



Palestine Economic Policy Research Institute

Enhancing The Capacity of the Palestinian Economy

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Mohammad Nasr

June 2003



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2. The terms of reference of the study are approved by an internal MAS scientific committee (consisting of senior researchers) to ensure accurate goals, appropriate use of scientific methodology and procedures and the timetable for completion.
3. The internal scientific committee supervises the work of the researcher or team of researchers through periodic progress reports.
4. The initial draft of the study is reviewed by the scientific committee for objective content-related amendments to be added to the second draft.
5. The second draft is then submitted for evaluation in accordance with the terms of reference to two or three external academic experts specializing in the subject. Provided that there is a positive evaluation by at least two experts, the researcher is asked to review the study taking into consideration the objective recommendations of these experts.
6. The study is presented for discussion at a public workshop attended by academics, researchers, and representatives from public and private sector institutions related to the subject of the research.
7. Comments and feedback from the workshop are incorporated into the study and the final draft is reviewed by the scientific committee to ensure that the necessary amendments have been made. The study is then edited.
8. Research papers written in English are translated into Arabic and published in both languages. An executive summary in English is attached to research papers written in Arabic.

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# Summary

## 1. Introduction

This study discusses the potential and means to enhance the local capacity of the Palestinian economy in the face of Israeli policies. It explores the options available and suggests appropriate policies to accomplish this goal. The study also aims to identify and analyze the structural distortions in the Palestinian economy, outlining the characteristics of the current economic situation and the impact of recent Israeli policies and measures following the outbreak of the Al Aqsa uprising on 28 September 2000.

## 2. Structural Distortions in the Palestinian Economy

The Palestinian economy is afflicted with various distortions and imbalances due to the policies and measures implemented by the Israelis following the occupation of the West Bank and Gaza Strip (WBGS) in 1967. The most significant of these distortions has been manifested in the decline in the contribution of productive sectors to GDP, employment, and exports, and exploitation for the benefit of the Israeli economy. Israeli policies restructured the Palestinian agricultural sector to match the needs of the Israeli economy and eliminated competition from Palestinian agricultural products through an open-bridges policy and by imposing various trade and non-trade restrictions to limit the flow of these products into the Israeli market. In addition, Israeli control of local water resources and the continuous confiscation of land caused great distortions in agricultural land, water prices, and agricultural wages which, in turn, caused production fluctuations, profit reduction and a deterioration in the economic role of the Palestinian agricultural sector. The lack of agricultural services, absence of financing institutions, and division of land through inheritance have resulted in the spread of small-scale family agricultural production, low productivity, and a decline in the competitiveness of Palestinian agricultural products.

Israeli policies have also contributed to the marginalization of the industrial sector by impeding industrial licenses, imposing random taxes on industrial establishments, imposing various restrictions on the import of raw materials and machinery for Palestinian factories, and creating obstacles to exports. Also, Israel has flooded Palestinian markets with cheap, low quality Israeli products that expose Palestinian products to unfair competition.

At the same time, Israel encouraged sub-contracting arrangements that increased the dependency of the Palestinian economy on that of Israel. This has led to distortions in the size of industrial establishments and the domination of small enterprises, which are mostly proprietorships or joint ventures.

The contribution of the Palestinian construction sector, particularly housing, to GDP has increased thanks to the rise in workers' remittances from abroad and Israel and also to the lack of alternative investment opportunities due to the political instability and uncertainty. There is also a discouraging investment environment in agriculture and industry, plus the absence of a strong financial system to absorb personal deposits and savings. The contribution of the construction sector has declined since the first Palestinian uprising in 1987 and it has been hit by various restrictions imposed by Israel on building permits outside municipality borders and the absence of infrastructure services.

The service sector has been subjected to various distortions during the Israeli occupation of the WBGs. Activities that serve the Israeli economy have flourished, in particular retail and wholesale trade, transportation to facilitate the flow of Israeli commodities into Palestinian markets, and the flow of Palestinian labor into Israel. Other services have deteriorated considerably due to Israeli restrictions on Palestinian merchandise trade and on the mobility of people and goods between checkpoints. As a result, investment in support services such as external transportation, insurance, and marketing services has declined. In contrast, the import of various services from Israel has increased.

