OFFICE OF THE QUARTET REPRESENTATIVE (OQR)

Report for the Meeting of the Ad-Hoc Liaison Committee on Action in Support of Palestinian State-Building

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AHLC Report, 27 May 2015

This report provides an update on the work of the Office of the Quartet Representative (OQR) in support of Palestinian economic growth and institution building since the last Ad-Hoc Liaison Committee (AHLC) meeting in September 2014, as well as a look at our forward strategy for 2015-16.

1. Executive Summary

• **Stalled political process:** Over a year on from the breakdown in talks between Israel and the Palestinians, there is still no tangible political horizon in sight. The last year has repeatedly presented us with reminders not just of where the flashpoints and difficulties persist, but also that in the absence of a political horizon, the vacuum quickly fills with animosity and violence. While 2014 should have been characterized by significant progress towards the two-state solution, it will instead be remembered for a bloody conflict in Gaza, and violent unrest in Jerusalem and the West Bank. Once again, we find ourselves in a highly unstable situation, with few indications that serious and sustained direct engagement between Israel and the Palestinians will begin any time soon. Those involved in the political negotiations are rightly taking a hard look at the traditional approach to the process to understand the best way to move forward. While the parties consider how to renew the efforts for a two-state solution, significant steps must be taken to bring about tangible, positive change throughout the West Bank, Gaza and East Jerusalem, thereby creating a supportive environment that moves us decisively towards renewed contacts.

• **Need for Palestinian economic empowerment:** The Palestinian economy remains heavily dependent on Israel. While a positive political horizon is essential for economic confidence, economic empowerment is vital to boost the Palestinian government's ability to govern its own economic affairs in line with development goals. This includes at the immediate stage a better implementation of existing agreements (especially the Paris Protocol), upgrading them where needed and ultimately replacing them with an alternative trade regime that could benefit both the Palestinian and Israeli economies for the longer term. A critical mass of measures by Israel and the Palestinians to enable free trade and investments will show the business and international community that there is a serious drive to improve Palestinian economic growth prospects.

• **Clearance revenues must be insulated from politics:** A vivid reminder of just how precarious the Palestinian economy has become, came earlier this year following the withholding of Palestinian tax revenues, bringing the PA — the largest employer in the Palestinian Territory — to the brink of bankruptcy and negatively impacting business and private consumption. A transparent and reliable process around clearance revenues is not only critical for the PA's fiscal autonomy, it is also vital for business confidence. It is therefore essential that Israel transfers these monies in a predictable, unconditional and transparent manner. In addition, the PA also needs to carry out contingency planning to better protect itself from disruptions to its finances.

• **Slow pace of Gaza reconstruction:** The situation in Gaza remains unsustainable nine months after the end of the last Gaza conflict. While the Gaza Reconstruction Mechanism (GRM) has already seen construction materials for repairs go to tens of thousands of Gazans, for many the recovery and reconstruction process is not happening fast enough and frustration continues to grow. Immediate as well as long-term solutions, particularly on shelter, energy and water, are still urgently needed for Gaza. If these basic needs are not addressed, there will be no sustainable recovery and redevelopment for Gaza. All involved need to take responsibility immediately to get Gaza out of its continuing deadlock, including Hamas, the Palestinian Authority, the Israeli government and donors who pledged assistance at the October 2014 Cairo Conference.

• **Lack of progress on Gaza reintegration:** The dire situation in Gaza is further exasperated by the stalled reconciliation process between Fatah and Hamas, as the rival factions continue to jostle for power rather than implement the June 2014 agreement. Despite the formation of a Government of National Consensus, Hamas and Fatah have failed to agree on the PA's deployment in Gaza. As long as the deadlock continues and the PA is not on the ground in Gaza, there will not be any significant improvement in the situation. An effective and tangible PA presence in Gaza is also a prerequisite for many of the donors who pledged funds at the Cairo Conference. Without the PA fully engaged, reconstruction, redevelopment and economic recovery for Gaza cannot take off.

