

THE IMPACT ON THE PALESTINIAN ECONOMY OF CONFRONTATION, BORDER CLOSURES AND MOBILITY RESTRICTIONS

1 October 2000 - 30 September 2001

This is the fifth in a series of UNSCO reports on the socio-economic impact for Palestinians of confrontation, border closures and mobility restrictions. The report covers the one-year period 1 October 2000 to 30 September 2001. The report is based on data from a wide variety of international and Palestinian sources, both official and non-governmental. Where possible, UNSCO has made the effort to find more than one source on which to base its conclusions. In particular, UNSCO would like to thank the Palestinian Central Bureau of Statistics (PCBS), the World Bank, the International Monetary Fund (IMF), the Israeli Central Bureau of Statistics (ICBS), and the Coordinator of Government Activities in the Territories (COGAT), Israeli Ministry of Defense.

1. INTRODUCTION

Unprecedented levels of confrontation and restrictions on mobility have characterized the current Israeli-Palestinian crisis, which has just passed its first anniversary. In recent days both of these elements of crisis have only increased in intensity, with the imposition of a strict buffer zone along the northern and north-western borders of the West Bank, tightened internal closures, especially in the West Bank, and the Israeli military incursions into various Palestinian towns and villages following the assassination of the former Israeli Minister for Tourism.

Despite numerous calls for a cease-fire, the level and intensity of violent conflict has been more or less unabated throughout the reporting period. As of 30 September 2001, between 700 and 800 persons have lost their lives, between 15,000 and 20,000 have been injured¹ and physical damage in the West Bank and Gaza now totals somewhere around US\$ 150 million.² While confrontation and violence have had a distinct negative impact, it is especially the Israeli closure policies that account for this impact.

Many organizations, including UNSCO, have reported on the economic impact of closure.³ **These reports concur that following a sharp decline at the start of the crisis, the Palestinian economy seems to have stabilized at a lower level of output**

¹ Information from Palestine Red Crescent Society and B'Tselem -The Israeli Information Center for Human Rights in the Occupied Territories.

² UNSCO estimate based on World Bank and official PA estimates.

³ The World Bank, the IMF, the PCBS, PECDAR and others have produced impact reports of one kind or another in the last year.

and employment. However, the most recent data suggests that the coping mechanisms adopted by Palestinians are not sustainable if the crisis continues. So far, the ability of the Palestinian Authority to continue to pay wages to public sector employees – based to a large extent on donor funding - has prevented the total collapse of the Palestinian economy. However, even with continuing public sector employment, a prolonged crisis and further tightening of closure measures will lead to a situation where coping mechanisms will no longer be sufficient to allow the majority of the population to enjoy basic commodities and services.

2. BORDER CLOSURES AND MOBILITY RESTRICTIONS

The policy of closure is being instituted as a security instrument to prevent, or minimize the threat of Palestinian attacks on Israeli security forces or citizens. However, the closure policy has become the single most important factor negatively affecting the Palestinian economy and living conditions. Closure implies varying degrees of movement restrictions on Palestinian people, vehicles and goods: 1) within the West Bank and Gaza; 2) between the West Bank and Gaza and Israel; and 3) at the international crossings between the West Bank and Gaza and the neighboring countries - Jordan and Egypt. Generalized movement restrictions were first imposed in the West Bank and Gaza during the Gulf War in 1991 and in the years since 1993 have become more formalized and pervasive.

2.1. INTERNAL CLOSURE

Internal closure within the West Bank and Gaza implies the establishment of a network of military and settler checkpoints, roadblocks and physical barriers impeding or totally inhibiting travel between villages and towns. While this policy has been a regular feature of the present crisis, a distinction must be made between severe and partial internal closure.

Severe internal closure entails the prohibition on Palestinian use of primary roads and the placement of physical barriers or manned checkpoints on many secondary roads between villages and towns. For Palestinians, travel on days of severe closure requires the use of secondary or tertiary roads resulting in time delays and increased travel costs, higher instances of road accidents, damage to vehicles, and risk and fear of intimidation and harm by military authorities or Israeli settlers at checkpoints.

Under **partial** internal closure, Palestinians are allowed to travel on most secondary roads while only some main roads are accessible, often with restrictions. With partial closure, Palestinian traffic is generally diverted away from Israeli settlements. In the West Bank, for example, the main road linking the northern and central areas has been only partially accessible for the last year, requiring Palestinians to use a circuitous route through the Jordan Valley. In Gaza, the use of main roads by Palestinians has frequently been restricted to certain hours. Portions of the main north-south artery (the Salah ad Din Road) have also sporadically been put under direct Israeli military control. Where north-

south traffic nears the Israeli settlements of Kfar Darom, Kisufim and Gush Qatif, Palestinian vehicles have generally been diverted to the east and west.⁴

In the West Bank, severe internal closure was in place during 240 days (about 66 percent of total days during the reporting period), and in Gaza for 18 days (about 5 percent of total days during the reporting period). Internal closure data for the third quarter of 2001 reveal that the severe tightening of internal closure in the West Bank that started on 2 June 2001 has remained in place. It should be noted that the intensity of ‘severe internal closure’ changes over time. Closure measures usually tighten immediately following Palestinian attacks inside Israel - for instance after suicide bombings. Over time these measures are often relaxed somewhat but almost always stabilize at a level that is more strict than before.

Table 1: Internal Closure percentages (severe and partial) for the West Bank and Gaza

	PERCENTAGE OF DAYS CLOSED				
	Q4-2000	Q1-2001	Q2-2001	Q3-2001	1 Oct 2000 to 30 Sep 2001
Internal Closure					
West Bank – severe	58.7%	70%	34.1%	100%	65.8%
West Bank – partial	41.3%	30%	65.9%	0%	34.2%
Gaza* – severe	12.0%	4.4%	3.3%	0%	4.9%
Gaza – partial	82.6%	95.6%	96.7%	100%	93.7%

* During the first week of the Al-Aqsa Intifada there was no closure at all in Gaza, which explains why the percentages do not add up to 100%.

Partial internal closure was in place in the West Bank during 125 days (34 percent of total days) and in Gaza during 342 days (94 percent of total days). These figures show clearly that internal closure is more severe in the West Bank, where it is used to offset the more porous nature of the border between the West Bank and Israel.

2.2. BORDER CLOSURES WITH ISRAEL

Since 1993, Palestinians have been required to apply for permits from Israeli military authorities in order to enter or transit through Israel or East Jerusalem, including when traveling between the West Bank and Gaza. Since the beginning of October 2000, this regime has been dramatically tightened, with travel permits frequently cancelled or not honoured, and crossings intermittently sealed off completely.

As measured at the Erez/Beit Hanun crossing, the border between Israel and Gaza was closed to Palestinians for 263 days (72 percent of total days). The Erez/Beit Hanun crossing was open on 102 days during the reporting period but even on these days the number of Palestinians crossing into Israel was much lower than before the crisis started

⁴ In its previous updates, UNSCO reported that both travel time and transportation costs in the West Bank and Gaza had more than doubled. While UNSCO has not collected further data on transportation costs and travel time, the results of the recent FAFO study: “Paying a Price: Coping with Closure in Two Palestinian villages” (December 2001) suggest that travel in the West Bank and Gaza remains expensive and time-consuming relative to pre-crisis levels.

as existing permits were cancelled and fewer new permits were issued. While during the second quarter of 2001 (April, May) restrictions at the Erez/Beit Hanun crossing were eased somewhat, the border was effectively closed during the third quarter of 2001, except for a few days at the end of September 2001 when small numbers of Palestinians (ranging from a handful to a few hundred per day) were allowed to cross.