Many obstacles hampered the growth and development of Palestinian tourism during the Israeli occupation. These include the neglect of tourist sites, depriving the Palestinian Territories of direct contact with the outside world, inequitable competition from the Israeli tourist industry, refusal of licenses for hotel building, the imposition of arbitrary taxes on Palestinian tourist establishments, particularly in East Jerusalem, and the lack of financial resources for Palestinian tourist activities. As a result, there has been a fall in the number of travel agents, tourist guides and hotels in operation in the Palestinian Territories.

The transportation sector was affected by Israeli restrictions on public driving licenses, the high cost of transportation caused by poorly-maintained roads, high taxes, expensive spare parts, and the lack of finance.

The financial sector was exposed to impediments and obstacles from the outset of the Israeli occupation, starting with the closure of all Arab and foreign banks operating in the WBGS. This deprived the Palestinian economy of loans and credit facilities required for real investment and directed resources to investment in non-productive sectors, particularly in real estate and housing. This also directed a considerable amount of local savings outside Palestine.

In addition to productive sectors, the second type of distortion is related to the Palestinian labor market. From the beginning of the Israeli occupation of the WBGS, the high wages in the Israeli market attracted growing numbers of Palestinian workers, in particular unskilled laborers. This deepened the dependency of the Palestinian economy on that of Israel and widened the gap between GDP and GNP. It also resulted in distortions in wage levels in the Palestinian Territories due to the decrease in labor supply, raising local wages without an increase in productivity. This, in turn, raised the cost of Palestinian products and reduced competitiveness and profit levels, eventually resulting in a drop in Palestinian agricultural and industrial production. Since demand in the Israeli market was for unskilled workers, skill levels in the Palestinian labor force declined.

The increase in income resulting from the wages of Palestinian workers in Israel destroyed the relationship between production and income in the Palestinian Territories by increasing aggregate demand in the Palestinian economy without a parallel increase in production. This promoted growth in imports of international goods while the prices of non-traded goods rose. The deterioration in productive sectors, particularly agriculture and industry, reduced labor absorptive capacity in these sectors and in the Palestinian economy in general. As a result, there was large-scale emigration of Palestinian workers, mainly to oil-producing countries in the Gulf.

The transformations that occurred in Palestinian economic relations with the rest of the world, especially Arab and Islamic countries and Israel, are considered the most dangerous distortion. It is manifested in trade relations, which have been almost entirely limited to Israel due to

the imposition of obstacles and restrictions under the pretext of security and political considerations. The Palestinian economy was deprived of export opportunities to Arab and Islamic countries and of the opportunity to import raw materials and machinery from cheaper sources. The competitiveness of Palestinian products was negatively affected and, accordingly, the Palestinian trade balance has suffered from a growing deficit that has been mainly financed by Palestinian labor in Israel.

The fourth type of distortion relates to resources and public utilities. Systematic plundering occurred by Israel during the occupation through various means, mainly value added taxes imposed on Palestinian imports from or through Israel, income and social security taxes imposed on Palestinian workers in Israel, and the seigniorage resulting from the use of Israeli currency. These distortions are estimated to cost the Palestinian economy around 15-25% of Palestinian GDP. The transfer of these funds to the Israeli Treasury rather than Palestinian public services and utilities has led to widespread neglect. This explains the deteriorating conditions of Palestinian infrastructure services and the decline in the quality and efficiency of electricity, water and sewage, communications networks, and the poor standard of educational and health services compared to neighboring Arab countries.

Israeli policies and measures continued even after the establishment of the Palestinian National Authority (PNA) in limited areas of the West Bank and Gaza Strip. The PNA did not undertake appropriate measures to remedy the situation, thereby aggravating the distortions and resulting in new ones, sometimes described as the 'distortions of the interests of individuals and groups'. This type of distortion results from the ties of certain groups of people with the Israeli economy, driven not by pressing need, but rather as a political expression of the future relationship between Israel and the Palestinians.

All these distortions have exerted a negative impact on the performance of the PNA during the interim period. There have been significant PNA achievements in institution building, the implementation of infrastructure projects financed by international donors, and the enactment of economic legislation during the first six years of its establishment. Yet, the cost of these achievements has been relatively high since they were accomplished without a clear vision or comprehensive developmental program and in the absence of

mechanisms for accountability or transparency to limit corruption. These accomplishments were achieved by various institutions and ministries that conducted direct but unorganized and uncoordinated relations with donors, wasting resources and efforts in the absence of a clear national agenda of priorities. During this period, the public sector suffered from structural distortions and inflation, duplication and conflict of authority between various public bodies, and a lack of organizational and legislative controls. Efficiency was therefore reduced and there was a general decline in performance.