• **Security and rule of law:** Effective governance is critically important for economic development in the West Bank and the Gaza Strip. Without police being able to effectively patrol and quickly access areas under Palestinian jurisdiction, Palestinians cannot enjoy effective protection and law enforcement, while economic development will be limited as business and service providers stay away. In April 2015, as a result of OQR's work with the Israelis and Palestinians, the IDF Central Command ordered significant changes to the movement and access conditions for the Palestinian Civilian Police (PCP) that will greatly enhance the ability of PA law enforcement agencies to operate effectively throughout the West Bank. These decisions need to be fully implemented, with further steps taken to ease PCP operations in Area B and Area C enabling quicker response times. Furthermore, effective government also requires a successful reintegration of the civil service in Gaza. The PA and Hamas must take immediate action on the roadmap on the consolidation of the civil service, designed and brokered by Switzerland.

• **Limited progress on movement and access:** There have been some positive developments and decisions by the Israelis that will impact the Palestinian economy. These include trade out of Gaza to the West Bank and Israel for the first time since 2007, steps towards containerization of the Allenby / King Hussein Bridge, and increased capacity at the Kerem Shalom terminal with Gaza. There has also been a welcome increase in the movement of Palestinians, including out of Gaza, and into Jerusalem, as well as an increase in work permits for West Bank Palestinians to enter Israel and changes to some of the requirements. Much more is still needed, however, to further boost economic activity given continuing restrictions on movement and access, both for Gaza and the West Bank.

• **Access to land for economic development:** Limited access to land resources remains a major obstacle to growth of the Palestinian economy. There is still some untapped potential in Areas A and B of the West Bank, where an expedited Land Registration program would help to bring down the cost of development. Area C is where the real economic potential lies, and is key for the development of industrial and economic zones as well as agricultural projects, but is highly politicized. Israel should, for example, fulfil its pledge to fast track permits for agricultural projects on 14,700 dunams of Area C land as it pledged at the last AHLC meeting as an immediate step.

2. Political and Economic Context

In the absence of a tangible political horizon, the vacuum that developed following the breakdown of the Israeli-Palestinian negotiations in April 2014 quickly filled with animosity and unrest. The bloody events of the last year, coupled with unhelpful unilateral moves by Israel and the Palestinians, mean that the sides appear more entrenched than ever in their positions. The Palestinian economy, already suffering from a long-term decline, has been further damaged by ongoing Israeli restrictions that stifle development, a reconciliation process that remains deadlocked due to the power struggle between Hamas and Fatah, and the continuing separation between Gaza and the West Bank as the PA still has not effectively deployed in the Strip.

World Bank figures indicate that the Palestinian economy contracted in 2014, entering into a recession. The Gazan economy contracted some 15 percent in 2014 largely as a result of the summer conflict, while the West Bank economy grew by just 4.5 percent. In 1994, Palestinian GDP per capita was just below that of Jordan, a third higher than Egypt, and five times higher than Sudan. By 2014, Palestinian nominal GDP per capita was less than half that of Jordan, almost 30 percent below Egypt, and only slightly higher than the GDP per capita of Sudan. With an overall unemployment rate of 44 percent in 2014, which soared to almost 70 percent for young people in Gaza, it is clear that the economic status quo is as unsustainable in the long-run as is the political status quo.

As the sides involved in the political negotiations consider how best to reconfigure the process so that real progress can be made on the two-state solution, changes are needed to create a more supportive environment to decisively move us towards the renewed contact. On the ground, basic, daily issues matter as much as the politics and are vital to the success of any future negotiations. Concrete actions must be taken to bring about tangible, positive change throughout the West Bank, Gaza and East Jerusalem, that would allow Palestinians' lives to function better.

The Palestinian economy remains heavily dependent on Israel. The economy faced a major fiscal upheaval when Israel withheld the clearance revenues. In order to safeguard the stability of the PA — which remains the largest employer in the Palestinian Territory — Israel must ensure that these monies are transferred in a predictable, unconditional and transparent manner, and for the revenues to be insulated from the political process. This is crucial not just for the stability of the PA, but also for business confidence in the Palestinian economy.

As ever, the removal or reduction of Israeli restrictions on Palestinian movement, trade, and access are key to securing economic growth. It is essential to work directly with the Government of Israel to remove or limit the impact of restrictions in Gaza, the West Bank and East Jerusalem, and identify instances when restrictions are out-of-date or disproportionate while addressing Israel's security needs.

