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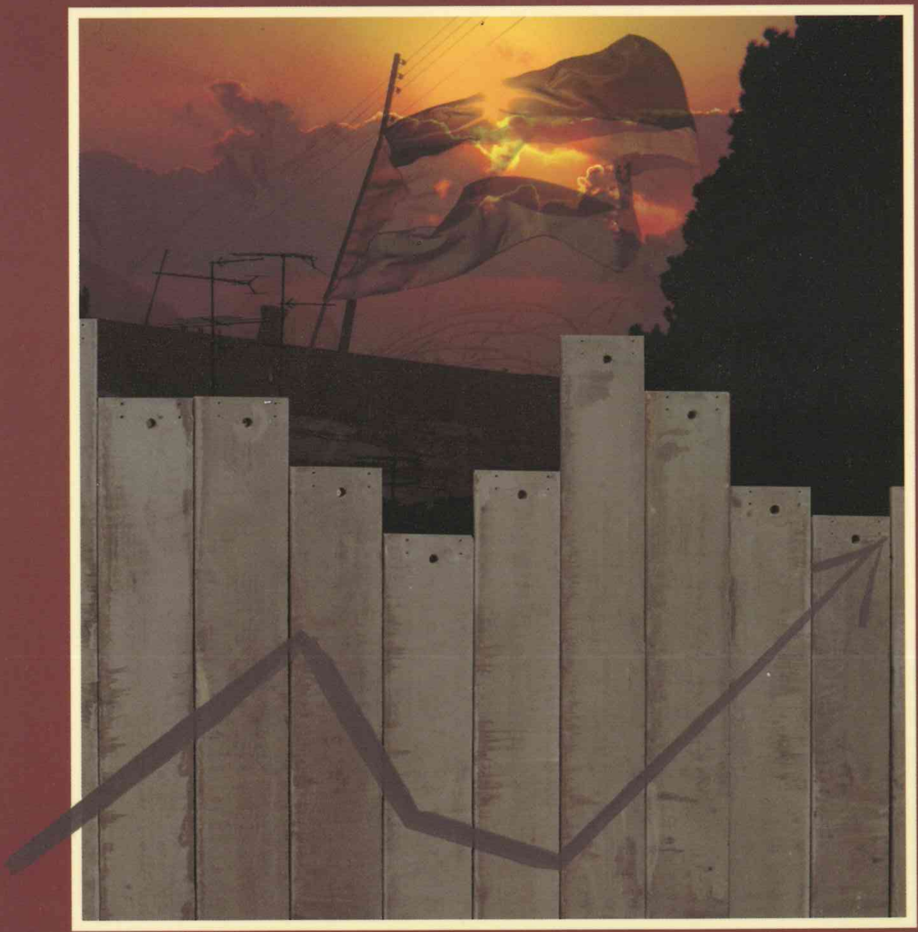
Palestinian Economy: Forty Years Of Occupation... Forty Years Of Arrested Development



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THE PALESTINIAN ARAB REGIONAL ECONOMY IN ISRAEL SIXTY YEARS OF DE-DEVELOPMENT … AND OCCUPATION?

Raja Khalidi
UNCTAD- Geneva

1. Why Palestinians in Israel?

A conference on the impact of forty years of Israeli occupation of the West Bank and Gaza Strip on the de-development of the Palestinian economy would be amiss if it ignored the wider historical and comparative contexts that are relevant to understanding the strategic implications of the conditions faced today. So it is apt that MAS has included the current topic subject in the conference, but in eventually publishing its proceedings its title might be usefully re-formulated as "Sixty years of occupation and the de-development of the Palestinian Arab economy". After all, Israeli military occupation and colonization of Palestinian territories after 1967 was an enhanced version of the more crude system in place in Arab areas in Israel from 1948-1966, itself a replica of the Mandatory 1945 military regulations that governed the dying days of the British Empire in Palestine.

The purpose of this paper is not only to provide a needed comparative context for understanding the last forty years in the context of the last sixty years (if not the last century). Certainly other comparative frameworks might be equally instructive in analyzing the prospects for Palestinian economic development, such as those deriving from conflict situations or nation building processes. However, the experience of Palestinian Arabs in Israel and the economic impact on them of six decades of Israeli policies of isolation, dispossession and discrimination, driven by the Zionist movement's imperative of Jewish state-building in Palestine, provide a relevant and immediate framework from which to draw lessons for the economy of the territories occupied by Israel in 1967.

Equally, this research effort seeks to explore a historically sound and development-friendly framework for elaborating a Palestinian national development strategy that encompasses *all* Palestinian Arab economic assets within the territory of Israel and the occupied territories - one which acts to re-balance the Arab-Jewish economic relationship along a path of equity, convergence and sustainability. While further economic analysis and monitoring is always welcome, in the case of Palestine the time to move from reflection to decision has long passed. New research and policy analysis, including the present endeavour, cannot substitute for policy leadership and action.

It is incumbent on intellectual and professional elites, not to mention those responsible for economic policy-making, to draw on the rich Palestinian and global development experience to shape truly *national* strategies, serious *development* policies and pro-active *state formation* institutional measures. These should not only measure up to the challenges of ending occupation, achieving Palestinian national rights and a just and comprehensive peace, in themselves uncertain goals in today's miserable circumstances. Nor can a repeat performance be accepted of the ill-conceived, misguided and ultimately abortive Oslo-inspired experience of attempting to assume the attributes of statehood in the absence of sovereignty.[1] Future Palestinian economic policy-action must also be grounded in a vision of social and economic justice that unifies, mobilizes and deploys the Palestinian people, and Palestinian human capital throughout the world, towards a development path worthy of a people which has long struggled for its liberty and independence.

Fortunately, in the case of the Palestinian Arab economy in Israel, empirical evidence is plentiful, covering different historical periods, sectors, trends and indicators. Additionally, this issue received intensive and extensive analytical treatment, from all ideological and disciplinary angles possible (not dissimilar the Palestinian economy in the occupied territories). So in this paper it is possible to draw upon the exhaustive data provided by the Israeli Central Bureau of Statistics since 1949 and numerous field and case studies by Israeli and Palestinian researchers. More recently, Palestinian research efforts in Israel have yielded a new database which in some areas goes further and deeper than available Israeli official statistics.

More problematic than ensuring adequate data sources is the more pertinent question of just what policy analysts should do with this wealth of information. Should the study of Palestinian Arab social and economic status in Israel remain a subset of the Israeli/Zionist settlement and state-formation experience, or instead be placed in the forefront of a Palestinian

[1] While the Palestinian institutional experience before and after Oslo could be analysed in the framework of a long-term nation-building exercise, it is arguable whether the post-Oslo process (and current "preparations for the Palestinian state" phase) was one of effective state-formation (in the economic development sense of the term) or rather one which delivered many of the attributes of a sovereign state except the actual sovereignty. This, however is not the subject of this enquiry.

national strategy for survival and development? In order to address this question in the sections that follow, I aim to encapsulate the main issues, hypotheses and evidence of Palestinian Arab economic performance in Israel in a selective and broader context, at the risk of not fully covering all relevant aspects.

This essay is premised on the observation that the Arab regional economy in Israel and the Palestinian economy in the occupied territories, all operating today within the Israeli economic system, constitute the remnants of the Arab part of the dual economy that functioned in Mandatory Palestine until 1948. Sixty years after the November 1947 United Nations Partition resolution, it seems that only its Annex on Economic Union has been realised, whereby it transformed the dual-economy model of Arab-Jewish relations in Palestine into a plan for "economic union" that has been operational since 1967, albeit in a distorted and unintended manner. This is followed by an analysis of the different theses and counter-theses advanced in research on the issue and of how Israeli and Zionist political-economy explanations for the Arab-Jewish development gap were eventually countered and effectively out-flanked by a body of mainly indigenous Palestinian Arab narratives. These dispel the myths of benevolent occupation, orientalist academic predispositions and neo-liberal economic analysis that dominated mainstream thinking on the subject for decades. Available data is then reviewed on the macro and sectoral levels to draw an accurate and up-to-date picture of the de-developed socio-economic status of Palestinian Arabs in Israel. Without making the links explicit here, this review implies a range of possible outcomes for the Palestinian economy in the West Bank and Gaza Strip (WBGS) under prolonged occupation.

This macro-view of the Palestinian Arab economies operating today within the Israeli economic orbit, forms the starting point for suggesting that the time is opportune for a new vision of a Palestinian national economic strategy that deploys a range of sub-regional economic assets and coordinated development programs. While the details of such a strategy are beyond the scope of this paper, it remains a national policy-making task that should no longer be dismissed for the reasons of political expediency imposed by the past, stage of struggle for Palestinian national self-determination, which increasingly appears to be failing to deliver on its promises.

2. The dual economy of Palestine/Israel: from Partition 1947 to Re-partition 2007

As the British Mandate in Palestine was drawing to a close in 1947, a dual economy model of Jewish-Arab economic relations had already taken root, diffused territorially and demographically throughout the country.[2] Six decades later, and several conflicts, border and regime changes down the road, the dual economy has been consolidated and is as operational as ever. Indeed the "viability" of the model has stood the test of time.[3] But it is configured and balanced along very different lines than when the Palestinian people were still a majority in their country.

In 1947, despite a demographic balance of power heavily in favour of the Palestinian Arab population, the economy of the Jewish minority was predominant, enjoying dynamic links with European capital, industrial know-how and high quality human resources. While exchanges were intense and often complementary between the mainly rural/agrarian Arab and urban/industrial Jewish economies (in labour, merchandise and services), each was at clearly different steps in the developmental ladder and on separate trajectories as far as external trade networks, financial links and structural transformation processes.[4] Nevertheless, the potential benefits to both sectors from continued close interaction could not be denied, assuming that could occur in the context of mutually agreed and balanced economic regulations, institutions and mechanisms. To the extent, therefore, that a "fair" political and territorial partition could be designed to govern post-Mandate Palestine, it was reasonable to expect that a blueprint for equitable and progressive economic cooperation could be advanced, building on the emerging dual economy model.

However, the dual economy in its current form comprises not two distinct economic systems, but more accurately, four. The Jewish Israeli economy, which has expanded territorially from within the 1949 Armistice lines to encompass and integrate Israeli settlements throughout the West Bank, is

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2 The "dual economy" was the most apt and widely used description of the two largely separate but linked (Arab and Jewish) economies that emerged until 1948 and composed together the "national" economy of Mandatory Palestine. The most recent comprehensive treatment of the subject may be found in Metzer, J. *The Divided Economy of Mandatory Palestine*, New York, Cambridge University Press, 1998.

3 Viability here understood more literally as feasible, or capable of surviving, rather than the various possible technical prerequisites for sustained, equitable and balanced growth and development.

4 Two contemporaneous accounts of the Mandate economy are Himadeh, S. *Economic Organisation of Palestine*, Beirut, American University of Beirut, 1939 and Hobman, J.B. *Palestine's Economic Future*, London, Lund Humphries, 1946.

ever predominant. The marginalised and relatively impoverished Palestinian Arab economies constitute together the other party to this peculiar dualism, operating in three separate and distinct regions more dependent on the Israeli centre than on each other: the remaining non-colonised areas of the West Bank, the now wholly isolated Gaza Strip and the Arab-majority sub-districts of central and especially northern Israel. After 60 years of failed integration of the latter region into the Israeli State, society or economy, and 40 years of occupation of the former two areas, the economic landscape of the Israeli-Palestinian conflict is now fractured and distorted and the Palestinian economies are separated from each other and from the Israeli economy as never before.

One of the ironies of the history of the Question of Palestine is that while the two-state territorial partition solution of United Nations General Assembly Resolution 181 of 1947 remains elusive, its secondary (annexed) provisions of "economic union" are today operational on a de facto, if not de-jure, basis. With the Israeli fiscal, monetary and trade regime in force throughout Israel and the occupied territories, full economic union in its most advanced form (albeit of the lopsided, dual-economy variety) is the economic law of the land.[5] Needless to say, this has emerged along different boundaries and on principles contrary to those envisioned by the framers of UNGA 181. This has created an re-partition of economic power on the ground today which does not follow the borders or balances assumed in UNGA 181, and which is best understood as an *outcome* of prolonged conflict, if not a tool of domination in the view of some Israeli strategists. What has happened, then, is the opposite of the UN vision of economic union (and, much later, the Oslo concept of economic cooperation), which was meant to facilitate the *resolution* of the conflict.

Conventional economic theory and experience promise that had economic union been pursued as designed in the context of implementing the political and territorial solution of UNGA 181, such an arrangement should have been able, over time, to achieve the goal of closing the dual-economy gaps that had emerged in Mandate Palestine. Regardless of whether such an outcome might have ensued, certainly there was an intention and reasonable possibility under the 1947 Partition Plan that a mutually beneficial economic union between two sovereign states might

5 The course of economic integration between sovereign nations (as for example followed in post-War Europe) usually goes from preferential- to free-trade to customs union (eg. the European Economic Community) to monetary/currency union (eg. the European Monetary Union) to full economic union (still unattained in Europe).

ultimately have been realized through convergence over time of per capita Arab and Jewish incomes. Without doubt, the economic “union” between Israelis and Palestinians that has effectively emerged is a construct that could not have been envisaged even by the most prescient UN bureaucrats 60 years in their worst nightmares. This is a union built not on peace, but instead born through intergenerational conflict, military-rule, discrimination, occupation and segregation between an industrializing, advanced, and sovereign centre on the one hand and a rural, poor, and leaderless periphery on the other.

It is from this broad historical perspective - contrasting what was planned and what could have happened with what did happen - that an examination of the current and future status of the Arab economy inside Israel is best conducted. As has always been the case, the path of Palestinian economic development remains subordinated to the political imperatives and facts on the ground. Accordingly, the forthcoming phase of the prolonged struggle over land, people and resources in Palestine/Israel will retain an important economic dimension. However, the concept of Israeli-Palestinian economic relations that has prevailed since (and been defined by) the Oslo Accords, appears increasingly obsolete in the light of the political prospects being shaped by the ongoing conflict.[6] This calls for a bolder recognition by economic policy analysts of the extent to which political and demographic realities on the ground have resulted in an economic power structure that transcends the usual parameters defining the economic implications of a two-state solution.

Generally, discourse on Israeli-Palestinian economic relations, even after seven years of intifada, disintegration and growing Israeli-Palestinian physical and economic separation, still assumes the possibility and desirability of achieving a balance in respective power and interests of two sovereign states: a Palestinian state for the Palestinian people in the WBGS and an Israeli state for the Jewish people (as well as for the citizens of its Palestinian Arab minority). At the least optimistic, there is a supposedly a possibility of levelling the playing field between the two unequal partners through policy interventions, appropriate trade regimes, aid and regional cooperation. Yet such a starting point simply doesn’t exist any longer, even if it may have still seemed plausible or attainable in 2000.

[6] Similar to UNGA 181, the Oslo Accords included an Annex on Economic Relations (know as the Paris Protocol) which enshrined and codified a modified version of the customs union between Israel and the occupied territories that was in force since 1967.

While the Israeli-Palestinian customs union established in 1994 is still the de-jure framework for relations between the West Bank and Israel, its survival between Gaza and Israel is increasingly in doubt. And in fact, all the weaknesses of the quasi customs union that were inherent from the outset are now fully exposed as Israel applies its provisions selectively and in line with its security and political agendas.[7] So as economic analysts and policy-makers question the viability of prolonging the current unsatisfactory and dysfunctional framework for Israeli-PA economic relations, it is useful to take a broader view, unencumbered by conventional assumptions about what is relevant, desirable and attainable for Palestinian development in such unique circumstances.

3. The challenge of economic development of the Palestinian Arabs in Israel since 1948

One of the factors that is usually discounted by all sources is the role and influence of the Palestinian Arabs in Israel in the overall Palestinian/Arab-Jewish/Israeli equation. This has been considered (at best) a marginal political or civil rights question of which even "final status" issues dare not speak. Only recently has this been redefined by Palestinian Arab civil society representatives in terms of a struggle for national and cultural autonomy within an Israeli "state of all its citizens", while the Arab demographic 'threat' continues to feature prominently in Israeli political (and scholarly) discourse. Meanwhile, this sixth of Israel's population (who also constitute almost a quarter of the Palestinian Arab population living within historic Palestine) straddle a geo-strategic position in the overall competition for natural resources and national income, both within Israel proper as well as between the Green Line and the current frontiers of Israel's effective control (i.e., the occupied territories). This has implications that go beyond the traditional confines and political borders of the discussion of the Palestinian-Israeli economic relationship. Indeed, be it from the perspective of the Palestinian development research *problematique* or of economic policy-making, this reality takes us back to before 1948 in beginning any serious discussion about future directions.

Notwithstanding decades of research by sociologists, geographers, political scientists and economists on many aspects of the Palestinian Arab economy in Israel, their extensive findings have yet to employ appropriate

7 The Palestinian economy and the policy environment shaping it has spawned voluminous literature over the decades, including reports and studies by United Nations and international agencies too numerous to reference here.

conceptual frameworks and methodological tools for examining past economic performance and future prospects. Certainly, (mainly Israeli and Palestinian) scholars working on this issue since the 1960s have made valuable contributions in a range of interrelated areas of research, such as agricultural modernisation and land use, labour force dynamics and human resources, entrepreneurial development and class and social differentiation. However, the economic status and potential of over a million Arab-Israeli citizens remains a marginal issue in academic research, technical fora and policy debate on the Israeli-Palestinian conflict. It is more of an exotic, non-issue generally viewed either as a subject for anthropological research or as a worthy struggle for equality, civil rights and integration within Israel.

For the Palestinian Arab minority in Israel itself, vital economic policy issues remain on their agenda, especially unemployment, local authority finances, housing, land tenure and industrial zoning, agricultural viability, poverty and social fragmentation and delinquency. But at the political level, these concerns have yet to be formulated into a coherent analysis of the Palestinian development experience in Israel and a platform for consideration of its strategic implications. The still-separate identity of Palestinian Arabs in Israel, confirmed by stubborn spatial, policy, cultural and demographic realities, has led to growing calls for political autonomy in Israel, most recently in the various manifestos and "Vision papers" of 2006-7.[8] But the economic implications of such a status remain unexplored, be it in the current context of continued absolute Israeli control or in an hypothetical future context of a two-state (or even one-state) political solution.

Meanwhile, the concept of an "Arab economy" in Israel is not clearly defined or understood, much less accepted. This is mainly because the Israeli democratic state-building narrative has always needed to present the Arab minority as part and parcel of Israeli society and state – indeed adding to the so-called 'cultural mosaic' that Israel is often portrayed as. Instead the subject for academic discussion and analysis has remained at the disaggregated level of Arab workers, farmers, workshops, entrepreneurs and localities in the Israeli economy. But even the intellectual constructs that dominated for many years the analyses of prominent Arab Israeli experts, steeped in the politics and ideology of the Israeli Communist Party, focused on a class analysis of the economic

8 Policy positions and constitutional proposals on Arab cultural, social and economic autonomy in Israel compiled and published by a group of Arab Israeli intellectuals, community activists and political leaders, culminating in "the Haifa Declaration" of May 2007.

deprivation of the Palestinian Arab population in Israel. The idea that national conflict, and not class conflict, was the underlying dynamic for Palestinian impoverishment in Israel remains difficult for this old guard to comprehend.

An important underlying factor that has perpetuated neglect of this issue in policy analysis of Palestinian development relates to the manner in which it has been treated in most of the literature, i.e. supposedly as a sub-theme of an Israeli development experience, rather than a feature of the broader conflict spanning the past century. Much of this literature, dominated over the years by Israeli academics, is devoted to trying to reconcile the subjected status of Palestinian Arabs in Israel with an assumption of their eventual, inevitable "integration" as equal citizens into the Israeli state, and hence their equal opportunities in the Israeli national economy.

The methodological acrobatics required to sustain such a suspension of belief have been impressive. To explain persistent Arab-Jewish economic inequality in Israel, a whole range of socio-economic factors have been cited at different periods: from the flight of Palestinian urban elites and leadership in 1948 to resistance of the Palestinian rural fellah to Israeli modernisation, to the operation of market forces which pulled Israel into the liberalised global economy and left behind “stragglers”, to more recent studies linking the perpetually low occupational status of Israeli Arabs in the work-force to their low educational achievements. Often, cause and effect is reversed in the quest for an economic narrative that fits with the Israel’s democratic credentials that imply equal rights and opportunities for all citizens.

Research and academic literature on Palestinian Arab economic conditions in Israel may be most usefully classified within two broad categories, largely defined by the explicit or implicit ideological positions that they embody (or don’t). The oldest and most pervasive trend, originating in the 1960s, was rooted in the liberal, social-democratic tradition of Israeli academia and orientalism, rooted in a humanistic reaction to the devastation wrought by Zionism to the Palestinian inhabitants of the country. This approach has today evolved into a form of “Zionist neo-liberalism”. It has always reflected a blind faith in the justice of the Israeli system, the ideal of equal rights for non-Jews in a Jewish state and a die-hard belief that the operation of the free market, with occasional state sponsored policy palliatives, could somehow correct the numerous distortions created by non-market forces.

