

Towards a Palestinian Development Vision !



PALESTINE ECONOMIC POLICY RESEARCH INSTITUTE

2005



Palestine Economic Policy Research Institute

TOWARDS A PALESTINIAN DEVELOPMENT VISION

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Preface

MAS is pleased to introduce this paper, which is intended to further stimulate the debate on the vision for the development of the Palestinian economy. It examines the identity of the Palestinian economy and its desired structure, looks the role that should be played by the various development partners, and explores the nature of the relationships that connect Palestine with its Arab neighbours and the rest of the international community. The Palestinian National Authority, the private sector and NGOs need to cooperate to come up with answers about the optimal direction of long-term development. These agreed answers must form the basis of future discussions between development partners and be effectively incorporated into all development policies and strategies, including the national budget. This would transform Palestinian development efforts from being ad hoc and uncoordinated into an efficient process with clearly defined and attainable goals.

MAS does not claim that this paper provides a complete and final vision, but it represents a serious attempt to establish the basis for one, relying on MAS's extensive experience and knowledge accumulated over the years. It is noteworthy to mention here that this paper has already been the subject of numerous discussions at local and regional workshops attended by many development experts and economics scholars. In accordance with its mission and role, MAS publishes this paper to further the debate. The aim is to develop and strengthen a development vision which represents the interests and aspirations of all development partners.

MAS would like to thank the Ministry of Planning for sponsoring workshops, and we extend our genuine gratitude to all those who participated in the discussions and enriched our project with their valuable comments and feedback. MAS is also grateful to ESCWA for distributing the paper and putting it on the discussion agenda of the conference on the Rehabilitation and Development of the Palestinian Economy, held in Beirut in November 2004. Finally, MAS would like to thank the Ford Foundation for financing the

paper and the workshops. We hope that it lives up to its title by stimulating debate about future development in order to reach a common vision, which will light the way for all those working in the field and guide them towards reaching sustainable social and economic development objectives for Palestine.

Dr. Samir Abdullah
Director General

CONTENTS

1. Introduction	1
2. The Palestinian Development Experience	3
2.1 Politics and Economics in Confrontation with the Israeli Project	3
2.2 The Challenge of Palestinian Development under Occupation	6
2.3 Development after the Creation of the Palestinian National Authority	7
3. A Palestinian Development Vision	9
3.1 The Need for a Comprehensive Development Vision	9
3.2 The Internal Palestinian Development Context	10
3.2.1 <i>Points of Strength</i>	10
3.2.2 <i>Points of Weakness</i>	15
3.3 The External Palestinian Development Environment	17
3.3.1 <i>Opportunities</i>	17
3.3.2 <i>Challenges and Threats</i>	20
3.4 Towards a Palestinian Development Vision	22
3.4.1 <i>The Development Vision</i>	23
3.4.2 <i>The Kind of Economy Desired by Palestinians</i>	25
3.4.3 <i>The Structure of the Desired Economy</i>	26
3.5 Main Development Objectives and Strategies	27
3.5.1 <i>Short-Term Development Objectives: Prior to Liberation and Independence</i>	28
3.5.2 <i>Long-Term Development Objectives: Post-Independence</i>	28
3.5.3 <i>Development Strategies: Current Priorities</i>	28
3.6 The Role of the State in Implementing the Development Vision	29
APPENDICES	31

1. Introduction

International development experience during the last three decades has shown that success in attaining development objectives is not primarily related to natural resources, geographical location or population size; it depends on a proper development vision, good and honest governance, and sound development management. States which failed to assure such factors, among them several countries in the Middle East, did not succeed in achieving their development objectives, regardless of their resource endowment. At the same time we find that states which managed to secure efficient development management and good governance, based on a development vision formulated in consultation with private-sector and civil-society partners and derived from a scientific analysis of opportunities and strengths in their development environment, managed to face up to development challenges and set their economies on a course of sustainable development. Some examples of countries belonging to the latter group are the newly-industrialised Asian economies or ‘tigers’ (Hong Kong, Malaysia, Singapore, South Korea, Taiwan and Thailand) and Ireland, which has also been labelled the ‘Celtic tiger’ owing to its recent economic performance.

Determination and discipline in development planning and implementation is pivotal to success. A national development vision should therefore seek to actively mobilise human and other resources towards the achievement of shared goals. In the Palestinian development experience, the question of a developmental vision has been a matter of intense discussion. Many working papers and articles have been written on the subject but no single development vision was commonly agreed upon by all the partners – the Palestinian National Authority, the private sector and civil society.

A preliminary version of this working paper was presented in Beirut in October 2004, as part of the ‘Arab-International Forum on the Reconstruction and Development of the Occupied Palestinian Territories’, which was sponsored by the United Nations Economic and Social Committee for West Asia (ESCWA) and the League of Arab States. Putting the issue of a national development vision on the agenda of this forum enabled the formulation of a Palestinian socio-economic vision agreed upon by a wide range of development partners in different sectors. The aim of this paper was to formulate that vision, with the participation of all partners in Palestinian development, on the basis of an analysis of the internal and external Palestinian development environment. Based on the

vision outlined, the paper identifies strategic objectives for Palestinian development, elaborates appropriate strategies for both the short and longer term, and emphasises the importance of mobilising and coordinating efforts across all sectors in the implementation of this vision.

This development vision has been presented in several local forums, including MAS Annual Conference in April 2005. It has gained support across the private sector, civil society and, most importantly, in the Palestinian National Authority. The Ministry of Planning is currently incorporating the vision into its forthcoming and revised Medium-Term Development Plan. It is our hope that this development vision will be able to guide the way for policy makers and other stakeholders towards sustainable growth and development in the Palestinian Territories.

2. The Palestinian Development Experience

Palestinian development has passed through extremely unfavourable circumstances during the last few decades. The Palestinian people were dispossessed and economically marginalised as large parts of their property and wealth were appropriated by the Israeli occupying power. Despite this national trauma, the Palestinian people have demonstrated a unique political, economic, social and cultural vitality, which has enabled them to persist in their struggle for independence and democracy. Thus, the Palestinian development experience constitutes an important point of departure and a major source for defining the desired socio-economic vision.

2.1 Politics and Economics in Confrontation with the Israeli Project

The modern Zionist Movement was founded at the end of the 19th century with the aim of establishing a Jewish homeland in Palestine. With the support of then-imperial powers (such as Great Britain), the Zionist movement succeeded in establishing the State of Israel in 1948 on an area covering more than three quarters of the land of Palestine. Assisted by Europe and the United States, Israel developed into a modern state, with advanced forms of governance and economic management, based on technology and science. However, the State of Israel persisted in discriminating against its Palestinian Arab citizens and in violating their rights. It obtained tremendous amounts of aid from the Zionist movement and from Jewish organisations and communities around the world. In 1967, Israel occupied the remainder of the Palestinian land – the West Bank and the Gaza Strip – in addition to large areas of neighbouring Arab countries. It embarked on colonising these territories and exploiting their riches, squeezing the means of livelihood of the original inhabitants and turning the territories into appendages of the Israeli economy. This was particularly apparent in the West Bank, the Gaza Strip and the Syrian Golan Heights. To date, the confrontation with Israel has seen conditions of outright war, low-level conflict and partial peace – conditions which fluctuate between relatively normal relations and openness, lukewarm peace, and a total rupture of relations.

Despite the successes achieved by Israel in the military field and in changing realities on the ground, it has so far failed to obliterate the cause of the Palestinian people and annul their inalienable national rights

guaranteed by international law. The Palestinian people have succeeded, through a century-long struggle and enormous sacrifices (and with the support of Arab and Muslim states and other peoples and governments around the world that sided with international legality and human rights) to remain in their homeland, to build their economic, social and cultural institutions, to preserve their Palestinian Arab identity, and to maintain international recognition of their national rights. This is manifested in a series of UN Security Council and General Assembly resolutions adopted over the years. Moreover, the declaration by US President George W. Bush that he envisions the establishment of a Palestinian state side by side with Israel was an outstanding indication of the growing international recognition of the Palestinian people's rights, as it was made by the president of the most powerful state in the world which has provided Israel with constant political, economic and military support during the last five decades. International recognition is also embodied in the Road Map, elaborated and announced in March 2003 by the so-called Quartet, which includes the United States, the European Union, Russia and the United Nations. The Road Map defines the final goal of negotiations as being the establishment of a Palestinian state alongside Israel.

