

# *Disengagement, the Palestinian Economy and the Settlements*

*The World Bank, June 23, 2004*

“To promote the economic revival which is a vital precursor to peace, both parties need to put economic issues back onto their primary agenda – which they are not currently doing.” *Economic Road Map, January 2004*

*This issues paper was prepared by the World Bank at the request of the Palestinian Authority (PA), the Government of Israel (GOI) and the Local Aid Coordination Committee. Field work in Gaza and the West Bank was carried out between May 6-17. The Bank team consisted of a dozen staff and consultants, and included two staff members from the UN (from UNSCO and UNDP) and one from the European Commission. Numerous meetings were held with a broad range of officials from the aid and donor community, the PA and GOI, as well as with various individuals in their private capacities. The views expressed in this paper, however, are those of the World Bank.*

## *Foreword*

The World Bank has been asked by the Palestinian Authority (PA), the Government of Israel and the international community to review various aspects of Israel's Disengagement Plan. I am pleased to present this initial assessment to all three parties.

As this paper reminds us, the Palestinian economy is in deep crisis. Disengagement alone will not alter this dangerous, unsustainable situation. If disengagement is implemented with wisdom and foresight, however, it could make a real difference.

The key to Palestinian economic growth is private investment, which has declined dramatically since mid-2000. Since investors cannot be expected to bring capital to an area in conflict, both the PA and Israel must do their utmost to restore calm and a sense of security in the West Bank and Gaza. In addition, the PA will need to move decisively to create an environment more attractive to investors.

Above all, Israel's restrictions on the movement of people and goods need major overhaul. These closure measures stifle any hope of Palestinian economic revival. Closure is a response to threats to Israeli security – but the paper argues that closure is not monolithic, and that major improvements can be made without compromising Israel's security, particularly in relation to the trade of goods across borders.

Donor assistance levels today average almost US\$1 billion each year. These contributions have played a vital role in alleviating hardship, and remain indispensable. Without a change in Palestinian economic prospects, though, it is difficult to expect donors to increase existing aid levels.

If the PA shows firm commitment to security and economic reform and if Israel seriously addresses closure, another major donor effort definitely *would* be justified. Under these circumstances an additional US\$500 million each year could help the Palestinian economy turn the corner.

Without an economic revival, today's Palestinian youth face a gloomy future, and their desperation will endanger any peace process. After ten years of concerted efforts to build a viable Palestinian economy, we are running out of opportunities. We cannot afford to let this one pass us by.

James D. Wolfensohn,  
President,  
The World Bank

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## *Summary*

a) The deep economic crisis in the West Bank and Gaza threatens to impoverish and alienate a generation of young Palestinians. It is undermining the credibility of the Palestinian Authority (PA), increasing the popular appeal of militant factions, and threatening Israel's security. Unless today's impasse is broken soon, the PA could melt away, leaving Israel with a poor, embittered neighbor with whom dialogue could be much more difficult.

b) The Palestinian recession is among the worst in modern history. Average personal incomes have declined by more than a third since September 2000, and nearly a half of Palestinians now live below the poverty line (see Figure 1).

c) Today's economic crisis has been caused by restrictions on the movement of Palestinian people and goods, or 'closures'<sup>1</sup>, which the Government of Israel (GOI) regards as essential to protecting Israeli citizens from attacks by militants. Without a major reform of the closure regime, however, the Palestinian economy will not revive and Israel's security gains may not be sustainable.

d) Of itself, Israel's Disengagement Plan of June 6 will have very little impact on the Palestinian economy and Palestinian livelihoods, since it only proposes a limited easing of closure. A focus on this over-arching issue is essential if disengagement is to deliver long-term benefits.

e) Indeed, were it accompanied by the sealing of Gaza's borders<sup>2</sup> to labor and trade or by terminating supplies of water and electricity to Gaza, disengagement would create worse hardship than is seen today. This could forfeit the international goodwill that Israel's initiative has created. Under such circumstances, the Plan's assertion that Israel is no longer responsible for the population of Gaza will not resonate. Nor

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<sup>1</sup> Closures affect the free movement of Palestinian goods and labor across borders and within the West Bank and Gaza. Closures take three basic forms: i) internal restrictions within the West Bank and Gaza, reinforced from time to time by curfews; ii) restrictions on the borders between Israel and the West Bank, and between Israel and Gaza; and iii) restrictions at the international crossings between the West Bank and Jordan, and between Gaza and Egypt.

<sup>2</sup> Use of this word in this paper does not imply any judgment by the World Bank on the appropriate location of any political borders. The term is used to denote boundaries between areas of economic jurisdiction, and the movement of people and goods across them. Unless otherwise indicated, though, the location of these economic boundaries is assumed to be the security fence that surrounds the Gaza Strip, and the 1949 Armistice Line (the 'Green Line') in the West Bank.

would donors appreciate the implication that they must bear the humanitarian consequences of this style of disengagement.

f) Disengagement will remove internal movement restrictions in Gaza and in part of the northern West Bank, but Palestinian economic recovery depends on a radical easing of internal closures throughout the West Bank, the opening of Palestinian external borders to commodity trade, and sustaining a reasonable flow of Palestinian labor into Israel.

g) Easing internal closures throughout the West Bank must be accompanied by a credible Palestinian security effort; as long as Palestinian violence persists, the case for dismantling closures will always be contestable. Over the coming year, though, the turmoil likely to attend the completion of the Separation Barrier will complicate efforts to free up movement within the West Bank.

h) Removing restrictions on the movement of cargo across borders is relatively simpler – technologies and administrative methods exist that permit the orderly flow of cargo *and* the maintenance of security. Introducing a new, efficient border cargo regime would make a major difference to Palestinian welfare and commercial prospects. The international community should focus on this key economic issue in its diplomatic dialogue with GOI.

i) An easing of closures alone, though, will not attract investors back to the Palestinian economy. A reinvigorated program of Palestinian reform, designed around measures that will create an investor-friendly business environment, is essential. There is no reason for the PA to delay implementation of such a program.

j) It is important to understand that additional donor money alone can not solve today's economic problems. Donor disbursements of c. US\$1 billion per annum (or US\$310 per person) are already very high. Additional aid in today's economy would help alleviate day-to-day hardship, but would have little lasting impact. As long as the web of Palestinian economic transactions remains shredded by closures, investors will stay away, and short-term gains will not be sustainable.

k) With a freeing-up of the constraints on economic activity and committed Palestinian reform, an additional major donor effort *would* make a difference – it would enable the Palestinian economy to turn the corner. An additional US\$500 million per annum, on top of existing disbursements, could by 2006 spur a growth in real personal incomes of

about 12% (and 20% in nominal terms), and could reduce unemployment to levels only slightly higher than prior to the *intifada*.

l) The alternative to this is stark. At the wrong end of the spectrum of possible outcomes is a Palestinian economy with unemployment levels of over 35% by 2006, and with poverty afflicting upwards of 55%, and 70% in Gaza. With the PA weakened as it is, the time to get things right is running out<sup>3</sup>.

m) As for the settlement assets that Israel will leave behind, those in Gaza have considerable economic value, and in time can make a significant contribution – provided that Gaza's borders are opened for trade. Prospects for economic recovery will be enhanced if the US and the EU give adequate preference to Palestinian products to help boost exports.

n) The manner in which the settlement assets will be transferred to the Palestinians remains a core issue. The PA should seize this opportunity to demonstrate transparency, equity and efficiency in receiving and disposing of the assets. The PA is advised to create a special agency for this purpose. The donors, through the Ad Hoc Liaison Committee, should provide the advice and assistance needed to ensure that the asset transfer process goes well and is acceptable to all parties.

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<sup>3</sup> The PA is the conduit for at least 70% of donor assistance today, and without a recognized authority much of this would be in doubt.

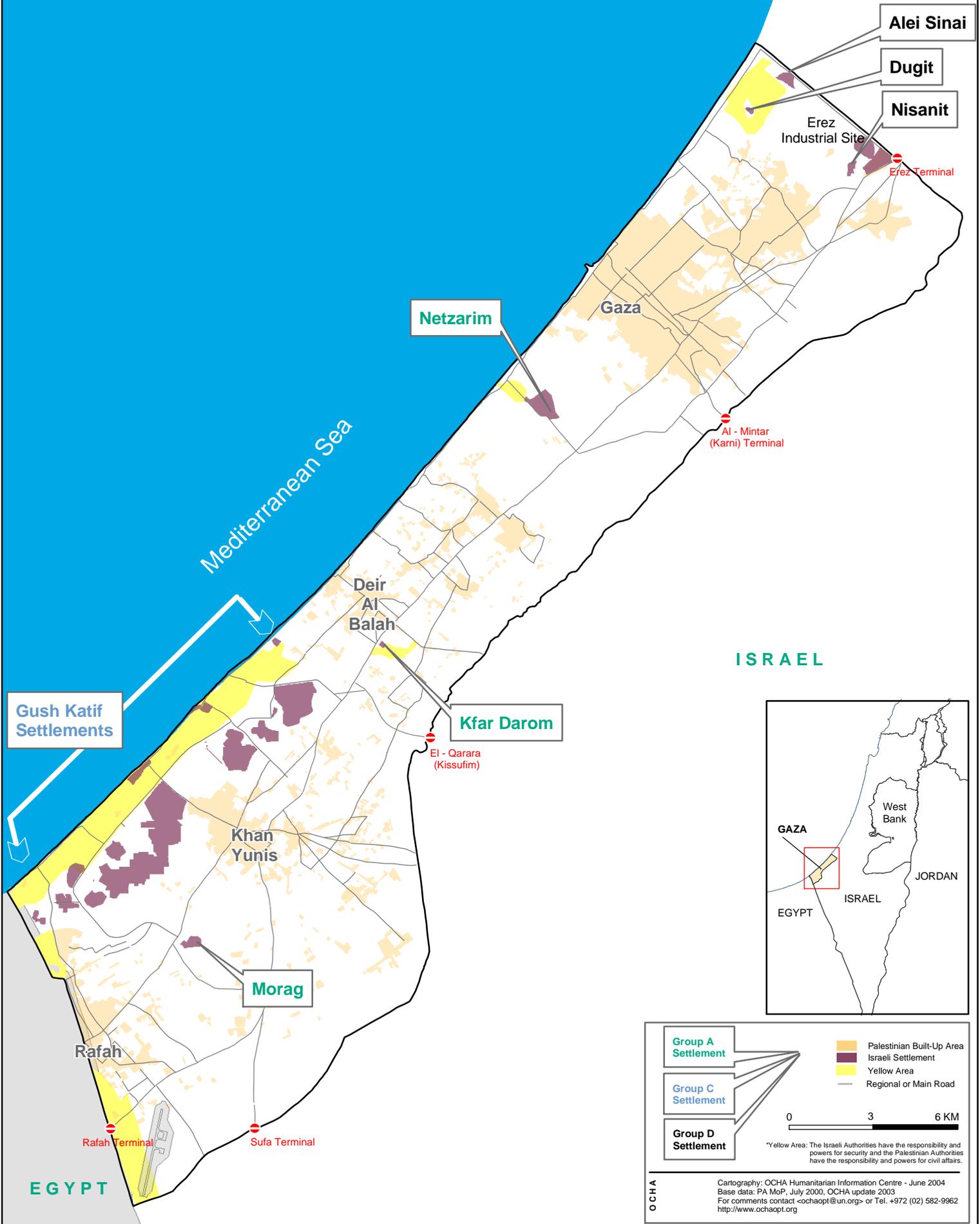
*Figure 1 – Economic Scenarios, West Bank and Gaza*

	Nominal GDP per cap. US\$	Nominal GDI per cap. US\$	Unemployment Rate (percent)	Poverty Rate (percent)	Gaza Poverty Rate (percent)
<b>As at end 2003</b>	925	1,467	26	47	64
	<i>Projected Outcomes by 2006</i>				
<b>1. Status Quo</b>	866	1,221	35	56	72
<b>2. Disengagement</b>	871	1,227	34	56	72
<b>3. Disengagement + lifting internal closures in West Bank and opening borders</b>	1,068	1,424	23	46	64
<b>4. Disengagement + lifting internal closures in WB and opening borders + extra US\$1.5 billion from donors over 2004-2006</b>	1,250	1,758	14	37	53

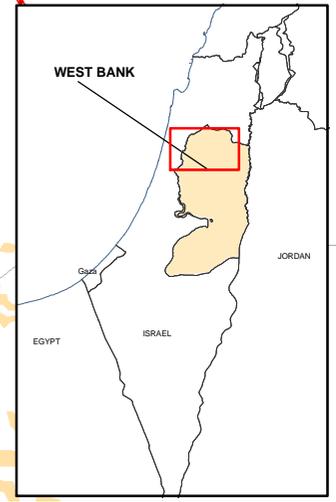
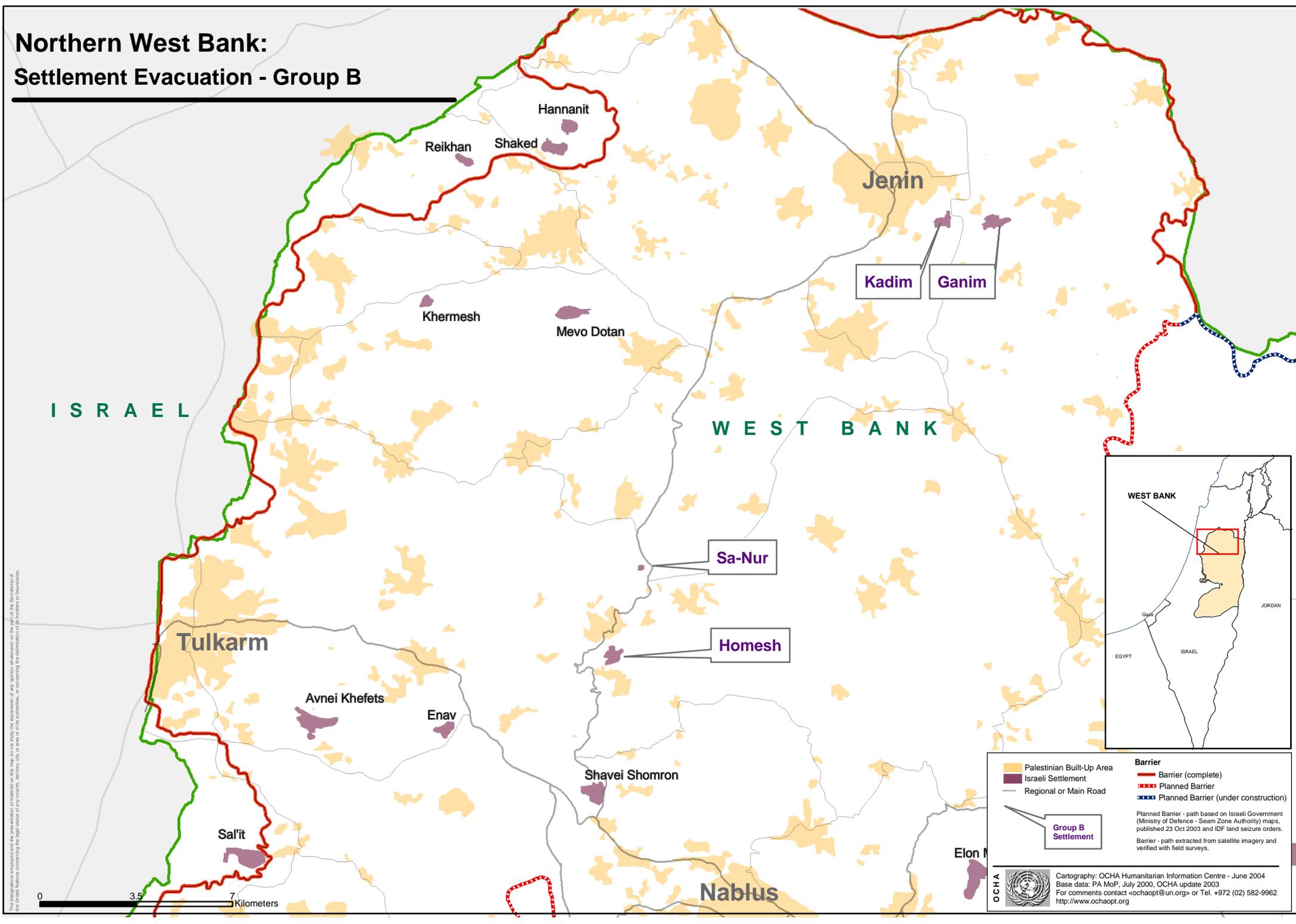
*Note:* Scenarios all assume labor flows to Israel are in gradual decline. Scenarios 1, 2, and 3 assume donor contributions of US\$1 billion (2004), US\$900 million (2005), and US\$900 million (2006) = US\$2.8 billion over three years. Scenario 4 assumes donor contributions of US\$1.3 billion (2004), US\$1.5 billion (2005), and US\$1.5 billion (2006), a total of US\$4.3 billion over three years.