While a positive political environment is essential to boost investor confidence, it is equally vital to empower the Palestinian government's ability to govern its economic affairs and set its own policies in line with economic development goals. This includes at the immediate stage a better implementation of existing agreements (especially the Paris Protocol), upgrading them where needed and ultimately replacing them with an alternative trade regime that could benefit both the Palestinian and Israeli economies for the longer term. In order to promote a shift towards economic empowerment, practical, constructive measures that can create change on the ground are also needed.

A critical mass of measures by Israel and the Palestinians to enable free trade and investments, taken collectively rather than incrementally, will send a strong signal to the business and international community that there is a serious drive for progress to generate an improvement in Palestinian economic growth prospects. This could include changes to the "dual use " list and procedures, access to Area C lands for development, expanded trade out of Gaza, reform of the clearance revenue system, improved Palestinian systems for export licensing and authorization, the deployment of Palestinian customs and border officials at the crossings, and the establishment of Palestinian import/export facilities.

Though the reporting period has seen continuing animosity between the sides, as well as a distinct lack of direct contact at the political level, there have nonetheless been a number of positive developments. This has included Israel allowing limited trade from Gaza to the West Bank, and from Gaza to Israel, as well as decisions on the movement of people out of Gaza, and on increased PA law enforcement access in the West Bank. Some of these steps reversed long-held policies, and required bold decisions by the Israeli leadership — illustrating that even at a time of a political stalemate, it is possible to promote the stability of the Palestinian Territory.

The current difficulties faced by the Palestinians and Israelis, as well as the international community working to support them in the pursuit of a two-state solution, are immense. Without a critical mass of fundamental changes on the ground that will bring about an improvement in Palestinian lives, there is a very real risk that the window of opportunity closes permanently on the two-state solution. It
is imperative that tangible, positive changes are made throughout the West Bank, Gaza and East Jerusalem to support the institutions and economy of a viable and peaceful Palestinian state.

Gaza: Immediate action needed

The difficulties faced by Gazans in the aftermath of the summer conflict are enormous — and frustration continues to grow as many of the solutions seem obvious. Core challenges to Gaza's future endure, including reconstructing shelter and housing, building critical water and energy infrastructure, reestablishing Gaza's connection with the West Bank, and reconstructing strong commercial links with the global economy. The immediate priority that drives all those who have a stake in Gaza — including Hamas, the PA, Israel, and the international community — should be improving the situation on the ground for ordinary Gazans.

Israel has taken some important steps on Gaza, but as long as the closure policy remains in place, with strict restrictions limiting trade, the entrance of materials, and movement and access, the pace of rebuilding Gaza will remain painfully slow. Israel should publish a revised list of "dual use " items that can be imported to Gaza, as well as allowing for increased import volumes of cement and other building materials, in a manner that meets its security requirements.

The international community turned out in force in Cairo in October and reaffirmed its commitment to the PA — both in terms of boosting its capacity to enable it to lead on the reconstruction of Gaza, and continuing support to enable the effective administration of the West Bank. Hamas and Fatah must end their power struggle and focus on making substantial progress on the reintegration of Gaza, under the auspices of the Government of National Consensus, which would improve the daily lives of ordinary Palestinians, and have a significant impact on the Gazan — and indeed wider — Palestinian economy. The process should lead to a Gaza that is more open, able to interact better with the West Bank, East Jerusalem and internationally, with the PA deploying at border crossings.

This is a major undertaking, with numerous challenges in the areas of governance, security and justice. A clear strategy is needed for institutional unification and integration in the justice and security sectors, including redeployment and reactivation of PA staff in Gaza. The fiscal implications on the PA's budget need to be taken into account, and measures to identify potential additional costs, and to cut unnecessary expenses, should be included. Donors should fully honor their commitments from the Cairo conference, and support the reintegration efforts, based on a credible framework, in order to increase stability in Gaza.

The Government of National Consensus will also need to be properly empowered to swiftly implement a broad and thorough recovery program for Gaza. Israel and the PA should build on the achievements to date of the UN-brokered Gaza Reconstruction Mechanism (GRM) by further improving the volume and pace of approval of large-scale projects, including for Gaza's water and energy infrastructural needs.