Since September 2000 the occupied Palestinian Territories have experienced full-scale aggression against the Palestinian people. This aggression is clearly manifested in the construction of the Israeli Separation and Annexation Wall, which seeks to deprive the Palestinian people of a large part of their land and water resources. The Wall also squeezes their means of livelihood and growth and restricts their movement to between isolated cantons, which allows the Israeli occupation authorities to control the population. The Israeli Government is proceeding with the construction of the Wall despite international condemnation and the advisory opinion provided on 9th April 2004 by the International Court of Justice in The Hague. This states that the Wall is contrary to international law, that it must be dismantled, and that Israel is under an obligation to make reparation for all damage caused by its construction.

Sharon's plan of disengagement from the Gaza Strip is considered a new chapter of the Israeli plan to marginalise the Palestinian people. The disengagement sought to decrease the political and financial burden resulting from the continued presence of the Israeli army and settlers in the Gaza Strip. By retaining full control over Gaza's borders, however, Israel continues the occupation of the Gaza Strip while also taking a firmer hold

of the West Bank by expanding the construction of settlements in this territory.

In the light of these developments, the prospects of a political solution to the conflict through negotiations have become dim. The situation may now develop in several directions, the most important among them being the following two possibilities:

1. A return to negotiations, implementation of international law, including UN resolutions, and the establishment of an independent Palestinian state on the territories occupied in 1967, side by side with Israel.
2. A continuation of the present state of affairs in the occupied territories and a state of 'no war – no peace' between the Arab states and Israel. With the continued construction of the Separation and Annexation Wall in the West Bank and continued control of Gaza's borders, Israel will undermine the creation of a viable Palestinian state.

Both scenarios necessitate that increased importance is assigned to economic and social development efforts and activities. In the first scenario, the future of the Palestinian people will depend on the proper management of economic and social development to build an independent state, with a modern economy capable of integrating into Arab and international markets and benefiting from globalisation. In this scenario, the Palestinian state and people will face the challenge of correcting the accumulated structural distortions, ending dependency on the Israeli economy, improving the investment climate, integrating the economy into regional and international markets, and launching the process of sustainable development.

In the second scenario, the focus will be on Palestinian national liberation and will depend not only on the firmness of the political position in confronting occupation, but will also rely heavily on the development of the Palestinian people's economic capabilities and the durability of their social fabric.

In any case, Palestinian economic success will depend on the development of the private sector and its adoption of advanced production technologies to improve the competitiveness of Palestinian products in local and foreign markets. Palestinian economic potential depends largely on the development of human capital as a stepping stone to improve productivity and competitiveness in all economic fields, especially in knowledge-

intensive industries. It also requires the development of civil-society organisations and their ability to consolidate social capital, develop safety nets for the weakest in society, and provide basic services.

Building up Palestinian society and its economic capabilities, especially by developing human capital, constitutes a direct answer to the economic, social and cultural marginalisation experienced by the Palestinian people. It is also a way of reversing the unjust division of labour that the occupation seeks to perpetuate using administrative and economic means to transform the occupied territories into a reservoir of cheap labour and a free market for Israeli products.

It is clear that economic confrontation, in the form of economic competition under conditions of peace, has been and will continue to be one of the main factors to promote the Palestinian liberation struggle and democratic project. Such a strategy undoubtedly requires the improvement of economic and social infrastructure and capital to develop the Palestinian ability to endure such competition. Palestinian economic capacity constitutes the first line of defence in protecting the Palestinian national project and the Arab region from Israeli economic domination, as well as in blocking the expansionist Israeli project.

International experience during the last two decades has shown the importance of economic competitiveness in preserving states and regimes and in creating a power balance in international politics. The Arab nations should benefit from this by taking advantage of their many assets and consolidating their economic potential, so as to enable their citizens to realise their aspirations of prosperity and sustainable development.

2.2 The Challenge of Palestinian Development under Occupation

Unanimity exists as to the impossibility of ensuring comprehensive and sustainable development in the Palestinian Territories as long as they remain under Israeli control. Nevertheless, resistance to long-term occupation requires adherence to confrontation strategies on several fronts – economic, social and cultural. The big military imbalance to the disadvantage of the Arab states, on the one hand, and the refusal of the Arabs to succumb to the aggressor, on the other hand, have resulted in the prolongation of occupation and continuation of the conflict.

The struggle against the occupation, aiming to restore legitimate Palestinian and Arab rights, is closely linked to the formation of a solid economic and social base, capable of mobilising people to remain in their homeland while maintaining the unity of the social fabric and supporting the political struggle for justice. This position emerged from the Conference on Development for Steadfastness, held in Jerusalem in 1982, which called for a development strategy focussing on the elaboration of socio-economic development programmes to encourage steadfastness and resistance against the occupation. This point of view regards development (with all it signifies in terms of improving living conditions by developing production, employment, infrastructure, services and the environment) as contributing to the consolidation of steadfastness, particularly if the fruits of development benefit the masses and are not confined to well-off groups. Accordingly, there is no contradiction between development and resisting occupation, and experience calls for combining the two in a creative manner.

2.3 Development after the Creation of the Palestinian National Authority

The signing of the Oslo Accords in September 1993, and the creation of the Palestinian National Authority in 1994, led to important changes in the Palestinian development environment. For the first time the Palestinian people in the occupied territories possessed an official body which was concerned with and had influence over the process of development. Donors provided tremendous amounts of aid to the Palestinian National Authority, with the aim of helping it face the problems of underdevelopment that had accumulated over the previous decades and launching an economic and social development process.

These changes were accompanied by an end to the occupation authorities' direct control over public and private investment permits, direct taxation and the licensing and supervision of banks in areas designated 'A' and 'B'. The Oslo accords stipulated the free movement of people and goods between the West Bank and the Gaza Strip through a 'safe corridor' and freedom of direct foreign trade for Palestinian companies. It also guaranteed Palestinian companies the right to use Israeli ports and airports for exports and imports, on the same conditions as their Israeli counterparts. These changes held a promise for the revitalisation of the Palestinian private sector and the development of investment policies and development strategies by the Palestinian National Authority.

However, according to the Oslo agreement Israel kept control of around 60 percent of the West Bank and Gaza Strip and most of the water resources. It also maintained total control over the movement of citizens and goods within the Palestinian Territories and across its borders. By dictating the flow of persons and trade, the main keys to development of the Palestinian economy remained in the hands of the Israeli occupation authorities. From the establishment of the Palestinian National Authority, and before the emergence of 'security risks', Israel used these keys in an arbitrary manner to undermine Palestinian development, thus continuing previously-practiced policies to obstruct economic growth and progress. Israel has blocked the creation of a 'safe passage' between the West Bank and the Gaza Strip, and since 1993 has followed a policy of blockades and closures.

3. A Palestinian Development Vision

3.1 The Need for a Comprehensive Development Vision

Among the shortcomings of the Palestinian National Authority in the period after its establishment was the weak performance in the economic development field, which negatively affected its struggle for liberation and independence. The Palestinian development process during this period was characterised by lack of focus and no consistency in its economic and social development strategies and policies. The Palestinians therefore failed to achieve their main development objectives, such as removing the economic and social structural distortions accumulated over the years of occupation, decreasing dependency on the Israeli economy, improving Palestinian-Arab economic relations, and creating a development environment conducive to building a modern and sustainable economy.

To overcome the shortcomings in the Palestinian development process, it is necessary for development partners in the Palestinian National Authority, the private sector and civil society to elaborate a development vision that enjoys their unanimous approval so that it can be used by the PNA to mobilise and unite efforts to create a modern, competitive economy capable of facing the challenges of globalisation. So far, development action has lacked a comprehensive development vision enjoying the backing of all Palestinian development partners in the implementation of plans and programmes. Thus, previous attempts to elaborate such a vision did not amount to more than academic exercises.

The development vision needs to address the major questions concerning the socio-economic structure required to develop resources and capacities to resist the Israeli occupation and the marginalisation of the Palestinians, creating conditions for political independence. The vision should also take into consideration long-term development objectives, particularly the transformation of the Palestinian economy towards sustainable development.

As mentioned above, a preliminary version of this paper was presented at the 'Arab-International Forum on the Rehabilitation and Development of the Occupied Palestinian Territory' in Beirut in October 2004. This forum was attended by development stakeholders from Palestinian public institutions, the private sector and civil society, and therefore constituted a good opportunity to reach a consensus on an appropriate development

vision. The vision and strategies presented in this paper were very well received by the Palestinian development community and were incorporated by the Ministry of Planning into its forthcoming and revised Medium-Term Development Plan (MTDP). However, the process of following up the implementation of the development vision (and of national development plans in general) is hampered by the ever-changing political situation, which creates new, urgent priorities, as well as by the overall lack of importance attributed to having such a programme.