Subsequently, and especially since the 1980s, new insights into the socio-economic situation of Palestinian Arabs in Israel began to emerge from a number of diverse ideological sources and disciplines which may be grouped under the rubric of "non-Zionist political economy". These latter contributions have in common an understanding of:

a) how the Jewish state-building policy environment before and after 1948 resulted in built-in impediments to Palestinian-Arab integration (politically, economically and socially) within Israel;
b) how successive Israeli governments have failed to address, much less act to ameliorate, the core issues; and
c) how historical processes of dispossession, segregation and marginalisation have disempowered this sizeable minority in Israel and created all-too visible ceilings to advancement.

In the first (Zionist neo-liberal) category, most research has focussed on sectoral/micro examinations which rarely took in the broader context, often ignored political dynamics and generally assumed a benevolent policy framework and path of integration that simply did not exist. The most notable examples of the earliest such research was the seminal book by Ben-Porath on the Arab labour force and monographs by Zarhi and Achziera on the growing socio-economic gaps between Jews and Arabs in Israel, none of which prescribed any radical policy responses.[9] Other research within this category, while also sectoral or empirical and survey-based, was informed by certain political assumptions or methodological approaches not always appropriate to the realities under investigation, as well as stereotyped and condescending analyses of the Arab population in Israel. Notable examples are the work of the Rehovot Institute experts Arnon, Raviv and Yalan (on Arab rural "modernisation") and of other sociologists or economists, such as Bar Gal (on geographical changes in Arab localities), Czamanski and Meyer-Brodnitz (on the workshop economy) and Lewin Epstein and Semyonov (on labour force occupational patterns).[10] An interesting contribution from this period was that of

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9 Ben Porath, Y. *The Arab Labour Force in Israel*, Jerusalem, Maurice Falk Institute, 1966; Zarhi, S. and Achziera, A. The Economic Conditions of the Arab Minority in Israel, Tel Aviv, Centre for afro-Asian Studies, 1966.

10 Arnon, M. and Raviv, M. *From Fellah to Farmer: a Study on Change in Arab Villages*, Rehovot, Study Settlement Centre, 1980; Yalan., E. et al, *The Modernisation of Traditional Agricultural Villages: Minority Villages in Israel*, Rehovot, Study Settlement Centre, 1972; Bar-Gal, Y. *Geographical Changes in the Traditional Arab Villages in Israel*, Durham, Centre for Middle East and Islamic Studies, 1980; Czamanski, D. and Meyer-Brodnitz, M. "Industrialisation in Arab Villages in Israel" in R. Bar-El (ed.) *Industrialisation in Rural Israel*, The Westview Press, Boulder, Colorado, 1986; Semyonov M., and Lewin-Epstein, N. *The Arab Minority in Israel's Economy: Patterns of Ethnic Inequality*, Boulder, Westview Press , 1993.

Gottheil who first advanced the idea of an Arab region in Israel as the appropriate object for analysis.[11]

In much of the research under this category, the sub-text adheres to deep-rooted Zionist fears of such as the potential Arab demographic threat (to the Jewish character of the State) and the security-first logic of Arab development in Israel. This school of thought accepts the structural exclusion of Palestinians from a wide range of employment and other market opportunities, especially in political echelons of government and in the increasingly pervasive security-sensitive Israeli military and IT industries. This body of research flourished in the 1980s as the Israeli State sought to grapple with rising Palestinian-Arab nationalist mobilisation in Israel and continues until today. Its proponents have maintained a lingering belief that growing gaps and distortions are amenable to correction by market forces or, if need be, by programmed government intervention and positive discrimination. Even recently, a group of highly respected Israeli economists proposed to re-visit "the question of whether Israeli Arabs operate in the same markets as the rest of the population" and whether "two distinct ethnic markets" exhibit "convergence over time".[12] As if this were a question that required yet more academic inquiry.

In fact had they had paid attention outside their narrow frame of reference and political correctness, they would have discovered that this question had been resolved quite definitively as of the 1980s, when a whole new body of discourse took shape under the new generation of research on this issue (what I have termed "non-Zionist political economy"). Some of this research has come from outside the economic sciences, shedding fresh light and opening new perspectives on both specific and more overarching aspects of Arab socio-economic status in Israel. Noticeably, most of these writers were either native or expatriate Palestinian Arabs as well as some Israelis whose scholarly capacities had not been diminished by ideological considerations or preferences.

This body of research, like that of the Zionist neo-liberal writers was empirically based and scientifically rigorous.[13] It was pioneered in the late

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[11] Gottheil, F. "On the economic development of the Arab region in Israel" in Curtis, M. and Chertoff, M. (eds.) *Israel, Social Structure and Change*, New Brunswick, Transaction Books, 1973.

[12] Ruth Klinov, Ephraim Kleiman and Meirav Yftach, "Market integration and separation of the Arab and Jewish sectors in Israel" (unpublished research proposal, 2004).

[13] Abu Kishk, B. "Arab Land and Israeli Policy", *Journal of Palestine Studies*, No. 41, 1981; Rosenfeld, H. "The Arab Village Proletariat", *New Outlook*, Vol. 7 No3., 1962; Rosenfeld, H. "The Class Situation of the Arab National Minority in Israel", *Comparative Studies in Society*

1970s by Abu Kishk in his research on Arab agricultural decline in Israel. Meanwhile, the anthropologist Rosenfeld (and later the sociologist Makhoul) provided the first serious investigations of Arab class transformation in Israel, in particular the proletarianisation of the Palestinian peasantry. This latter process was seen as inextricably linked to the loss of Arab agricultural land to State expropriation and the growing need of the expanding Jewish economy for cheap labour. This was followed-up by the sociologist Zureik, who treated the subject in the context of a model of "internal colonialism" which remains a strong thesis even today. The political institutional analysis of Lustick introduced a useful approach to understanding the system of state control, based on mechanisms of cooptation, separation and dependence. More recent work by Schnell, Sofer and Drori has examined with greater precision the dynamics underlying weak Arab industrialisation despite evidence of entrepreneurial potential and resources.

Other treatments in the non-Zionist political economy tradition, which explicitly incorporate the overriding external (policy, institutional and spatial) constraints in explaining stunted Arab development in Israel have been produced by Palestinian social scientists, including Haidar (sociologist), Khamaise (geographer) and the present author (economist).[14] In the analyses of this more recent group of contributions, the various gaps and constraints recognised by all the aforementioned research are understood and consolidated into a comprehensive whole, pitting a discriminatory, hegemonic Jewish state (and economy) against an ethno-national minority with a broad range of common features, capacities and interests, yet unable to access its fair share of national resources. This plays out in persistent gaps/imbalances in Arab educational advancement, occupational progress and capital accumulation (Haidar), in a losing struggle to maintain access to natural resources and obtain national finance for development (Khamaise) and in an overall adverse path of degradation of terms of trade (labour, goods and services) between the Arab regional economy and the national/Jewish economy (Khalidi).

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and History, No. 20, July 1978; Makhoul, N. “Employment Structure of the Arabs in Israel”, *Journal of Palestine Studies*, No. 43, 1982; Zureik, E. *Palestinians in Israel: a Study in Internal Colonialism*, London, Routledge and Kegan Paul, 1979; Lustick, I. Arabs in the Jewish State: Israel’s Control of a National Minority, Austin, University of Texas Press, 1980; Sofer, M., Schnell, I. and Drori, I. “Industrial Zones and Arab Industrialisation in Israel”, *Human Organisation*, Winter 1996, 55, 4;

14 Haidar, A. *On the Margins: the Arab Population in the Israeli Economy*, New York, St. Martin’s Press, 1995; Khamaisi, R. *Planning and Housing Among the Arabs of Israel*, Tel Aviv, International Centre for Peace in the Middle East, 1990, Khalidi, R. *The Arab Economy in Israel: Dynamics of a Region’s Development*, London, Croom Helm, 1988

A new generation of Palestinian Arab research in Israel has been encouraged in recent years by the work of *Mada al Carmel* Research Centre for Applied Social Sciences, as exhibited in the recent work by Shehadeh and its co-sponsorship of primary field research on socio-economic conditions of the Arab minority.[15] Shehadeh has pursued an innovative line of enquiry, drawing on the wealth of literature referred to above, which re-casts Israeli economic policies towards its Arab citizens (indeed towards the Arab region) as a form of mercantilism, the guiding philosophy of pre-WWII global economic relations. This emphasises protectionist and interventionist policies driven by industrialisation and state-building imperatives and the pre-eminence of national sovereignty over relations with external actors. This framework is applied in the Arab Israeli context to characterise the dependency relationship between an Israeli Jewish economic centre, which is capital-intensive, highly protected and in control of the levers of political power, and an impoverished, de-industrialised and capital-poor Arab periphery, relying on export of labour/commodities to the centre in return for a steadily increasing consumption of manufactured goods from the dominant economy.

Notwithstanding the different disciplines and divergent viewpoints informing the research of the two approaches, they do share some consensus on certain points:

- That persistent gaps do exist between the Arab and Jewish sectors of the Israeli economy in most, if not all, socio-economic and development indicators;
- That these gaps are not coincidences of history or explainable simply by comparative sectoral resource allocations, but rather emanate from distinct exogenous processes which impede the free operation of theoretically perfect (but actually imperfect) markets;
- That while long-term convergence might be possible, this is no less complex or certain to occur in the short-term than is global convergence between developed and developing, or rich and poor countries, and will require policy intervention to assure such an outcome;

[15] Shehadeh, A., *De-development: Israeli economic policies towards the Arab national minority*, Haifa, Mada al Carmel Centre, 2006 (in Arabic); The Galilee Society, *Palestinians in Israel, 2004: socio-economic survey*, Shafamr, 2005, in cooperation with Mada Al-Carmel Centre. This latter publication was not the first of its kind: in 1992, the now-defunct Jaffa Research Centre (Nazareth) published the first indigenous statistical field survey findings on Arab cities and villages in Israel.

- ✧ That marginalisation of Arabs in Israel is not unrelated to the dominant Jewish and Zionist character of the State and its development policy preferences and priorities; and,
- ✧ That the political, economic and social processes which have contributed to marginalisation began well before 1948 and, in the absence of any resolution of the overarching political conflict since then, they continue today to lock-in and further degrade the position of Arabs in Israeli economy and society.[16]

On the other hand, there remain major points on which there is a divergence of opinion. For example, there are clear differences as to:

- ✧ Whether the determinant processes that have perpetuated Arab underdevelopment in Israel are related primarily to internal (Arab) constraints and the "normal" development path, OR whether they are intrinsic to the particular (existential) situation of being (even generations later) Palestinian Arab in a Jewish State;
- ✧ Whether the overall impact of the modern, capitalised, liberalised and globally connected Israeli Jewish economy has been to pull the rural, less developed, traditional Arab society into the 21st (or at least the late 20th) century, OR whether its impact has been to maintain the Arab sector's less developed, subservient and fragmented role as a source of cheap labour, goods and services if not a captive consumer market.
- ✧ Whether the Palestinian Arab minority will remain leaderless and lacking the necessary "self-consciousness" and distinct, separate identity within Israel OR will succeed in mobilising itself and pulling its full potential weight within the overall Israeli-Palestinian-Arab conflict.

What seems beyond question is that without a radical rethinking and political re-positioning of the Arab minority in Israeli politics and society and within the broader context of the Israeli-Palestinian context, effective policies and programs that favour the development of the Arab economy in Israel are unlikely to emerge. And it is an open question as to whether an Israeli-Palestinian permanent status agreement can be reached without addressing comprehensively the future of the Palestinian Arab citizens of Israel.

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16 This process is similar to that of 'de-development' analyzed by Sara Roy and the concept of "adverse path-dependence" introduced by UNCTAD in research on the Palestinian economy in the occupied territories.

4. An Arab regional economy in Israel: integrated or separated?

In 1988, I published the findings of my own examination of the Arab economy in Israel, which utilized tools of (sub-national) regional economic analysis. The goal was to provide a useful context and relevant methodology for identifying the comprehensive and systematic socio-economic disparities between the Arab and Jewish sectors of the Israeli economy. The analysis identified four factors that defined the Arab “region”: Israeli state policy, geo-physical features, the social and political network and organisation and persistent economic differentials (with the Jewish economy). Five-year plans for Arab sector development and political initiatives by different Israeli governments (largely related to electoral campaigns and promises) since the 1960s and until today have demonstrated only limited State concern and disproportionately small resource allocations to correct the imbalances between the Arab and Jewish sectors of the economy. Understanding the Arab-Israeli economy as a marginalized, impoverished and largely subservient *region* of a *national* economy served the dual objective of elaborating a comprehensive profile of its structure and performance, and of providing a policy framework in which to design and implement a strategy for its sustained development.

As such a strategy could not be expected from the Israeli State, it would have been possible for Palestinian economic/development policy-makers to take up the challenge of fitting it within a broader programme of “steadfastness”, development and institution building, linking up with Palestinians in the occupied territories. In fact, the post-Oslo configuration on the ground could have made such an option more feasible as exchanges were legitimised and expanding during this period between Palestinian Arabs in Israel and the PLO-ruled areas of the West Bank and Gaza. But at the same time the political conditions imposed by Oslo, which removed the case of Palestinians in Israel from the Palestinian negotiating agenda with Israel, effectively severed the political links that hitherto developed between Palestinian civil society and political elites in Israel and the PLO. While the Palestinians in Israel may have considered themselves "an inseparable part of the Palestinian people",[17] they were clearly placed (by the terms of the Oslo accords and the effective distraction of the PLO with the affairs of the new Palestinian Authority - PA) on the Israeli side of the dividing line when it came to national politics and negotiations over "final status issues".

[17] This had become a rallying slogan of the Palestinian nationalist revival in Israel during the 1980s and until Oslo.

Relegated to the domain of civil and human rights issues since then, the fate of the Palestinian Arab minority in Israel has separated from the course of the Israeli-Palestinian conflict, as if their share in final status issues had already been unilaterally resolved as an internal Israeli affair. The ebb and flow of political conflict has regularly impacted Arab citizens in Israel, while terms such as "fifth column" and "transfer" continue to appear prominently, if intermittently, in the Israeli policy debate on the Arab minority. External shocks affecting the Arab economy and increasing its marginalisation include: the first, and especially the second, *intifada*; the mass immigration of Soviet/Russian Jews; the importation of low-skilled (especially Asian) labour to replace Palestinian construction, agricultural and service sector workers; the first Gulf War of 1991 and the more recent Lebanon War. In the first few years after the outbreak of the 2000 *intifada* (which had immediate spillovers in the streets of Galilee), Arab citizens were especially hard-hit economically by a widespread (undeclared) boycott by Jewish consumers and employers, quickly revealing the divide that the Oslo period had neatly masked and signalling that their fate was likely to remain subject to Israeli/Zionist imperatives.

It remains to assess how well the regional economic model of the relationship between the Arab and Jewish sectors in Israel reflects current realities through re-examining key gap indicators and relationships in the light of more recent data, a first attempt at which is presented here. And while the model has yet to be applied as a policy-making tool, its potential relevance can only be greater in the light of the latest wave of Palestinian Arab “regional autonomy” activism, especially as persistent socio-economic gaps can have a consciousness-creating effect within a specific community over a prolonged period.

In fact, such a conceptual framework allows for introduction of suitable economic methodological tools for analysing an issue that had generally been the domain either of non-economists or of sectoral specialists (labour, agriculture, entrepreneurship etc). A regional economic analysis also acknowledges the fact that the Arab-Israeli economy is a subordinate part of an economic regime which itself is a national economy. It furthermore accommodates the widely accepted spatial, state policy, structural dependency and divergence aspects that characterise the relationship between what is Arab and what is Jewish within the Israeli economy. Finally, and no less important today, is that a regional economic analytical angle allows for strategic planning not only for this part of the Palestinian Arab economy within Israel, but equally for the fragmented Palestinian economy under occupation.

Currently available data are not easily comparable with that used in my previous research for regional spatial analysis, so it is not possible here to make direct comparisons with indicators for the situation in the mid-1980s. However, two major sources of recent primary data may be considered: the Israeli Central Bureau of Statistics (ICBS) has published new comparative socio-economic data for Arab and non-Arab localities, while the first non-official, Palestinian Arab statistical publication on Arab household conditions in 2004 further details the situation. [18] Israeli official statistical sources are generally highly reliable, accurate and consistent over time, though separate series for indicators specific to the Arab population are not available in all sectors and have become less so in recent years. The new Palestinian statistical source used ICBS statistical series to establish the frame for their own field surveying, which probed deeper in certain areas and investigated indicators that official sources do not include or consider relevant.

4.1 Persistent socio-economic gaps

Official Israeli sources confirm the *extent to which the poorest and weakest sectors of the Israeli economy are predominantly Arab as well as the extent to which the Arab economy is predominantly poor*. An Israeli version of the "human development index" for 2003 covers 197 Israeli local councils and municipalities accounting for just under 6 million people. These councils and municipalities include the bulk of the total Israeli population (of 6.4 million in 2003) as well as the bulk of all localities in Israel.[19] Of the total 197 localities covered, 70 are Arab, representing some 838,000 persons, or about 80% of the Arabs of Israel. The remaining 250,000 Arab Israelis live in smaller villages (grouped in regional councils) or in the five mixed cities (Akka, Haifa, Ramla, Lod, Jaffa).

The data provided by this source on this critical mass of the Arab regional economy paint a dismal picture of the results of 60 years of alleged "integration", indeed Arab exclusion, in Israel. Of the 197 Arab, Jewish, and mixed localities, the composite socio-economic index of 102 localities is below that of the median locality. Of these, two-thirds (66) are Arab localities. Only four small Arab villages (conspicuous either for their

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18 Israel, Central Bureau of Statistics, *Characterization and Classification of Local Authorities by the Socio-Economic Level of the Population,* 2003; The Galilee Society, *Palestinians in Israel, 2004… op.cit.*

19 Those not covered comprise Israeli kibbutzim and the smallest Arab villages, plus around 40 Arab villages and localities (mainly settled Bedouin) not recognised by the State.

ethnic composition – Christian/Druze-- and/or participation in Israeli military service) are found above the median. Of the 10 localities at the bottom of the index, 7 are Arab; of the 70 least advantaged localities, 52 are Arab; only among the top 30 localities of the 102 below the median do poorer Jewish localities outnumber poorer Arab localities (26 to 14).

When the unweighted averages are compared, the differences between the Arab population and the national average acquire sharper focus:[20]

- The median age of the Arab population included in this index is extremely young (eight years – well below the median age of the national population of twenty-eight; this implies major long-term employment challenges for a young and growing Arab population;
- While only 16% of Israeli families on average have families of 4 or more children, the Arab average is twice as high (33%) - attesting to increasing pressure on Arab regional housing, social services and utilities;
- Arab average per capita income, net of taxes is under half the national average (at around NIS 1300 per month, approximately $300), a gap that has narrowed over time, but which remains striking in a State which claims equal opportunities and treatment for all citizens, regardless of origin;
- Whereas 44% of the total population were "sub-minimum wage earners" (and significantly less if only the Jewish population is counted), 57% of Arabs fall within that category;
- Conversely, 8.6% of all Israeli full-time employees (almost all of whom were non-Arab) earned more than twice the minimum wage, as compared to around 2% of Arabs;
- Even in the category of what is perhaps the most desirable consumer status symbol among Arab-Israelis, an average of 12% of motor vehicles in Arab localities in 2005 were new, compared to the national average that was more than twice that;
- Educational achievement is the only category where the gap is relatively narrow: 40% of Arab students attain their secondary matriculation certificate, compared to a national average of 49% (and probably 60% of Jewish Israelis); and,
- By contrast, fewer than 7% of Arabs between the ages of 20 and 29 are in higher education as compared to a national average twice that proportion.

[20] All of the following gaps would be sharper if comparisons were made between all Arab localities with all Jewish localities rather than with the national averages (whose levels are reduced by the inclusion of Arab localities).

According to a recent Israeli report, the Arab population's part in the gross national product (GNP) in 2006 stood at 8 percent, though Arabs comprise almost 20 percent of the country's population.[21] The average per capita GNP in the Arab sector is $7,700, while the average per capita GNP among the population as a whole more than double at $19,000 (and of course even higher if compared to the levels for the Jewish population alone).

The separate, yet dependent, Arab region in 2004 derived only 29% of total household income from agriculture, family business or the Arab private sector; 15% was derived from wages and salaries from the Israeli government (teachers, municipal and civil service employees and 18% from the Israeli private sector.[22] A disproportionately high percentage of Arab household income – 33% - derives from state social welfare payments and benefits (old age, unemployment, disability, low-income, children or retirement). Together with income derived from other non-Arab sources this means that two-thirds of Arab household income is dependent on the Israeli state or private sector.

While Zionist political economy might interpret such data as indicative of Arab integration, nothing could be further from the truth. Certainly the Arab regional economy is fully integrated into (and maybe resembles) the economy of the poorest localities in Israel (which, as we have seen, are predominantly Arab). But only a third of Arab household income might be related to any sort of productive 'integration' in the national economy, while another third reflects the unproductive, marginalised and financially dependent status of many households. The other third of Arab household income reflects the core of the Arab region's productive capacity, though its relative productivity is low since it is occupies around half of the employed labour force which work in the Arab regions of Israel (see below). Meanwhile, available data on the scale of Arab productive activity in regional agriculture or industry or producer services and the generally low rate of (primitive) capital accumulation and financial assets throughout the Arab sector belie any pretence that might be argued regarding spillover or trickle down effects benefiting the Arab region from its links with the Jewish national economy. In the classic terminology of centre-periphery development analysis, the "backwash" effects of the primacy of the Jewish (Zionist) economy seem to obliterate any "spread" effects of the process of "integration".