The closure of borders with Israel has also resulted in the effective closure of the “Safe Passage” route, designed to allow Palestinians to move relatively freely between the West Bank and Gaza. After one year in operation - with mixed results - the route was closed by Israeli authorities on 6 October 2000 and has remained so.

Precise data on the number of days during which the borders between Israel and the West Bank were open or closed for Palestinians is more difficult to obtain due to the more porous nature of the border. The best method available is to rely on the number of permits issued and estimates of the number of Palestinian workers crossing into Israel.

Table 2: Border Closures with Israel

	PERCENTAGE OF DAYS CLOSED				
	Q4-2000	Q1-2001	Q2-2001	Q3-2001	1 Oct 2000 to 30 Sep 2001
Border Closures with Israel					
Erez passengers	85.9%	73.3%	36.3%	92.4%	72.1%
Erez commercial	100%	100%	100%	100%	100%
Karni Muntar	22.8%	5.6%	7.7%	5.4%	10.4%
Sufa/Qarara ⁵	100%	83.3%	23.1%	54.3%	64.9%

The number of permits issued to Palestinian workers decreased substantially during the very first weeks of the current crisis and there have been no changes in this situation since then. There was a sharp decline in labour flows from the West Bank to Israel during the first three months of crisis, followed by a slight recovery during the first two quarters of 2001. The partial recovery may be the result of Palestinians learning how to cope with closure and being more willing to cross into Israel illegally despite the risks involved. However, during the third quarter of 2001 there is again a decline in the estimated number of Palestinian workers managing to cross into Israel.⁶

The third quarter decline suggests that closure measures have tightened since June 2001, both in terms of internal closure within the West Bank and along the border between Israel and the West Bank. This finding is supported by the conclusions of a recent study, commissioned by UNSCO, of two Palestinian villages in the West Bank.⁷

⁵ The Sufa/Qarara commercial crossing is closed during weekends. Weekends constitute 26 percent of all days during July, 29 percent during August and 30 percent during September 2001. The figures in the table include weekends as closure days.

⁶ Based on data from: UNSCO Report on the Palestinian Economy, Spring 2001; and PCBS Labour Force Surveys.

⁷ FAFO Paying a Price: Coping with Closure in Two Palestinian Villages (Oslo: December 2001).

The study found that more and more Palestinians who used to work in Israel are now seeking work closer to home or have become unemployed as travel to Israel has become too difficult and/or dangerous.

Third quarter data on the closure of commercial crossings from Gaza into Israel show a mixed picture. Of the three commercial border crossings between Gaza and Israel, the Erez/Beit Hanun crossing was closed at the start of the current crisis and has not been reopened since. However, the Sufa/Qarara crossing, which was completely closed until the end of March 2001, has since been reopened on most business days. As a result we see that the percentage of closure days has dropped from 100 percent at the end of January 2001, to 65 percent at the end of the third quarter of 2001. However, the Sufa/Qarara crossing was once again closed during the last three weeks of September 2001.

The Karni/Muntar crossing has been the only commercial crossing that has been open throughout the reporting period. The Karni/Muntar crossing was open on all days during July and August 2001, but was closed for a number of days in September 2001.

Again, it is more difficult to assess the impact of closure on commercial traffic for the West Bank-Israel border. The more porous nature of that border, as well as the availability of Israeli-registered trucks that can cross in and out of the West Bank without permits, facilitates commercial transactions across the border. On the other hand, the tightening of internal closure in the West Bank undoubtedly had a negative effect on the volume of commercial traffic across the West Bank-Israel border.

2.3. CLOSURE OF INTERNATIONAL CROSSINGS

Both passenger and commercial traffic through international crossings has also been severely hindered during most of the reporting period, reducing the flow of people and goods between the West Bank and Gaza and the rest of the world. However, unlike the situation within the West Bank and along the borders of the West Bank and Gaza with Israel, movement restrictions imposed on Palestinian passengers along the international crossings seem to have eased somewhat during the third quarter of 2001.

Table 3: Closure of International crossings

	PERCENTAGE OF DAYS CLOSED OR PARTIALLY CLOSED				
	Q4-2000	Q1-2001	Q2-2001	Q3-2001	1 Oct 2000 to 30 Sep 2001
Closure of International crossings					
Allenby passengers	18.4%	52.2%	14.3%	7.6%	23.0%
Rafah passengers	39.1%	73.3%	54.9%	16.3%	45.8%
Allenby commercial	44.6%	70.0%	98.9%	100%	78.4%
Rafah commercial	69.6%	74.4%	53.8%	89.1%	71.8%
Gaza International Airport	45.7%	74.4%	100%	100%	80.0%

The Allenby/Karamah bridge between the West Bank and Jordan has been closed to Palestinian passengers for 84 days (23 percent of all days during the reporting period).

During the third quarter of 2001, the bridge was closed for 7 days (about 8 percent of all days in the third quarter).

The Rafah crossing between Gaza and Egypt has been closed or partially closed for 167 days (46 percent of all days during the reporting period). During the third quarter of 2001, the Rafah crossing was closed for only 15 days (or 16 percent of days) although the figures do suggest some tightening of the closure towards the end of the third quarter of 2001. Gaza International Airport was open for the last time in February 2001. Since then it has been closed on all days and remained so during the third quarter of 2001.

The figures for the commercial land crossings at Allenby/Karamah and Rafah suggest almost full closure during the third quarter of 2001. However, here we need to note that Allenby/Karamah was totally closed on only 7 days (7.6 percent of days during the third quarter of 2001) while Rafah was totally closed on 15 days (16.3 percent of days during the third quarter). On most days, both these crossings were partially closed which, in practical terms, means that the number of hours the bridge is open is decreased and inspections are more strict. As a result, on partially closed days, much fewer trucks can pass than was the case before the crisis.

3. IMPACT ON THE PALESTINIAN ECONOMY

3.1. IMPACT ON PRODUCTIVE ACTIVITIES

UNSCO estimates that total income losses to the Palestinian economy during the reporting period (October 2000–September 2001) range between US\$ 2.4 to 3.2 billion. These estimates include only lost income and not other losses related to the destruction of public and private assets or their replacement costs. The estimates are calculated in relation to pre-crisis predictions of economic performance for the year 2000 and do not take into account the economic growth that would have been achieved in 2001 in the absence of crisis.⁸ Moreover, these estimates include East Jerusalem and combine internal losses, incurred due to reduced Palestinian domestic production, and external losses, which refer to wage-income lost by Palestinians no longer employed in the Israeli labor market.⁹

The value of domestic economic losses or internal losses accumulated over the reporting period range between US\$ 1.87 to 2.67 billion. Accordingly, the daily domestic loss

⁸ In the spring of 2000, the IMF and PA Ministry of Finance anticipated year 2000 GDP to reach US\$ 5,338 million.

