Of the total tax bill of 1983 and 1984, local government revenue constituted under 7 per cent of the total tax transfers by the territories in those two years. 95/ The balance of transfers to "government" is therefore destined for the Israeli central tax authorities.

89. The scale and significance of the transfer of Palestinian financial resources to Israeli authorities can be seen in relation to a number of indicators, including GNP. The proportion of GNP transferred to Government through taxation alone has doubled, from 6 per cent in 1978 to 12 per cent in 1984, with the increase most noticeable since 1982. The amount of tax thus transferred to Israeli authorities in 1984 ($170 million) was equivalent to

46 per cent of the gross factor income from employment in Israel, 16 per cent of GDP and 11 per cent of GNP, more than double of all private transfers received from abroad, and some $7 million more than the $165 million total of transfer payments credited to the territories.

(ii) Migrants' remittances

90. In view of the demographic patterns of migration and Israeli restrictions on "reunification" of migrant and resident members of Palestinian families, it can be assumed that, at most, half of the total permanent migrant labour force maintains regular links with the territories and transfers remittances to the territories (i.e., some 76,000 persons from a migrant labour force estimated at about 152,000 in 1984). 96/

91. No official Israeli data exist on the scale of permanent migrants' remittances actually transferred to the territories. However, one alternative method of calculation uses official Jordanian data for transfer payments by emigrant Jordanian (West and East Bank) workers, an estimate of the total size of the West Bank migrant labour force and the proportion of their transfers to Jordan that reach the territories. 97/ Accordingly, the amounts of transfers to the territories from West Bank migrants alone are well above the total for transfer payments to the territories from all sources provided in Israeli statistics. The significance of this alternative source of information does not arise from the degree to which the figures are precise. Rather, the presentation of such alternative data series exhibits the extent to which official Israeli estimations of transfers from abroad underestimate the weight of migrants' remittances in supporting the territories' inhabitants. 98/

(iii) International aid

92. A third type of transfer is constituted by official aid from a variety of Palestinian, Arab and non-Arab international private and official sources. These transfers, which became increasingly substantial in recent years, have perhaps the most important role in promoting economic activities in the territories. Being an expression of a humanitarian and political will and commitment to assist the Palestinian people, they are less subject to changes in local or regional economic fortunes than are factor income and remittances. They are the only source of external finance the size and deployment of which can be actively influenced by non-economic factors, such as donors' and recipients' outlooks.

93. The longest existing form of aid 99/ is that received by the West Bank from the Jordanian Government since 1967 to cover a variety of government and welfare services obligations established prior to 1967. This is complemented by aid provided by Jordanian welfare and charitable societies. A further source comprises aid from Arab and Islamic States, and from Arab regional development funds and banks which fund specific projects in the territories.

94. Since 1979, the Jordanian Palestinian Joint Committee for the Support of the Steadfastness of the Palestinian People in the Occupied Homeland has been the major channel of Arab aid to the territories. 100/ The Joint Committee was meant to receive from the major Arab oil-producing States 101/ an annual budget of $150 million for a 10-year period commencing in 1979. Between 1979 and 1985, however, the total receipts of the Committee from these sources had amounted to just under $400 million as against an expected amount of over

$1 billion. 102/ The Committee's funding of activities in the field was carried out either directly or, more often, through Jordanian financial institutions entrusted with managing the Committee's funding in the territories within their particular fields of competence. 103/

95. Since 1979, the bulk of Arab transfers to the territories was allocated by the Joint Committee, though annual disbursements have fallen over the years. In the 1979-1985 period, the Joint Committee allocated approximately $462 million for projects in the occupied territories, of which only some $410 million was actually disbursed, owing to the unfulfilled committments of donor States. 104/ The share of official Arab transfers channelled into the territories by the Joint Committee had risen from 60 per cent in 1979 to 80 per cent in 1983. By 1984, its share had fallen to just over 50 per cent.

96. There are two major categories of international sources of finance operating in the territories: international agencies (United Nations) and private voluntary organizations (PVOs). The United Nations has been involved in providing relief and welfare services to Palestinian refugees since 1949, through the United Nations Relief and Works Agency for Near East Refugees (UNRWA). Aid from UNRWA and some PVOs is rooted in humanitarian concerns regarding certain basic needs of Palestinians (primary education, health care, material support for hardship cases) that are insufficiently catered for by the Government. UNRWA's expenditures in the areas constitute the bulk of international transfers to the territories. In almost every year between 1978 and 1984, UNRWA transfers have accounted for more than 80 per cent of all international aid to the territories. 105/