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21 According to the Center for Development of Arab and Jewish Enterprise, quoted in Haaretz 10/9/2007.

22 The Galilee Society, *Palestinians in Israel, 2004…*

The one, most significant, socio-economic indicator in which the Arab community holds the undisputed lead is that of poverty, whereby there are almost the same number of poor Arab and Jewish households in Israel. Data published by the Israeli National Insurance Institution, shows how the incidence of Arab poverty has deepened in the past decade and how state policy has not alleviated it to the extent that it has lessened the incidence of Jewish poverty.[23] In fact, after payment of national insurance benefits to Jewish poor households, the incidence of poverty among them was brought down by over 50% in most years since 1990, whereas among Aarb Israeli poor, social benefits only reduced the incidence of poverty in most years by under 40%. Consequently, the rate of poverty among Jewish households (after payment of benefits) since the late 1990s has hovered around 15%, whereas among Arab households the rate has grown steadily and alarmingly, from 28% in 1996 (its lowest level since 1990) to 50% by 2004.

4.2 Natural resource constraints and agricultural decline

This snapshot of socio-economic gaps is underpinned by many factors, too numerous to present here, but well covered in the wealth of literature referred to above. Suffice it to say that one of the most important features in the transformation of the Arab regional economy in Israel has been agricultural decline and marginalisation. It is true that the falling share of agriculture in Israeli GDP reflects a developmental transformation, whereby heavy, medium, light (and later high-tech) industries and services gradually replaced agriculture as the leading production and export sector. But the contraction in Arab agriculture (for which value data are not available since the 1980s) was not accompanied by the emergence of more productive, technologically advanced or lucrative activities. In the Arab sector, the flight from agriculture was mainly a consequence of a shrunken and narrow natural resource base (land, and of course, access to water), competition with a highly organised, state-supported Jewish agricultural export establishment and the pressure on land exerted by a rapidly growing rural population, leading to a process referred to as *in-situ* urbanisation. In addition to massive land expropriations since 1948, most recently in the 1970s and 1980s as part of largely unsuccessful campaigns to "Judaise the Galilee", increasing pressure is exerted on otherwise fertile agricultural land by burgeoning *rurban* populations, constricted by narrow residential zoning possibilities.[24]

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23 In Shehadeh, *De-development…* 2006

24 A recent comprehensive treatment is provided in Ghazi Walid Falah, "Dynamics and patterns of the shrinking of Arab lands in Palestine", *Political Geography*, Vol. 22, No 33, 2003, pp. 179-209.

The decline in Arab agriculture can be glimpsed through reference to agricultural and crop area changes over the past 30 years. Compared to the predominantly agrarian pre-1948 Palestinian society, only 22.5 % of Arab households today still own agricultural holdings (while agriculture accounts for less than 2% of all employed Arabs and even less of Arab household income).[25] This reflects not only the erosion of Arab control over land owing to decades of Zionist/state encroachment and the developmental transformation of the Arab economy, but also a persistent belief in the intrinsic value of land and agriculture notwithstanding the enormous pressures exerted to detach Palestinian Arabs in Israel from their roots in the land that surrounds them.

Available official data show that while the total area devoted to agriculture has actually expanded in Israel by 4%, in the Arab region it has fallen by 16% in 30 years.[26] As non-crop agricultural activities (livestock, fisheries) have increased their share of total area devoted to agriculture in Israel, the area devoted to crops has fallen by 5%: in the Arab economy the decline has been of the much higher magnitude of 25%. In both the national and regional economies, this has been offset by a steady increase in livestock breeding, of around 150% in the Arab sector and about as much in the Jewish sector. Notably, by 2001, more than 50% of Israeli livestock was within the Arab sector, indicating a rational shift by Arab farmers into more lucrative sectors of Israeli agriculture.

Meanwhile, the pattern of utilisation of crop area - between fruit and olive plantations, vegetables/potatoes/melons (VPM, mainly irrigated) and (rainfed) field crops - has shifted nationally (and especially in the Jewish economy) away from the third branch towards cultivation of export/cash crops, especially in the second branch. In Arab agriculture, the decline in field crops was accompanied by a secular decline in the cultivation of more lucrative (and labour intensive) vegetables. Whereas Arabs cultivated 23% of these Israeli cash-crops 30 years ago, their share of the national VPM area is around 10% today. Not surprisingly, Arab farmers have rationally moved out of this branch that is the most water-resource intensive as they have consistently received less water quotas from the authorities than Israeli collective farms and *kibbutzim*. The adaptability and coping skills of the hard-core of the Arab agricultural sector is in itself a clear rebuttal of the myths of Arab peasant mentality which Zionist political economy has promoted, thereby masking the real underlying economic dynamics of Arab de-development in Israel.

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25 The Galilee Society, *Palestinians in Israel, 2004…*

26 Israel Central Bureau of Statistics, Agriculture in Israel, 2001–2003, Area and Livestock, Table 2, Page 67.

Consistent with the increasingly unattractive long-term income prospects from Israeli agriculture, the sharp struggle over land and water resources and the increasing pauperisation of Arab rural communities (leading to subsistence levels of economic activity), the greatest shift in Arab agriculture has been the steady increase (67% over 30 years) of land devoted to (olive) plantations, which constitute around 25% of all Israeli plantations. Of the 179,000 dunums[27] of Arab olive and fruit plantations in 1999, 22% were irrigated; of the much larger area of 849,000 dunums of plantations cultivated by Jewish farms, 82% were irrigated, seventeen times the total irrigated plantation area in Arab localities.[28] Cultivation of olives is a traditional and obvious response of poor Palestinian communities attempting to survive in the face of state encroachment on Arab land (much as in the occupied territories). It is also an economic utilisation of scarce, strategic resources, requiring minimal investment and operating costs, but reaping substantial benefits in the form of a major staple of the Arab rural food-basket.

4.3 Labour force and occupational differentials

The labour force characteristics of Arabs in Israel also continue to exhibit important differentials with the Jewish labour force, though less sharp than in previous periods. While labour force participation rates of Arab males in Israel are close to those of Jewish males, low female rates among Arab women keep the overall participation rate at around 40%, compared to a national average of 60%.[29] Unemployment rates among Arab Israelis are consistently higher than in the Jewish economy (12% compared to 8.3% nationally in 2000). And Arabs remain more concentrated than Jews in low-skilled occupations: 16% of all employed Arabs in 2000 were unskilled as compared to 7% of all employed Jews; 20% of employed Arabs were found in the top three occupational categories as compared to 37% of Jewish employed. The largest two sectoral employers of Arabs in Israel are manufacturing (21% of all employed in 2000) and construction (15%), though these two sectors employ only 18% and 4% of Jews, respectively. A larger proportion of the Jewish labour force is employed in public and private services than Arabs: 34% and 38% compared to 26% and 33%, respectively. Meanwhile agriculture, which employed 17,000 Arabs in 1980, only absorbed half as many workers by 2000 (not all of

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27 1 dunam = 1000 sq. m. or a fourth of an acre.

28 "Statistical Abstract… "*op.cit.*, Table 19.6.

29 Participation rate measure the proportion of the working age population actually employed or seeking employment. Labour force data presented here are for 2000 and taken from the Israel Central Bureau of Statistics, *Statistical Abstract of Israel, 2005,* Table 12.20.

whom were employed on Arab farms). The decline in Jewish agricultural employment has also been important though not as steep, from 60,000 to 39,000 in the same period.

One of the dominant features of regionalism in the Arab-national economic relation is found in the spatial dimension of work patterns, namely the extent to which Arab labour is physically mobile between Arab and Jewish regions. This is an important indicator given the significance of physical separation and confinement in the overall domination of Arab economic and demographic power in Israel. According to 2004 data,[30] 46% of employed Arabs work in their localities or in other nearby Arab localities and 3% in Arab localities in more distant areas while 22% worked in nearby Jewish localities or (mainly Jewish) mixed cities (Akka, Haifa, Tel Aviv, Lydda, Ramleh) and 29% in Jewish or mixed localities further away. Of all employed Arabs, 45% work within nine kilometres of their localities and 25% between 10 and 29 kilometres of their place of residence. While the share of Arab mobile labour has declined since the 1980s as local service employment opportunities have emerged, the vast majority of those employed who were mobile, and half of all employed Arabs, are engaged in the Jewish Israeli economy.

4.4 The Arab craft workshop economy

One of the bright spots of Arab economic experience in Israel that was evident until the 1990s at least, and is perhaps less so today was the degree of entrepreneurial initiative demonstrated by the diminutive, but nevertheless robust, Arab workshop economy. While largely a family-based small and medium enterprise (SME) sector, with the exception of certain larger plants which have since the 1990s gone out of business, Arab industrialisation in Israel emerged in traditional branches such as food and beverages, textile and clothing, building materials (including stone extraction, cutting and polishing), as well as wood and metal processing (also largely for construction). There are only few examples of initiation of newer, more advanced manufacturing plants, often as a result of occasional but disjointed State or philanthropically motivated Funds to develop the Arab sector that have a long history of failure or half-heartedness.[31]

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30 The Galilee Society, *Palestinians in Israel, 2004…*

31 Shehadeh A., *De-development…* provides an excellent and comprehensive account of the repetitive and largely unsuccessful initiatives (or unfulfilled promises) to develop Arab industry or related infrastructure of successive Israeli governments (usually out to woo the Arab vote before elections) since the 1990s.

In the last available (unofficial) field survey data from the early 1990s, there were around 900 Arab industrial plants in Israel, around 27% of which were textile and clothing workshops (almost all wiped out by Israeli trade liberalisation since then) and 19% were in the food and beverages branch while building materials, wood and metal products accounted for slightly lower proportions.[32] Of 514 of those surveyed in detail at the time, 55% were micro-enterprises (1-5 workers) and 44% could be considered small or medium enterprises (SMEs); The vast majority (over 80%) were located in residential areas, with only 10% located in industrial zones (the lack of which in most Arab localities constitutes one of the major infrastructural impediments to Arab industrial development). Investment levels in industrial capital were low, whereby in only a few cases were private investors able to raise more than NIS 150,000 (around $30,000 at the time) to invest in industrial development, more or less the same level of annual turnover of two-thirds of the workshops in residential areas. Only among those plants situated in industrial zones was there a greater incidence of investment above NIS150,000 – and in only 20 of the 514 surveyed enterprises was the level of plant investment above NIS1 million.

The persistent dilemma of Arab industry is well analysed by Sofer and Schnell in a more recent analysis, which is worth quoting at length:[33]

"The current pattern of industrial development in Arab settlements in Israel represents, above all, adaptation to restructuring processes operating throughout the Israeli economy. The result may be viewed as a form of peripheral industrialization of small plants specializing in less-advanced industrial production. The peripheralization process and the fact that Israeli Arab industry has remained marginal to the national economy should be understood in the context of the structural conditions in which Arab entrepreneurship is embedded. The impact of three forces is stressed: government policy, large corporations, and the internal socio-cultural properties peculiar to the Arab population in Israel."

"The resulting form of industrialization is based on restructuring processes formatted as a number of distinctive development stages, which must be understood within the wider framework of Israel's economic restructuring. The dominant form of capitalist production affected the transformation of the Israeli Arab economy at each period, from state management to corporate dominance, and currently succeeded by a new accumulation

[32] Statistics from 1990 (Jaffa Research Centre) and 1992 in Sofer *et. al,* 1996.

[33] Sofer M and Schnell I, 2000, "The restructuring stages of Israeli Arab industrial entrepreneurship" *Environment and Planning* A 32(12) 2231 – 2250 (Abstract)

regime affected by globalization processes… Majority - minority relations…. supported by a selective government policy, have since been superseded by the relations conducted between the Jewish-dominated core and the Israeli-Arab-subordinated periphery…Furthermore, the result is a failure by Arab entrepreneurs to penetrate the more privileged sectors of the national economy, partly because of the failure of the Israeli political and economic elite to respond to Arab efforts at expansion into the larger economy."

4.5 Shallow financial sector

An additional perspective on the diminished power of the Arab economy in Israel is evident in the performance of the only Israeli commercial bank which operates exclusively in Arab localities, the Arab Israeli Bank, a subsidiary of Israel's second largest bank, Leumi. Though it is not the only Israeli bank operating in the Arab region, with significant Arab commercial capital most likely working through larger Israeli financial institutions, its presence in all the main Arab localities and its client base being exclusively Arab renders it an interesting source of information on savings and investment indicators for the region.

The Arab-Israeli Bank ranks thirteenth (in terms of its total assets) in the list of fifteen Israeli banks, with total assets of NIS3.8 billion (under $1 billion), compared to NIS260 billion (or around $600 billion) for the largest Israeli bank (Hapoalim) in 2006. Its parent, Bank Leumi, posted assets of NIS241 billion, which illustrates the insignificant scale of commercial banking operations in the Arab economy as compared to the national economy, at least from the vantage point of one major institution. The Arab Israeli Bank accounts for only 0.2% of total Leumi assets. Deposits in this institution accounted for 0.3% of credit provided to the public and 0.37% of all public deposits in the Israeli banking system,

The Bank's credit/deposits ratio is 72%, which is significantly higher than most banks' ratios (for Leumi the corresponding ratio is 52%), with credit growing exactly as much as deposits (NIS 270 million) from 2005-2006. Slightly over 10% of total bank credit to the public is due to risky borrowers, a fairly prudent level. The Bank posted a net profit ratio in 2006 of around 24%, possibly making it one of Leumi's top earners. The Bank's risk based capital ratio is high at around 20% compared to averages around 10% for almost all other Israeli banks. This indicator of high capital adequacy (financial soundness from a bank-regulation point of view) is perhaps reflective of the limited financial intermediation role possible for a financial institution working in the Arab economic environment in Israel, a sound position which allows it to maintain a high credit/deposit ratio. Simply put, this institution could de-securitise more of its existing capital with relatively little risk attached to the corresponding assets accrued, but it would appear that credit demand in the Arab sector is not overwhelming or especially dynamic as to warrant aggressive credit marketing.

5. The Palestinian regional economies in the orbit of the Israeli national economy - an economic paradigm for the one-state solution?

It should not be understood from this analysis of Arab-Jewish socio-economic differentials that time has stood still for Arabs in Israel or that they have been totally bypassed by Israeli development. In fact their predicament, especially in the past few decades, is perhaps more an outcome of processes that mainly bypassed them (or at least weren't designed for them) than of designs that targeted them. Their basic needs, such as health care, universal education and social welfare have not been neglected by the State and proximity to (and employment in) the more advanced Jewish economy has allowed for 'gains' that many a Palestinian living under occupation or in exile would envy. The newest Arab generation is increasingly "Israelized" (and "globalized") culturally, as the pre-1948 traditions that sustained social cohesion gradually deteriorate and falter (degradation of social capital). And the progressive path of Israeli economic development has freed up lower and middle occupational levels where Palestinian Arabs hitherto could not compete, such that more educated Arab professionals are gaining a foothold in the national economy, outside the specific context of the Arab traditional communities where they were raised. These facts should not be discounted in any assessment of how far Palestinian Arabs in Israel have progressed in sixty years and what potentials that creates for their future.

For example, the emergence of Arab capitalists in the past decades, generated largely through consumer services and retail or larger-scale commerce is an indicator of the potential for mobilising "ethnic" economic power. However the newest Arab "newly-rich" are concentrated in intermediating between Jewish or overseas producers and Arab communities as compared to industrial capital accumulation until the 1990s, which was oriented to the national economy. While much is conspicuously consumed by these new Arab commercial elites, or saved through residential construction and land acquisition (and rarely invested in new enterprises or areas of business), a financial policy framework for mobilising more "developmental" investment within the Arab region remains lacking.

Nevertheless, there is little evidence of significantly greater Arab *integration* in the Israeli economy today than at any past time (except perhaps until the 1960s when the Arab areas were ruled by Israeli military government and regulations. Economic exchanges between Arabs and Jews in Israel have not entailed inclusive development, and continue on the distorted and disadvantaged basis that has always characterized the regional-national relationship. However many examples may exist today of Palestinian Arab success stories in Israel (and there are individual examples of innovative adaptation, breaking through barriers and capital accumulation), a 'regional' approach to understanding Arab de-development in Israel does not seem to have lost its validity. In fact, most of these success stories are uniquely Arab insofar as they emanate from confronting adversity and exhibit an entrepreneurial tenacity and social adaptability that only such a dire situation can generate.

The structural trends and binding constraints on which Israeli economic success has depended are the same factors that have perpetuated a separate and wholly dependent economic status of the Palestinian Arabs in Israel. And the economic fate of the latter is almost as confined to the region in which they reside as is the fate of the economy of the Palestinian people encircled in Gaza or fragmented in zones behind the Separation Barrier. Political developments among the Palestinian Arabs in Israel in the wake of the Oslo Israeli-Palestinian peace accords, which have featured growing Arab political autonomy and calls for more, beg the need for an autonomous (*read: regional*) social and economic development strategy, powered from within and to the extent possible, self-reliant. It is high time that the lessons of Palestinian economic development under prolonged conflict are absorbed and the potentials for mobilisation of their potential economic power are explored.

One dimension of Arab Israeli economic conditions since the 1990s has acquired growing relevance until 2000: the still largely undocumented economic links between the Arab-Israeli economy and the Palestinian economy in the WBGS under the PA. This did not reach a degree of economic *integration*, but could be characterised as intensive and focused *exchange*. The mainly informal commercial, labour and financial relations that emerged between the Galilee/Triangle areas and the West Bank and Gaza, especially as the latter grew steadily in the second half of the decade, were indicative of more than just market forces or even geographic proximity.

For both sides of the exchange, the common basis for this relationship differs from that which exists between (non-Arab) Israeli consumers, contractors, or exporters on the one hand, and the PA economy on the other. Certainly, the monopolistic commercial and investment deals with PA economic agents were almost totally the domain of an Israeli commercial elite, mainly retired senior security and military officials with ties to the more politically influential sectors of the national economy and global capital. But common factors such as consumption patterns, income levels, business culture, language, and social solidarity, among others, naturally placed the relationship between the Arab-Israeli and PA economies in a different category than that between the Israeli and PA economies. And while that relation has yet to be consolidated in line with a "neo-dual economy" model, the comparative advantages of exchange between the WBGS and the Arab regional economy in Israel are demonstrative of structural complementarities that need to be recognised.

Even today, many Galilee or Triangle based Arab capitalists and commercial agents maintain business (trade and other services) flows with the PA markets through the Jerusalem-Ramallah corridor and other limited contact/entry points. Until 2001, Gaza enjoyed a booming export trade with Arab-Israelis, who came by the busloads to buy cheap imported Egyptian consumer goods and fresh Gaza agricultural products. Throughout the Oslo-period, workers from Gaza found regular employment and shelter in Arab communities throughout northern Israel, but are today hunted down relentlessly by Israeli police as illegal migrants. This distinctive link has been interrupted and the Gaza region of the Israeli-Palestinian economic cluster is today totally separated from the Palestinian economy in the West Bank and the Arab regional economy in the north.

At the current stage of the conflict, as the two-state option seems to recede on the horizon to be replaced by unknown outcomes, it appears timely to project what has been learnt about historical processes, and what we know about the economic facts on the ground, towards elaborating a strategic developmental policy framework in line with the emerging realities of the Palestinian-Israeli conflict. In the classic dependency model, the relation between dominant and dominated economies is that of a hub-spoke link, whereby the functional economic relation is between the centre and the periphery, with limited exchange between the peripheries themselves. Fresh empirical and analytical research (beyond the scope of this paper) could demonstrate that the functional relationship linking all components of the Arab economy *(i.e., regional)* in Israel/Palestine (i.e., WB/GS, Galilee/Triangle) with the Jewish *(i.e., national)* Israeli economy is that between an isolated, less advanced (or de-developed) region *(periphery)* and an expanding, liberalized, hi-tech national economy *(centre)*.

One of the realities that has changed are the attributes of institutional, administrative, and limited fiscal autonomy that the PA economy acquired in 1994 but largely lost in recent years. Despite all the shortcomings of the PA self-government experience since 1994, it has revealed a potential for national governance unknown within the Arab-Israeli community, whose political organisation capacities rarely extend beyond the limits of Arab local government. So if there is to be a new stage in Palestinian economic governance, it will certainly have to go beyond the experiment that was the PA and be able to grapple with the real attributes of statehood and assume true sovereign functions and if it is to launch a process of state-formation.

Yet we seem to be very far from that, both politically and in terms of institutional and policy preparedness. Meanwhile, the still apparently legitimate case for the "viability" of an independent national economy in a WBGS liberated of Israeli settlements and occupation is increasingly rendered redundant by the facts of Israeli settlement expansion. While the Separation Barrier has cantonised the West Bank, the manner in which the Israeli "withdrawal/disengagement" of Gaza has transformed realities there into a socio-economic disaster-zone, light years away from the much trumpeted Oslo model of Singapore on the Mediterranean, bodes ill for what might come next.