⁹ The internal losses are reflected in the Gross Domestic Product, while the external losses leads to reduction in net factor income from abroad, and influences thus the Gross National Income (GNI).

average ranges between US\$ 6.0 to 8.6 million per business day. Calculations are based on a ranged estimate method.¹⁰

Table 4: Aggregate Income Losses (Q4 2000 - Q3 2001)

	Q4 2000	Q1 2001	Q2 2001	Q3 2001	Total/ Average
External Impact					
Number of Potential Working Days	68	69	70	70	277
Average Daily Wage in Israel (nominal US\$)	27.27	25.38	25.98	24.94	25.89
Number of Palestinian Workers in Israel	44,000	72,000	74,000	63,000	62,750
Number of Palestinian Workers unable to work in Israel	102,000	74,000	72,000	83,000	83,250
Total Wage Income Loss (million US\$)	189.1	129.6	130.9	144.9	594.5
Internal Impact					
Number of Calendar Days	92	90	91	92	365
Number of Business Days	77	76	78	79	310
GDP Loss (million US\$) (50% Decline in Domestic Economic Activity)	663	654	672	680	2,669
GDP Loss (million US\$) (35% Decline in Domestic Economic Activity)	464	458	470	476	1,868
High Estimate of Aggregate Loss (million US\$)	854	786	808	827	3,263
Low Estimate of Aggregate Loss (million US\$)	654	589	606	622	2,462

Whereas internal losses reflect the total impact of the crisis - including confrontation and acts of violence - it is particularly the imposition of border closures and movement restrictions that are the main causes of domestic production decline.

The disruptions in production and income are accounted for by several phenomena. First, the absence of free movement of people and goods has resulted in a significant contraction in the geographic scope of most Palestinian businesses. According to a recent UNCTAD study, the internal closures have, in effect, divided the West Bank and Gaza into 54 isolated areas.¹¹ In addition, the recent FAFO study of coping mechanisms in two Palestinian villages affected by closures found that businesses that normally marketed their goods mainly in towns nearby, had to either scale down production or close completely. The combination of internal movement restrictions and border closures has disproportionately affected those businesses dependent on external markets such as the tourism sector.¹²

Second, Palestinian productive activity has been hampered by the unavailability of raw materials in local markets. This is especially true for the construction sector. Third,

¹⁰ See the method used in UNSCO "Impact on the Palestinian Economy of Confrontation, Border Closure and Mobility Restrictions, 1 October 2000 - 30 June 2001," July 2001. Also, see Annex 1 of the present report for an explanation of the methodology.

¹¹ UNCTAD Secretariat Report on UNCTAD's Assistance to the Palestinian People (Geneva: August 2001).

¹² FAFO Paying a Price: Coping with Closure in Jericho (Oslo: December 2001).

internal movement restrictions severely hampered the ability of employees to reach their places of employment. The FAFO studies in Jericho, Gaza City and two Palestinian villages give many examples of employees arriving at work hours late or not at all with obvious losses in productivity and output.

Fourth, the fact that closure measures are strict but not always complete means that, in practice, vehicles are forced to take long detours on secondary or tertiary roads. This has resulted in increased transportation costs and a greater probability that goods are damaged during transport.

The combination of these factors increases overall transaction costs. **While transaction costs for Palestinian businesses are already high,¹³ the imposition of the most strict movement restrictions and border closures to date has increased total transaction costs to an unprecedented level.**

Finally, the loss of employment in the West Bank and Gaza and, more importantly, the loss of employment in Israel, Israeli settlements and industrial zones has resulted in a significant decrease in income for households, which in turn has led to a dramatic decrease in demand for locally produced goods and services.

In an effort to quantify the effects of closure, the Center for Private Sector Development - a subsidiary of the Palestinian Businessmen Association - has found that as a direct result of the crisis:

- Sales volumes dropped by 47 percent;
- Estimated profit rates are at only 47% of their pre-crisis levels;
- The productive capacity utilization rate of sampled firms dropped to 50 percent from 86 percent before the crisis;
- Transportation costs increased by 26 percent;
- The cost of primary inputs increased by 26 percent;
- The portion of goods damaged during transport increased by 20 percent; and
- Confidence in the future declined considerably (57% of all sampled firms intends to reduce production, and 12% of firms is expecting a complete shutdown).¹⁴

In addition to domestic losses, Palestinians lost income earned from work in Israeli controlled areas. These losses are estimated with relatively high reliability by using the quarterly results of the labour force survey conducted by the PCBS. The value of lost income-generating opportunities for Palestinian workers in Israeli controlled areas over

¹³ See IMF West Bank and Gaza Economic Performance, Prospects and Policies (Washington DC: 2001) That report notes: “[U]sually the performance of the Palestinian economy is hampered by a complex system of permits and security checks, transportation procedures and fees and considerable uncertainty surrounding their implementation in practice,” p. 62.

¹⁴ See Center for Private Sector Development (CPSD), “The State of the Private Sector,” October 2001 (in Arabic). Survey is based on responses from 518 private firms evenly divided over the industrial, agricultural and services sectors.

the reporting period is estimated at US\$ 594.5 million, an average of US\$ 2.1 million per working day.

3.2. *IMPACT ON TRADE*

The flow of goods and services traded with Israel and the rest of the world has been considerably affected by the ongoing crisis. Based on value-added tax (VAT) clearances presented in Table 8, Palestinian imports from Israel declined by more than 33 percent while exports declined by more than 17 percent in the first half of the year 2001 compared to the same period of 2000.

Table 8: Registered Palestinian-Israeli Non-Agricultural Trade Based on VAT Clearances, First Half 2000 - First Half 2001¹⁵ (in nominal NIS)

MONTH	PALESTINIAN IMPORTS FROM ISRAEL	PALESTINIAN EXPORTS TO ISRAEL
January 2001	433,644,024	249,420,618
February 2001	365,996,071	170,626,359
March 2001	377,579,012	50,211,424
April 2001	438,369,588	216,798,106
May 2001	455,813,118	83,510,829
June 2001	448,661,535	53,982,488
First Half 2001 Total	2,520,063,347	824,549,824
First Half 2000 Total	3,788,824,935	1,001,794,476
First Half 20001 Monthly Average	420,010,558	137,424,971
First Half 2000 Monthly Average	631,470,823	166,965,746
Changes	-33.49%	-17.69%

At the same time, a survey undertaken by the Palestinian Federation of Chambers of Commerce has found that total imports into the West Bank and Gaza has declined by 56.1 percent compared to pre-crisis levels.¹⁶ Especially large declines were observed in the following import categories: capital goods (83.7 percent), vehicles (79 percent), household equipment (63.3 percent), construction materials (52.7 percent) and consumption products (48 percent). Imports from Arab countries decreased by 62.2 percent, from Israel by 44.5 percent and from Europe by 41.5 percent. In addition the survey, indicates an increase of 25 percent in the cost of imports and an increase of 46.1 percent in import time delay.

