
ANALYSIS: Visions for a healthier West Bank economy

RAMALLAH, 9 January 2012 (IRIN) - Izz Tawil draws a black circle on the flip-chart in his office in Ramallah, capital of the West Bank in the occupied Palestinian territory (oPt).

"The Palestinian economy is a closed cash-circle," the general manager of the Palestinian microfinance network Sharakeh explains.

He goes on to draw several small arrows on the line, meant to indicate different elements of an isolated system: At the bottom, there is the construction worker, who gets his salary from a company contracted by the Palestinian Authority (PA), while the PA itself is kept alive through foreign aid.

"And this aid is the only fuel that keeps the circle running," Tawil says, with a serious mien.

Humanitarian aid to oPt increased dramatically from US\$863 million in 2008 to \$1.3 billion in 2009. After Sudan, oPt was the [second largest recipient of aid in the world](#) in 2010. Economists and businessmen warn that the PA's dependency on aid and vulnerability to external shocks could lead the entire West Bank economy to collapse, provoking a humanitarian crisis. Among the most vulnerable are the owners of small businesses and all those who depend on foreign aid channelled through the PA.

Tawil is among a number of people in the West Bank with suggestions for a better way forward.

Coping with aid cuts

Shortly after the 2006 elections which brought militant group Hamas to power in oPt's Gaza Strip, donors cut off more than \$1 billion in aid to the PA as a means of boycotting Hamas. Since then, the West Bank economy has trembled over and over - despite a resumption of aid transfers to the PA in December 2007.

2011 was an especially troublesome year for the PA's budget, which was hit by delayed payments from Arab countries, temporary aid cuts of \$200 million by the US Congress, and a temporary freeze on Israel's monthly transfer of \$100 million in tax funds to the PA. Though both Israel and the US later resumed payments, Israeli officials made clear that they would freeze funds again should Fatah, the dominant political party in the West Bank, form a unity government with Hamas.

The threats raised fears of a crisis scenario similar to 2006, when the PA's budget slid from \$180 million to \$55 million a month, amid running debts of \$1.7 billion. The crisis left government employees, who have a relatively high spending power, without salaries. Banks imposed a more restrictive borrowing policy on businesses; and the unsafe environment made foreign investment appear risky and less attractive.

As withholding aid has become a way to punish the Palestinians for unwanted political manoeuvring, the PA is now seeking more financial independence. 2013 is supposed to be the last year "in which the PA will need any external financing to help with recurrent expenditures," Prime Minister Salam Fayyad announced in a [2011 interview with the Associated Press](#).

But it will not be easy, given such aid amounted to about \$1.5 billion of the PA's \$3.7 billion budget in 2011. The remaining sources of income were about \$105 million in monthly tax refunds from Israel, and much smaller domestic tax revenues.

The dangers of credit

At first glance, the Ramallah-centred West Bank economy seems solid. Many new neighbourhoods are being built around the city and expensive cars are not uncommon. The West Bank economy grew by 7.6 percent (GDP) in 2010, according to the World Bank.

But much of what may have seemed like a boom in Ramallah is veneer.

The economy grew by only 4 percent in the first half of 2011, according to the Bank, and unemployment remained at about 16 percent. According to one employee at a Ramallah branch of the Arab Bank, everything is bought on credit - "even wedding dresses... \$300 is enough for a loan of 10,000".

With a total of \$1.09 million in debts, the PA - including its public institutions and employees - is the biggest of all Palestinian debtors, representing 40 percent of what is owed to Palestinian banks, according to Shirin al-Ahmad, a division chief at the Palestinian Monetary Authority (PMA).

"A political shock like that of 2006," al-Ahmad added, "would mean that these 40 percent become a risk factor for hundreds of thousands of Palestinians, because no money from the PA means no salaries, and no salaries means that people can't pay back their loans, or need to take out new ones."