97. More recently, the United Nations Development Programme (UNDP) has stepped up its commitment to infrastructural, social welfare and productive development projects in the territories. It implemented a programme including 23 projects between 1980 and 1986 and totalling some $9.5 million in resources (i.e. an average annual figure of under $1.4 million) while an indicative planning figure of $17 million was set for total programme expenditure for the five year 1987-1991 period (i.e. an average annual figure of almost $3.5 million). 106/ Other United Nations agencies have also been involved in the provision of aid to the territories, either directly or in collaboration with UNDP. 107/

98. International PVOs have become increasingly active in project funding in the territories in recent years, disbursing both official aid and private contributions. The European Economic Community (EEC) is another factor in international financing of development efforts in the territories, working directly or through European PVOs to fund projects. Like UNDP, much of PVO funding is aimed at meeting some of the long-neglected immediate developmental requirements. The emphasis is on agricultural and small industrial projects, community development and various self-help schemes, job-creation projects and women's advancement programmes as well as certain larger infrastructural requirements. 108/

99. The pattern of allocation of aid is biased in favour of social development and welfare services. This is to be expected in the case of UNRWA, for example, which disburses most of its expenditures on education and health. The pattern of expenditure of the Joint Committee was more diversified, given its wider range of commitments and aims. Educational institutions (universities, post secondary colleges and vocational training,

primary and pre-school education) received the largest share of Joint Committee funding. Health services (hospitals and related large-scale projects) received the second largest share of the Committee's funding. The third largest sectoral allocations, in equal shares, were: (i) support for municipalities' services, roads and transport; (ii) social welfare needs and religious institutions; and (iii) aid to housing co-operatives and home building. The remainder went to agricultural projects and co-operatives, village electrification projects, aid to small industries and workshops, public health, land purchase and other activities.

100. The largest share of PVO funding until 1983 went to drinking water and sewage projects and agricultural development projects, including irrigation. Social welfare and education also received PVO support. Industry, however, has not benefited greatly from either PVO or UNDP funding. Infrastructural needs - specifically sewage projects - and educational programmes received, after health projects, the second largest shares of UNDP funding in the period under review. The unique position of UNDP and its favourable relations with the parties concerned has allowed it to take the initiative in this sector. UNDP funding has also been directed to agricultural projects, both for training and for improved productivity.

101. An important factor which affects the eventual pattern of disbursement are the policy guidelines laid down by the Israeli authorities. It has been argued that the procedure whereby some agencies submit proposals to the authorities results in some proposals on production or economic development being turned down, while infrastructual and social service projects are approved. 109/ However, there are indications that such factors are becoming less influential, as the authorities appear to have developed more flexible guidelines in this regard. 110/ On the whole, while locally perceived and expressed priorities have an initial effect in determining the pattern of deployment of international transfers to the territories, the final outcome can be altered by factors such as donors' preferences, operational and technical considerations, and the policies of the Israeli authorities.

102. Most agencies operating in this sphere had not, at least until very recently, included loan programmes as a suitable or feasible tool for delivery of aid, and relied primarily on direct grants. Local participation in finance was encouraged through tying external grants to local counterpart funds. 111/ Almost all of the aid provided until 1983 by PVOs was in grant form, as was the case with aid from United Nations agencies. Non-concessionary finance as loans appears to have become increasingly favoured by PVOs in recent years, with more of them initiating revolving fund or other loan arrangements, 112/ working when possible through local Palestinian credit institutions.

103. Loan programmes have been an essential element of the aid provided to the territories by the Joint Committee. Since its inception, the Committee was able to offer a significant proportion of its total aid to the territories in the form of loans because of the involvement of Jordanian banking institutions in the Committee's grants and loan procedures. When loans could not be channelled through the existing Jordanian financial institutions, the Committee itself became a source of direct loans for projects such as village electrification, loans to agricultural firms, and Gaza Strip municipality housing projects. This initial experience has provided a sound basis on which

to build more effective programmes of aid, closely monitored and managed by recipients and donors in the interest of the long-term development of the occupied Palestinian territories.