The following two chapters present a so-called SWOT analysis of the Palestinian development environment, examining the most salient points of Strength and Weakness in the internal context and the Opportunities and Threats existing in the external environment. This analysis will then guide the formulation of an economic and social development vision connected to the Palestinian reality.

3.2 The Internal Palestinian Development Context

3.2.1 Points of Strength

a) Positive Characteristics of Population and Work Force

It is estimated that around 3.8 million Palestinians live in the West Bank and Gaza Strip, 2.4 million of them in the West Bank and 1.4 million in the Gaza Strip. The growth rate of the population is around 3.3% per year¹. The distribution of the population according to different age groups indicates that 47% are under 15 years old, 57% are 19 years old or younger, and an additional 28.5% belong to the 20-39 year-old age group. These figures clearly show that the Palestinian population is characterised by its youthfulness. This factor is linked to the ability to accept change, acquire new skills, operate new technologies, and develop existing abilities. However, it also has some negative aspects, such as high levels of dependency and low levels of labour force participation, which affect the standard of living.

The Palestinian work force is distinguished by a high level of education. Statistics from 2004 show that 26% of the labour force completed more than 12 years of education, 31% completed 10-12 years of education and 25% completed 7-9 years of schooling². These figures indicate that the

¹ Palestinian Central Bureau of Statistics (PCBS) (2005) *Population Statistics*.

² PCBS (2005) *Labour Force Annual Report 2004*.

Palestinian labour force is relatively well educated, which enables it to explore and establish new, knowledge-intensive industries that depend on modern technology.

b) Strong Human Capital Base

The Palestinian development experience is characterised by a focus on the development of human capital. This is, to a large extent, a result of the value attributed to education by Palestinian families and the high allocations for education in household budgets. Civil society organisations have also contributed to building human capital by providing relatively large-scale educational services. Appendix 1 provides an overview of the main education indicators in the Palestinian Territories.

Human capital has been the main distinguishing factor of the Palestinian people during the past decades and will most probably continue to be so in the future. Historical events experienced by the Palestinians have played an important role in the creation of this reality. The usurping of the greater part of the resources and wealth of Palestine (land, water and other assets) and long years of undermining the investment climate have directed the Palestinian people to invest in human beings through education. The attention paid to educating children increased and became an established tradition in Palestinian families, regardless of changes witnessed in the labour market or the Palestinian economy which did not always provide the best opportunities for making use of qualifications. The scope of employment of Palestinian human capital was therefore extended to states in the region, such as Saudi Arabia, the Gulf States and others.

c) Accumulated Experience and Capital in Palestinian Expatriate Communities

The presence of almost five million Palestinians abroad³ constitutes one of the assets of the Palestinian economy and an important source of support for the development of the occupied Palestinian territories. However, this resource has not been fully or appropriately utilised, and only a very small portion of Palestinian human and financial capital in the diaspora has been attracted to and invested in Palestinian development. Moreover, insufficient efforts were exerted to benefit from Palestinian communities abroad in order to access the markets of their host countries. We believe that there are great benefits to derive from the Palestinian expatriate

³ Not including the approximately 1.3 million Palestinians living in Israel.

community, as a source of human and financial capital, technology transfer, research and development, and as a tool to access international export markets and attract foreign investment to Palestine.

d) Vitality of Civil Society and Accumulated Social Capital

The occupied Palestinian Territories are characterised by the formation and operation of a civil society distinguished by its vitality, especially in development activities and the provision of services. This provides a large opportunity for societal participation at all levels of planning and implementation of development strategies and programmes. Hundreds of non-governmental and quasi-governmental institutions are involved in development activities covering Palestinian cities, villages and refugee camps, seeking to preserve the social fabric in the face of the war waged by the occupation authorities to marginalise and fragment Palestinian society⁴. Throughout years of occupation, civil society was able to establish a chain of relations and values that greatly contributed to strengthening the structure of the society and protecting a common identity and history.

Civil society organisations (CSOs) have been able to carry out direct development activities to improve the quality of life for hundreds of thousands of citizens, especially the poor and other vulnerable groups. These activities include health, educational and social services, in addition to activities directed at creating jobs, fighting poverty, providing micro-finance and activating safety nets for various groups of Palestinian society. The last few years witnessed the expansion of CSO activities into new fields focusing on human rights, democracy and the rights of women and children. CSO activities and services cover all of the West Bank and the Gaza Strip and have a large number of beneficiaries. In addition, these organisations are generally characterised by good financial capabilities and skilled administrative personnel.

Social capital also contributed to the consolidation and unity of Palestinian society during the current *Intifada*. This is reflected in the social and material aid received by Palestinian families affected by the Israeli aggression. Throughout the *Intifada*, relatives, friends and neighbours have remained one of the main sources of humanitarian assistance for Palestinians in need, both in terms of the value of the aid and the

⁴ A census of Palestinian non-governmental organisations conducted by MAS in mid-2000 revealed the existence of 926 non-governmental organisations operating in the West Bank and Gaza Strip. ('Mapping of Palestinian NGOs in the West Bank and Gaza Strip', MAS, 2001)

frequency of assistance extended. Other important assistance providers include UNRWA, the Palestinian National Authority (including the Ministry of Social Affairs) and trade unions⁵.

e) Geographic Location, Climate, and Historical, Religious and Cultural Wealth

The geographic location and climate are considered elements of strength in the Palestinian economy that can be exploited after the end of occupation. Palestine is located in a globally strategic position as a point of contact between three continents, Europe, Asia and Africa. It is characterised by a unique combination of assets that make it an extremely attractive place for international tourism. There are religious and historical sites that are considered among the most sacred for the major monotheistic religions. In addition, the mild climate attracts tourists and pilgrims during all seasons of the year.

There is tremendous potential for the Palestinian tourism sector to benefit from religious, cultural and historical tourism, as well as business travel and conferences, leisure and health tourism. The tourism industry in Palestine has also encouraged activities that supplement the tourism and culture sector, including the restoration of historical sites, the organisation of festivals and cultural activities, and the development of tourist-related services such as restaurants and hotels, entertainment centres, travel services and traditional industries (souvenirs, wood, glass, embroidery and leather products). The improvement of tourist infrastructure and services has greatly increased the prospects of expanding tourism activities. Tourism grew impressively in the late 1990s, which points to the potential of the industry in Palestine. However, increased Israeli military activity since the start of the *Intifada* led to a collapse in tourism and its related infrastructure⁶.

f) Energetic and Experienced Private Sector

The Palestinian private sector has constituted the main driving force for Palestinian development in the unfavourable investment environment

⁵ PCBS (2005) Impact of the Israeli Measures on the Economic Conditions of Palestinian Households, 14th round: July-September 2005.

⁶ PCBS data indicate that the number of hotels increased from 67 in 1996 to 108 in 2000, distributed as follows: 43 in Jerusalem, 50 in the West Bank and 15 in the Gaza Strip. With the political crisis they dropped to 69 in 2002, and in 2005 there have been between 75 and 80 hotels operating in the WBGS. Other facilities, such as restaurants, travel agencies, souvenir shops and factories, have also decreased dramatically since 2000.

resulting caused by occupation policies. Since the beginning of the occupation the Israeli authorities attempted to hamper Palestinian private sector growth. This was achieved through a series of complex administrative measures, including licensing requirements for every step of investment, production and trade, and Israeli commercial policies being enforced on the Palestinian economy. Moreover, Israel's unilateral imposition of a customs union turned the Palestinian economy into a free market for Israeli companies, and forced Palestinian producers to enter into unequal competition with Israeli companies enjoying the support and protection of the Israeli government. Despite all these obstacles, hundreds of private enterprises were established, covering most fields of economic activity and depending totally on self-financing capabilities. Some of these enterprises managed to compete with Israeli companies and withstood the situation of shrinking demand, coupled with increased risks and costs, at the time of the first *Intifada* of 1987.

After its establishment in 1994, the Palestinian National Authority announced its commitment to market economy principles and support for the pioneering role of the private sector. It started developing the legal and institutional framework to form the basis for a competitive environment. As a result, the Palestinian economy witnessed an increase in private investment, partly by Palestinian investors returning from abroad. Such investments were particularly reflected in the development of the financial sector, with banks, insurance companies and a stock exchange being established. Furthermore, several investment holding companies, tourist hotels and new industries appeared, and the private sector was also the driving force in the development of the communications system, the electricity sector, and industrial zones. Despite the big losses incurred by the private sector during the last five years, it has demonstrated a tremendous ability to withstand the pressure and adapt to the unfavourable business climate. Employment statistics for 2003 indicated that the private sector had succeeded in creating 53 thousand jobs since 1999⁷.