Even more vulnerable than PA-employees are those with no regular income at all. Without steady work, they are not eligible for loans from any of the 18 banks that operate in the West Bank and the Gaza Strip. This is why 43,100 Palestinians need to borrow from one of Sharakeh's 11 microfinance institutions, with a total credit portfolio of \$74.6 million, of which \$54.7 million can be attributed to clients in the West Bank.

Building an independent economy

"Most of our clients want to run a small business. They are the backbone of the West Bank economy," said Tawil, the general manager of Sharakeh. "If the cash injections from foreign aid delay PA employees' salaries, small businesses like groceries are the first that feel the results."

Mazen Khayyat, owner of a clothing shop in the centre of Ramallah, told IRIN his business was hard hit by the cuts in aid in 2006.

"My debts rose in 2006 from almost nothing to 27,000 New Israeli Shekel [NIS - \$7,013]. At the end of 2011, my debts reached 39,500 NIS [\$10,260]. In 2006 alone, my profit decreased by 17 percent compared to the year before. All this was because people generally look for cheaper products when the economy is weak. And because most of my clients are government employees or their families, the problem was especially severe in 2006. When their

salary comes late, they buy only the most necessary.”

Tawil hopes that by lending to people with no steady income, micro-credit institutions can help build a more independent economy from the bottom up. He suggested the PA support these businesses by giving them tax exemptions. He also recommended university graduates be given more incentives to open a business.

“No one takes the risk involved in business in this unsafe environment,” he said, “because a regular income, financial safety and a loan have become core values for young people.”

His call for less aid is shared by leading Palestinian entrepreneurs, such as Bashar Masri, who is leading the construction of the new West Bank city of Rawabi for 40,000 future residents between Ramallah and Nablus.

Some foreign companies have refrained from investment in the West Bank because of the recurrent danger of violent conflict, the political unpredictability and the many restrictions on trade, mobility and access, imposed by Israel.

The World Bank has identified these restrictions as the main obstacle to private sector growth in oPt. So-called Investment Guarantee Funds had provided insurance for some investors against risks resulting from war and conflict in the past, but their reach is limited. Businessmen argue independence from aid would make the arena more attractive.

“Although cutting aid might hurt in the beginning, more businesses also bring more tax revenues for the PA,” Masri said, adding that “sometimes it has to get worse, before it can get better.”

Despite the many obstacles, some private equity funds recently started investing in the West Bank, Masri explained, adding that one of them, a British fund called Blakeney, invested around \$100 million in local projects. “Foreign funds [are showing] more and more interest,” he said.

“Private sector could collapse”

Rawabi’s budget of \$800 million is entirely financed by a fund from Qatar, providing independence from the PA and from foreign aid - something most private sector projects in the West Bank lack.

Take for instance the 750 local construction companies represented by the Palestinian Contractors Union (PCU).

“Many projects contracted by the PA got their money far too late and had to take out expensive loans,” PCU-chairman Adel Odah explained. “This way at least 30 companies went bankrupt in the last two years. Much profit is lost by paying interest rates to banks. If the PA goes bankrupt, the entire private sector could collapse,” he warned.

Replacing aid

The PA is well aware of the risks: “The PA is teetering at the edge of collapse at any point of time,” Prime Minister Fayyad said at the beginning of December, and began curbing its dependency on aid three years ago, according to Ghassan Khatib, a senior PA official.

Between 2008 and 2011, the PA brought down the deficit covered by donors from \$1.8 billion to about 1 billion, he said, adding that this trend would continue, “hopefully until the PA needs no more aid”.

Fayyad said the PA’s operational costs should become independent of aid by 2013.

The question is how.

“On the one hand, we will replace aid by raising taxes and collecting them more effectively. On the other, we will reduce expenditures,” Khatib explained. Some saving measures, such as restricting PA employees’ use of their government sponsored cars outside working hours, have already been taken.

Khatib said the need for external support would decrease this year, but noted the PA had no control over Israel’s behaviour.

“But their withholding of our tax money will not keep us from pursuing national unity with Hamas,” he added.

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