PALESTINIAN ECONOMIC PROSPECTS:

AID, ACCESS AND REFORM

Economic Monitoring Report
to the Ad Hoc Liaison Committee

THE WORLD BANK
September 22nd, 2008

Executive Summary

At the May 2nd, 2008, Ad Hoc Liaison Committee (AHLC) meeting, the World Bank, noted that the estimated economic growth arising from parallel actions by the Palestinian Authority (PA), Israel and the donors had not been fully realized. This AHLC report takes stock of further progress on the three parallel conditions for Palestinian economic revival- PA reforms, donor aid and Israeli resolution of the M&A restrictions. It also defines and analyzes the extent of economic restrictions as a collective set of barriers - physical, institutional and administrative - that combine to prevent Palestinian access to its own economic potential, and to the rest of the world.

The months since the May AHLC have witnessed some improvements in security, but in varying degrees across different areas. In Gaza, a 'Tahdi'ah' (calm) between Israel and Hamas was activated on June 19th, 008 Since then, attacks out of Gaza have fallen significantly, but continue to take place, as do other attacks within Israel, and in Jerusalem. Palestinian inter-factional tension continues in the West Bank and Gaza, with arrests of people and closures of NGOs by each side, resulting in an alarming deterioration in the ability of civil society organizations in both the West Bank and Gaza to continue to cater to vulnerable groups, particularly, youth and children. Furthermore, within the West Bank, a worrying trend in settler violence is on the increase. As a general direction, however, there has an overall reduction in hostilities, particularly between Israel and Gaza since June 19th.

Over the past 9 months the PA has made significant progress on implementing the reform agenda laid out in the Palestinian Reform and Development Plan (PRDP). The PA has successfully contained its wage bill, reactivated the budget process and, after excluding one-off revenue items, is projected to reduce the recurrent fiscal deficit on a commitment basis from 27% of GDP in 2007 to about 23% in 2008. The donor community has responded to these reforms by supporting the PA with about $1.2 billion in budget support to the end of August. Gaza, however, remains outside of the reforms as Hamas remains in control of security and the most important ministry positions there.

The PA has made considerable efforts in re-establishing law and order and curbing the activities of militias, another commitment under the PRDP. As a follow-up to the November 2007 deployments in Nablus, the PA undertook a comprehensive mobilization of forces to enhance security in Jenin in May 2008. This is in addition to security initiatives undertaken elsewhere in the West Bank, and is part of a broader reform agenda that has received broad international support at the Berlin Conference on Palestinian Civil Security and the Rule of Law held on June 24th.These deployments of Palestinian Security Forces across West Bank towns have produced encouraging results, and have been met with support by the local population. However, the impact and authority of the Palestinian Security Forces has been severely undermined by continued Israeli incursions to carry out arrests of suspected militants, whom Israel regards as not having been effectively contained

Israel has announced a series of measures in support of the Palestinian economy, including but not confined to: (a) the upgrading or removal of a number of roadblock/obstacles across the West Bank; (b) the increase in working hours at the Allenby Bridge between the West Bank and Jordan; (c) plans for the issuance of an additional 5,000 permits for Palestinian workers to work in Israel; and (d) the issuance of special permits for farmers from Jenin and Nablus to travel to the Jordan Valley using their agricultural vehicles. Of particular impact is the decision on a moratorium on house demolitions in Area C of the West Bank due to the lack of building permits, which was put into effect by the Israeli authorities in April 2008. However, demolitions in East Jerusalem continued, with several demolitions as of August 008.

The support of Quartet Representative Tony Blair, manifest in a May 13th Agreement on several initiatives, is beginning to yield results but requires further support. Several aspects of the May 13th agreement with the PA and Israel have been implemented, including the removal of a number of key roadblocks within the West Bank, the facilitation of the first phase of the North Gaza Emergency Sewage Treatment Plant, the mobilization of donor funds to complete a $500 million Mortgage Facility, and the July 28th Frequency Allocation Agreement between Israel and the PA, enabling Wataniya, a second mobile operator, to begin operations in the West Bank. Moving forward, further support for the May 13th package by Israel and the PA is critical, given their significance as precedents for a revival of the Palestinian economy. It is also noteworthy that these measures were intended as a means and not an end in the Palestinian development narrative. Despite the progress to date, most items in the May 13th package remain uninitiated or incomplete.