# The Gaza Strip:

## Settlement Evacuation - Groups A, C and D



# Northern West Bank: Settlement Evacuation - Group B



Palestinian Built-Up Area	Barrier (complete)
Israeli Settlement	Planned Barrier
Regional or Main Road	Planned Barrier (under construction)
Group B Settlement	

Planned Barrier - path based on Israeli Government (Ministry of Defence - Seam Zone Authority) maps, published 23 Oct 2003 and IDF land seizure orders.

Barrier - path extracted from satellite imagery and verified with field surveys.

**OCHA** Cartography: OCHA Humanitarian Information Centre - June 2004  
 Base data: PA MoP, July 2000, OCHA update 2003  
 For comments contact <a href="mailto:c-ochaopt@un.org">c-ochaopt@un.org</a> or Tel. +972 (02) 582-9962  
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# *I - The Palestinian Economy Today - Few Prospects*

## *Steep Decline*

1. **Between September 2000 and late 2002, the Palestinian economy experienced one of the deepest recessions in modern history.** The decline in real per capita GDP reached almost 40% by the end of 2002, exceeding the scale of economic losses suffered by the US in the Great Depression, or Argentina during the recent financial collapse<sup>1</sup>. Unemployment increased from 10% of the workforce to an average of 41% during 2002<sup>2</sup>, and the number of the poor<sup>3</sup> rose from 20% to over 50% of the population. In Gaza, unemployment exceeded 46% of the workforce, and the poverty level rose to 68%. Private investment and trade fell dramatically through 2001 and 2002<sup>4</sup>.

2. **The precipitator of this economic crisis has been ‘closure’** – a multi-faceted system of restrictions on the movement of goods and people designed to protect Israelis in Israel itself and in the settlements. Closures have cut through the web of Palestinian economic transactions, raising the costs of doing business and disrupting the predictability needed for orderly economic life. Any sustained Palestinian economic recovery will ultimately require the dismantling of the closure system, and this needs to be borne in mind when assessing the potential impact of the Modified Disengagement Plan of June 6.

## *Fragile Stability*

3. **The Palestinian economy stabilized in 2003.** This reflected diminished levels of violence, fewer curfews<sup>5</sup> and more predictable (albeit intense) closures – and adaptation by Palestinian businesses to the contours of a cantonized West Bank economy. It also reflects the fiscal stimulus from Israel’s resumption of revenue transfers in late 2002. Led by increased construction activity and informal transport and commerce, 97,000 new jobs were created in the West Bank and Gaza, and unemployment and poverty levels both fell by some 4-5 percentage points (**Table 1**).

4. **This stabilization, however, possesses little vitality.** The economy continues to function at well below its previous capacity<sup>6</sup>, and under today’s movement restrictions cannot generate the employment needed to absorb a rapidly expanding workforce – let alone mount a sustained attack on unemployment. With the population growing at 5.2% in 2003 (and 5.5% in Gaza), 2003’s GDP increase of 6% translated into per capita GDP (or domestic output) growth of only about 1%<sup>7</sup>. The quality of most new jobs created in 2003 was also poor, with more than half classified as self-employed or unpaid family labor in commerce and agriculture – low-skilled jobs with limited potential, evidence of a growing ‘informalization’ of the economy. Investment and trade remained depressed in 2003: private investment totaled at most US\$600 million, roughly one-third of 1999 levels, while exports actually decreased, contributing only 14% to GDP<sup>8</sup>.

5. **Sustaining this recovery will prove difficult.** Stabilization in 2003 resulted from factors which will either not be repeated (the return of US\$294 million in tax

revenues withheld in 2001 and 2002), or may not last (violence has escalated again in Gaza, and resistance to the completion of the Separation Barrier could intensify; labor flows to Israel may decline this year). Some localized easing of movement in the West Bank may occur as the Barrier is completed, but this is unlikely to offset the economic losses associated with its construction (particularly in East Jerusalem), the restricted access into and out of the new “seam zones” between the Separation Barrier and the Green Line, and the impermeability of the Barrier itself<sup>9</sup>.

6. **Bank projections point to further decline under the political ‘status quo’.** Although this should *not* be taken as a World Bank recommendation, we have for illustrative purposes projected a decline in Palestinian employment levels in Israel, owing to GOI policy inclinations<sup>10</sup>. Assuming that the closure regime remains essentially unchanged, no appreciable revival in private investment can be expected. Without new sources of capital, the trend towards informalization will continue, and new entrants to the labor market will outstrip the economy’s ability to provide work. As **Table 2** (“Status Quo” scenario) shows, by 2006 real GDP per capita (domestic output) would drop by about 12% from 2003 levels, while real GDI per capita (overall incomes including aid transfers) would decline by 22%. Unemployment would increase to 35% by 2006 and poverty levels would reach 56%.

### ***A Weakened Palestinian Authority***

7. **The PA’s effectiveness has declined over the past year, though it is still delivering essential services.** Persistent restrictions on movement and sustained fiscal crisis have taken their toll on the PA. To its credit, the civilian apparatus still functions quite well, and PA core services – education, health, water and electricity, sewerage and solid waste – continue to be delivered on a regular basis. Inevitably, however, service standards are in decline<sup>11</sup>. The performance of the security services is less commendable, with instances of lawlessness in some areas of the West Bank and Gaza (for instance, Jenin, Nablus, and Rafah). The PA’s Reform Program, launched in mid-2002, lost much of its early momentum during the summer of 2003. It has registered relatively few achievements in the past year, most of them clustered in the public financial accountability sphere<sup>12</sup>.

8. **The PA’s fiscal position remains very precarious.** Throughout 2001 and most of 2002 GOI withheld the tax revenues it collects on the PA’s behalf, and domestic collections plummeted; thanks to donor budget contributions of roughly US\$1 billion over the period, the PA was able to function. In 2003, although Israel transferred Palestinian revenues every month and the PA’s own revenue performance improved considerably<sup>13</sup>, donor budget contributions declined steeply<sup>14</sup>. At the same time, PA expenditures have risen significantly during the *intifada*, driven by increases in recruitment and wage levels (the monthly salary bill is now 28% higher than in 2002, and 64% higher than in 1999<sup>15</sup>). The 2004 PA Budget shows a US\$650 million budget deficit before external financing. Donors are likely to cover at least US\$350 million of this, but with no recourse to medium-term debt the PA has been obliged, as in the past, to cut operating costs<sup>16</sup> and incur debt to private suppliers<sup>17</sup>. Without additional donor funds, the PA may need to cut salaries later this year. This could prove highly destabilizing<sup>18</sup>.

### ***Poverty and Social Stress***

9. **Palestinian social resilience is notable<sup>19</sup>, but the number of families unable to cope is poised to increase quite sharply.** Sixteen percent of the total population, and one quarter of all Gazans, live in deep or “absolute” poverty, and are unable to feed themselves adequately, even with food aid<sup>20</sup>. The population as a whole has reduced its per capita food consumption by 30-35% since 1999<sup>21</sup>, and were it not for donor assistance (food aid having increased five-fold since 2000), malnutrition would be at levels associated with much poorer countries<sup>22</sup>. Donor and PA observers have predicted the demise of Palestinian coping mechanisms on several occasions<sup>23</sup>, and caution is called for – but time series data from 2001 to 2003 indicate that the number of the poor who have savings has fallen from 70% to 13%, and that a third now depend on cash from friends or relatives, compared to almost none in 2001<sup>24</sup>. The latest University of Geneva Perceptions Survey shows that 30% of Palestinians have exhausted all financial means, and another quarter expect this to occur “soon”<sup>25</sup>.

10. **From a socio-political perspective this is a disconcerting picture.** As conflict and economic crisis feed one another in a malevolent cycle, a generation of young men and women is growing up in an environment of curfews, movement restrictions and urban decay. Their experience is reflected in declining grades<sup>26</sup>, high levels of dysfunctional stress<sup>27</sup> and, as frequently shown in credible opinion polls, widespread support for violence against Israelis<sup>28</sup>. Unemployment among males 15-24 years of age in Gaza stands at 43%<sup>29</sup>; up to 70% of entrants to the job market during the *intifada* are unemployed, with little prospect of getting a job. Such damage to the social fabric cannot be offset by providing humanitarian relief, important as this has been.

### ***Excessive Dependence on Donor Assistance***

11. **The PA, the Palestinian economy and Palestinian personal incomes have come to depend on high levels of donor financial support.** Cushioned by unprecedented amounts of donor assistance, Palestinian society has withstood the economic shocks of the last four years without social disintegration. Donors have more than doubled their pre-intifada disbursement levels, providing an average of US\$950 million per annum between 2001-3, and in so doing adding 30% to GDP and over 20% to Palestinians’ disposable incomes. Without donor help, living standards would be far worse; of the estimated \$713 million spent in 2002-3 on welfare instruments (food, cash support, job creation), some 97% was donor-financed<sup>30</sup>. This insinuation of donor funding into the core of the economy will be hard to unravel without a general economic recovery. Although there was little sign of “donor fatigue” through 2003<sup>31</sup>, these levels of assistance cannot be counted upon indefinitely. At the last major conference on the Palestinian economy in Rome in December 2003, delegates stressed that the lack of a clear political horizon made it increasingly difficult to argue for sustained high levels of donor assistance to the West Bank and Gaza. As of mid-2004, only a quarter (c. US\$75 million) of the 2004 UN Consolidated Humanitarian Appeal has been financed<sup>32</sup>.

## ***II - The Economic Benefits of Disengagement - Of Itself, Very Limited***

### ***The Plan and Closure***

12. **The Disengagement Plan would restore internal mobility in Gaza and ease movement in part of the West Bank.** The evacuation of the settlements and redeployment of the army along the Philadelphi Route and outside the Gaza “envelope” would result in free movement throughout Gaza. In the northern West Bank, evacuation of the four settlements would provide “Palestinian territorial contiguity” in a limited area (**Maps**). In addition, the Plan proposes that Israel and the donors should “help improve the transportation infrastructure in Judea and Samaria, with the goal of providing continuous transport for Palestinians.....to facilitate economic and commercial activity” (see *The Modified Disengagement Plan, Annex 1*).

13. **A disengagement of this type would benefit the Palestinian economy in two ways – reduced internal closures, and the transfer of settlement land and assets.** These benefits may be quite modest, however:

- ***Internal mobility*** in *Gaza* would be greatly improved by the opening of the Erez – Rafah main road and by access into security areas that are currently prohibited (such as the Al-Mawasi area that lies between the Gush Katif settlements and the sea). In the *northern West Bank* local mobility should also improve, but a more general easing of closure inside the West Bank will not automatically follow. The Plan indicates that “Israel will work to reduce the number of checkpoints throughout the West Bank”, but progress would depend on GOI’s security calculus<sup>33</sup>. The additional Palestinian transport infrastructure called for under the Plan is intended to connect areas behind the Separation Barrier and to avoid settlements. Construction would take time, however, and could prove controversial from a donor perspective<sup>34</sup>.
- ***The settlements and military installations*** in *Gaza* sit on 55-75 square kilometers of land (see paragraph 58), much of which is well-watered and of good arable quality. The economic potential of these areas will be limited, though, unless Gaza’s border trade regime changes. The four *West Bank* settlements are small dormitory communities without appreciable productive output (see further in Section IV).

14. **The Disengagement Plan does not incorporate a change in border trade regimes.** Israel will “monitor and supervise the outer envelope on land, will have exclusive control of the Gaza airspace, and will continue its military activity along the Gaza Strip’s coastline.” Evacuation of the Egyptian border area would be considered “later on”, depending on “the security reality” – and could lead to the establishment of a Gaza airport and seaport. Thus today’s Gaza and West Bank border trade regimes would, for now, remain in force. These regimes are highly restrictive, and rely on laborious “back-to-back” offloading/reloading methods. Only a fraction of pre-crisis exports (and a rather larger fraction of previous imports) pass through the borders today<sup>35</sup>.

### *In the Short-Run, Little Economic Benefit*

15. **With internal closures only partly eased and with the external border regime unchanged, disengagement would not deliver significant economic benefits.** To illustrate this, the Bank compared the more predictable effects of the Disengagement Plan with the *status quo* scenario described in paragraph 6. Using the same assumptions on labor flows (declining) and on donor assistance (relatively stable), we incorporated free internal movement in Gaza and an easing of local restrictions in the northern West Bank. We also assumed modest agricultural and industrial output from the settlement areas. No significant private investment response was factored in, however, given the current political situation and border trade regime.

16. **Under such assumptions, the probability of further Palestinian economic decline does not change.** The differences between the *disengagement* and *status quo* scenarios are negligible – see **Table 2** (“*Disengagement*” scenario). High population growth and the reduction in work in Israel would result in a cumulative real GDP per capita decline of about 12% by 2006; real GDI per capita would drop by some 22%. At 56% and 34% respectively, poverty and unemployment levels would essentially remain the same as under the *status quo* scenario<sup>36</sup>.

17. **A step-by-step withdrawal could further reduce these aggregates.** The uncertainties and potential delays associated with a gradual withdrawal might exacerbate conflict, and this could lead to additional economic damage. In Rafah, damage to housing and roads alone this May has been estimated at around US\$22 million, or 2% of Gaza’s 2003 GDP<sup>37</sup>.

18. **A disengagement process in which labor flows are cut abruptly, the external envelope of Gaza is further restricted to trade, or electricity/water supplies are terminated would seriously worsen Palestinian economic, humanitarian and social prospects.** Such possibilities were aired in the political debate preceding the Israeli Cabinet vote of June 6. The Plan, however, indicates that Israel will continue to supply electricity and water, admit workers and remit Palestinian taxes collected on the PA’s behalf<sup>38</sup>. Any sudden terminations would create economic shocks that would be very hard to counter.

