



Palestinian Economic Prospects: Aid, Access and Reform

Economic Monitoring Report
to the Ad Hoc Liaison Committee



The World Bank
September 22nd, 2008

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Acronyms

AHLC	Ad-Hoc Liaison Committee
AMA	Agreement on Movement and Access
CMWU	Coastal Municipal Water Utility in Gaza
COGAT	Coordinator of Government Activities in the Palestinian Territories
EC	European Commission
EU	European Union
GDP	gross domestic product
GNP	gross national product
GOI	Government of Israel
ICA	Investment Climate Assessment
IMF	International Monetary Fund
LACS	Local Aid Coordination Secretariat
MENA	Middle East and North Africa
MOF	Ministry of Finance
MOP	Ministry of Planning
MTEF	Medium-Term Expenditure Framework
MTIT	Ministry of Telecommunications and Information Technology
NGO	non-governmental organization
ODA	official development assistance
OQR	Office of the Quartet Representative
PA	Palestinian National Authority
PCBS	Palestinian Central Bureau of Statistics
PFM	Public Financial Management
PRDP	Palestinian Recovery and Development Plan
PSCC	Private Sector Coordination Council
PEA	Palestinian Energy Authority
PLC	Palestinian Legislative Council
PMA	Palestinian Monetary Authority
PWA	Palestinian Water Authority
SWG	Sector Working Group
TA	technical assistance
UNRWA	United Nations Relief and Works Agency
UNSCO	Office of the United Nations Special Coordinator
WBG	West Bank and Gaza

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Executive Summary

At the May 2nd, 2008, Ad Hoc Liaison Committee (AHLC) meeting, the World Bank, noted that the estimated economic growth arising from parallel actions by the Palestinian Authority (PA), Israel and the donors had not been fully realized. This AHLC report takes stock of further progress on the three parallel conditions for Palestinian economic revival- PA reforms, donor aid and Israeli resolution of the M&A restrictions. It also defines and analyzes the extent of economic restrictions as a collective set of barriers- physical, institutional and administrative- that combine to prevent Palestinian access to its own economic potential, and to the rest of the world.

The months since the May AHLC have witnessed some improvements in security, but in varying degrees across different areas. In Gaza, a 'Tahdi'ah' (calm) between Israel and Hamas was activated on June 19th, 2008. Since then, attacks out of Gaza have fallen significantly, but continue to take place, as do other attacks within Israel, and in Jerusalem. Palestinian inter-factional tension continues in the West Bank and Gaza, with arrests of people and closures of NGOs by each side, resulting in an alarming deterioration in the ability of civil society organizations in both the West Bank and Gaza to continue cater to vulnerable groups, particularly, youth and children. Furthermore, within the West Bank, a worrying trend in settler violence is on the increase. As a general direction, however, there has been an overall reduction in hostilities, particularly between Israel and Gaza since June 19th.

Over the past 9 months the PA has made significant progress on implementing the reform agenda laid out in the Palestinian Reform and Development Plan (PRDP). The PA has successfully contained its wage bill, reactivated the budget process and, after excluding one-off revenue items, is projected to reduce the recurrent fiscal deficit on a commitment basis from 27% of GDP in 2007 to about 23% in 2008. The donor community has responded to these reforms by supporting the PA with about \$1.2 billion in budget support to the end of August. Gaza, however, remains outside of the reforms as Hamas remains in control of security and the most important ministry positions there.

The PA has made considerable efforts in re-establishing law and order and curbing the activities of militias, another commitment under the PRDP. As a follow-up to the November 2007 deployments in Nablus, the PA undertook a comprehensive mobilization of forces to enhance security in Jenin in May 2008. This is in addition to security initiatives undertaken elsewhere in the West Bank, and is part of a broader reform agenda that has received broad international support at the Berlin Conference on Palestinian Civil Security and the Rule of Law held on June 24th. These deployments of Palestinian Security Forces across West Bank towns have

produced encouraging results, and have been met with support by the local population. However, the impact and authority of the Palestinian Security Forces has been severely undermined by continued Israeli incursions to carry out arrests of suspected militants, whom Israel regards as not having been effectively contained.

Israel has announced a series of measures in support of the Palestinian economy, including but not confined to: (a) the upgrading or removal of a number of roadblock/obstacles across the West Bank; (b) the increase in working hours at the Allenby Bridge between the West Bank and Jordan; (c) plans for the issuance of an additional 5,000 permits for Palestinian workers to work in Israel; and (d) the issuance of special permits for farmers from Jenin and Nablus to travel to the Jordan Valley using their agricultural vehicles. Of particular impact is the decision on a moratorium on house demolitions in Area C of the West Bank due to the lack of building permits, which was put into effect by the Israeli authorities in April 2008. However, demolitions in East Jerusalem continued, with several demolitions as of August 2008.

The support of Quartet Representative Tony Blair, manifest in a May 13th Agreement on several initiatives, is beginning to yield results but requires further support. Several aspects of the May 13th agreement with the PA and Israel have been implemented, including the removal of a number of key roadblocks within the West Bank, the facilitation of the first phase of the North Gaza Emergency Sewage Treatment Plant, the mobilization of donor funds to complete a \$500 million Mortgage Facility, and the July 28th Frequency Allocation Agreement between Israel and the PA, enabling Wataniya, a second mobile operator, to begin operations in the West Bank. Moving forward, further support for the May 13th package by Israel and the PA is critical, given their significance as precedents for a revival of the Palestinian economy. It is also noteworthy that these measures were intended as a means and not an end in the Palestinian development narrative. Despite the progress to date, most items in the May 13th package remain incomplete.

Economic Developments

The economic projections of the PA's Palestinian Reform and Development Plan (PRDP) assumed a relaxation in economic restrictions, and a resolution of the situation in Gaza.

The economic restrictions have remained and the situation in Gaza continues to deteriorate. Consequently, the Palestinian Central Bureau of Statistics (PCBS) estimates that real GDP growth in the West Bank and Gaza in 2007 was 0.5%. IMF analysis notes a drop in GDP of -0.5% in 2007, and modest growth of 0.8% in 2008. This trend represents a continued but marginal drop in Gaza's indicators given their already-depressed levels, matched with a slight rise in indicators in the West Bank. Despite anecdotal indications that within the West Bank and Gaza, the West Bank may be experiencing a recent increase in economic activity, this trend is unlikely to be significant. With a

growing population and a shrinking economy, real per capita GDP is now 30% below its height in 1999. From 1994 until 1999 the Palestinian economy was growing on average at about 6% per year. If this trend had continued, GDP per capita would nearly be 85% higher than it is currently. In addition to growth being low, the economy's productive base continues to hollow out as evidenced by the changing GDP structure. IMF estimates of GDP indicate that the PA's wage bill alone is equivalent to over 27% of GDP.

As the Palestinian economy declines it is becoming more aid dependent. So far this year until end-August the PA has received \$1.2 billion in recurrent budget support, but requires about \$1.85 billion in recurrent budget support, in addition to the estimated \$300 million in development aid, in 2008. Thus, external aid will be at least 32% of GDP.

The closure policy on Gaza since the events of June 14th, 2007 continues to erode the Strip's industrial backbone. The Palestinian Federation of Industries (PFI) estimates that 98% of Gaza's industrial operations are now inactive. According to PFI, of Gaza's 3,900 industries, 23 are operating. As a result, Gazan banking sector activity is estimated to have dropped from 40% of total Palestinian banking to about 7%. Ironically, discussions with various representatives of the banking sector point to an emerging market for the supply of currency and industrial inputs as a result of the closures and the prevailing lawlessness in Gaza, leading to a redistribution of wealth from the formal private sector towards black market operators.

Closure of Gaza is also resulting in the collapse of the municipal sector. Municipalities, providing key services such as water, sewage, solid waste etc. are facing a deep financial crisis. The impoverishment of the population and the near absence of private sector activities imply that municipalities are unable to collect fees for service provision and are unable to pay staff salaries. The ability of municipalities to provide basic services is also severely constrained by their inability to import spare parts and supplies for the provision of basic services such as water and sanitation.

Despite the 'Tahdi'ah' called on June 19th, little progress has been made so far toward improving living conditions of the population in Gaza. First, the increase in fuel and humanitarian imports remains far below needs. Secondly, not only are the quantities of inputs entering Gaza insufficient to resuscitate the private sector, the categories and combinations of items allowed to enter are not conducive to most industrial operations. Thus, the increase in the use of the crossings is necessary to avoid a scenario where more 'categories' are allowed in, but with reduced quantities for each category. Moreover, there is still no progress on allowing exports out of Gaza, beyond a set of possible shipments which may be made as a gesture to various donors. For Gaza's economy to revive, it must be able to import a large quantity of industrial and agricultural inputs, and export its products and agricultural produce. Lastly, the reversal of

Gaza's humanitarian crisis extends beyond the entry of goods, and must include the access of the population to the West Bank for all purposes, Israel and elsewhere for health, education and other social services.

Progress with the Parallel Actions towards Palestinian Revival & Growth

A. The Palestinian Authority

The Palestinian Authority has largely maintained its path set out in the PRDP, with continued fiscal reforms, and efforts at enhanced Public Financial Management. These reforms are profound, and must be complemented by continued efforts elsewhere, including a revision of the unsustainable pension system, an operationalizing of the draft procurement law, and further steps to strengthen the public financial management system, among others. Some of the accomplishments to date include the following:

- The Ministry of Finance (MoF) is posting monthly revenue/expenditure statements on the web and has begun to integrate recurrent and development expenditures within the Medium Term Expenditure Framework provided in the PRDP. The MoF has also introduced a computerized accounting system and has linked it to 10 ministries.
- The PA has reduced government employment from over 180,000 in late 2007 to about 141,000 in the first half of 2008, well below the 153,000 limit set in the PRDP.
- The PA has improved its collection procedures for electricity bills. Defaulters on electricity bills will not receive government services unless they settle their bills. In addition, 45,000 pre-paid electric meters have been installed and over 50 municipalities have registered to join the Northern Electric Distribution Company.
- The Ministry of Social Affairs has established a more efficient targeting method, ranking of up to 50,000 poorest households on the basis of 42 proxy poverty variables. At present, a ranking of 29,000 households has been completed.
- By the end of June 2008, the MoF's new internal audit department had initiated audits of four line ministries.

Despite the reforms and the reduction in the deficit, the fiscal crisis persists. In 2008, the need for external budget support is estimated at about \$1.85 billion, of which about \$1.2 billion had been received by the end of August. While the 2009 budget calls for \$1.3 billion in budget support (and \$0.5 billion of development aid), with the restrictions restraining growth, it is questionable whether the current level of budget support can be reduced.

The PA has also carried out initial steps towards enhanced security in cities and towns under its control. In an effort to enhance security in Palestinian towns and cities, additional PA forces have been mobilized in Nablus, Jenin, and elsewhere in the West Bank. The deployment of Palestinian Security Forces has produced encouraging results, and has been regarded as positive by the local population. However, the impact of the PA's security initiatives have been mitigated by continued IDF incursions, restricted mobility of security and judicial personnel, and limited accompanying economic gains.

With regard to support to the private sector, the PA may leverage the success of the Palestinian Investors' Conference (PIC) in Bethlehem. The fact that the PIC was successfully conducted, despite the complex logistical requirements, is a testament to the considerable potential arising from Israeli-Palestinian cooperation. However, the ability of the PIC to translate into tangible improvements in the economy will depend on the extent to which all sides are able to follow up on and facilitate the investments.

B. The Donor Community

For their part, donors had provided approximately \$1.2 billion in recurrent budget support by the end of August 2008. This has allowed the PA to sustain operations and pay back a significant amount of arrears. However, initial PA estimates indicate that development assistance has fallen short across all the PRDP programs. Indeed, in the next revision of the PRDP the PA plans to reduce its budget for development assistance in 2009 from \$624 million to \$503 million. The PA attributes the slow progress to: less-than-expected donor commitments in 2008, the restrictions on movement and access, the closures on Gaza, and the long-lead time to launch development projects after two years of PA paralysis.

While donor assistance has been essential to the realization of the PA's PRDP, this assistance since the Paris Conference has been ad hoc and unpredictable. Since Paris, the PA has been unable to plan expenditures beyond a two-month horizon due to difficulties in securing recurrent budget support, and delays in translating development project pledges to actual commitments. Also, due to the ongoing closures on Gaza, little if any development assistance has reached the Strip.

C. Israel

Israel has removed some obstacles to movement within the West Bank; a welcome first step in a path towards potentially reversing the paralysis confronting the Palestinian economy. However, indicators show that economic restrictions have increased during this period. Since June, the IDF has removed some obstacles to facilitate movement. Beyond a few that yielded positive results in terms of movements of goods and people, such as the opening of the Shave

Shomron roadblock during daylight hours, the obstacles removed were found by UN OCHA to be of minor or no significance. The most recent OCHA report finds a slight deterioration in access because of the increased number of barriers. The total number of obstacles has increased from 563 in the beginning of 2008 to 609 in May of 2008, representing a 62% increase over the baseline of August 2005. Furthermore, approximately 57% of the Separation Barrier has been constructed and another 9% is under construction. About 87% of the route runs inside the West Bank and East Jerusalem, isolating communities and separating tens of thousands of people from services, their lands and livelihoods. Despite the commitments under the Road Map and at Annapolis, Israeli settlements continue to expand and very few outposts have been removed.

An Analysis of the Economic Restrictions Confronting the West Bank and Gaza

The restrictions on Palestinian economic potential involve more than roadblocks and checkpoints. With due regard to Israel's security concerns, there is consensus on the paralytic effects of the current physical obstacles placed on the Palestinian economy. In reality, these restrictions go beyond concrete and earth-mounds, and extend to a system of physical and administrative restrictions that prevent the realization of Palestinian economic potential. This system of economic restrictions encompasses: (a) **Access to Economies of Scale:** Palestinian businesses are unable to achieve sufficient 'economies of scale' to warrant additional investment, business growth and/or additional entrants into the market; (b) **Access to Natural Resources:** This covers a number of resources essential to the exploitation of Palestinian economic potential. Key among them is access to land, water, cultural heritage and telecommunications radio frequencies, among others; and (c) **Access to an investment horizon:** Investors in a Palestinian economy face an unclear horizon with which to measure and mitigate their risks. This is linked to the uncertain political horizon, as well as the prevailing system of permits and visas that create uncertainty for investors.

Conclusion

The PA, Israel and the international community have taken steps towards stability and prosperity, albeit in different intensities. The PA has continued in its path of fiscal and security reform, on which it must continue and in a way that also addresses the lingering fracture with Gaza. The donors have provided substantial amounts of aid, but in an ad hoc manner that left the PA with little ability to plan finances. Israel has announced a series of steps to remove physical obstacles within the West Bank, which will only have an impact insofar as the number and the scope of the restrictions being addressed are scaled up significantly. The challenge moving forward with the removal of economic restrictions is to go beyond isolated gestures towards a

profound revision in the fundamentals of the Palestinian economy. It is thus essential to convert these initiatives to a new status quo, rather than a series of isolated exceptions that are consuming a substantial amount of time by all players, and that are a distraction from dialogue on longer-term issues.

As a result of the growing economic restrictions, the IMF analysis indicates a drop in GDP of -0.5% in 2007, and a modest growth of 0.8% in 2008. The events of the past months have yielded several conclusions. First, any effort at revival that excludes Gaza is likely to lead to partial results. Secondly, the more the Gazan and West Bank economies diverge, the harder it will be to reconcile. Thirdly, aid and reform without access are unlikely to revive the Palestinian economy. Intertwined in this issue is the important matter of Israel's security concerns, and its legitimate need to undertake actions to that end. However, overwhelming evidence suggests that the current restrictions correlate primarily to settlement locations and expansions.

Introduction

1. On May 2nd, 2008, the World Bank issued a report to the Ad Hoc Liaison Committee (AHLC) for the West Bank in Gaza, noting the virtuous cycle of economic growth arising from parallel actions by the PA, Israel and the donors had not been fully realized. The formation of the Caretaker Government in mid-2007, and the resumption of aid have reversed the impacts of the aid boycott in 2006 and 2007, but only partially. Real GDP was negative in the first half of 2007 but began to recover in the West Bank during the second half. Because of the situation in Gaza, real GDP growth in 2007 was then estimated to be about 0%, which given the rapidly growing population indicated falling per capita income. Moreover, economic indicators had not changed considerably, despite the resumption in aid. The Palestinian Authority (PA) had implemented a sequence of steps centering on control of expenditures and medium-term reforms to bring the PA back to financial sustainability, and had achieved some important milestones in this area. The PRDP had been underwritten by donors. The efforts of the Quartet Representative had also introduced a set of concrete deliverables that, if adopted by the parties, could help trigger a much-needed private sector response. However, the private sector revival required for a virtuous cycle of growth was not realized due to continued restrictions on movement and access. As a result, the report noted zero GDP growth in 2007. As for 2008, the IMF projected a GDP growth of 3.0% that, taking into account population growth, leaving per capita incomes static if not lower than the previous year.