D. Conclusions and Recommendations

104. In general, the economy of the territories is, at present, characterized by a high degree of fragmentation reflecting an increasing distortion in the structure of output and income, a widening gap between domestic and national output, and a high degree of openness. The problem is further compounded by the absence of indigenous institutions capable of dealing with the adverse effects of policies under occupation for the past twenty years. Bold efforts are needed to reverse this state of affairs through a conscious strategy aimed at developing the economy of the territories. The policy orientation of the measures required ought to be guided by a set of objectives that reflect the aspirations of the Palestinian people, bearing in mind the resource endowments of the economy, and its present distorted structure. The following basic objectives and policy considerations could serve as a frame of reference for designing appropriate policy measures required in each area of economic and social endeavour:

(a) Accelerate the growth of the domestic economy at a rate sufficient to sustain natural increases in population and to bring about improvements in the level of per capita income;

(b) Increase productivity in the neglected areas of agriculture and industry and expand the output of essential goods by promoting import substitution industries based on local raw materials, and by diversifying exports through expansion in trade relations;

(c) Stabilize the general price level and reduce the prices of essential commodities;

(d) Create productive employment opportunities throughout the territories to absorb both natural increases in the labour force and migrant Palestinian workers employed in Israel and the rest of the world;

(e) Accelerate the rate of development expenditures with a view to creating the basic infrastructural facilities that provide external benefits to the economy, and increasing the absorptive capacity of the territories for further productive investment;

(f) Provide appropriate incentives to encourage local and foreign investors in productive sectors;

(g) Gear monetary and fiscal policies to the short-term and long-term requirements of sustained economic growth and stability;

(h) Establish and strengthen appropriate financial institutions aimed at mobilizing, allocating, and managing domestic resources in line with the needs of the economy;

(i) Establish the requisite institutional capabilities within the public administration of the territories for the effective formulation and implementation of economic and social policy measures;

(j) Promote, above all, the entrepreneural spirit which has served as the basis for economic endeavour and achievements in the territories.

105. Undoubtedly, the realization of these objectives would be dependent upon institutions capable of handling the crucial interplay of various economic and social policy instruments. Obviously, such institutions are lacking in the territories and the issues involved are dealt with by facilities operated by, or under the direction of, the occupation authorities.

106. The financial sector, serving as the main auxiliary force in the economy, is expected to contribute to the realization of some of the objectives outlined above. The actual role it has played in this process during the last twenty years has been marginal. The institutional and policy shortcomings in this area are striking not so much because of their undeveloped nature as because of the deterioration that this sector has experienced since the occupation of the territories. Indigenous banks and financial institutions were replaced by branches of Israeli banks with the majority located in major Israeli settlements. Israeli currency was declared legal tender, to be subsequently joined by the Jordanian dinar which was allowed to circulate in the West Bank. Businesses operating in vital economic sectors have been obliged to confine their needs to limited personal savings and/or resort to the informal financial market characterized by high interest rates and difficult guarantee requirements. The situation has been particularly serious in rural areas where the cost and conditions of finance, even for seasonal credit, are far beyond the means of the average inhabitant.

107. Efforts made to redress the situation have not met with success. The absence of an indigenous banking system, coupled with the dual, if not triple, currency standard, and the growing credit needs of the economy have prompted local informal facilities to emerge and fill the gap. The role of moneychangers has been significant in this respect, though they have not been able to fill the crucial gap in financial intermediation. Renewed efforts are needed to replace the very fragile, vulnerable and ad hoc arrangements by appropriate financial institutions suited to the dire needs of the economy in the areas outlined above.

108. Attempts made to re-open local banks in the Gaza Strip resulted only in the re-opening of the Bank of Palestine in 1981, coinciding with the worsening economic situation in the Strip. However, owing to numerous restrictions imposed on its operations, the Bank has had only a marginal impact on the financial and credit conditions in the Strip. A re-examination of the constraints which have stifled the operation and role of this Bank is urgently called for. This is particularly needed at this crucial juncture as the Gazan economy is experiencing the most severe recession in 20 years of occupation. In the West Bank, efforts to re-open local banks since their closure in 1967 finally resulted in the re-opening of a branch of the Cairo-Amman Bank in 1986. While this signals a move in the right direction, much of the success expected will depend on the manner in which the branch is treated in terms of its resource base, nature and scope of its operations.

109. To begin with, the resources of the newly-opened branch need to be augmented through external contributions until it has succeeded in mobilizing adequate domestic savings. The Central Bank of Jordan may be able to serve not only as a repository of reserves but also as a promoter and the lender of last resort in order to help the branch take calculated risks. The branch could also be allowed to open its other branches elsewhere in the territories to mobilize the savings of inhabitants over a wider area, and thus carry out financial intermediation and provide credit to the urgent priority areas of the economy, especially agriculture, industry and housing. It is also vital for the newly opened branch to establish links with existing formal and informal entities such as co-operatives, insurance companies, moneylenders and the large number of professional institutions in order to mobilize greater savings.

