Office of the Quartet Representative
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OFFICE OF THE QUARTET REPRESENTATIVE (OQR)

Report for the Meeting of the Ad Hoc Liaison Committee

Back to the Future: Integrating the Political and Economic Tracks

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Executive Summary

Background

The Palestinian Authority (PA), established in 1994, served as an important building-block for the Palestinian drive toward statehood but has well-exceeded its five-year interim time horizon. The Oslo framework also led to the 1994 economic agreement (otherwise known as the 'Paris Protocol') governing Palestinian-Israeli relations in four important sectors: trade, labor, fiscal affairs and monetary issues. The absence of political progress on permanent status arrangements during the Oslo process and at Camp David in 2000 was followed by the outbreak of the Second Intifada and a breakdown in Palestinian-Israeli relations. After many years of economic difficulty and an internal Palestinian disagreement between Fatah and Hamas, renewed Palestinian and international efforts were exerted in 2007 to rebuild the Palestinian Authority and invigorate economic conditions on the ground. The Palestinian Reform and Development Plan (PRDP) implemented by the Government of Prime Minister Salam Fayyad from 2008-2010, aimed to prepare the institutions of the Palestinian Authority for statehood in line with the objectives of the political negotiating process.

The deepening fiscal predicament of the PA is connected to the current consequences of the political process but also flows from the cumulative effect of long-term restrictions on the Palestinian economy. Apart from the shortfalls in donor assistance, tax revenues, and private investment as a result of political uncertainty, there are important Israeli restrictions affecting the sustainability of Palestinian economic growth and job creation. The two most important restrictions relate to economic cohesiveness and access to natural resources. The physical separation between the West Bank, East Jerusalem and the Gaza Strip, has led to insufficient cohesiveness in the Palestinian economy to support rapid growth and expanded job creation. This problem is further compounded by a restriction on Palestinian use of land and water in Area C in the West Bank, especially in the Jordan Valley, and by constraints on the competitive use of the electro-magnetic spectrum to grow the Palestinian telecommunications sector.

This paper, entitled 'Back to the Future: Integrating the Political and Economic Tracks' takes stock of the Palestinian economic context since Oslo and emphasizes the importance of adopting a multi-track approach (akin to the Annapolis process during 2007-2008) on the path to reaching a final status agreement. Chapter II of the paper, following an introduction, reviews the evolving context of the Palestinian economy and the constraints placed on its growth due to shifts in Israeli-Palestinian relations and changes on the ground. Chapter III of the paper argues in favor of integrating the political process with negotiations on the economic track. The economic track can proceed at three levels: (i) focusing on permanent status economic negotiations alongside the political negotiations; (ii) improving the implementation of current economic arrangements pending final status; and (iii) generating a positive surrounding environment for average Palestinians residing in the West Bank and Gaza Strip. Giving Palestinians and Israelis a true sense of transformative change on the ground will reinforce public readiness to support positions negotiated by Palestinian and Israeli officials.

The paper also focuses on ways to better implement the interim economic arrangements between Palestinians and Israelis and examines the growing importance of the service sector within the Palestinian economy, particularly its export component. Chapter IV of the paper reviews in detail the context and implementation difficulties of the 'Paris Protocol' arrangements between the Palestinians and Israelis, and provides recommendations on how to strengthen the implementation of these arrangements ahead of a permanent status economic relationship between the two sides. These recommendations can be examined and implemented in the current period until a permanent status agreement is reached. Chapter V examines private sector development in the West Bank and Gaza Strip with a special focus on the growing role of services within the Palestinian economy. Specific attention is paid to the export of services especially in the tourism, travel, and telecommunications and information technology (ICT) sectors. Chapter VI provides conclusions and recommendations.

Economic Context since Oslo

The Protocol on Economic Relations (or 'Paris Protocol) covered a range of economic sectors and established a mechanism for Palestinian-Israeli economic consultation and tax collection. The Protocol explicitly mentioned five economic sectors (labor, agriculture, industry, tourism and insurance) and established the Joint Economic Committee (JEC) as the agreed mechanism for consultation and joint decision-making. The deterioration in Israeli-Palestinian relations towards the late 1990s severely weakened the implementation of the Protocol and adversely affected the Palestinian economy. Three important factors shaped by the protracted occupation and changing events on the ground, continue to restrict economic growth: (i) the evolving physical separation between the major internal Palestinian markets; (ii) limitations on access to natural resources; and (iii) continuing restrictions on access to an effective investment horizon.