The increase in the number of supporting institutions further added to the vitality of the Palestinian private sector and strengthened its role. Among these institutions are the Federation of Industries, the Palestinian Investment Promotion Agency (PIPA), the Federation of Chambers of Commerce, Industry and Agriculture, the Palestine Standards Institution, the Palestine Trade Center (PalTrade) and the Palestinian Businessmen's Association. These institutions seek to develop an appropriate and

⁷ UNCTAD (2004) *TDB (Trade Development Board) Report*.

competitive investment environment in Palestine. They also aim at developing competitive advantages in different sectors through the development of exports, encouraging and facilitating local and foreign investments, and by representing the interests of the private sector to the PNA.

To sum up, the experience of the Palestinian private sector has increased its ability to handle and adapt to a high-risk, volatile environment. Consequently, foreign companies will find in it a partner to exploit hundreds of profitable investment opportunities in Palestine after the occupation ends, in fields ranging from tourism, industry and agriculture to modern technology and services.

3.2.2 Points of Weakness

We now turn to the main weaknesses of the Palestinian economy, which can be summarised as the limited capacity of the governmental sector, the shrinking resource base, accumulated structural distortions, and the limited economic participation of women.

a) Limited Capacity of the Governmental Sector

Palestine lacks a well-functioning governmental sector, capable of efficiently providing public services and formulating appropriate policies and regulations. This is partly due to the fact that the Palestinian National Authority is still a new structure, which has been operating for only a decade while being constantly challenged by the Israeli occupation authorities and policies. Clearly, the political and economic instability that prevailed during the last ten years contributed to causing deviations from modern concepts of public administration. However, the process of setting up the Palestinian National Authority was also not carried out in accordance with sound practices for building public institutions.

A comprehensive effort to reform the governmental sector has been underway since mid-2002 at the initiative of the Palestinian Legislative Council and with the support of civil society organisations and the international donor community. The aim is to secure the capacity of the public sector to shoulder its duties in safeguarding the Palestinian national project, assuring security and justice for the citizens, and providing the necessary legal and administrative framework to boost private sector-led development. Reform is also necessary to decrease the size of the governmental sector and increase its effectiveness in meeting citizens' needs with public services and goods.

b) Shrinking Resource Base

The West Bank and Gaza Strip are anyway considered poor in natural resources, with regard to geographical size, richness of soil, availability of water, and endowment of mineral resources. The colonial nature of the Israeli occupation, made explicit by its settlement policies, has put down tremendous restrictions on the Palestinian people's use of these natural resources, particularly land and water. Appendix 2 shows a summary of Palestinian natural resources in the West Bank and Gaza Strip.

c) Accumulated Structural Distortions and Dependency on the Israeli Economy

The policies pursued by Israeli occupation authorities resulted in the accumulation of structural distortions in the Palestinian economy. Most salient among them are the weakness of infrastructure and the formation of a resource gap resulting from the fact that private consumption has become higher than the gross domestic product (GDP).

The Palestinian dependence on the Israeli economy is another structural deformation which is clearly illustrated by the Israeli dominance of Palestinian trade exchanges. In 2002, Israel was the source of 75% of Palestinian commodity imports⁸. It is also estimated that more than 90% of commodity exports are destined to the Israeli market⁹. Furthermore, a large number of Palestinian workers depend on employment in Israel. Almost one-fourth of the Palestinian labour force was employed in Israel and the settlements before the Intifada, but the number has dropped gradually to about 10% in 2005¹⁰. This dependency has weakened the link between labour productivity and wages in the Palestinian economy, as well as the relationship between production and consumption. It has also contributed to the lack of industrial diversity, the prevalence of traditional industries over modern and high-tech enterprises, and the shortage of supportive technical know-how and research and development needed to meet the needs of the business sector. The main structural deformations of the Palestinian economy are described in further detail in Appendix 3.

Concerted efforts were exerted during the period 1994-2000 to address these distortions, but the policies enacted by Israel since the outbreak of

⁸ PNA Ministry of Finance (2004) unpublished data.

⁹ PCBS (2004) unpublished data.

¹⁰ PCBS, Labour Force Surveys.

the second *Intifada* in 2000, including closures and the destruction of infrastructure, have undermined the few achievements realised.

d) Limited Participation of Women in Economic Activities

Women's participation in productive activities remains very low, with only about 14% of women of working age employed or actively looking for a job compared to 69% of men¹¹. The low level of female participation constitutes one of the main weaknesses of the economy, and must be addressed in order to raise the level of development and strengthen the productive base. Undoubtedly, the high level of unemployment decreases the possibilities available for women's participation. Nevertheless, it is mainly attributable to the backwardness of prevailing concepts about working women and the lack of supporting services such as childcare facilities. It is also necessary to assure equal pay for equal work and to expand education and training centres that focus on qualifying women to participate in different areas of productive activity in order to encourage them to seek employment. The UNDP's Arab Human Development Report of 2003 emphasised that increasing women's economic participation is considered one of the main goals in raising the level of economic development in Arab societies.

3.3 The External Palestinian Development Environment

3.3.1 Opportunities

a) Affiliation to the Arab Nation and its Markets

The Palestinian people are part of an ancient nation numbering over 300 million people, inhabiting a strategic geographical area linking three continents and covering around 6% of the total area of the world. In addition, the Arab world possesses the largest global reserves of oil and natural gas. It is also distinguished by being the cradle of three important religions (Judaism, Christianity and Islam) and several civilisations that contributed to the advancement of science and culture. Economically, the Arab world represents a large market, with a production value of more than US\$700 billion and annual investments of around US\$150 billion. The value of its exports exceeds US\$270 billion and its imports are worth around US\$220 billion per year. The contribution of the Palestinian economy to the Arab market is only around 0.5% of production, 0.3% of

¹¹ PCBS (2005) Labour force surveys, <http://www.pcbs.gov.ps>.

investments, 0.15% of exports and 0.37% of imports¹². All in all, the opportunities presented by Palestine's affiliation to the Arab nations constitute a major potential economic force that can be used to liberate and promote the Palestinian economy.

At present, however, the potential strengths of the Arab world are not properly reflected in its political, economic and cultural status at a global level. Nevertheless, they are not based on temporary circumstances, but on stable conditions. Thus, the possibility of exploiting these factors, to develop the role of the Arab nation economically and culturally, remains an attainable possibility. Such an effort would require an elaborated development vision coupled with a reinforced democratic process, improved governance, efficient development management, the opening-up of the Arab economies and society, and partnerships between the private sector, civil society and the government. If this can be achieved, the influence of the Arab world will increase tremendously. It will also create a powerful support base for the liberation and development of the Palestinian economy and society.

b) International Sympathy for the Palestinian Cause

There is nowadays widespread international support for the Palestinian cause and the struggle of the Palestinian people to end the occupation and to establish an independent Palestinian state with Jerusalem as its capital. The experience of the past years has proved that there is great international will to provide political, economic and moral support to the Palestinian people. In the wake of the signing of the Oslo accords the international community provided generous assistance to help the Palestinian people build their homeland and institutions. On average the Palestinian people received around US\$500 million annually during the period 1995-2000 and US\$1 billion annually after the intensified Israeli aggression which started in 2000. International sympathy and support constitute an important advantage that must be consolidated and used in the interest of Palestinian development, especially in the development of trade.

c) Preferential Trade Agreements with International Markets

The Palestinians have signed preferential trade agreements with several major economic entities over the world. In 2001 the Arab League decided to grant Palestinian products duty-free access to all its member states. This

¹² The United Arab Economic Report for 2003, Arab Monetary Fund.

decision has been partially implemented in Saudi Arabia, the United Arab Emirates, Jordan, and Yemen, and has the potential to help increase Palestinian exports to Arab markets and consequently create thousands of jobs.

Palestinian products were also granted preferential treatment in major international markets. Most important is the Interim Association Agreement between the European Community and the PLO/PNA, which granted Palestinian goods access to the European market, free of custom duties or fees and without limitations on quantity. As regards imports from Europe, some taxes and fees were kept but set to be gradually reduced and completely abolished after the fifth year of the signing of the Agreement. The Agreement, moreover, allowed the Palestinian National Authority to maintain temporary protection of some industries that both parties agreed were infant industries. It also stipulated special treatment of agricultural products that are excluded from free entry to the European market.

The United States has extended preferential conditions to Palestinian products similar to those it grants to Israeli goods. Moreover, an economic agreement with Canada provides for a mutual opening of markets to each other's goods and services, while taking into consideration the need for the PNA to protect some nascent industries. Palestine has also concluded a free trade agreement with Turkey and an economic and trade cooperation agreement with the EFTA countries (Iceland, Liechtenstein, Norway and Switzerland).