Nevertheless--and this is only one reality that is counterpoised to the others-- even in the context of Israeli " separation" policy, the economy of some 3.5 million Palestinians in WBGS and of another 1.2 million Palestinian Arabs in Israel remains fixed within the Israeli economic orbit. This has intensified since the Oslo period, which did witness some diversification and economic "autonomy" for the WBGS. The increasingly fragile PA economy remains dependent on the centre for access to trade, jobs, technology and consumption, even public services such as health and education. Both the PA regional economy and the Arab regional economy in Israel operate as part of the Israeli national customs, financial and monetary regimes. The three regions are almost identically affected by national macroeconomic, trade and (most components of) fiscal policy with almost non-existent institutional autonomy that could affect the external policy environment.

All of these features imply that there is more correlation between the WBGS and Galilee/Triangle than has so far been recognised, especially as the most significant convergence that seems to be occurring is between the impoverished (Arab) regions themselves, in an unintended “race to the bottom''. In the last few years the structural resemblances between the Palestinian regional economies have become more striking. Though per capita incomes of Palestinians in the WBGS have plummeted since 2000 to under one fifth the level among Arab-Israelis, [34] living standards and economic patterns in both regions remain much closer to each other than to those in the Jewish economy. While the WBGS economies retain a limited domestic productive base (agricultural and industrial), external trade is conducted wholly with Israel or through Israeli intermediaries. Structural economic features are similar in terms of the primacy of imports over exports and consumption over savings and investment. An eroding agricultural and feeble industrial base is increasingly giving way to a so-called service economy, wholly oriented to one dominant market and a narrow range of non-productive services sectors. And in all the Palestinian regional economies, domestic capital when invested locally finds its safest allocation in real estate. Relatively high educational standards do not translate into better occupational or employment opportunities, with unemployment high in all regions.

Perhaps the strongest remaining (primarily political) justification for not considering Palestinian economic development in Israel/Palestine from the angle of regional analysis is the political imperative of Palestinian national self-determination within the WBGS territorial boundaries. Nonetheless, it must be acknowledged that despite appearances to the contrary, *this is to all intents and purposes one macro-economy, with a dual institutional/policy framework and structure/performance.* Such a conceptual framework for analysis of Palestinian economic prospects, which re-casts issues in the context of the operation of a single economy's relations to its regional components, is not a function of methodological preferences, but of reality. Indeed, analysis of the three Palestinian regional economies in isolation from each other and from their common relation with the Israeli/Jewish economy is a function of outmoded nationalist ideologies.

Accordingly, it is necessary to explore anew the underlying dynamics of the relationship between the Jewish and Arab economies in Israel/Palestine, on the assumption that together, they actually constitute one macro-economy. For example, a simple way of viewing the imbalance in the national-regional economic relation is to estimate the share of the Palestinian Arab regional economies in the total GNP of the macro-economy of the Israeli-Palestinian economic union. In 2006 total Israeli GNP was $141 million, which if added to the GNP of the occupied territories (of around $5 billion) amounts to a total of $146 million, with

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[34] If calculating according to the statistics quoted above for Arab-Israeli per capita GNP of around $7,700 – compared to levels in WBGS that have recently fallen below $1500.

the Arab regions therein accounting for $16 billion. This is strikingly low when considering that the almost 5 million Palestinian Arabs within the borders of Israel/Palestine constitute 45% of the population living in that territory but only produce around 11% of its national income. This highlights the scale of the challenge of Jewish/Arab economic convergence, which remains even further away on the horizon than it was six decades ago, when Arabs (in 1944) still constituted 70% of the total population of Mandate Palestine, but their share of national income was still 40%.[35]

Using regional analysis and other statistical analysis, new research is needed to identify dynamic factors such as complementarities, flows, specialisation and comparative advantages between regions, as well as the trends in key gaps between the underdeveloped and advanced regions of the macro-economy. Together with the micro- and sectoral research findings from concurrent research, this analysis should set the scene for a framework for development policy planning that could deliver sustainable social and economic gains for the Arab-Israeli economy as one of the less developed regions of the Israeli-Palestinian "economic union". As part of such a new research effort, it would be useful to explore commercial relations between the three regional economies, before and since the *intifada*, to reconstitute the national accounts (of Israel/Palestine together) and to estimate the regional accounts (Arab/Jewish) of the Israel/Palestine economic union. This could indicate future directions for research and analysis, including key regional gaps and imbalances requiring policy action, complementarities and potentials for regional integration, and institutional arrangements for sustainable regional integration and future economic union.

An important aim of such research would be to establish whether within the current political configuration or even a two-state solution there is a trade off between the benefits of greater integration of Palestinian regional economies in WBGS and Israel and the costs that that would entail in terms of reducing the scope for breaking WBGS dependency on the Israeli metropole, so to speak. And whether, on the other hand, within the context of a longer-term reconfiguration of the Palestinian national struggle, a Palestinian-Palestinian economic union of sorts could reasonably be expected to emerge as a counterweight to Israeli economic predominance, again regardless of the specific contours of any forthcoming political settlement.

The purpose, at this late stage, of engaging in a collective, interdisciplinary effort to investigate the conditions and prospects of the Arab economy in

35 E. Zureik, *The Palestinians in Israel... op.cit.*, p. 58.

Israel, should above all aim to contribute to elaborating an "actionable" economic and social development vision and the necessary policies and mechanisms to achieve it. This is imperative for several reasons. Most immediately, this neglected sector of the Palestinian people has a unique development experience to learn from and build upon. Of equal importance is the Arab community's geo-political-economic position within the Palestinian-Israeli conflict and the need to factor that into any long-term resolution of the long struggle over the land of Palestine/Israel. If nothing else, this region should benefit from any "peace dividend" that might emerge in the context of a comprehensive settlement in the region and the expected development cooperation and resources that might ensue.

Regardless of the ultimate re-configuration of borders and the government that might ensue if a peace process resumes, such a policy framework should be capable primarily of responding to Palestinian Arab development needs under any circumstances, be they a continuation of the status-quo, the two-state solution or even a bi-national state solution. While the future of Palestinian Arab citizens in Israel and their compatriots in the WBGS might proceed along different political tracks (integration/equality and separation/sovereignty, respectively), the common features of their historical relation with the Israeli national economy are too glaring to ignore. And the similarities in their economic structure and performance are an outcome of similar processes delivering similar results in different "legal" contexts and at different stages of the conflict in Palestine/Israel. Ultimately, the results of this line of academic inquiry would be equally beneficial for the long-term prospects of the Jewish/Israeli economy, even if a cost is to be incurred in contributing to redressing regional imbalances and narrowing economic disparities.

So the hypothesis, that since 1967 the economic union designed in 1947 for partitioned Palestine has become a reality, has a bearing on how to address Palestinian development policy for the future. If circumstances continue to undermine the possibility of forging ahead and completing the Partition (politically and territorially with two states), then current realities need to be accepted as definitive and as having overridden any remaining political imperative for separate sovereignties in Palestine. This would imply the need to design a Palestinian Arab tri-regional development programme in the context of a future one state solution - one that would aim to transform the bantustan-type economic relation that exists today to an integrated, bi-national, dual-economy development programme.

The economic record of the World Bank and the International Monetary Fund in the West Bank and Gaza: an assessment

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ABSTRACT

The aim of this paper is to review and assess the economic analysis and policy recommendations made for the West Bank and Gaza Strip (WBG) by the World Bank and the IMF, from their first involvement in 1992 up to the present day. We first discuss why and how these institutions became involved in the effort to realize the international community's goal of supporting peace by bringing about a swift and tangible improvement in the living standards of the WBG's inhabitants. We then consider the various roles they played in the WBG, where the Bank in particular was operating outside its usual remit.

The paper proceeds to review the major studies produced by the Bank/IMF on the WBG's economy, concentrating on the identification of bottlenecks and needed reforms. The following section considers these contributions in terms of the key policy recommendations regarding trade policy, labour market policy, public versus private sector, fiscal policy and the currency question. We pay particular attention to whether the recommended policies were in line with the 'Washington Consensus'.

The publicly stated aims of improving living conditions and laying the foundations for a sound viable economy in the WBG have not been achieved after one-and half decades of hard work and \$10bn in foreign aid. What went wrong in the approaches of the Bank/IMF? We attempt to identify factors which must have contributed to the failure. We point out first that the particular and highly politicised conditions in the WBG forced the Bank to continuously divert resources from long term development to short-term relief and budget support. On the other hand the Bank/IMF discovered that their ability to use grants and loans to persuade their clients to follow a particular policy path was severely curtailed in the case of the WBG.

Clearly, these two issues have a common origin in the relation between economics and politics. The Bank apparently hoped in the beginning to be able to separate the two aspects, to be able to pursue development without, or prior to, having a political settlement. The Bank wasted a great deal of effort and time in attempting to do the impossible, for example in its tireless, though unsuccessful, efforts to design, negotiate and implement 'closure-proof trade routes'.

The absence of a comprehensive political settlement, and therefore the inadequacy of the PA's economic policy tools meant that the Bank's flagship approach, the Comprehensive Development Framework (CDF), was also inapplicable in the WBG. The aim of a CDF is to ensure that projects and programmes are carried out within a holistic approach to development. Without this the Bank became no more than a monitor and a project-executer unable to formulate and implement a development vision with complementary roles for the different levels of government, multilateral and bilateral aid agencies, civil society and private sector.

The Bank/IMF have devoted a lot of resources to analysing the economics of the WBG, applying up-to-date, mainstream economics. They have provided excellent documentation of the costs of the closure policy, made some genuinely useful contributions on the sectoral and project levels, and developed an attractive analysis of labour flows and of the optimal trade regime for an independent state. However, their policy recommendations have been less useful. First, they are closer to the recommendations these institutions typically make for a wide range of developing countries. Second, few of them were of practical or immediate use for Palestinian policy makers, in particular the recommendations for fiscal discipline and control of the public wage bill, and for the promotion of an enabling environment for private investment.

The aim of the Bank/Fund's interventions was from the beginning, in some sense, political. However, the political constraints under which they operated prevented them from addressing core issues which have a direct bearing on the development of the WBG. This put the Bank/IMF experts in an insoluble dilemma: while they had been given a mandate to help create prosperity that would be conducive to the peace process, they were not permitted to address the core issues which eventually derailed the process. Nowhere was this clearer than with the issue of Israeli settlements.

Past experiences made clear that the WBG had little chance of becoming a viable economic entity unless it acquired sovereign control over its external borders in territories with full geographical unity and contiguity.

This must have become obvious to the two institutions by the mid-1990s, but they were unable seriously to address these issues. In that sense the Bank/ IMF were never going to be able to fulfill their objectives: they were on a hiding to nothing.

In the period since the Oslo agreement in 1993 the World Bank and the International Monetary Fund (IMF) have been significantly involved in the West Bank and Gaza (WBG), providing advice and assistance of various kinds and (in the Bank's case) finance. Over this period the economy of the WBG has, on balance, clearly deteriorated. Our aim in this paper is to review and assess the economic analysis and policy recommendations made for the West Bank and Gaza Strip (WBG) by the World Bank and IMF, from their first involvement in 1992 up to the present day. We first discuss how the Washington institutions became involved and what forms their involvement took. In section 2 we review their analytical contributions in the form of their principal reports and studies on the economy of the WBG. Section 3 considers these contributions in terms of the key policy issues: trade policy, labour market policy, public versus private sector, fiscal policy and the currency question. Section 4 considers the particular characteristics of the WBG and the specificity of the Bank and Fund's policy recommendations. In section 5 we offer a critical assessment of the contributions of the World Bank and the IMF. Section 6 concludes.

1. The scope of the institutions' involvement

The involvement of the World Bank in the West Bank and Gaza Strip (WBG) as a separate area dates back to early 1992. Soon after the end of the first Gulf war the two superpowers at the time, the USA and the USSR, sponsored a Middle East peace conference which convened in Madrid on October 30, 1991. The cosponsors asked the World Bank to participate, as supporter to the chair, in three of the multilateral working groups established. One of these working groups asked the Bank in November 1992 to expand its contribution to include an in-depth assessment of the development needs of selected economies in the Middle East including those of the WBG. The request was formally conveyed to the Bank by the US State Department which described the Bank's contribution as "critical to the success of the overall peace process" (Shihata et al., 1992/94. p. 20). The Bank responded by preparing a number of studies and reports, the most important of which was a six-volume study on the economy of the WBG (World Bank, 1993), which was published just two weeks after the breakthrough in negotiations between Israel and the PLO that led to the signing of the Declaration of Principles (DoP) in September 1993, the first document of the so-called Oslo Accords.

The World Bank was then asked by a number of countries to consider providing urgent technical and financial assistance to the 'Territories' (i.e. the WBG). This was problematic, because under its Articles of Agreement the resources and facilities of the Bank should be made available only to member countries,[36] and the WBG was not a member, a potential member or legally under the jurisdiction of a member country. However, the Bank was able to circumvent this as the result of a pioneering legal opinion by the Bank's legal department, which argued that Bank assistance to the WBG was acceptable because it would be for the "benefit of Bank members", since several member countries would benefit from peace in the Middle East (Shihata et al., 1992/94, p. 37). The Bank also found a way of providing assistance to the WBG through an alternative institutional arrangement, by establishing and administering 'trust funds' where the funds had been provided by bilateral, multilateral or other donors and were administered by the Bank as trustee, in return for a fee, subject to appropriate procedures. It was also established, as a precedent, that the Bank could allocate staff and budgetary resources to work in the WBG and could make grants to the trust funds out of its own net income.

The IMF became involved shortly after, and has been providing technical assistance (mainly on tax administration and public expenditure management) to the Palestinian Authority (PA), the Palestinian Central Bureau of Statistics (PCBS) and the Palestine Monetary Authority (PMA) (IMF, 1995, pp. 1, 29-32). Over time the IMF extended the scope of its economic advice (see section 2 below) but its involvement remained limited to technical assistance and economic analysis. It was mandated by donors to assist in the preparation of the first wave of reforms launched in 2000 under the title of the Economic Policy Framework, and the second wave of reforms launched in June 2002 through the Transparency and Financial Accountability Support Group which it co-chaired. In recent years the IMF has been closely involved in drawing up the PA's budget and monitoring its expenditure.

The World Bank, on the other hand, came to play a much larger role. As Schiavo-Campo (2003, p. 9) put it "By dint of circumstance, the Bank found itself in a role more central in WBG than in any other major post-conflict situation, before or since". The Bank's role in the WBG can be classified under three headings.

[36] Articles of Agreement I (§ i) and III (section 1 § a), available at http://siteresources.worldbank.org/EXTABOUTUS/Resources/ibrd-articlesofagreement.pdf. The restriction applies to the IBRD and IDA (the Bank's arm which provides concessional loans to poor countries) but not to the IFC, the World Bank's affiliate which provides loans to private sector enterprises. The IFC was able to extend its direct services in the WBG because its loans do not require any guarantee from government (see Shihata *et. al.*, 1992/94, p. 35).

First, it performed its traditional role of supervising and financing project execution (particularly for infrastructure projects), evaluating economic conditions, formulating socio-economic priorities, judging and designing macroeconomic policies and helping to lay the foundations for long-term growth. The 'intellectual' role of the Bank in these areas has been remarkable: its website lists no less than 223 documents produced by the Bank on the economy of the WBG between 1993 and mid-2007, including working papers, sector reports, project papers, country economic memoranda, public expenditure reviews and country financial accountability assessments. To facilitate its activities in these areas the Bank established two trust funds just after the first donor 'Conference to Support Middle East Peace' held in Washington on October 1, 1993. The first was the Trust Fund for Gaza which later became the Trust Fund for Gaza and the West Bank (TFGWB) and the second was the Technical Assistance Trust Fund (TATF). The former started with a $50 m grant transferred to it from the Bank's own surplus.[37] It was administered by the IDA, provided credit on the IDA's standard terms (40 years maturity, a grace period of 10 years and zero interest) and was allowed to accept contributions provided by other donors provided that these were at all times used in ways consistent with the IDA's Articles of Agreement. The TFGWB received $380 m from the Bank's surplus in four replenishments between 1993 and July 1999. It was the main vehicle to finance rehabilitation projects and infrastructure projects in the early stages. However, with the deterioration of overall conditions in the WBG towards the end of 1995, the TFGWB placed even greater emphasis on employment generation and so-called community development (Schiavo-Campo, 2003, p. 6). By January 2007 it had committed $440 m to 33 different projects (which also attracted significant co-financing), $259 m of which had been disbursed (see table 1).

The TATF was established by the Bank to accept contributions from other donors intended to finance the cost of feasibility studies for priority economic and social infrastructure projects and to provide non-project technical assistance for institutional building and training. The TATF was financed by 12 bilateral donors who provided $23.6 m. It supported over 80 projects and was supposed to close by 1997, but its life was extended for four years (to 2001).[38]

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37 The original aim was to provide credit for emergency rehabilitation projects in Gaza. The TFGWB extended $30m in credit to PECDAR to finance part of the Emergency Rehabilitation Programme in the WBG 1994-6.

38 Most of the aid is granted on basis of the Bank's highly subsidized IDA criteria. For information on the activities of the IFC (the Bank's arm to support private businesses) in the WBG see World Bank (2002b) and World Bank (Update 2005).

Second, the Bank acted on behalf of the international community as coordinator of the contributions and activities of the numerous bilateral and multilateral donors and international and local NGOs operating on the ground in the WBG. At the first donor conference, held in Washington only three weeks after the signing of the DoP, representatives of 30 donor states and 11 international organizations met and pledged $2.1 bn over 5 years in aid for the development of the WBG. The Conference decided to establish an Ad Hoc Liaison Committee (AHLC) and asked the World Bank to act as its secretariat with a mandate to coordinate aid and provide assistance to the Palestinian people. With the shift of much of the operational decision-making to the field, the AHLC created in November 1994 a local Joint Liaison Committee which included representatives of Israel and the Palestinian Authority and was co-chaired by the local representatives of Norway, the UN and the Bank. In 1995, the aid coordination committee "established 12 sector-working groups, many of which were ineffective… This structure was replaced in 1999 by a simpler set of four groups corresponding to the main sectors in the Palestinian Development Plan: infrastructure, productive sectors, social sectors, and institution building." (Schiavo-Campo 2003, p. 5). Finally, the Bank plays a leading role in the Local Aid Coordination Committee which facilitates coordination on the ground among leading aid agencies (about 30 of them).[39]

Third, the World Bank has also been acting in a highly unconventional way in the WBG: mobilising resources to finance recurrent public expenditures and emergency relief programmes, monitoring and supervising the actual use of these resources, and playing an indirect, yet visible and active role in the politics of the Israeli-Palestinian conflict, by documenting, mediating, facilitating and even putting forward proposals that address security matters.

Much of the recurrent and relief spending was done via a special trust fund, known as the Holst Fund, set up in January 1994 to provide financial support for the start-up of a new administration, the PA. The fund came

[39] A World Bank evaluation study describes the Bank's coordination role and the dilemma it faces as follow: "Aid coordination in WB&G does not lend itself to business-as-usual approaches: over 40 official donors are active; aid flows are high; and the environment is volatile. International assistance has been closely tied to the peace process, is delivered in the absence of a sovereign state, and critical political, economic, and security issues are unresolved. Delivery pressures on both the donors and the PA are intense. The PA is highly dependent on foreign aid but has had limited capacity to manage it. Donors have strong (and often competing) commercial, strategic, or economic interests and bilateralism is pervasive. In these circumstances, political issues invariably become aid coordination issues and vice-versa; aid coordination is thus a daunting task" (World Bank, 2002b, page 5).

into existence on basis of an initiative from the US and was "an innovative response to a clear need, although the donor community had never done anything quite like this: finance relatively large start up and recurrent cost for the establishment of an administration" (World Bank, 2002b, p.9). "Many donor countries and agencies which wanted to support meeting these start-up and recurrent costs, but were unwilling or unable to do so directly, requested …that such a trust fund be established and administered by the Bank" (Shihata *et. al.*, 1992/94, p.21). The Holst Fund was the first major umbrella multi donor trust fund (MDTF) established and administered by the Bank and "became a model for subsequent initiatives".[40] The Bank set up a tight monitoring system, employing an international auditing firm to supervise, check and periodically evaluate expenditure.

The Holst Fund was originally supposed to provide financial support for the PA for two years only, but its operation was prolonged and it remained open until March 2001. From mid-1996 the Fund started to mobilise and use additional resources for emergency job creation to mitigate some of the effects that the closure imposed on the WBG. In 2000 the Bank itself transferred $12 m from the TFGWB to the Holst Fund to finance emergency activities. Total disbursements from the Holst Fund amounted to about $285 m, about $60m of which went to emergency job creation (see table 1).