3. Forward Strategy and Progress Review

Since the previous AHLC meeting in New York in September 2014, the Office of the Quartet Representative (OQR) has focused its work with the Palestinians, Israel and the international community on areas where substantial improvements in the Palestinian economy and institutions of governance can be made in the interim in order to shift the status quo and create a favorable and supportive environment ahead of a renewed push on the political front.

OQR is focusing on five development areas, which represent the fundamentals of economic and institutional growth:

1. Effective Government
2. Movement and Trade
3. Unlocking the Value of Land
4. Reliable Infrastructure
5. Investment Promotion

By promoting key projects that would bring about real economic and institutional development in these areas, the OQR will assist the Palestinians to build the institutions and economy of a viable state, and help to advance new Palestinian realities on the ground. Although these projects would benefit from and advance more easily under a favorable political climate, OQR believes it is possible to achieve real progress on the priority projects even under the current circumstances.

Economic empowerment that boosts the Palestinian government's ability to govern its economic affairs and set its own policies in line with economic development goals is key to bringing about progress. The implementation of the interim agreements, including the Paris Protocol on economic affairs, must be considered along with the required actions, measures or amendments needed for the PA to effectively carry out its economic policies. Measures that can enhance economic and trade arrangements between the parties to empower the Palestinian government and economy should be explored. This includes at the immediate stage a better implementation of existing agreements (especially the Paris Protocol), upgrading them where needed and ultimately replacing them with an **alternative trade regime** that could benefit both the Palestinian and Israeli economies for the longer term. A recent report by OQR, in partnership with the Palestinian International Business Forum and the International Council of Swedish Industries (NIR), found that transition to a new Palestinian-Israeli Free Trade Agreement (FTA) would ultimately mean a major economic boost for both parties (the report is due for publication in June). Until the political situation makes it possible for the parties to start negotiating an FTA, clear and specific interim actions could be taken to bring about a fundamental change in the nature of Palestinian—Israeli economic relations, in order to ensure greater independence and growth. Such measures would make it possible to cut through the constraints, restrictions and bureaucracy that restrict Palestinian economic development.

The following sets out OQR's strategy for 2015-16 and reviews the main developments in our work since the September 2014 AHLC meeting:

Effective Government

Financial reforms, anti-corruption legislation, and the strengthening of the judiciary have all helped to build international confidence in the PA as an effective government. Yet despite significant improvements in PA capacity and governance in recent years, significant gaps and deficiencies remain.

Effective government requires coherent institutions and a legal framework that protects rights of citizens and meets the needs of a modern economy. All these are prerequisites to building a state. Furthermore, given the mutual dependence between effective government and economic development, the absence of institutional and governance capacity will impede the successful reforms in key sectors of the economy. While private sector actors can drive development, government institutions must have the capacity to fulfil their enabling role.

In this regard, the Gaza reintegration process is important. The process must be led by the PA, and include the reintegration of the civil service in Gaza, which currently remains stalled despite the roadmap presented by Switzerland. OQR is supporting the process, including through discussion with the PA on institutional unification and integration in the justice and security sectors, and redeployment and reactivation of PA staff in Gaza.

As part of our work on **governance and rule of law issues,** OQR launched a project in 2012 to track the areas of operation of the PCP, as well as Israeli restrictions on their movement in Areas A, B and C. Under the project, supported by the Government of the Netherlands and the U.S. Institute of Peace, OQR developed a dedicated GIS mapping tool, enabling the PCP to track its areas of operations, as well as restrictions on access in enforcing the rule of law. The tool has proved to be a valuable asset in PCP planning, and its communication with Israel regarding the easing or elimination of these restrictions. Through this project, OQR has worked with the PCP and IDF to objectively map current movement conditions and to examine options for expanded PCP access in the West Bank in line with the Interim Agreement, in addition to more efficient distribution of PCP stations and resources.