19. **An additional US\$1.5 billion in donor assistance over three years under these conditions would increase per capita GDP, but would no more than offset otherwise declining personal incomes.** The Bank modeled the impact of disbursement increases of c. US\$500 million per annum in 2004-6. This would boost real GDP per capita by 7% by 2006, but as a result of the decline in work in Israel, real per capita GDI would be unchanged from 2003. Poverty and unemployment would remain stuck at levels similar to those of today. This outcome makes it difficult to justify such extra outlays, other than on humanitarian grounds.

20. **If the Erez Industrial Estate closes, this will represent a further serious setback for the Gaza economy.** On June 8, Israeli Minister of Industry and Trade Olmert announced that Israeli factories would be evacuated from Erez, leaving its future in doubt. Erez has been closed most of the time since mid-January, having come under attack by Palestinian militants from within Gaza. Until recently, Erez

employed about 4,900 Palestinians, who between them would have supported at least 3% of the Gaza population (without accounting for significant indirect employment generated by the estate). About 100 of the 200 businesses in Erez are Palestinian-owned. The Disengagement Plan proposes that Erez be “transferred to an agreed-upon Palestinian or international body.”

21. **Erez offered several attractions for Palestinian investors.** These included, first, access to the Israeli market; second, direct interaction with Israeli businessmen; and third, a lack of environmental or regulatory oversight (as compared with the Gaza Industrial Estate (GIE), which is run by the PA). In time some of the businesses could transfer to the GIE, but GIE products have only limited entry to Israel (exports through Karni were suspended for 24 days in May 2004, for example). The immediate issue is whether output from Erez will continue to be given direct access to Israel – irrespective of who takes over the management of the estate.

22. **It is essential that the PA take steps to prevent a further erosion in Palestinian-Israeli economic cooperation.** As described below (paragraph 38), Palestinian economic revival will depend to a significant extent on rebuilding links with Israeli businesses. The Palestinian attacks on the Erez crossing and Erez Industrial Zone challenge this concept. Unless the PA is prepared to confront such violence, the willingness of both Israeli and Palestinian entrepreneurs to work together on-site could disappear. Commenting on Minister Olmert’s decision, the President of the Israeli Manufacturers Association said “we should be clear that if we retreat from the model of economic cooperation with the Palestinians, it reflects a serious crisis. This decision represents one of the most serious crises in the peace process”<sup>39</sup>.

### ***III - Changing Today's Economic Reality***

#### ***Summary***

23. **The key to restoring Palestinian economic vitality is for Israel to dramatically ease internal closures and restore the predictable flow of goods across borders.** A resolution of the economic crisis of the last 45 months requires that it be addressed at source.

24. **Closures, however, cannot be viewed in isolation from security, in particular the threats posed by militants seeking to enter Israel.** Security *per se* is beyond the scope of this paper, but a maximum PA effort to fulfill its security obligations under the Road Map is needed if the donor community is to argue for a major easing of today's closure regime.

25. **Even today, though, it should be possible to re-establish a regular, predictable import/export regime without compromising Israeli security.** Technologies exist that can rapidly normalize border trade and thereby remove a critical impediment to competitive export – as well as end the frequent complications associated with humanitarian shipments.

26. **An enhanced security environment and Israeli import/export reform need to be accompanied by a serious PA effort to create conditions attractive to private investors.** Investors are likely to perceive the West Bank and Gaza as high-risk for some time to come, and the PA must do everything it can to assure an investor-friendly climate.

27. **GOI and PA commitments of this kind would justify an additional major financial effort by the donors.** The previous two sections describe an economic situation without prospects, in which substantial donor assistance serves mainly as a brake on the speed of descent. With open borders, a reformist PA and a growth-oriented process underway, the geometry changes. This is a situation much more attractive to donors – one in which they can alleviate the impacts of high transitional unemployment while investing in growth-oriented infrastructure projects. Financial assistance alone cannot solve today's economic crisis, but it can make a decisive contribution under the right circumstances.

28. **Israel should, at the least, maintain current flows of Palestinian workers for several years to come.** Although the scenarios used below once again assume a decline in labor flows<sup>40</sup>, such reductions would greatly complicate and dampen any recovery<sup>41</sup>. Many economists believe that the Palestinian economy must *in time* abandon its reliance on exports of labor to Israel in favor of exports of goods and services to Israel and third countries – but creating competitiveness will not happen overnight. An orderly economic adjustment process is vital to the maintenance of political and social stability<sup>42</sup>.

### ***A Reasonable Economic Future is Possible***

29. **A reduction in violence, a major easing of internal closures and the revival of trade across borders could hold today's stabilization in place, depending on the number of Palestinian workers allowed into Israel.** Modeling the impact of these developments under the *same* labor assumptions as were used earlier, real GDP per capita would grow by about 8% over the period 2003-6, but real GDI per capita would still decline by some 9.5%. Unemployment would gradually fall to 23%, but poverty would persist at high levels (46%) – see **Table 3** (“\$2.8 billion” scenario).

30. **Were donors to provide generous additional assistance, however, the Palestinian economy could turn the corner.** We have once again assumed additional donor disbursements of US\$1.5 billion over the 2004-6 period, with about half of this as development-oriented expenditure (see also paragraph 51 below), giving a total of US\$4.3 billion over three years, or about US\$380 per person per year<sup>43</sup> (see **Table 3**, “\$4.3 billion” scenario). With an additional donor effort of this magnitude, real GDP per capita would grow 26% by 2006, and real GDI per capita 12%. At the same time, unemployment would fall to only 14% – close to pre-*intifada* levels – though poverty would remain worryingly high at about 37%, underlining the need for a sustained, long-term poverty alleviation strategy even under a scenario of general economic recovery. These encouraging growth rates would increase significantly if GOI were to maintain current levels of Palestinian workers in Israel.

31. **As it is most unlikely that these levels of donor assistance would be sustained for long, it is imperative that the PA use any such windfall to create infrastructure, skills and an environment attractive to private investors.** If the opportunity were lost, growth would falter and unemployment and poverty would once again soar – even with a major relaxation of closure.

### ***Borders and Trade***

32. **Creating an export-based economy depends above all on efficient, unimpeded access to Israeli and third-country markets.** The current security-oriented border regime – and access through the West Bank or Gaza to the borders – involves unpredictable delays, and uses inefficient methods which add considerably to transaction costs and make it impossible to fulfill export orders on time<sup>44</sup>.

33. **In recent times, over 90%<sup>45</sup> of Palestinian exports have gone to or through Israel.** Primary attention should therefore be given to regularizing cross-border trade with Israel.

34. **There are a number of steps which can be taken to maintain or even enhance Israeli security while greatly improving cross-border cargo management.** For *exports*, extensive use can be made of advanced electronic equipment at checkpoints, with large, truck-size scanners at border crossings such as Karni and Erez in Gaza and along the Green Line in the West Bank<sup>46</sup>. Along with inspection facilities sized to handle containers; this should considerably reduce, and in some cases eliminate the need for back-to-back unloading and reloading procedures. In addition, simple but meaningful facilitation measures can be introduced – such as

extending border operating hours and ensuring perishable cargoes are given priority<sup>47</sup>. For *imports* from certain countries, pre-shipment inspections by third parties and transport in specially sealed containers should allow some relaxation of the current requirement that all cargoes destined for Gaza and the West Bank must be inspected upon entry at Israeli ports. Bonded warehouses<sup>48</sup> or logistic facilities for cargo moving to and from Gaza and the West Bank could also be introduced at Haifa and Ashdod.

35. **International gateways for the Palestinian economy, and a link between Gaza and the West Bank, should also be developed.** The export routes running through Israel (to the seaports of Ashdod and Haifa and to Ben Gurion airport) have been unreliable and costly, due to inconsistent security procedures and the need to use Israeli logistic service providers. Similar issues arise in relation to cargo moved through Jordan and Egypt<sup>49</sup>. *If* a satisfactory security protocol can be established, a sea port in Gaza, provided it is accessible to West Bank businessmen and efficiently run by a private operator, is likely to be competitive – particularly if initiated as a ‘Roll-On, Roll-Off’ facility, which could be built in a relatively short time and for as little as US\$15-20 million. **Annex 2** further discusses the possible development of international gateways, including the now-defunct Gaza Airport, as well as the “safe passage” between Gaza and the West Bank.

36. **It is important to note that all of these measures are compatible with the economic agreements still in effect between Israel and the Palestinians.** They also conform to what the Aix Group calls a “rescue phase”, consistent with Phase I of the Road Map<sup>50</sup>. If Israel indicates a willingness to adjust the border trade regime, a number of other initiatives are worth exploring<sup>51</sup> – in particular the possible creation of duty and tax free Export Processing Zones in Gaza and the West Bank, and on the border with Egypt (particularly if agreement can be reached with Egypt on the unimpeded movement of goods in bond to Egyptian ports).

### ***Developing Palestinian Exports***

37. **Palestinian economic recovery will depend on re-building commercial cooperation with Israel.** Israel will remain the primary Palestinian trading partner for some time to come<sup>52</sup>. Israel, the PA and donors should accordingly focus on what can be done to repair such linkages, to include launching an urgent review of the feasibility of current and future industrial zones.

38. **The best way to access third countries appears to lie in partnerships with Israeli companies.** The business model that carries the most logic today, and which benefits both Palestinian and Israeli economies, is one in which Israeli companies secure market access for high-end products wholly or partly produced by Palestinian enterprises. Examples of actual or potential cooperation include perishable agricultural products exported through Israeli outlets (flowers, strawberries), and Israeli outsourcing of manufacturing processes and services (in order to maintain competitiveness – for example in textiles, software and high-tech manufacturing, or back-office operations<sup>53</sup>).

39. **A future Palestinian state should aspire to build its own export base, but it will take time before such exports make an appreciable contribution to living**

**standards.** Palestinian products today have little independent penetration in international markets. Cost structures – both labor and other inputs – are high compared with those of Jordan and Egypt<sup>54</sup>, while productivity is still poor<sup>55</sup>. It is always dangerous to speculate on where entrepreneurs will discover new opportunities – but potential sources of competitive advantage include tourism, with a possible re-launch of Jericho, the development of the Gaza coast and the expansion of tourism-oriented crafts (embroidery, olive wood products, ceramics, etc); olive oil<sup>56</sup> and agricultural products for direct export to the US and the EU under preferential trade arrangements<sup>57</sup>; and high value-added garments and apparel for niche markets. Significant retooling and adjustment is needed, though, and donors should intensify programs aimed at building competitiveness at the firm and the industry levels<sup>58</sup>.

### *Creating a Growth-Oriented Economic Environment*

40. **If donor funds are to be put to effective use, the PA needs to build an environment attractive to investors.** Although the impact of PA efforts will remain limited unless GOI addresses the restrictions on internal movement and external trade, this is no reason to delay important reform measures<sup>59</sup>.

41. **Investors will continue to be deterred as long as the current conflict persists.** This paper is not the place to discuss the specifics of Palestinian security, but it is clear that the PA needs to establish control of the domestic security environment as a precursor to economic recovery.

42. **The holding of national and local elections would re-legitimize the PA and renew investor confidence in Palestinian governance.** All parties have insisted for the past two years that democracy lies at the heart of the Palestinian reform process. So far, though, neither local nor national elections have been held, although both are long overdue. The recent PA decision to press forward with early local elections is a welcome step. The PA (with donors in support) should speed up efforts to develop the requisite legal and institutional frameworks and to complete voter registration. For its part, Israel will need to facilitate campaigning and voting so that a valid democratic process is feasible.

43. **Maintaining PA fiscal stability is essential.** The PA's difficult fiscal situation was described in paragraph 8, and donors will need to step up their budget contributions later this year to ensure that short-term stability is maintained. For its part, though, the PA must take decisive steps to contain the escalating wage bill. Much hinges on the Salary Containment Plan which the Council of Ministers is committed to preparing this month. Once the employment market recovers, moreover, a major program of public sector retrenchment will be unavoidable. This in turn requires that the General Personnel Council be restructured so it can play a constructive role in civil service reform.

44. **A related and worrying issue is the non-viability of the PA's current pensions systems.** Without comprehensive reform, the system will go bankrupt within two years<sup>60</sup>. The PA is now tackling the problem with purpose, and a National Pension Committee will shortly complete a draft of an appropriate new law<sup>61</sup>. A major donor contribution will be needed to finance the transitional costs of the new system<sup>62</sup>, however – possibly upwards of US\$500 million through 2006.

45. **Legal, judicial and regulatory reform has slowed considerably.** A number of laws important to the orderly conduct of commercial activity have been pending for a considerable time; they need finalizing and providing with enabling regulations<sup>63</sup>. Other laws need revising<sup>64</sup>. The shortcomings of the Palestinian courts system are widely acknowledged and have in part been corrected<sup>65</sup>, but there is an urgent need to improve the infrastructure of the court system and give priority to training judges and lawyers – as well as to ensure the implementation of court decisions. The slow progress in this vital sector can in part be attributed to long-standing competition between the Supreme Judicial Council and the Ministry of Justice, and the PA is urged to resolve this issue<sup>66</sup>.

46. **More liberal access to credit will be needed to fuel any recovery.** Commercial bank lending is constrained by collateral requirements that rely excessively on land titles – scarce commodities in the West Bank and Gaza, where less than half the land in the Gaza Strip and only about 30% of the land in the West Bank is registered. Apart from a major land-titling program, allowing a wider range of assets to be used as collateral, expanding leasing and adopting more creative methods for assessing credit risk would all help expand credit opportunities. The Palestinian Monetary Authority (PMA) should avoid setting arbitrary targets for commercial bank lending<sup>67</sup>, and should give banks greater flexibility to offer new services.

47. **PA transparency has improved considerably during the last two years; nonetheless, further measures are needed to create confidence among investors, the public and donors.** One key omission is the lack of an independent audit function. New draft legislation paves the way for root-and-branch reform of the General Control Institute, but this will take 2-3 years to bring results; until then, the PA should contract international auditors to fill the gap. In the interest of minimizing anti-competitive bias, the PA should move ahead with liquidating equity holdings and privatizing most public enterprises. Public procurement also deserves attention, since existing laws are only partially observed by PA agencies<sup>68</sup>. Other measures that would help deepen transparency are the publication of the terms of exclusive licenses, and the adoption of conflict of interest and financial disclosure provisions for senior government officials.

### *Developing the Infrastructure of Gaza and the West Bank*

48. **A well-functioning infrastructure is important from a number of perspectives – to improve the quality of life and popular confidence in the future, and to build a stable platform for private economic activity.** An added benefit is the short-term impact of public works programs on the local construction industry and on employment.

49. **If violence in Gaza and the Northern West Bank abates, donor-financed rehabilitation and development work will accelerate somewhat** – as it did during the comparative calm in mid-2003. A cease-fire in Gaza would encourage donors to repair key components of the infrastructure network (for instance, the main north-south highway and a number of internal/urban roads), as well as press ahead with basic needs projects delayed by insecurity – the schools required to absorb new school entrants, new health clinics, the extension of the water and electricity distribution networks, a desalination plant, priority sewerage and solid waste projects<sup>69</sup>. The

restoration of freer movement in the northern West Bank would encourage rehabilitation of degraded local roads (Jenin-Nablus, inter-municipal roads in the northern governorates), as well as delayed school and health infrastructure projects.