After the Holst Fund closed in 2001 such operations were performed by the Peace Facility Trust Fund (established to allow the Bank and other donors to react quickly to emerging needs). A total of $25 m was disbursed through this fund before it was closed down. It was replaced by yet another fund in 2004, the Public Financial Management Reform Trust Fund, in response to the demand to create a new mechanism through which donors could provide pooled contributions to finance the PA's budget via the single treasury account on the MoF (World Bank, *Update*, November 2005, p. 24). By the time the fund was closed (December 2005) total disbursements amounted to $273 m (World Bank contribution $20 m, EC: $164.8 m (World Bank, *Update*, September 2006). The Bank launched in 2002 another trust fund, the Emergency Services Support Program (ESSP), to mitigate the effects of economic crisis and the inability of the PA to

[40] Schiavo-Campo (2003, p. 6). He also points out that the proposal for an MDTF was, after a preliminary positive legal opinion initially turned down by the senior Bank management "because it would set a new precedent with reputational and fiduciary risks for the Bank (as trustee). Unlike trust funds for investment purposes, which are subject to normal Bank safeguards, procurement and disbursement rules, the fungibility of aid entails special risks in financing recurrent costs. In addition, there was no precedent for quick-disbursement of loans for purposes other than balance-of-payments financing". However, the argument for a new mechanism to finance the start-up with the Bank as trustee prevailed.

meet its non-salary recurrent costs. Between March 2002 and June 2005 the ESSP financed about $160 m. Finally, and in response to the renewed fiscal crisis, the Bank re-launched in August 2006 the ESSP trust fund and widened its scope to include the maintenance costs of power and water stations. By January 2007 commitments to ESSP amounted to $62 m from nine donor countries.

According to the Bank's former director in the WBG, the Bank has disbursed about 6% of the funds that have been spent since 1993 in the territories, and has administered about 14% on behalf of other donors (World Bank, *Update*, November 2005, p.5). Tables 1 and 2 make clear that the largest share of the Bank's spending went through trust funds designed to finance the PA's budget, recurrent and emergency relief expenditure. During 2001-06 only a little more than one-quarter of the foreign assistance extended by the international community to the WBG went to development purposes.

2. Review of major reports[41]

The World Bank's six volumes

The World Bank study of 1993 under the title *Developing the Occupied Territories: An Investment in Peace* was the first comprehensive study of the WBG economy. It made the Bank the leading source of expertise on the WBG and the coordinator of international assistance. Volume I provides a summary overview, the other volumes cover macroeconomics, the private sector, agriculture, infrastructure and human resources.

The study highlighted four basic structural imbalances in the WBG economy: high dependency on employment outside the territories, low degree of industrialisation, high dependency of foreign trade on one market – Israel, and very poor level of infrastructure and social services. It identified the most important challenge for the future as the creation of employment opportunities for newcomers to the labour market and for those who would no longer be able to find work outside the WBG. And it recommended that policy should be designed to stimulate growth in productive sectors and services, to increase exports in order to reduce the dependency on employment in Israel, to develop import substitution, to diversify trade relations and to bring about a substantial improvement in public infrastructure and services.

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[41] This review does not cover the large number of sectoral studies and surveys in such areas as health, poverty, pension schemes and public sector management.

The study argued that a political settlement was “a necessary but not sufficient condition for economic development”, and that development would depend also on the “quality of the economic management” (1993, vol. I, p. 13). The Bank singled out three key aspects of the strategic choices of policymakers with regard to economic management: the relation between public and private sectors (where it argued private initiatives and investment should be the driving forces); relations with the outside world (with a stress on economic openness and a discussion of the costs and benefits of a free trade agreement versus a customs union with Israel); and the feasibility and desirability of an independent macroeconomic policy (particularly the pros and cons of the WBG having its own currency). These three issues dominated economic research and debate on the WBG over the following decade.

The study concluded that although the growth of agriculture was constrained by limits on water, and the growth of industry by the limited market and lack of raw materials, reasonable growth, domestic employment and diversification could be expected. Much would depend, however, on ‘good policy’. With good policy, a smooth decline in Palestinian employment in Israel and an external private and public capital inflow of $2.5 bn over a five year transition period, a growth rate in excess of 3% in per capita income was sustainable. If there was a sharp reduction in employment in Israel, an extra foreign capital inflow of $350 m would be needed over the five years to avoid a rise in unemployment and a fall in wages and income.

The study defined ‘good policy’ in the traditional manner, i.e. sound public management of the economy with regard to fiscal discipline, pro-trade policies and pro-private investment policies, but it added another important element: a peace agreement which would reduce risk and uncertainty, allow a substantial flow of foreign capital and relax some of the supply-side constraints. “‘Poor policy’ could be offset by official capital flows, but only for a while, since private capital is unlikely to flow in while the political uncertainties remain unresolved, and policy conditions are not perceived to be investor-friendly” (vol. 1, p. 15). In the absence of good policy and adequate foreign financing, income per capita in the WBG could fall by 20% within a decade. The WBG “could enter instead into a period of sustained decline in incomes, employment and welfare… There are many downside risks which if not guarded against could easily trap the OT economy into a low level equilibrium” (p. 15).

The six volumes developed a range of possible economic outcomes, which depended on assumptions on fiscal and institutional management, capital inflows and employment in Israel. The most optimistic of the six scenarios projected a real per capita income growth of 4% per annum over 1994-8, and the most pessimistic a decline of about 3% per annum.[42]

Emergency assistance and public investment 1994-6

The World Bank's (March 1994) report, *Emergency Assistance to the Occupied Territories*, recalls that participants in the 42 donor conference which took place only three weeks after the signing of the DoP "felt strongly that there was an urgent need to deliver tangible benefits to the Palestinian population to reinforce the momentum towards peace" (1994a, preface). Thus a World Bank mission was sent to the WBG in November 1993 with the mandate to provide a framework that would ensure effective use of donor assistance for the immediate needs of the WBG, and to identify the technical assistance required. The result was a report in two volumes, the first of which contains a sectoral description of the economy and proposes an investment programme, with the external financing necessary, for the public sector. The second volume details the complementary technical assistance package needed to support project preparation and institution building. This was the first investment plan for the WBG, referred to as the Emergency Assistance Programme (EAP) and covering the three years 1994-6. The overarching goals of the EAP were "to provide tangible benefits to the Palestinian population quickly, equitably, and effectively, while laying the foundation for sustainable development over the long term" (p. 1).

The process of drawing up the plan involved two steps. First, the Bank mission (and the Palestinian counterpart staff) established broad sector strategies. Second, all sorts of Palestinian institutions, NGOs, municipalities and even private individuals were asked to submit proposals for projects to be financed by foreign donors. Some 2,600 investment and technical assistance proposals with an estimated total cost of $2.8 bn were received. These proposals created "the basis for a sound program" (p. 3).

The report proposed an investment programme with a total cost of $1.2 bn for the three years. One half of this was allocated to public sector investment support (with water and waste-water getting the largest share, followed by power), 25% to private sector investment support and 20% to start-up expenditure support, by both the central administration (to finance

[42] Per capita income growth turned out to be below the worst-case scenario.

a $108 m budget deficit in 1994) and the NGOs. Budget support was expected to be required for 1994 only. The report stressed that the donor community would need to finance the proposed EAP in its entirety, but donor-pledged funds for 1994-5 were in aggregate sufficient and the mix of loans and grants also appeared satisfactory: "The priority now is to match donor pledges to specific sectoral projects and programs in a timely manner" (p. 13). Finally, the report emphasised that the effectiveness of the assistance would depend on how rapidly the Palestinians could develop a capacity to allocate, coordinate and use donor resources. Insofar as the implementation of the EAP was concerned, the Palestinian Economic Council for Development and Reconstruction (PECDAR), which was established in October 1993, was made the primary agency for aid management, the implementation of investments and the design of economic policies.

The Bank's other major publication in the same year is *The West Bank and Gaza: The Next Two Years and Beyond* (World Bank, 1994b). This updated the expenditure and revenue figures for the EAP and drew up an agenda for the future, noting that "Risks are high that potential opportunities could easily be squandered if the policy framework is not supportive of both short term stability, and sustainable growth… In the short term, a sharp deterioration in standards of living would destabilize a fragile socio-economic situation…Medium and long-run success will depend on structural policy choices." The study pointed out that the "recent tightening of labour mobility to Israel makes it crucial to reconsider the scope of the extent of the relief effort that is required in the immediate future" (1994b, p. iii).

The report focused on the resulting problems of unemployment and poverty, and recommended the development of an emergency relief and poverty alleviation programme that would phase out as economic growth picked up, the initiation of direct job creation programmes and the development of the PA's welfare functions to protect the most vulnerable groups. It also emphasised the significant tensions which Palestinian policymakers faced and the fact that significant private investment would occur "only if … the strategic uncertainty is resolved by a believable political settlement" (p. v).

Development under Adversity

This book (World Bank and MAS, 1999), the product of a major collaboration between the World Bank and MAS, was intended to be a sequel to the Bank's *Developing the Occupied Territories*. It covers the whole range of economic and to some extent social policy, with three parts and thirteen chapters. Part I deals with recent developments. The first chapter discusses the worsening economic outcomes since 1994, in the WBG mainly due to Israel's closure policy.[43] The second surveys recent political developments and the third examines in detail the 'harsh reality' of closure. This addresses the policies involved in closure, the macro impact, the effect on the labour market, household adjustment, the impact on firms, the long-term impact on growth (via investment) and the budgetary and other effects on government. It concludes that the recent poor performance of the Palestinian economy is essentially the result of the sudden disengagement of the Palestinian and Israeli economies as the result of permit and closure policies, and argues that the optimal policy would be to free up trade and labour flows within the West Bank, between West Bank and Gaza and between both and Israel. If such measures are impossible, then "fundamental changes will have to be made that allow the Palestinian economy to function with minimal links to Israel." (p. 65)

Part II discusses policies for growth and job creation under adverse conditions. A chapter on private investment identifies a range of legal and regulatory barriers to investment, as well as the overriding issue of political stability and uncertainty. The chapter on international economic relations discusses the existing regime, the need for improved transport links (port and airport), and the future trade regime (where it limits itself to identifying the advantages and costs of different regimes). The next two chapters cover the development of financial intermediation so far, and obstacles to its further growth; and the trends in fiscal revenues and budgetary expenditures. There is an interesting analysis of the WBG's vulnerability to shocks, of ways to reduce that vulnerability and of possible stabilisation responses. The final chapter examines the trends in donor assistance. Throughout there is an attempt to identify steps that the PA and PMA can take to minimise the difficulties being experienced by the Palestinian economy, but recognition that a favourable resolution of the peace process is essential to sustainable long term development.

[43] Closures in the WBG have taken three forms: (i) internal closures prohibiting movement within the WBG, reinforced by curfews; (ii) external closures of the border between Israel and the WBG (and so between the West Bank and Gaza); and (iii) the external closing of international crossings between the West Bank and Jordan, and between Gaza and Egypt. Between 1993 and 1999, the WBG were subject to 311.5 days of comprehensive (external) closure. Days of closure increased sharply after the Intifada; 2002 saw more than 250 days of closure, which means that the Palestinians had only 3 months of unrestricted movement (Kanafani, 2004). The sources for closure data are the UN Special Coordinator for Middle East Peace Process (UNSCO) and Palestinian Ministry of Labour (1995-2005).

Part III focuses on longer term issues, with the argument that Palestinian policymakers should be acting now to put in place an enabling environment for growth, so that "growth will occur if, when, and as, the political situation starts improving , and hopefully, as a political resolution is reached" (World Bank and MAS, 1999, p. 155). There are chapters on three sectors regarded as essential for growth and in need of reform and modernisation: education, health and infrastructure. Each chapter considers how the WBG compares in its area with other countries (poorly in the case of education, a little better on health, very poorly on infrastructure) and makes recommendations for reorganisation and reform. Even in these areas the political issues cannot be ignored. On infrastructure, for example, "Infrastructure development, economic growth and the peace process can powerfully reinforce each other. The ability to expand infrastructure is conditioned by the continued legacy of Israeli occupation. While the easing of this legacy and its associated restraints is permitting some new investment, further relaxation of the limitations needs to occur to stimulate growth." (p. 193)

IMF reports 1995-2001

The IMF produced and published in hard copy form a series of five reports between 1995 and 2001 which considered longer term as well as shorter term issues. The first of these was formally a "background paper issued in connection with the 1995 Article IV consultation with Israel" (IMF, 1995, subtitle) while the later reports contained disclaimers of the sort "Any views expressed in this study are those of the authors and should not be attributed to the IMF, its Executive Directors, the Palestinian authorities, or the authorities of any member country." (IMF, 1997, p. v).

The 1995 report (IMF, 1995) included a section on structural features of the WBG economy and sections on Fund technical assistance and Fund-Bank collaboration, but its main section was on macroeconomic developments and policy issues, supported by appendices on the methodology used in estimating macro data and on budgetary matters.

The 1997 report (IMF, 1997) covered recent economic developments with particular emphasis on the effects of the 1996 border closure, but it also included sections on institution building in the fiscal area, on developments in money and banking and on trade policy. The latter identified the benefits for the WBG of participation in a de facto customs union with Israel, but also noted that for the WBG this trade regime "might not be best suited for its economic circumstances… and development strategy" (page 38).

The 1998 report (IMF, 1998) is notable for a chapter on private investment under uncertainty, which provides a careful analysis of the "particularly adverse impact" (p. 25) of the regime of border closures and identifies that and other obstacles to the recovery of private investment. This report also includes a chapter on monetary policy in the absence of a domestic currency, which considers but rejects the possibility that the Palestinian Monetary Authority could affect the economy via the credit channel transmission mechanism; a chapter on fiscal policy which is long on general principles but short on WBG data; and a chapter on the trade system which focuses on the implications of the closure regime and Israeli security procedures, and ways to ease those constraints (but it returns at the end to the desirability of a non-discriminatory trade regime for the WBG, see section 3 in this paper).

The 1999 report (IMF, 1999) includes a fiscal policy chapter with some detailed data on the PA's budget, together with a range of international comparisons. A chapter on the re-emerging banking sector covers institution building (including the payments system and the new PMA law) but also discusses the slow growth of bank credit. Other chapters discuss donor assistance and public investment; the Palestinian labour market since Oslo; social issues and expenditure; and the medium-term economic prospects of the WBG and what could improve them.

The 2001 report (IMF, 2001) discusses economic developments up to September 2000 and then the effects of the "turmoil and closures" since then, which are characterised as "the most damaging shock the Palestinian economy has experienced over the past 30 years" (p. 20). This report also contains a significant discussion of transactions costs in the Palestinian economy, essentially those due to closures and security procedures and other mainly Israeli-imposed regulations. Other chapters look more towards the longer term, considering demographics and long-term growth; Palestinian trade (with gravity model estimates of the future trade pattern); fiscal policy over the medium term; and the choice of exchange rate regime.

World Bank studies on the effects of the intifada and the Israeli responses

The World Bank produced a series of four studies documenting the devastating economic and social effects of the Israeli measures undertaken in response to the Palestinian intifada which started in September 2000, under the general title *Intifada, Closure and the Palestinian Economic Crisis – An Assessment*. In the first of the series (November 2001) the World Bank reported that per capita income had declined by 12% in 2000, that "the PA is effectively bankrupt, since tax revenues have dwindled to a quarter of previous levels" and that the full collapse of the economy and government had been averted only because donor funding had increased by 25% in terms of disbursements and 40% in terms of commitments, relative to pre-intifada levels. The study made clear that "In effect, long-term investment has had to be sacrificed to short-term consumption" (p. 2).

A more comprehensive study was produced in March 2002 (World Bank, 2002a). Losses to GNI were estimated at $2.4 bn for the first 15 months of the intifada (as against an annual GNI of $5.4 bn in 1999). The Bank estimated total physical damage between September 2000 and December 2001 at $305 m, about 60% of which was in the agricultural sector. The damage to donor-financed projects increased in 2001. It noted that "Nearly 1,100 people died as a result of the conflict between September 28, 2000 and early December 2001, and nearly 19,000 were injured. Of the dead, 860 were Palestinian and 218 Israeli; of the injured, 16,780 were Palestinian…" (2002x. p. 2). And the report stated that "The proximate cause of the Palestinian economic crisis is Israel's closure of the Palestinian territories". (p. iv)

The study dealt in detail with the economic impact of the closure on employment, trade, investment and the fiscal accounts. It spelled out the institutional responses to the extraordinary crisis (in health, education and social services) and examined the social impact with respect to the dramatic rise in poverty and households' coping strategies. The role of foreign assistance in avoiding total collapse was reaffirmed. "The Palestinian Authority (PA) is effectively bankrupt, since tax revenues have dwindled to one fifth of previous level" (p. v). However, donors' commitments had increased sharply from $692 m in 1999 to $973 m in 2000 and $1228 m in 2001, an increase which was "primarily due to an infusion of external budgetary support for the PA" (p. 59). Nearly all of this foreign aid took the form of emergency assistance: budget support (which went mainly to emergency employment schemes), food and cash assistance and employment programmes. This shift to emergency relief was thoroughly documented in a review of the responses of six major donors.

In an attempt to predict the future prospects the study made use of the Bank's macroeconomic quantitative model of the WBG (with seven sectors and four agents) under assumptions for the exogenous variables which generated three scenarios: the status quo; an optimistic scenario (easing of closures) and a pessimistic scenario (harsher closures). The growth in GNI per capita in 2002 was found to be -3%, 17% and -20% in the three cases respectively (p. 81). The required external finance needed to support the emergency and relief programmes was estimated at $1.5 bn, $1.1 bn and $1.7 bn for 2002 in the three scenarios (p. 90). The study ended with a list of immediate priorities for Israel (to lift the system of internal and external closures and to transfer the revenues withheld), for donors (to ensure adequate support) and for the PA (to maintain discipline on its expenditure).

The following two studies on the effects of Intifada (May 2003 and October 2004) followed the same methodology and presentation as the 2002 study: the economic and social impacts, the institutional response (including that of donors), and recommendations to Israel, the PA and donors. The core messages were not much different from those in the 2002 study. The 2003 report, for example, stated that "World Bank analysis shows the limited power of donor assistance under conditions pertaining in 2002. Since the beginning of the Intifada, donors have provided about $315 per person per year, an unprecedented level of international financial commitment. Despite the importance of these contributions in staving off fiscal disintegration and the disappearance of the PA as a viable service provider, the economy has contracted by almost a half" (p. xv). There was, however, one key difference from the previous report, that the PA had now adopted a serious programme of reform. In the light of that the Bank expected donor disbursements in 2003 to be $1.5 bn. It discussed the relative merits, from microeconomic and welfare perspectives, of four donor assistance instruments: budget support, food aid, cash assistance and job creation schemes. It argued that budget support had the highest economic and welfare benefits, while job creation programmes had been less successful. The report ended with the standard recommendations to Israel to ease internal and external closure, transfer clearance money on a regular basis and facilitate the work of the humanitarian agencies.

The Bank has been involved from the start in efforts to facilitate the movement of Palestinian goods to, from and within the WBG. The aim was to make Palestinian trade easier without compromising Israel's stringent security requirements, through the redesign of border crossing facilities, the adoption and monitoring of new management procedures and the appropriate use of modern security technologies. The hope was to put in place a sort of 'closure-proof' route for Palestinian trade. The Bank's efforts in this respect were intensified at the end of 2004 in connection with Israel's plan to disengage from Gaza. The Bank prepared an overview paper and four technical papers which addressed many of the issues related to the movement of trade and security (see, for example, *Linking Gaza to the West Bank – Convoys*, September 2005, and *The Door to Door*

Movement of Goods, July 2005). Its technical papers were strongly reflected in the text of the agreement between Israel and the PA on movement and access at Rafah crossing (to Egypt).

Unfortunately the Bank's work on this front had little success. However, its technical team has maintained its activity and still produces regular reports on the matter, the latest being a comprehensive report on movement and access restrictions in the West Bank: *Uncertainty and Inefficiency in the Palestinian Economy* (May 2007). This report documented and updated the various forms of movement restrictions and geographic cantonisation being imposed on the West Bank, including administrative impediments (Israel's control of the population registry and the issues of family unification and residence), the restricted areas and roads, and the devastating effects of the Separation Barrier on the Palestinian population.

Long-term Policy Options for the Palestinian Economy

In July 2002 the World Bank published a major analysis of alternative long-term strategies for the Palestinian economy (World Bank, 2002a). We shall deal with the analysis of trade and labour market policy and the conclusions reached in section 3. Here we simply present the findings of the final chapter of the report, which addressed past (1968-2000) Palestinian economic performance, where it argued that growth had been transitional rather than sustainable, that is, driven by capital accumulation rather than high total factor productivity growth. Thus "economic integration of WBG with Israel has not produced the positive dynamic gains – notably in terms of productivity growth and technological transfers – predicted by the model of economic convergence" (p. 80). It then analysed potential growth over the next ten years in terms of five scenarios which reflect varying assumptions on 'closures and confrontation', transactions costs, workers employed in Israel, and the trade regime. The simulations suggested some preference for the 'non-cooperative economic separation' scenario between Israel and the WBG, a scenario which was based on the following assumptions: closure and confrontation end in the near future, transactions costs are higher (due to continuing obstacles to trade with Israel) and workers employed in Israel are low, but the trade regime is non-discriminatory with tariffs (on imports from third countries) being lowered at a rate of 10% per annum: this scenario offers dynamic gains in investment and productivity leading to strong export-driven GDP growth, but with costs in the form of higher unemployment.