Unfortunately, the benefits to Palestine from these international and bilateral trade agreements have been limited. This is mainly due to the effects of Israeli occupation measures, including total border control and closure policies, which further complicates an already challenging transition towards trade liberalisation and competitiveness.

d) Globalisation

Despite differences of opinion regarding the effect of globalisation on developing countries, the accompanying IT and communications revolution, the transparency of international relations, and the increase in cultural exchanges provide a more appropriate environment than ever for promoting the Palestinian national project. The revolution in communications and information has revealed the ugly face of the occupation, including the denial of the basic rights of Palestinians to self-determination and development. The benefits of increased information flows are not reaped without effort, however. There is a heavy

responsibility on our shoulders to transmit reliable facts and information and to create a proper image of the Palestinian people, underlining our firm commitment, by words and deeds, to universal human values.

3.3.2 Challenges and Threats

a) Israeli Control over Keys to Palestinian Economic Development

According to the Oslo interim agreements, Israel maintained control over 60% of the West Bank and the Gaza Strip and over international border crossings with Jordan and Egypt. It also maintained the possibility of isolating Palestinian communities from each other and the rest of the world, by applying closure policies to undermine Palestinian internal and external trade and to paralyse the movement of citizens with the aim of weakening economic activity.

Moreover, Israel has undermined the development of legislation and the rule of law, and prevented or delayed the construction of infrastructure such as the seaport, airport, road networks, wells, electricity generating systems, IT and telecommunications projects, and the safe passage between the West Bank and the Gaza Strip. The Israeli government has also destroyed existing facilities and establishments during the last four years through military action.

b) Unilateral Israeli Measures: The Separation Wall and Gaza Disengagement Plan

The Israeli government's unilateral plan, exemplified by the Separation and Annexation Wall in the West Bank and the disengagement from the Gaza Strip, represents a dangerous escalation of the aggression against the Palestinian people and the violation of their rights to land, water and other assets. The plan aims to decrease the costs of occupation, politically and economically, by confining the Palestinians to isolated communities which are easier to control. It also allows Israel to dominate the resources of the Palestinian people for purposes of Jewish settlement, thus squeezing the means of livelihood of Palestinian citizens, instilling despair and pushing them to emigrate from their homeland.

While the Separation Wall will never fulfil the Israeli government's objective of forcing the Palestinian people to leave their homeland, it will worsen the living conditions of the Palestinians and harm their quality of life. It will also further undermine the investment climate and create a state of economic depression accompanied by high rates of unemployment and

poverty. As regards the disengagement plan for the Gaza Strip, its threat is centred around Israel's desire to avoid responsibility for the development of the small, over-crowded and resource-poor Gaza Strip while retaining control over its borders and strengthening its hold of the West Bank.

c) Lack of Involvement by the US Administration in the Middle East Peace Process

The events of the 11th September 2001 led to the emergence of a neoconservative political current in the United States, setting American policy on the path of military adventures to assure US domination over energy sources. This policy coincided with increased political and economic support for the Israeli occupation and the weakening of its role in the peace process. This allowed Israel to resume the use of military force. The continued adherence by the American administration to such a course will enable the Israeli government to continue its aggression and settlement construction, thereby undermining every possibility of returning to the path of negotiations.

d) Danger of Declining International Assistance

It is evident that the Israeli occupation of the West Bank and Gaza Strip will eventually lead to a decline in international aid, as the occupation authorities are required by international law to carry the responsibility for development activities and the welfare of Palestinian citizens under occupation, according to the Fourth Geneva Convention¹³. The donor states will not want to appear to shoulder this responsibility. However, this will not close the door on humanitarian aid through UNRWA and other international organisations. In a scenario of reduced aid flows, it is probable that the role of Arab assistance in consolidating Palestinian steadfastness will increase to compensate for the decline in international aid. The not-improbable threat of declining international assistance calls for finding new cooperation mechanisms and strategies that enable the Palestinians to face future challenges.

e) Collapse of the Palestinian National Authority's Institutions

The threat of a collapse of the Palestinian National Authority affects the Palestinian national project in general and the development process in particular. Indeed, it will be difficult for the PNA to remain functional if

¹³ Convention (IV) relative to the Protection of Civilian Persons in Time of War. Geneva, 12 August 1949.

Israel retains its occupation of the West Bank and Gaza Strip and continues to violate agreements concluded with the Palestinian Liberation Organization. The continued inability of the PNA to exercise the powers vested in it and to perform its duties will eventually lead to a loss of its credibility and *raison d'être*. The difficulties of collecting public revenue may further increase, to a degree where it becomes impossible for the PNA to cover the expenses of its institutions and public service provision. The problems linked to a collapse of the Palestinian National Authority include, in addition to an interruption of public order and vital services, the laying off of tens of thousands of officials currently employed in the public sector.

3.4 Towards a Palestinian Development Vision

The analysis of the internal and external development environment clearly reveals the current challenges facing the Palestinian people in their ongoing struggle to mobilise resources to achieve political independence from the 38-year-long Israeli occupation. This is at a time when the freedom struggle is complicated by the US Administration's backing of the Israeli Government's policies, the inability of the United Nations to enforce its resolutions, the weakness of the Arab World, and the weakness of the Israeli peace camp. Consequently, Palestinian resources have to be divided between efforts to achieve political independence and in meeting the growing needs of Palestinian society for social security and law enforcement. The Palestinian National Authority is also required to provide educational and health services, address the problem of unemployment and poverty, and assure a competitive business environment to encourage private investment and develop exports.

The analysis of the socio-economic development environment also reveals that, despite accumulated distortions in the socio-economic structure due to years of occupation, the Palestinian people possess important and firmly-established points of strength which can be depended on to confront the challenges of occupation and development. However, success requires that the Palestinian people focus all their resources and efforts in strategic areas, to assure that they are most effectively invested. This is why it is absolutely essential that the key stakeholders in Palestinian development unite around a clear development vision, in order to unify their main economic and social objectives and implementation strategies. The development vision should also conform to the political vision defined in accordance with the Palestinian people's legal points of reference, as represented by the resolutions of the Palestinian National Council.

3.4.1 The Development Vision

The Declaration of Independence by the Palestinian National Council on the 15th November 1988 states that:

“...by virtue of natural, historical and legal rights (...) and relying on the authority bestowed by international legitimacy as embodied in the Resolutions of the United Nations Organization since 1947 (...) the Palestinian National Council hereby proclaims the establishment of the State of Palestine on our Palestinian territory with its capital Jerusalem. The State of Palestine is the state of Palestinians wherever they may be. The state is for them to enjoy in it their collective national and cultural identity, theirs to pursue in it a complete equality of rights. In it will be safeguarded their political and religious convictions and their human dignity by means of a parliamentary democratic system (...) Governance will be based on principles of social justice, equality and non-discrimination in public rights of men or women, on grounds of race, religion, colour or sex, under the aegis of a constitution which ensures the rule of law and an independent judiciary. Thus shall these principles allow no departure from Palestine’s age-old spiritual and civilizational heritage of tolerance and religious coexistence. The State of Palestine is an Arab state, an integral and indivisible part of the Arab nation...”

The Declaration sets the political framework in which our development vision is defined. We also find clear references to the identity of the desired economy in documents produced by the Palestine Liberation Organization and the National Authority. Based on these documents, we have formulated an economic and social development vision attempting to outline the desired features of the Palestinian economy in the future. The development vision can be summarised as follows:

The State of Palestine is an independent, sovereign Arab state in the West Bank and Gaza Strip, within pre-June-1967 boundaries and with East Jerusalem as its capital. It has a modern economy, with human capital as its main asset and driving force. The state is capable of employing human capital in different economic sectors, accumulating skills and capacities to raise the productivity, quality and competitiveness of production, and establishing a firm basis for long-term development towards a knowledge-based and sustainable economy. The private sector plays the leading role in a competitive business environment and an economy integrated into the Arab world and open to regional and international markets. It is a state which achieves real gender equality and strengthens women’s economic and societal participation on an equal basis with men. Its social capital is the unity and solidarity of Palestinian society, which is a source for adherence to an Arab-Palestinian identity and culture, human values and religious tolerance.