110. The branch may also be allowed to operate with a flexible range of interest rates aimed at raising real rates of interest above the level of inflation to influence the choice between alternative uses of private savings. This could be further accompanied by fiscal incentives. The branch could also be allowed to adopt a system of differential rates of interest for various types of credit to desired areas. A complementary tax policy could further strengthen the effectiveness of such measures. In an effort to develop an entrepreneural outlook for autonomous investments, it may be necessary to accept a longer gestation period for the effectiveness of these and other incentive measures.

111. General government budgets, both of Israel and local Palestinian authorities, serve as the fiscal determinant affecting the level of income and demand, providing basic services, influencing economic activities and promoting growth and development. However, the limited size of government budget has rendered the role of fiscal policy marginal with respect to the level of income and demand, basic services and economic activities. The overall level of government revenues and expenditures reflects a neutral budget approach in the territories. The lack of a policy favouring and encouraging private investment in productive sectors has prompted the private sector's contribution to gross capital formation to be concentrated in housing and construction works.

112. The only area where an interventionist government budgetary policy has been pursued is in taxation. In addition to changing the structure and rates of existing taxes, new taxes have been imposed intended not so much to stimulate economic activity or to satisfy equity and stabilization considerations, as to increase government revenues. In the present recessionary situation, there is hardly any merit in either retaining, or adding to, the distortions that affect the incentives to work, save and invest.

113. The most striking change in the income tax law is the replacement of collection procedures and courts of appeal by military orders introducing inequitable assessment, collection and appeal procedures. All these have eroded public confidence in the purpose and objectivity of the income tax system. The involvement of the public, through their legitimate institutions and interest groups, in all these areas is considered a major factor in the effectiveness of any tax system. The application of this important concept leaves much to be desired in the territories.

114. One area which deserves serious consideration concerns tax assessment of artisans and traders who are either unable or unwilling to keep books. An objective and realistic approach could rely on such factors as capital, volume of business, type of trade, the normal level of profit, location and other pertinent issues. These can be determined in consultation with local authorities, chambers of commerce, taxpayers' professional associations, as well as tax experts. It is equally necessary to consider establishing standardized systems of accounts with adequate and clear instructions coupled with appropriate training on the methods and techniques involved. Obviously, the success of all such efforts would depend on the conviction of the taxpayers that the tax laws and procedures applicable are those that prevailed in the territories prior to 1967 and that revenues from all taxes are clearly and adequately reported and spent on expressed needs of the territories.

115. As for resource allocation, the role of the tax system in influencing entrepreneurial decisions has been nil. No investment-related incentives are at work in the territories, although the relevant Jordanian and Egyptian laws are theoretically still in force. On the contrary, the amendments of existing taxes and the imposition of new ones have served to discourage entrepreneurs. As in the area of monetary policy, fiscal incentives can go a long way in supporting the local economy towards the realization of a number of the objectives outlined earlier. In fact, a combination of monetary and fiscal incentives based on the prevailing laws of the territories could encourage productive investments. The tax system by itself can play a significant role in this process. The benefits accruing from tax incentives will not only induce investments by increasing the rate of return but will also serve to diversify business geographically throughout the territories. In view of high tax rates and limited allowances, the benefit of any tax incentive offered to both individuals and juridical Palestinian entities will be high. Efforts could concentrate on promoting the corporate type of business enterprise. The corporate tax rate could be lowered and applied also on the profits of limited liability companies as well as other forms of economic enterprises and/or organizations. In the absence of an adequate banking system, and capital market, such a move could, at least, promote self-financing to a certain extent.

116. The shortcomings of the tax system briefly outlined necessitate envisioning its overall reform within an integrated and co-ordinated set of policy measures guided by short and long-term economic and social objectives in the territories. Such an approach is more likely to bring the conceptual and structural aspects of taxation into line with the requirements of a dynamic fiscal system aimed at bolstering the process of economic and social change and development in the territories. The assistance of the international community in the improvement of all the areas outlined could be appropriately solicited.

117. The growing inadequacy of domestic sources of finance, both public and private, has forced the inhabitants of the territories to rely increasingly on external financial support for subsistence and accumulation of capital. As with the increasing remittances of workers in Israel, the economic interaction which has developed between the territories and the Arab countries in goods and labour services has enabled the former to counter the range of restrictions imposed on the local economy. However, any possible positive aspect of such external flows into the territories must be seriously examined in terms of the capacity it creates within the local economy to generate, over time, the impetus for sustained growth and development.

118. Lack of appropriate policies and measures has caused much of the income from migrant labour to be absorbed in high-level consumption, housing and construction works. The lack of indigenous financial institutions has restricted the deployment of such income into productive investments. Not only have incentives for productive investments been lacking but restrictions have reduced the actual size of funds allowed into territories. These restrictions have only recently been relaxed - at a time when the level of economic activity, especially in the labour-importing Arab oil-producing countries, is at its lowest.

