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UNCTAD REPORT: INTENSIFIED AID AND URGENT ACTION NEEDED TO AVERT PALESTINIAN ECONOMIC COLLAPSE
Projections indicate economic decline to levels not seen for a generation

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"The Palestinian economy in 2006 is highly vulnerable, being subjected to a process of de-development that recent events have only accelerated and deepened"

The economy of the occupied Palestinian territory is on the verge of collapse, a new UNCTAD report warns. Dwindling donor support has left the Palestinian Authority (PA) in a perilous financial position and UNCTAD projections indicate that per capita income for 2006 will be half pre-2000 levels, unemployment will affect half the Palestinian workforce by the end of the year, and two out of three Palestinian households will fall below the poverty level.

UNCTAD´s annual report on assistance to the Palestinian people (TD/B/53/2) suggests policy measures and initiatives for averting economic collapse. It also calls for greater donor support and for more options to be put at the disposal of Palestinian policy makers. The report will be reviewed at the forthcoming meeting of UNCTAD´s governing body, the Trade and Development Board, in Geneva on 29 September.

The Palestinian economy: decline and isolation

By the end of 2005, the Palestinian economy was already too weak to withstand further intensification of the protracted conflict in the region, the report notes. Since then, it has had to cope with reduced donor assistance. The modest recovery achieved over the period 2003-2005 masked the economy´s shrinking productive capacity as a result of tightened mobility restrictions, the destruction of physical capital, and the loss of almost one-fifth of the West Bank´s agricultural land to the Israeli separation barrier. Income growth was mainly driven by net current transfers (mainly donor funds) of about US$1.3 billion per year, equivalent to one-third of annual gross domestic product (GDP), and fell short of bringing real per capita national income to the level achieved more than 10 years ago.

Poverty continues to widen and deepen. The report notes that median household monthly income declined to $355 per month by the end of 2005, some $30 below the absolute poverty line of $385. The overall household poverty rate soared from 61% in the last quarter of 2004 to 66% at the end of the second quarter of 2006. Households have exhausted coping strategies and are becoming heavily indebted, with 65% depending on informal borrowing to subsist.

The unemployment rate declined by 4% in 2005 in relation to 2004, but remained high at 29%, leaving 260,000 Palestinians jobless. The economy also witnessed an expansion in the informal sector to compensate for lost jobs in Israel and in local markets. The disruption of commercial networks further fragmented the economy, with each community pursuing limited objectives and dissipating meagre resources through lack of coordination with the similar efforts of other localities.

This led to an increased dependence on external support and on imports (especially from Israel), as reflected by a trade deficit representing 55% of GDP in 2005. Between 2002 and 2005, the Palestinian trade deficit widened by 60%, increasing from $1.7 billion to $2.7 billion. In 2005, the trade deficit with Israel was responsible for three-quarters of the total Palestinian trade deficit. International aid to the Palestinian people was not sufficient to pay for the unbalanced trade with Israel. Fifty-five cents of every domestically produced dollar is a liability owed to the rest of the world, with 40 of those cents owed to the Israeli economy.

Impact of reduced aid

The cessation of most international aid to the PA following the Palestinian elections in early 2006 indicates a deeper economic decline is expected for the current year than that registered in 2002. Projections point to unprecedented unemployment, poverty and social tensions. UNCTAD anticipates that real per capita gross national disposable income (GNDI) will plummet to about $1,200 per person in 2007, a level not seen for a generation, if the level of aid is reduced by 30% per annum in 2006-2008. The cumulative losses over this period are estimated at $3.5 billion in potential GDP and 328,000 lost job opportunities. Assuming a higher 50% reduction in annual aid, GDP losses are estimated to reach $5.4 billion over that period, while potential job losses are estimated at 531,000. Added to this is the weakening of the Palestinian Government´s managerial and technical capacities, the development of which has been the focus of donor support since 1994. These capacities are also essential for the sovereign functioning of the envisioned Palestinian State.

The report cautions that even under a more positive scenario of increased aid, greater mobility, and the resumption of Israeli transfers of tax revenues to the PA, the Palestinian economy is unlikely to achieve sustained growth. Projected GNDI per capita in 2006-2008 is projected at below the 1999 level, and unemployment rates are expected to remain high. What is really required to avert such outcomes, the report says, is not only sustained levels of international aid, but also action to provide decision makers with a range of policy instruments to allow them to manoeuvre the economy onto a path of a sustainable recovery and development.

Recommendations for urgent action

While stressing the need for a national development strategy to address the economy´s structural weaknesses, the report says several urgent steps are needed to respond to the current crisis. These include formalizing the informal sector as a major tool for poverty alleviation and job creation, and adopting prudent fiscal policies to contain the economic crisis. The PA is advised to avoid cutting allocations for social services and to avoid dramatic reductions in its wage bill. The report says the PA should link aid efforts to the Palestinian budgetary process and to development objectives. There is also a need to reconsider the existing trade regime that has locked the economy into "adverse path dependence," and to refrain from hasty liberalization. The report says public reform efforts should be based on a national economic vision to ensure responsiveness to the strategic imperatives of Palestinian national sovereignty and to achieve development goals.

The report cautions that while the quantity of aid is important, it is the quality that matters most. More aid is better if and only if doesn´t distort development potentials and processes - that is, if it assists the PA in implementing non-distorting policies or in removing internal and external distorting constraints. The Quartet´s Temporary International Mechanism (TIM) for aid to the Palestinian people promises to avert a humanitarian catastrophe and growing insecurity. However, UNCTAD stresses that it is important that TIM remain temporary, international and a mechanism, rather than being transformed into a standing policy tool for conditioning donor aid to the Palestinian people or for inserting donor criteria into Palestinian development plans.

UNCTAD´s response

Extremely adverse field conditions have obliged the UNCTAD Secretariat to be increasingly selective and flexible in its technical assistance activities but nonetheless it has achieved sustained progress in the occupied territory, the report contends. UNCTAD has recently completed the second phase of the ASYCUDA customs modernization and automation project with the installation of ASYCUDA++ prototype in the customs headquarters and at three pilot sites. Following the Israeli unilateral disengagement from Gaza in September 2005, the ASYCUDA team has played a central role in ensuring Palestinian customs´ responsiveness to emerging needs at the Rafah Border, and in Palestinian preparations for statehood.

The Secretariat also completed activities under the Integrated framework for Palestinian macroeconomic, trade and labour policy. Palestinian policy-making capacity has been strengthened and the integrated simulation framework has been installed in several Palestinian public and research institutions. Activities under the first phase of EMPRETEC Palestine have also been completed, with the graduation of 123 aspiring entrepreneurs, 16% of whom are women. Ten have started their own businesses and 13 have expanded or reopened existing operations.

Steady progress has also been made in the Establishment of the Palestinian Shippers Council (PSC) project. The PSC has been officially launched with regional offices in the West Bank and Gaza, and is addressing problems reported by members. The PSC has 120 founding members and has secured extra free storage days for Palestinian goods from Israeli port operators. Activities also have proceeded under the Capacities in Debt Monitoring and Financial Analysis (DMFAS) project, which involves building Palestinian capacities in the areas of debt management, public finance and medium-term planning.

Despite Secretariat appeals to the donor community, several projects remain unfunded, including the next critical phase of ASYCUDA. This shortfall comes at a time when UNCTAD projects are demonstrating their growing relevance and are establishing themselves as important tools for linking relief to development. The report contends that funding shortages threaten to reverse years of institution building, even in the private sector.

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