In April 2015 as a result of OQR's engagement with the Israeli authorities, the IDF Central Command ordered significant changes to the rules for the movement and operations of PCP and other security forces in the West Bank, in line with the provisions of the Interim Agreement. These changes constitute the broadest easing or removal of restrictions on the operations of the PA security forces in the last fifteen years, and in some areas since the establishment of the Palestinian Authority. At the request of the IDF and PCP, OQR has produced maps for both sides to reflect these changes and to enhance coordination between the two sides. These changes should now lead to free movement of PA security forces in all of Area A, and faster coordination times in Areas B and C. This will result in a more effective and contiguous security footprint for the PA in the West Bank. In addition, the IDF has permitted the establishment of three new Palestinian police stations in the Jerusalem suburbs of Abu Dis, A-Ram and Biddu. Some 60 officers have already been deployed, with armed Palestinian patrols launched for the first time in these towns since the Oslo Accords.

OQR's Rule of Law team will continue to monitor and facilitate the implementation of these changes. The team will also focus on possibilities for further easing of coordination procedures and access over time. In addition, OQR will work with the parties to upgrade the coordination process to considerably reduce the PCP's response time. While the move from the need for written coordination to telephone coordination in many cases is already an improvement, transition to a more efficient and ideally computerized system will ease coordination even further.

Movement and Trade

The removal or reduction of Israeli restrictions on Palestinian movement, trade, and access remain essential to securing economic growth. Movement and access restrictions, both physical and regulatory, hinder economic development in the West Bank and the Gaza Strip and affect nearly all aspects of Palestinian life. The reporting period did see a welcome increase in the movement of Palestinians, including out of Gaza and into Jerusalem, as well as an increase in work permits for Palestinians entering Israel and changes to some of the requirements. Israel must continue to build on these decisions, to further boost economic activity, including by allowing visas for investors from the region who wish to visit the Palestinian Territory.

Current infrastructure, regulations, and restrictions governing Palestinian trade are too constricting to support meaningful Palestinian trade growth. Palestinian firms are currently faced with highly prohibitive trade barriers and costs, severely limiting their ability to trade. According to the World Bank's Doing Business 2015 database, a Palestinian firm pays the equivalent of USD 1750 to export a container, with the process taking an average of 23 days. By comparison, the MENA average is significantly lower at USD 1166 and 20 days, and the Israeli average far lower again at only USD 620 and 10 days — under half the time and almost a third of the cost. A similar situation is seen for imports. A Palestinian firm pays USD 1425 per container and takes 38 days, the MENA average is lower at USD 1307 and 24 days, and the Israeli average a fraction of this at just USD 565 and 10 days. In short, Palestinian imports and exports cost significantly more and take significantly longer than their immediate competitors.

Shipping containers are universally recognized as the single most important logistical factor capable of increasing overall trade volumes and trade efficiency at border crossings. Yet containers are not in use at the key border crossings of Allenby / King Hussein Bridge, and Kerem Shalom / Kerem Abu Salem. Containerization of border crossings, increasing the permitted height for pallets to 1.7 meters, and extended, reliable hours at border crossings are some of the key measures that would help Palestinian traders bring down their costs.

The reporting period has seen some important developments in the area of movement and trade in recent months, and OQR will continue to work with the parties to continue this positive momentum. While at present, Palestinian trade to and from markets to the east (Jordan, Saudi Arabia, the Gulf States, East and Far East Asia) is limited, an established **Jordan Valley trade route** would increase trade diversification, as well as volume, and strengthen the Palestinian economy. To this end, OQR is focusing on enabling container trade at the Allenby / King Hussein Bridge, working closely with the PA, and the U.S., Dutch and German governments. Both Jordan and Israel are constructive counterparts in securing progress on this project.

The projected operational date of a new container-capable facility on the Israeli-side of the crossing is now late summer 2016, and the planned new Jordanian facility will not be ready before then. OQR is working with the relevant authorities on an interim solution to introduce containerization of trade already in 2015, and a mobile scanner, funded by the U.S. Government, is expected to be in place on the Jordanian side this summer. Following this development, the Israeli authorities informed OQR in April 2015 that they have agreed to the following: While they will not allow loaded containers to enter the West Bank until their full facility is operational in August 2016, they will allow for out-bound, loaded containers to leave through the crossing to Jordan as soon as the Jordanian authorities have their scanner and processes ready to receive containers. Israel will also allow for the entry from Jordan of empty containers (this is important due to the system of control that shipping companies maintain on leased containers). They will equip their facility at Allenby to handle the movement of containers back-to-back. OQR will continue to focus on this file with a view to seeing these commitments being fulfilled in the coming six months.