119. The entire issue of migrant labour and its income is in need of serious consideration in view of the deteriorating economic situation in the territories. Some of the incentive schemes designed along the guidelines indicated for the revival of the Palestinian economy could serve as a useful frame of reference for efforts aimed at enhancing the contribution of this source of income to economic growth and development. Another major external source of finance, i.e. private and official transfers, has also become increasingly important in recent years. It has, in fact, reduced the total reliance on the remittances of Palestinian workers in Israel and elsewhere.

120. The different sources of Arab and non-Arab international support have increasingly served as a substantial source of finance to the territories. However, given the present status of the territories, the size and deployment of such resources will continue to be influenced by a wide range of factors that lie beyond the control of the territories. These include donors' preferences, operational and technical considerations, as well as policies of the occupation authorities towards the nature and direction of external aid.

121. On the whole, external aid has largely consisted of grants. This has been primarily influenced by lack of institutional finance facilities to assist in making local counterpart funds available as loans, whether at the public or private sector level. It is only recently that direct or revolving fund arrangements for loans have also been considered a suitable tool for the delivery of external aid. An increase in the use of external aid, both as grants and loans, is dependent on the relaxation of procedures for the approval of projects. Equally important is the ability of the territories to formulate and implement viable projects and to create and develop local financial institutions capable of providing local counterpart funds. In all of these areas, the international community can play a constructive role in encouraging and supporting the emergence of the conditions and policies conducive to the free and healthy development of the Palestinian economy.

Notes

1/ Calculated from Israel, Central Bureau of Statistics, Judea, Samaria and Gaza Area Statistics, Vol. XV, No. 1, (Jerusalem, C.B.S., 1985) pp. 168 and 175 respectively, and Israel, Central Bureau of Statistics, Judea, Samaria and Gaza Area Statistics, Vol. XV, No. 2 (Jerusalem, C.B.S., 1985) pp. 72 and 79, respectively.

2/ S. H. Rolf, "The territories: an economic question", The Jerusalem Post, 27 February 1986, p. 10.

3/ For further details, see "Recent economic developments in the occupied Palestinian territories" (TD/B/1102), pp. 5-6.

4/ Calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... op.cit., Vol. XV No. 1, pp. 163-176; and ibid., Vol. XV No. 2, pp. 67-80.

5/ Calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... op.cit., Vol. XV No. 1, pp. 10 and 77 and ibid., Vol. XV No. 2, pp. 166 and 173; and The World Bank, World Development Report 1985, (New York, Oxford University Press, 1985), p. 151.

6/ Based on information derived from Israel, Central Bureau of Statistics, Statistical Abstract of Israel 1975, (Jerusalem, Central Bureau of Statistics, 1975), p. 694; Israel, Central Bureau of Statistics, Statistical Abstract of Israel 1978, (Jerusalem, Central Bureau of Statistics, 1978), p. 774; Israel, Central Bureau of Statistics, Statistical Abstract of Israel, 1985 (Jerusalem, CBS, 1986) pp. 714 and 265.

7/ The market exchange value of the Israeli shekel dropped from 1,000 Jordanian fils per shekel in 1971 to 1.2 fils per shekel in 1984. Field information provided by a leading moneychanging office in Nablus, the West Bank, 1986.

8/ United Nations, Living conditions of the Palestinian people in the occupied territories - Report of the Secretary-General (A/40/373), p. 7.

9/ See M. Benvenisti with Z. Abu-Zayed and D. Rubinstein, The West Bank Handbook: A political lexicon, (Jerusalem, The Jerusalem Post, 1986) p. 3.

10/ S. Roy, The Gaza Strip Survey, (Cambridge, the West Bank Data Base Project and Harvard University Press, 1986) p. 139.

11/ Calculated from M. Benvenisti, A Survey of Israel's Policies, (Jerusalem, West Bank Data Base Project, 1984) p. 13; S. Roy, The Gaza Strip ... op.cit., p. 38; UNCTAD, "Selected statistical tables on the economy of the occupied Palestinian territories, (UNCTAD/ST/SEU/1), table 19.

12/ Figures on value of output can be found in Israel, Central Bureau of Statistics, Statistical Abstract of Israel, 1984 (Jerusalem, CBS, 1984), p. 769; Israel, Central Bureau of Statistics, Statistical Abstract of Israel 1986, (Jerusalem, CBS 1986) p. 713; Israel, Central Bureau of Statistics, Judea, Samaria ... op.cit ,Vol. XV, No. 2, pp. 97-103; Figures on employment are from Israel, Central Bureau of Statistics, Statistical Abstract 1986 ..., op.cit., p. 705.