2. This AHLC report takes stock of further progress on the three parallel conditions for Palestinian economic revival- PA reforms, donor aid and Israeli resolution of the M&A restrictions; and defines and analyzes the extent of economic restrictions as a collective set of barriers- physical, institutional and administrative- that combine to prevent Palestinian access to its own economic potential, and to the rest of the world. The basic formula remains the same; aid without access is unlikely to lead to sustainable results. With over half of the population under the age of 18, the link between actions today and the prospects for a sustainable and stable Palestinian state are evident.

3. As will be shown in this report, the period since the last AHLC has seen some positive gestures by all sides towards stability and prosperity. The challenge moving forward is to go beyond cosmetic steps to profound revisions in the fundamentals of the Palestinian economy, and to convert these initiatives to the status quo, rather than the exception. In assessing the impact of these events, and deconstructing the system of economic restrictions that alter their impacts, the Report surveys the extent to which further revisions to the economy

must be done, rather than to undermine the steps to date. It is thus important to not only adopt a comprehensive view of the restrictions on Palestinian economic development, but to illustrate how these various restrictions interact. Consistent with the spirit of the AHLC, the analysis seeks to support a forward-looking approach for a comprehensive undertaking towards the reversal of the course of the Palestinian economy.

Recent Developments and Prospects

Recent Events

4. The months since the May AHLC have witnessed some important milestones in reform, security and access. In Gaza, a 'Tahdi'ah' (calm) between Israel and Hamas was activated on June 19th, 2008. Since then, as a general trend, there has been a clear reduction in hostilities between Israel and Gaza. According to the Israeli Ministry of Foreign Affairs, almost 1,450 rockets and 1,200 mortars were launched from Gaza in 2008 alone. In June, and until the Tahdi'ah, 84 rockets and 153 mortars were launched. According to UN estimates, prior to the beginning of the ceasefire, the IDF had conducted 25 air strikes and a number of land incursions into the Gaza Strip.¹ Since the Tahdi'ah, and as of the time of this report, attacks out of Gaza fell significantly: 7 rockets and 16 mortars were launched, with corresponding response from the IDF. However, within the West Bank, a worrying trend in settler violence is increasing. In July, Israeli settlers from Bracha settlement fired several improvised rockets towards neighboring villages. The UN Office for the Coordination of Humanitarian Affairs (OCHA) also reports a 46% increase in settler violence in July 2008 alone. The Israeli NGO Yesh Din reports that incidents in the first half of 2008 are 8% higher than all of 2007.

5. Inter-factional tension continues in the West Bank and Gaza. The Hamas authorities in Gaza are reported to have continued arrests of people and closures of institutions associated with Fatah. In the West Bank, Palestinian security forces conducted search and arrest campaigns and closed down some Islamic Associations and charitable organizations notably in the southern West Bank. Particularly since April 2008, the activities of civil society organizations in both the West Bank and Gaza continue to be severely constrained by closures implemented by Hamas, the PA and IDF.² Many of the closed NGOs in Gaza were funded by UN agencies and other donors, including the World Bank. The closures will most directly affect women, youth and children. Recreational, artistic, sports and cultural activities serving over 14,000 children and youth were affected as were job creation programs serving some of the poorest households.

6. Over the past 9 months the PA has made significant progress on implementing the reform agenda of the Palestinian Reform and Development Plan (PRDP). The PA has

1 Briefing to UN Security Council by Lisa Buttenheim, Director, Asia-Pacific Division, Department of Political Affairs, June 27, 2008.

2 In early July 2008, the IDF closed 8 NGOs in Nablus associated with Islamic charitable societies. The Palestinian Authority raided such charities in Hebron in August 2008. Also, on July 25th Hamas-affiliated personnel in Gaza raided and closed 160 NGOs allegedly associated with Fatah or secular movements, of which 130 were subsequently reopened. In all these incidents the authorities confiscated computers, documents and furniture. However, there were no written warrants, inventories of confiscated assets or handover documents signed. These actions in the West Bank and Gaza are against Palestinian Law No. 1 of 2000 which stipulates that associations must be given written notice and a legal timeframe to respond to any allegations by the government. It also represents a violation of the freedom of association.

successfully contained its wage bill, reactivated the budget process and, after excluding one off revenue items, is projected to reduce the recurrent fiscal deficit on a commitment basis from 27% of GDP in 2007 to about 23% in 2008. The donor community has responded to these reforms by supporting the PA with about \$1.2 billion in recurrent budget support to the end of August. Gaza, however, remains largely outside of the reform process as Hamas remains in control of security and the most important ministry positions there. However, PA civil servants, paid and controlled by the Ramallah government, continue to provide the bulk of basic government services.

7. The PA has made considerable efforts in re-establishing law and order and curbing the activities of militias. As a follow-up to the November 2007 deployments in Nablus, the PA undertook a comprehensive mobilization of forces to enhance security in Jenin in May 2008. This is in addition to security initiatives undertaken elsewhere in the West Bank, and is part of a broader reform agenda that has received broad international support at the Berlin Conference on Palestinian Civil Security and the Rule of Law held on June 24th. These deployments of Palestinian Security Forces across West Bank towns have produced encouraging results, and have been met with support by the local population. However, the impact and authority of the Palestinian Security Forces has been severely undermined by continued Israeli incursions into these towns to carry out arrests of suspected militants, whom Israel regards as not having been effectively contained.

8. Israel has announced a series of measures in support of the Palestinian economy. In a May 21st, 2008 note from the Civil Administration, a list of recent steps was highlighted, including: (a) the removal of a number of roadblock/obstacles across the West Bank³; (b) the increase in working hours at the Allenby Bridge International Border Crossing between the West Bank and Jordan⁴, and the issuance of a small number of special permits for public transportation from the northern West Bank to the Bridge; (c) the issuance of an additional 5,000 permits for Palestinian workers to work in Israel, in addition to a number of Businessman Certificates to encourage investment⁵; (d) the issuance of 110 special permits for farmers from Jenin and Nablus to travel to the Jordan Valley using their agricultural vehicles; and (e) the facilitation of 120 buses and 20 cars from Nablus/Jenin to the Jordan Valley, with 140 car permits in the Jordan Valley. Of particular impact is the decision on a moratorium on house demolitions in Area C of the West Bank due to the lack of building permits, which was put into effect by the Israeli authorities in April 2008. However, demolitions in East Jerusalem continued, with several demolitions as of August 2008.

3 According to COGAT, the impact of these measures has been seen in the increase in the traffic of goods through the commercial crossings in the West Bank, which according to their estimates has risen by 44% since the 2nd half of 2007 (from 158,571 trucks in the second half of 2007 to 228,643 trucks in the first half of 2008). However, it should be noted that increasing restrictions on alternative routes around these crossings would also contribute to a rise in the number of trucks passing through these crossings. Trucks through the Allenby Crossings are reported by COGAT to have increased from 5,807 in the second half of 2007 to 6,776 in the first half of 2008.

4 The working hours are now until 8:00 pm, Sunday-Thursday, but travelers are required to arrive much sooner in order to be processed.

5 However, advisors to Prime Minister Fayyad note that these permits have not yet been issued.

9. The efforts of Quartet Representative Tony Blair towards a momentum of Confidence-Building Measures, manifest in a May 13th Agreement on several initiatives, are beginning to yield results but require further support. Several aspects of the May 13th agreement with the PA and Israel have been implemented, including the: (a) tackling of some roadblocks within the West Bank; (b) the facilitation of the first phase⁶ of the North Gaza Emergency Sewage Treatment Plant to provide urgent water and sanitation services in Gaza; (c) mobilization of donor funds to complete a \$500 million Mortgage Facility to energize the housing sector; (d) the July 28th Frequency Allocation Agreement between Israel and the PA, enabling Wataniya, a second mobile operator, to begin operations in the West Bank; (e) Israeli plans to provide additional permits for Palestinian workers in Israel⁷; (f) facilitated entry of Arab citizens of Israel into Jenin to spur growth in the local market⁸; and (g) an Israeli decision on a moratorium on house demolitions resulting from lack of building permits in Area C, among others. The Quartet Representative has also played an important role in mobilizing recurrent budget support to the PA in order to mitigate the fiscal crisis, and in obtaining a decision by Israel on August 7th to facilitate the entry of currency into Gaza after months of delays, thereby allowing for the salary payment of 400,000 civil servants and their families, who are regarded by all as being unduly affected by the current situation. Moving forward, further support for the May 13th package by Israel and the PA is critical, given their significance as precedents for a revival of the Palestinian economy. Despite the progress to date, several items in the May 13th package remain incomplete. For example, only a few of the agreed obstacles have been removed, and only partially; the North Gaza Sewage Treatment Plant has most, but still not all, goods to complete construction and begin operations; and the entry of critical items of the maintenance of the water and sanitation sector, also agreed to in the May package, has not moved forward. Also, as of the time of this report, further shipments of cash into Gaza have not been allowed by Israel.

10. In May, the PA hosted a large Palestinian Investor Conference (PIC) in Bethlehem, attended by over 2,000 participants and during which over US \$1.4 billion in new investment deals were announced. In addition to attracting investors from around the world, the event represented a successful precedent for Israeli-Palestinian coordination, whereby Israeli facilitation of all aspects of the event was notable. Another significant development was the presentation of the Bethlehem Declaration, representing a consultative process by which the Private Sector Coordinating Council (PSCC) and PA worked towards a common understanding on priorities for the private sector. Topics addressed include the prevailing legal and regulatory framework, public-private partnerships, revitalization of Gaza, and reorganization of economic relationships

6 The NGEST is a two-phased project. Phase One consists of the construction of nine infiltration basins, and a pumping system to move sewage from the old Beit Lahia site to the new one. Phase Two involves the construction of sewage treatment facility.

7 In response to this, advisors to Prime Minister Fayyad note that, in fact, no additional permits have been provided. The Israeli 2009 budget imposes a levy on construction employers hiring Palestinian workers, to equalize their wage with foreign workers. This has stalled any issuance of permits.

8 Advisors to PM Fayyad note that the numbers allowed into Jenin are insignificant in comparison to the 35,000 visitors that entered Jenin on a daily basis in 2000.

with Israel. It also included the creation of a Ministerial Committee⁹ which is planning a National Economic Dialogue Conference towards the end of the year. Ultimately, the success of the PIC will depend on follow-up action undertaken by the PA and Israel to secure new investments, as a large portion of the investments announced in Bethlehem come from a small number of very large projects that had been negotiated over the previous year or longer.

11. The introduction of Wataniya, the second Palestinian mobile operator, is an important new development with the potential to have a significant impact on the economy. This \$350 million license deal was signed with the PA over 18 months ago, but was operationalized in July 2008 due to delays in securing the needed frequencies from Israel to the PA. A second mobile operator will provide a significant boost to the local economy and to the PA's budget. As such, the facilitation of all remaining aspects of Wataniya's activation, including Israeli permits to import and construct the necessary infrastructure in the West Bank and Gaza, is a priority, as is the continued facilitation of the operations of the current mobile provider in order to ensure a level playing field in the sector.

⁹ This committee is headed by the Prime Minister. On the PA side, it includes the Ministries of National Economy, Finance, Tourism and Agriculture. On the Private Sector side, it includes the Private Sector Coordinating Council.

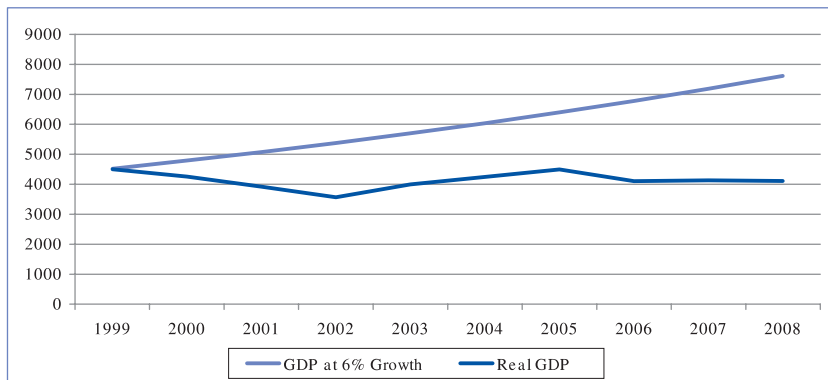
Economic Developments

12. At the Paris Conference in December 2007, the PA unveiled the Palestinian Reform and Development Plan (PRDP) which relied on growth of about 3.5% in the first year rising to about 5% in the third year of the plan. These growth projections were based upon the assumptions of a relaxation in economic restrictions on the Palestinian economy, and a resolution of the situation in Gaza. However, the economic restrictions have remained in place and the situation in Gaza has continued to deteriorate. As a result, the Palestinian Central Bureau of Statistics (PCBS) estimates that real GDP growth in 2007 was a mere 0.5%. Results from the first quarter suggest that growth in 2008 is slightly negative. IMF analysis notes a drop in GDP of -0.5% in 2007, and modest growth of 0.8% in 2008. This is likely due to a continued yet marginal drop in economic activity in Gaza, given its already-low base, matched with a modest rise in economic activity in the West Bank.

13. In addition to growth being low, the economy's productive base continues to hollow out as evidenced by the changing GDP structure. In 1999, Agriculture and Industry accounted for nearly 25% of GDP, and Education, Health and Public Administration was less than 20%. In the first quarter of 2008, Agriculture and Industry combined were approximately 19% of GDP and Education, Health and Public Administration accounted for almost 25%. IMF estimates of GDP indicate that the PA's cash wage bill alone is equivalent to over 27% of GDP. Furthermore, PCBS estimates that in 2007, manufacturing output was approximately 1.8% lower than in 2006 and 23% lower than in 1999. The lack of investment is also evidenced by the fact that the construction sector has seen little growth in the last four years and is less than 20% of its size in 1999. Recently, a few large housing construction projects have been announced in the West Bank, including a new planned community north of Ramallah, which will require over US \$500 million in private investment. If these projects actually come to fruition they would be a large boost to the construction sector and the Palestinian economy as a whole.

14. As the economy stagnates and the population grows, per capita income continues to fall. The PCBS completed a new census at the end of 2007, which revealed a 2.6% average annual population growth for the last decade. With a growing population and a shrinking economy, real per capita GDP is now close to 30% below its height in 1999. From 1994 until 1999 the Palestinian economy was growing at about 6% per year. If this trend had continued, GDP per capita would be nearly 85% higher than it is currently.¹⁰

¹⁰ PCBS has not yet released revised population figures for years between 1997 and 2007. The graphs are based on the unrevised figures.

Figure 1: Real GDP per capita vs. GDP per capita at 6% Growth

Source: PCBS and World Bank Staff Calculations

15. As the Palestinian economy declines it is steadily becoming more aid dependent.

So far this year until end-August the PA has received \$1.2 billion in recurrent budget support and may require almost \$1.9 billion in recurrent budget support in 2008. Thus, with the IMF estimating nominal GDP at just over US \$6.6 billion, external recurrent budget support will be the equivalent of at least 28% of GDP (and 32% of GDP including the projected development aid). By comparison, in 2007 the estimated recurrent and developmental budget support added up to 25% of GDP.

16. There are no separate figures for recent output in the West Bank and Gaza. Despite some anecdotal indications that the West Bank could be experiencing a increase in economic activity, there is no evidence that this increase is substantial. The Israeli Civil Administration reports that the number of trucks crossing between Israel and the West Bank in the first half of the year increased by more than 44% compared to the last half of 2007. In addition, tourist visits to Jericho and Bethlehem increased significantly in 2008. However, the figures on trucks also include traffic to Israeli settlements, and tourism represents only a small percentage of the Palestinian economy. In addition, the real value of domestic tax collections has fallen. Thus, whatever growth has been witnessed in the West Bank is unlikely to be substantial.

17. Unemployment in the West Bank rose from 17.7% in 2007 to 19% in the first quarter of 2008, while unemployment in Gaza has increased from 29.7% to 29.8%. These figures do not take into account underemployed workers who have turned to unpaid family labor or seasonal agriculture. The figures also do not include the many discouraged workers who have left the labor force.¹¹ The labor force participation rates are low and dropping. In the West Bank

¹¹ Unemployment figures do not include the large number of "workers absent from their usual work." In the PCBS calculations, these workers are assumed to be temporarily away from jobs due to illness, work stoppage, natural disaster or for other reasons but still receiving normal pay. UNRWA estimates that nearly 45,000 Gazans have become "absentee" workers since the first half of 2007.

it fell from 44% in 2007 to 42.3% in the first quarter of 2008, and from 38% to 37.5% in Gaza. Adding discouraged workers would increase the unemployment rate to 25.7% in the West Bank and 35.5% in Gaza.¹²

Figure 2: Unemployment in the West Bank and Gaza



Source: Palestinian Central Bureau of Statistics.

18. Palestinian unemployment is likely to increase if Israel proceeds with plans to levy taxes on Israelis hiring Palestinians. The Israeli authorities have announced an increase in the number of Palestinian workers granted work permits in Israel, including a recent statement referring to 5,000 new permits. However, the Israeli Government has introduced a new levy on Israeli recruiters of Palestinian workers in Israel. According to PA estimates, an average Palestinian worker earns about NIS 4,000/month. With this new levy- estimated at NIS 2,500-3,000 per worker per month- a Palestinian worker will now cost NIS 6,500-7,000 month, thus reducing all their comparative advantage vis-à-vis the more expensive Israeli workers.