OQR is also working with the sides to support an initiative for the installation of a conveyor belt to improve the efficiency of moving sand and other bulk goods from Jordan to the West Bank. This will reduce the congestion of trucks on the bridge, thereby increasing efficiency for the crossing for passengers and for goods that cannot be transported via conveyor.

Increasing **Gaza trade** would have a significant impact on the economy and employment in the Gaza Strip. OQR has continuously lobbied for trade between Gaza and the West Bank, as well as exports from Gaza to Israel, as a key step to revitalize the Gaza economy, support job creation, and help strengthen the legitimate private sector — all in accordance with Israel's security needs. There is considerable potential, given the pre-closure levels of trade. For example, in Q1-Q2 2007, an average of 230 trucks per week of agricultural produce and manufactured goods left Gaza for the West Bank, Israel and other destinations. A large proportion of furniture products went to Israel, and 50 percent of furniture producers interviewed by OQR recently said that Israel is their preferred market for sales outside Gaza.

In late 2014, Israel allowed trade of agricultural produce as well as furniture and textiles between Gaza and the West Bank for the first time since 2007. OQR and others continued to lobby Israel to allow transfer of goods from Gaza to Israel, which was finally permitted in March 2015, albeit on a very limited scale. The current permit for exports from Gaza to Israel is limited to four types of vegetables, with a monthly maximum quota for each type (for example, 200 tons of tomatoes and 50 tons of eggplant per month), and will expire in September at the end of the current Jewish year. In order to make a substantial difference to the Gaza economy, this order must be extended — and with enough lead-in time so that producers can plan ahead and plant sufficient seeds to meet both local and external demand.

In addition, exports should also be expanded to include other types of vegetables,

fruits, as well as garments and furniture — all of which currently pass through Israeli territory en route to the West Bank, thereby demonstrating they satisfy Israeli security requirements. Furthermore, OQR will continue to lobby Israel to eliminate limits on pallet height, reduce excessive transfer costs and maximize reliability for transfers of produce between Gaza and the West Bank and to Israel, in line with decisions made by Israel following the 2014 Gaza conflict. These steps are essential for the private sector in Gaza to make their trade commercially viable and sustainable.

OQR has also continued to push for containers to be allowed into and out of the Gaza Strip. In an important first step, the Israelis are looking at ways to expand capacity at the Kerem Shalom crossing, as well as preparing space for containers.

Unlocking the Value of Land

Limited access to land remains one of the major obstacles for the development of the Palestinian economy, given the significant overcrowding in Gaza, and that over 60 percent of the West Bank is defined as Area C under full Israeli control. The PA is faced with governing a territory that is fragmented and lacks contiguity. Area C is the only major contiguous area of territory in the West Bank, home to more than 250 Palestinian communities. Palestinian urban centers are artificially bound, unable to expand into the urban periphery to meet the needs of population. This situation, together with the lack of registered land, is the root cause of high land prices in areas under PA control, and has widespread knock-on consequences for the wider West Bank economy.

Area C is however a major political hurdle, where Palestinian villages face insurmountable difficulties in securing approvals for master plans and building permits. The majority of the area remains inaccessible to large-scale Palestinian investment and economic enterprise. Despite the current political climate, Israel must realize that given its economic importance, expanded access to and development of Area C by Palestinians is absolutely critical for the future viability of the Palestinian economy and state. A number of specific projects with a very high and quantifiable impact on Palestinian development, and which require access to Area C land to be successful, must be pursued.

In order to provide a coherent and informative tool to empower economic development and policy planning, OQR is undertaking an **economic mapping exercise,** which will complement the work of UN Habitat, the Palestinian Ministry of Planning and Administrative Development, and the World Bank. The GIS maps

developed by OQR for the police access project are currently being adapted to apply various additional "layers" that relate directly to work on major issues for the Palestinian economy, such as housing, economic zones, infrastructure etc. OQR will make the tool available to help decision-makers and stakeholders take better-informed decisions on investments, thereby putting capital to more productive use.