13/ For more details, see H. Frisch, Stagnation and Frontier Arab and Jewish Industry in the West Bank, (Jerusalem, The West Bank Data Base Project, 1983).

14/ See M. Benvenisti, A Survey of Israeli Policies, op.cit., pp. 15-18.

15/ United Nations , Living conditions of the Palestinian people in the occupied territories - Report of the Secretary-General (A/39/233), p. 27.

16/ M. Benvenisti, 1986 Report : Demographic, economic, legal, social and cultural developments in the West Bank, (Jerusalem, the West Bank Data Base Project, 1986).

17/ Israel, Central Bureau of Statistics, Statistical Abstract 1986, op.cit., p. 696.

18/ Jordanian-Palestinian Joint Committee, Report on the housing project in support of national steadfastness in the occupied territories, 1986, p. 4, (in Arabic).

19/ F. Gharaibeh, The Economies of the West Bank and Gaza Strip, (Boulder, Co: Westview, 1985) p. 97. Also see A. Rabinovich, "Arab villages engage in pre-emptive activity", The Jerusalem Post, 12 December 1986.

20/ United Nations, Living conditions ... (A/39/233), op.cit., pp. 20-21.

21/ E. Balassanian, "Policy recommendations to alleviate the housing problem in the occupied Palestinian territories", Paper presented to the United Nations (HABITAT) Seminar on the Living conditions of the Palestinian people in the occupied territories, March 1985, p. 2.

22/ See e.g., A. Gerson, Israel, The West Bank and International Law, (London, Frank Cass, 1978), p. 116, and United Nations, The Legal Status of the West Bank and Gaza, New York, 1982, pp. 17-20.

23/ M. Benvenisti, et al., "The West Bank Handbook ...", op.cit., pp. 113-121.

24/ United States, Department of State, Country Reports on Human Rights Practices for 1985 (Washington D.C., G.P.O., 1986), p. 1276. Up to 50 more settlements had been targeted for construction by the end of 1986, in United Nations, "Living Conditions ... A/39/233", op.cit., pp. 57-62.

25/ Benvenisti, "1986 Report ..." op.cit., pp. 29 and 34.

26/ B. Ashhab, Al-Fajr, 24 October 1986. See also Jerusalem Post, 1 March 1986.

27/ Al-Fajr, 27 June 1986.

28/ For more information on Israeli settlement policy, see M. Benvenisti, "A survey of Israel's policies", op.cit., pp. 49-69.

29/ The Jerusalem Post, 3 December 1986.

30/ Ha'aretz, 16 January 1986.

31/ New Outlook, January/February 1986, pp. 35-37.

32/ M. Benvenisti, "1986 Report ...", op.cit., pp. 16 and 51.

33/ F. Gharaibeh, "The Economies ...", op.cit., pp. 124-125.

34/ Israel Defence Forces, Notes, Orders and Appointments, Judea and Samaria and Gaza District Areas, Military Orders Nos. 7, 18, 26 and 30 (1967), and No. 705 (1981).

35/ Ibid, Military Orders, Nos. 9 and 21 (1967), 445 (1971), 487 (1972), 640 (1980), 671 (1980), 719 (1981), 767 and 1024 (1982).

36/ Israel Defence Forces, "Notices, Orders ...", op.cit, Military Orders Nos. 13, 34, 41, 76, 83 and 89 (1967), 155 and 179 (1968), 721 (1977), and 823 (1980).

37/ Gharaibeh, "The Economies ...", op.cit. p. 123

38/ A. Mansour, "Monetary Situation: Constraints and Proposals for Possible Remedies", a paper submitted to Habitat Seminar on the living conditions of the Palestinian people in the occupied Palestinian territories, Vienna, 25-29 March 1985.

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40/ Israel Defence Forces, op.cit., Military Orders Nos. 258 (1967) and its subsequent amendments, 163 (1968), 719 (1981) and 1070 (1983). See also Bank of Israel, Foreign Exchange Control, Explanatory Guide, (Jerusalem, Bank of Israel, 1981), chapter III, pp. 19-21 and chapter IV, section (b).

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43/ Calculated from: Israel, Central Bureau of Statistics, Judea, Samaria ... op.cit., Vol. XV, Nos. 1 and 2", op.cit., pp. 164 and 171, and 68 and 75, respectively; R. Meron, "Economic Development ..." op.cit., p. 66; and D. Zakai, "Economic Development ...", op.cit., p. 71.

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47/ Ibid.