Economic Performance and Reform under Conflict Conditions

The IMF produced a further report in 2003 which had a much stronger focus on the short term. Of five main sections the longest was on economic performance under the impact of the intifada; it argued that the impact had been severe – with falls in real GNI per capita of 11% in 2000, 20% in 2001 and another 20% in 2002 – but the Palestinian economy continued to function and now (i.e. September 2003) the IMF thought the worst might be over. The following section analysed the effects of the conflict on the Palestinian financial system, which had been subjected to major stress but had survived, while the PMA was making progress in building its capacity to supervise the banking system.

The three remaining sections, which constitute more than half of the report, were concerned with budgetary and public sector management issues. One section analysed the evolution of the fiscal situation in some detail, with comprehensive data on revenue and expenditure from 1996 to 2002; an examination of the effects of the intifada (including the withholding of tax revenues due to the PA by the Israeli authorities) on revenue, expenditure and aid flows; and analyses of the 2003 budget and of future budget trends.

The second of these sections detailed the progress that had been made in financial accountability and fiscal reform. It argued that "these reforms have placed the Palestinian Authority to a level of fiscal responsibility, control and transparency which rivals the most fiscally advanced countries in the region" (*sic*, p. 9).

The final section of the report examined the further reform developments starting from 2002, including the 100 days reform programme announced by the PA in June 2002, the Reform Action Plan of the Quartet's International Task Force on Palestinian Reform of July 2002, the appointment of a Palestinian prime minister (Mahmoud Abbas) in April 2003 and the Quartet's 'performance-based roadmap' to a two-state solution of April 2003 (the key statement is reprinted as an annex to the report). It highlighted six key areas for reform in addition to fiscal policy – market economy, local government, ministerial and civil service reform, judiciary and the rule of law, elections, and civil society. It concluded that some progress had been achieved but much remained to be done; further progress would depend on the Palestinian will to reform and Israeli willingness to alleviate the closure regime.

Disengagement

The World Bank produced two major reports on Israel's projected 'disengagement' from Gaza. The first of these (World Bank, 2004a) was prepared at the request of the PA, the Israeli government and the Local Aid Coordination Committee. It emphasised the dire state of the Palestinian economy, with nearly a half of Palestinians below the poverty line, as the result of an economic crisis which had been "caused by restrictions on the movement of Palestinian people and goods, or 'closures'" (p. i). It explained (with numerical simulations for scenarios corresponding to the status quo, disengagement, disengagement plus easing of closures/opening of borders, disengagement plus easing of closures/opening of borders plus increased donor assistance) that disengagement on its own would not produce any significant economic benefits, and that if it were accompanied by the sealing of Gaza's borders to labour and trade and/or the cutting off of water and electricity supplies it would generate even greater hardship. It argued that Palestinian economic recovery required "a radical easing of internal closures throughout the West Bank, the opening of Palestinian external borders to commodity trade, and sustaining a reasonable flow of Palestinian labour into Israel" (p. ii). But it also argued that the PA should renew its efforts to create an investor-friendly business environment. In this case an increase in donor assistance might be possible, but its management would have to be facilitated rather than obstructed by the Israeli Defence Forces; the report also noted that the destruction of donor-financed infrastructure was a serious issue for donors. The report discussed various possibilities for the transfer of assets left behind in the settlements. It also recommended further work on ways to facilitate border cargo management, i.e. ways to allow Palestinian trade in ways that fulfilled Israel's security requirements.

The second report (World Bank, Dec 2004) took a similar form but made its points even more strongly. Even on its 'disengagement plus' scenario Palestinian poverty was projected to be 45% in the West Bank and 70% in Gaza in 2008 (as opposed to the current 38% and 65%, and the 53% and 76% projected for 2008 under the status quo), and it insisted that "Recovery depends above all on a comprehensive Israeli approach to lifting closure… Israel is urged to re-examine the concept of 'economic separation'. If labour permits are no longer issued from 2008 and if the quasi-Customs Union is abrogated once Israel withdraws from Philadelphi, Palestinian economic recovery may stop in its tracks." On the other hand, the PA was urged "to demonstrate strong and sustained commitment to security reform" (2004c, p. 26). The Bank called for the abolition of the back-to-back system for the transport of Palestinian goods, the establishment of a RoRo terminal in Gaza as the first stage of a full seaport, the re-establishment of a West Bank-Gaza transport link, and so on. A range of such measures taken by both sides would lead to the Bank's 'economic recovery' scenario under which poverty would decline to 31% in the West Bank and 58% in Gaza. "If, and only if the parties take sufficient steps to move the economy back onto a path of sustainable growth, a donor funding conference would be justified, with donors expected to pledge substantial additional funds" (p. 30), and under that scenario of economic recovery with increased assistance poverty would fall to 24% and 49%.

3. Key policy issues in the reports

Trade arrangements

The World Bank's original six-volume work had considered the choice between a customs union and a free trade agreement with Israel, but without coming down on one side or the other. The study applied a simple gravity analysis and concluded that the WBG does "overtrade" with Israel. It noted that "Given the close economic relations with Israel that have evolved over the past 25 years, the economies of the OT and Israel are bound to be inextricably interwoven for the foreseeable future", but argued that "From the perspective of WBG, a strategy that attempted to open up opportunities elsewhere, especially with Jordan, Egypt and the Gulf countries, while maintaining open trade relations with Israel would make sense" (vol. I, p.14). Shortly after its publication the Paris Economic Protocol, signed in 1994 as part of the Oslo Accords, formalised a quasi-CU relationship between Israel and the WBG, with only minor modifications to allow the PA to set its own customs duties and tariffs on a limited number of commodities imported mainly from Jordan and Egypt. This aspect of the Protocol led to what was one of the major debates on economic policy from the mid-1990s, because it was clear that the PA's future trade regime was one of the policy decisions that would have the most far reaching implications for the Palestinian economy's prospects for growth and prosperity. The *Development under Adversity* study (World Bank and MAS, 1999) also identified the advantages and disadvantages of CU and FTA for the WBG but again without committing itself.

A much clearer position was taken by the World Bank's (2002c) *Long Term Policy Options*, which built on several key papers by World Bank economists. The first of these was Astrup and Dessus (2001) which deployed a static CGE model for the WBG to quantify the welfare gains from adopting a CU, an FTA and a non-discriminatory trade regime (NDT), with welfare measured in terms of the purchasing power of households' income. They stressed the high costs of the obstacles to trade created by the Israeli closure policy, but they also argued that "trade policy matters. Moving away from the present customs union framework may present advantages, because the current fiscal and trade framework creates harmful distortions, and creates great dependency on Israeli security concerns. Adopting a more neutral regime would allow rebalancing trade flows with the rest of the world, and is likely to generate gains of specialization, additional welfare for the households and possibly lower transaction costs" (p.20). The authors stressed the benefits of liberal, low-tariff policies, whose adoption of which would make an FTA or an NDT more beneficial than a CU, with welfare gains of 3% of GDP. However, the paper could not establish a clear preference between FTA and NDT. Its implicit conclusion, that the trade regime which is most economically beneficial may be also the one which provides the WBG with the greatest degree of political control, ran against the 'conventional wisdom' which had prevailed until then, according to which the PA faced a trade-off between economic benefits and policy autonomy.

The second paper which fed into the 2002 study was Schiff (2002). He provided a partial equilibrium analysis and calculated the dollar cost and returns for the WBG from four alternative trade regimes (including an FTA with Jordan). The paper concluded that "Nondiscriminatory trade policy is unambiguously superior to an FTA with Israel… The West Bank and Gaza should pursue a nondiscriminatory trade policy with all its neighbours, but *only* under the condition that the trade policy be open, transparent, and enforced by a credible lock-in mechanism" (abstract).[44]

The *Long Term Policy Options* (World Bank 2002c) study differed from these papers on the technical level insofar as it used a dynamic CGE model to trace the long term economic growth implications of different trade regimes. It could therefore identify the trade-offs likely to be faced by Palestinian policymakers. The analysis compared five different scenarios which involved different assumptions about the degree of closure, the level of transactions costs, the number of Palestinians working in Israel and the nature of the trade arrangement (CU or FTA or NDT). In particular, its scenarios 3, 4 and 5 were based on the same assumptions about closure (peaking in 2002, ending in 2003) and about transactions costs (20% lower than in 2000), but different assumptions about the number of workers in Israel corresponding to the different trade regimes (165,000 in 2010 under a CU, 70,000 under an NDT and 145,000 under an FTA). While in the short run the CU option looked more attractive, it turned out that the NDT policy leads to higher exports, stronger productivity performance and in the long run faster growth.

44 See also Dessus and Ruppert-Bulmer (2004).

Over the same period the IMF, whose initial reports had been restricted to macro and fiscal issues, began to address a wider set of policy concerns, including trade policy. Its 1997 report noted that the quasi-customs union enshrined in the Paris Protocol gives access to the Israeli market, but "forces the WBGS to adopt a trade regime that might not be best suited for its economic circumstances (resource endowments) and development strategy" (p. 38). The IMF's 1998 report was mainly concerned with the trade implications of Israeli security procedures, but argued that the long term objective for the WBG should be a non-discriminatory trade regime.

The 2001 report first used a gravity model of trade to identify the trade pattern which an independent state in the WBG would be likely to have. It found that the predicted levels of WBGS exports to and imports from Israel were well below the actual current levels, while the predicted levels of trade to and from the rest of the world (mostly the US, European Union and Japan) were above current levels. But since these results came from point estimates which had no measure of statistical significance, the report re-estimates the model with dummies for WBGS trade with Israel and for WBGS trade with the rest of the world. In this case the coefficient on the former was positive but not significant, while that on the latter was negative and significant. Hence the IMF argued that the WBG was not currently doing an unusually large amount of trade with Israel, though it was trading significantly less with the rest of the world than it could be. However, this conclusion is not robust: since the coefficients on the dummy variables were broadly comparable in magnitude the difference in significance was due mainly to the variability of the dummies, and that was bound to be higher for the WBG-rest of world dummy since there were more observations where that dummy was equal to one, while for the WBGS-Israel dummy there was only one such observation (Cobham, 2004, p. 45 and note 16). More interestingly, perhaps, the predictions suggested that the largest share of the WBG's future trade was likely to be with the European Union (rather than with Israel). The report then addressed the issue of trade policy, where it argued that "the PA should adopt an open, nondiscriminatory, and transparent trade regime characterized by the absence of quotas and trade monopolies. The chapter also makes the case for the PA to adopt a low, uniform import tariff rate (5-10 percent) across the board with no exceptions." (p. 99)

However, this consensus, on a non-discriminatory trade regime, based on serious technical analysis, was almost casually dismissed by the World Bank in its 2006 Country Economic Memorandum in favour of (full implementation of) the Paris Protocol's quasi-CU. In this report the Bank first insisted that the WBG does not significantly overtrade with Israel. Next it compared four different trade regimes: the Paris Protocol as fully implemented, a CU with customs borders (whereby the PA can directly collect import taxes), autonomy in trade policy with multilateral liberalisation (similar to an NDT), and an FTA with Israel. After a brief and non-technical treatment which discussed the benefits, risks and prerequisites of each of the four alternatives (but makes almost no reference to the preceding literature), the study concluded that the first option was the best. "While on purely economic grounds multilateral trade liberalization always produces the highest welfare returns, there are some arguments in favour of option A combined with deeper, policy-induced integration." (2006, p. 54) These arguments included significant dynamic gains from closer integration with Israel as a developed economy with good institutions and competitive markets, the significant costs associated with imposing rules of origin, and the probable effects of interest groups which might hinder the adoption of a low and uniform tariff rate. However, no attempt was made to quantify these gains, or the costs involved.

The role of the public sector versus that of the private sector

Both the World Bank and the IMF have always taken the view that undistorted markets and the private sector are the primary engine of economic growth. According to the Bank's 1993 study the public sector would have an important role in reforms needed to accelerate private sector development – in the areas of the legal framework, access to markets, the financial system, land use, regulation, the tax system, physical infrastructure and human capital – but "any involvement by the public sector in directly productive ventures or interference in the marketplace… should be resisted" (1993, vol. 1, p. 13). The IMF's first report refers to "the need for a strategy which is outward-looking, led by the private sector, and able to promote sizable nondebt creating private capital inflows for investment in productive, labor-intensive activities" (1995, p. 28). Later statements by both institutions in effect assume that private-sector-led growth was the only strategy available (e.g. World Bank, 2002, chapter 5; IMF, 2001, chapter 2). These assumptions reflect a wider, post-Washington Consensus, view in which the role of aid is auxiliary to that of private financial flows and the Bank sees its core mission "to promote an enabling environment for private investment".

Unfortunately, for all the emphasis on the creation of a supportive environment for private sector growth – where the PA undertook many of the policies recommended to it – private sector productive investment has never attained the levels hoped for (although residential investment has been strong). Indeed, the Bank has referred to productive investment in the private sector as the “missing link in Palestinian economic growth over the last decades (2002c, p. 55). An analysis by Sewell (2001) of the data collected (in mid-2000) in the WBG for the Bank’s World Business Environment Survey found that for 77% of the respondents policy instability and uncertainty were the biggest constraints on firms’ operations and growth, and for 70% the biggest regulatory and administrative burdens were Israeli security procedures. The issue of the high transactions costs imposed on Palestinian businesses by Israeli security procedures has been repeatedly investigated and documented by the World Bank over the years (e.g. 2002c, chapter 4; see also IMF, 2001, chapter 3).

Governance and fiscal discipline

From its first study the World Bank took the view that good governance and sound public finances were essential: “future economic growth and development in the OT is critically dependent on the performance of the private sector. Unleashing this potential requires the creation of a legal and regulatory environment that supports private sector initiative. The legal system should provide a set of rules that govern property rights, their exchange and the settlement of disputes….the rules should be perceived as transparent, stable and enforceable, through mechanisms that are seen to be fair and efficient” (1993, vol. I, p. 17). Similar views can be found in many of the later reports. In 2000, for example, the Bank said that “it is crucial to foster an enabling environment for private sector activity and promote further institutional and policy reform within the PA” (World Bank, 2000, p. xxi), while in 1999 it argued that the PA’s failure to curb rapid expansion in the wage bill meant that “the PA Executive does not have the same issues of choice facing cabinets in other governments, such as whether incremental resources should be spent on bricks and mortar for building or paving for roads, whether they should be used to raise public sector wages or even whether they should be given back to tax payers in tax relief” (1999, p. 16).

Indeed, there were three main concerns that were repeatedly expressed in these publications: the uncontrolled expansion of public employment; poor transparency in public finance; and a poor investment climate due to the corruption and inefficiency of the public sector, weak institutions or anticompetitive practices by the PA, through its direct involvement in productive and trade activities. The IMF has also been concerned from the start with fiscal discipline (e.g. IMF, 1995, pp. 1, 26-9). The IMF was central to the reforms of the early 2000s in which the PA’s semi-public enterprise monopolies were made subject to greater transparency and regulation within the Palestinian Investment Fund, while the accountability and transparency of fiscal expenditures and receipts were greatly improved and arrangements introduced to control expenditure more carefully and to mobilise additional revenues (IMF, 2003, chapter VI; see also Adam, Cobham and Kanafani, 2004).

Although the need to curb public employment was repeated in almost every report and set of policy recommendations, the Bank has been aware from the beginning of the severe pressure on the PA regarding its fiscal policy. The Bank's public expenditure review of the WBG in 2007 makes clear that employment in the public sector is "driven by a host of complex and powerful dynamics. Some are understandable, such as the relatively high levels of unemployment and demographic pressure to create jobs for new entrants into the labor force; the precipitous collapse in remittances from workers in Israel; a highly constrained private sector's inability to absorb surplus labour; and the pressure to incorporate irregular militia into the security forces in Gaza." Indeed, the 2007 study states boldly: "It would be unfair to place responsibility for the PA's current fiscal and administrative conditions upon the Palestinians. No administration could easily cope with the massive collapse in revenues that the PA was confronted with in 2006." (2007a, p. v).

The issues of plain corruption, nepotism and the relative efficiency of the public administration also seem to have been overemphasized (due to political pressure on the Bank to accommodate Israel's demands and the need to appear balanced by putting demands on the Israeli as well as the Palestinian sides). The World Business Environment Survey of 2000 made clear that actual corruption in the form of payments to officials was relatively low in the WBG (Sewell 2001, see also World Bank, 2002b, p. 62), though respondents were concerned at that time (before the reforms mentioned above) about competition from PA-connected businesses which might receive favourable treatment. By 2007, on the basis of an Investment Climate Assessment survey of 401 enterprises throughout the WBG, the World Bank was reporting that "relative to other countries in the region, the Palestinian investment climate is good: petty corruption is low, the bureaucracy is relatively efficient and financial markets are well developed… Managers know they need to invest and have access to the necessary resources. However, they are unwilling to do so unless they are assured secure and predictable access to both domestic and international markets… Corruption and government regulations do not appear to be a major constraint on investment. Most managers reported not having to pay any bribes and for those who did, they paid less on average than in most neighbouring countries. The average time it took to obtain a business license was only 30 days, which is half the time reported in Turkey.” (World Bank, 2007d, p. ii).

Growth accounting

The IMF’s 2001 report included a growth accounting exercise for the WBG, according to which the WBG experienced 6% annual growth over the 1970-99 period with the following contributions: 2.1% from the increase in capital stock, 2.1% from the increase in employment and 1.4% from the improvement in total factor productivity (TFP) (IMF, 2001, Table 2.1). This is a very high average rate of TFP growth indeed, twice as high as the average in eight MENA countries between 1973 and 1994, but much lower than that of other countries from 1994 to 1999. The authors also constructed a cross-country model (in the style of Barro and Sala-i-Martin, 1995) for 85 countries over 1970-99 to analyse the causes growth and obtained results. They found, for example, that a 20% increase in openness (share of trade to GDP) was associated with a real per capita GDP growth rate that was higher by 0.1% per year; an improvement in the fiscal balance by 3% of GDP increased the annual growth rate by 0.2%; and real GDP per capita growth in landlocked countries (the case of the WBG since it is denied direct access to the sea) was lower by 0.6% than other countries (2001, p. 46). They then examined the growth differentials between the WBG and groups of comparator countries, finding a large underperformance of the WBG economy from 1995 to 1999 which could not be attributed to fundamental factors, but was “primarily due to the output collapse in 1995 and 1996, a period when the Palestinian economy was subject to extensive closures” (2001, p. 47). The IMF then made some relatively standard policy recommendations, with a particular emphasis on the composition of public expenditure (where it called for a switch from wage payments to education and health spending) and on the need to strengthen the legal system in the WBG. However, the report was also quite clear that the major bottlenecks for the WBG economy are in effect political: “the initial conditions for economic growth are generally good… Nor do policy makers have to undertake serious and problematic macroeconomic stabilization policies… Thus, once the political and security situation improves and once the main obstacles and distortions to the Palestinian economy are addressed – especially those that cause the high costs for foreign trade and the deficiencies in the judiciary and legal framework – it should be able to enjoy an extended period of high growth”. (p.49)

The World Bank study on long-term policy options (World Bank, 2002c) also provided some growth accounting results. The reports a slower rate of TFP growth (0.3-0.4 annually over 1969-2000) and argues that

"Palestinian growth has been transitional rather than sustainable because it was driven by capital accumulation" (p. 76) rather than high total factor productivity growth.

Population and labour market

The WBG's heavy dependence on outside sources of employment, particularly on Israel's labour market, was identified in the first World Bank study as one of the four structural imbalances from which the WBG economy suffered. The report noted that, while the Palestinian labour force had roughly doubled between 1967 and 1993, domestic employment opportunities had increased by only about 25%; and out of 319,000 employed persons in WBG in 1992 more than 36% were working in Israel. Moreover, a key assumption distinguishing the Bank's different scenarios for future WBG growth concerned the smoothness with which a reduction in the number of Palestinian workers in the Israeli labour market was managed (World Bank, 1993, vol. 2, chapter 5). In the event, there were sharp fluctuations through the 1990s in that number with a stronger downward trend over time, while the private sector in the WBG failed, due to closures and other constraints, to create sufficient jobs to compensate, and the increase in public employment was in part an attempt by the PA to address this problem. The World Bank was forced by the same pressures to shift its emphasis from long term development spending to securing the financial viability of the Palestinian administration. With the intensification of the closures since late 1996, and particularly after the outbreak of the second intifada, the Bank's energies were devoted almost entirely to crisis management and job creation schemes.

The IMF 2001 report estimated the likely changes in population size, age structure and labour force participation in the WBG up to 2025, and used results from its growth accounting exercise to compute the growth in GDP, investment and productivity required in order to reduce unemployment, under different scenarios for the employment in Israel, immigration and the rise in real wages. Under plausible assumptions on demographic trends and labour force participation, the labour supply in the WBG would increase by 4.4% a year during 2001-10. In order to absorb this rise while at the same time reducing the high unemployment (by 50% in year 2010 from its level of 8.8% in 1999), domestic employment would have to expand by 6-7% a year. To achieve this while at the same time allowing for an annual increase in real wages of 1.5%, real GDP would need to grow at the extraordinary rate of 8% and TFP by 1.2 % a year.