This vision is derived from the most salient features of the Palestinian economic and social reality with its different dimensions. It needs to be adopted by all development partners in order to direct resources and efforts towards developing Palestinian human and social capital as a means to build an economy capable of putting an end to Israeli economic domination and setting itself on the path of sustainable development. The development vision is based on the following factors and points of departure:

- ✧ Development experience indicates that human capital is one of the main contributors in achieving high rates of growth and in bridging the gap between the developing world and industrial countries. In today's global trend towards knowledge-driven economic structures, human capital makes a vital contribution to productivity growth and technological progress. It has been estimated for OECD countries that human capital accounted for, on average, 22% of productivity growth in the period 1960-90 and for 45% of the productivity differential with the sample average in 1990. Around two thirds of these figures show the direct impact of schooling on the level of productivity, while the remaining third reflects its contribution to technological progress¹⁴. The economic impact of human capital is also visible at the micro-economic level, in the positive relationship between school achievement and individual income¹⁵. In addition to economic benefits, human capital produces social gains in areas such as health and personal well-being, social cohesion and governance. Palestine should benefit from the international development experience of the last decades and emphasise the crucial importance of investment in the human being as the most important lever of development.
- ✧ Investment in human capital is in conformity with the traditional attention paid by Palestinian families to education, putting children's schooling at the top of family spending priorities. Indicators of school enrolment, at all levels, show that Palestine has a relatively solid human capital base, achieved through long years of investment in human beings inside Palestine and in Palestinian communities abroad¹⁶. This constitutes the starting point of development towards a

¹⁴ De la Fuente & Ciccone (2003) *Human Capital in a Global and Knowledge-Based Economy*, <http://pareto.uab.es/wp/2003/56203.pdf>.

¹⁵ Ibid.

¹⁶ According to the PCBS (2005) gross enrolment in basic education decreased from 97% in 2000/2001 to 93% in 2004/2005. Gross enrolment in secondary education, however, increased from 58% to 72% in the same period. Girl's enrolment rates were higher than those of boys. As for tertiary education, the World Bank reports an increase in enrolment rates from 10% in 1995 to almost 17% in 1999 and more than 23% in 2003 – above the average for Arab states.

knowledge-based economy and production structure in Palestine. In the UNDP Education Index, based on literacy and gross enrolment in primary, secondary and tertiary education, the Palestinian Territories has a value of 0.86 compared to an average level of 0.61 for Arab States, 0.84 for Middle Income Countries, and 0.76 for the world¹⁷.

- ✧ High levels of social capital have played a decisive role in preventing the disintegration of the Palestinian society in the face of extremely difficult economic and political circumstances. The adherence to moral values, solidarity, collective social care, and participation in civil society organisations have buttressed Palestinian society against the burdens of occupation and strengthened the steadfastness of citizens. The World Bank, in one of its assessment reports of the *Intifada*, highlights the social cohesion and resilience characterising Palestinian society: “*Despite violence, economic hardship and the daily frustrations of living under curfew and closure, lending and sharing are widespread and families for the most part remain functioning. (...) The West Bank and Gaza has absorbed levels of unemployment that would have torn the social fabric in many other societies.*”¹⁸
- ✧ Investing in human capital and safeguarding social capital are emphasised in the vision as the main Palestinian development objectives. Development activities should focus on them to build a sound foundation for sustainable economic and social development .

3.4.2 The Kind of Economy Desired by Palestinians

There is general agreement among Palestinians that the private sector should play a leading role in economic development, supported by a modern and efficient framework of public institutions. The state is expected to use its economic and institutional capacity to direct development activities and create an enabling and competitive environment to encourage investment, ensuring the rule of law, collective social responsibility, and a fair distribution of the fruits of development on both the social and geographic level. The Palestinian economy should be integrated into other Arab economies and open to international markets, building strong partnerships with Arab and other foreign investors.

¹⁷ UNDP, Human Development Report 2004, <http://hdr.undp.org>, accessed 27.07.2005.

¹⁸ World Bank (2003) *Twenty-Seven Months – Intifada, Closures and Palestinian Economic Crisis: An Assessment*, p. xiii.

3.4.3 The Structure of the Desired Economy

Based on the SWOT analysis in chapters 6 and 7, human resources were identified as the single most important asset to the Palestinian economy. The future strategy for economic development in the West Bank and Gaza Strip should therefore focus on promoting knowledge-intensive sectors and activities. Knowledge-based activities and companies exist across all industrial sectors and comprise the high value-added areas that rely on the innovative skills and knowledge of a highly-educated workforce. Therefore, the transition towards a sustainable knowledge economy has to focus on the following two fields of economic activity:

- ✧ Developing knowledge-intensive, high value-added activities within traditional industries.
- ✧ Promoting the introduction of new, dynamic and knowledge-intensive industries.

The major policy topic related to building a knowledge economy concerns the development of human capital, or the “*knowledge, skills, competencies and attributes embodied in individuals which facilitate personal, social and economic well-being*”¹⁹.

Realising our vision of creating a knowledge-rich economy will require gradual transformations of the economic structure towards producing goods and services with a higher knowledge content and a clear comparative advantage. This will lead to the creation of new jobs and increased absorption of the scientific qualifications and professional skills of Palestinian human resources, particularly by sectors in which Palestine has actual and potential comparative advantages.

The economist Michael Porter discusses the concept of national competitiveness in his classic work ‘The Competitive Advantage of Nations’ stating that ‘*a nation’s standard of living in the long term depends on its ability to attain a high and rising level of productivity in the industries in which its firms compete*’²⁰. As mentioned above, the vision outlined in this paper suggests that Palestine should enhance the proportion of exports and general economic activities that compete on the basis of superior knowledge and skills, rather than relying on traditional commodities. This requires an analysis of existing resources and

¹⁹ Human capital as defined by the High-Level Group on the Employment and Social Dimension of the Information Society (ESDIS).

²⁰ Porter, M. (1998) *The Competitive Advantage of Nations*, p. 2.

characteristics in Palestine that can be used to develop comparative advantages in knowledge-intensive industries.

Building on the strengths outlined in chapter 6, and particularly the potential of Palestinian human capital²¹, certain sectors can be identified as presenting a potential comparative advantage in Palestine. De Castro and Jensen-Butler (2004) identify potential new and dynamic industries including clusters of financial services, ICT-based services (particularly services directed at the Arab World and services requiring linguistic interfaces) and other consultancy services. They also discuss the potential for developing high value-added activities within traditional industries, focusing on labour-intensive, design-intensive, high-quality goods, involving elements like strong product innovation, marketing and technological capacity and relatively inexpensive factors of production. Palestinian sectors with such potential include furniture, textiles and clothing, footwear, jewellery, certain food products and tourism- and culture-related industries. Finally, the Palestinian higher education sector can be developed to attract students from the Arab World²².

3.5 Main Development Objectives and Strategies

Development objectives and strategies are designed to reinforce points of strength, remedy points of weakness, take advantage of opportunities and confront challenges and threats in the Palestinian development environment. The Palestinian context is characterised by a linkage between national liberation tasks on the one hand, and democracy-building and development on the other hand. This means that national political goals are intertwined with the objectives of economic development. It is therefore natural that development efforts should assist the national liberation process in the pre-independence stage, while thereafter being directed at achieving sustainable development. In the following sections we define a set of strategic objectives for each of these stages, in addition to listing some strategies that need to be immediately implemented to promote both short- and long-term development objectives.

²¹ These areas of potential include the relatively high level of general education, equal education levels for men and women, good language skills, strong entrepreneurial capacity etc.

²² De Castro, E.A. & Jensen-Butler, C. (2004) 'Strategies for economic development, the role of Gaza and the future of the refugee camps' in Cobham, D. & Kanafani, N. (eds) *The Economics of Palestine*, Routledge.

3.5.1 Short-Term Development Objectives: Prior to Liberation and Independence

- ✧ Support the struggle to end the Israeli occupation and prepare for independence through building the political, cultural, economic and social capacities of the Palestinian people.
- ✧ Protect the Palestinian National Authority from disintegration and ensure that it continues to provide vital public services.
- ✧ Work to remove distortions in the economic and social structure.
- ✧ Develop human capital and strengthen social capital.
- ✧ Address unemployment and poverty, and prevent the emigration of the labour force, especially skilled workers, by creating jobs and developing administrative and technical qualifications that will be needed to build a modern Palestinian economy after independence.

3.5.2 Long-Term Development Objectives: Post-Independence

- ✧ Complete the process of transforming the Palestinian National Authority into a state governed by a solid legal framework and efficient, competent and transparent institutions.
- ✧ Complete the removal of structural distortions in the economy and society.
- ✧ Develop a socio-economic structure drawing on the unique Palestinian resource endowment to build national competitiveness in knowledge and modern technology.
- ✧ Continue to develop Palestinian human capital in a manner that can realise the development vision of building a knowledge-based Palestinian economy.
- ✧ Improve the investment climate to encourage private sector activity and attract local and foreign investors.
- ✧ Integrate the Palestinian economy into the regional Arab economies and make the utmost use of their sizeable resources.
- ✧ Increase trade and economic cooperation with other international markets to reap the benefits of globalisation.