On the export side, the survey found that during the crisis, total exports from the West Bank and Gaza to Israel and other countries declined by 50.3 percent compared to pre-crisis levels. Palestinian agriculture exports declined by 52.6 percent while industrial exports fell by 49.6 percent. Palestinian exports to Israeli markets declined 51.9 percent

¹⁵ PA Ministry of Finance, Gaza, October 2001.

¹⁶ Palestinian Federation of Chambers of Commerce, "Palestinian External Trade and Israeli Impediments", July 2001 (Arabic). The study, which was conducted during the second quarter of 2001, was based on a survey of 177 private firms with international trade activities.

while exports to Arab countries dropped by 27 percent. Furthermore, time delay to export agricultural products increased by 49.4 percent and by 59.4 percent for manufactured products

The sizable slowdown in international trade activities is directly related to the strict internal closure, impeding the mobility of people and products within the West Bank and Gaza, increased closure of the border with Israel, as well as tightened Israeli security measures at the commercial ports which restrict business hours and the volume of truck shipments. In addition, lower income levels have affected aggregate consumer demand for imported goods as Palestinian consumer spending is increasingly limited to essential products.

One of the trade-related effects of the crisis with longer-term implications concerns the declining competitiveness of Palestinian goods in foreign markets. While restrictive Israeli measures, resulting in increased overall transaction costs and time delays, are increasing the already existing Palestinian competitive disadvantage in the short term,¹⁷ reduced exports are disconnecting Palestinian exporters from their customers abroad. **Loss of exposure to the foreign markets and resources needed to regain such customers may cause greater disadvantages in the long term for Palestinian exporters.**

3.3. IMPACT ON INVESTMENT

The combination of declining economic activity, declining consumer and business demand and increasing political insecurity has induced a collapse of investor confidence. There are convincing indications that this has led to lower investment levels. Already established entrepreneurs have reallocated funds earmarked for investment to maintaining existing operations and few new businesses are started.¹⁸ Moreover, during the reporting period, the US\$ value of market capitalization of companies registered on the Palestinian Stock Exchange (PSE) declined by 34 percent while the Al Quds Index declined by more than 37 percent.¹⁹

Construction activity—the principal form of real investment in the Palestinian economy--as experienced a particularly sharp decline. Available data indicates that newly licensed construction in the West Bank and Gaza dropped by 57.5 percent in the first half of 2001

¹⁷ The Palestinian Chambers of Commerce and the Center for Middle East Competitive Strategy conducted a study on Palestinian transaction costs in 1998. The study concluded that Palestinian businesses seeking to export or import through Israeli ports faced transaction costs that are, on average, 35 percent higher than for an Israeli firm in the same industry. See “The Transaction Costs Study: An Examination of the Costs of International Trade in the West Bank,” August 1998.

¹⁸ As noted in the study by the Center for the Private Sector Development (CPSD), 57 percent of the sampled firms expressed intentions to reduce production, and 12 percent had plans to shutdown completely. Both these prospects will dampen real productive investment. Op cit, CPSD, The State of Private Sector, October 2001.

¹⁹ Palestine Stock Exchange, “Monthly Trading Statistics Bulletin”, September 2001.

relative to the first half of 2000, declining from 2,547,164 to 1,081,616 square meters.²⁰ Other indicators show a similar trend. New company registrations declined to 314 in the first half of the year 2001 in contrast with 1,128 companies registered in the same period of 2000, a decline of 72 percent.²¹ Moreover, over the first three quarters of 2001, the value of outstanding credit extended by the banking system to private businesses declined by 8.4 percent from US\$ 749.57 million in December 2000 to US\$ 686.57 million in September 2001.²²

The decline in private sector investment is accompanied by a serious slowdown in public sector investment as well as donor-funded investment. Declining revenues are forcing the PA to focus spending on salaries of public sector employees, social services such as education and health and some emergency support. Generally, PA data indicates that total public investment fell by approximately 17 percent in 2000 relative to 1999 and a larger fall is anticipated for 2001.²³ Furthermore, the strict closure has caused many donors to seize or postpone the implementation of existing and planned donor-funded projects.

In conclusion, the continued deterioration in the Palestinian business environment, combined with absence of public spending to maintain and expand infrastructure and public services, will create serious disincentives to private investment, hinder capital accumulation, and thus thwart job creation potential in the future. Such a phenomenon undermines living levels in the longer term and raises average poverty rates.

4. IMPACT ON PALESTINIAN FISCAL ACCOUNTS

One year of crisis has had a disastrous effect on the Palestinian fiscal accounts. Over the first nine months of the crisis, revenues declined by 57 percent if compared to the last nine months prior to the crisis. A comparison of budget revenues prior to and after the onset of the crisis indicates severe shortfalls. Monthly average revenues declined 34 percent in the first quarter of the crisis (Q4-2000) relative to the quarter before the crisis (Q3-2000). The revenue shortfall was 71 percent in the second quarter of crisis and 76 percent in the third (refer to Table 6). This sharp progressive decline is due to three factors. The first is the suspension by the Israeli authorities, as of 20 December 2000, of tax clearance transfers. As of end-September 2001, these withholdings had reached

²⁰ UNSCO calculations based on data provided by the Palestinian Engineers Association in Ramallah and Gaza, October 2001.

²¹ Based on data provided by the Companies Controller in the West Bank and Companies Registrar in Gaza, October 2001.

²² Based on data provided by the Palestinian Monetary Authority in Ramallah, November 2001.

²³ World Bank, *One Year of Intifada – The Palestinian Economy in Crisis: A Rapid Assessment*, Al Ram, October 2001 (draft).

approximately US\$ 268 million.²⁴ As these tax clearance transfers usually amounted to approximately 60-65 percent of total PA fiscal revenues (not including foreign assistance), the complete suspension of these transfers has dealt a severe blow to the PA's fiscal accounts.

Table 9: Fiscal Accounts of the Palestinian Authority on a Monthly Average Basis
(US\$ million)²⁵

	Q1- 2000	Q2- 2000	Q3- 2000	Q4- 2000	Q1- 2001	Q2- 2001	Q3- 2001
Domestic revenues	31	30	33	21	26	22	22
Clearance revenues	42	72	55	28	0	0	0
Wage expenditures	47	51	53	55	55	57	57
Non-wage expenditures	35	52	54	50	38	34	33
of which emergency expenditures	n.a.	n.a.	n.a.	23	19	16	n.a.
PA-financed capital expenditures	0	2	1	2	0	0	
Expenditure arrears (net accumulation)	1	1	19	1	31	19	20
External budgetary support	0	0	0	18	26	48	49
Stock of withheld revenue clearance	0	0	0	10	89	178	268
Stock of expenditure arrears	93	n.a.	n.a.	155	250	305	365
Employment (000's)	107	n.a.	113	115	117	119	119

Second, **the contraction of the Palestinian economy, increased unemployment and the accompanying decline in demand is quickly eroding the PA's revenue base.** And finally, tax collection is clearly hampered by the increasingly strict movement restrictions in the West Bank and Gaza.

Increasing amounts of external budgetary support, predominantly from Arab countries and the European Union, has enabled the PA to continue paying the salaries of public sector employees and, despite budget cuts, maintain the operation of basic social services such as health and education.²⁶ In addition, the PA is still able to provide some emergency support to the most vulnerable, although emergency expenditure figures clearly show a downward trend over the last three quarters.