Some attribute this to lack of experience and attempts by the PNA to focus on political and social targets and handling the political struggle and negotiations with Israel. Others attribute it to the absence of a comprehensive Palestinian developmental vision, lack of a legislative framework to organize and control public recruitment, and the domination of political and factional factors in place of professional considerations.

In addition, or as a result, there have been distortions in the relationship between the public and private sectors. Despite declared PNA policy of promoting a market economy, most of its economic and trade practices demonstrate the contrary. A competitive relationship has developed between the PNA and the private sector and weakened the investment environment in the WBGS. PNA business practices have taken various forms, mainly public monopolies including imports of tobacco, cement, and petrol, partnership in private enterprises, granting monopoly concessions on the basis of personal contacts and favoritism rather than on the basis of competition, and failure to implement regulations to control the monopolistic behavior of the franchised firms.

Distortions have reverberated on the public budget, which shows the heavy dependency of Palestinian public revenues on Israel and the weakness of the tax base in local revenues. The budget demonstrates the low share of capital expenditure to total expenditures and the random, unplanned development of current public expenditures since the establishment of the PNA, with growing security expenditures and declining social, educational, and health expenditures that are incompatible with Palestinian needs.

### **3. Palestinian Economy and Al-Aqsa Intifada**

The policies and measures imposed by the Israelis following the start of Al-Aqsa Intifada exposed the fragility of the Palestinian economy and its dependence on the Israeli economy. Israeli siege and closures of Palestinian areas, frequent long periods of closure of borders and checkpoints, reoccupation of Palestinian cities, villages, and camps, the destruction of infrastructure and public and private Palestinian establishments, and withholding Palestinian funds collected by Israel on behalf of the PNA have all had a destructive effect on the Palestinian economy.

There is a sharp decline in demand for Palestinian local products due to the reduced purchasing power of Palestinian households hit by rising unemployment and drops in wages. Consumption has also declined due to contractions in PNA expenditure in response to deteriorating current revenues and restrictions on movement that have deprived consumers from reaching major markets. There was also a decline in foreign demand since prompt delivery could not be guaranteed, a high percentage of goods decayed en route due to recurrent border closures and delays on bridges, and there was a fall in demand for capital goods needed for Palestinian firms.

Palestinian production has been impeded as a result of workers being unable to reach their jobs, measures hindering the delivery of raw materials and other inputs into the Palestinian Territories, the rising costs of transportation and distribution, the destruction of agricultural land, the bombing of factories, and the dismantling of industrial areas and border zones.

Israeli aggression has had an extremely destructive impact on the investment environment in Palestinian areas, aggravating the prevailing unstable conditions and leading to a decline in anticipated rates of return on investment. This contributed to substantial deterioration in private investment, along with the lack of local capital for investment and in view of the conservative policies of banks in granting credit. Public investment financed by international donors also deteriorated as the majority of resources were redirected towards relief and emergency priorities. In any case, most infrastructure projects that were underway were halted as a result of the obstacles created by Israel, the restrictions imposed on worker mobility, or by the unavailability of resources needed for production.

In the Palestinian labor market, Palestinian workers in Israel and the settlements were unable to reach their jobs. Closures also prevented and restricted the mobility of persons and goods within Palestinian areas, bringing productive life to a halt and interrupting the normal life of hundreds of thousands of workers and employees. In Gaza, the Israeli army imposed a restricted maritime siege, chasing and shooting fishermen to prevent them from fishing and destroying ships and nets. The sharp decline in the number of workers, particularly in Israel and the private sector, caused an upsurge of unemployment rates and poverty levels.

Many attempts have been made to estimate the impact of Israeli policies and measures on the Palestinian economy following Al-Aqsa Intifada. The results have been inconsistent and vary according to the author, the period of time covered, and the assumptions and methodologies utilized. Most studies included losses in GDP as a result of interrupting productive sectors, losses incurred from jobs lost in Israeli markets and settlements, losses from Israel withholding Palestinian taxes and VAT refunds (clearance revenues), losses in assets, plus additional burdens created by the effects of Israeli measures, such as medical care and rehabilitation for the wounded, welfare programs for the families of people killed in the Intifada, and emergency job-generation programs.