The World Bank's (2002c) study addressed these issues, building on papers by Astrup and Dessus (2002) and Schiff (2002). The first of these used a calibrated dynamic general equilibrium model to contrast the (existing) emphasis on the export of labour from the WBG, which they argued had Dutch disease-type implications (discouraging domestic production and investment), with a strategy which promoted the export of goods instead. They identify a trade-off where the export of goods strategy produces lower per capita income initially than the labour export strategy, but involves increased export competitiveness as the result of reduced access to the Israeli labour market. In their analysis the goods export strategy is associated with an NDT and a low VAT rate, and it generates higher potential growth with higher per capita incomes after seven to nine years. Moreover, under this strategy the availability of savings for investment is a serious constraint, which means that development aid has a much greater developmental impact.

Schiff (2002) also emphasised the costs of the labour export strategy, including the depreciation of skills and the disincentive to education, as well as Dutch disease effects. Moreover, "by raising WBG wages, access to Israel's labour market may result in permanent productivity losses for the WBG manufacturing firms" (p. 26). He goes on to suggest the introduction of fee-based permits for working in Israel (at about 10% of the wage rate in the WBG), which would also provide additional fiscal revenue to the PA. World Bank (2002c) provides a detailed discussion of labour trends in the WBG, including the profiles of the employed and unemployed, and models the partial equilibrium impact of changes in the labour flow to Israel on employment and wages in the WBG. Its assessment of the implications of labour market integration encompasses points made by Astrup and Dessus and Schiff, and explains the difference from labour flows in other contexts: "The dual nature of the Palestinian labor market vis-à-vis integration with Israel yields inferior outcomes compared to other examples of labor migration from low-income to high-income countries. This can be explained by two main factors. In the first place, labor flows to Israel constitute a very large share of Palestinian employment – nearly one-fourth – which distorts wages in the domestic economy. And secondly, the lack of knowledge transfer, distortionary trade policy and weak business environment together discourage investment and human capital accumulation, contrary to the positive feedback effects typical of other dual labor markets." (p. 48) The World Bank goes on to endorse the Schiff plan for fee-based work permits which would reduce the incentives to seek low-skill high-paying Israeli jobs and provide a new source of revenue for the PA. "One of the primary advantages of the permit fee," the paper argues, "is that its cost is partially borne by Israeli employers (assuming that reduced labor flows raise Israeli wages), and actually benefits Palestinian employers" (pp.50-1).

Macroeconomic policy and the currency issue

The World Bank has not addressed the macro policy issues facing the WBS in any detail, and the IMF was slow to do so. Its 1998 report included a chapter on monetary policy in the WBG in the absence of a (Palestinian) domestic currency, which considered carefully whether the Palestine Monetary Authority could influence economic activity via the credit channel by means of various 'indirect' instruments: the determination of reserve requirement rates, the remuneration of reserve deposits, the placement of reserves, and the institution of differentiated reserve rates on the basis of banks' assets. It reported some regression results which suggested that credit was probably not rationed in the WBG, and that attempts to use these instruments to affect it would have little impact. In addition, the manipulation of reserve requirements could have adverse consequences for revenue and for the stability of the banking sector.

The IMF's 2001 report included a full discussion of the choice of exchange rate regime for a Palestinian state in the WBG. Against a background of basic information on openness, the banking sector and the existing three-currency monetary arrangements in the WBG, it considered the pros and cons of fixing the exchange rate; measures to boost the credibility of a Palestinian currency; the case for a currency board; and the issues of seigniorage and the 'exit option' (the possibility of devaluation). The chapter did not make an unequivocal policy recommendation, but it emphasised the issue of credibility rather than fixity/flexibility and argued that if a Palestinian currency were to be introduced it would be more likely to be successful if it were introduced under a currency board arrangement.

4. The West Bank and Gaza as a special Case

In section 1 we discussed the problems posed for the Bank and the Fund by the fact that the WBG was not a member of either institution. But the WBG was an unusual client for the two institutions in many other respects as well. First, most obviously, it is not a separate well-defined territory with recognized borders, and even the limited areas which are under some sort of PA control are separate and disconnected. The WBG has no control over its international crossings and no sovereignty over its natural resources. In addition, the WBG economy has few of the features common to developing countries, such as a history of excessive government intervention and regulation, high protective tariffs encouraging rent-seeking, ailing productive public enterprises or a history of borrowing and a high stock of (domestic or external) debt. Instead, the WBG economy is characterised by structural imbalances created by decades of occupation: the high dependence on external employment, low industrialisation, dependence on a single partner for nearly all external trade, and poor human and physical infrastructure, as identified by the World Bank in its original (1993) study. On the other hand, the PA has at its disposal only a fraction of the economic policy instruments normally available to other governments (monetary, fiscal, trade policy and other instruments.)

It follows that the problems facing the WBG were different from those confronting other developing countries, and the core reason for these problems, the lack of political and economic sovereignty, had not and has not been remedied.

How much the particular nature of the WBG was addressed by the World Bank and the IMF is a difficult question. On the one hand, much of the analysis which the Bank and the Fund presented contained a clear recognition of the specific features of the WBG. For example, the Bank's work on labour flows mentioned above was careful to explain why, although dual labour markets elsewhere had positive effects on balance for the poorer community, this was not so for the WBG. Similarly, the Fund's work on financial and monetary matters emphasised the unusual existing situation (with three currencies in everyday use, the sheqel, the dollar and the dinar), and its discussion of the exchange rate regime for a future Palestinian state considered the case for a separate Palestinian currency as well as that for continuing the status quo.

On the other hand, much of what the Bank and the Fund prescribed was in line with their standard policy recommendations. Table 3a sets out the ten key elements of the Washington consensus as identified by Williamson (1990; 2003), together with comments on how far each element might apply to the WBG and how much the Bank and Fund advocated that it should be applied in the WBG. It is immediately clear that many of these policies could not be applied to the WBG because the PA did not have control of the relevant instruments and/or because the key problems lay elsewhere. – e.g policies 3-7 on tax reform, financial liberalisation, the exchange rate, tariffs and quotas and foreign direct investment; and, to some extent, policies 8, 9 and 10 on privatisation, competition and property rights. However, where the policies could be applied to the WBG, the Bank and Fund tended to press for them – policies 1 and 2 on fiscal control and public expenditure, and to some extent policy 8 on privatisation. Table 3b sets out nine key policies included in Poverty Reduction Strategy Papers signed off by the Bank and the Fund between 1999 and March 2005 in Heavily Indebted Poor Countries (HIPC) and non-HIPC countries, as identified by Jones and Hardstaff (2003).[45] Here also it is clear that a majority of the policies do not apply in the WBG for one reason or another.

It is therefore not surprising that the policy advice which the World Bank and the IMF provided to the PA was limited in its range and its usefulness. The one broad recommendation which they made on repeated occasions centred on the reduction of the budget deficit, and in particular the control of public employment and the reform of public pension schemes. The Bank did a good job on the sectoral level, particularly in undertaking free-standing investment projects and providing useful surveys and recommendations which helped to improve education, health and public administration. At the macro level, however, its input was inevitably restricted.

5. An initial assessment

After a decade and half of full engagement, $10 bn in foreign aid and hundreds of surveys and studies, what had been achieved on the ground in the WBG? Did the international community manage to bring about "tangible benefits to the Palestinian population quickly, equitably and effectively, while laying the foundation for sustainable development over the long run" (1994a, p. 1)?

Table 4 helps to give an answer. It provides basic data on the evolution of the WBG economy from the early 1990s to 2005. The general picture is of limited and fluctuating improvements in the 1990s (partly due to the very low starting point in the early 1990s after the first intifada), and much worse performance from 2000 onwards. GDP per capita, which measures the income arising from domestic activities, fluctuated over the period (largely in response to the variations in closure) but ended up well below where it had started. GNI per capita – a measure of income per head which

45 According to Jones and Hardstaff, the PRSPs included an average of 5.4 of these policies in their sample of 24 HIPC countries, and an average of 6.6 in their sample of 18 non-HIPC countries. In some cases it can be presumed that countries had already implemented policies not included in their PRSPs.

includes the income coming from outside the territories – had a similar trend but experienced a significantly larger decline between 1994 and 2003. Employment rose over the period, mainly in the public sector (a 60% increase between 1999 and 2006), but the rate of unemployment remained extremely high (especially in Gaza). By 2005 half of the population was living below the poverty line.

A recent report from the World Bank (2007c) confirms this gloomy outcome: "The decline in the Palestinian economy since the second Intifada has left per capita GDP at $1,129 in 2006, about a third less than its level of $1,612 in 1999 ... More troubling than the negative growth is that the GDP is being increasingly driven by consumption financed by remittances and donor aid while investment has fallen to exceedingly low levels leaving little productive base for a self sustaining economy" (p. 2). The report registered the dramatic increase in the poverty rate, unemployment, health indicators (physical and mental), the quality of education and participation in the labour force, particularly that of women. It reports that the PA forecasts a need for at least $1.62 bn in donor assistance per year to close the fiscal gap, of which 91% will go to meet recurrent expenditure needs as opposed to development aid.

Clearly the attempt to improve the Palestinian economy was unsuccessful in itself. The failure to maintain living standards, not to say improve them, means that the Palestinian population did not experience the promised 'peace dividend' and consequently the generous international aid seems to have been unsuccessful as a way to broaden the public constituency for peace and encourage further moves towards a final settlement.

The World Bank's assessment of what went wrong

The World Bank produced two major reports assessing its activities and aid effectiveness in the WBG. The first (World Bank, 2000) was sponsored by the Ad Hoc Liaison Committee's secretariat (i.e. the World Bank) and concentrated on the effectiveness of aid in general, while the second (World Bank, 2002b) was undertaken by the Bank's own Operations Evaluation Department (OED) and examined the Bank's role in the WBG.

The first study, written towards the end of the period of two years of relative stability and relative ease of Israeli closure (1998-99), concluded that "the overall impact of the donor effort has been very constructive. More than US$2.7 billion has been disbursed in the WBG since the first donors' conference in Washington in 1993. Donor aid has helped to build and sustain a Palestinian Administration that now provides a broad range of services to its population.” (2000, pp. ix-x) Moreover, “donor aid has played a key macroeconomic role in cushioning the impact of mobility restrictions and other external shocks” (p. xi). The report also evaluated aid effectiveness at the sectoral level, with respect to infrastructure, education, and health.

On the basis of the debatable assumption that all donor financed development expenditure directly augments the domestic stock of productive capital the report concludes: “Comparative analysis suggests that donor aid since 1993 has increased the GDP growth rate by 1-2 % over what it would have been in the absence of aid” (p. 26). Therefore, the report concludes, the production capacity of the WBG economy in 1998 was 6-7 % higher than would have been the case without donor-financed capital expenditure. However, “the positive effects of donor assistance in 1994-97 were offset by the cumulative negative effects of closure and other restriction. Yet, without such assistance the Palestinian economy would have certainly experienced a much more precipitous – and politically destabilizing – decline.” (pp. 26-7).

The report pointed to the disappointing performance of the private sector where it identified as key stumbling blocks “political uncertainty, a complex legal system and weak judicial system, increasing reports of public corruption and the murky operations of PA-linked commercial enterprises.” (2000, p.xi) Placing its emphasis on the performance of the PA rather than external factors, the report called for improved economic planning and institutional and policy reform on the part of the PA: “*In the absence of a clear and unequivocal commitment to reform at the highest levels of the PA, there is little prospect for progress in these areas*. And without reform, donor assistance will not be as effective as it otherwise might be. Indeed, *without such reform, there is little likelihood of real, sustained economic growth*.” (2000, p. xxi, emphasis in original)

The second evaluation, carried out by the Bank’s own Operations Evaluation Department (OED), made clear from the outset the impact of political events on the Bank’s activities and results: “The overall outcome, sustainability, and institutional development impact of Bank assistance must be seen in the context of an unstable political environment and severe periodic economic crises resulting from border closures.” (2002b, Memorandum to the Executive Directors and the President, p. 1) The report pointed out that, while a number of assumptions made by the international community at the start of operations in the WBG turned out to have been wrong, “the most important assumption, however, was that the political process would be smooth and would not interfere with economic development” (p. 5).

The study considered the Bank’s achievements against four criteria: living standards (where it listed the improvements, up to the end of 2000, in the infrastructure, education and health sectors), poverty alleviation (the poverty rate had declined from 27% to 22% between 1996 and 1999), private sector development (where the results were very disappointing: the share of private investment to GDP had declined from 20% to 14% between 1994 and 1998) and institutional development (rather modest achievements). The OED rated the overall outcome of the Bank’s assistance to the WBG as “satisfactory”, the institutional development impact as “modest”, and the sustainability (the likelihood that the benefits of the assistance would be resilient to risk) as “uncertain”. However, it concluded that “The Bank’s performance has been timely and relevant. The Bank has been required to play many roles in a complex and highly politicized context, and in general, it played them well.” (2002b, Memorandum, p. 3)[46]

The study noted the pressures on the Bank “to focus on short-term emergency relief, to avoid using leverage (such as amount and timing of lending; conditionality) to bring about reforms, and, in general, to operate in ways that are not always consistent with the Bank’s longer term development role.” (2002b, Memorandum, p.3)[47]

It should be noted that the two evaluating reports came to the same overall conclusion: “The overall impression that emerges from the aid effectiveness study is positive: donor support slowed the overall economic decline, contributed to economic growth, and strengthened key institutions

46 Encouraged by the fact that a number of projects supported by the Bank in the WBG were heralded in the Bank as ‘best practice’ and that three of the Bank’s projects in the WBG were selected in 2000 as among the best 29 projects across the Bank for excellence in supervision, the report concludes, “Thus, in most respects, the Bank’s performance has been excellent and should serve as a model for other post conflict situations.” (2002b, Memorandum, p. 3)

47 See also: “In a highly politically charged situation, compounded by the economic crisis, the Bank found itself operating in ways that were inconsistent with its more traditional role of supporting long-term economic and social development. For example, the Bank administered the financing of recurrent budgetary expenditures over a number of years, something it has never done before (...) Most important, the Bank has been unable to use leverage (conditionality; delayed program/project funding; and overall levels of funding) in support of the implementation of important reforms, particularly in public sector management and in sound economic policies; political pressures of other stakeholders and the fragility of the whole situation were simply too great to allow the Bank to operate as it would have in a more “normal” setting.” (2002b, pp. 13-14)

and local capacities. In doing so, donors have contributed to political stability, thus helping to sustain continued Israeli-Palestinian negotiation." (2000, p. xx). "Thus, although donor assistance fell short on support to longer-term development efforts, its reorientation was consistent with trying to sustain a positive environment for the peace process". (2002b, p. 5).

Both of the studies put the emphasis not on the positive effects of aid but on what would probably have happened in the absence of aid, for example, "OED finds that in spite of the poor economic performance in WBG, it would have been worse in the absence of donor, and in particular, Bank assistance" (2002b, p. 24). What the reports argue, in other words, is that foreign assistance in general, and the Bank's efforts in particular, have succeeded in preserving the fragile administrative and socio-political structure in the WBG and, in doing so, kept the hope of future negotiation and a future settlement of the conflict alive. This may be an achievement of some kind, but it is obviously not the original mandate given to the Bank or the IMF or the mandates to which these two institutions are used to working, that is, long-term development or the management of financial and balance of payments crises.

6. A wider perspective

The World Bank and IMF were operating on unfamiliar ground in the WBG and soon made two important discoveries: first, the need to divert resources to finance relief and current expenditure would become chronic and not limited to a couple of years as originally expected; second, their ability to use grants and loans to persuade their clients to follow a particular policy path was severely curtailed in the case of the WBG.

The Bank was repeatedly obliged to shift its resources away from long-term development projects to the financing of relief efforts, job creation and recurrent expenditure (see tables 1 and 2)[48]. We saw earlier how the life of the Holst Fund was extended, and how new trust funds were established and financed by the Bank's own surpluses to carry out employment-generation programmes and emergency relief activities. The Bank was undoubtedly under heavy pressure to direct its efforts and resources to remedy some of the harsh consequences of the Israeli closures

48 The Bank pointed out that "In 2000, the ratio between development and emergency assistance was approximately 7:1 in favor of development assistance. By 2002, the ratio had shifted to almost 5:1 in favor of emergency assistance." (2003, p. xvii).

which were suffocating the economy of the WBG. The international community feared that the economic crisis (which resulted from the political failure) would lead to the eventual total collapse of the peace process. Therefore, avoiding a human tragedy and preserving the structure of the PA were the top priorities. This meant in reality that the overall aim of foreign assistance to the WBG has actually shifted over time, from the provision of a peace dividend to the avoidance of collapse. The Bank's own evaluation of the effectiveness of foreign aid to the WBG concluded that: "donor support slowed the overall economic decline", and "donor aid has played a key macroeconomic role in cushioning the impact of mobility restrictions and other external shocks" (World Bank, 2000, pp. xxi, xi).

The second 'discovery' was the limits to conditionality, the limits to the Bank's ability to use leverage such as the timing or amount of lending to engage the recipient government in addressing particular problems. Clearly, when the target of aid turned out to be the prevention of the collapse of the PA and the so-called peace process, there could be hardly any scope for conditionality. This was expressed clearly by Roberts (2005), a former director of the Bank's office in the WBG: "The history of donor assistance to the Palestinians, indeed, is notable for its lack of performance conditionality, with aid levels determined to a large extent by guesstimates of what is needed to 'maintain political momentum' or, in recent years, to permit the survival of the PA" (p. 24).[49]

In addition, several authors have argued that the use of foreign assistance mainly to maintain the 'political momentum' led the international community to allow the PA to create and maintain a parallel financial system operating without proper public accountability, a system financed by monopoly control of sales of certain commodities, and to provide the 'walkabout' money with which President Arafat secured political loyalty (see Roberts, 2005; Le More, 2005). However, applying the standard conditionality procedure in the WBG would not have been easy or, in fact, fair because the PA's ability to meet any economic target depends crucially on Israeli behaviour: In this case, of course, Israeli action would be detrimental to whether the PA succeed in meeting the target and in receiving the 'prize'. The case would have been completely different if Israel had borne the costs of its occupation and stood to benefit from the WBG meeting the conditional targets.[50]

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[49] There were two exceptions when conditionality was imposed on (and accepted by) the PA: the EU budget support instruments which operated between 2001 and 2003, and the World Bank's Public Financial Management Reform Trust Fund, established in 2004.

[50] On the extraordinary power of the third party, Israel, see also Schiavo-Campo (2003, p. 4): "The key distinguishing features of Palestine to which the funding and programming of post-conflict

The attempt to isolate economics from politics

Clearly, the two 'discoveries' mentioned above, the need to divert resources from development to relief effort and the issue of conditionality, have a common origin in the relation between economics (growth, employment, sound institutions and policies) and politics (negotiating a political settlement in the region). The Bank apparently hoped in the beginning to be able to separate the two things from each other. In its 1993 study the Bank pointed out that "As the Bank mission to the OT was a *technical mission*, with neither the mandate nor the expertise to deal with political or security aspects, this study does not take any position on issues that are on the agenda for bilateral negotiations. The focus instead is on policies, institutions, and investment – where optimal choices are largely invariant to eventual political arrangements that may emerge from the bilateral negotiations. (vol I, p.1, emphasis in original).[51]

However, it became clear, only a few years after the Oslo agreements, that the development of the WBG depended on a political settlement and that allowing the Bank's experts to do what they are best at should follow such a settlement and not the other way around.[52] As the settlement failed to get any closer, the frustration of the Bank's experts and other aid people on the ground grew stronger, together with the realisation that no amount of foreign aid could offset the effects on the WBG economy of the (internal and external) closures. Yet the Bank kept trying to isolate economics from politics in order to allow the economy to get moving and its policies to take effect. Its tireless, though unsuccessful, efforts to design, negotiate and implement the so-called 'closure-proof trade routes' are just one example of their attempt to separate economics from politics. Another is the "industrial zones" situated on the borders between the WBG, Israel and other neighbouring countries to permit work and exports to continue even during periods of closure and curfews. With time, and with the

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reconstruction had to adapt were the constraints posed by Israel, the excessive centralization of decision-making in the Palestinian Authority, and the patchwork nature of the territories under Palestinian control".

51 See also the Bank (2002c) report: "Any future peace accord and related economic agreement will need to isolate political variables from the economic sphere, in order to avoid repeating the current situation in which economic objectives are undermined by competing constituent demands in an unsettled political environment." (p. xxxiii)

52 Joseph Stiglitz, the Senior Vice President and Chief Economist of the World Bank pointed that out in a speech in Gaza in November 22, 1997: "In concluding my remarks this morning, I would like to say that the Palestinian economy faces great adversities. But, it also has great potential. In the four years since the Oslo Agreement, the adversity seems to have been getting the better of the potential. The most important obstacles to the development of the Palestinian economy are political: the extreme uncertainty and instability that have plagued the peace process." (Address to the Conference on Development Under Adversity, on the World Bank Web site).

intensification of Israel's siege of the WBG the Bank must have discovered that bringing about "swift and tangible improvements in living standards in the territories" was inseparable from the issues of security and political arrangements between Israel and Palestine. One of the Bank's reports (2004c) reveals clearly this shift in attitude: "While money, and in particular donor money, has an important role to play in reviving the economy, it is not the determining factor… To change this frustrating dynamic, the underlying causes of economic decline need to be addressed… For recovery to take place, the Government of Israel needs to roll back the system of restrictions on the movement of people and goods...it is these various closure measures that are the proximate cause of four years of Palestinian economic distress" (2004c, pp. 1-2).[53]

On the ground, the Bank made repeated attempts to secure the mobility of Palestinian people and goods under the heavy and demanding umbrella of Israel's security requirement, in accordance with Israel's "security first" principle. The Bank started to formulate practical proposals for closure-free trade routes and special mobility permits for business people and lobbied strongly for the introduction of advanced detecting equipment at military checkpoints and border crossings, in order to facilitate a smoother flow without undermining security, but in vain. In 2004 it produced a number of technical papers which became the basis for the agreement between Israel and the PA on the operation of the Rafah border crossing between Gaza and Egypt in November 2005 (an agreement brokered by the US Secretary of State, Rice). This agreement was effectively frozen little more than one year after it was signed.