At the municipal level, public finances are increasingly focused on basic utilities while the provision of services (such as garbage collection) and public investment (such as the building of roads) are halted or postponed. While municipalities are experiencing a decline in revenue base, similar to that of the PA at the central level, municipalities do not benefit from foreign budget support and rarely receive budget support from the PA.

²⁴ Information and data provided by the IMF, November 2001.

²⁵ Information and data provided by the IMF, November 2001.

²⁶ The Ministry of Health's operational expenditures were cut by 22 percent in 2001 in comparison to 2000 (from US\$ 3 to 2.3 million per month). See op cit World Bank, "One Year of Intifada."

5. IMPACT ON THE LABOUR MARKET

5.1. LABOUR MARKET INDICATORS

Labour market figures for the West Bank and Gaza indicate that the crisis has produced a drastic decline in employment, reversing the strong trend in employment growth witnessed since 1997.²⁷ The sharp deterioration in labour market conditions in the first three months of the crisis was followed by a marginal improvement in the first half of 2001. However, indicators for the third quarter of 2001 suggest a further worsening of labour market conditions.

Trends in Employment

The outbreak of the crisis in October 2000 led to an immediate and direct loss of some 182,000 jobs, out of an estimated total of 661,000 jobs (Table 7). By early 2001, the situation had stabilized: by the end of the second quarter of 2001, nearly 36,000 (or 20 percent) of the disemployed workers had recovered their employment - bringing down the total number of workers disemployed between the onset of the crisis and mid-2001 to 147,000. However, this marginal rebound in employment was eroded in the third quarter of 2001 - mainly due to the tightening of border closures and mobility restrictions - with the estimated number of employed workers declining by about 9,000. **Stated differently, by the end of the third quarter of 2001, the number of employed persons was 23.5 percent lower relative to the same period in 2000, before the onset of the crisis.**

Table 7: Estimates of Palestinian Disemployment, Q3-2000 to Q3-2001²⁸

	Q3-2000	Q4-2000	Q1-2001	Q2-2001	Q3-2001
Total Palestinian employment					
Number of employed	661,000	479,000	490,000	515,000	506,000
Number of disemployed workers	0	182,000	171,000	148,000	155,000
Domestic Employment					
Number of employed	515,000	435,000	418,000	441,000	443,000
Number of disemployed workers	0	80,000	97,000	74,000	72,000
Employment in ISI					
Number of employed	146,000	44,000	71,000	74,000	63,000
Number of disemployed workers	0	102,000	75,000	72,000	83,000

On average, more than half of the disemployed workers were those employed in Israel, Israeli settlements and industrial zones (ISI). As a direct result of border closures and permit cancellations, **the number of Palestinian workers in ISI declined precipitously**

²⁷ Employment statistics are UNSCO estimates based on the PCBS Labour Force Survey produced quarterly and covering the period from third quarter 2000 to the third quarter 2001. All employment statistics are inclusive of Palestinian workers holding East Jerusalem identification documents.

²⁸ UNSCO estimates based on PCBS Labour Force Surveys. Note that in addition to the direct impact of the crisis, some of the decline may also have been due to seasonality of some types of employment. Thus disemployment stemming from the crisis may be somewhat overstated.

from an estimated 146,000 in the third quarter of 2000 to 44,000 workers in the fourth quarter of 2000, representing a 70 percent decline. By mid-2001, despite the border closures and movement restrictions, the number of workers in ISI had spiked upwards to 74,000 due to an increase in non-permitted labour flows from the West Bank to ISI. In the third quarter of 2001, labour flows to ISI once again dropped to reach an estimated 63,000 persons. Between third quarter 2000 and third quarter 2001, overall Palestinian employment in ISI has declined by some 57 percent.

On a regional basis, the decline in the number of workers in ISIs from West Bank and Gaza was 48 percent and 90 percent respectively.²⁹ Workers from the West Bank –unlike those from Gaza – have been able at times to enter ISI clandestinely, explaining the lower rate of decline.³⁰

In addition to substantially reducing Palestinian labour flows to Israel, **the crisis has disrupted internal economic activity to such an extent that some 72,000 private sector jobs were destroyed during the reporting period.** This represents a 14 percent decline in domestic employment during the reporting period.

The sharpest decline in domestic employment occurred in the first six months of the crisis, mainly due to supply-side constraints facing businesses (restricted access to input and output markets and higher transaction costs) combined with depressed demand. Thus, between the third quarter of 2000 and the first quarter of 2001, the number of persons employed in the domestic economy declined from about 515,000 to 418,000. However, by mid 2001, partly due to donor-funded employment schemes,³¹ domestic employment began to rebound and the number of employed rose to an estimated 443,000 persons.

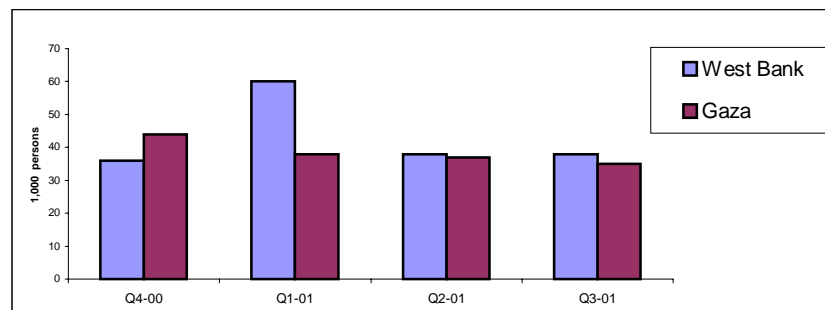
By region the decline over the reporting period in domestic employment was 11 percent in the West Bank and 22 percent in Gaza. Thus, despite a much smaller working-age population in Gaza relative to the West Bank, by mid-2001 the number of jobs destroyed in the domestic economy was nearly equal in the two regions (see Figure 1).

²⁹ In absolute terms, the number of workers from Gaza employed in ISI declined by some 30,000 from the onset of the crisis to about 3,000 workers in the third quarter of 2001. Over the same period, the number of workers from the West Bank employed in ISI declined by about 56,000 to 60,000 workers.

³⁰ Note that non-permitted labour flows from the West Bank workers occurred despite longer - and more difficult - travel conditions and security risks. This indicates a strong dependency of many workers on jobs in ISI.

³¹ On the basis of data received from donor agencies, UNSCO estimates that through donor-funded employment schemes a total of 1,391,668 working days were created in Gaza and 1,697,813 in the West Bank. By dividing these numbers by 310 (the number of working days during the last four quarters), UNSCO estimates that the donor-funded employment schemes have created the equivalent of 4,489 full-time jobs in Gaza and 5,477 such jobs in the West Bank.

Figure 1: Number of Disemployed Workers in the Domestic Economy by Region, Q4-2000 - Q3-2001³²



The dramatic decline in the number of employed signifies that the ratio of the employed to working age population, already low by international standards, declined from 39.5 percent in the third quarter of 2000 to 29.2 percent in the second quarter of 2001. In other words, this means that **by mid-2001, for every employed person, 3.4 persons between the ages of 15 and 64 were without employment.** This also implies a higher dependency ratio.