19. The crisis in Gaza has led to a drastic increase in poverty. The official poverty rate for 2007 was 51.8%, compared to 47.9% in 2006. In the West Bank poverty slightly declined, falling from 22% in 2006 to about 19.1% in 2007. The percentage of Gazans in Deep Poverty continued to rise, increasing from 33.2% in 2006 to 35% in 2007.¹³ These rates reflect actual consumption. If remittances and food aid are excluded and poverty is based only on household income, the poverty rate in Gaza and the West Bank would soar to 79.4% and 45.7% respectively and the Deep Poverty rate would increase to 69.9% and 34.1%.¹⁴ This illustrates the high levels of aid

¹² PCBC Labor Force Survey Q1 2008.

¹³ PCBS uses two measures of poverty: Deep Poverty (absolute) and Poverty. The Deep Poverty line reflects a budget for food, clothing and housing only. For a family of six the deep poverty line in 2006 was NIS 1,837. The Poverty line adds other necessities including health care, education, transportation, personal care and housekeeping supplies; raising the line to NIS 2,300 for a family of 6. Thus, the percentage of households in Poverty includes those in Deep Poverty.

¹⁴ PCBS: Poverty and Living Conditions in the Palestinian Territory, 2007

dependency in the West Bank and Gaza, particularly taking into account the fact that the majority public sector salaries are financed with foreign aid.

20. Poverty and the global rise in food prices have taken a heavy toll on Palestinian living conditions, as has the dramatic rise in catastrophic health payments by households. The consumer price index for food has increased by 28% in Gaza and 21.4% in the West Bank from June 2007 to June 2008. Despite the large inflows of aid, a recent WFP survey found that food insecurity continues to rise, and is estimated to have increased from 34% in 2006 to 38% in 2007.¹⁵ Food insecurity is even more pronounced in Gaza, reaching 56% of households. Approximately 66% of income earned in Gaza is spent on food, with 56% of income is spent on food in the West Bank. The analysis also reveals that Palestinians are eating less; 75% of Palestinians have reduced the quantity of food they buy and 89% have reduced the quality. The lack of protein and vitamins has increased the prevalence of anemia and other nutrient deficiencies and is likely to have long term health consequences on children. Furthermore, from 2006-2007, the percentage of Palestinian households spending 10% or more of their total household expenditures on health increased from 5.5% to around 12.1% – a more than two-fold increase in the prevalence of catastrophic health payments in one year. A similar rate of increase in excessive health spending is witnessed using discretionary household expenditure during the same time period.¹⁶

21. The social impacts of the current crisis are no less significant. Continuing conflict is perpetuating an internal cycle of violence, fragmenting social cohesion and affecting psychosocial well-being. A 2006 survey concluded that nearly three quarters of the Palestinian population suffers from severe depression as a result of the current situation.¹⁷ Women, who historically play a key role in providing income for their households, are being increasingly relegated to the informal market as a result the restrictions on access and movement. Their participation in the labor market, at 15.7 percent¹⁸, is amongst the lowest in the world. Also, since September 2000, youth have been caught literally and figuratively in the crossfire of the conflict. Nearly 75% of the total injured during the second Intifadah were between 10 to 29 years old.¹⁹ As of June 2008, 62% of those killed in the Israeli-Palestinian conflict are youth between 15 to 29 years of age.²⁰

15 WFP/FAO/UNRWA rapid food security survey conducted March/April 2008 as reported in World Food Program, "Food Security and Market Monitoring Report, July 2008: Report 19.

16 Mataria, A. "Analyzing Health Equity in the West Bank and Gaza," World Bank, Draft Health Policy Report August, 2008

17 Near East Consulting, "Depression in the Occupied Palestinian Territories," Sept 2006.

18 PCBS, Labor Force Survey, December 2007.

19 PCBS, "Palestinian Youth: Facts and Figures," 2001.

20 PCBS, «Youth in Palestinian Territory, Statistical Indicators» 12 August, 2008

The Gaza Strip

22. The closure policy on Gaza since the Hamas takeover of Strip on June 14th, 2007 continues to erode the Strip's industrial backbone. Over 54% of employment in Gaza was private sector-driven prior to the closure.²¹ Gazan manufacturers imported 95% of their inputs. About 76% of their furniture products, 90% of their garments and 20% of their food products used to be exported to Israel, and some to the West Bank. The Palestinian Federation of Industries (PFI) estimates that 98% of Gaza's industrial operations are now inactive. According to PFI, of Gaza's 3,900 industries, 23 are operating; 6 produce wheatflower, one produces clothing, and the remainder provide food processing. Nearly 40,000 farmers in the agricultural sector and more than 70,000 workers in other sectors (34,000 in the industrial sector) lost their jobs. As a result of the moribund economy, Gazan banking sector activity is estimated to have dropped from 40% of total Palestinian banking, to about 7%.²² Their ability to function is also compromised by the restrictions on the entry of currency into Gaza.²³ Discussions with various representatives of the banking sector point to an emerging market for the supply of currency and industrial inputs as a result of the Israeli closures and the prevailing lawlessness in Gaza, leading to a redistribution of wealth from the formal private sector towards black market operators.

23. Closure of Gaza is also resulting in the collapse of the municipal sector. Municipalities, providing key services such as water, sewage, solid waste etc. are facing a deep financial crisis. The impoverishment of the population and the near absence of private sector activities imply that municipalities are unable to collect fees for service provision and are unable to pay staff salaries. The ability of municipalities to provide basic services is also severely constrained by their inability to import spare parts and supplies for the provision of basic services such as water and sanitation.

24. While the IT sector has circumvented movement and access restrictions to some extent, it is still too nascent to alter the course of the Gazan economy. Gaza's emerging IT sector engages in hardware, services and software development/outsourcing. Firms specializing in software development and outsourcing have been particularly effective, with Gazan firms seeking to tackle new US, European and Arab markets. There are 1,000 new graduates in IT every year, of which 600 are in Gaza.²⁴ However, the nascent IT sector's impact on the Gazan economy is minimal, and the sector remains constrained by the current closures (for training, marketing, business relationships, participating in trade fairs), thus stopping them from achieving economies

21 Private Sector Coordination Council (PSCC), Effect on Private Sector in Gaza, July 12, 2007.

22 Estimates provided by Cairo Amman Bank in Gaza.

23 In August, and after months of requests by the Palestine Monetary Authority and the international community, the Israeli authorities allowed for the entry of NIS 68 million into Gaza, and the recycling of approximately NIS 20 million in old currency. This allowed the PA to pay public sector salaries in Gaza, albeit on a staggered basis.

24 Engineering design is another sector with the same fundamentals.

of scale. Moreover, several donors who regard this as a promising sector continue to focus on firms in the West Bank.

25. On 19 June, at 6 am, the ‘Tahdi’ah’ (i.e., calm) between Israel and Hamas came into effect. Despite the agreed calm, several incidents took place subsequently in which Palestinian factions launched rockets into Israel, and Israel reacted to each of these by closing the crossings. Nevertheless the ceasefire is still holding, and there has been an increase in the flow of goods through the crossings. In a briefing to the World Bank, the Israeli Ministry of Foreign Affairs notes that, since the calm: (a) goods entering Gaza have increased from 60-70 trucks per day to 90/day, with the Sufa Crossing at full capacity; (b) fuel for the power plant has increased from 2.2 million liters/week to 2.9 million liters/week; (c) Diesel has increased from 800,000 liters/week to 1.2 million/week; and (d) greater quantities of other types of fuel, including cooking fuel, have been allowed into Gaza.

Table 1: Comparison of Flow of Goods in/out of Gaza since the Tahdi’ah²⁵

	Before June 2007	June 2007- June 2008	After Tahdi’ah (June 22 on)
Average Monthly Imports, All Terminals (Trucks)	9400	1930	4715
Average Monthly Exports, All Terminals (Trucks)	1440	0	0 ²⁶
Average Monthly Aggregate Imports(Trucks)	4500	0	2122
Average Monthly Cement Imports (Trucks)	1000	0	123
Average Monthly Metal Imports (Trucks)	80	0	1
Average Monthly Cooking Gas Imports (‘000 Kg)	5000	4525	4118
Average Monthly Diesel Supply (‘000 liters)	8500	4138	4788
Average Monthly Benzene Supply (‘000 liters)	1500	1463	0.541

Source: Paltrade, August 2008.

26. Despite the truce, and the marginal reduction in closures on Gaza, little progress has been made so far improving living conditions of the population there. First, the increase in fuel and humanitarian imports remains far below needs. According to the UN, fuel imports increased by ¼ in June compared to May (from 11.4 million liters in May to 14.1 million liters

²⁵ Paltrade.

²⁶ No exports were allowed out of Gaza since February 2008. Since June 2007, only 132 truckloads, mainly strawberries, potatoes, and flowers had passed through Kerem Shalom. Paltrade.

in June, including industrial diesel for the Gaza power plant). However, this was 54% of Gaza's monthly needs (about 26 million liters). The amount of cooking gas entering Gaza in June (3 million liters) increased by only 0.5% compared to May, and constitutes about 40% of monthly needs. The Coastal Municipal Water Utility (CMWU) is receiving approximately 40% of its fuel requirements.²⁷ In their July 24th Report, the UK House of Commons International Development Committee noted that "...The humanitarian situation in Gaza has been acute. Food, fuel and water have been in short supply and the public health system has been under severe pressure..."²⁸

27. Consequences of the shortage of fuel and other humanitarian items continue to be apparent. These include the curtailed production of electricity by the Gaza Power Plant, the major restrictions of water supply, the continued use of vegetable oil to run vehicles, the accumulation of 600 tones of garbage a day on the streets, and the daily dumping of 70-80 million liters of raw or partially treated sewage into the Mediterranean Sea. The linkages between this situation and the emergence of 40 cases of bacterial meningitis in Gazan hospitals are apparent.²⁹

28. The existing minimal social services such as health and education are further disrupted by on-going tensions. About 50% of health workers have been on strike since August 30th, 2008. Most Gaza hospitals are only providing emergency services, with about 40% of health workers reporting to work. In the education sector, about 60% of teachers are said to be reporting to work in Gaza and student attendance ranges between 50% and 80%. A one day universal strike was called on September 8th, 2008 for all university staff.³⁰

29. Due to the closure policies and recent actions by the authorities within Gaza to intervene, various donor projects targeting an improvement in basic services to Gaza's population are unable to be completed, or even start. Gaza's water and sewage system continues to be in urgent need of rehabilitation. In the long term, the Gaza Strip requires three modern sewage treatment plants to ensure that all waste water is properly treated. The Israeli authorities have recently allowed in a number of spare parts into Gaza and increased the fuel supply, and have continued to facilitate the completion of the North Gaza Emergency Sewage Treatment Plant. However, at the time of this report, the project remains incomplete due to the inability to bring all goods in. The Israeli authorities note that efforts are made to facilitate the entry of all goods through one crossing, as the Kerem Shalom Crossing was closed after an attack by militants in Gaza. The Kerem Shalom Crossing has reopened on August 19th and is regarded as being able to increase the flow of goods. Moreover, the June takeover of one of the buildings of the Palestinian Water Authority (PWA) by Hamas-affiliated personnel is also regarded as an

27 The UN Humanitarian Monitor for the Occupied Palestinian Territory, June 2008.

28 The Humanitarian and Development Situation in the Occupied Palestinian Territory, 11th Report of Session 2007-2008, UK House of Commons, International Development Committee, July 24, 2008.

29 According to Physicians for Human Rights, forty cases of bacterial meningitis were found in Mohammad Al-Doura Hospital in Gaza, which according to them is due to the water and sanitation problem.

30 WHO informal reports, September 1st, 2008 and September 7th, 2008. UNICEF informal report, August 25th, 2008.

impediment to project implementation in Gaza, as are the closures of critical NGOs there by Hamas affiliates. With regard to actions taken within Gaza that have impacted donor assistance, the Israeli authorities have noted the continued refusal of Hamas to accept the conditions posed by the international community, and the need for this report to reflect "...the responsibility borne by the Hamas regime in Gaza, for the low living standards in the area under its control, and in the fact that Hamas probably is responsible for the allotment of the products entering Gaza, controlling their distribution."³¹

30. The reversal of Gaza's humanitarian crisis extends beyond the entry of goods, and must include the access of the population to the West Bank for all purposes, and to Israel and elsewhere for health, education and other social services. Recent analysis by Physicians for Human Rights shows a combination of increased referrals out of Gaza- due in no small part to the closure of Rafah Crossing with Egypt and the lack of medical spare parts in Gaza- along with a reduction in Israeli permits to exit to and through Israel. There has been a sharp increase in the proportion of patients denied exit permits: from 10% in the first half of 2007 to 35% in the first half of 2008.³² Access to education and training opportunities outside of Gaza is equally limited.^{33,34} According to the Israeli NGO Gisha, as of January 2008, 480 of the 1,100 students and family members that requested to leave Gaza were granted exit.^{35,36} Recently, the Ministry of Defense informed the UN of a decision to provide an additional 100 exit permits for Gazans wishing to study abroad. Currently, the estimated requirement is for 600 exit permits.

31. In addition to humanitarian relief, there is an urgent need to revive Gaza's private sector. The current increase in the quantities and categories of items entering Gaza is a necessary step, but is insufficient. Karni, the main commercial crossing between Gaza and Israel, remains closed, except for a conveyor belt transporting cement, grain and fodder. The Kerem Shalom crossing was closed between April 19th and August 19th as a direct result of an attack from Gaza on the crossing, and as of the time of the report was allowing only 25 truckloads

31 Israeli Ministry of Justice comments on this report, September 8th, 2008

32 Physicians for Human Rights-Israel, Access to Health Care Report, July 2008. More recent reports place the rejection rate as closer to 44%.

33 Excerpt of letter from Foreign Minister Tzipi Livni to Member of Knesset, July 7, 2008: «The policy of not permitting exit abroad for students from Gaza is part of the Security Cabinet decision from 19.09.07 which defined Gaza as a hostile entity and placed restrictions on the borders for passage of goods and movement of people from the Strip and to it except for humanitarian cases. As of today, there is no change in this policy. At the same time, after consideration of particular cases, a few exceptions were approved, following, among other things, requests made by international actors. The Ministry of Foreign Affairs is in touch with the relevant authorities in the security system in order to analyze the policy in this matter and its implementation according to the circumstances of each case, among other things by responding positively to requests from friendly countries and this in parallel with the work of military authorities in the security system to clarify its position on this subject.» Gisha, Students Still Trapped in Gaza, July 16, 2008.

34 The events surrounding the US Fulbright Scholarship cancellations for seven students on May 29th, and reinstatement of some, due to lack of exit permits are well-documented.

35 Gisha: Legal Center for Freedom of Movement, Held Bank: Students Trapped in Gaza, June 2008.

36 In August-September 2007 and again in December 2007-January 2008, Israel arranged shuttle bus services allowing Gazans to travel via the Erez crossing directly to the Nitzana and Karem Shalom border crossing. Only around 480 students successfully exited Gaza via the shuttles during the 07-08 academic year. Since January 13, 2008, Israel has not allowed any students out via the shuttles.

per day.³⁷ The daily averages of truckloads through Sufa and Karni have increased, but remain well-below the daily average of 450 truckloads in January 2007.³⁸ Lastly, the Rafah Crossing with Egypt, regarded as a potential trade route for the Palestinian economy, has been closed even for passengers since the Hamas elections in early 2006.

32. Not only are the quantities of inputs entering Gaza insufficient to resuscitate the private sector, the categories and combinations of items allowed to enter are not conducive to most industrial operations. While the expansion of categories to include some inputs (cement, gravel, steel bars, pipes, spare parts, wood, etc.) is a very welcome step and has triggered a partial return of the construction sector, over 90% of imports remain humanitarian items. Furthermore, the partial entry of one input has rendered some of the other inputs useless for production. For instance, substantially more gravel was allowed to come into Gaza, but relatively less cement, steel bars, plaster, wood, etc. As a result, the process by which inputs are being allowed in is rendering a large proportion unusable in the production process.³⁹ Thus, the increase in crossing utilization, and daily operations, is necessary to avoid a scenario where more 'categories' are allowed in, but with reduced quantities for each category.⁴⁰

33. Most critical for Gaza's private sector is the ability to export to and through Israel, which is still not permitted. Thus, to the extent there is production under the current circumstances, it is geared towards the local market which itself is struggling to withstand the collapse of its private sector. For Gaza's economy to revive, it needs to be able to import a large quantity of industrial and agricultural inputs, and export its products and agricultural produce. On July 23rd, the Government of the Netherlands announced that Israel had allowed the import of Dutch seeds for Palestinian flower growers. This represents an opportunity for crops to be grown and exported by the winter season – provided that the closure of Gaza is relaxed.

34. On June 26th, the Private Sector Development and Trade Sector Working Group of donors asked the Palestinian Private Sector Coordinating Council (PSCC) to survey the Gaza private sector and to provide their immediate needs in order to sustain themselves. The PSCC's note focused on: the release of 1,790 containers currently held at Israeli ports and storages since June 2007; financial aid to help the private sector cover demurrage costs; increase in imports to 800 trucks per day and removing restrictions on the types of goods to allow for exports; increase in fuel imports to meet local demand; ease movement of businesspeople, and

37 Paltrade.

38 Paltrade, and UN Gaza Strip Inter-Agency Humanitarian Fact Sheet, June 2008. According to Paltrade, in normal times Gaza needs 850 truckloads of imports daily to sustain its economy.