50. **Unless donors perceive a fundamental change in Palestinian economic prospects, though, there is unlikely to be much “additional money”.** There is no shortage of viable projects<sup>70</sup>, and many have long since been identified and designed. However, donors may not feel inclined to step up funding levels on the basis of reduced violence alone. They are more likely to reallocate from within an annual aid envelope remaining in the US\$900 million – US\$1 billion range.

51. **The rationale for a major additional donor effort is a scenario promising true economic revival.** Under such a scenario, the main constraints to public investment would be the availability of donor finance, and PA implementation capacity. We have estimated that a “major new effort” might bring in another US\$1.5 billion over the 2004-6 period (for a total of US\$4.3 billion). *If* such a target could be achieved, only part of these funds could be made available for infrastructure. Even with a recovering economy, up to US\$1 billion per year would need to be devoted to a combination of budget support, humanitarian assistance and the transition to a new public pensions system. This would leave about US\$500 million each year for the rehabilitation and development of infrastructure<sup>71</sup>, and for the creation of public and private capacity.

52. **Any detailed assessment of Palestinian reconstruction and development needs will require careful prioritization.** The precedent for this is the PA’s Socio-Economic Stabilization Plan 2004-2005, in which the Ministry of Planning (MOP) demonstrated a commendable ability to tailor programs to available resources, and to balance budget support, humanitarian and development priorities. It is appropriate that any further reconstruction planning related to the Disengagement Plan should mesh with work being done by MOP on the PA Medium-Term Plan.

### ***GOI Facilitation of Humanitarian and Development Assistance***

53. **The Disengagement Plan recognizes the importance of sustained flows of donor assistance to Gaza and the West Bank.** The Plan indicates that Israel “views very favorably continued activity of the international humanitarian organizations and those that deal with civil development which aid the Palestinian population. The State of Israel will coordinate with the international organizations the arrangements that will make this activity easier.” Such assurances have, however, been given before.

54. **Donor frustration with operational policy of the Israeli Defense Force (IDF) is considerable.** On November 7, 2003, the donor Task Force on Project Implementation (TFPI)<sup>72</sup> sent to the Government Coordinator for the Territories a note asking GOI to take steps to improve the operating environment, which “has now deteriorated to a degree which many donors consider both unmanageable and unacceptable....GOI has given multiple assurances from the highest levels that donor activity and humanitarian aid will be fully facilitated. These assurances contrast dramatically with the facts on the ground<sup>73</sup>.” By and large, this remains the case today.

55. **The destruction of donor-financed infrastructure assets is a serious issue for donors.** While the scale of this is now significantly less than in 2001-2<sup>74</sup>, during May 2004 appreciable damage was done to economic infrastructure in Gaza (road surfaces, electricity transformers, water mains, the environs of the Gaza Industrial Estate<sup>75</sup>). Much of this had been built or repaired with donor funds. Donors have expressed reluctance to invest in major new infrastructure assets as long as they perceive a risk of damage or destruction, and this continues to inhibit productive investment.

## *IV - The Settlements - Transferring the Assets*

56. **The Quartet statement of May 4, 2004 noted the importance of determining “equitable and transparent arrangements” for the disposal of settlement assets<sup>76</sup>. This section suggests how this might be done<sup>77</sup>.**

### *The Settlements and Their Productive Potential*

57. **A total of 21 settlements are at issue in the Disengagement Plan – 17 in Gaza and 4 in the West Bank – see Maps<sup>78</sup>.**

58. **The 17 settlements<sup>79</sup> in Gaza occupy 15-20% of the land<sup>80</sup> and by December 31, 2003, contained a population of 7,254 in approximately 1,500 to 2,000 houses<sup>81</sup>. Some 32 square kilometers have been allocated to agriculture, and 160,000 square meters are occupied by buildings<sup>82</sup>. There is a small industrial zone inside the Katif Settlement Block – Neveh Dekalim, where 18 enterprises provide employment for 90 Israelis and 120 Palestinians.**

59. **Although situated on some of the best-watered and richest arable land in Gaza, the settlements use little of it and produce at well below the area’s potential.** Data on the economic output of the settlements needs further analysis. By one account, though, the 17 Gaza settlements produce c. US\$33 million in gross output per annum, equivalent to only 3% of the 2003 GDP of the rest of the Gaza Strip. Most of this (US\$25 million) is derived from agriculture<sup>83</sup> – with only 3.3 of the 32 square kilometers of agricultural land in use (of 740 farming lots approved, 310 are idle; the Gaza settlers also farm 26.5 square kilometers of land leased from the Israel Lands Authority).

60. **Expansion of the area under irrigation seems attractive, but the scarcity of water in Gaza and today’s border management regime mean that careful planning will be needed.** The Gaza aquifer, which lies below the Katif Block, is the only water source in Gaza and is already over-abstracted. The aquifer has a sustainable yield of about 96 million cubic meters per year<sup>84</sup>, but some 140 million cubic meters was used in 2003 (with the settlements consuming 7-10 million cubic meters of this). To avoid further over-exploitation of the aquifer, the PA should explore purchasing irrigation water from Israel. For illustrative purposes, though, one can predict that tripling the area under irrigation would yield gross output of some US\$50 million<sup>85</sup>, equivalent to about 5% of Gaza’s 2003 GDP. This would not be realized at once, and assumes that the agricultural capital would be handed over intact (greenhouses, pumps, irrigation systems, trees, etc.), that the land can be put into production without undue delay, that the border cargo regime is altered – and that markets can be found for the produce.

61. **The Disengagement Plan also calls for the evacuation of four small settlements in the northern West Bank.** These settlements house around 550 people<sup>86</sup>, and are “dormitory communities”. They do not contain any agricultural or industrial enterprises, and their productive potential is negligible – particularly if the houses were to be dismantled by GOI.

### ***Handover and the Role of the International Community***

62. **GOI believes that the PA may be unwilling or unable to secure the settlements, leading to looting and destruction, or to seizure of houses and other assets by militants.** The Disengagement Plan accordingly states that “in general, houses belonging to settlers and other sensitive structures such as synagogues will not be left behind” – but that the “water, electricity, sewage and communications infrastructures will be left in place.” In relation to productive assets, the Plan indicates that “the State of Israel will aspire to transfer other structures, such as industrial and agricultural facilities, to an international third party that will use them for the benefit of the Palestinian population.”

63. **GOI has indicated that it will not negotiate the withdrawal process with the PA, but has signaled a willingness to coordinate the process at a technical level, either directly or through a third party.** There are obvious benefits to coordination, which would give access to the information needed to plan the orderly transfer, administration and disposal of the assets.

64. **The Disengagement Plan proposes that settlement assets be handed over to a third party, but custodianship of this type raises many questions.** First, it is unclear that a third party has the legal authority to receive, administer and dispose of these assets<sup>87</sup>. A more pressing question is how a custodian could in reality secure the assets against destruction, looting or squatting in the event of a breakdown of Palestinian authority. Third, a custodian would have to accept a significant reputational risk – even a token pass-through role would not absolve the custodian of blame for any subsequent misuse of the assets.

65. **A more practical alternative to custodianship is for a third party to act in close support of the PA.** This would be more compatible with the views of the PA, which sees itself as the rightful custodian of the relinquished assets. In order to ensure a smooth transition, a third party could serve as a “technical partner” to the PA. In this capacity, it could assist with, and monitor, the asset transfer and disposal process, and could interface between the PA and GOI as necessary. Third party involvement of this kind would help create public confidence that settlement assets would not be misappropriated. By leaving a light footprint rather than assuming direct responsibility, the international community would strengthen, not displace the PA.

66. **The Ad Hoc Liaison Committee (AHLC) could act as “sponsor” for the handover process**<sup>88</sup>. The AHLC is a technical forum of key donors, the membership of which includes all the Quartet parties. It is chaired by Norway, and the World Bank serves as its Secretariat<sup>89</sup>. The “technical partner” to the PA, along with the PA itself, could provide regular reports to this body.

### ***Preparing for Handover***

67. **Without detailed information on the settlement assets, their transfer and disposal cannot be properly planned.** GOI should make relevant information available to the PA or the third party well in advance of the first evacuations. Such information should include detailed data on public and private infrastructure and land use.

68. **GOI should ensure that departing settlers preserve any assets intended for handover to the Palestinians.** This might be done by conditioning government compensation on delivering the assets to GOI intact.

69. **The PA, in its turn, needs to mobilize without delay.** Adequate preparation will involve a considerable number of steps – creating a mechanism to oversee the process, determining the legal status of the lands and organizing a transparent claims procedure, agreeing on the use of the settlement areas and assets, arranging for any interim use pending disposal, and conducting a public information campaign. This preparatory period would take *at least* six months.

70. **Receiving, administering and disposing of the settlement assets is a task which the PA is in principle capable of handling.** It should be remembered that the PA assumed a broader range of functions over a much larger area in 1994, at a time when it had almost no capacity. Nonetheless, the unprecedented nature of this challenge and its visibility mean that high-quality PA performance is essential. The principal question for the PA is whether this is best assured using existing institutional structures, or whether it makes sense to establish a specialized agency to manage the process<sup>90</sup>.

71. **Practical considerations point to the creation of a special agency.** The task involves a multitude of transactions across PA institutional boundaries, and will be very laborious. The existence of a single responsible agency would clarify accountability, simplify monitoring and provide a single point of focus for the work of the third-party “technical partner”.

72. **The legal framework establishing the special agency needs to be in place before the evacuation of the first settlement.** Such an agency is best created by the Palestinian Legislative Council and should provide it with regular reports. It should be strictly temporary in nature (in other words, its mandate should expire on a pre-determined date). Its responsibilities should include ensuring an efficient claims process, receiving and managing settlement assets pending their disposal, coordinating preparations for disposal and implementing the disposal process. After the disposal of the assets of a particular settlement is complete, the agency would have no further role or authority there, and the regular municipal and PA structures would assume jurisdiction. Adequate coordination and cooperation with PA ministries and municipalities would need to be structured into the *modus operandi* of the agency.

73. **An important aspect of the PA’s response should be careful involvement of the municipalities.** Those areas which the PA does not decide to retain as ‘public land’ would in time come under municipal jurisdiction<sup>91</sup>. In the Katif Block, in particular, this gives rise to a need for technical and fiscal support to the municipalities concerned – to ensure that settlement infrastructure (roads, electricity grids and sewage systems) is well-integrated, and that the aquifer is properly protected.

### ***Claims on Land***

74. **A transparent land claims adjudication process will be essential.** It is recommended that the special agency should receive and adjudicate property claims<sup>92</sup>.

Accordingly, the law establishing the agency should detail the procedures to be used, and should define the rights of former owners (including whether restitution requires a return of property, or whether the PA has the option of paying compensation). A public information campaign will be particularly important to ensure confidence in the land claims process.

75. **The status of settlement lands is complicated.** According to the Palestinian Land Authority, about 90-95% of the land on which the settlements are built in the Gaza Strip was declared 'public land' during the Ottoman period. However, some individuals cultivated some of this land. Pursuant to the Ottoman Land Code (which remained in effect during the British and Egyptian administrations) these individuals could assert ownership after ten years of cultivation, and their descendants may now come forward<sup>93</sup>. In the West Bank, land registration has been restricted<sup>94</sup>, and GOI has declared a considerable quantity of land privately held (but unregistered) to be 'public' –subsequently using it to create Israeli settlements. A significant number of individual land claims should be anticipated against evacuated properties in the West Bank.

### *Disposing of the Settlement Assets*

76. **There is serious concern among Palestinians, international observers and GOI that settlement assets may find their way to those with power or connections.** This would seriously damage the PA's reputation. A well-prepared and well-publicized policy based on clear economic and social goals and on rational physical plans will do much to avoid such an embarrassment.

77. **In deciding the best use of settlement assets, the PA may wish to take five factors into account:** first, private claims on the relinquished land; second, the trade-off between productive and social uses of space; third, environmental constraints; fourth, the usefulness of the infrastructure left behind for Palestinian needs; and finally, planning for the longer-term (with particular attention to environmental considerations).

78. **Assets can usefully be broken into three categories: public infrastructure, productive assets and houses.** *Public infrastructure* (roads, electricity and water installations) is in principle best handed over to the responsible PA/municipal authorities. *Productive assets* (land, industrial infrastructure and equipment) can be sold to investors using transparent auction methods, unless the land is needed for public projects or for green areas/tourism. *Houses* are a more difficult proposition.

79. **If the houses are left standing, their disposal needs careful thought.** It is worth noting the many potential controversies associated with disposing of settlement houses, and the consequent need for open discussion and a clear advance plan.

- If the houses were *given away*, there would be many more claimants than properties, and intense pressures on the distributing party could be guaranteed.
- If the houses were *rented at full economic cost*, this would restrict potential tenants to the better-off – doubtless causing popular resentment, given the large number of families that have lost their homes in Gaza<sup>95</sup>.

- Alternatively, houses could be *rented at subsidized cost*, but this would again cause allocation problems, as well as risking dilapidation and burdening the PA with maintenance costs (both rental options would involve the vexing business of public housing administration).
- A cleaner solution might be to *sell the houses*. One option here is *sale at subsidized cost*, with eligibility restricted to specific groups (the poor, or those who have lost their houses, or refugees<sup>96</sup>). Here again, allocation and dilapidation issues could arise. Another option would be to *sell the houses on the open market*. This would favor the wealthier, but sale proceeds could be put into a fund to benefit the poor and disadvantaged. A variant of this would be use of the sale proceeds to simultaneously “densify” the housing blocks with low-cost units.

80. **Allowing temporary occupation of vacated houses and land is a tempting option, but should be avoided.** Even with advance planning, there will be lags between evacuation and asset disposal, and this will create pressure to allow temporary use of vacant houses and land – not least, to prevent squatting and looting. International experience, from the Balkans in particular, shows that temporary occupation may be impossible to reverse peacefully. Instead of this, a maximum effort should be made to dispose of the assets quickly.

### *Securing the Settlements*

81. **Whether the settlement assets can be protected after their evacuation depends on the general security situation.** Put another way, if current political/social processes break down, there is little that can be done to secure the settlements. If the overall security environment is positive, the integrity of the settlements is likely to be respected, and problems would hopefully be limited to isolated incidents of theft or squatting. It should be noted that there are many empty housing units in Gaza City; despite the scale of house demolitions and internal displacement, they have not been subject to takeover by squatters.

82. **The best form of protection of the settlements is an open process of public consultation resulting in clear plans and procedures.** As pointed out already, though, it will be important to minimize the time between the transfer and the disposal of the assets.

83. **Public consultation and the provision of information are also essential to the success of the transfer and disposition process.** For this process to succeed, the PA must not be reluctant to engage with the public; instead, it should see this as a chance to re-assert leadership, show sensitivity to public concerns and demonstrate technical competence. Civil society, municipal governments, and the PLC all have essential roles to play. It will also be important to disabuse the public of some of the more fanciful expectations that evacuation of the settlements may give rise to. Local communities, in particular, need to be seen as key partners; their support can help ensure that local leaders help protect the assets against misappropriation or destruction.