Standard and Adjusted Unemployment Rates

Disemployed workers either joined the ranks of the unemployed or exited the labour force, presumably due to their belief that under conditions of protracted crisis, no employment could be found. The crisis therefore led to a substantial increase in both the numbers of the **unemployed** (persons seeking but not finding work) and of **discouraged workers** (persons who cease searching for work and who, by definition, are outside the labour force). As such, both the **standard unemployment rate** and the **adjusted unemployment rate**, which accounts for discouraged workers, increased substantially during the reporting period.

In the first three months of the crisis (October - December 2000), some 116,000 workers joined the ranks of the unemployed, bringing the total number of unemployed to 189,000 by end 2000 (Table 8). The standard unemployment rate rose from 10 percent in the third quarter to 28.3 percent in the fourth quarter of 2000. By mid-2001, the unemployment rate declined to 23.7 percent but, by the end of the third quarter, it had risen to 25.3 percent. In absolute terms, by the end of the third quarter of 2001, the estimated number of unemployed reached a total of 172,000 persons. **Thus, more than one year into the crisis, the core unemployment rate in the West Bank and Gaza has more than doubled from about 11 percent to more than 25 percent.**

³² UNSCO estimates based on PCBS Labour Force Surveys. The absolute decline in employment by region is calculated relative to Q3 - 2000. Note that the number of dislocated workers in the West Bank spiked in the second quarter of the crisis (January-March 2001). This was largely due to a reduction in the number of unpaid family workers during this period, which may be explained by the seasonal decline in agricultural employment, rather than the direct impact of the crisis.

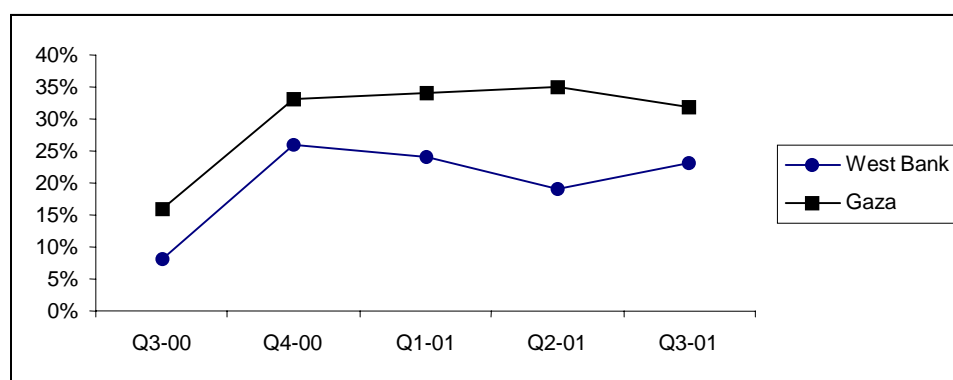
Table 8: Labour Market Indicators in the West Bank and Gaza, Q3-2000 and Q3-2001³³

	Q3-2000	Q4-2000	Q1-2001	Q2-2001	Q3-2001
Labour Force Participation Rate	43.5%	39.2%	38.8%	38.3%	38.3%
Standard Unemployment Rate	10.0%	28.3%	26.9%	23.7%	25.3%
Adjusted Unemployment Rate	20.2%	39.8%	37.8%	35.3%	36.5%
Labour Force	734,000	668,000	669,000	674,000	679,000
Employed	661,000	479,000	489,000	515,000	506,000
Unemployed	73,000	189,000	180,000	160,000	172,000
Discouraged Workers	94,000	127,000	117,000	120,000	120,000
Adjusted Unemployed	167,000	316,000	297,000	280,000	292,000

Using the broader definition of unemployment - which accounts for persons discouraged from seeking employment - the adjusted unemployment rate reached nearly 40 percent by end-2000. The adjusted unemployed numbered some 292,000 persons at the end of the third quarter of 2001, after rising to 316,000 at end-2000.

By region, in continuation of a long-term trend, the unemployment rate remained substantially higher in Gaza relative to the West Bank throughout the crisis period. In the first months of the crisis, the standard unemployment rate increased dramatically in both regions (from 7.5 to 26.3 percent in the West Bank and from 15.5 to 33.5 percent in Gaza).

Figure 2: Standard Unemployment Rate in the West Bank and Gaza, Q3-2000 to Q3-2001³⁴



In the first half of 2001, unemployment continued to rise in Gaza, while it declined slightly in the West Bank (as indicated in Figure 2). Due to these region-specific fluctuations, by mid-2001, the unemployment rate was 16 percentage points higher in

³³ UNSCO estimates based on PCBS Labour Force Surveys for the relevant period.

³⁴ Data are from the relevant PCBS Labour Force Surveys.

Gaza than in the West Bank (35 percent versus 19 percent). By contrast, in the third quarter of 2001, the unemployment rate in Gaza decreased to 32 percent, while it rose to 24 percent in the West Bank, narrowing the gap between the two regions. Accounting for discouraged workers, the adjusted unemployment rate reached 31.5 percent in the West Bank and 48 percent in Gaza in the third quarter of 2001.

Labour Force

The increase in the number of discouraged workers, noted above, has decreased the labour force participation rate to its lowest level since the inception of the labour force surveys in 1995. Between October 2000 and September 2001, the labour force participation rate declined from 48.3 to 38.3 percent. Due to this decline, the size of the labour force was reduced by 7.6 percent over the same period, despite the rapid 4.2 percent growth in working age population. In Gaza, the contraction in the absolute size of the labour force was a more dramatic 13.6 percent. Such a contraction in the economically active population – i.e. a retrenchment in the supply of labour available for the production of goods and services in the economy – is indicative of a severe macroeconomic crisis.

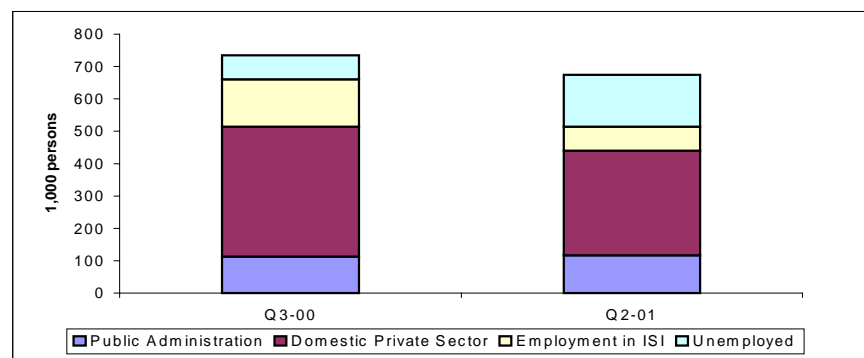
5.2. UNDERLYING LABOUR MARKET DYNAMICS

Private domestic employment

The prolonged crisis has produced a severe shock to the labour market – as witnessed by the dramatic increase in the number of destroyed jobs and the associated rise in the rate and number of unemployed. As noted earlier, 72,000 jobs in the domestic private sector were destroyed during the period October 2000 - September 2001.