39 The Palestinian Federation of Industries also notes a need for inputs and items to cover the local demand for 120'000 dozens of school notebooks and the same number of writing pens and pencils. Also needed are 110 containers of raw materials to produce school clothing.

40 According to Paltrade, the post-calm increase of humanitarian items from 11 to 30 has not been matched with a commensurate increase in import truckloads into Gaza, nor the usage of the crossings to full-capacity. As a result, imports of certain categories of items have actually decreased.

students, out of Gaza; inflows of currency to maintain banking operations; facilitation of all donor projects providing basic services, particularly water and sanitation; and extension of the fishing zone to at least 12 nautical miles. As of the time of this report, none of these requirements have been met.

Progress with the Parallel Actions Towards Palestinian Revival and Growth

35. The World Bank's report for the AHLC meeting on May 2nd, 2008 highlighted the need for parallel actions by the PA, Israel and donors as a necessary precondition for a revival of the Palestinian economy. The section below surveys the steps taken by all parties during the period of the Caretaker Government of the PA. As can be seen, efforts have been made by all sides in this regard, but with varying intensities. The PA has continued its fiscal and security reforms, but this has been contained within the West Bank. The donor community has provided substantial amounts of aid, albeit in a less-than-consistent manner. Israel has implemented some partial removals of restrictions on the Palestinian economy, but these have been insufficient to make any observable impact, and have been offset by other measures. As such, with acknowledgement of Israel's legitimate security concerns and the need to protect its citizens, it can be observed that the lack of sufficient progress in lifting the economic restrictions has not only stifled Palestinian growth, but it has likely dampened the benefits from PA's reforms and the donors' assistance.

Parallel Actions by the PA: Public Sector Reforms

36. In December 2007, the PA published its Palestinian Reform and Development Plan (PRDP), reflecting its reforms commitments. To date, it has largely maintained this path with continued fiscal reforms, and efforts at enhanced Public Financial Management. This laid a 3-year plan of comprehensive reforms focusing particularly on strengthening the PA's fiscal position, improving public financial management and restoring law and order. Since its introduction, the PA has made steady progress on implementing the PRDP's most important reforms. Some of the more noteworthy accomplishments are:

- The Ministry of Finance (MoF) is posting monthly revenue and expenditure statements on the web.
- The MoF distributed a 2009 budget circular to ministers and heads of agencies at the Council of Ministers on July 7th, 2008. This draft budget circular attempts to integrate recurrent and development expenditures within the Medium Term Expenditure Framework provided in the PRDP. This unified budget circular will improve the integration of the government's policy, planning and budgeting process and gives ministries significantly more scope in justifying their requests for recurrent and development budget resources.
- The PA has reduced government employment from over 180,000 in late 2007 to about 141,000 in the first half of 2008, well below the 153,000 limit set in the PRDP.

- The MoF has introduced a new computerized accounting system that with links to 10 ministries. The new system integrates fiscal information that was previously held in separate systems, and improves both the accuracy and the timeliness of reporting.
- The PA has made progress towards a culture of payment of utility bills. The PA has won its appeal to the courts against the suspension of the "Certificate of Payment" for electricity bills. Procedures were modified to establish a list of consumers defaulting on their electricity payments, in place of the onerous practice of requiring all citizens to produce a "Certificate of Payment" when requesting government services. In addition, 45,000 pre-paid electric meters have been installed and over 50 municipalities have registered to join the Northern Electric Distribution Company, which will further rationalize spending on electricity and enhance collections. The MoF has also introduced incentives for utilities and municipalities to pay bills for the supply of bulk power.
- The Ministry of Social Affairs (MoSA) has taken steps to make the social safety net more efficient. It has established a new and more efficient targeting method. The PA intends to have its targeting database fully operational by end-2008, including a ranking of up to 50,000 poorest households on the basis of 42 proxy poverty variables. At present, a ranking of 29,000 households has been completed. The MoSA will need to continue to add an additional 5,000 households monthly to its poverty targeting database in order for the PA to begin initiating a gradual merger of the various cash benefit programs, including the Special Hardship Case (funded by the EU PEGASE) with the World Bank-funded Social Safety Net Reform Project.
- The PA has devoted substantial effort to reestablishing its system of financial controls and enhancements are now being made. By the end of June 2008, the MoF's new internal audit department had initiated audits of four line ministries.

37. The PA's recurrent deficit – estimated at about \$169 million in the second quarter and \$447 million in the first half of 2008 – was considerable but has been accompanied by a reduction in the overall fiscal gap as a result of reform. Given the current inflation projections, in real terms the deficit is on track to be substantially lower than budgeted. After excluding one-off revenue items, the recurrent fiscal deficit on a commitment basis is projected to reduce from 27% of GDP in 2007 to about 23% in 2008. This would be a remarkable step towards fiscal discipline given the difficult environment.⁴¹ On a cash basis, the annual deficit is set to be almost 15% more than budgeted because the PA is making much larger arrears payments than planned. Arrears payments for the year are projected to be NIS 1,277 million while the budget provided for only NIS 781 million.

⁴¹ The deficit figure has been adjusted to remove a \$197 million dividend received from the Palestine Investment Fund, which was not budgeted, and which was fully used to repay PA debt to the PIF.

38. The reduced fiscal gap reflects mixed efforts by the PA to maintain revenues in a weak economy, and some success in controlling expenditures. While revenues increased in nominal terms in the first half of the year, taking out dividend payments by the Palestine Investment Fund (PIF) reveals only a 3% increase. Tax revenues are predicted to be flat and clearance revenues show a slight increase. Thus, there is no indication from domestic revenues of any growth in the economy, and in real terms revenues have declined. On the expenditure side, spending has been largely in line with the budget in the first half of 2008. There have been no general increases in salaries except for a statutory annual increase of 1.5% in nominal terms. The wage bill in the first half of the year, in Shekel terms, is in line with the budget and the number of PA employees is below the ceiling stated in the PRDP.

39. Net Lending in 2008 is projected to be nearly 25% less than in 2007 in local currency terms, despite its initial 17% increase in the first half of 2008 due to an increase in world food prices and a larger-than-expected deduction of debts from clearance revenues by the Government of Israel.⁴² The PA reports that electric utilities have increased their collection rates and their payments to the Israeli Electricity Corporation (IEC). The improvement in collection rates can be traced to the structural reforms including distributing prepaid meters and requiring Certificates of Payment, as mentioned earlier.

40. Despite the reforms and the progress in reducing the deficit, the fiscal crisis persists. In 2008, the need for recurrent budget support is estimated at about \$1.85 billion, of which about \$1.2 billion had been received by the end of August. A further \$0.3 billion of development budget support is projected. The 2009 budget projects a need for about \$1.3 billion in recurrent and \$0.5 billion in development budget support. However, with no economic growth, and with the restrictions intensifying, it is questionable whether the projected reduction in recurrent budget support can be achieved, as the need for social assistance will increase, especially if the situation in Gaza persists. Thus, the PA will most likely need a growing amount of external budget support.

41. Further progress towards fiscal stability will require a review of the current pension system for PA employees which is insolvent and operates on funding from the PA budget. The PA is accumulating Pension Fund arrears with respect to the payment of the government's contribution averaging nearly \$5.8 million a month in 2008. Consequently, pension reform is an important long term goal of the PA and is necessary for fiscal sustainability. The PA has made planning for pension reform an important goal of the PRDP and in the second quarter of 2008 it continued to obtain technical assistance, including from the World Bank, on options for reform. This assistance is ongoing and additional missions are planned for the next quarter.

⁴² Net lending refers to the amounts withheld from the tax clearance revenues by the GOI to pay for electricity, water and other services consumed but not paid for by local governments. They account for 15%-20% of expenditures.

42. On the Public Financial Management (PFM) front, there remains room to exploit the current reform momentum Moving forward, the PA has already identified in the PRDP some further steps to strengthen its PFM infrastructure, including: (a) continuing to improve the integration of the recurrent and development budgets so that the budget can unify the planning processes of the PA and donors; (b) completing the consolidation of line ministry bank accounts for cash management purposes; (c) developing cash forecasting capability to both support the management of PA bank accounts, and assist donors to program the flow of budget support; and (d) building the capacity of the external audit agency so that it is in a position to carryout an audit of financial statements prepared by the PA..

43. Moreover, the PA's efforts to improve the overall public sector management and governance would be further strengthened by adding a new legal framework for public sector procurement that would meet internationally accepted standards. This would support the effective use of public expenditures and donor assistance. A new procurement law and the implementing regulations were drafted in 2006, but were not passed. The enactment of the new law and regulations constitutes the critical path of procurement reform.

44. The Palestinian Monetary Authority (PMA) has made significant strides in its capability to serve as a central bank for any future Palestinian state. The PMA is procuring and implementing a new electronic payments system, which will greatly increase the efficiency of the Palestinian payments system. It has brought on-line a new electronic credit bureau that will enhance banks' ability to assess risk. Furthermore, the PMA has introduced a new set of anti-money laundering regulations that represent a commendable initiative that can be complemented by further steps in terms of legislation and enforcement.⁴³ Moving forward, the PMA faces two main challenges. The first is to identify, in collaboration with the Central Bank of Israel, alternatives after a number of large Israeli banks announced plans to end correspondent relationships with Palestinian banks. The second challenge is to maintain the payments system functioning in Gaza while ensuring that funds go to the purposes intended, and at the same time mitigating against continued Israeli restrictions on the entry of currency into Gaza. For much of the past year, Israel has restricted the entry of cash into Gaza. Given that nearly 30% of monthly cash injections into Gaza are sent back to Israel in commercial transactions, there is a need of regular imports of currency. The absence of regular flows of cash has prevented the PA from paying full salaries to employees in the Strip.

⁴³ In its September 8th response to this section, the Israeli Ministry of Justice notes that "While some of the provisions in the law are quite up to date, such as those relating to DNFB, the Anti-Money Laundering Decree Law recently passed by the PA falls short of international standards in a number of respects. For example, the Decree Law does not include Terrorist Financing as a predicate offence, as required by the FATF recommendations. In addition, the list of predicate offences included in the Decree Law is phrased in a general manner, and does not provide clear definitions of the criminal elements required under each offence. Furthermore, Israel has not seen any indications of implementation or enforcement of the Decree Law, including reporting, identifying customer due-diligence, investigating etc. It should also be noted that the Palestinian Monetary Authority is not a member of any FATF style regional body."

45. As mentioned earlier, the PA has also carried out initial steps towards enhanced security in the Palestinian towns and cities in the West Bank under its control. While still at the early stages of implementation, these efforts must continue, with the support of all sides based on a reasonable appraisal of the need for incremental steps. In an effort to enhance security in Palestinian towns and cities, additional PA Security Forces have been mobilized in Nablus, and in Jenin in May, along with security operations elsewhere in the West Bank. According to officials in these cities, the deployment of Palestinian Security Forces has produced encouraging results, and has been regarded as positive by the local population. An ICG report shows that increased movement in Jenin has led to an exceptional rise in enforced judgments and completed criminal investigations.⁴⁴ These mobilizations were intended to trigger an incremental and locally-supported enhancement in security, and to demonstrate the dividends of stability through a matching package of economic projects, unshackled movement restrictions and security assistance. To that end, some equally-incremental steps have been taken by Israel, particularly in Jenin where a number of work permits and movement certificates⁴⁵ were issued, where several police stations were reopened, and where a new regulation has been instituted allowing for the entry of Arab citizens of Israel into Jenin by foot. The international community has also sought to underwrite these initiatives, through commitments made at the Berlin Conference on Palestinian Civil Security and the Rule of Law on June 24th, as well as through a series of donor-financed small-scale projects in these cities. At this Conference, the PA presented a Judicial Reform Strategy which represents an impressive, if yet unimplemented, stock-taking of urgent reforms in the legal system and the rule of law.

46. However, the impact of the PA's security initiatives have been limited by continued IDF incursions, restricted mobility of security and judicial personnel, and limits to the accompanying economic gains. Continued IDF operations in Nablus, Jenin and elsewhere are seen as having undermined the authority of the PA Security Forces. The Israeli authorities view these incursions as caused by an increased PA focus on curbing criminal, and not militant, activity, as well as the release of several prisoners suspected of affiliation with attacks on Israelis. Conversely, PA officials stress the need to operate in a way that builds local support. PA officials also stress the need to carry out arrests based on credible evidence, rather than to act as an implementing agency based on lists provided by Israeli intelligence services. Regardless, it is imperative that Israeli-Palestinian cooperation take place, including the curbing of Israeli incursions. At the same time, the PA can explore efforts to upgrade its security presence, and to ensure that militant activity is prevented in a more sustainable manner. This effort must, in turn, be supported by donors and Israel, through an immediate increase in development projects, and a less cosmetic reduction in restrictions on the movement of residents out, and tourists/clientele, into these cities. For example, only a few hundred Arab citizens of Israel are currently allowed to enter Jenin

44 ICG interview, Ramallah, June 2008.

45 According to some estimates, these include 22 Businessman Certificates, 1,000 work permits and 13 VIP cards.

on foot. However, in 2000 approximately 20,000 cars and tens of thousands of Arab citizens of Israel crossed into Jenin on Saturdays.⁴⁶ Overall, it is worth noting that the PA's security initiatives did improve security for the Palestinian population without any commensurate deterioration in the security of Israeli citizens, thereby challenging the 'zero-sum' narrative that seems to have prevailed to date.

47. With regard to support to the private sector, the PA faces an opportunity to leverage the success of the Palestinian Investors' Conference (PIC) in Bethlehem. The fact that the PIC was successfully conducted, despite the complex logistical requirements is a testament to the considerable potential arising from Israeli-Palestinian cooperation. As such, the PIC is best regarded as a concept rather an event, and represents an important precedent which must be exploited as expediently as possible. Forty-six business-to-business investment meetings took place during the conference, and 15 took place afterwards. At the same time, several follow-up initiatives were identified with the Israeli authorities to facilitate the access of Arab and Palestinian investors into the West Bank and Gaza. The ability of the PIC to translate into tangible improvements in the Palestinian economy will depend on the extent to which PA institutions are able to follow up on these agreements, through the Joint Economic Committee and elsewhere.

48. Clearly, all reforms and initiatives, despite their successes and impacts, are regarded as partial insofar as they exclude the population of Gaza. As mentioned in previous AHLC reports, Gaza represents a large part of the Palestinian population, economy and identity. As such, the lack of progress in resolving the current stalemate is perhaps the foremost obstacle to Palestinian economic development, and one whose resolution is equally in the domain of the authorities in Gaza.

⁴⁶ International Crisis Group, July 2008.

Parallel Actions by Donors

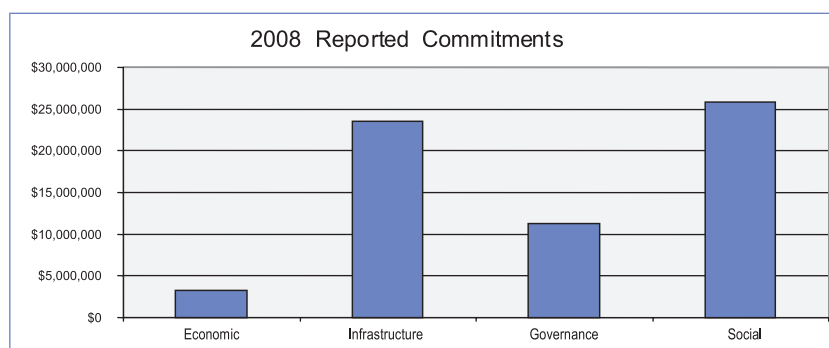
49. Until the end of August 2008, donors had provided approximately \$1.2 billion in recurrent budget support. This has supplemented the PA's tax and clearance revenues, and allowed the PA to sustain operations since the Paris Conference in December 2007, as well as pay back a significant amount of arrears of public sector salaries and private sector contracts. These much-needed funds also assisted in ensuring payments to public sector employees in Gaza, which has been critical in mitigating the debilitating impacts of the current closure policy imposed by Israel.

50. While information on actual donor commitments and disbursements against PRDP programs is still being compiled, initial PA estimates indicate that development assistance has fallen short across all the PRDP programs.⁴⁷ Commitments recorded by the Ministry of Planning did not exceed \$64 million at the end of August 2008, although some PA officials estimate it might be as high as \$150 million to date. Indeed, in the next revision of the PRDP the PA plans to reduce its budget for development assistance in 2009 from \$624 million to \$503 million.⁴⁸ The information available to date indicates that the infrastructure and social sectors have higher levels of commitments than the governance and economic development programs (see figure below). The PA attributes the slow progress to less-than-expected donor commitments in 2008, the negative economic outlook resulting from continued restrictions on movement and access, the complete closure of Gaza to development projects, and the long-lead time to launch development projects after two years of PA paralysis. Finally, the launching of the PRDP process has necessarily resulted in some adjustment period for both the PA and donors.