3.5.3 Development Strategies: Current Priorities

- ✧ Link short-term development efforts with long-term objectives, so as to direct interventions to improving economic growth and efficiency, creating an appropriate legal and institutional framework, and preparing for the economic transition towards sustainable development after independence.

- ✧ Invest in all levels of education, especially in primary education²³, as well as in scientific research and culture, focusing on quality, efficiency and productivity to generate Palestinian human resources capable of participating in the knowledge economy.
- ✧ Develop an investment climate that is appropriate for attracting local and foreign investors and for enabling the private sector to perform a leading role in economic development.
- ✧ Continue the process of reform of the Palestinian National Authority, improving the efficiency of the governmental sector and enabling it to play an effective role in the management of development.
- ✧ Consolidate the partnership between the PNA, the private sector and civil society to expedite the implementation of the development vision, following up the advancement of policies, plans and programmes, and coordinating the division of labour.

3.6 The Role of the State in Implementing the Development Vision

Once there is a consensus among development partners (the PNA, the private sector and civil society) about a development vision, its realisation will require conscious action – planned by, and continuously coordinated among, all stakeholders. Here, the state has to take on the main responsibility of safeguarding the vision by specifying and directing the development activities. It also has to work as a catalyst to stimulate the private sector and mobilise Palestinian civil society.

The actions required to influence the behaviour of variables in the economic structure need to be taken within an institutional and legal framework, preferably through the use of economic policies and not by administrative means or diktats. Based on the administrative, legislative and judicial powers vested in the state, and the tremendous economic capabilities at its disposal through the public budget and other means, the state can use different policies to influence the behaviour of society's units, i.e. companies, individuals and institutions. The policy tools at the disposal of the state include economic policies – fiscal and monetary policies, including production and distribution of public goods, trade policy, industrial policy, agricultural policy, tourism policy and others –

²³ Psacharapoulous (1994) argues that rates of return from investment in education are particularly high at the primary level, and especially in less developed countries. This suggests that primary education, in most circumstances, deserves priority in the allocation of resources. (For more details see Psacharapoulous, G. (1994) 'Returns to Investment in Education: A Global Update', *World Development* 22(9):1325-43.)

and social policies, related to education, health, gender etc. These tools should be used in a coordinated manner to guarantee the attainment of development objectives. If public policies are not synchronised they will lead to clashes and contradictions in the directions of their influence.

To ensure a coordinated use of policies, the state needs to elaborate specific development strategies to guarantee reaching the expected objectives. It is vital that the state not be satisfied by achieving coordination of its own institutions and policies, but involve all concerned partners in the private sector and civil society in the formulation of policies and their implementation. This will test the ability of the state efficiently to mobilise and allocate resources to achieve the objectives outlined in the development vision, which must be supported by all development partners in all sectors.

Appendices

Appendix 1: Education Indicators in the Palestinian Territories

Appendix 2: Palestinian Natural Resources

**Appendix 3: Structural Distortions in the Palestinian Economy
Resulting from the Israeli Occupation**

Appendix 1: Education Indicators in the Palestinian Territories

Following are some indicators reflecting the development of education at different levels during the past decade:

- ✧ Illiteracy in the Palestinian Territories is declining steadily, despite the surge in violence in 2000. The illiteracy rate among the Palestinian population aged 15 years or more was 7.7% in 2004, compared to 10.8% in 2000 and 15.7% in 1995²⁴.
- ✧ The total number of schools and kindergartens increased from 1,910 in the 1994/1995 school year to 2,646 in 2000/2001 and 3,093 in 2004/2005. The schools were distributed according to supervising authority as follows: 1,661 government schools, 273 UNRWA schools and 258 private schools²⁵.
- ✧ The number of students in schools and kindergartens was 1,117,054 in 2004/2005, divided almost equally between males and females, compared to 1,045,622 during 2000/2001 school year, a 6.8% increase²⁶.
- ✧ The drop-out rate was 0.7% at the basic (elementary) level and 3.0% at the secondary level during the 2004/2005 school year, the latter declining from 3.7% in 2003/2004.
- ✧ Data concerning the number of tertiary educational institutions during 2003/2004 indicate the existence of 11 universities and 9 colleges granting B.A. degrees. Eight of the universities and 6 of the colleges are located in the West Bank, and 3 universities and 3 colleges are in the Gaza Strip. Community social science colleges numbered 20, 16 of them in the West Bank and 4 in the Gaza Strip²⁷.
- ✧ The number of students enrolled in Palestinian universities and colleges increased by 313% between 1994/1995-2003/2004, from 29,507 to 121,886, equally distributed between men and women²⁸.
- ✧ Statistics of 2002/2003 indicate that the percentage of students enrolled in pure science faculties, including the Faculties of Science, Medical Professions, Agriculture, Architecture, and Information Technology, was 25.3% of the total number of students enrolled in

²⁴ Palestinian Central Bureau of Statistics (2005) Education Indicators, <http://www.pcbs.gov.ps>.

²⁵ Ibid.

²⁶ Ibid.

²⁷ Ibid.

²⁸ PNA Ministry of Education and Higher Education (2005) *Palestinian Higher Education Statistics 2004*, <http://www.moehe.gov.ps>.

higher education institutions. Meanwhile, 22.5% of students enrolled in the Faculty of Economics and Business Administration²⁹. The Strategic Plan for Palestinian Higher Education aims at raising these percentages.

²⁹ Palestine Economic Policy Research Institute (MAS) (2004), Al-Ja'fari, M. & Lafi, D., *Matching Higher Education Graduates with Market Needs in the West Bank and Gaza Strip*, Ramallah.

Appendix 2: Palestinian Natural Resources

Land

The area of the West Bank and Gaza Strip amounts to 6,020 square kilometres, or 22% of the area of historical Palestine. Since 1967, Israel has used a set of complex bureaucratic mechanisms to expropriate up to 79% of the WBGS territory. Of these areas, 44% were confiscated for 'military purposes', 20% for 'security reasons', 12% for 'public use', and 12% as absentee property³⁰. After the Israeli disengagement from the Gaza Strip in August 2005, the Palestinians gained control of this land area, but Israel still retains control over all external borders, including the airspace and coastline. As for the West Bank, a series of bilateral agreements between Israel and the Palestinian National Authority stipulate full Palestinian jurisdiction over a limited area of the West Bank (Area A), and civil jurisdiction over another part (Areas B). After the Sharm El-Sheikh agreement in 1999, the Areas A and B constituted 41% of the West Bank and Gaza Strip, while Area C, which remained under Israeli control, make up around 59% of the area³¹.

Most of the land confiscated by Israel was used to establish settlements and to create land reserves for the future expansion of the settlements. In 2004, the Palestinian Central Bureau of Statistics counted 172 'formal' Israeli settlements – 155 in the West Bank and 17 in the Gaza Strip – in addition to 170 other settlement sites and outposts. The settlements were inhabited by 440 thousand Israeli settlers³², which is equal to 12% of the Palestinian population in the West Bank (including Jerusalem) and Gaza Strip. As a result of the Gaza Disengagement, all 17 settlements in the Gaza Strip (populated by approximately 8,000 settlers) were evacuated, as well as four settlements in the West Bank.

The built-up area of settlements in the West Bank covers approximately 155 square kilometres. In comparison, 54 square kilometres of Palestinian built-up land in the Gaza Strip are inhabited by 1.4 million Palestinians³³. Added to the built-up area in the settlements is the settlers' road network,

³⁰ PASSIA (2004) 'Land and Settlements' in *Agenda 2005*, Jerusalem.

³¹ Ibid.

³² PCBS (2004) Statistical Reports on Israeli Settlements in the Palestinian Territory, <http://www.pcbs.gov.ps>.

³³ PCBS (2005) Land Use statistics 2004.

which has fragmented the West Bank and hinders travel and commerce between Palestinian towns and villages.

In mid-2002 Israel started the construction of a Separation Wall in the West Bank, cutting across Palestinian land and dividing and isolating Palestinian communities. Since then, large areas of land have been confiscated, trees uprooted and buildings demolished to create space for the Wall. The Wall has also cut off communities from their lands, friends and relatives, jobs, schools, health clinics and other public services. Israel has planned the path of the Wall so that important water resources and the maximum number of settlements end up west of it, while Palestinian communities are imprisoned behind the Wall. The total route of the Wall, existing and planned, stretches over 681 kilometres³⁴ and cuts deep into the West Bank by up to 20 km from the 1967 borders. As is shown in the table below, at least 9.5% of the total area of the West Bank will end up west of the Wall.