Given the contraction in domestic private sector employment, the share of the public sector in total domestic employment grew from an estimated 28 percent in October 2000 to 36 percent in June 2001. **The crisis has therefore reinforced the importance of the public sector as a source of employment.** Although public employment in the past has served to absorb labour, it is clear that this is no longer a viable option given the current size of the public sector and its budgetary constraints.

Figure 3: Composition of the Palestinian Labour Force



The weakening of the domestic private sector is all the more worrisome as prior to the onset of the crisis, the domestic private sector had been demonstrating an increasing capacity to absorb the unemployed and new entrants to the labour force. The private sector contribution to total domestic employment grew steadily from 38.2 percent in the 1997-1998 period to 70 percent in the first half 2000 period.³⁵ **Rapid population growth makes the regeneration of domestic private sector activity an even more critical long-term challenge.**³⁶

6. IMPACT ON POVERTY

6.1. DECLINE IN AGGREGATE REAL WAGE INCOME

As nearly two-thirds of Palestinian households derive most of their income from the labour market, unemployment has had a severe impact on living levels. The protracted economic crisis and has severely affected the livelihoods of Palestinians. **In the first months of the crisis, aggregate real wage income dropped by an estimated 40 percent.**³⁷ The drop was largely due to the decline in the number of jobs rather than significant changes in wage rates.³⁸

In the first half of 2001, aggregate wage income improved somewhat to a level 32 percent lower than the pre-crisis level, mainly due to an increase of Palestinian employment in ISI in early 2001. However, by the third quarter of 2001, once again largely due to the decline in number of persons employed in ISI, real wage income fell to a level 37 percent below pre-crisis levels, indicating the extent to which aggregate wage income is highly sensitive to the availability of employment in ISI.

Between the third quarter of 2000 and the third quarter of 2001, real wage income declined most rapidly for workers in ISI as a group (60 percent), followed by workers in

³⁵ See UNSCO Report on the Palestinian Economy, Spring 2001.

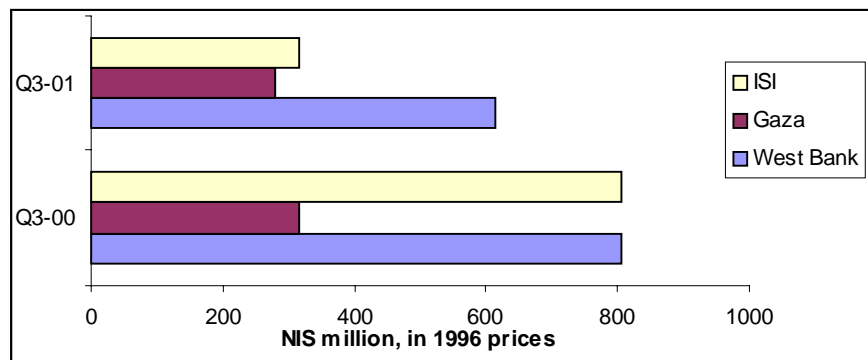
³⁶ Between June 2000 and June 2001, the working age population in the West Bank and Gaza grew by some 5 percent.

³⁷ In the absence of household income data, an approximate measure of the reduction in household income can be derived from changes in the number of *wage-workers* and *wage rates*. To calculate the reduction in real wage income by region: i) nominal NIS daily and monthly wages were deflated using the average regional Consumer Price Index with a 1996 base period; ii) per worker monthly wage income was calculated as the product of the average daily wage rate and the average number of days worked per month; iii) total quarterly wage income by region is the product of quarterly wage rates and the number of wage employees per region. For simplification, it is assumed that all Palestinian workers in Israel are wage employees (according to the PCBS, about 96 percent are wage employees). Nominal wage rates and the number of wage employees per quarter are taken from the PCBS, Labour Force Surveys. The consumer price index is from PCBS Consumer Prices series.

³⁸ Between third quarter 2000 and third quarter 2001, real wages fell by 6 percent in ISI and by 8.7 percent in the West Bank, whereas they increased by 6 percent in Gaza.

West Bank (24 percent) and in Gaza (11 percent). The slower rate of decline in Gaza was due to the rapid increase in real monthly wages following the outbreak of the crisis. Rather than indicating an increase in general living standards, the increased wage rates suggest that worsening economic conditions have pushed low-skilled workers - situated in the lower part of the wage distribution - into the ranks of the unemployed. Hence, the crisis may have had a disproportional impact on households who depend on low-paid employment in Gaza.

Figure 4: Estimated Palestinian Aggregate Real Wage Income by Place of Employment³⁹



6.2. COPING WITH RISING POVERTY

Various studies indicate that faced with income losses, households are reducing expenditures, using personal savings, delaying payments and incurring debt.⁴⁰

Although such strategies have enabled households to survive through the crisis period thus far, they are unsustainable in the medium term. There are indications, for example, that in addition to cutting down on non-essential commodities, poorer households have started to decrease their consumption of food commodities, raising fears of the potential for malnutrition. In addition, households that have already depleted their personal savings risk succumbing to spiralling indebtedness.

Declining household income has led to a rapid rise in the number of poor households. The World Bank estimates that the share of the population living below the

³⁹ UNSCO estimates based on wage, consumer price and employment data from PCBS.

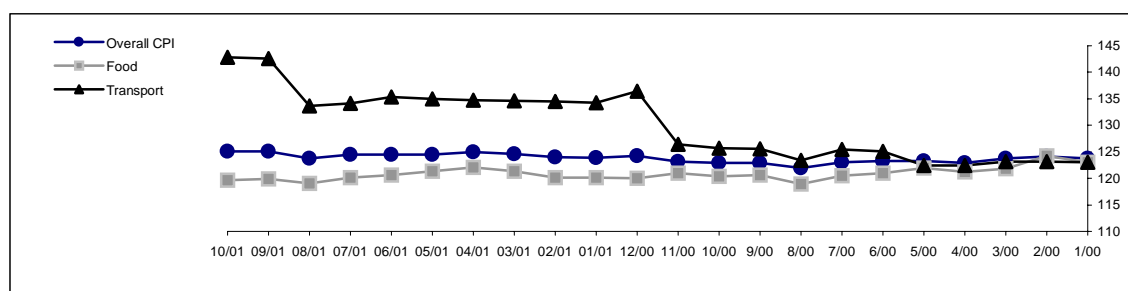
⁴⁰ See PCBS, Press Conference on the Survey Results of The Impact of the Israeli Measures on the Economic Conditions of Palestinian Households, September 2001. Data collection took place during the period 14/7/2001 to 23/8/2001. According to the results of a recent field survey, the median monthly income of households decreased from NIS 2,500 before the closure to NIS 1,500 during the period July-August 2001. See Bir Zeit University Development Studies Program Public Opinion Poll 3, 19 February 2001.

poverty line will climb to 46 percent by the end of 2001.⁴¹ According to the World Bank, the crisis has most severely affected the southern Gaza Strip and the remote villages of the West Bank - regions with the highest concentration of poverty prior to the crisis.