47 In its September 8th response to this report, the Israeli Ministry of Justice writes: "Difficulty in implementing donor assistance pledges has been a central problem in the institution-building process, which we would suggest be addressed by the international community. As we have mentioned before, one possible solution to this problem might be the creation of a suitable unified international monitoring system, designed to track the transfer of donor funds, all the way from the initial pledge down to the final end user. This system might provide uniform international standards for the transfer of funds by donors, including monitoring, auditing and reporting mechanisms. These standards should be formulated in accordance with international standards, and guarantee sufficient flexibility to operate with different donor states." However, the World Bank regards the task envisioned as the role of the PA.

48 Presentation by Mr. Judeh Jamal, Head of the PRDP implementation team, to Private Sector Development and Trade Sector Working Group, August 20th, 2008.

Figure 3: Recorded Development Project Commitments through August, 2008



Source: Commitments recorded in Ministry of Planning PAMS database by August, 2008.

51. While donor assistance has been essential to the realization of the PA's PRDP, this assistance since the Paris Conference has been ad hoc and unpredictable. Since Paris, the PA has been unable to plan expenditures beyond a two-month horizon due to difficulties in securing support for the recurrent budget, and delays in translating development project pledges to actual commitments. In terms of recurrent budget support, the presence of multilateral mechanisms such as the EU PEGASE and World Bank PRDP Multi-Donor Trust Fund has added some relative stability to the PA's financing patterns.⁴⁹ However, neither mechanism contains sufficient resources to cover the PA's entire monthly needs, thus necessitating regular PA efforts to secure monthly assistance packages from a variety of donors, many of whom have pledged funds in Paris but have yet to transfer resources.⁵⁰

52. Because of the ongoing closure of Gaza, little if any development assistance has reached the Strip.⁵¹ With the exception of a water treatment facility benefiting from direct intervention by Quartet Representative Blair, and other small-scale projects, there are no substantial development projects currently underway in Gaza. This is a result of the current closure policy which prevents the entry of project-related goods into Gaza, as well as a lack of programming of assistance by several donors. As such, the divergence in indicators between the

⁴⁹ To date, the World Bank-administered PRDP Multi-Donor Trust Fund has disbursed over \$230 million to the PA, through the contributions of the UK, Norway, Kuwait, Australia, Canada, Finland and France. The World Bank has also disbursed an additional \$40 million from its own resources towards the PA's PRDP.

⁵⁰ In its September 8th response to this statement, the Israeli Ministry of Justice notes that "...although the existing EU and World Bank mechanisms may provide sufficient levels of monitoring and reporting for the specific donors and funds to which they apply, they leave a gap in the overall monitoring of donor funds to the PA – they do not provide stability regarding those funds sought by the PA from the "variety of donors" referred to in the Report. As stated above, we would like to propose that the Report mention that, in order to address this gap, international standards should be established for the transfer of all funds to the Palestinian Authority. These standards should be adopted by all international donor states or organizations."

⁵¹ In his February 2008 report titled 'The Road Out of Gaza', Nathan J. Brown of the Carnegie Endowment for Peace wrote, "The international community has proclaimed its support for Palestinian reform and development, but it does not have many places where it can spend money other than paying the salaries of those who work for a non-functioning government'.

West Bank and Gaza are likely to continue, even in the event of the removal of the closures on Gaza.

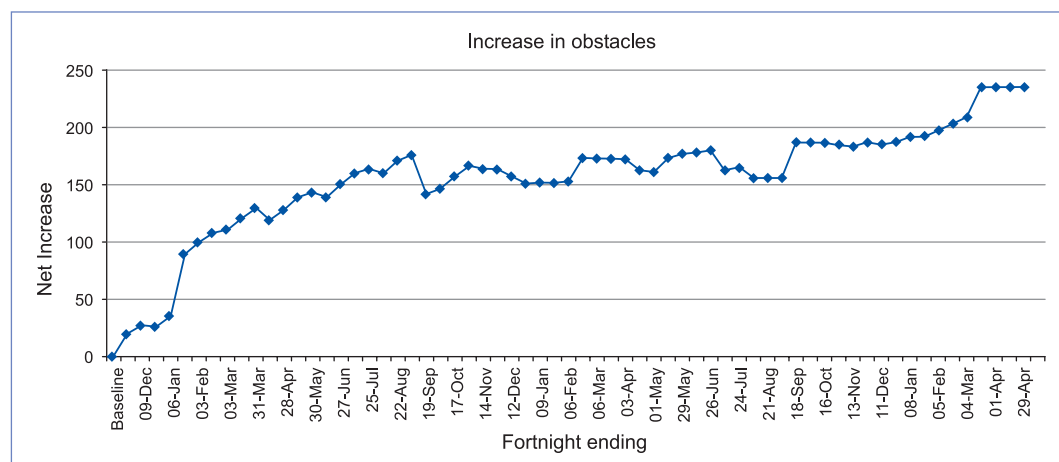
53. Aid coordination continues to be managed at the local level through the Local Development forum (LDF), and the associated strategy groups (SGs) and sector working groups (SWGs), with mixed results.⁵² These forums have helped maintain the collective donor dialogue with the PA ministries and agencies, and have been the primary venue for information sharing in terms of the PRDP process. However, these groups have had limited success in increasing the levels of development assistance to projects proposed under the PRDP programs. To date, many of the PRDP development projects remain unfunded, and several donor initiatives continue to be formulated and implemented outside the PRDP prioritization process. Furthermore, these donor groups have yet to evolve towards a higher level of coordination that would unify donor efforts around agreed sector strategies and within collaborative funding mechanisms. Some exceptions to this are recent efforts within the education and municipal development sector working groups to develop sector wide assistance programs. There is a need to replicate this across sectors, and to explore options for a more disciplined PA-led framework for long-term project planning.

52 In its September 8th letter, the Israeli Ministry of Justice wrote: "In order to address some of the obstacles encountered by the existing forums dedicated to aid coordination on the local level, the international community might consider recommending the establishment of a unified internal Palestinian mechanism for interface and coordination with international donors, designed to address, in a unified manner, all aspects of coordination between Palestinian entities and the international community, coordinating internal auditing monitoring and verification mechanisms, prioritizing between projects and overseeing project implementation, inter alia." The World Bank regards the current PA institutions as capable of undertaking this function under the parameters set out in the PRDP.

Parallel Action by Israel : Closures and Economic Restrictions

54. Israel has recently removed several barriers within the West Bank, which is regarded by all as a welcome first step in reviving the Palestinian economy. However, overall indicators show that economic and movement restrictions have increased during this period. Since June 2008, the IDF has removed a number of earth mounds, and partially lifted a few roadblocks that are regarded as having facilitated the flow of people within the West Bank. These roadblocks include the Shave Shamron checkpoint around Nablus, the Kvasim checkpoint by Hebron, and the Bir Nabala checkpoint near Ramallah.⁵³ Beyond these, the obstacles removed were found by OCHA to be of minor or no significance, and focus on minor upgrades of the restrictions rather than their removal. Despite these measures, the most recent OCHA report finds a slight deterioration in access because of the increased number of barriers, the continuing prohibition of Palestinians using approximately 700 km of key roads, and the increased number of curfew incidences. The total number of obstacles⁵⁴ has increased from 563 in the beginning of 2008 to 609 in May of 2008, representing a 62% increase over the baseline of August 2005. The total hours under curfew in the first half of 2008 were 1,050 compared to 287 in the first half of 2007, and the total number of curfew incidents was 71 in the first half of 2008 compared to 26 in the first half of 2007.

Figure 4: Increase in Obstacles



Source: OCHA Implementation of the Agreement on Movement and Access report no. 65.

53 Shave Shomron has been opened for only daylight hours, and Kvasim has been frequently closed during the past month, so neither removal is complete.

54 Obstacles as defined by OCHA include checkpoints, partial checkpoints, earth mounds, road gates, road blocks, earth walls, trenches, and road barriers.

55. Approximately 57% of the Separation Barrier has been constructed and another 9% is under construction. About 87% of the route runs inside the West Bank and East Jerusalem, isolating communities and separating tens of thousands of people from services, their lands and livelihoods.⁵⁵ Under current plans, when the Barrier is complete, approximately 35,000 West Bank Palestinians will live between the Green Line and the Barrier, requiring special permission to remain in their homes or cross into the rest of the West Bank. Another 26,000 in eight communities will be surrounded on four sides by the barrier, with a tunnel or road connection to the rest of the West Bank. Nearly a quarter of a million residents of East Jerusalem will be cut off from the rest of the West Bank.

56. Despite the commitments under the Road Map and at Annapolis, Israeli settlements continue to expand and very few outposts have been removed. At the end of 2007 there were an estimated 460,000 settlers of which about 40% were in East Jerusalem.⁵⁶ There were 492 housing starts in the West Bank settlements in the first quarter 2008, up from 270 in the first quarter 2007. There are currently 2,515 buildings under active construction in the settlements in the West Bank. Despite Israel's commitment to removing outposts established after 2003, only two small ones have been removed and the settlers were compensated by being allowed to expand other outposts. In July 2008, the Israeli authorities approved construction of 22 permanent houses in Maskiot settlement in the Jordan Valley.

57. The closures on Gaza, and the movement and access restrictions in the West Bank, have also affected the efforts of donors to support the Palestinian economy. UNRWA/WFP analysis on the use of the six crossings between Israel and the West Bank estimates that more trucks and staff will be needed in the future to transport the same amount of humanitarian goods, adding approximately \$3.9 per metric ton for transport. This excludes other costs, including going through the back-to-back procedures that requires off-loading, scanning of loads, and reloading onto a truck. The cost increase related to Gaza results from the closure of Karni, the main crossing for goods, as of June 12th, 2008. As a result, humanitarian agencies such as WFP and UNRWA must now undergo an additional process of palletization of humanitarian goods in order to send them through the Sufa or Kerem Shalom crossings, adding another \$70 per metric ton. These figures exclude the vast demurrage costs incurred by the UN agencies as a result of lengthy delays in clearing and permitting the entry of shipments to the Gaza Strip. Since June 2007, UNRWA and the WFP have incurred at least \$4 million in storage, demurrage, transportation and palletization costs for imports to Gaza.

55 All data in this section on the Separation Barrier is taken from the OCHA, "Update on the Humanitarian Impact of the Barrier". Update no. 8, July 2008.

56 World Bank estimates based upon data from the Israeli Central Bureau of Statistics and the Jerusalem Institute of Israeli Studies.

An Analysis of the Economic Restrictions Confronting the West Bank and Gaza

58. The restrictions on Palestinian economic potential involve more than roadblocks and checkpoints. With due regard to Israel's security concerns, there is consensus on the paralytic effects of the current 'movement and access restrictions' on the Palestinian economy. A report by the International Development Committee of the UK House of Commons, Published on July 24th 2008, noted that: "...it is important for Palestinians to be able to move around their own country for education, to receive healthcare, to visit their families, to work and to trade, irrespective of whether their journeys are regarded as strategically significant to international negotiations. Neither Israel nor the international community should lose sight of this..."⁵⁷ However, the common view of these restrictions extends only to the network of checkpoints and barriers riddling the West Bank, and partitioning the West Bank from Gaza, and both from Israel and the rest of the world. In reality, these restrictions go beyond concrete and earth-mounds, and extend to a system of physical, institutional and administrative restrictions that form an 'impermeable barrier' against the realization of Palestinian economic potential. Thus, tackling checkpoints alone, while potentially having a massive impact on economic revival, must be complemented with a broader address of the system of barriers facing the Palestinian economy, which includes:

- **Access to Economies of Scale:** Palestinian businesses are unable to achieve sufficient 'economies of scale' to warrant additional investment, business growth and/or additional entrants into the market. This is why over 95% of businesses are 10 employees or less. Capital intensive industries are also few and far between, and occupy the bulk of the market space. This is due to Israeli restrictions that have fragmented the West Bank's Palestinian population into economically isolated pockets, increasing the costs of trading with each other and between Israel and the West Bank and Gaza. The West Bank and Gaza are now almost completely delinked, with Gaza starkly transforming from a potential trade route to a walled hub of humanitarian donations. These restrictions, furthermore, prevent full trade with Israel, and with the rest of the world. More importantly, the restrictions against movement in and through East Jerusalem preclude a main economic hub for Palestinian businesses.
- **Access to Natural Resources:** This covers a number of resources essential to the exploitation of Palestinian economic potential. Key among them is access to land, water, cultural heritage and telecommunications radio frequencies, among others.

⁵⁷ The Humanitarian and Development Situation in the Occupied Palestinian Territory, 11th Report of Session 2007-2008, UK House of Commons, International Development Committee, July 24, 2008.

- **Access to an Investment Horizon:** Beyond the physical impediments affecting access to inputs, supply chains, and markets, investors in a Palestinian economy face an unclear horizon with which to measure and mitigate their risks. This is linked, first and foremost, to the uncertain political horizon, and the resulting unpredictability in the investment horizon. In addition, the system of permits and visas make it difficult for foreign investors and create uncertainty for local investors.

Access to Economies of Scale

59. The West Bank and Gaza is a small, underdeveloped economy next to a much larger, and in the case of Israel, a much more developed economy. Consequently, its growth depends on maintaining open trade with its neighbors. Trade flows represent 85% of Palestinian GDP, with imports of goods and services representing over 80% of total flows and exports around 20%. Around 90% of Palestinian trade is with Israel.⁵⁸ However, with the deteriorating security situation Israel has increasingly imposed barriers to trade. In addition, changes in the Israeli economy have reduced the market for traditional Palestinian goods.⁵⁹ Thus, future growth will depend on enterprises being able to reach beyond Israel and access new world markets.

Alternative Trade Routes for the West Bank

60. West Bank enterprises have essentially two options to access the world market—through Israeli ports or airport, or through Jordanian ports or airport.⁶⁰ Israel will undoubtedly remain the West Bank's main trading partner for the foreseeable future. However, in order for the Palestinian economy to grow, Palestinian businesses will have to break their dependence on Israel and access the wider world markets. To this end, the PA has signed a number of agreements that provide Palestinian goods preferential entry into other markets. However, for Palestinian enterprises to take full advantage of these preferences there must be significant improvements in trade logistics and a relaxation of Israel's strict security regime.

61. The main constraints to trade between the West Bank and the outside world are the internal restrictions, the commercial crossings along the Separation Barrier and the inefficient operation of the Allenby Bridge. If Palestinian enterprises are to successfully penetrate the international market, all of these issues must be addressed, while at the same time not jeopardizing Israel's security. Improved trade logistics will increase the competitiveness of Palestinian goods which is necessary if Palestinian enterprises are to achieve efficient scale and move toward higher value added products.

62. To access the wider world market, Palestinian enterprises first face the challenge of moving within the West Bank itself. The numerous Israeli road blocks, restricted areas and growing settlements have cut the Palestinian communities into separate cantons, which significantly raise transportation costs and limit the ability of Palestinian enterprises to achieve economies of scale.⁶¹ As a result, internal trade has declined and external trade has also

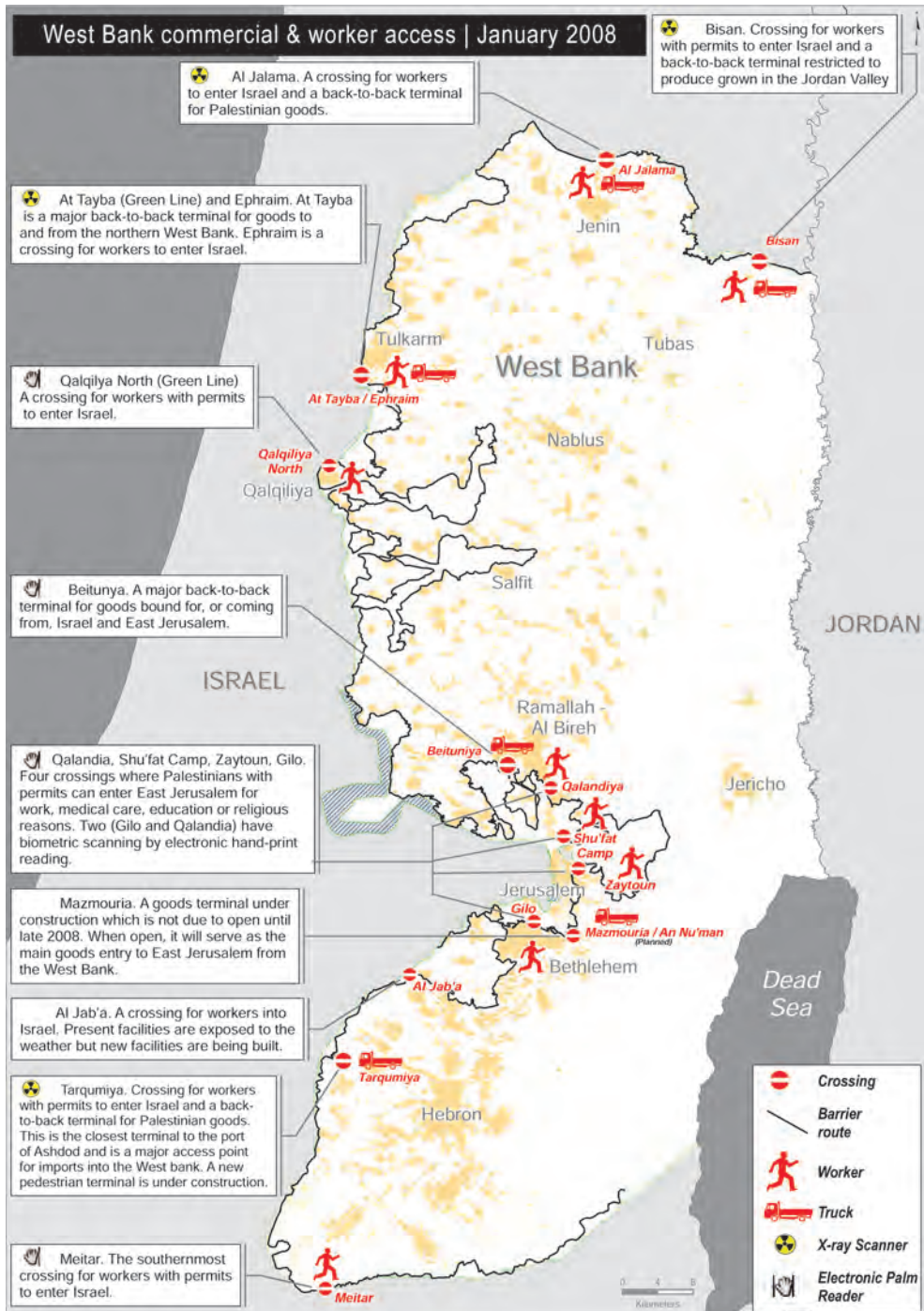
58 There are no accurate statistics for trade with Israel. Since the borders with the West Bank are porous, much of the trade takes place informally and is not reported. However best estimates suggest that trade with Israel accounts for anywhere from 85%-90% of total trade flows.