48/ L. Harris "Money and Finance in the West Bank and Gaza", (mimeographed report, The Open University, November 1985), pp. 27-28.

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53/ See, J. Dawoud, "The Bank of Palestine ..." op.cit., p.12; Bank of Palestine, Bank of Palestine in Twenty Years, Gaza, 1980, pp. 22-24; and, Bank of Palestine, Report of the Board of Directors of the Bank of Palestine for 1984, (Gaza The Bank, 1985).

54/ L. Harris, "Money and Banking ...", op.cit., pp. 22-23.

55/ M. Arafeh et al., The Cooperative Movement in Jordan, (Amman: Jordan Cooperative Organization, 1977) p. 5 (in Arabic).

56/ L. Harris, op.cit. p. 24.

57/ Ibid., pp. 2-13.

58/ The Jerusalem Post, 19 September 1986. The Value Added Tax (VAT) Department of the Military Authorities recently issued regulations requiring Palestinian moneychangers to submit to the Department daily accounts of their transactions with names and ID card numbers of their customers, AL-FAJR, 14 November 1986, p. 14.

59/ The Jerusalem Post, 19 September 1986.

60/ The Jerusalem Post International Edition, 27 September 1986, p. 5.

61/ AL-FAJR, 10 October 1986, p. 9.

62/ For discussions of the pre-1948 fiscal system of Palestine, see S. B. Himadeh, "Economic Organisation ..." op.cit., p. 507-510; République Française, Ministère des Affaires Economiques, Institut National de la Statistique et des Etudes Economiques, Mémento Economique, La Palestine, (Paris, Presses Universitaires de France, 1948), p. 146-150; Ottensooser, "The Palestine Pound ..." op.cit., p. 70.

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64/ See World Bank, "World Development ...", op.cit., pp. 226-227.

65/ Expenditure figures are calculated from Israel, "Budget ..." op.cit., and tax figures are from Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 2, op.cit., pp. 73-80.

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84/ Net national disposable income figures for 1978-83 calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1, op.cit., pp. 164 and 171; Figures for 1984 calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1 op.cit., pp. 68 and 75.

85/ Calculated from Israel, Central Bureau of Statistics, "Statistical Abstract 1985", op.cit., p. 725.

86/ Ibid.

87/ Data on factor income should be treated with caution - the Israel Central Bureau of Statistics states that the reliability of those items in national accounts which include transactions between residents of the territories and Israel is "especially poor", Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 2, 1985, op.cit., p. 82.

88/ 1978-80 figures from Meron R., "Economic Development, 1970-80 ..." op.cit., p. 8; 1981 and 1982 figures from D. Zakai, Economic Development in Judea; Samaria and the Gaza District, 1981-82, (Jerusalem, Bank of Israel, 1985), p. 59; 1983, 1984 figures from D. Zakai, "Economic Development 1983-84 ..." op.cit., p. 65.

89/ It appears that the official Israeli data underestimate factor income from the rest of the world and overestimate the factor income accruing from labour in Israel. An alternative calculation of net factor income produces a very different result which indicates an overall lower level of net factor income from Israel, at between 50 per cent and 65 per cent of those for Israeli data for the period. These alternative calculations are arrived at using data for average daily net wage, average work days and number of Palestinian workers in Israel, calculated from Israel, Central Bureau of Statistics, Quarterly Statistics of the Administered Territories, Vol. XII (Jerusalem, Central Bureau of Statistics 1982); Royal Scientific Society, "Financial and Banking ...", op.cit., p. 117; Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1, op.cit., p. 114; Israel, Central Bureau of Statistics, Judia, Samaria, ... Vol. XV, No. 2, op.cit., p. 174; Israel, Central Bureau of Statistics, "Statistical Abstract 1985", op.cit., p. 721.

90/ Calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1 op.cit., pp. 164, 167, 171, 174; Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 2, op.cit., pp. 71, 73, 78 and 80.

91/ Calculated from Israel, Central Bureau of Statistics "Statistical Abstract 1985 ...", op.cit., p. 708.

92/ Calculated from Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1, op.cit., pp. 164, 167, 171, 174; Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 2 op.cit., pp. 68, 73, 75, and 80; Israel, Central Bureau of Statistics, "Statistical Abstract ... 1985, op.cit., p. 712; Israel, Central Bureau of Statistics Statistical Abstract of Israel 1984, (Jerusalem, Central Bureau of Statistics 1984); Israel, Central Bureau of Statistics, Statistical Abstract of Israel 1981, (Jerusalem, Central Bureau of Statistics 1981), p. 720.

93/ Not to be confused with remittances. Official series do not provide data for remittances per se, but rather cover all transfers to private persons.