The high cost of land, insufficient supply of registered land, inefficient regulations, and limited access to finance, all contribute to a mismatch of housing supply and demand in the West Bank. The shortage of housing facing Palestinians in the West Bank would also be helped through authorized expansion into Area C lands around urban centers. **Affordable housing,** defined as USD 40-60,000 / unit, is very scarce, while high-end units, at over USD 100,000, are relatively abundant. In 2014, OQR and the World Bank commissioned an effective demand survey to look at the preferences of low- and mid-income households in the West Bank.

Over the last six months, OQR has presented the survey results in a series of workshops around the West Bank, bringing together senior Palestinian officials, real estate developers, banks, and development agencies to discuss how best to reduce housing prices. The survey found that there is considerable demand for affordable housing, including smaller units, in the West Bank, where some 70 percent of Palestinian households currently cannot afford average house prices. By building smaller units and optimizing design, developers could cut housing prices significantly and reach new market segments. The results point to significant opportunities for developers to build homes at affordable prices for the Palestinian market.

OQR continues to hold follow-up discussions to identify potential areas suitable for affordable housing development, including in Area C. The team will work with the PA, developers, banks, and development organizations on their commitments with a goal of launching a pilot affordable housing project by the end of 2015. OQR has also conducted a regulatory reform study, identifying the key regulatory barriers to affordable housing. The results and recommendations from this report will be shared in the coming months, with a view to hopefully changing the most inefficient regulations.

Efforts to support the PA in developing major new industrial zone projects — such as the **Jenin Industrial Free Zone (JIFZ)** being developed by the Turkish Industrial and Technology Parks Development and Management Company (TOBB-BIS), or plans for an industrial zone in Hebron — have the potential to create tens of thousands of new jobs, and boost manufacturing GDP and exports. In order to unlock the value of land

for Palestinian businesses to invest in production capacity, OQR is assisting the parties involved in the development of the JIFZ. The project seeks to leverage the strategic location of the JIFZ, with good access to trade routes, in order to attract export-oriented businesses. Construction of the project is expected to begin this year and it will be operational within three years. The JIFZ is expected to have a significant impact on the economy in general and of the northern West Bank in particular, by attracting investment, increasing exports and providing tax and other revenues for the PA. Exports from the zone will contribute to reducing the Palestinian current account deficit.

As an example of potential impact of optimal implementation, TOBB-BIS expect the Zone to generate up to 10,000 direct jobs and 15,000 indirect ones over time. To put this number into perspective, there are around 53,000 unemployed people in the northern governorates of the West Bank including Nablus, Jenin, Tubas and Tulkarm.

Reliable Infrastructure

Insufficient build-out of planned large-scale infrastructure remains a serious problem throughout the Palestinian Territory. In Gaza in particular, the water and energy infrastructure crisis is at a dangerous crossroads — and this has also been recognized by Israel. OQR therefore focuses its attention on these critical needs. However, it will be very difficult to achieve tangible progress on building Gaza infrastructure that is reliable, fit for purpose and will serve future generations without real steps being taken by Israel and without the PA properly engaging in Gaza.

Gaza's primary water supply — the Coastal Aquifer, providing 98 percent of Gaza's drinking water — has become increasingly contaminated, with 96 percent of extracted groundwater being unsuitable for human consumption according to WHO standards. Years of over-extraction have depleted groundwater reserves and caused the intrusion of both seawater and sewage. If over-extraction continues at the same rate, the UN predicts that the aquifer will become unusable next year, and irreversibly damaged by 2020. The best long-term solution for an adequate supply of water is through the construction of a large-scale **desalination plant and associated works.** The direct economic impact of this — USD 500 million project would be profound in terms of construction related employment. The further positive economic benefit of a healthy labor force with the corresponding reduction in lost man-days and decrease in related healthcare costs are significant where indirect economic impact could be as high as USD 2.8 billion. This year is seen as "make or break" for the project, and OQR will work on advancing the overall project through engaging and coordinating between with the stakeholders (Israel, PA, and the international community), as well as providing support to advance the financial and technical aspects of the project.