6.3. *COST OF LIVING*

The relative stability of overall consumer prices in the Palestinian economy, throughout the crisis period suggests that in aggregate, declining incomes were not aggravated by increases in price of essential consumer goods and services (Figure 5).⁴² In particular, food prices - which account for an estimated 40 percent of household expenditure - fell marginally (by 0.6 percent) between the onset of the crisis and September 2001. Transport prices, which rose by 13.5 percent between September 2000 and September 2001, were the main exception to this general trend, illustrating the impact of movement restrictions on this commodity.

Figure 5: Overall Consumer Price Index, Food and Transport Price Indices, 2000-2001 (1996=100)



The relative stability of prices for most consumer goods and services suggests that upward pressure on prices, resulting from supply-side factors, i.e. the reduction in the flow of commodities, was counteracted by downward pressure resulting from declining income and consumer demand.

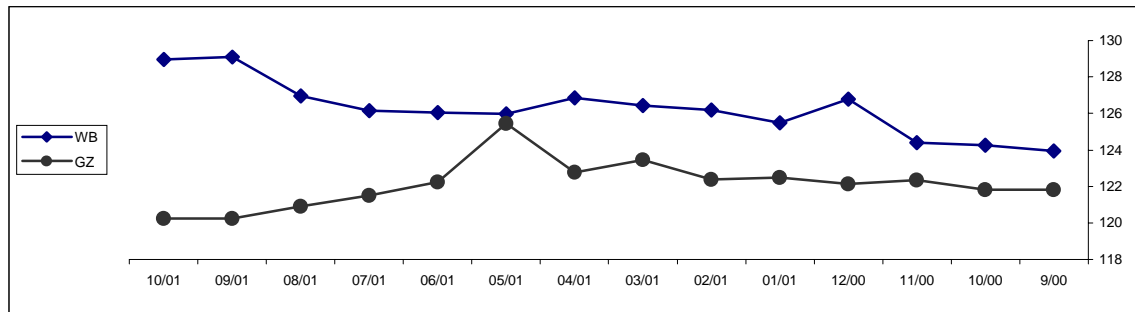
Changes in price levels, however, generally varied between the West Bank and Gaza, reflecting regional differences in market dynamics. Between third quarter 2000 and third quarter 2001, on average, prices increased in the West Bank (by 3.4 percent), whereas they decreased in Gaza (by 0.7 percent). This suggests that supply factors, namely transportation problems, was the dominant factor in determining prices in the West Bank, whereas in Gaza, demand factors pushed prices downwards. This may be corroborated by

⁴¹ See World Bank, "Brief on the Economic and Social Situation in the West Bank and Gaza," 6 April 2001. Note that for a household consisting of two adults and four children, the poverty line is approximately US\$ 2.1 in consumption expenditures per person per day.

⁴² In the Palestinian Territory, on average, the all-item CPI rose by 1 percent between the period January-September 2000 and the period January-September 2001. UNSCO estimates based on PCBS Consumer Price Index, Revised Series. Various issues, January 2000- September 2001.

the fact that transport prices grew substantially faster than the national average in the West Bank (by 21.9 percent between September 2000 and September 2001).

Figure 6: Overall Consumer Price Index in West Bank and Gaza, September 2000- September 2001 (1996=100)



Moreover, anecdotal evidence suggests that there were considerable locality-level differences in price levels in the West Bank, especially of food commodities. There are indications that in food-producing areas, prices have been depressed because goods cannot make it to market, whereas in non-agricultural areas—especially larger cities—food prices have risen steeply because of relative scarcity of these same goods.

7. CONCLUSIONS

The present crisis, which has now lasted for more than one year and for which there is as yet no end in sight, has severely disrupted the previous four years of economic recovery. Whereas in the four years prior to the crisis, GDP and GNI were steadily rising and unemployment and poverty figures were declining, poverty is now so widespread that soon more than half of the population in the West Bank and Gaza will have to survive on US\$ 2 or less per day.

As the level of confrontation and violence did not change much between the second and third quarters of 2001, further economic decline in the West Bank and Gaza can be attributed to the tightening of the closure during the third quarter of 2001, as well as the prolonged duration of the crisis.

While during the first two quarters of 2001, macroeconomic indicators were suggesting that Palestinians had quickly adapted to the Israeli imposed border closures and mobility restrictions, third quarter data would suggest that the coping mechanisms adopted to offset the direct effects of closure, will not be sustainable in the medium to long term.

The continued ability of the PA - with substantial external budget assistance - to pay salaries and provide a minimum level of basic social services, has thus far prevented even more dire economic consequences. As the PA will not be able to absorb the growing number of unemployed, and as donor-funded employment schemes are only able to

provide temporary work for limited numbers of people, the prospects for economic stabilization, not to say recovery, are dim in the absence of a political breakthrough.

ANNEX 1: CALCULATING AGGREGATE INCOME LOSSES

INTERNAL INCOME LOSSES

The calculations used to approximate internal income losses are based on IMF and PA Ministry of Finance estimates of West Bank and Gaza GDP growth rates and PCBS estimates for GDP in 1999. UNSCO estimates that nominal GDP would have reached US\$ 5,338 million in 2000 in the absence of the crisis.

The high estimate (50 percent) for GDP decline as a result of confrontations, border closures and mobility restrictions comes from the PCBS. The low estimate (35 percent) comes from the World Bank. Even though these estimates of GDP decline were made in early 2001, both the PCBS and the World Bank have recently indicated to UNSCO that these estimates are still valid today.

Calculation:

- By dividing the expected GDP for 2000 by the number of business days⁴³ in the West Bank and Gaza, one gets the expected GDP per day ($5,338 / 310 = \text{US\$ } 17.22$ million);
- Multiplying the expected GDP per day with 0.35 (low estimate) or 0.5 (high estimate), one gets the estimated loss in GDP per day;
- Multiplying the expected GDP loss per day with the actual number of business days in each quarter, one gets the estimated GDP loss per quarter.

Example: For the fourth quarter of 2000, the low estimate for total internal losses are:
 $(5,338 / 310) \times 0.35 \times 77 = \text{US\$ } 464$ million

EXTERNAL INCOME LOSSES

For the calculations used to approximate external income losses, UNSCO uses mainly data from the PCBS. Both the 'Average Daily Wage in Israel (nominal US\$)' and the 'Number of Palestinian workers unable to work in Israel' are indicators based on data that come out of the PCBS's quarterly Labour Force Survey. The 'Number of Potential Working Days' indicator reflects the actual number of days that Palestinians would normally work in Israel. The total number of working days after four quarters equals 365 calendar days minus 1.5 weekend days for each week minus Jewish holidays.⁴⁴

Calculation:

- By multiplying the Average Daily Wage in Israel with the Number of Palestinian workers unable to work in Israel, one gets the external income losses per working day;
- Multiplying the figure for external income losses per working day with the actual number of working days in each quarter, one gets the total external income losses per quarter.

Example: For the fourth quarter of 2000, the total external income losses are:
 $27.27 \times 102,000 \times 68 = \text{US\$ } 189.1$ million

⁴³ The number of business days is calculated by taking 365 calendar days minus all Fridays and Islamic holidays. For the period 1 October 2000 to 30 September this means a total of 310 business days.

⁴⁴ Please note that UNSCO uses the term 'working days' when referring to external losses and 'business days' when referring to internal losses.