## V - Next Steps

84. **This paper shows that without a committed GOI effort to facilitate movement and trade, the Palestinian economy will not recover. This has an important bearing on the proposed Quartet work program in the economic sphere.** Without prejudice to the critical need for Palestinian security reform, we would propose that the Quartet focus on a dialogue on what can be done to address closure and kick-start the Palestinian economy. This paper argues that important steps can be taken that will make a serious difference *without* risking Israel's security.

85. **There are a number of discrete tasks which can usefully be launched at once and which will feed into any such dialogue.** These can be handled under the umbrella of the AHLC and could be facilitated by the World Bank in its role as Secretariat, if so requested, in close collaboration with GOI, the PA and the donor community.

- **An in-depth review of ways to facilitate border cargo management**, to include an appraisal of infrastructure and technology requirements;
- **A rapid review of the feasibility of industrial estates/export processing zones under an improved border management regime.** Among the estates and zones that merit consideration are the existing estates at Erez and Karni, those proposed near Jenin and Tulkarem in the West Bank, and one on the Egyptian border;
- **A study of Palestinian export possibilities under a reformed border regime**, to include a time-bound program of Palestinian policy measures needed to facilitate export growth, as well as a discussion of the adequacy and uptake of current Palestinians export quotas, and of other potential export incentives
- **A detailed review of the settlement assets and their potential uses**, to include a review of the legal status of the land in the settlements;
- **Design work on the structure, functions, staffing and support needs of a special PA agency** to be charged with managing the transfer and disposal of settlement assets and the review and adjudication of claims, to include framing the necessary enabling legislation.

86. **These preparatory studies should be accompanied by a joint PA-donor effort to define a time-bound, monitorable agenda of top-priority Palestinian reforms.** This merits a higher level of energy by both the PA and the donors to this important topic.

87. **It is suggested that AHLC members convene around this initial assessment shortly, in order to agree on next steps and responsibilities.** Among the agenda items at such a meeting might be the following:

- **The establishment of a work program for the coming months**, with agreed assignments and expectations;

- **A review of progress under the new World Bank-administered Reform Trust Fund, and a discussion of additional PA budget support needs for the remainder of 2004.** This could usefully include a review of the status of the Palestinian pension reform process and donor financing requirements.

88. **If commitment by the GOI, PA and the Quartet to creating a proper enabling environment for economic development is forthcoming, a full reconstruction assessment of the type mentioned in the May 4 Quartet Action Plan would be very useful<sup>97</sup>.** The Action Plan proposes that UNSCO and the World Bank support the PA in carrying out such an assessment. One way to proceed would be for the donors to support the efforts of the Ministry of Planning as part of, or as a supplement to, ongoing work on a Palestinian Medium-Term Plan. This could then lead to a donor funding conference, at which it would be important to define a “quick-hitting” program of investments. Neither a general assessment nor a high-profile donor meeting have much added value in today’s stagnant economic environment, however. Donors are already providing high levels of emergency, humanitarian and reconstruction assistance and appear disinclined to do much more without a quantum shift in Palestinian economic prospects.

# ***Annex 1 - June 6 Cabinet Decision on Disengagement***

## ***Excerpt from Statement by Cabinet Secretary Yisrael Maimon, June 6***

The Cabinet has continued to discuss the Disengagement Plan and has decided as follows:

1. The Cabinet approved a Modified Disengagement Plan, Appendix A, but this decision does not amount to an evacuation of settlements.
2. The Cabinet has approved the preparatory work detailed in Appendix C.
3. After the end of the preparation work the Cabinet will reconvene to hold a separate discussion and decide whether or not settlements should be evacuated, which settlements and at what pace, considering the circumstances at that time.
4. The Modified Disengagement Plan approved as per 1 above was preceded by an exchange of letters between U.S. President George W. Bush and Prime Minister Ariel Sharon on April 14, 2004. The letter from the U.S. President is presented herein.

Attached are Appendices A and C (Appendix A – Modified Disengagement Plan - Key Principles; Appendix C – Format of Preparations for the Modified Disengagement Plan).

At the conclusion of the discussion on the matter the Prime Minister noted that in two sessions the Cabinet discussed the aforementioned issue for 15 hours; it was a deep and comprehensive discussion, one of the most important the Cabinet has had in recent years. The Prime Minister added that the intention is to complete the implementation of the Plan by the end of 2005. Likewise he intends to complete the necessary preparation work by March 1, 2005.

Immediately after the end of the preparation work the Government will convene to make decisions about the continued execution of the plan. The Prime Minister stressed that once the decision is taken all of the ministers have to stand behind it. The Prime Minister thanked Minister Tzippi Livni, his Bureau Chief Dubi Weissglass, Cabinet Secretary Yisrael Maimon, Director General of the Ministry of Justice Aharon Abramowitz, Chairman of the National Security Council Giora Eiland and the ministers, who spent days and nights to find an agreed formula for the approval of the plan.

## ***Appendix A – Modified Disengagement Plan - Key Principles***

### **I. Background - Diplomatic and Security Significance**

The State of Israel is committed to the peace process and endeavors to reach an agreed arrangement based on the vision presented by U.S. President George W. Bush.

The State of Israel believes it must take action to improve the current situation. The State of Israel has reached the conclusion that there is currently no partner on the Palestinian side with whom progress can be made on a bilateral peace process. Given this, a modified disengagement plan has been drawn up, based on the following considerations:

- a. The stalemate embodied in the current situation is damaging; in order to break the stalemate, the State of Israel must initiate a process that is not dependent on cooperation with the Palestinians.
- b. The aim of the plan is to bring about a better security, diplomatic economic and demographic reality.
- c. In any future permanent arrangement, there will be no Israeli presence in the Gaza Strip. On the other hand, it is clear that some parts of Judea and Samaria (including key concentrations of Jewish settlements, civilian communities, security zones and areas in which Israel has a vested interest) will remain part of the State of Israel.
- d. The State of Israel supports the efforts of the United States, which is working along with the international community, to promote the process of reform, the establishment of institutions and improving the economic and welfare conditions of the Palestinian people, so that a new Palestinian leadership can arise, proving itself capable of fulfilling its obligations under the Road Map.
- e. The withdrawal from the Gaza Strip and from the northern part of Samaria will reduce friction with the Palestinian population.
- f. Completion of the plan will negate the validity of any claims against Israel regarding its responsibility for the Palestinian population of the Gaza Strip.
- g. The process in this plan does not detract from relevant existing agreements between Israel and the Palestinians. The relevant security arrangements will remain in force.
- h. International support for this process is widespread and important. This support is vital in ensuring that the Palestinians fulfill their obligations in terms of fighting terror and implementing reforms, in accordance with the road map. Only then will the sides be able to resume negotiations.

## **II. Key Points of the Plan**

### **A. The Process**

1. The necessary preparations will be undertaken for the implementation of the plan (including administrative work to determine the criteria, definitions, estimates and preparation of necessary legislation).
2. Immediately after the completion of this preparation work there will be a Government discussion to decide on the evacuation of settlements in consideration of the circumstances at that time – whether to evacuate or not, and which settlements.

The settlements will be split into the following four groups:

1. Group A - Morag, Netzarim, Kfar Darom.
2. Group B - The four settlements in northern Samaria (Ganim, Kadim, Sa-Nur and Homesh).
3. Group C - The Gush Katif block of settlements.
4. Group D - The settlements in the northern Gaza Strip (Aleï Sinai, Dugit and Nisanit).

It is noted that after the end of the aforementioned preparations the Government will convene periodically to decide on the question of whether there will be any evacuation or not, regarding each of the groups separately.

3. The continuation of the process as described above and below will be subject to the decisions the Government makes as stated in section 2 above and carried out in accordance with the contents of the decisions.

### **3.1 The Gaza Strip**

1. The State of Israel will withdraw from the Gaza Strip, including Israeli settlements, and will redeploy outside the area of the Strip. The method of the withdrawal, with the exception of a military presence in the area adjacent to the border between Gaza and Egypt (the Philadelphi Route), is detailed below.
2. Once the move has been completed, there will be no permanent Israeli military presence in the evacuated territorial area of the Gaza Strip.

### **3.2 Judea and Samaria**

3. The State of Israel will withdraw from northern Samaria (four settlements: Ganim, Kadim, Sa-Nur and Homesh) as well as all permanent military installations in the area, and will redeploy outside the evacuated area.
4. Once the move has been completed, there will be no permanent Israeli military presence in the area.
5. The move will provide Palestinian territorial contiguity in the northern parts of Samaria.
6. The State of Israel, along with the international community, will help improve the transportation infrastructure in Judea and Samaria, with the goal of providing continuous transport for Palestinians in Judea and Samaria.
7. The move will make it easier for Palestinians to live a normal life in Judea and Samaria, and will facilitate economic and commercial activity.

### **3.3 The withdrawal process is slated to end by the end of 2005.**

## **B. The Security Fence**

The State of Israel will continue to construct the security fence, in accordance with the relevant cabinet decisions. In deciding on the route of the fence, humanitarian considerations will be taken into account.

## **IV. The Security Reality after the Evacuation**

### **A. The Gaza Strip**

1. The State of Israel will monitor and supervise the outer envelope on land, will have exclusive control of the Gaza airspace, and will continue its military activity along the Gaza Strip's coastline.
2. The Gaza Strip will be completely demilitarized of arms banned by current agreements between the sides.
3. The State of Israel reserves the basic right to self defense, which includes taking preventive measures as well as the use of force against threats originating in the Gaza Strip.

### **B. The West Bank**

1. After the evacuation of the northern Samaria settlements, there will be no permanent military presence in that area.
2. The State of Israel reserves the basic right to self defense, which includes taking preventive measures as well as the use of force against threats originating in the area.
3. Military activity will remain in its current framework in the rest of the West Bank. The State of Israel will, if circumstances allow, consider reducing its activity in Palestinian cities.
4. The State of Israel will work to reduce the number of checkpoints throughout the West Bank.

## **V. Military Infrastructure and Installations in the Gaza Strip and the Northern Samaria Region**

All will be dismantled and evacuated, except for those that the State of Israel decides to transfer to an authorized body.

## **VI. The Nature of Security Assistance to the Palestinians**

The State of Israel agrees that in coordination with it, consulting, assistance and training will be provided to Palestinian security forces for the purpose of fighting terror and maintaining the public order. The assistance will be provided by American, British, Egyptian, Jordanian or other experts, as will be agreed upon with Israel.

The State of Israel stresses that it will not agree to any foreign security presence in Gaza or the West Bank without its consent.

### **VII. The Border Area between the Strip and Egypt (the Philadelphi Route)**

The State of Israel will continue to maintain military presence along the border between the Gaza Strip and Egypt (the Philadelphi route.) This presence is an essential security requirement. The physical widening of the route where the military activity will take place may be necessary in certain areas.

The possibility of evacuating the area will be considered later on. This evacuation would be conditioned, among other factors, on the security reality and on the level of cooperation by Egypt in creating an alternative credible arrangement.

If and when the conditions permit the evacuation of the area, the State of Israel will be willing to consider the possibility of setting up an airport and a seaport in the Gaza Strip, subject to arrangements agreed upon with the State of Israel.

### **VIII. Real Estate**

In general, houses belonging to the settlers, and other sensitive structures such as synagogues will not be left behind. The State of Israel will aspire to transfer other structures, such as industrial and agricultural facilities, to an international third party that will use them for the benefit of the Palestinian population that is not engaged in terrorism.

The Erez industrial zone will be transferred to an agreed-upon Palestinian or international body.

The State of Israel along with Egypt will examine the possibility of setting up a joint industrial zone on the border between Israel, Egypt and the Gaza Strip.

### **IX. Infrastructure and Civilian Arrangements**

The water, electricity, sewage and communications infrastructures will be left in place.

As a rule, Israel will enable the continued supply of electricity, water, gas and fuel to the Palestinians, under the existing arrangements and full compensation.

The existing arrangements, including the arrangements with regard to water and the electromagnetic area, will remain valid.

### **X. The Activity of the International Civilian Organizations**

The State of Israel views very favorably continued activity of the international humanitarian organizations and those that deal with civil development, which aid the Palestinian population.

The State of Israel will coordinate with the international organizations the arrangements that will make this activity easier.

The State of Israel suggests that an international mechanism (such as the AHLC) be set up, in coordination with Israel and international bodies, that will work to develop the Palestinian economy.

## **XI. Economic Arrangements**

In general, the economic arrangements that are currently in effect between Israel and the Palestinians will remain valid. These arrangements include, among other things:

- A. The movement of goods between the Gaza Strip, Judea and Samaria, Israel and foreign countries.
- B. The monetary regime.
- C. The taxation arrangements and the customs envelope.
- D. Postal and communications arrangements.
- E. The entry of workers into Israel in accordance with the existing criteria.

In the long run, and in accordance with the Israeli interest in encouraging Palestinian economic independence, the State of Israel aspires to reduce the number of Palestinian workers entering Israel, and eventually to completely stop their entrance. The State of Israel will support the development of employment sources in the Gaza Strip and in the Palestinian areas in the West Bank, by international bodies.

## **XII. The International Crossing Points**

### **A. The international Crossing Point between the Gaza Strip and Egypt**

- 1. The existing arrangements will remain in force.
- 2. Israel is interested in transferring the crossing point to the "border triangle," south of its current location. This will be done in coordination with the Egyptian Government. This will allow the expansion of the hours of activity at the crossing point.

### **B. The International Crossing Points between Judea and Samaria and Jordan**

The existing arrangements will remain in force.

## **XIII. The Erez Crossing Point**

The Erez crossing point will be moved into the territory of the State of Israel according to a timetable that will be determined separately.

**XIV. Summary**

The goal is for the implementation of the plan to bring about an improvement in the situation and a break from the current stagnation. If and when the Palestinian side shows evidence of its willingness and ability to actually take action to fight terrorism, a full cessation of terror and violence and the carrying out of reforms according to the Road Map, it will be possible to return to the track of discussions and negotiations.

## *Annex 2 - Gateways*

The Disengagement Plan indicates a conditional willingness to set up a seaport and airport in Gaza. For Israel, security is of prime concern. Security can be assured if funds are made available for appropriate technology and infrastructure, and if rigorous inspection – if necessary, using third parties – is assured.

### *Current International Gateways: Alternatives to Israeli ports and Ben Gurion Airport*

Under current restrictions, the only international gateway available for Gaza as an alternative to exiting through Karni to Ashdod or Ben Gurion is **the land route through Rafah**. This would provide access to Port Said (Egypt) for trans-shipments to and from Europe. For this route to be feasible, secure and efficient cargo clearance facilities and processes would have to be developed at Rafah, and a protocol agreed with Egypt for the unimpeded movement of goods in bond direct to/from the three Egyptian ports, along with favorable treatment for transit cargo moving through their facilities.

A principal alternative to transit through Israel for the West Bank is **by land through Jordan**, with connections to the Gulf and Asia through the port of Aqaba for sea freight, and Queen Alia airport for airfreight. The land connections to Aqaba would run through King Hussein/Allenby Bridge or Prince Mohammed/Adam Bridge. Importers currently use the first bridge, while the second is used for exports, principally citrus and fresh products. Currently, only a small volume of Palestinian external trade passes through Jordan. For this gateway to be a viable alternative to export *via* the Israeli ports, the border crossing procedures need considerable improvement, and transit agreements and new handling arrangements for Palestinian cargo need to be worked out with Jordan.