59 See the World Bank's 2006 Investment Climate Assessment for a discussion of the changing relationship between the Israeli and Palestinian private sector.

60 It is also possible to send goods across Israel and through Egypt. However, the costs are so high that this is not competitive for goods not destined for Egypt.

61 See World Bank 2007 Report for a detailed description of restrictions in the West Bank.

Figure 5: West Bank Crossings



<http://www.ochaopt.org/documents/Commercial%20Crossings%20V5.pdf>

undoubtedly been affected. The World Bank's 2006 Investment Climate Assessment found that in 2000 nearly 60% of West Bank enterprises made a significant share of their sales outside of their home city, but by 2006 this number had dropped to less than 40%. Furthermore, a World Bank-Paltrade Survey found that the increasing restrictions in the West Bank have: (a) raised the cost of inputs and equipment, as well as the time wasted taking less efficient alternative routes; (b) reduced utilization of the current truck fleet; and (c) prevented accurate planning and efficient allocation of resources.

63. For trade to and through Israel, which constitutes the vast majority of Palestinian trade, goods must navigate a series of crossings that are a key factor for trade logistics for West Bank enterprises. In 2005 the Israeli authorities issued a report stating that: "Israeli security forces will transfer the bulk of their monitoring and control efforts from checkpoints inside the West Bank and the Gaza Strip to crossing points along the revised route of the security fence. This will mean a sharp reduction in the number of roadblocks and barriers within the Gaza Strip and the West Bank..."⁶² All Israeli/Palestinian trade will go through the crossings once the Separation Barrier is complete.⁶³ Currently, the six planned commercial crossings and some smaller crossings are either operational or near completion.⁶⁴ However, the promised reduction in internal restrictions has not materialized.⁶⁵ In January 2008 the World Bank commissioned PalTrade to monitor four crossings. To date the results have been mixed. While no queuing has been observed, the average time to process a shipment out of the Palestinian areas was one hour and 45 minutes.

64. Critical to the Palestinian economy is the extent to which the crossings can accommodate the demand once the Separation Barrier is closed. Since Israel is the main trading partner for the WB&G, these crossings are a determining factor of the size and competitiveness of Palestinian trade. There are no reliable estimates of the volume of traffic between the entire West Bank and Israel, since much of the traffic does not currently use the Crossings. A recent Economic Cooperation Foundation (ECF) study⁶⁶ found that only 15% of traffic in the southern West Bank currently passes through the Tarqumia Crossing and less than half of this uses the back-to-back facilities. Despite handling only a fraction of the actual traffic, the average waiting time for Palestinian trucks was one hour and a half, which ECF estimates adds at least 15% to the cost of

62 "Israeli Assistance Steps and Humanitarian Measures Towards the Palestinians: Following the Palestinian Elections and the Sharm el-Sheikh Summit." Israeli Ministry of Foreign Affairs, May 2005.

63 The Separation Barrier is designed to enhance Israel's security by preventing Palestinians from moving into Israeli controlled areas. In most places the Barrier runs inside the Green line and encompasses about 10% of pre -1967 West Bank. Because of this the International Court of Justice has ruled it illegal.

64 The crossings of Bardala/Bet Shean, Jalameh, Irtah/Sh'a'ar Ephraim, and Tarqumia have all been established and the Beitunia commercial checkpoint continues to be operated by the IDF near Ramallah. The planned crossing point of Mazmouria near Bethlehem is still to be completed. Beitunia is a crossing between Ramallah and Jerusalem and as such is well inside the 1967 Green line.

65 The number of closure obstacles reported by OCHA rose from 566 in September 2007 to 607 in April 2008. This figure does not include checkpoints placed on the Green Line, flying checkpoints and the Barrier. OCHA reports a slight deterioration in the overall access situation in the West Bank in the first half of 2008 based on the number of obstacles, prohibitions on the use of roads, the increase in curfews and long queues of Palestinians at crossings.

66 "A Survey of Freight Traffic Between Israel and the Southern West Bank and the Tarqumia Crossing in Particular," Unpublished report by Yaakov Garb, March 2008

shipping goods.⁶⁷ There is recognition of this capacity constraint by the Israeli authorities, who have begun exploring options expanding this capacity. Furthermore, the Israeli authorities have yet to institute a “known trader” system or a sophisticated risk management system; all outgoing shipments are subject to full inspection by scanners, and in some crossings 60% are subject to additional manual inspections. Moreover, none of the Crossings involve any coordination between the Israelis and Palestinians, despite the existence of the Palestinian General Administration for Crossings and Borders (GACB).⁶⁸

65. To access the world market, Palestinian enterprises can send their goods through Israel or Jordan. Israel currently provides the most economical and best services, so despite the security constraints, the majority of shippers send goods through Israel. However, the introduction of the commercial crossings, tighter Israeli security requirements and improving services in Jordan is likely to shift traffic towards the Jordan route. For sea shipments to North America and Europe, Israeli ports offer an advantage despite the high internal transport costs imposed by security restrictions in the ports and elsewhere. However, for flows from Asia, Aqaba offers significant savings relative to Haifa, while Aqaba is served by routes that do not continue through Suez. For air shipments, Israel’s advantages are less clear. While Ben Gurion Airport offers more flights to Europe and North America and has better facilities, its costs are marginally higher than Jordan’s airport. Moreover, Israeli security requirements create a burden. Nevertheless, most Palestinian shippers currently view Ben Gurion as a better option.⁶⁹ Time-sensitive crops such as flowers and herbs require shipments by air, whereby Jordan’s Queen Alia offers competitive rates and service. However, because of conditions at the border, most shippers continue to use Ben Gurion. In the first half of 2008 there were successful shipments of herbs and pharmaceuticals across the bridge and through Jordan. However, these were specially coordinated and are not the norm.

66. As Israeli crossings and security are tightened, no other alternatives have been provided to Palestinian traders. While Palestinian trade with Israel will be routed through the crossings, for trade with the rest of the world it is critical to find alternatives to the trade route through Israel. The Allenby Bridge with Jordan will take on increased importance and it is vital to both increase its capacity and its efficiency. Improving operations at Allenby would increase the competitiveness of Palestinian products in the Gulf- a significant potential market for Palestinian products- and make Aqaba port a competitive alternative to Israeli ports. Improved handling facilities would also encourage a greater use of Queen Alia airport for fragile goods that need immediate shipments. Currently, the operations in place do not allow for the full exploitation of the Allenby Bridge. First, while both Jordan and the PA utilize the ASYCUDA

67 However, COGAT recently estimated that in 2007 on average 1,037 trucks per day crossed both ways. This is well above the average total throughput for the 4 crossings that are being monitored by PalTrade, which is less than 350 per day.

68 This issue is not solely the responsibility of the Israeli authorities. On the Palestinian side, there does not appear to be a clear mandate for the management of the crossings.

69 Shipments through Egyptian ports are not economical because of additional road transport costs and the added border crossing with its delays and informal payments.

system for customs processing, there is no linkage since Israel, which is the intermediary, does not use this system and is reluctant to share data. Secondly, complicated procedures for crossing the border reduce the usefulness of Jordan as an outlet for Palestinian goods. Thirdly, the lack of cold storage and the requirement to conduct back-to-back loading prevents the export of sensitive agricultural products, or pharmaceuticals that require a temperature controlled environment.

67. The Israeli authorities have recently extended the hours of operations at Allenby, but note that the Crossings are underutilized due to insufficient demand. In technical discussions with the Israeli authorities, they state that while Allenby can accommodate 70 export trucks and 50-60 import trucks per day, there are currently about 30-40 export trucks and 30 import trucks passing through each day. However, this low demand is entirely reasonable given the limited capacity, lack of cold storage and protected facilities, the risk of damage from inspections, and the uncertainty of crossing delays. It is also reasonable to assume a considerable increase in demand once these constraints are removed. Immediate needs include an increase in handling equipment;⁷⁰ providing cold storage facilities; increasing the size of scanners at the Israeli-controlled side of Palestinian crossing between the West Bank and Jordan, to avoid having to break the cargo into small pallets; and a risk management system on the Israeli-controlled side. Ideally operation of Allenby should be handed to the PA in accordance with past agreements so that it can control the border of a future Palestinian state and coordinate with Jordanian authorities. Palestinian exports could also be assisted by upgrading / reopening the Damya bridge crossing.

Alternative Trade Routes for Gaza

68. While the current closure regime appears to have precluded any discussion on trade routes for Gaza, the topic remains an essential factor in the long-term sustainability of the economy of the Strip. As noted earlier, the current closures befalling Gaza have altered the nature of the economy, and have acted to "...convert a densely-populated and poor region to an internationally-supplied welfare project."⁷¹ Nevertheless, the development of the Strip's trade infrastructure and prospects remain a priority, without which Palestinian development will not be realized.

69. World Bank analysis shows that using the Rafah Crossing to ship goods from Gaza to Egypt's container terminal at the Suez Canal or to Cairo Airport is more efficient than through Israel's ports and airports. By air, the Crossing has the added attraction of providing direct access to the Gulf and other Middle East locations (as well as Europe), and permitting the use of cargo capacity on passenger aircraft (not allowed at Ben Gurion). By sea, Egypt offers comparable services in time and cost to Europe, faster times to Asia and less expensive and faster service to the Gulf. It also offers greater frequency to all destinations. By land, Rafah offers the

⁷⁰ Currently, the equipment moves between exports and import. Dedicated equipment for each would allow exports and imports to flow simultaneously.

⁷¹ Nathan J. Brown, *The Road Out of Gaza*, Carnegie Endowment for International Peace.

possibility of trucking goods directly to Gulf countries in 4-5 days. Finally, while the distance from Rafah to the Egyptian gateways is further than to Israel's, in terms of cost and time it is expected to offer comparable and more reliable service when the border crossing and procedures at the gateways are taken into account. The West Bank and Gaza enjoy generous trade arrangements with the EU. Under the Arab Free Trade Area Agreement (AFTAA), Palestinian goods have duty-free access to this burgeoning market. According to a recent study by the Peres Center and Paltrade, merchandise imports into this zone amounted to \$170 billion in 2005 and are projected to reach over \$500 billion by 2015⁷².

70. The legal basis for using Rafah are in place including the Agreement on Movement and Access (AMA) which allows for Rafah to be used for exports immediately, and the Arab League Agreement on Transit which allows for duty-free transit of Palestinian goods through Egypt. However, there is still a need for straightforward procedures for a secure supply chain at the Rafah terminal and transit protocols to be agreed between the Palestinian and Egyptian Governments, preferably with the support of European, UN or other border monitors at Rafah.

71. However, opening Rafah must not be a substitute for efforts to reopen crossing with Israel, and to make them more efficient and transparent. Opening Rafah is complimentary to efforts to improve the border crossings with Israel, particularly at Karni. An effective Rafah corridor will introduce competition to monopolistic border operations on the Israeli side. The Karni Crossing has been largely closed and almost no commercial imports or exports have been allowed. Sufa and Kerem Shalom have become the alternatives for commercial foodstuffs and humanitarian aid. However, neither has the infrastructure of Karni for large scale imports and exports. So, Karni must be opened to allow for effective trade with Israel, and must be made more efficient.

72. In general, Israeli policies even before the Hamas takeover were rendering Palestinian exports uncompetitive. Changes were introduced in Ashdod in early 2007. One, for example, dictated that goods originating in the West Bank and Gaza be held for 48 hours at the port. Also, air cargo originating in West Bank and Gaza is prohibited from being shipped on passenger airlines out of Ben Gurion. Even before the Hamas takeover, it took a West Bank firm an average of 10 days to clear customs and a Gazan firm 30 days. But it also took as many as 30 days for goods destined for the West Bank and 60 days for goods destined for Gaza to clear. In comparison, goods imported by Israeli firms cleared customs within a day or two.⁷³

72 "The Untapped Potential", December 2006 by the Peres Center for Peace and Paltrade.

73 Prior to the Hamas takeover, and per the Agreement on Movement and Access (AMA), the Rafah crossing was turned over to the PA, with 3rd party monitoring by the (EUBAM) and additional scrutiny through the operation of CCTV cameras by Israeli security. The experience of Rafah as a passenger terminal was positive until the kidnapping of Corporal Gilad Shalit and the closure of the crossing. Prior to this, the crossing's performance was a dramatic improvement over the period of Israeli control. There was coordination between customs and Palestinian security forces at the crossing and the PA Customs Department introduced electronic customs reporting for goods carried by passengers (using the UN's ASYCUDA ++ system). The EU monitors and CCTVs used by all parties, including Israeli security at Kerem Shalom assuaged concerns about the security of the crossing.

Access to Natural Resources

73. The dependence of the West Bank and Gaza on humanitarian assistance is particularly unfortunate given the West Bank and Gaza endowment of resources, and its potential for economic development, including agriculture and tourism as well as urban and industrial growth. As the below section will show, the restrictions confronting the Palestinian economy go beyond the movement of goods and people, and involve access to the resources necessary to create wealth and economic opportunities.

Access to Land

74. The West Bank which is fragmented into enclaves that are fractured by a system of movement restrictions between them due in large part to the 1995 Oslo Accords⁷⁴ which created, as an interim (5-year) measure, three distinct zones Areas A, B, and C, with different security and administrative arrangements, including land administration.⁷⁵ Area A corresponds to all major population centers, where the PA has full responsibility for civilian and security matters. Area B covers most rural centers, where the PA handles only civil affairs, with security under the Israeli military. The territorial space of Areas A and B is not contiguous, and consists of some 227 enclaves under partial or full Palestinian control.⁷⁶ Each enclave, whether Area A or B or a combination of both, is surrounded by Area C, which covers the entire remaining area and is the only contiguous area of the West Bank. Area C is under full control of the Israeli military for both security and civilian affairs related to territory, which includes land administration and planning.⁷⁷

75. Area C accounts for 59% of the West Bank, and is sparsely populated and underutilized by the Palestinian population. Of this, a large portion of Area C- covering 38.3% of the West Bank, is restricted from current or future Palestinian use. Today only a fraction of the Palestinian population resides in Area C. Exact figures are not available, but it has been estimated that between 70,000 and 230,000 Palestinians reside there.⁷⁸ Conversely, an estimated 461,000

74 The status of Area C was not intended to be a permanent issue, awaiting final status discussions. A phased process was envisioned in the 1995 Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip. In fact, there were a series of IDF redeployments in the West Bank between 1994 and 2000 (until the Second Intifadah).

75 The Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip, Washington, D.C. (September 28, 1995), Article XI

76 Amnesty International's report, *Israel and the Occupied Territories: The Demolition and Dispossession of Palestinian Homes* (December 1999).

77 The Interim Agreement did, however, transfer civilian affairs not related to territory to the Palestinian Authority in Area C in areas outside of the settlements and Jerusalem (e.g., health, education, commerce, etc.).

78 OCHA Special Focus "Lack of Permit" Demolitions and Resultant Displacement in Area C, May 2008. The broad range is due to the method of estimation which can vary widely since many Palestinian villages are located partially in Area A and B on the one hand, and partially in Area C, so it is difficult to determine the actual number specifically residing in Area C.

settlers live in Area C as of 2007.⁷⁹ The portion of the West Bank that precludes Palestinian use includes the following:

- **Numerous settlements have emerged since 1967, and cover about 5.1% of the West Bank.** These are heavily concentrated in and around East Jerusalem, but also include 123 “official” settlements and 105 outposts in Area C. In the West Bank, the built-up area of the settlements covers only 52,000 dunums, which constitutes 1.5% of Area C, but their jurisdictions cover more than half a million dunums, covering about 5.1% of the entire West Bank.^{80, 81} Furthermore, the land set aside for the future expansion of the settlements surpasses the needs of the fast growing settler population. Between 1987 and 2005 the settler population grew by over 150% and the land area controlled by settlements by more than 400%⁸².
- **Another 23% of the West Bank is restricted to Palestinians by order of the Military Commander of the West Bank**⁸³ comprising: closed military areas and bases, and Israeli declared natural reserves (with some overlap between the two).
- **A further 10.2% of the West Bank, including 42 Palestinian villages, will be enveloped by the most recent route of the Separation Barrier, approved by the Israeli Cabinet in April 2006.**⁸⁴ The enclosed areas include valuable agricultural land and substantial water resources, which has severely impacted Palestinian farmers. The Barrier also isolates East Jerusalem, traditionally the political, social, and commercial centre of Palestinian life.