The Ministry of Finance estimates the overall losses of the Palestinian economy since the start of Al-Aqsa Intifada until mid-October 2001 (for 12 and a half months) to be \$7 billion, equivalent to \$6.7 billion annually, including all the aforementioned items. The Palestinian Economic Council for Development and Reconstruction estimates losses to be \$5.7 billion, while the Ministry for Planning and International Cooperation estimates Palestinian social and economic losses from the beginning of Al-Aqsa Intifada up to the end of 2001 (15 months) at approximately \$7.5 billion, or \$6 billion annually. These results are similar in respect to estimates and methodologies.

In contrast, the United Nations Special Coordinator in the Occupied Territories-UNSCO estimates losses in GDP for nine months from the beginning of the Intifada up to the end of June 2001 at between \$1.86–2.46 billion, equivalent to \$2.5–3.3 billion annually. It also estimates losses in the first six months of 2002 at \$1.1 billion. The Palestine Policy Economic Research Institute-MAS estimates GDP losses during the first half of 2001 at \$580 million, equivalent to \$1160

million annually, which is a considerably lower estimate than others. The World Bank estimates Palestinian material losses in capital assets during the first 15 months of the Intifada (up to the end of 2001) at \$305 million.

Losses that defy all material estimates are in Palestinian human capital; the dead, wounded and handicapped, plus the social and psychological effects resulting from Israeli aggression and policies. Such losses are not included in these studies.

#### **4. Main Assumptions**

Most studies on the Palestinian economy were initially based on the assumption of political and economic relations coordinated between an independent Palestinian state with full control of its resources and borders and Israel in the wake of a peace settlement resolving the long and bitter conflict and initiating a new era based on mutual interests and cooperation.

Some time following the Israeli-Palestinian Declaration of Principles in 1993, these hopes faded as Israeli practices reflected the true intention to continue domination of the Palestinian Territories. This necessitates a revision of the prevailing assumptions regarding Israeli goals.

This study assumes that strategic Israeli goals comprise the following:

- ✧ Occupy and confiscate Palestinian land.
- ✧ Uproot the Palestinian people and settle Zionists in Palestine.
- ✧ Marginalize the remaining Palestinian population to facilitate their control.

Palestinian goals can be divided into different interrelated stages, each tied to specific political obligations and conditions and requiring different policies and mechanisms. In this study, short-term refers to the continuation of the Israeli occupation prior to an agreement on the final status issues and the establishment of an independent Palestinian state. For the sake of analysis, this period will be divided into two; the first is the current stage, which we may call the 'survival stage' and which will end when Israeli reoccupation of Palestinian areas since 28 September 2000 ceases. This stage is a continuation of the current status and it is assumed that the Palestinian goal is to maintain and preserve the existence of the Palestinian people in Palestine and avoiding compulsory emigration and marginalization.

The second stage, which will be called ‘enhancing the local capacity of the Palestinian economy’, will start with the withdrawal of Israeli military forces to the lines of 28 September 2000 and will last until the conclusion of an agreement on the establishment of a viable, independent Palestinian state within the 1967 borders with Jerusalem as its capital. It is presumed that the Palestinian goal at this stage would be to reform the distortions in the Palestinian economy, enhance its local capacity, minimize its heavy dependency on Israel, and diversify relations regionally and internationally, all of which are fundamental to state building.

The study identifies the long term as the stage that follows the establishment of an independent Palestinian state. It is presumed that Israel will withdraw at the beginning of this stage to the 1967 borders and dismantle settlements while other final status issues such as Jerusalem, refugees, and water resources would be resolved. At this stage, basic legislation will be ratified and the reconstruction of infrastructure and institution-building will be completed. The main goal for the Palestinian economy will be to eradicate any heritage from the occupation, reform inherited distortions, and restructure the economy towards a comprehensive, sustainable development that guarantees a higher quality of life for the Palestinian people.

It is obvious that short-term goals may contradict long-term ones due to the variations in the political environment prevailing during the various periods. The political goals, particularly in the short term, are the main focus of this study as many other studies deal with the long-term developmental issues.