### *Gaza-West Bank*

The “**safe passage**” has been inoperative since October 6, 2000. The reinstatement of secured convoys would appear to be the best approach. Convoys could consist of tractor-trailers carrying sealed containers, following appropriate pre-shipment inspection and scanning. Eventually it might be possible to relax the use of convoys, relying instead on electronic means to monitor container movements (e.g. GSP-linked transmitters or transponders), with obligatory reporting stations along the route.

### *A Gaza Sea Port*

Construction of a **full-scale Sea Port** in Gaza, financed by several European donors, began in August 2000 but was suspended in October 2000. Phase 1 was expected to cost around \$100 million. The site was not optimally located, due to limited options, and there was extensive debate about its appropriate size.

Another possibility would be to develop a **Roll-On, Roll-Off (RoRo) facility** to connect with the new Suez Canal Container Terminal at Port Said for trans-shipment to all destinations. The proposed service to Port Said would initially involve small

RoRo vessels (1200-1500 lane-meters). Three vessels operating at a loaded-to-empty ratio of 65:35 would provide an annual effective capacity of 125,000 loaded TEUs. A RoRo facility would function, in effect, like a land crossing for containers moving in and out of Gaza. The RoRo facility should be privately operated, and could provide for the transport of all non-bulk shipments in containers using lowboy trailers, but this arrangement would mean that essential commodities such as grains, fertilizers, and cement would have to be shipped in bagged form.

A RoRo facility is simple in design – essentially an approach channel, a pier, an access road, warehouses, and transportation and security equipment. Preliminary estimates suggest it might cost c. US\$15-20 million and could be constructed in less than a year. The commercial viability of such a facility needs to be assessed, but the estimated trip costs and average delivery times appear comparable or superior to the land route through Rafah. The PA would need to formalize a protocol for the movement of vessels and for the operation of the facility with GOI, as well as to agree with the Government of Egypt and an operator/operators at the container terminal at Port Said (on services to be provided, including berthing facilities).

The possibility of a RoRo service to Genoa or a port in southern Italy providing direct access to Western Europe by road could also be explored. Although this would involve a longer journey time and would require larger, more costly vessels, it would avoid the time for trans-shipment at Port Said, reducing travel time to Europe by 2-to-4 days.

The development of a RoRo facility would not preclude its eventual expansion into a full-service port: there are cargoes like coal, cement and fuel oil as well as construction materials that cannot be carried this way. Initially these would need to continue coming in through Israeli ports.

It would be sensible to site the RoRo facility in a place which is suitable for expansion to a deepwater port. With the whole of the Gaza coastline potentially available, there is no need for the facilities to be located on the same site as the abandoned port project. At least 40 hectares of land and 1500 meters of waterfront should be set aside for the RoRo terminal and the deepwater port.

### ***The Gaza Airport***

Airfreight services from the **Gaza Airport** were limited prior to the *intifada*, due to Israeli security concerns. The substantial capital investment required to restore the airport to operating condition and to establish handling facilities for perishables (c. US\$50 million) may not be justified in the short run. It may, however, make sense to introduce a helicopter service between Gaza and Amman in the interim. This would require the agreement of the civil aviation authorities in Israel and Jordan, as well as the introduction of mutually agreeable security provisions. The cost for the helicopter service would be higher than a fixed wing operation, but is better suited than a fixed-wing aircraft for short distances, and does not require a runway or a large terminal. Assuming four flights per aircraft per day, a round trip would cost between US\$200-250.

## Tables

<b>Table 1. Recent Macroeconomic Indicators</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Gross Domestic Product (GDP), US\$ million	4,179	4,116	3,329	2,831	3,144
GDP per capita, US\$	1,493	1,409	1,087	879	925
Real GDP growth rate	8.8%	-5.6%	-14.8%	-10.1%	6.1%
Real GDP per capita growth rate	4.3%	-9.6%	-18.7%	-14.5%	0.6%
Cumulative Real GDP per capita change since 1999		-9.6%	-26.5%	-37.2%	-36.8%
GDI per capita, US\$	1,896	1,839	1,513	1,326	1,467
<i>West Bank</i>	2,113	2,035	1,662	1,452	1,621
<i>Gaza Strip</i>	1,555	1,532	1,282	1,130	1,227
Real GDI growth rate	8.5%	-2.9%	-9.1%	-2.6%	11.5%
Real GDI per capita growth rate	4.0%	-7.0%	-13.3%	-7.4%	5.7%
Cumulative Real GDI per capita change since 1999		-7.0%	-19.4%	-25.4%	-21.1%
Poverty Rate	20%	27%	37%	51%	47%
<i>West Bank</i>	13%	18%	27%	41%	37%
<i>Gaza Strip</i>	32%	42%	54%	68%	64%
Unemployment Rate	12%	14%	26%	31%	26%
<i>West Bank</i>	10%	12%	22%	28%	24%
<i>Gaza Strip</i>	17%	19%	34%	38%	29%
Population (million)	2.80	2.92	3.06	3.22	3.40
<i>West Bank</i>	1.71	1.78	1.87	1.96	2.06
<i>Gaza Strip</i>	1.09	1.14	1.20	1.26	1.33

Table 2. Macroeconomic Indicators Under Various Scenarios	2003	"Status Quo"			"Disengagement"			"Disengagement Plus Lifting Internal Closures throughout the West Bank"		
		2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross Domestic Product (GDP), US\$ million	3,144	3,262	3,351	3,401	3,266	3,360	3,422	3,276	3,472	3,637
<i>West Bank</i>	2,172	2,269	2,347	2,399	2,272	2,354	2,414	2,279	2,432	2,566
<i>Gaza Strip</i>	973	993	1,004	1,002	994	1,007	1,008	998	1,040	1,072
GDP per capita, US\$	925	913	894	866	915	897	871	917	926	926
<i>West Bank</i>	1,052	1,048	1,035	1,012	1,049	1,038	1,018	1,053	1,073	1,082
<i>Gaza Strip</i>	729	706	678	643	707	680	647	709	702	688
Real GDP growth rate (West Bank and Gaza)	6.1%	1.6%	0.4%	-0.8%	1.8%	0.6%	-0.5%	2.2%	3.6%	2.3%
Real GDP per capita growth rate (West Bank and Gaza)	0.6%	-3.3%	-4.3%	-5.4%	-3.1%	-4.1%	-5.0%	-2.8%	-1.3%	-2.4%
Cumulative Real GDP per capita change since 2003		-3.3%	-7.4%	-12.4%	-3.1%	-7.1%	-11.7%	-2.8%	-4.0%	-6.3%
Gross Disposable Income (GDI) per capita, US\$	1,467	1,382	1,299	1,221	1,383	1,301	1,227	1,386	1,331	1,282
<i>West Bank</i>	1,621	1,546	1,463	1,385	1,547	1,466	1,391	1,550	1,501	1,455
<i>Gaza Strip</i>	1,227	1,130	1,047	973	1,131	1,049	977	1,134	1,072	1,018
Real GDI growth rate (West Bank and Gaza)	11.5%	-3.0%	-3.6%	-3.6%	-2.8%	-3.4%	-3.4%	-2.6%	-1.5%	-1.4%
Real GDI per capita growth rate (West Bank and Gaza)	5.7%	-7.7%	-8.1%	-8.1%	-7.5%	-8.0%	-7.8%	-7.3%	-6.1%	-6.0%
Cumulative Real GDI per capita change since 2003		-7.7%	-15.2%	-22.0%	-7.5%	-14.9%	-21.6%	-7.3%	-13.0%	-18.2%
Poverty Rate	47%	50%	52%	56%	49%	52%	56%	49%	50%	51%
<i>West Bank</i>	37%	40%	43%	47%	40%	43%	47%	39%	40%	42%
<i>Gaza Strip</i>	64%	68%	69%	72%	66%	69%	72%	66%	66%	68%
Unemployment Rate	26%	28%	31%	35%	28%	31%	34%	28%	29%	31%
<i>West Bank</i>	24%	26%	29%	33%	26%	29%	32%	26%	27%	29%
<i>Gaza Strip</i>	29%	32%	35%	39%	32%	35%	38%	32%	33%	35%
Population (million)	3.40	3.57	3.75	3.93	3.57	3.75	3.93	3.57	3.75	3.93
<i>o/w Gaza Strip</i>	1.33	1.41	1.48	1.56	1.41	1.48	1.56	1.41	1.48	1.56

	2003	\$2.8 billion in Total Donor Assistance Over 2004-2006			\$4.3 billion in Total Donor Assistance Over 2004-2006			Impact in 2006 of Increasing Donor Support over period 2004-2006
		Amount of Donor Support:			Amount of Donor Support:			
		\$1.0 billion	\$0.9 billion	\$0.9 billion	\$1.3 billion	\$1.5 billion	\$1.5 billion	
		2004	2005	2006	2004	2005	2006	
<b>Table 3. Selected Macroeconomic Indicators Under "Complete Withdrawal Plus Trade Facilitation" Scenario with Different Aid Assumptions Over 2004-2006 and Impact in 2006 of Increasing Donor Support</b>								
Gross Domestic Product (GDP), US\$ million	3,144	3,338	3,740	4,196	3,703	4,468	4,909	+ 713
<i>West Bank</i>	2,172	2,322	2,620	2,959	2,575	3,130	3,463	+ 503
<i>Gaza Strip</i>	973	1,016	1,120	1,236	1,127	1,338	1,446	+ 210
GDP per capita, US\$	925	935	998	1,068	1,037	1,192	1,250	+ 182
<i>West Bank</i>	1,052	1,072	1,156	1,249	1,190	1,381	1,461	+ 212
<i>Gaza Strip</i>	729	723	756	793	802	904	928	+ 135
Real GDP growth rate (West Bank and Gaza)	6.1%	4.1%	9.4%	9.2%	15.4%	17.9%	7.2%	
Real GDP per capita growth rate (West Bank and Gaza)	0.6%	-1.0%	4.3%	4.2%	9.8%	12.3%	2.2%	
Cumulative Real GDP per capita change since 2003		-1.0%	3.2%	7.6%	9.8%	23.3%	26.1%	+ 18.5 pts.
GDI per capita, US\$	1,467	1,403	1,403	1,424	1,590	1,757	1,758	+ 334
<i>West Bank</i>	1,621	1,570	1,583	1,621	1,772	1,969	1,987	+ 365
<i>Gaza Strip</i>	1,227	1,147	1,126	1,124	1,310	1,433	1,411	+ 287
Real GDI growth rate (West Bank and Gaza)	11.5%	-1.4%	2.4%	3.6%	11.6%	13.3%	2.3%	
Real GDI per capita growth rate (West Bank and Gaza)	5.7%	-6.2%	-2.4%	-1.2%	6.2%	8.0%	-2.4%	
Cumulative Real GDI per capita change since 2003		-6.2%	-8.5%	-9.5%	6.2%	14.7%	11.9%	+ 21.4 pts.
Poverty Rate	47%	48%	48%	46%	42%	37%	37%	- 10 pts.
<i>West Bank</i>	37%	38%	38%	36%	32%	27%	27%	- 9 pts.
<i>Gaza Strip</i>	64%	66%	64%	64%	61%	53%	53%	- 11 pts.
Unemployment Rate	26%	27%	25%	23%	22%	16%	14%	- 9 pts.
<i>West Bank</i>	24%	25%	23%	21%	20%	13%	12%	- 9 pts.
<i>Gaza Strip</i>	29%	31%	29%	28%	26%	20%	20%	- 8 pts.

## Endnotes

<sup>1</sup> GDP losses during 1929 and 1933 in the US were some 25-27%. Between 1998 and 2002, real per capita GDP in Argentina fell by 28%, while in 2002 the poverty rate rose by a half – from 38% to 57% of the population. In Iraq, GDP dropped by 31% in 2003.

<sup>2</sup> Using the standard International Labour Organisation (ILO) definition, which excludes “discouraged workers” – those without jobs who are so pessimistic about getting one that they have stopped looking. Including them among the unemployed produces a “relaxed definition” of unemployment and unemployment rates of 20% in first nine months of 2000 and 41% in 2002.

<sup>3</sup> The poverty line used for the West Bank and Gaza is US\$2.1 per day in 1998 prices, or NIS 1800 per month for a family of six, and reflects what was considered a minimum budget for food, clothing, housing and housekeeping supplies, health care, education and transportation.

<sup>4</sup> In late 2000, nearly 475,000 Palestinians were employed in the private sector, private investment totaled some US\$1.6 billion, and private output contributed 85% to GDP. By the end of 2002, 122,000 private sector jobs had been lost and private investment had shrunk to as little as US\$500-550 million for the year. Trade suffered commensurately, with exports declining by 35% between 1999 and 2002 (from US\$684 million in 1999 to US\$442 million in 2003). Over the same period, imports declined from US\$3,352 million to US\$2,015 million, a decrease of 40%.

<sup>5</sup> In the six-month period November 2003 to March 2004, an average of 35,531 people were under curfew each day – as compared with an average of 177,787 in the previous six-month (May – October 2003) period (*Mid-Year Review of the Consolidated Appeals Process*, UN Office for the Coordination of Humanitarian Affairs, June 2004).

<sup>6</sup> For example, gross value added in manufacturing declined from US\$682 million in 1999 to US\$330 million in 2002 – a drop of 52% – while manufacturing productivity fell by 47% per worker.

<sup>7</sup> Real per capita GDI (Gross Disposable Income, the measure of all sources of income) increased by about 6%, as a result of improved access to Israeli labor markets and the transfer to the PA of previously withheld tax revenues by the GOI.

<sup>8</sup> As compared to 16% of a significantly larger GDP in 1999. By comparison, Israeli exports contributed 38.5% of GDP in 2003.

<sup>9</sup> According to OCHA, some 13.5% of the West Bank (191,000 acres), excluding East Jerusalem, will lie between the Barrier and the Green Line if Barrier construction proceeds in accordance with GOI’s announced plans of October 2003. “This area, which is currently inhabited by 189,000 Palestinians, will include 39,000 acres enclosed in a series of eight enclaves. A further 152,000 acres will be caught between the Green Line and the Barrier in closed areas.” *Mid-Year Review of the Consolidated Appeals Process*, op. cit.

<sup>10</sup> According to the Disengagement Plan, “In the long run, and in accordance with the Israeli interest in encouraging Palestinian economic independence, the State of Israel aspires to reduce the number of Palestinian workers entering Israel, and eventually to completely stop their entrance.” We have assumed 2003 employment levels persist into 2004 (an average of 33,000 laborers per day), and decline to 25,000 in 2005 and 15,000 in 2006.

<sup>11</sup> For example, higher education spending per student has fallen by about a third during the *intifada*, at a time when the tertiary system needed revamping to serve the needs of a modern economy. PA environmental and preventive health services are in abeyance due to lack of funding, and dirty drinking water is increasingly common (over half of the households in the West Bank may by now be drinking contaminated water, according to the *Village Water and Sanitation Program, West Bank – Environmental Health Assessment – Phase II*, USAID, June 2003. The disposal of liquid and solid wastes has been compromised by municipal budget shortages as well as by closures.