76. The remainder of Area C land that is accessible for Palestinian use is subject to Israeli military regulations covering land administration, preparation of plans, and permits for construction. In 90% of the villages in this area, building permits are not forthcoming. Planning and construction in Area C are subject to the Jordanian law of 1966, which was revised by Israel in 1971, centralizing village planning and the granting of permits with the Israeli Civil Administration.⁸⁵ Since the 1990s, the Civil Administration has unilaterally prepared ‘Special Partial Outline Plans’ for 10% of the approximately 130 Palestinian villages in Area C, the basis on which building permits are granted (another 27 plans were announced on May 13th, of which 13

79 World Bank calculations based on Israeli Central Bureau of Statistics population figures and the Jerusalem Institute of Israel Studies, Statistical Yearbook of Jerusalem.

80 Bimkom.

81 OCHA, op. cit., (page 41)

82 The Humanitarian Impact on Palestinians of Israeli Settlements and Other Infrastructure in the West Bank, UN Office for the Coordination of Humanitarian Affairs (OCHA) July 2007, pages 12 - 18.

83 Ibid, page 51

84 OCHA, op. cit., pages 48-50.

85 Instead of a three-tier hierarchic system (local committees, regional committees and a Supreme Planning Council), Israel created a centralized planning system which, regarding the Palestinians, included only one single planning institution (the SPC) which includes only Israeli employees of the Civil Administration.

were regarded as approved but not implemented).⁸⁶ Palestinian applications to build on private land outside of the demarcation lines are rejected by the Civil Administration as they are outside the outline plan, or are not permitted according to the old British Mandate plans (e.g. zoned for agriculture or a nature reserve). Permits are also rejected if the owner cannot prove ownership, which can be difficult when two thirds of the West Bank lands have not been registered⁸⁷. The Israeli Ministry of Defense data shows that, between 2000 and 2007, 6% of construction permits were granted to Palestinians.⁸⁸ During the same period, 4,993 demolition orders were issued, of which 1,663 were executed. Conversely, 97% of building requests were approved in 1972.⁸⁹ However, since May 2008 and as a result of agreements with Quartet Representative Tony Blair, the Israeli authorities have observed a welcome moratorium on house demolitions in Area C.⁹⁰ Demolitions in East Jerusalem, which is not covered under this moratorium, continue.

77. Compounding the difficulty of utilization of land is the fact that 70% of the land in the West Bank is not registered. Partial efforts at systematic land registration were made during the British Mandate, and later during the Jordanian administration. However, land registration in the West Bank ceased completely since Israel's administration of the West Bank in 1967, leaving only 30% of the land in the West Bank registered. In 1980's, Israel declared all land that was not registered or under cultivation as "State land", thus precluding it from use by Palestinians. However, even where title to land is registered, it has in some cases been subject to requisition primarily for settlement-related activities.⁹¹

78. These multi-faceted obstacles, compounded by movement and access restrictions, are precluding the exploitation of valuable land in the Jordan Valley and East Jerusalem. While there is no physical barrier along the Jordan Valley, travel restrictions create a de facto separation from the rest of the West Bank. Restrictions on movement in the area have impacted investors. In East Jerusalem, use of land is hampered by "green zones" around Palestinian neighborhoods

86 These "special partial outline plans" usually also include some main roads, sometimes sized and located seemingly without regard for the village needs and existing structures, and sometimes specify different types of residential areas as well, but rarely designate any commercial, industrial, or public areas.

87 This requirement is upheld by the Israeli civil administration despite the fact that the Jordanian Law did not require proof of ownership for approval of building permits.

88 This is in comparison to 18,472 housing units which were constructed in the settlements during the same time period (According to the Israeli Central Bureau of Statistics, completed construction in the Settlements from 2000 till September 2007). As compiled by Peace Now.

89 See «The Prohibited Zone - Israeli planning policy in the Palestinian villages in Area C», Bimkom, to be published October 2008 for this and additional information on planning in Area C.

90 Since the May announcement one house was demolished in Qalqilia on 19 June. However, house demolitions are proceeding at a much higher rate in East Jerusalem, which is not covered by the moratorium. Between the beginning of May and 3 July, 11 houses were demolished, most of them in the Beit Hanina area.

91 The construction of settlements and outposts on private Palestinian land was deemed illegal under Israeli law pursuant to a decision of the Supreme Court of Israel involving the settlement of Elon Moreh in 1979. A report by Peace Now using data from the Civil Administration reveals that over 32% of the land in settlement jurisdictions is private land owned by Palestinians (Etkes, Dror and Ofra, Hagit "Breaking the Law in the West Bank - The Private Land Report", November 2006). The Sasson Report found that 15 outposts have been established solely on private Palestinian land and 39 on a combination of public and private land (Summary of the Opinion Concerning Unauthorized Outposts produced by Talia Sasson, and made public on October 18, 2005, available at www.mideastweb.org).

which limit their expansion, the cost of obtaining building permits, the absentee property law which discourages Palestinians from registering land, and the Separation Barrier.⁹² The Palestinian Central Bureau of Statistics (PCBS) data shows that between 1967 and 2002, 82% of housing units built in East Jerusalem were for Israelis, as opposed to 18% for Palestinians.⁹³

79. Thus, land use restrictions will stunt the Palestinian economy so long as the majority of lands are precluded from investment, and movement restrictions render non-contiguous areas unattractive for urban expansion. The extent of the impacts includes: (a) **donor-driven development:** Public infrastructure projects in Area C also require permits, which in turn require an Outline Plan. Thus, despite available donor resources, spending for public investment in Area C is minimal; (b) **agricultural development:** Area C holds 63% of the West Bank's agricultural lands.⁹⁴ Low-intensity agricultural production is generally permitted in Area C. However, the permit system constrains permanent investments and the intensification of agriculture; (c) **industrial development:** Access to land and water is a key constraint for industrial development. The PA is planning for four industrial parks, which require suitable public or private land close to the commercial crossings with Israel and Jordan (Jalameh, Tarqumiyah, Jericho Agro-industrial Park and Bethlehem). Suitable land is mostly in Area C, and obtaining permits for construction of the industrial sites and associated infrastructure has proven to be a time-consuming and bureaucratic process;⁹⁵ and (d) **urban growth:** The restrictions in Area C impact not only development in Area C, but in Areas A and B as well, where over 90% of the Palestinians reside. First, by preventing urban areas from spreading into Area C, they create artificial land scarcities which have led to distortions in the land market.⁹⁶ Secondly, they limit the scope for municipalities and village councils to efficiently use the land at their disposal to provide services to their growing populations.⁹⁷

92 According to B'Tselem ("Statistics on Demolition of Houses built without Permits in East Jerusalem"), in the period of 1996-2000, the number of recorded building violations was four and a half times higher in Israeli neighborhoods of Jerusalem (17,382 violations) than in Palestinian neighborhoods of East Jerusalem (3,846 violations). Nevertheless, during this same period, the number of demolition orders issued in West Jerusalem was four times less (86 orders) than the number in East Jerusalem (348 orders). In other words, while over 80 percent of building violations were recorded in West Jerusalem, 80 percent of actual demolition orders were issued for buildings in Palestinian East Jerusalem.

93 Jerusalem Statistical Yearbook, No.7, June 2005, p. 171.

94 A Review of the Palestinian Agriculture Sector 2007 – Consulate General of Spain in Jerusalem.

95 Located near Jenin, Jericho, Bethlehem, and Hebron, these industrial parks are at various stages of progress. In all cases, PIEFZA states that available land is the largest obstacle to establishing these parks, in addition to permits for construction of the estate and arrangements and permits for necessary infrastructure. Industrial parks require a sizable plot of land near main transportation routes, adequate services, population centers for access to labor, and preferably near one of the main commercial crossings into Israel to minimize transport and shipping. Source: Interview with PIEFZA, June 2008.

96 The past few years have witnessed an explosion of land prices, particularly in areas of high population density. In Ramallah, for instance, the municipality reports that prices of commercial land in the city have doubled each year for the past three years, reaching \$4000/sq.m. Even more striking is the clear differential between prices of otherwise similar land in Area A vs. Area C, where the premium for land classified as A or B vs. C can range from 30% to over 150% or more, depending on the location and the perceived relative «safety» of the property of Area C from confiscation or demolition.

97 The most striking illustration of this issue is the Qalqilya municipality, where the built-up area of the city has already exceeded not only the municipal master plan limits but even the Area A territory within which it is situated, with unlicensed construction spilling out into the surrounding Area C territory.

Access to Water, Power and Basic Service Infrastructure

80. Access to clean and adequate water is at a point of crisis in both the West Bank and Gaza. In the West Bank, there is a serious shortage of piped fresh water supply. Average daily per capita consumption is only about 50 liters per capita per day (l/c/d), a shortfall of about 100 l/c/d from the World Health Organization's worldwide target of 150 l/c/d. This figure takes into account system losses which are estimated at 40% of supply, an unacceptably high figure and a major investment priority. Furthermore, Gaza faces a water and sanitation crisis. While there is close to universal water supply there, per capita daily consumption is only 78 l/c/d on average. Moreover, water quality is poor, with high nitrate and chloride concentrations, supply is unreliable and, as in the West Bank, system losses are unacceptably high at about 40% of supply.

81. Palestinian use of water in the West Bank - most of which lies in Area C- is limited to 17% of total water in the aquifers. Israel uses the remaining 83% either through its settler population or pumping from the shared aquifers for consumption in Israel.⁹⁸ Israel uses the remaining 83% either for its settler population in the West Bank or pumping from the shared aquifers for consumption in Israel or for sale back to the Palestinian utilities. Palestinian allocations from wells are restricted with rare approvals for new wells or for increasing outputs from existing wells dug before 1967. As a result, Palestinian annual water extraction has actually dropped about 10% from 120 million cubic meters (mcm)⁹⁹ since the mid-1990s.¹⁰⁰ This is despite the fact that 10%-14% of Palestinian GDP comes from agriculture, as opposed to 2-3% of Israel's GDP. Only 10% of Palestinian agriculture uses irrigation; the rest is rain-fed.¹⁰¹ In the Jordan Valley, Palestinian allocations from wells are restricted with rare approvals for new wells and or increasing outputs from existing wells dug before 1967. Gaza, on the other hand, relies on wells that are increasingly

98 This number refers to the Mountain Aquifer (western, northeastern, and eastern aquifers) and excludes transboundary (Coastal Aquifer) and other aquifers (Carmel, Galilee, etc.) in general in Israel. This also does not include surface water, primarily the Jordan River. The PWA notes that Palestinian access to water in the Mountain Aquifer has dropped since the Oslo II Interim Agreement was signed, from 118 mcm in 1995 to 106 mcm in 2007. This equates to 15.6% with Israeli in control of the remainder.

99 The Palestinian Water Authority notes that the amount accessible from the mountain aquifer by Palestinians in the West Bank has dropped from 118 mcm in 1995 to 106 mcm in 2007 due to several factors: the limited number of permits for new wells and the rehabilitation of old wells; the loss of wells due to the construction of the wall and the confiscation of land where some wells are located; the reduction of irrigatable land since 1995 due to the confiscation of land by the construction of the wall and the high cost of transport which is a product of the restrictions on access and movement; and finally recurrent droughts which to some degree includes climate change and which remains difficult to quantify.

100 Total Palestinian consumption in 2006 was 333.3 million cubic meters (mcm), comprising consumption of 170.6 mcm in the West Bank and 162.7 mcm in Gaza. Within the West Bank, about 106 mcm/yr is currently extracted from the Mountain Aquifer; a 10% reduction since the 1990s. The remainder is provided by Israel.

101 Sources: PWA Statistics; World Health Organization, Health Conditions of, and Assistance to, the Arab Population in the Occupied Arab Territories, including Palestine, 58th World Health Assembly, May 17, 2005; and PLO Negotiations Affairs Department, Presentation on Water and the Two State Solution, July 2007.

infiltrated by seawater due to over-pumping by all parties. As a result, the UN estimates that Gaza will have no drinking water in the next 15 years¹⁰².

82. The Israeli and Palestinian Authorities continue regular dialogue on water resource management, which Israel regards as adequately addressed by the Oslo Agreements. In discussions with the Israeli authorities, officials note that Israeli water consumption dropped from 500 cu.m/cap/year in 1967 to 170 cu.m./cap/year currently, while Palestinian water consumption rose from 86 cu.m/cap/year in 1967 to 100 cu.m/cap/year currently. The major reason for this disparity is Israeli control over West Bank aquifers. Moreover, Palestinian extraction of water in Gaza is 3 times renewable resources¹⁰³. The Israeli authorities add that scarcity of this common resource requires the Palestinian Water Authority (PWA) to minimize water losses, enhance distribution, and rationalize its use of potable water. As such, the PWA must develop alternatives such as infrastructure for water treatment and reuse, and improved irrigation techniques in Palestinian agriculture.¹⁰⁴ It is worth noting that the PA, along with Israel and Jordan, is an active participant in the on-going Red Sea-Dead Sea Water Conveyance Study Program. If deemed feasible, such a water conveyance could bring up to 500 mcm per year of new potable water to the region, of which the PWA would have a yet undetermined share. The Red-Dead studies started in May 2008, and any decision on financing and construction would only come in late 2010.

83. Access to water, as well as electricity is hindered by inadequate infrastructure and the inability of the PA to obtain Israeli permission for infrastructure development in these areas. While the Israeli authorities provide some services through the Israeli electricity or water companies, most of the population in Area C is still directly dependent on the PA for electricity distribution, water supply, waste management, and telecommunications services, which have been hampered by the difficulty of obtaining Israeli permits. Attempts by the PA to provide electricity to some villages west of the Separation Barrier have been frustrated by their inability to obtain permits to enter the area. Even villages which lie mostly or entirely in Areas A or B, officially under Palestinian control, frequently have their key infrastructure in Area C. There are several examples of village councils in those circumstances who have requested permits to

102 Unfortunately, plans to enhance water availability and wastewater reuse in Gaza have been delayed by the suspension or postponement of several donor projects. Examples of key projects include: USAID's \$140 million for the Gaza Seawater desalination plant and the Gaza North-South carrier, and KfW's approx Euro 70 for the Central Wastewater Treatment Plant. The World Bank-financed North Gaza Emergency Sewage Treatment Plant is facing delays due to the lack of entry of urgent supplies and equipment to complete the work. Wastewater reuse is at risk, and all poorly treated sewage generated from 70 million cubic meters of water supply is now pumped into the sea.

103 About 160 mcm is abstracted per year, approximately three times the sustainable limit of 55 mcm/year

104 In an earlier response on this issue, the Government of Israel asserts that "...all actions relating to water issues are undertaken according to the 1995 Water Agreement between Israel and the Palestinians. Israel fulfills all of its obligations and more (diverting 60 million cubic meters instead of 23 to the Palestinians), and has offered the Palestinians to assist in countering water shortages in various ways." GOI adds that since 1967, the water quantity drawn by Israel from the Mountain aquifer is diminishing in favor of the Palestinians. Thirdly, GOI notes that it has offered the PA several options to access more water, including a donor-financed desalination plant to be built in Hadera, Israel that would then sell desalinated water to the Palestinians. Lastly, GOI notes that it has reduced by 50% the use of potable water in Israeli agriculture, while the Palestinian side has not, thus raising the need for potable water.

improve road access, or install water supply pipelines, to no avail.¹⁰⁵ According to the PWA, about 33% of the villages representing about 9% of the West Bank's population are not connected to the water networks, and there is a limited scope to assist them. There are also issues beyond the quantity of fresh water supplies in the West Bank. Communities without piped water must rely on rainwater capture or fresh water tanker deliveries of questionable water quality and reliability. Water tanker deliveries are expensive, with prices as high as NIS 20 per cubic meter.

84. Despite its importance to the PA and the sustained support of the donors, the development of infrastructure for water and wastewater services has been particularly problematic. The PWA reports over 140 projects awaiting approval from the Israeli authorities, including development of wells, springs, transmission lines, and wastewater treatment plants. Two stages of approvals are required; an approval through the Israeli-Palestinian Joint Water Committee, followed by a building permit by the Israeli Civil Administration. Recently, there was an approval granted and a construction permit issued for the Nablus West WWTP and the Hebron WWTP, however obtaining these approvals is subject to long delays. Current efforts by the Israeli authorities, brokered by the Office of Quartet Representative Blair, to facilitate the approvals for water and power projects, are welcome but require expediting; only two meetings have been held over a period of six months. The PWA and the World Bank are currently conducting a study on the economic impacts of the systematic delays of water infrastructure projects, to assess this issue further.¹⁰⁶

85. In Gaza, the closure regime currently underway is preventing adequate maintenance of infrastructure for water and power. The lack of entry of the necessary spare parts, materials and equipments for the water and wastewater facilities has resulted in constructing new wells, thus compromising quality of water, quicker aquifer deterioration. The inability of treatment plants to run efficiently implies increased dumping of untreated sewage- about 80 million liters per day at the height of the siege- into the sea¹⁰⁷. In addition to the considerable environmental impact, this represents a loss of potentially treated water that could be used to recharge the aquifer, and thus avoid sea intrusion into this critical reserve. Unfortunately, a joint Israeli-Palestinian coordination meeting, brokered by the Office of the Quartet Representative, that took place on August 27th which addressed the facilitation of the entry of items critical for maintenance of water and sanitation services into Gaza achieved little results in this respect.