The goal of this period, i.e. ending the occupation, may be accomplished through a strategy that increases the costs of occupation and minimize its profits for the Israelis. At the same time, this strategy should minimize the negative impacts on the Palestinian economy of opposing and resisting the Israeli occupation. It is suggested that this strategy be based on the following main components in the short-term:

- ✧ Enhance the local capacity of the Palestinian economy.
- ✧ Minimize the dependency on Israel.
- ✧ Diversify Palestinian economic relations.

Although these are intertwined components, this study will focus on enhancing the local capacity of the Palestinian economy. The other two components will be dealt with in separate, complementary studies.

## 5. Strategy for the Current Stage: Survival Policies

In view of the aforementioned assumptions, strengthening the survival of the Palestinian people in their homeland require a strategy based on the following elements:

### 5.1 Reconstruction and compensation for damage resulting from Israeli siege and closures

High priority must be given at this stage to reconstruction and compensation to those affected by the ongoing situation in order to reduce suffering and enhance the ability to resist. In particular, attention should focus on the repair of infrastructure and emergency humanitarian needs, mainly ensuring basic food supplies.

### 5.2 Respond to the basic needs of the Palestinian people by supporting major productive sectors

Support for productive sectors, primarily agriculture, industry, and construction, would provide both essential commodities for Palestinian consumers and create job opportunities.

In the agricultural sector, the following policies should be adopted:

- ✧ Provide for and support imported agricultural production requirements.
- ✧ Focus on agricultural products that supply local Palestinian demand and consumption rather than external markets at this stage.
- ✧ Provide incentives to increase meat and dairy production.
- ✧ Contribute financially to agricultural production processes, marketing, and the purchase of inputs.
- ✧ Invest in rural infrastructure.
- ✧ Assist in providing property and production insurance, especially for small farmers.

The following policies are required to enhance the capacity of the Palestinian industrial sector:

- ✧ Encourage Palestinian industry to provide alternatives to Israeli products, especially essential commodities, with emphasis on standards, good quality, and price.
- ✧ Encourage the private sector to use local raw materials.

- ✧ Encourage the establishment of small enterprises in Palestinian areas since these have a number of advantages, especially in light of existing Israeli restrictions on movement.
- ✧ Give priority to local products in public purchases. Also, encourage local and international institutions to purchase local products for charitable ‘in kind’ programs for Palestinians rather than imported products.
- ✧ Support the transportation and distribution of national products, particularly for small enterprises, by providing appropriate marketing facilities.

It is possible to support the construction sector through the following measures:

- ✧ Rapid repair and reconstruction of damaged houses.
- ✧ Financing housing associations, especially projects halted due to lack of finance.
- ✧ Give priority to local contractors in public construction projects.
- ✧ Establish an insurance fund against political risks.
- ✧ Encourage mortgage institutions to provide residential loans with easy repayment and interest conditions to those on low incomes.

The internal trade sector must be also encouraged to focus on marketing, distributing and supplying sufficient national products to meet local demand. The promotion of products from Israel or the settlements that have Palestinian-manufactured substitutes must be discouraged under all circumstances. Palestinian businessmen must be encouraged to abstain from exploiting the current circumstances to raise the prices of essential goods or sell perished and expired goods. The Ministry of Procurement should play an active role in monitoring and taking action against those who violate these rules.

### 5.3 Enhance labor absorptive capacity of the Palestinian economy

Job opportunities can be created in the local Palestinian economy via the following:

- ✧ Encourage labor-intensive industries such as food production and construction.

- ✧ Provide incentives for industrial enterprises to absorb the unemployed. For example, the PNA could subsidize part of their wages, offer tax exemptions, and/or give priority to national products in public purchases.
- ✧ Provide rapid retraining programs for unskilled workers.
- ✧ Continue emergency job creation programs.

#### 5.4 Avert the collapse of Palestinian institutions

The collapse of Palestinian institutions must be prevented to ensure that these bodies carry on their role of supporting the Palestinian population.

At this stage, educational institutions can be supported through:

- ✧ Support for the current budgets of universities and higher education institutions.
- ✧ Contribute to the payment of fees for needy students or provide them with supplies in kind and of national origin.
- ✧ Provide loans for students to enable them to continue their education and support themselves.
- ✧ Build new schools for the increasing numbers of students and maintain existing ones.
- ✧ Increase allocations to the Ministry of Education to provide the equipment and requirements of schools.