Integrating the Political and Economic Tracks

There are two important reasons for integrating the political and economic tracks with any diplomatic initiative aimed at achieving a permanent status settlement. First, agreement on the economic track serves as a litmus test for prospects of a breakthrough in political negotiations. If it is not possible to reach an agreement on the economic issues concerning both sides, there is little chance of reaching true consensus on the sensitive core political issues of the conflict. Second, in view of the well-entrenched cynicism on both sides given the long-history of repeated attempts at progress and a daily reality which provides no grounds for optimism about an alternative, it is important to give public opinion a true sense of impending positive change on the ground. Such changes will have to be far-reaching along the path towards a two-state solution to be effective. If the Palestinian and Israeli populations are able to get a glimpse of how things can be under a new peaceful framework between both sides, they would be more ready to support political negotiations.

There are three important dimensions to the integration of the political and economic tracks. The first dimension is the formal economic negotiations on the permanent status economic relations between Israel and Palestine in the future. This economic track can run in parallel or closely behind progress achieved on the political track. The second dimension relates to the full implementation of the current interim economic agreements ahead of full agreement and implementation of a new permanent status economic framework. The third dimension relates to the surrounding environment and effecting positive change on the ground. Achieving such change will boost the sustainability of the Palestinian Authority, encourage donors to increase development assistance flows to the Palestinian Authority (especially if the changes are large and transformative), and counter the deeply held doubts about the possibility of a comprehensive peace settlement.

Improving the Implementation of the Paris Protocol

Since its signing in 1994, the Paris Protocol has served as the governing framework for economic relations between the Israel and the Palestinian Authority. The Protocol was meant to be in place for five years and covers taxation, trade policy, monetary and financial issues and five different economic sectors (labor, agriculture, industry, tourism and insurance). During the ensuing nineteen year period, only parts of the Paris Protocol have been fully implemented whilst other parts have been neglected as a result of the fluctuations in Israeli-Palestinian relations and the changing situation on the ground in the West Bank and Gaza Strip.

There are different ways to strengthen the implementation of the Paris Protocol pending an agreement on permanent status economic issues. The key recommendations of this report are as follows: (i) re-activating the Joint Economic Committee (JEC) and its sub-committees to agree and implement a joint agenda to improve implementation; (ii) updating the lists of items eligible for import by Palestinian business people under a different tariff regime; (iii) facilitating the return of Palestinian customs control at key border crossings; (iv) opening up normalized two-way trade between the Gaza Strip and the West Bank; and iv) Israeli recognition of the free trade agreements signed between the Palestine Liberation Organization (PLO) and other countries for the benefit of the PA. Chapter IV examines in detail the provisions of the Paris Protocol, assesses overall progress enacting the provisions, and provides recommendations on how to improve implementation. A summary list of these recommendations is provided in Box 2 in the last chapter of the report.

Spurring Palestinian Economic Growth: A Focus on Services

Rejuvenating private sector-led development is a top Palestinian economic priority. A growing and prosperous private sector would create jobs, improve living standards, accelerate economic growth, and greatly support the fiscal position of the PA. One segment of the Palestinian private sector with immense growth potential is services, particularly in external trade. The contribution of the service sectors to Palestinian GDP has increased from 60 percent in 1995 to about 72 percent in 2011 whereas the productive sectors declined from 40 percent in 1995 to just below 30 percent in 2011. Two important service markets in the private sector are tourism and ICT.

The report's key recommendations to promote these important services in the Palestinian economy are as follows: (i) locations in the West Bank are opened to Palestinian investment in tourism infrastructure, particularly in the area of the Jordan Valley and the Dead Sea; (ii) large scale investments are made in a wide range of Palestinian tourism services and infrastructure in support of the hotel and restaurant markets, including tour operators, travel agents, tour guides, food and beverage agents, museums, cultural heritage sites and sporting activities; (iii) Palestinian telecommunication companies are given larger allocations of additional 2G frequencies and new allocations for 3G/4G frequencies, allowing them to compete with Israeli companies; (iv) Palestinian companies are more readily allowed to build telecommunication infrastructure in Area C to ensure appropriate coverage for customers; and (v) imports of required network hardware for Palestinian companies are permitted and facilitated for both the West Bank and the Gaza Strip.

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