105 Qaryut, south of Nablus, is an example of a village, officially under Palestinian civil control, with almost all its infrastructure in Area C. In 1999, the village council submitted a request for paving the dirt-road, with no success so far. Likewise, every request submitted to install a water supply pipeline has been denied.

106 PWA has requested the World Bank to conduct a study on the economic impacts of the systematic delays of water infrastructure projects. The study will have particular focus on delays derived from planning, approval and implementation restrictions for water works and water management, beyond Palestinian control, in the context of Israeli occupation, containment and settlement. The tailoring of "Poverty and Social Impact Analysis" (PSIA) methodologies to the study was deemed relevant in order to focus on the impacts of (i) delays related to Area C in the West Bank, (ii) on water quality and health impacts in Gaza, and (iii) on conflict-related governance issues of the sector.

107 Consisting of 60 million liters pumped from Gaza city, 8 million liters from the Middle Area and 12 million liters from the Rafah Area (Coastal Municipal Water Utility, August 2008).

Access to Cultural Heritage

86. The West Bank and Gaza are rich in historical, cultural, and religious sites and contain a number of extraordinary geological features, the majority of which remain unexploited.

UNESCO has identified 20 outstanding sites that reflect this rich heritage; 16 sites are located in the West Bank and 4 in Gaza. However, Palestinians have been unable to translate this resource into a competitive tourism sector. According to some estimates, tourism currently contributes approximately 3-4% to Palestinian GDP, down from 10% in 1999, which was a peak year prior to the Second Intifadah. On the other hand, Israel has been developing some of these sites in the West Bank, with restricted Palestinian access to them.¹⁰⁸

87. The tourism sector has seen positive though fragile developments since 2007. During the past two years, the overall hotel occupancy rate in the Palestinian Territories stood at 24%.¹⁰⁹ However, there has been an observed increase in tourism over the past year, with a number of hotels estimating full bookings in certain periods.¹¹⁰ According to the Israeli Civil Administration, during the first half of 2008 the number of tourists in Bethlehem grew by 94.3% in comparison to the first half of 2007. In Jericho, the number of tourists grew by 42.7% over the same period. However, progress has been geographically isolated, and has not encompassed the entire tourism sector, nor has it been sufficient to translate into a substantial contribution to Palestinian GDP. As it stands, the Palestinian tourism industry remains fragmented and dominated by a small number of Palestinian companies, as the current movement restrictions preclude the emergency of sufficient economies of scale to allow for new entrants. The inability of Palestinians to travel freely within the West Bank (including East Jerusalem) and Gaza also prevents the emergence of internal tourism. Within the Palestinian areas, poor maintenance of historical sites has become more acute as a consequence of the recent political environment, and the shortage in funds. Efforts to develop a common Israeli-Palestinian framework for reviving Palestinian tourism have not yielded much fruit; there have been to date two meetings of the Joint Tourism Committee this year, with few tangible results. In addition, a tourism master plan said to be under preparation for the Jordan River baptism site has so far excluded Palestinian involvement.¹¹¹

88. There is consensus among all sides on the need for a revival of the Palestinian tourism sector, and several initiatives have sought to trigger this revival. Sustaining impacts, however, requires a fundamental address of the current restrictions on the Palestinian economy. The PA's PRDP foresees the restoration and preservation of tourism sites, as well as

108 According to the PLO Negotiations Support Unit (NSU), this includes the Herodian Site in Bethlehem and the Good Samaritan Site in the Jordan Valley.

109 There are over 82 operating hotels in the Palestinian Territories, of which 30% are located in Jerusalem, 20% in the central West Bank, and 19% in the southern West Bank.

110 Discussions with PADICO, the holding company that owns the Al-Jacer Intercontinental Hotel in Bethlehem, indicates that the occupancy rate has reached over 85% this year, from an almost non-operational level approximately two years ago.

111 Based on discussions with Friends of the Earth, Middle East (FOEME).

enhanced marketing of these sites. The May 13th package of Confidence-Building Measures developed by Quartet Representative Tony Blair noted that “the facilitation of access from and to Bethlehem will be improved on a permanent basis. Five-hundred new trader permits and the existing permits for tour guides will be renewed, on an ongoing basis.” However, progress appears to be limited to date. Several initiatives have been undertaken, including renewal permits for tour guides and traders, but these are unlikely to provide any tangible improvements in a sector that has historically provided one-tenth of Palestinian GDP. Facilitated access to Bethlehem remains an exception during high-profile events, rather than the daily rule, although the Israeli authorities have allocated some budget to increase capacity of Rachel’s Tomb Checkpoint. Access to land-critical for key sites in East Jerusalem, Bethlehem, and the Jordan Valley- remains elusive. Lastly, and as mentioned earlier, the Jordan Valley, and particularly the Dead Sea and Jordan River, which offer significant untapped potential, are inaccessible to Palestinian tour operators, visitors and investors.

Access to Telecommunications Frequency

89. Assignment of telecommunications frequencies is governed by the Oslo Accords which require agreement by both sides. Under those interim arrangements, the PA is to present its requirements based on needs through the Joint Technical Committee, which are to be fulfilled within a period not exceeding one month. Frequencies were to be allocated by Israel expediently whenever possible, or an alternative would be presented which was to be acceptable to the Palestinian side.

90. Currently, the structure of the Palestinian Telecommunications market is heavily influenced by Israeli limitations on the amount of frequency assigned to Palestinian companies. The Palestinian Telecommunications market is serviced by only one company, Paltel/Jawwal. On July 28th, after over 18 months of negotiations, Israel agreed to the incremental allocation of 4.8 Mhz of frequency to a Wataniya which allowed for the introduction of competition into the sector.¹¹² The introduction of a new operator is expected to inject over \$350 in new license fees to the, with an immediate transfer of \$80-100 million. Secondly, Wataniya will invest an additional \$350 million in the Palestinian Authority over 10 years, create 750 skilled jobs for Palestinians and generate 1,500-2,000 indirect jobs. The entry of a new provider into the sector is also likely to yield service and pricing gains from competition. However, it is worth noting that the current monopolistic environment is a function of restrictions on the access to frequencies by Israel; throughout this period both the incumbent Paltel (Jawwal) and the entrant Q-Tel (Wataniya) have had similar difficulties in receiving new frequencies and facilities, to expand operations of the former, and initiate operations of the latter. For instance, Jawwal currently serves over 1 million subscribers using the frequencies assigned to it 10 years ago, when its based

¹¹² The PLO Negotiations Support Unit (NSU) adds that the Israeli allocation is partial since the request made by the Palestinians included frequencies for the introduction of 2G and 3G services. Israel’s current allocation enables the introduction of the 2G services only.

consisted of 120,000 subscribers only. Similarly, several wireless data operators, licensed by the PA, have also been unable to begin operations due to the lack of available frequencies.¹¹³

91. While until recently the Palestinian telecommunications market was characterized by a single operator, in reality competition existed in the mobile market. Israeli operators, authorized under the Oslo Agreement to offer services to the settlements, covered a large part of the territory of the West Bank.¹¹⁴ According to both operators, the lack of sufficient frequencies for Palestinian providers¹¹⁵ requires the installation of more infrastructure than needed, leading to extra costs and lower quality. Moreover, infrastructure construction in Area C requires Israeli permits, which are not often granted. At the same time, most of the West Bank is covered by Israeli mobile operators. According to some estimates, Israeli operators cover 80% of the West Bank and capture at least 20% of the market.¹¹⁶ Given the scattered geography of the settlements, the mobile coverage reaches most of the West Bank, including many of the most densely populated Palestinian towns and villages.¹¹⁷ In addition, Palestinian operators face other restrictions, including: (a) the requirement to route international communications through a licensed Israeli operator; which increases costs; (b) the lack of a direct long-distance connection linking the West Bank with the Gaza strip; and (c) difficulties in obtaining Israeli permits to build infrastructure in large parts of the country.¹¹⁸

113 According to NSU, Israel has also been holding the release of radio frequencies for the introduction of broad band services and Voice-Over-Internet (VOIP) services as well. The PA liberalized the provision of the broad band and VOIP service and issued 7 licenses for broad band companies, and another 7 licenses for the VOIP services. Although the request was made 9 months ago, Israel has not released any radio frequencies yet..

114 The presence of Israeli operators in the West Bank also implies leakage of tax revenues from the PA to Israel through unauthorized Israeli mobile operators in the West Bank and Gaza. According to PA officials, the revenue collected by Israeli operators in the West Bank is not subject to taxation from the PA. The PA estimates that the lost annual tax revenues due to unauthorized Israeli operations amounts to \$60 million.

115 At the time of this report, both Jawwal and Wataniya do not have access to the entire set of frequencies they had requested earlier. Wataniya has been given frequencies to initiate operations, with a commitment to provide more in the future. Jawwal continues to seek additional frequencies to upgrade services.

116 World Bank, Introducing Competition in the Palestinian Telecommunications Sector, January 2008.

117 The Israeli authorities indicate that the marketing of Israeli SIM and recharge cards in the West Bank is done in areas that are not under control of Israel, or under its jurisdiction. The PA indicated that the Israeli operators continue exceeding what is provided in Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip ("Oslo 2"— 9/28/95) - ANNEX III, Art. 36, and are deliberately targeting the Palestinian customers, for example, by installing infrastructure with high power in settlements of a few hundred settlers and which is directed towards densely populated Palestinian cities and villages and by installing infrastructure in Areas C with the pretext of providing coverage to the bypass Roads. In addition, according to the PA, Israeli operators use direct marketing in Arabic via SMS to Palestinian users.

118 World Bank, Introducing Competition in the Palestinian Telecommunications Sector, January 2008.

Access to an Investment Horizon

92. The most pernicious effect of the system of economic restrictions is the level of uncertainty it creates for existing and prospective investors. From a trade perspective, firms cannot accurately predict how long it will take to move their goods, they can not commit to delivery times and consequently are unable to enter the most lucrative export markets. From an investment perspective, investors cannot accurately assess the horizon facing their investment, nor their prospects for supervision of their investments, particularly for those of Arab and Palestinian origins, due to potential difficulties in securing entry into the West Bank and Gaza.

93. Clearly, and as can be easily observed, the Palestinian private sector contains a number of highly effective and successful enterprises who are able to produce world-class products and services, and trade globally. A number of these enterprises effectively exploited the Palestinian Investment Conference in Bethlehem to showcase their technologies and products, and to attract investment interest. However, while their presence has been and continues to be critical to the survival of the Palestinian economy, they represent only a fraction of Palestinian entrepreneurial potential, and their numbers reflect the artificially limited size of the Palestinian economy. Moreover, and as noted by several representatives of the Palestinian private sector, they are able to prosper only insofar as they can effectively circumvent the restrictions on movement and access.

94. Ultimately, international investment in the Palestinian economy must reflect a decision on whether money spent in the West Bank and Gaza will yield a better risk-return horizon compared to countries elsewhere.¹¹⁹ In this regard, the uncertainties related to the Palestinian Territories are closely tied to the progress of the final status discussions between Israel and the Palestinian Territories. However, until then, there is significant room for improvement in the investment climate, not least of which is the need for further clarity in the visa/residency regime. Israel maintains control of the population registry¹²⁰ and it remains difficult for foreign investors, particularly those of Palestinian descent who are the most likely investors, to obtain

119 The Israeli Ministry of Justice notes that: "This section treats economic restrictions (primarily with relation to entry and movement of goods), and the Israeli visa regime, as major causes of uncertainty discouraging international investment in the Palestinian economy. This should be balanced by acknowledging the difficulties placed on Israel in this matter due to security considerations it must take into account even in this context. We also suggest that the Report refer here to an additional factor deterring investment, which we believe has a greater impact on this matter than the visa regime: the legal environment in the PA. The Palestinian legal system generally suffers from poor enforcement and out of date legislation in the commercial field. Continuing updating Palestinian commercial legislation, and providing better enforcement, would increase legal certainty, and thereby encourage investors to invest in the PA."

120 This registry is based on a census taken by Israel immediately after seizing the Territories in 1967.

visas.¹²¹ In May, the GOI facilitated a number of visas for important visitors to the Palestinian Investment Conference held in Bethlehem. In addition, the Israeli Ministry of Foreign Affairs has established a committee to review applications and grant visas to large scale investors. However, this is widely regarded as an exception, with no observable changes in Israeli policy. Furthermore, the Israeli authorities continue to limit family reunifications that allow Palestinians to unite with their families in the Territories. The uncertainty in the security of residency and land tenure is often cited by Palestinians as a major reason for the lack of investment. In December 2006, the Civil Administration outlined new procedures for entry into the West Bank and Gaza. In March 2007 a similar statement was issued by the Israeli Ministry of Foreign Affairs. However, these two notices address only the issue of temporary admissions.^{122, 123}

121 A person who is not registered in the population registry can acquire status via an application for family reunification which can be submitted by a first degree relative who is a resident of the Territories, which effectively refers to foreign spouses of a resident of the territories. Children under 16, on of whose parents is a resident may also be registered in the Palestinian population registry. The Oslo Accords granted the PA the authority to administer applications from residents and children under the age of 16 in the population registry. However, approval of family unification applications and issuance of visitor permits for foreigners remained under the control of Israel. Moreover, approval of children under the age of 16 in the population registry requires that one of the parents be resident in the Territories, and that the child be present, at the time of registration. However, Israel requires children over the age of five who are not in the registry to have a visit permit, thus controlling applications. After the Second Intifadah, Israel froze processing of visitor permits and family reunification applications. As of late 2007, Israel has approved 12,000 family reunification applications. Also, Israel has been providing entry permits to children fairly regularly since November 2006 (Hamoked, Center for the Defense of the Individual, Residency in the Occupied Palestinian Territories).

122 Campaign for the Right of Entry/Re-Entry to the Occupied Palestinian Territory.

123 The June 2007 update of the Campaign for the Right to Enter the oPt notes that in June 2007, a random sample of visa renewal applications submitted to the Israeli authorities by the Palestinians Authority indicates that approximately 30% of the applicants are being denied their request for visa extensions. The Campaign also noted that Israel's continued refusal to lawfully process family reunification applications affects as many as 500,000 to 750,000 people who may be forced to leave the oPt to keep their families united.

Conclusion

The PA, Israel and the international community have taken steps towards stability and prosperity, albeit with different intensities. The PA has continued in its path of fiscal and security reform, on which it must continue and in a way that also addresses the lingering fracture with Gaza. The donors have provided substantial amounts of aid, albeit in an ad hoc manner that left the PA with little ability to plan finances. Israel has announced a series of steps to remove a few physical obstacles within the West Bank, which will only have an impact insofar as it is scaled up in number and the scope of the restrictions being addressed. The challenge moving forward with the removal of economic restrictions is to go beyond isolated gestures towards a profound revision in the fundamentals of the Palestinian economy. It is thus essential to convert these initiatives to a new status quo, rather than a series of isolated exceptions that are consuming a substantial amount of time by all players, and that are a distraction from dialogue on longer-term issues.

95. As a result, IMF analysis indicates a drop in GDP of -0.5% in 2007, and a modest growth of 0.8% in 2008. The events of the past months have yielded several conclusions. First, any effort at revival that excludes Gaza is likely to lead to partial results. Secondly, the more the Gazan and West Bank economies diverge, the harder it will be to reconcile. Thirdly, aid and reform without access are unlikely to revive the Palestinian economy. As such, international manifestations of support towards a viable Palestinian state and institutions are incomplete insofar as they do not tackle Israeli economic restrictions in parallel. Intertwined in this issue is the important matter of Israel's security concerns, and its legitimate need to undertake actions to that end. However, overwhelming evidence suggests that the current restrictions correlate to settlement locations and expansions. Recent evidence also supports the possibility of removal of economic restrictions without a commensurate risk for citizens within Israel.

96. In order to tackle these economic restrictions, it is imperative to widen their definition beyond the physical manifestation of checkpoints across the West Bank. The common view of restrictions extends only to the network of checkpoints riddling the West Bank, and partitioning the West Bank from Gaza, and both from Israel and the world. In reality, these restrictions go beyond concrete and earth-mounds, and extend to a system of physical, institutional and administrative restrictions that stifle Palestinian economic potential. This system includes: (a) access to economies of scale, as Palestinian businesses are unable to achieve a critical mass to warrant additional investment and business growth; (b) access to natural resources essential to the exploitation of growth opportunities, including land, water, cultural heritage and telecommunications frequency, among others; and (c) access to an investment horizon on which business decisions can be made.