The health sector (public and private) could be enhanced by:

- ✧ The reconstruction of damaged health institutions.
- ✧ Procuring medical equipment, ambulances, and medications from locally produced sources.
- ✧ Encouraging hospitals and health institutions to recruit qualified doctors and nurses.
- ✧ Increasing allocations to the Ministry of Health to cover rising expenses caused by the large numbers of casualties of Israeli aggression.
- ✧ Establishing health centers in rural areas to serve people who cannot get to cities for treatment.
- ✧ Providing health insurance and medication, especially for needy citizens.

The growing number of people living in poverty can be provided with assistance through:

- ✧ Increasing allocations to the Ministry of Social Affairs to assist poor households, in particular those most affected by Israeli measures.
- ✧ Putting pressure on international organizations and institutions to provide more financial and in-kind assistance for the needy.

#### 5.5 Improve public sector performance

Although there are steps that cannot be undertaken in the current situation, such as elections, there are other measures that should be taken immediately:

- ✧ Adoption of a clear mechanism for identifying political, economic, and social priorities for the Palestinian people.
- ✧ Coordinate international assistance to achieve optimal utilization. Also, avoid duplication and waste by following transparent monitoring systems and adopting objective and defined criteria.
- ✧ Reform and modernization of all public institutions, especially the judiciary, through the review and modification of all legislation relating to economic activities in light of Palestinian circumstances.
- ✧ The privatization of PNA companies and investments, in particular trade monopolies.
- ✧ Elimination of non-principal public expenditures, reallocating public revenues towards supporting the survival of the Palestinian people.

### 6. Strategy for the Next Stage: Enhancing Local Capacity Policies

Based on the assumption that Israeli forces will withdraw to the lines of 28 September 2000, the main strategic goal during this stage would be the enhancement of the local capacity of the Palestinian economy through the following policies and measures:

#### 6.1 Alleviation of distortions in the Palestinian economy, particularly in labor market and trade

Despite the current difficult situation, the restructuring of distortions should be initiated immediately. In future stages, greater measures must be taken to speed this process, given that any progress in one sector will reflect positively on other sectors.

The elimination or reduction of distortions in production requires an improvement in public performance with political and economic reforms to improve investment, particularly the legal

environment, in order to encourage competition. Corporations that promote investment and rebuild infrastructure need to be established in order to reduce the costs of production, transportation, and distribution, thereby improving the competitiveness of Palestinian goods.

Distortions in the labor market could be eliminated or reduced by the absorption of the majority of the Palestinian labor force in the Palestinian economy, especially the private sector. The productivity of Palestinian workers must be increased in order to provide well-paid job opportunities. This will strengthen the export of Palestinian products in lieu of labor. Vocational training programs are required to improve worker productivity, in addition to the provision of other factors of production, especially modern and developed capital.

The heavy dependency on Israel must be reduced by diversifying economic and trade relations with Arab countries, discussed in a separate section and handled in more detail in complementary studies on Palestinian economic relations with the Arab world and Israel.

Distortions in resources, public services, and utilities demand a review of Palestinian economic agreements with Israel in respect to water allocations. International pressure needs to be put on Israel to halt land confiscation policies. Agreements regarding the transfer of taxes, tariffs and excises collected by Israel on behalf of the PNA must be revised and modified. Extra resources need to be allocated in the PNA budget for infrastructure projects.

Distortions resulting from ties with the Israeli economy serving the interests of some Palestinian groups can be reduced by the reorganization of economic relations with Israel through specified channels and implementing the economic and administrative public reforms outlined above.

## 6.2 Enhance productive sectors, especially agriculture, industry and construction

The agricultural sector could be supported via the following measures:

- ✧ Expand agricultural production by increasing the area of land under irrigation. This requires land reclamation, water

reserves, support for imported agricultural equipment and inputs, the encouragement of investment in marketing infrastructure to control the supply of agricultural products, and the provision of storage, refrigeration, and sorting services for plant production and slaughterhouses for animal production.