The increased involvement of the Bank in security matters, and its continuous failure to change the harsh facts on the ground, not only led to a waste of effort and frustration but also threatened the already fragile reputation of the Washington institutions. In 2004, the Bank reported that "Over the course of the last four months, GOI engaged with the Bank-led donor team in a wide-ranging series of discussion of Israeli security policies as they impact on the Palestinian economy" (2004, page 8). The Bank reported that there were then no less than 743 obstacles in place in the West Bank preventing the movements of people and goods and cutting

[53] In this report (made in connection with the Road Map agreement) the Bank introduced clear-cut conditionality: unless there are substantial changes in the overall political/security setting the report stated that "economic revival is a distant prospect, and it would be hard to justify a major new donor financing drive" (2004c, p. 2). Thus any quantum increases in donor assistance would be wasted in today's distorted policy environment and would do little to attract private investment

the territories into isolated patches. Israel "proposed that the donor community consider financing 52 new roads (totalling approximately 500 kilometres) and 16 under/overpasses in locations throughout the West Bank – stressing that this should be seen as a practical suggestion intended to deal with the realities on the ground" (World Bank, 2004, p. 9). Although the Bank's report which covered this went on to stress that both the PA and the international donor community were opposed to the scheme, the Bank's reputation was inevitably tarnished, with rumours on the web suggesting that the Bank was going to fund Israeli military checkpoints.[54]

Did aid promote diplomacy or reduce its urgency?

Whether the international assistance to the WBG and the conditions under which it was deployed has really aided the diplomatic process is not clear. Keating, the head of the UNSCO Office in Jerusalem during 2001-04, observed that international aid has "been complicit in, and used to support, diplomatic reluctance to face the facts" and that aid was used to camouflage rather than to address the resolution of core political problems (2005, p. 2). If that is so, then in the absence of aid political developments would have taken quite a different turn, i.e. Israel might have had to accept responsibility for the humanitarian crisis, and the appropriate counterfactual might have involved, at the very least, less closures and less restrictions on Palestinian mobility.[55] Just as it is well known in the development litterateur That foreign aid can delay institutional and policy

[54] Inter-Press Service, February 25, 2005. http://www.commondreams.org/headlines05/0225-08.htm (accessed September 12, 2007). The attempts to 'revive' the WBG economy without addressing the core political issue continue to the present day. A report ordered by the UK's current Prime Minister Brown two years ago and published in September 2007 had as its aim to find measures to bolster that economy which would be separate from the politics of the problem. This is what the World Bank, among others, have been trying since 1995, without success (and indeed with adverse results).

[55] The risk that aid would actually indirectly delay the political solution and that foreign assistance would end up financing the Israeli occupation was reached by Le More who argued that "in the course of the last decade the international donor community has financed not only Israel's continued occupation but also its expansionist agenda – at the expense of international law, of the well-being of the Palestinian population, of their right of self-determination, and of the international community's own stated development and political objectives… In addition, aid not only relieves Israel of its responsibilities under international law but it has also clearly helped sustain its occupation, which would have been much trickier and more onerous to maintain had the international community not footed the bills" (2005, pp. 983, 993). Halper (2005) expresses a similar opinion: "However, the attempt to inject funds and resources into a political conflict, in which the stronger party employs tactics of de-development and deliberate impoverishment, results only in contributing to its perpetuation" (p. 190). Also, "Humanitarian assistance may actually hinder resistance and liberation by contributing to a 'steady state' situation whereby oppression becomes tolerable, even sustainable, over time" (p. 192).

reform rather than enhancing it, aid to the WBG may have played a role in reducing the urgency of the political solution to the Palestine problem.

Only once does the Bank seem to have decided to escape from this dilemma and to demand the creation of a situation which would allow it to carry out its mandate. This is probably one of the very rare occasions when the Bank said that ‘no more money is needed’. In its 2004 report to the international community the Bank stated clearly that “On the basis of what is on offer today, economic revival is a distant prospect, and it would be hard to justify a major new donor financing drive… If significant progress is made against a set of agreed indicators, a major new donor effort would then be justified – and a donor pledging conference should be called. Calling such a conference in absence of adequate progress would be counterproductive, however, and should not be considered”. (2004c, p. 2)[56]

However, it is arguable that this came much too late, when the Bank and the IMF were already so deeply involved in the WBG that they could not withdraw. The Bank and Fund should have made their assistance sufficiently conditional on support for the peace accord, should not have accepted to operate under such constraints for so long, and should have pushed against them much earlier.[57]

Post-conflict strategies and comprehensive development frameworks

Some of the problems in the Bank’s operations in the WBG can be highlighted by reference to the general strategies it was developing over the period. First, the Bank’s experience in the WBG (and later in Bosnia and Herzegovina), where it was involved in coordinating the efforts of a large number of external donors, dealing with sensitive political issues and funding recurrent expenditure and relief efforts, led it to develop a general strategy for dealing with ‘post-conflict’ situations. In 1997 the Board of Directors established a Post-Conflict Unit and endorsed a new policy agenda for post-conflict reconstruction. The aim of the new policy framework was to give the Bank a mandate to ease the transition to

[56] Amazingly, also in this report the Bank abandoned its long-held stand of not making statements or recommendations which have a bearing on the final status negotiations. The report states “In light of PA and donor objections to their location inside the West Bank, it is recommended that all West Bank border terminals be located on the 1949 Armistice (Green) line” (2004c, p. 24).

[57] One can perhaps argue that this is too much to ask from the Bank. As Schiavo-Campo (2003, p. 11) points out: “Nor can one underestimate the huge impact of the uncertainties and obstacles created from the Israeli side, especially after 1995. In other situations, however, the Bank was able to stand firm on basic policies. In the high profile, pressure-cooker circumstances of WBG, the Bank could not succeed in doing so, and the short term urgencies won out over the longer-term aims”.

sustainable peace after hostilities had ceased, and to support socio-economic development, in association with the UN system, the IMF, other institutions, and bilateral donors (World Bank, 1998). The interventions envisaged included jump-starting the economy through investment in key productive sectors, re-establishing the framework of governance by strengthening government institutions, repairing vital physical infrastructure, rebuilding and maintaining key social structure, and targeting assistance to those affected by war. The new framework emphasised the importance of flexibility (it even referred to the need for a pragmatic and 'opportunistic' approach – World Bank, 1998, p. 31), and argued for local offices with authority to take decisions. With respect to the WBG, the Bank had already set up an office in Jerusalem in 1994, which was the only regional office with decentralised status at the end of 1994. The IMF also had a Resident Representative for the WBG, based in the World Bank building in Jerusalem, from 1995. But the key problem in implementing the 'post-conflict' strategy in the WBG was that the WBG was (and is) in the midst of a permanent conflict situation.[58]

Second, the absence of policy tools at the disposal of the PA meant that the Bank's flagship strategy framework known as the Comprehensive Development Framework (CDF), developed from 1999, was also inapplicable in the WBG. The objective of a CDF is to ensure that projects and programmes are identified and planned within a holistic approach to development, considering structural, social, macroeconomic and financial dimensions. It should also bring into view the complementary roles of different levels of government, multilateral and bilateral aid agencies, civil society and the private sector. An assessment report made by the Bank's own Operation Evaluation Department points to an even more serious problem preventing the adoption of a CDF in the WBG: "In a post-conflict situation, CDF principles are particularly challenging, such as developing a long-term vision. Given the on-going peace negotiations in the WB&G, articulating such a vision could pre-empt delicate and difficult discussions between the Israelis and the Palestinians" (World Bank, 2002 b, p. 17).

[58] See Schiavo-Campo (2003, p. iii), who emphasises in a post-conflict reconstruction situation the "need for a definite political resolution of the conflict and clear mandate for the Bank". This is exactly what was not available in the case of the WBG.

7. Conclusions

Economic analysis versus economic policy recommendations

The World Bank and the IMF have devoted a lot of resources to analysing the economics of the WBG and of a future Palestinian state, applying up-to-date, mainstream economics to the specific situation in the WBG. They have provided excellent documentation of the costs of the closure policy, and made some genuinely useful contributions on the sectoral and project levels (capacity-building in public health and education, support for local government structures and service delivery). In particular, World Bank economists have developed an interesting and appealing analysis of labour flows between the WBG and Israel (and the settlements), and made a major contribution to the question of the optimal trade arrangements for an independent state (though as shown above there has been an extraordinary volte-face on this issue in the latest Bank report on the subject). IMF economists have produced well-founded analyses of financial and monetary developments in the current situation and policies for the future. Given that other work on these topics has been relatively limited,[59] it is not surprising that the research of the Bank and the Fund is a required starting-point for any economist wishing to work in this area.

However, the policy recommendations of the Bank and Fund have made a less useful contribution. First, they are closer to the recommendations these institutions typically make for a wide range of developing countries, except where those policies are clearly inapplicable to the WBG, and that inevitably provokes suspicion about the appropriateness of the Bank/Fund recommendations for the WBG. Second, few of the policy recommendations made by the Bank and IMF were of practical immediate use for Palestinian policy makers, in particular the recommendations for fiscal discipline and control of the public wage bill, and for the promotion of an enabling environment for private investment. Both issues are undoubtedly important in the light of the serious macroeconomic challenges which the Palestinian economy faces, relating to the reversal of the historic role of the private sector as the main stimulus of the WBG economy. But since neither the private investment environment nor the fiscal stance is fully under the control of the Palestinians the recommendations were of little practical use to the PA. The international community was also aware that public employment had increased mainly to compensate in part for the closure of the Israeli labour market to

[59] Apart from the Bank/Fund there have been many and varied contributions from the Palestine Economic Policy Research Institute (MAS), UNCTAD, and a number of other works such as Cobham and Kanafani (2004), Arnon *et. al.* (1997).

Palestinian workers. Third, that the recommendations did not directly address the roots of the structural defects in the WBG' economy. Several of the features which the Bank and the Fund pressed the PA to reform were, to a large extent, features that had originated in, or at least been perpetuated by, the contractual arrangements between Israel and the PA. This is particularly true regarding the PA's murky monopoly trade activities during the 1990s.[60]

The failure to challenge the political constraints

The aim of the Bank's and Fund's interventions in the WBG was from the beginning, as the OED put it, to provide "an environment conducive to the peace process" (World Bank, 2002, Memorandum, p. 1). The institutions' mandate was therefore always in some sense political, significantly more so than many of their activities in developing countries. However, the political constraints under which they operated prevented them from addressing core issues which have a direct bearing on the short-term and long-term development of the WBG. This put the Bank/IMF experts in an insolvable dilemma: while they were given a mandate to help create prosperity that would be conducive to the peace process they were not permitted to address the core issues which eventually derailed the process all together. Nowhere was this more clear than with the Israeli settlement issue. The massive expansion of the Israeli settlements and settlers on the Palestinian territories was the most important factor in derailing the whole peace process: "settlement expansion placed a dagger in the heart of the Oslo process**",** wrote Roberts (2005, p. 22), yet not a single report from the Bank or IMF addressed this issue (or other similar issues such as the sharing of underground water, or any of the other sensitive final status issues). With the increased confiscation of land and the completion of the separation wall, foreign aid was struggling to catch up with the shrinking resource base and increased isolation and cantonisation of the cities and villages. Aid may have prevented worse outcomes (even lower nutrition levels, a humanitarian crisis) but it could not compensate for the destruction of productive capacity and human capital. 'Chequebook diplomacy', as Lasensky (2005) calls it, even of the magnitude seen in the WBG, evidently did not work in this case, and arguably can never do so. Indeed, the perceived need for aid as short-term life support (rather than investment for the future) meant that donor "policies were complicit in some of the negative trends that ultimately overwhelmed the process" (pp.

60 On the incentive for the PA to actively interfere in the retail trade of some strategic commodities in order to limit fiscal leakage and counter Israel's dominating suppliers, see Kanafani et al (EJ and 1998).

41-3). The potentially constructive role for the Washington institutions with respect to the reconstruction of the WBG was just one more casualty of the indecisiveness of the international community with regard to the Palestine-Israel conflict.

Many observers, inside and outside Palestine, believed in the mid-1990s that the ‘peace process’ could (though it would not necessarily) end in an acceptable peace settlement with a comprehensive two-state solution. Nevertheless, the World Bank and the IMF can be criticised for being slow to realise the nature of the political situation in which they were operating, for accepting Israeli conditions on Palestinian reform which were arguably designed to provide an alibi for Israel’s refusal to change its own policies rather than to promote Palestinian reform, and for not doing more to resist being drawn into merely ‘financing the occupation’ rather than assisting its long-term development. And they can be criticized for not challenging the overarching political constraint which they (and, even more so, the Palestinians) faced. It is evident, both from the reports produced by the Bank and the Fund since 1993 and from the bitter experience on the ground in the WBG, that the Palestinian territories had little chance of becoming a viable economic entity unless the Palestinians acquired sovereign control over their external borders in territories with full geographical unity and contiguity. This must have become clear to the two institutions by the mid-1990s, but they were unable seriously to address these issues. In that sense the World Bank and the IMF were never going to be able to fulfill their objectives; they were on a hiding to nothing.

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Table 1.WEST BANK AND GAZA PORTFOLIO
(January 2007, US$million)

	Bank's own financing		Co-financing		
	Committed	**Disbursed**	**Committed**	**Disbursed**	**Total**
TFGWB	440	259	146	113	373
TATF	-	-	24	24	24
Holst Fund	12	12	273	273	285
Peace Fund	-	-	25	25	25
Public Finance MRF	20	20	273	273	293
ESSP (02-05)	60	60	100	100	160
ESSP (06-)	-	-	62	9	9
Total	**532**	**451**	**903**	**817**	**1,168**

Source: constructed from data and information from World Bank (WBG Update, March 2007)

Table 2: Aid Disbursements grants and loans ($ mill) [4]

Type of Aid	2001	2002	2003	2004	2005	2006
Development Aid[1]	175.0	310.9	448.9	368.1	381.4	252.8
Humanitarian Aid[2]	214.0	351.4	339.1	377.0	491.0	412.9
Budget Support[3]	540.0	497.2	251.0	361.1	349.0	738.2
Total	929	1,159.6	1,039.0	1,106.2	1,221.3	1,403.9

Source: World Bank (2007c)

Notes:

1- Development disbursements from Ministry of Planning PAMS database. Some humanitarian aid may be misclassified in this category, particularly in the health sector.

2- Humanitarian aid disbursements from Ministry of Planning PAMS database; these include UNRWA support and are adjusted by inputs from some key donors.

3- Budget support disbursements from Ministry of Finance and IMF.

4- These figures were compiled by the World Bank based on Ministry of Planning, Ministry of Finance, IMF, and donor data. These figures may not be entirely accurate because of the lack of harmonised and consistent reporting on aid.

Table 3a: The Washington Consensus (Williamson, 1990/2003)

	Policy	Comments with reference to WBG
1	Budget deficits… small enough to be financed without recourse to the inflation tax	Bank/Fund pressure to control deficits; no inflation tax (no Palestinian currency)
2	Public expenditure redirected from politically sensitive areas that receive more resources than their economic return can justify … toward neglected fields with high economic returns and the potential to improve income distribution, such as primary education and health, and infrastructure	Bank/Fund pressure to contain public sector wage bill, especially spending on security services
3	Tax reform … so as to broaden the tax base and cut marginal tax rates	Key problem for WBG is Israeli holdup of tax revenues
4	Financial liberalisation, involving an ultimate objective of market-determined interest rates	No initial financial repression, but no currency so no monetary policy
5	A unified exchange rate at a level sufficiently competitive to induce a rapid growth in non-traditional exports	No currency so no separate exchange rate; key problem is Israeli security procedures hindering exports
6	Quantitative trade restrictions to be rapidly replaced by tariffs, which would be progressively reduced until a uniform low rate in the range of 10 to 20 per cent was achieved	WBG is in customs union with Israel so has to accept Israeli tariffs, which are now relatively low, but Bank/Fund pressure for future independent state to operate nondiscriminatory trade policy
7	Abolition of barriers impeding the entry of foreign direct investment	No such barriers; key problem is uncertainty and instability deterring inflows
8	Privatisation of state-owned enterprises	No state-owned enterprises as such, but PA interests in semi-monopolies; Bank/Fund pressure for transparency and competition
9	Abolition of regulations that impede the entry of new firms or restrict competition [note in Williamson (2003): applies to labour as well as product markets]	No such regulations (product or labour markets); key problem is uncertainty/stability affecting investment and Israeli control of labour flows
10	The provision of secure property rights, especially to the informal sector	Key problems are judiciary and lack of full land registration (inherited from occupation)

Table 3b: Standard policies in Poverty Reduction Strategy Papers (Jones and Hardstaff, 2005)

	Policy	Comments with reference to WBG
1	Strict monetary policy	No Palestinian currency so no monetary policy
2	Strict fiscal policy	Bank/Fund pressure for deficits to be controlled
3	Trade liberalisation	Trade arrangements decided by Israel (with which PA is in customs union), but Bank/Fund pressure for future independent state to operate nondiscriminatory trade policy
4	Water privatisation/greater private sector involvement in water supply	Water in WBG entirely controlled by Israel
5	Privatisation	No major state enterprises to privatise, but Bank/Fund concerned with PA semi-monopoly enterprises and competition issues
6	Investment deregulation	Existing regulation light; problem elsewhere
7	Capital account/financial liberalisation	Inflows to WBG subject to liberalised Israeli regulations
8	Agricultural liberalisation	WBG agriculture relatively unregulated, but expansion hindered by inability to obtain additional water resources and severe Israeli obstacles to exports
9	Increased labour market flexibility	Labour market already highly flexible

Table 4: Summary of West Bank and Gaza Estimated Macro Economic Trends (Excluding East Jerusalem)

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Per capita GNI (constant 1997 $)			1,590.4	1,601.2	1,526.5	1,638.5	1,815.2	1,888.9	1,684.6	1,411.1	1,267.8	1,374.3		
Per capita GDP (constant 1997$)	1765.2	1762.7	1,406.2	1,388.2	1,347.8	1,437.7	1,546.2	1,612.3	1,458.3	1,301.8	1,191.3	1,272.3	1,246.2	1,281.6
Per capita GNI real annual growth %				0.7%	- 4.7%	7.3%	10.8%	4.1%	-10.8%	-16.2%	-10.2%	8.4%		
Per capita GDP real annual growth %		0.1%	- 20.2%	-1.3%	-2.9%	6.7%	7.5%	4.3%	- 9.6%	- 10.7%	- 8.5%	6.8%	- 2.1%	2.8%
Investment (mill $)	784.8	684.5	1,051.5	1,065.0	1,160.6	1,310.6	1,531.1	2,081.2	1,445.5	1,122.0	677.9	1127.2		
Export (mill $)	348.8	289	441.9	497.2	552.6	586.3	723.3	732.1	673.9	498.0	458.3	443.1	605	648
Import (mill $)	1,738.1	1,334.9	2,288.3	2,231.8	2,437.9	2,637.9	2,962.8	3,629.4	3,032.5	2,761.2	2,257.9	2,781.4	3,100.0	3,484.0
Employment (1,000) - of which % in Israel	319.2 36.2	315.8 26.6		417 16.2	429 14.1	481 17.1	549 21.7	588 22.9	600 19.6	505 13.8	477 10.3	564 9.7	578 8.7	633 9.9
Labour participation ratio	39	38		39.0	40.0	40.5	41.4	41.6	41.5	38.7	38.1	40.3	40.4	40.7
Unemployment rate % (ILO Definition)	4.2	6.7		18.2	23.8	20.3	14.4	11.8	14.1	25.5	31.3	25.6	26.8	23.5
Underemployment rate				21.1	11.9	9.3	6.5	5.4	5	3.9	4.3	6.2	6.4	6.6
Poverty rate (% of pop. with < $2.1 per day) - **WB** - **Gaza**					16 42	16 38	14 33	13 32	18 42	27 54	41 68	37 64	38 65	46 63
Food Price index					100	106.17	113.91	119.28	121.22	120.65	123.78	129.51	132.30	137.29
External Assistance, mill $		97	293	318	434	480	457	482	549	929	1,160	1,039	1,106	1,221

Sources: 1992-94: ICBS. 1995-2005: PCBS, national accounts (various issues), labour force survey (various issues), consumer price index (various issues). Poverty data was taken from the World Bank (2004a), World Bank (2006a). External assistance: Net receipt (disbursement) of ODA to WBG (excluding support to UNRWA), 1993-98: World Bank (2002a), 1999-2000: World Bank figures cited in Keatring *et al*. (2005), 2001-05: World Bank (2007c).