<sup>12</sup> In 2004 the World Bank completed a Country Financial Accountability Assessment for the West Bank and Gaza. The CFAA is a standard Bank instrument and is designed to offer a rigorous and objective assessment of a country’s public financial management (PFM). The

conclusion of the CFAA for the West Bank and Gaza is as follows: “The Palestinian PFM system is judged to be adequate insofar as the World Bank’s criteria and standards for approval of a general budget support operation (or adjustment lending) are concerned. The World Bank has a four-point scale for assessing the fiduciary risks inherent in government financial management systems: low, moderate, significant and high. This CFAA has concluded that the risk level in the Palestinian PFM system is still significant, but that it should be possible to achieve a rating of moderate by the time of the next CFAA if the proposed program of PFM reforms is well-implemented. A key factor in the current rating is the lack of a properly functioning external audit institution. It should be understood that the World Bank provides budget support to many countries in which the level of fiduciary risk is assessed as significant, or even high – presuming that there is a strong government commitment to needed reform. Compared with many of these countries, the Palestinian PFM system shows significant strengths. Of 26 CFAAs completed in 2003, the risk level was assessed as high in 14 countries, significant in 8 countries, moderate in 3 and low in only 1 country. An important factor which qualifies the PA’s PFM system as adequate under the World Bank fiduciary requirements for budget support is a track record of significant improvements in the last two years. The PA’s agreement to a continuing reform program, incorporating the PFM benchmarks set out above, reinforces this judgment.”

<sup>13</sup> In 2003 monthly revenues ran at 80% of pre-crisis levels in spite of the depressed economic situation.

<sup>14</sup> In 2001, donor budget support amounted to US\$540 million, in 2002 to US\$465 million and in 2003 to US\$250 million.

<sup>15</sup> Average salaries in 1999 were US\$44 million per month; in 2000 they were US\$52 million per month, and in January–March 2004 they averaged almost US\$72 million per month (Ministry of Finance and IMF data).

<sup>16</sup> These averaged \$23 million monthly in January-March, or 43% less than the budgeted amount of \$40 million.

<sup>17</sup> Arrears to commercial banks totaled US\$253 million, or 7% of GDP, at end-April 2004, while arrears on pensions and to commercial suppliers totaled US\$317 million (9% of GDP – IMF data).

<sup>18</sup> One of the effects of the recession is the greater share of public sector employment in the economy. Some 22% of the workforce is now employed by the PA – in Gaza, one third of the workforce and one half of all wage-earners are supported through PA employment. While the productivity of some segments of this workforce is questionable, PA salaries effectively double as welfare payments and inject critical demand into the economy. For a full discussion of the macroeconomic and welfare benefits of salary support to the PA, see Annex 1 of *Twenty Seven Months – Intifada, Closures and Palestinian Economic Crisis*, World Bank, May 2003.

<sup>19</sup> “What is quite remarkable is the continued cohesion of Palestinian society. Despite violence, economic hardship and the daily frustrations of living under curfew and closure, lending and sharing are widespread and families for the most part remain functional....donors were saying even prior to Operation Defensive Shield that the Palestinian society was absorbing levels of unemployment that could well have fractured the social contract in industrial societies” – *Twenty-Seven Months* (op. cit.).

<sup>20</sup> The deep or “absolute” poverty line is estimated at US\$1.5 per person per day (NIS 1,235 per household of six per month – World Bank/PCBS estimates). OCHA has recently estimated that 600,000 Palestinians – some 17% of the populations – “are depending almost entirely on outside aid” (*Mid-Year Review of the Consolidated Appeals Process*, op. cit.).

<sup>21</sup> *Poverty Update*, World Bank/Palestinian Central Bureau of Statistics, forthcoming.

<sup>22</sup> Global acute protein-calorie malnutrition (GAM) among children aged 6-59 months was estimated by Johns Hopkins/Al Quds University at 9.3% overall and 13.3% in Gaza in their January 2003 survey. The Gaza figure is comparable to Eritrea in 1995, Yemen in 1997 and Nigeria in 1999 – and also to UAE in 1995. Due in large part to well-targeted food assistance, these numbers declined dramatically in 2003: by 19% overall, and by 65% in Gaza. FAO and

WFP nonetheless estimated earlier this year that almost 40% of Palestinians suffer “food insecurity” (i.e. they do not have “sufficient, safe and nutritious food for a healthy life”) while another quarter of the population is at risk of becoming food-insecure. In the West Bank, patterns of food insecurity correlate with the footprint of the Separation Barrier. WFP estimates that 40% of the population of Qalqilya are food-insecure, and that 55% of the population of Jenin District are at risk of becoming so (*Vulnerability Assessment*, World Food Programme, 2004).

<sup>23</sup> Notably the World Bank, in *Fifteen Months – Intifada, Closures and Palestinian Economic Crisis*, March 2002.

<sup>24</sup> While difficult to estimate, private remittances appear to contribute only 7% of an average family’s disposable income. Private remittances thus average about US\$0.30 c. per person per day, or NIS 225 per family of six per month (World Bank estimates).

<sup>25</sup> *Palestinian Perceptions Survey*, Graduate Institute of Development Studies/University of Geneva (IUED), 2004 (unpublished).

<sup>26</sup> Over 40% of parents in Gaza recently reported a decline in their children’s school grades, according to the *Palestinian Public Perceptions Survey*, op. cit. This is corroborated by official sources. For example, UNRWA reports a decline in test scores in its schools between 2000/1 and 2003/4 – Arabic pass rates in Grade 8 fell by 12%, math pass rates in Grade 6 by 35% and science pass rates in Grade 4 by 33%.

<sup>27</sup> In a survey carried out in 2003 in Rafah by the Gaza Community Mental Health Program, out of a sample of 994 children, 54% were found to be exhibiting serious clinical signs of Post-Traumatic Stress Disorder.

<sup>28</sup> Public support for “military actions against Israel” increased from 40% in May 1997 to a peak of 85% in October 2001, and declined thereafter, remaining nonetheless at 68% in December 2003. Support for suicide operations increased from 33% in May 1997 to 76% in April 2001, and has since declined also – but remained at 62% in December 2003 (Source – *Palestinian Opinion Pulse Polls*, Jerusalem Media and Communications Center, December 2003). In the GCMHP study cited above, 66% of the 994 children of age 10-19, when asked about ways of coping with their situation, said they would concentrate on their schooling – but 24.7% said they would like to be ‘martyrs’. *Prevalence of PTSD among Palestinian Children in the Gaza Strip*, European Child and Adolescents Psychiatry Journal, April 2003.

<sup>29</sup> Or 51% under the ‘relaxed’ definition.

<sup>30</sup> World Bank analysis suggests that without donor assistance, absolute poverty levels would be almost 40% higher.

<sup>31</sup> Overall disbursements fell from US\$1.026 billion in 2002 to US\$898 million in 2003 – a decline of 12%. However, if the Arab League donors are discounted, contributions from others (principally the US and the EU) increased by about 30%. The same is true for types of assistance other than budget support; these increased by over 20%.

<sup>32</sup> *Mid-Year Review of the Consolidated Appeals Process (CAP) for 2004*, op. cit.

<sup>33</sup> In March 2004, movement from one locality to another was controlled by a network of 695 obstacles – 57 checkpoints, 96 road blocks, 420 earth mounds, 17 walls, 38 gates and 67 trenches, in addition to the use of “flying checkpoints” (*Closure Map*, OCHA, March 2004). On June 14, 2004 the IDF announced the dismantling of 40 dirt blockades.

<sup>34</sup> Some donors have argued that financing such roads could amount to a *de facto* recognition of the permanency of the Separation Barrier and/or certain settlements.

<sup>35</sup> In *Gaza*, most cargoes now transit through the Karni terminal (some aggregates pass through Sufa; the transport of goods through the Rafah crossing to Egypt has all but ceased). Trucks arriving from either side are offloaded and reloaded, and in the case of Palestinian export cargoes are subject to electronic scanning (with scanners only able to accept pallets of a very restricted depth). Procedures applicable to Israeli importers are less rigorous. Karni is also the main terminal for humanitarian cargoes, which unlike commercial cargoes can enter in containers but are subject to a daily quota established for UNRWA and WFP. Since the suicide attack in Ashdod on March 15, 2004 by militants who hid in a container coming from Gaza, empty humanitarian containers exiting Karni have been subject to delays and drilling to

check for secret compartments. From early May 2004, Karni was closed to commercial exports, though remaining open for humanitarian cargoes. In protest, Palestinian handlers refused to allow any containers out of Karni and humanitarian agencies faced serious supply shortages (at one point UNRWA was obliged to suspend its emergency food aid deliveries for almost a month). In the *West Bank* all commercial border cargoes must cross at one of eight “back-to-back” terminals.

<sup>36</sup> Should internal closures be significantly eased throughout the West Bank (rather than in the northern areas alone), the decline would be somewhat less marked (see “*Disengagement plus Lifting of Internal Closure throughout the West Bank*” scenario in **Table 2**). Real GDP per capita would decline by 6% and real GDI per capita by 18%; unemployment would fall to 31%, while poverty would still affect over 50% of the population.

<sup>37</sup> World Bank estimate, based on preliminary data from UNRWA, OCHA and Rafah Municipality, June 2004.

<sup>38</sup> “Israel will enable the continued supply of electricity, water, gas and fuel to the Palestinians, under the existing arrangements and full compensation.....in general the economic arrangements that are currently in effect.....will remain valid. The arrangements include.....the movement of goods between the Gaza Strip, Judea and Samaria, Israel and foreign countries.....the taxation arrangements and the customs envelope.....the entry of workers in accordance with the existing criteria.” *Disengagement Plan*, op. cit.

<sup>39</sup> *Olmert Decides to Shut Erez Industrial Zone Permanently*, Ha’aretz, June 9, 2004.

<sup>40</sup> The daily average during the first quarter of 2004 was 33,100 workers, excluding East Jerusalem residents with Israeli or Jerusalem identity cards. This number was composed of 13,200 permit-holders from Gaza and the West Bank, and another 19,900 who crossed without permits from the West Bank. (World Bank staff calculations, based on Palestinian Central Bureau of Statistics (PCBS) and Israeli Central Bureau of Statistics (ICBS) data).

<sup>41</sup> Careful readers of the World Bank’s May 2003 economic assessment, *Twenty-Seven Months – Intifada, Closures and Palestinian Economic Crisis* may recall that the “Lifting of Internal Closure plus Trade Facilitation” scenario projected real GDP gains of 21.2% in 2003 and 11.9% in 2004, and may wonder why the scenario used today (“Disengagement plus Trade Facilitation) envisages lower growth rates. Several factors explain the difference in projections. First, significant new information on the economy’s performance in 2002 has become available that was not on hand at the time *Twenty-Seven Months* was written. Working with the data available, the Bank initially overestimated the decline in GDP in 2002, and hence overestimated, in percentage terms, the rebound that would occur if internal and external closures were relaxed. Second, with the passage of another year, productive capacity has been further degraded due to the inefficiencies of sub-optimal production runs, inadequate maintenance of capital stock and scant new investment. Third, the passage of another year has meant another year of Palestinian exclusion from international markets (the longer this absence continues, the more difficult it becomes to re-enter international markets). Fourth, the reality of the Separation Barrier means that external access from the West Bank will, at least for a time, become more time-consuming and expensive than without the Barrier, while as its construction is likely to give rise to tension and disruptions. As far as personal incomes are concerned, the scenario in *Twenty-Seven Months* assumed higher levels of Palestinian employment in Israel than we do now.

<sup>42</sup> The Aix-en-Provence Group, for example, argues that domestic Palestinian production and exports are compromised by the upward pressure on domestic wages and prices exerted by higher Israeli wage levels. “During the Oslo period, Palestinian economic growth was not export-led but rather was driven by consumption deriving from higher incomes from workers’ remittances. The positive aspects of this growth pattern included higher incomes and reduced poverty, but were offset, especially during closures, by high uncertainty, income volatility, persistent poverty and non-competitive domestic wages.....while income from higher wages in Israel creates effective demand for locally-produced goods, it hinders domestic production and exports because of the upward pressure these wages exert on domestic wages and prices. In addition, most labor exports to Israel are low-skilled and capture only a small portion of

value-added, as well as having few backward technical linkages.” *Economic Road Map – An Israeli-Palestinian Perspective on Permanent Status*, the Aix Group, January 2004. The Aix Group is an ad hoc non-official grouping of Israeli, Palestinian and international experts, including Israeli officials from the ministries of Finance and Industry, Trade & Labor, Palestinian officials from the ministries of Finance, Planning and National Economy, and officials from the French Government, the European Commission (EC), the IMF and the World Bank, all acting in their personal capacities either as participants or as observers. They met several times during 2002-3. The paper sets out a practical vision of a final economic status arrangement between the States of Israel and Palestine.

<sup>43</sup> This appears to be an unprecedented amount on a per capita basis. It can be compared to other high-profile “post-conflict” cases such as Bosnia (US\$215 per person per annum for 5 years) or East Timor (US\$235 per person per year for 2 years).

<sup>44</sup> For imports, it is possible to compensate for unreliable deliveries by building up inventories. However, the costs associated with financing a large inventory and the loss in value of the goods stored for several months add substantially to the delivered cost of imports (2%-5%). For exports, the cost of delay and uncertainty is more substantial because there is no easy way to compensate for unreliable deliveries. Foreign buyers, taking advantage of the globalization of trade and the resulting increase in competition among suppliers, have gradually tightened their delivery requirements. They have become less tolerant of late shipments and more inclined to reject goods that are delivered after the contracted delivery date. In addition, they have decreased their order cycle times in order to reduce inventories. The resulting decrease in lead times is a potential problem for producers who depend on imported raw materials and who are thereby vulnerable to delays in both inbound and outbound supply chains. The importance of reliability has led importers and exporters to develop alternative routes. Some provide fast transit times at higher cost, others are slower but cheaper. At present, neither option is available to the West Bank and Gaza.

<sup>45</sup> Based on 1998 data, the World Bank estimated that 96% of Palestinian exports of goods were destined to the Israeli market. The extent to which these exports are consumed in Israel or re-exported to another final destination is unknown. At the same time, an estimated 76% of Palestinian imports came from or through Israel (*Long-Term Policy Options for the Palestinian Economy*, World Bank, 2002).

<sup>46</sup> The question of whether such facilities should be located adjacent to the Separation Barrier arises. Where the Barrier is constructed along the Green Line, this should not be controversial. Where the Barrier deviates from the Green Line, locating terminals on or adjacent to the Barrier would be. Some donors take the view that financing such facilities could be considered as *de facto* acceptance of the current location of the Barrier.

<sup>47</sup> Leading members of the Palestinian private sector are currently forming a Palestinian Shippers’ Council, which intends to review with its Israeli counterparts steps to ease the movement of Palestinian goods while explicitly recognizing Israel’s security concerns. Consideration is being given to seeking the involvement of a respected international agency to assist all parties.

<sup>48</sup> By placing cargo in a bonded warehouse, an importer avoids duty until it is removed. It would then proceed under bond to Gaza or the West Bank, where duty would be paid. This procedure would need to be tied to non-invasive security scanning to be cost-effective.

<sup>49</sup> *Transit Trade and Maritime Transport Facilitation for the Rehabilitation and Development of the Palestinian Economy*, UNCTAD, 2003.

<sup>50</sup> The *Economic Road Map*, op. cit., describes a process leading to final status agreement based on the creation of a mutually-beneficial Free Trade Area as the basis for economic relations between Israel and Palestine. Moving in this direction would require complementary measures such as the development of a system of Rules of Origin, agreement on standards, dispute resolution mechanisms, more predictable regulation of labor flows, close coordination of indirect tax policies and their administration, the development of the Palestinian revenue capacities (currently some 60% of Palestinian revenue is collected by GOI on the PA’s

behalf), mutually agreed regulation of labor flows, decisions about the Palestinian monetary regime and currency, and the encouragement of Israeli investment in Palestine.