- ✧ Exploit the comparative advantage of Palestine in producing a number of agricultural commodities for export to European markets in line with the Euro-Mediterranean agreement and to Arab markets, especially Gulf countries. Palestinian producers and exporters should be provided with sufficient information regarding these export markets.
- ✧ Encourage agricultural exports by establishing export promotion institutions and special trade corporations to promote Palestinian exports and by focusing on standards and specifications.
- ✧ Increase animal production by encouraging joint animal production projects with neighboring Arab countries, particularly poultry inputs and outputs, fodder factories, lifting Israeli sanctions on grazing, and cooperating in grazing with neighboring countries like Jordan and Syria. This would expand animal breeding and increase meat and dairy production.
- ✧ Establish an agricultural cooperative bank or an agricultural loan corporation to overcome financing problems.
- ✧ Establish a special agricultural insurance corporation with nominal fees against natural and political risks.

Most of the policies outlined above for tackling the current situation must be maintained in view of the possibility of persistent Israeli siege and closures and even reoccupation.

It is possible to support the industrial sector by:

- ✧ Focusing on industries with potential to utilize skilled labor, such as software and information technology industries.
- ✧ Ensuring high quality standards by supporting the Standards and Specifications Institute.
- ✧ Establishing new industrial zones and developing existing ones by facilitating investment opportunities and providing the necessary services.
- ✧ Providing Palestinian industries with temporary protection in local markets. Tariff protection cannot be imposed on national

products without Palestinian control of international borders. Products from national industries can be supported by tax exemptions, soft loans and/or support for production requirements, especially water and electricity costs.

The construction sector is expected to play an active role in the next stage in the reconstruction of damaged infrastructure, residential and non-residential buildings. Infrastructure in Palestinian areas requires development and improvement and new residential units must be constructed to meet growing demand. This may be done through:

- ✧ Construction of residential units at reasonable cost, mainly for the benefit of low-income families.
- ✧ Encourage cooperative housing projects by providing infrastructure services and establishing cooperative housing associations and support organizations.
- ✧ Providing loans with easy repayment and interest conditions through the Palestinian Mortgage and Housing Corporation or by providing incentives to other financial institutions.
- ✧ Facilitating land and housing registration procedures to provide appropriate collateral.
- ✧ Reorganizing the plans of Palestinian cities and villages to expand the area of land eligible for sale in order to bring down land prices.
- ✧ Providing the private sector with incentives to invest in the construction sector by improving relevant legislation relating to rental property, land classification and land and housing registration.
- ✧ Encouraging local construction or related industries, such as cement, concrete, asphalt, crushing stones, aluminum, and metal bars.

### 6.3 Preparation for the economy of an independent state

Preparations for state building require laying the foundations for sustainable development in addition to reducing distortions in the economy, continuing administrative and economic public reform, and regaining trust in Palestinian investment that has been severely weakened by recent developments. This requires the following measures:

- ✧ Draw up and ratify economic legislation and modern mechanisms and measures conducive to promote investment. These would include providing information on investment opportunities, conditions, and corporations, as well as facilitating licensing and registration.
- ✧ Develop and enhance the capacity of Palestinian public institutions to attract foreign investment and encourage local investment that will increase the competitiveness of Palestinian products.
- ✧ The reconstruction, maintenance and development of damaged infrastructure not repaired in the current stage, especially the airport and major roads linking Palestinian areas, plus resuming important halted projects such as the port in Gaza.

In addition, a basic requirement to promote investment and economic development is to enhance human capital through better educational, health, and social conditions. Basic requirements to develop Palestinian human capital are investment in education, particularly at primary level, ensuring higher education meets the needs of Palestinian society, retraining teachers, developing school curricula, and improving school buildings and equipment. In addition, Palestinian universities should be assisted to adapt their programs to make them compatible with Palestinian development priorities, giving special attention to vocational training in view of labor market needs. The private sector should be encouraged to participate in vocational training and support for scientific research.

#### 6.4 Diversification of economic and trade relations to reduce relations with Israel and increase integration with Arab and Islamic countries

A separate MAS study deals with the diversification of economic and trade relations with Arab and Islamic countries while this study proposes policies and measures for the PNA to strengthen relations with Arab and Islamic economies. These include the following:

- ✧ Encourage exports to Arab countries by the application of trade agreements concluded with these countries stipulating preferential treatment for Palestinian exports and by concluding new trade agreements and protocols with Arab and Islamic countries especially the Gulf Cooperation Countries.