Economic Developments

The economic projections of the PA's Palestinian Reform and Development Plan (PRDP) assumed a relaxation in economic restrictions, and a resolution of the situation in Gaza. The economic restrictions have remained and the situation in Gaza continues to deteriorate. Consequently, the Palestinian Central Bureau of Statistics (PCBS) estimates that real GDP growth in the West Bank and Gaza in 2007 was 0.5%. IMF analysis notes a drop in GDP of -0.5% in 2007, and modest growth of 0.8% in 2008. This trend represents a continued but marginal drop in Gaza's indicators given their already-depressed levels, matched with a slight rise in indicators in the West Bank. Despite anecdotal indications that within the West Bank and Gaza, the West Bank may be experiencing a recent increase in economic activity, this trend is unlikely to be significant. With a growing population and a shrinking economy, real per capita GDP is now 30% below its height in 1999. From 1994 until 1999 the Palestinian economy was growing on average at about 6% per year. If this trend had continued, GDP per capita would nearly be 85% higher than it is currently. In addition to growth being low, the economy's productive base continues to hollow out as evidenced by the changing GDP structure. IMF estimates of GDP indicate that the PA's wage bill alone is equivalent to over 27% of GDP.

As the Palestinian economy declines it is becoming more aid dependent. So far this year until end-August the PA has received $1.2 billion in recurrent budget support, but requires about $1.85 billion in recurrent budget support, in addition to the estimated $300 million in development aid, in 2008. Thus, external aid will be at least 32% of GDP.

The closure policy on Gaza since the events of June 14th, 2007 continues to erode the Strip's industrial backbone. The Palestinian Federation of Industries (PFI) estimates that 98% of Gaza's industrial operations are now inactive. According to PFI, of Gaza's 3,900 industries, 23 are operating. As a result, Gazan banking sector activity is estimated to have dropped from 40% of total Palestinian banking to about 7%. Ironically, discussions with various representatives of the banking sector point to an emerging market for the supply of currency and industrial inputs as a result of the closures and the prevailing lawlessness in Gaza, leading to a redistribution of wealth from the formal private sector towards black market operators.

Closure of Gaza is also resulting in the collapse of the municipal sector. Municipalities, providing key services such as water, sewage, solid waste etc. are facing a deep financial crisis. The impoverishment of the population and the near absence of private sector activities imply that municipalities are unable to collect fees for service provision and are unable to pay staff salaries. The ability of municipalities to provide basic services is also severely constrained by their inability to import spare parts and supplies for the provision of basic services such as water and sanitation.

Despite the 'Tahdi'ah' called on June 19th, little progress has been made so far toward improving living conditions of he population in Gaza. First, the increase in fuel and humanitarian imports remains far below needs. Secondly, not only are the quantities of inputs entering Gaza insufficient to resuscitate the private sector, the categories and combinations of items allowed to enter are not conducive to most industrial operations. Thus, the increase in the use of the crossings is necessary to avoid a scenario where more 'categories' are allowed in, but with reduced quantities for each category. Moreover, there is still no progress on allowing exports out of Gaza, beyond a set of possible shipments which may be made as a gesture to various donors. For Gaza's economy to revive, it must be able to import a large quantity of industrial and agricultural inputs, and export its products and agricultural produce. Lastly, the reversal of Gaza's humanitarian crisis extends beyond the entry of goods, and must include the access of the population to the West Bank for all purposes, Israel and elsewhere for health, education and other social services.

Full report:

Complete document in PDF format (Requires Acrobat Reader)