94/ From Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 1, op.cit., pp. 164, 167, 171, 174; Israel, Central Bureau of Statistics, Judea, Samaria ... Vol. XV, No. 2", op.cit., pp. 68, 73, 75, and 80. The overall increase in the share of transfers from government should, however, be seen in light of the gradual decline in total transfer payments to the territories.

95/ Calculated from Israel, Central Bureau of Statistics, "Statistical Abstract 1985 ...", op.cit., pp. 745-746.

96/ Calculated from figures in G. Kosseifi, "The Forced Migration of Palestinians from the West Bank and Gaza Strip, 1967-83", in Population Bulletin of ESCWA, No. 27, December 1985. For different methods of classifying financial flows of migrant labour, see, G. Swamy, International migrant workers' remittances: Issues and Prospects, (Washington D.C., World Bank, 1981).

97/ Here adapting a method originally applied in I. Zaghloul, Transfers of Jordanians and Their Effect on the Israeli Economy, (Amman, Central Bank of Jordan, 1984) p. 11.

98/ Though showing a greater level of remittances than indicated in Israeli data, these estimates are possibly inflated owing to problems in estimating the actual size of the Palestinian migrant labour force, the proportion of remitances to Jordan which they are responsible for, the proportion of remittances subsequently transferred to the territories, and the scale of Gaza Strip migrants' remittances.

99/ One source of aid, namely that of humanitarian and other aid by the Palestine Liberation Organization (P.L.O.) to the territories, is not included in the discussion owing to absence of data.

100/ Established by the Arab States' Summit of 1978, the Joint Committee was intended as a Jordanian-Palestinian channel of Arab aid to the territories, for the purposes of "steadfastness". This is understood as the "preservation of the underpinnings of the existance of the Palestinian people in the occupied homeland and their national identity, in its political, economic, cultural, psychological and ideological aspects", F. Bseiso, "A strategy for supporting national steadfastness in the occupied territories - the scientific and operational context", Samed al Iqtisadi, Vol. 6, No. 49, 1984 (in Arabic).

101/ Iraq, Libyan Arab Jamahiriya, Algeria, Saudi Arabia, United Arab Emirates, Qatar and Kuwait.

102/ According to figures provided by the Joint Committee, Amman, 1986.

103/ For more information on the operation of the Joint Committee, see: (i) F. Bseiso, "A strategy ...", op.cit.; (ii) F. Bseiso, "The occupied homeland between the requirements of the support of steadfastness and the committments of the Arab boycott of Israel" in Shuoun Arabiya, June, 1985, (in Arabic); and (iii) Y. Sayigh, "Towards an enhanced guidance of Arab economic assistance to the West Bank and Gaza Strip", unpublished study prepared for the Arab Fund for Economic and Social Development, AFESD, 1985 (in Arabic).

104/ Figures provided by Joint Committee, Amman, 1986.

105/ Information presented here is based on: data supplied by UNRWA; For data on UNDP: estimated according to data in Governing Council of the UNDP, "Programme Implementation - Special Programmes of Assistance - Assistance to the Palestinian people, Report of the Administrator", (New York, DP/1985/18). For EEC data: estimated according to data provided by the EEC representative office in Amman, 1986. For PVO data, from M. Benvenisti, "U.S. Government ..." op.cit., and from agencies annual reports.

106/ Governing Council of the UNDP, "Programme Implementation - Special Programmes of Assistance - Assistance to the Palestinian people, Report of the Administrator", (New York, DP/1986/22) p. 2 and annex II.

107/ See, United Nations, Assistance to the Palestinian People, (report of the Secretary-General), (E/1987/86).

108/ For discussions on the role of aid agencies in Palestinian development, see, A. Qassem, "Funding sources for development in the occupied territories (Jerusalem, Arab Thought Forum, 1986) (in Arabic); Y. Sayigh, "The Palestinian Economy Under Occupation" Journal of Palestine Studies, No. 60, 1986; G. Abed (ed), Economic Development Under Prolonged Occupation, forthcoming.

109/ Based on an analysis of projects submitted by three United States based PVOs to the Israeli authorities - M. Benvenisti, "U.S. Government ..." op.cit.

110/ The Report of the UNDP Administrator for 1986 states that "... approvals of proposed UNDP projects are being granted by the parties directly concerned at a faster rate than ever before" - UNDP, "Programme Implementation ..." *op.cit.* (DP/1986/22), p. 2

111/ M. Benvenisti, "U.S. Government Funded ..." *op.cit.*, p. 8.

112/ In some recent cases, these are managed by local Palestinian credit institutions, such as the Gaza Bank of Palestine.