- ✧ Conclude new bilateral trade agreements with Arab and Islamic countries, particularly with the Gulf Cooperation Council (GCC).
- ✧ Encourage standards and specifications to be met and provide marketing, technical, and promotional services for Palestinian products.
- ✧ Provide Palestinian businessmen with information on available markets, especially in Arab and Islamic countries.
- ✧ Facilitate the participation of Palestinian businessmen in international and regional trade exhibitions.
- ✧ Encourage the import of raw materials from Arab and other countries in line with the economic agreements concluded with Israel, in particular the Paris Protocol.
- ✧ Encourage investment from the Arab world and Palestinian Diaspora by establishing productive individual or joint projects that will support the survival of the Palestinian people.
- ✧ Connect Palestinian areas to Arab infrastructure, especially electricity, water, communication and telecommunication networks which might be obstructed by Israel.

#### 6.5 Improve public performance and carry out political and economic reforms

It is important to take rapid action to improve public performance at this stage, including administrative and economic reform as follows:

- ✧ Speed the reform process by providing a transparent and adaptable legal and institutional framework, ensuring the independence of the judiciary, improving the performance of courts, providing appropriate protection for investors, and modernizing economic legislation to encourage competitiveness.
- ✧ Build modern public institutions based on transparency rather than individualism and corruption which waste public revenues and allow public positions to be used for personal benefit.
- ✧ Clarify regulations, provide information, prevent the duplication of functions, ensure posts are given to those most appropriate for the task, and ensure coordination between ministries to avoid the duplication and waste of revenues.

- ✧ Pursue a clear economic policy and plans based on the interim goals and priorities of the Palestinian economy.
- ✧ Reorganize the public budget to reflect Palestinian goals and priorities, including reducing public employment in the various security services and reallocating public revenues for educational and health services.
- ✧ Restructure the tax system to encourage investment and production and to limit tax evasion.
- ✧ Continue the privatization of PNA investments and corporations, especially public trade monopolies, and prevent privileges and monopolization unless there is a national economic interest. Even where such exists, it must be subject to public bidding. There must be also legal criteria to control monopolies and supervise their activities.
- ✧ Adopt a clear and transparent policy for public employment and promotion that will attract qualified personnel to economic administration.
- ✧ Draft and enact disclosure laws applicable to high-ranking government officials in both civil and security departments.

## **7. Conclusion and Findings**

It is not anticipated that Israel will alter its intentions or practices towards the Palestinian people unless there is a high price to be paid for extending occupation of Palestinian areas. Israel must find that the benefits of maintaining its occupation are much less than the losses incurred at political, economic, and social levels. At the same time, the Palestinian people must feel that the costs of resisting Israeli occupation are not excessive or beyond endurance. The Israeli authorities are banking on increasing the suffering of the Palestinian people to an intolerable level that will force emigration or surrender.

The struggle against Israeli occupation is an Arab-Israeli conflict rather than a Palestinian–Israeli conflict since Israeli political, economic, and military designs extend beyond Palestine to the Middle East as a whole. There should therefore be a united Arab and Islamic stance in support of the Palestinian people as follows:

- ✧ Provide political support for the Palestinian people and their cause in international forums.
- ✧ Provide financial support for reconstruction and establish a compensation fund.

- ✧ Support the current PNA budget to cover current expenditures and the salaries of public employees. Also, support developmental projects to enhance the local capacity of the Palestinian economy, especially those projects that international donors are reluctant to assist.
- ✧ Support the Palestinian private sector by opening Arab and Islamic markets to Palestinian exports with preferential treatment and exemptions. Also, support the cost of imports essential for the Palestinian economy and establish joint projects, particularly in agriculture and industry. Contribute to a fund to support the Palestinian private sector similar to the emergency fund suggested by the World Bank or the Investment Guarantee Fund -MIGA against political risks, sponsored by the International Insurance Bank.
- ✧ Support educational institutions, particularly universities, via a fund to support university budgets and needy students during the period of the Intifada.
- ✧ Provide financial and in kind support to the health sector and purchase in kind support, especially medical supplies, from Palestinian companies.
- ✧ Support housing projects in the WBGS.

Arab and Islamic support should not be limited to formal assistance from governments but should include other financial institutions such as the Arab Fund for Economic and Social Development and the Arab Corporation for Investment Guarantee, in addition to local and private sector institutions.