<sup>51</sup> One example would be the list of products for which the Palestinian Authority has autonomy in tariff setting, which could be adjusted to provide more scope to reflect Palestinian comparative advantage. Currently, the effective rate of trade taxes is higher on Palestinian imports (around 17%) than average Israeli trade taxes (around 11%), due to the different type of goods imported by West Bank and Gaza. Another example could be to ease constraints on the access of Palestinian goods to Jordanian and Egyptian markets; this could be looked into in the context of arrangements for the trans-shipment of goods to export markets through these countries. A third might be to look into ways of compensating the Palestinian Authority for losses associated with the current revenue sharing system. At present, indirect exports to the West Bank and Gaza are not adequately accounted for. The Bank in 2002 estimated the lost revenues associated with indirect imports at around US\$174 million per year, and annual welfare losses at US\$90-140 million when compared to a non-discriminatory trade policy.

<sup>52</sup> In 2000, for example, 85% of garments produced in the West Bank and Gaza were commissioned by Israeli buyers and up to 40% of Palestinian garments were shipped to Israel for re-export (World Bank data).

<sup>53</sup> Such as data entry services for credit card companies, banks and airlines, and tele-marketing and after-sales services targeted to Arab markets.

<sup>54</sup> In terms of wage competitiveness, prior to the crisis Palestinian workers were on average paid relatively high wages (c. US\$300-350 per month) compared with other regional labor markets, such as Jordan (c. US\$110 per month) and Egypt (c. US\$60-80 per month). Electricity and telecommunication service costs are currently significantly higher than regional countries that would likely be competitors.

<sup>55</sup> The productivity of Palestinian garment manufacturers is about 40-45% that of firms in comparable developing countries. One reason for this is the low level of investment in equipment and technology; the bulk of the garment sector consists of basic operations using standard lockstitch machines with no cutting equipment or CAD/CAM systems (on most subcontracting orders, cutting has in the past been done by Israeli contractors).

<sup>56</sup> Once again, though, cost structures are not favorable. Work is needed to introduce high-yield varieties, improve harvesting and handling to reduce acid levels, raise quality (inc. through the use of organic methods to tap into this high-end market) and package output more attractively.

<sup>57</sup> Though direct exports are quite low, Palestinian firms benefit from duty-free, quota-free access to the US market dating back to arrangements put in place by the Clinton Administration shortly following the signing of the Oslo Accords – and similar preferential market access has been granted to the European market by the EC. However, agricultural products still need to meet the standards and specifications of these markets. This requires the introduction of new growing techniques, elimination of certain pesticides and attainment of firm/industry-level certification to effectively enter these markets. Typically this would take several years.

<sup>58</sup> USAID is providing firm-level financial restructuring support while the EC is supporting firms in the tourism industry, particularly in the Jerusalem area, and has recently undertaken studies related to olive oil and olive wood products, furniture, automotive parts and business associations. These provide a useful basis for future assistance. DFID has also launched work on prospects for boosting foreign investment.

<sup>59</sup> Much of this section is based on the PA's Six-Month Reform Action Plan and the extensive work of the donor Reform Support Groups.

<sup>60</sup> According to World Bank estimates, the Gaza Pension Insurance Corporation (GPIC) will deplete its pension assets within approximately two years. This depletion may have been accelerated by recent wage increases, which are passed through into pension payments. Security service personnel currently have no pension scheme in place.

<sup>61</sup> The law would introduce a financially sustainable system along with a new, independent pension agency to help ensure that pension assets were adequately safeguarded.

<sup>62</sup> These transitional costs include the clearing of PA arrears to the Gaza scheme, as well as the financing of the pension liabilities for the past service of existing employees.

<sup>63</sup> Including the Capital Markets Law, the Securities Law, the Companies Law, the Industry Law, the Law of Leases and the Competition Law.

<sup>64</sup> In particular the recently-adopted Social Security Law. If implemented, it would establish a financially unsustainable system of private sector pensions precisely when the PA is taking action to ensure the sustainability of public sector pensions.

<sup>65</sup> The reforms of 2002 laid the foundation for the separation of executive and judicial powers, and for an increase in the powers and capacity of the civil courts to adjudicate commercial disputes, both areas which have been of major concern to the private sector.

<sup>66</sup> The issue concerns jurisdiction over court administration and judicial training. An ad-hoc committee has been established by the Office of the President to resolve the matter, but no concrete progress has yet been made yet. In addition, there is an urgent need for the Supreme Judicial Council to establish clear criteria for the appointment and promotion of judges.

<sup>67</sup> Currently the PMA sets very stiff reserve requirements for commercial banks not meeting certain lending targets.

<sup>68</sup> A recent World Bank Country Procurement Assessment has recommended establishing an independent Oversight Procurement Authority, and drafting a revised and unified procurement law.

<sup>69</sup> In addition, donors and private contributors will likely be financing the construction of houses for those in Rafah whose homes were recently destroyed.

<sup>70</sup> Creating a modern infrastructure in Gaza would involve the expansion of the combined-cycle power plant, the possible exploitation of off-shore gas reserves, the construction of a RoRo terminal (and later, a deep-water port), and rebuilding the Gaza Airport. West Bank landmark projects would include a major expansion of the highway system and the extension of electricity and water distribution networks.

<sup>71</sup> The draft World Bank *Infrastructure Assessment* argues that under a scenario of major economic improvement some US\$270-305 million can be absorbed each year on priority projects in the core infrastructure sub-sectors.

<sup>72</sup> The TFPI is the main donor body charged with liaising with GOI in relation to the delivery of development and humanitarian assistance. It is co-chaired by the US, the European Commission, UNSCO and the World Bank.

<sup>73</sup> The note also says "... (security) measures compromise our work, and have dramatically negative and often indiscriminate effects on the living conditions of the civilian population..... In the absence of significant improvement of the conditions under which the international community operates, many donors are now reviewing the basis on which their operations in the West Bank and Gaza Strip can continue."

<sup>74</sup> It is estimated that over US\$200 million in donor-financed capital assets was destroyed by the end of 2002 (*Twenty-Seven Months*, op. cit.).

<sup>75</sup> At the GIE, for example, about 500 meters of brine water pipeline and 300 meters of Road No. 8 (financed by the Bank) were destroyed, while other ancillary infrastructure (the fence and entrance roads) was damaged.

<sup>76</sup> "As Israel withdraws, custody of Israeli-built infrastructure and land evacuated by Israel should transfer through an appropriate mechanism to a reorganized Palestinian Authority in coordination with representatives of Palestinian civil society, the Quartet, and other representatives of the international community to determine equitable and transparent arrangements for the ultimate disposition of these areas as quickly as possible."

<sup>77</sup> The following terms are used throughout this section: *evacuation* means the physical departure of Israeli settlers and the IDF from the settlement sites; *transfer* implies the legal handover of assets from Israel to the PA or a third party; *administration* refers to their temporary management; and *disposal* means the transfer of ownership to the final owner.

<sup>78</sup> The section's main source of information on Israeli settlements in Gaza is *Feasibility Study: Relocating Settlements from Gaza Strip Area*, Israel's National Security Council, April 2004.

<sup>79</sup> The settlements are located in three main areas: 3 settlements (Nisanit, Dugit, Alei Sinai) in the northwest corner bordering Israel; 3 isolated settlements ranged in a north-south trajectory (Netzarim, Kfar Darom, Morag); and the remaining 11 settlements located along the southern coast in the Katif Block (Gush Katif) adjacent to Tel Sultan and Khan Younis. One of the 17 (Shalev in the Katif Block) is uninhabited. Of the 16 inhabited settlements, 2 are urban settlements – the larger being Neveh Dekalim in Gush Katif (near Khan Younis), and the smaller, Nisanit (near Jabalya). The other 14 settlements are rural and include 8 *moshavim* (agricultural settlements, which use c. 9% of the Gaza Strip).

<sup>80</sup> According to the PA Ministry of Planning, the Gaza-Jericho Agreement gives Israel control of about 15% of Gaza, covering the settlements and the military installations. Israeli control also includes the 'yellow' areas (in particular the coastal areas adjacent to the Katif Block), and buffer zones along the borders, around settlements and along certain roads. These buffer zones have expanded during the *intifada*. According to MOP, Israel controls up to 38% of Gaza under this definition. The Bank estimate, which needs further work, refers to land in or in the immediate vicinity of the settlements that is not now inhabited by Palestinians.

<sup>81</sup> Estimates of the number of houses in Gaza settlements vary from 1,550 to 2,050 (the latter figure including 60 that are under construction). More work is required to establish the exact number of houses.

<sup>82</sup> With some 144,400 m<sup>2</sup> for residential buildings, 5,900 m<sup>2</sup> for offices and commercial services, 300 m<sup>2</sup> for banks, 2,600 m<sup>2</sup> for industrial facilities and 6,500 m<sup>2</sup> for hotels (now unused), according to reports from local councils provided to the Israeli Ministry of the Interior in the last quarter of 2003 submitted for purposes of municipal taxation. According to 2001 Israeli Central Bureau of Statistics figures, there are 9 schools in the Gaza settlements.

<sup>83</sup> Jerusalem Post, August 3, 2003. The remainder is derived from small-scale industry. To understand these value figures better, they need to be deconstructed to reveal direct and indirect subsidies.

<sup>84</sup> To this can be added another 14 million cubic meters of potentially reusable effluent that is dumped because of a lack of infiltration infrastructure.

<sup>85</sup> The current value of gross output per km<sup>2</sup> exceeds US\$7 million per annum – though this probably includes subsidies that would not be available to Palestinian farmers. World Bank calculations show that the annual value of agricultural production per km<sup>2</sup> of irrigated land in the north-west West Bank is between US\$4-5 million for mixed citrus and horticulture under good management (and some US\$120-150,000 for rainfed agriculture). Tripling the Gaza settlement area under cultivation to 10 km<sup>2</sup> and assuming average productivity of US\$5 million per km<sup>2</sup> per year would give an output figure of US\$50 per annum.

<sup>86</sup> They comprise Ganim (population 170 as of January 2003) and Kadim (149) southeast of Jenin; and Sa-Nur (33) and Homesh (198), overlooking one of the main routes between Jenin and Nablus.

<sup>87</sup> Any transfer of assets would need to be conducted with the agreement of all of the parties concerned, such that the legal responsibilities associated with ownership, custodianship or management of the assets were clear. The PA would need to agree to any third party's role in receiving or administering these assets. Any agreement would also need to be in line with international law and previous agreements signed by Israel and Palestinian representatives, in particular the Oslo Accords.

<sup>88</sup> The *Disengagement Plan* mentions that "State of Israel will aspire to transfer...structures, such as industrial and agricultural facilities, to an international third party that will use them for the benefit of the Palestinian population that is not engaged in terrorism." The *Plan* also mentions the AHLC in the context of development assistance to the Palestinians: "The State of Israel suggests that an international mechanism (such as the AHLC) be set up, in coordination with Israel and international bodies, that will work to develop the Palestinian economy."

<sup>89</sup> The AHLC was established in the context of the Washington Conference of October 1, 1993 to support the Middle East peace process. Its objectives are to coordinate and promote donor assistance to the Palestinian people, to foster private sector trade and investment and to monitor developments in the Palestinian economy. The AHLC consists of representatives of Canada, the European Union, Japan, Norway (as Chair), Russia, Saudi Arabia, the United Nations, the United States and the World Bank (as Secretariat). Egypt, Jordan and Tunisia participate as associate members, while the PA and Israel have attended meetings either as observers or as full participants, depending on the political climate.

<sup>90</sup> For the planning phase, the PA has already established a Ministerial Committee chaired by the Prime Minister. Under its aegis, the Ministry of Planning is in the process of updating a previous physical plan for Gaza, the Ministry of National Economy is looking into the economic impact of an Israeli withdrawal, the Ministry of Housing and Public Works has been reviewing shelter and housing questions and the Negotiations Affairs Department is investigating various policy and legal aspects of redeployment and evacuation. Other bodies exist that are responsible for issues germane to asset disposal. For instance, a Ministerial Committee involving the Ministry of Justice, the Palestinian Land Authority, the Ministry for Public Works and Housing, the Ministry of Local Government and a representative of the President's Office is charged with the management of public land – while municipalities play an important role in land use planning.

<sup>91</sup> The PA will need to decide whether settlement land set to remain in the public domain – be it 'public land' or private land for which owners have been compensated – should devolve to municipal or PA management. The use and disposal of municipal land is sufficiently regulated, but no clear and transparent procedures exist for administering 'public land'. If settlement land reverts to public land, additional safeguards will need to be devised to ensure its proper use.

<sup>92</sup> A key reason for administering claims outside the courts is that the number of claims might overwhelm the court system, where there is already a backlog – thus individuals might have to wait for a long time to have their claims resolved, and any plans for use of the land would remain in limbo. A right to appeal to the court system could be provided for, however. As an alternative to the special agency, a body could be established under the Land Authority to adjudicate the claims (after which the Land Authority would register a successful claimant as an owner) – though focus and speed are more likely to be achieved if this capacity is embedded in the special agency.

<sup>93</sup> Ownership should have been registered in the Land Registry, but the British did not carry out comprehensive land registration, and many land users did not register. Egyptian efforts at land registration were preempted by the war of 1967. Many of the descendants of these users are understood to be in possession of documents (mostly tax records) that prove cultivation of the land for the required period. In these cases the PA may consider the land to be privately owned, entitling the former user's heirs to obtain ownership rights once the property is vacated.

<sup>94</sup> Only about 30 percent of the land in the West Bank is registered.

<sup>95</sup> According to UNRWA's Press Release of 31 May 2004 (see [www.un.org/unrwa/news](http://www.un.org/unrwa/news)), in Rafah alone, 1,199 houses (housing 11,215 people) have been demolished or damaged beyond repair since September 2000 – including 277 between May 1-24, 2004 (3,451 people). For Gaza as a whole, the total number of houses destroyed/damaged beyond repair as of May 31, 2004 is 2,225 (housing 21,143 people), and for the West Bank, over 600 during the first three years of the *intifada* (UNRWA data).

<sup>96</sup> In light of recent IDF operations in Rafah, it has been suggested that Internally Displaced Persons (many of whom are refugees) should be given preferential access to the housing units. From an international legal perspective, any movement of IDPs or refugees would need to be carried out on a voluntary basis, thereby avoiding the issue of forced resettlement. The politics of providing registered refugees with housing in an evacuated settlement are also highly complex.

<sup>97</sup> The Quartet's *Gaza Disengagement Action Plan* of May 4 proposes that by July 3 "World Bank/UNSCO, in cooperation with the donor community, assess reconstruction and development needs for Gaza and part of West Bank: assess the value of resources to be left behind by departing settlers and possible uses (including a mechanism to rule on possible Palestinian claims of ownership), and assess overall reconstruction needs in Gaza, including airport/seaport, industrial estates, other infrastructure" – with the assessment to be followed up by a " Ministerial-level AHLC/Consultative Group meeting of all donors to generate needed assistance and coordinate project priorities" in September 2004.