Area cut off or surrounded by the Separation Wall

	Area (km ²)	Percentage of West Bank
Area west of the Wall, including Ariel, Ma'aleh Adumim and East Jerusalem	536.2	9.5%
Area west of segments of the Wall requiring further approval	205.4	3.7%
Area of Palestinian towns and villages east of the Wall that are completely or partially surrounded	160.5	2.9%

Source: B'Tselem (2005) The Separation Barrier: Statistics, <http://www.btselem.org>.

On 9th July 2004 the International Court of Justice (ICJ) in The Hague issued an Advisory Opinion on the Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory. The ruling states that the Wall is contrary to international law, that it must be dismantled, and that Israel is under an obligation to make reparation for all damage caused by its construction³⁵.

³⁴ B'Tselem (2005) The Separation Barrier: Statistics, <http://www.btselem.org>.

³⁵ International Court of Justice (2004) *Advisory Opinion on the Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, 9th July 2004, The Hague.

Water Resources

The Palestinian use of water resources in the West Bank and Gaza Strip is strictly controlled by the Israeli authorities, which divert up to 85% of Palestinian groundwater resources for Israeli use³⁶. The daily average per capita consumption is estimated at 65 litres for domestic use (compared to the 100 litres/day/capita recommended by the WHO), while the gross per capita water supply has increased to 106 litres per day³⁷. This disparity is due to the high level of leakages and system losses resulting from the poor quality of the supply network.

The restrictions on Palestinian water use do not take into consideration the minimum requirements for population growth, nor the agricultural and industrial needs of the Palestinian people. This has resulted in the deterioration of the quality of life and the environment, including the drying up of large areas of agricultural land, especially citrus orchards. In the Gaza Strip, water is over-pumped from the aquifer which has caused seawater intrusion. The salinity of many wells renders the water unfit for human consumption or even for irrigation.

Other Natural Resources

The Palestinian Territories are considered poor in natural resources except for the Dead Sea salts and minerals, which represent a unique natural wealth. This resource, however, is not available to the Palestinians since Israel controls all exploitation rights. The West Bank also possesses huge amounts of good-quality marble, and exploration indicates the existence of commercial quantities of natural gas off Gaza's coastline.

³⁶ Palestinian Hydrology Group (2004) *Water for life*.

³⁷ World Bank, *West Bank and Gaza Update*, November 2004.

Appendix 3:

Structural Distortions in the Palestinian Economy Resulting from the Israeli Occupation

In this appendix we describe the main structural distortions in the Palestinian economy and how they affect present and future development. We will not, however, focus on how they emerged and developed.

1. Weakness of Infrastructure

Palestinian infrastructure suffered severe neglect and underinvestment from 1967 and until the creation of the Palestinian National Authority in 1994. Despite the fact that the occupation authorities collected tax revenues, estimated at 20% of the Gross Domestic Product (GDP) annually, spending on infrastructure did not exceed 1% of GDP per year. After the establishment of the Palestinian National Authority some international donors, especially the European Union, the World Bank, and United Nations development agencies, led a campaign to reconstruct different areas of the infrastructure, including physical infrastructure such as roads, energy, water, sewerage, and solid waste systems. The intervention also focussed on social infrastructure such as schools, training centres, health care establishments and social welfare institutions. Despite the fact that around US\$200 million was invested annually in those facilities during the period 1995-2000³⁸, the quality and quantity of infrastructure have not progressed to the required level and still need substantial investment to reach the level of other countries in the region.

Among the important decisions taken by the PNA was the one to privatise the communications sector and electricity generation. The Palestinian Communications Company was able to develop its services significantly before the outbreak of the *Intifada* in 2000. As for the Palestine Electricity Company, it was established in 2000 in the Gaza Strip and built Palestine's first power station with an electricity generation capacity of 140 megawatt. It started operating in 2003 under extremely challenging conditions, especially to the difficulty of supplying the station with gas.

2. Chronic Investment Gap

Data on Palestinian national accounts indicate that net consumption always exceeds the Gross Domestic Product. This means that the income

³⁸ The Palestinian Economic Council for Development and Reconstruction (PECDAR)

generated by the local economy is not sufficient to meet consumption needs. As a result, the state is obliged to turn abroad to secure loans or obtain aid to fund investments. Before 2000, net factor transfers from abroad used to cover a large part of the investment gap. However, after Israel closed its market to Palestinian workers, foreign aid became the main source for bridging the gap. It is necessary to find an alternative for this temporary source, since foreign assistance cannot continue indefinitely.

3. Israeli Monopoly over Palestinian Foreign Trade

In the wake of the 1967 occupation, Israel imposed a unilateral asymmetric customs union on the Palestinian territories. While Israeli goods enjoyed complete freedom of entry to the Palestinian market, administrative restrictions and other non-tariff trade barriers were imposed on Palestinian goods entering the Israeli market and third countries. On the eve of the signing of the Oslo Accords, the bulk of Palestinian foreign trade was with Israeli companies. Non-compliance by Israel with the Paris Protocol on economic relations between Israel and the Palestinians, and its arbitrary use of security justifications and closure policies, has prevented the expansion and diversification of Palestinian foreign trade. In 2002, Israel was the source of 75% of Palestinian commodity imports³⁹. It is also estimated that more than 90% of commodity exports are destined for the Israeli market⁴⁰.

4. Strong Dependence on Israeli Labour Market

The anti-development policies applied by the occupation authorities aiming to restrict Palestinian economic growth have weakened the ability of the economy to create enough jobs to absorb the increase in the labour force. Consequently, increasing numbers of workers were forced to search for jobs outside the Palestinian economy. Many university graduates emigrated to the Arab oil-rich states, while other workers were obliged to seek employment in the Israeli market. This led to a situation where up to one third of the Palestinian work force was dependent on the Israeli market, as was the case during 1991-1992. That situation continued after the creation of the Palestinian National Authority, despite the application by Israel since 1993 of new measures to limit the number of Palestinian workers in its market. On the eve of the outbreak of the second Intifada in

³⁹ PNA Ministry of Finance (2004) unpublished data.

⁴⁰ PCBS (2004) unpublished data.

September 2000, 146,000 Palestinian workers (about 22% of the labour force) were employed in Israel and the settlements⁴¹. Due to closure policies adopted during the *Intifada*, however, this number has declined to around 10% of the labour force in 2005.

5. Weak Relationship between Labour Productivity and Wages

The strong dependence of the Palestinian labour force on the Israel market led to high wage levels in the Palestinian economy, as workers received higher wages in Israel than in the occupied territories. This led to an increase in real wages in the Palestinian territories regardless of productivity levels. Consequently, an imbalance in the behaviour of economic variables was created, which greatly affected profits, the competitiveness of Palestinian goods, and economic growth in general. The weakening of the relation between productivity and wages led to increased production costs, one of the main reasons for the lack of competitiveness of Palestinian products in relation to the products of neighbouring states. It also constitutes an important obstacle to expanding Palestinian-Arab commercial exchanges. Hence, reduced employment possibilities for Palestinian workers in Israel, despite the negative short-term impact on the Palestinian economy, constitute an important opportunity to return to normal relations between wages and productivity and improve the competitiveness of Palestinian products.

6. Weak Relationship between Production and Consumption

The imposition by Israel of a unilateral customs union transformed the Palestinian economy into a free market for Israeli companies. Israeli supply and demand became the main elements of influence over production and consumption decisions in the Palestinian market. This, in turn, led to the increased production of goods demanded by Israel and shrank the production of goods that clashed with competition by Israeli companies. As a result, the structure of the Palestinian economy was rebuilt in a manner that weakened the forward and backward linkages between different sectors and the various branches within the same sector. At the same time, the new conditions allowed for interdependence and relationships between Palestinian and Israeli companies through trade and sub-contracting.

⁴¹ IMF (2003) *Economic performance and reform under conflict conditions*, <http://www.imf.org>.

7. Weak Industrial Diversity and Dominance of Traditional Industries

Inappropriate conditions for development limited industrial diversification and delayed the emergence of new and dynamic industries. It also slowed down the modernisation of production technologies, which consequently led to lower quality, increased production costs, and an inability to develop competitiveness in relation to other states.

8. Shortage of Research & Development and Business Support

Palestinian private sector companies in general, and industrial firms in particular, lack basic services to help them enter the international market. Such services include assistance to expand research and development (R&D) and develop new products, to adapt products to international specifications and standards, to open new markets, to secure financing, to participate in international exhibitions, to develop promotion activities etc. Some services are available, but only to a very limited extent. For example, the resources available to the Palestine Trade Center (PalTrade) only enable it to organise a small number of activities to promote Palestinian products in targeted export markets. There is also a severe shortage in the R&D services needed to supply industry with new ideas and designs to help raise the quality and competitiveness of their products.