A reliable and uninterrupted supply of water from the desalination plant as well as water treatment will depend upon a reliable and uninterrupted supply of electricity. Indeed, reliable electricity supply is a major factor for economic development in all economic sectors and is identified in Palestinian business surveys as being one of the top three most significant impediments to economic growth, along with political instability and lack of capital. Overall, Gaza continues to face a massive electricity deficit, with around 200 MW reaching the area, while demand is closer to 450 MW. OQR is focusing on long-term solutions for Gaza power generation. This includes working with the Israelis and Palestinians on a strategy to ensure reliable and enduring energy solutions for Gaza. OQR is thus focusing on **gas for Gaza**, as the availability of natural gas in Gaza will enable the Gaza Power Plant to be expanded, thus generating considerably more electricity locally. Furthermore, a supply of natural gas to Gaza would enable Palestinian industries that are heavy users of energy to generate their own electricity on a cost-efficient basis, resulting in considerable savings.

Investment Promotion

Political uncertainty, continuing security and movement restrictions, and limited access to finance are among the major factors preventing wide-scale investment in the Palestinian economy. A confusing and complicated process to apply for visas, via Israel, is repeatedly mentioned by potential investors as a major barrier to entry. Over the past fifteen years, investment levels in plant and machinery have more than halved as a share of GDP — falling from nearly 13 percent in 1999 to under 5 percent in 2013 — and are showing no signs of increasing. Today's investment levels are not sufficient for Palestinian businesses to maintain and replace existing equipment, being less than their replacement value. If these levels do not increase significantly, and soon, businesses will see a decrease in their productivity and output over the coming years, losing ground to their competitors in Israel, Jordan, and the Gulf. Palestinian GDP and employment, already too low, will decrease even further as a result.

The Palestinian investment climate is in long-term decline. While a political horizon would certainly help buoy the Palestinian economy at a macro level, at a micro level there is nonetheless existing growth potential. Credible opportunities for improving and promoting investment opportunities exist in most Palestinian economic sectors (including in light manufacturing and tourism), but several significant opportunities are currently concentrated in the two sectors at opposite ends of the technology scale: agribusiness and information technology.

While agriculture as a percentage of GDP has continued to decline, (the sector's contribution as share of GDP has dropped from 11.4 percent in 1994 to just 4.1 percent in 2013), the area of **agribusiness** has seen steady economic growth over the past five years, mainly due to the introduction of new high-value crops and new technologies in farming and food processing. Exports of Palestinian food products were around USD 240 million in 2013, and given that the local market share for Palestinian processed fruits and vegetables is about 20 percent, there is considerable export potential. OQR is working to attract and mobilize significant new investments in this sector, for example through investment in the processing of fruits and vegetables, as well as exploring options for investment in production of new, high-value fresh crops for processing.

Where physical restrictions limit investment in many areas, information technology should have an advantage in attracting new ventures given that the main resource for developing this sector is qualified human capital. Palestinian universities produce over 2,500 **IT** graduates annually, but few are able to find jobs upon graduation. The unemployment rate among university graduates is 30 percent (24 percent in West Bank and 39 percent in Gaza). Compared to other economic sectors, the IT sector is underrepresented in terms of overall employment and job creation, even though it is seemingly producing a qualified labor pool and does not suffer from constraints such as movement and access issues that other industries are faced with. There is a significant opportunity to build the sector if a robust comprehensive approach to the IT ecosystem is developed.

As part of its work on an **IT ecosystem** for the Palestinian Territories, OQR is working with the Palestinian Authority on its objective of e-government to introduce 10 Government to Citizens (G2C) services. This would also attract international IT companies to the country, and develop the local skills and market. In addition, OQR is working to attract international IT companies to the Palestinian Territory to create jobs, either by establishing their own presence or by contracting with Palestinian IT companies or to expand existing contracts.

As a part of this work, OQR approached SAP — the market leader in enterprise application software — to connect the company with Palestinian universities. As a result, seven Palestinian universities joined SAP's University Alliances program in April 2015 to develop highly qualified graduates with skills that are in high demand. The next step will be to work with SAP to create a road-map for employment through their Young Professionals Program for graduates.

Conclusion

The potential for Palestinian economic growth will remain severely limited as long as Israeli administrative and security measures continue in the ongoing absence of a political horizon. Should Israel take substantial steps to advance the Palestinian economy, it would result in major economic benefits for both parties. Substantial improvements in movement and access as well as other economic empowerment measures will help boost private sector activity, and create more employment opportunities — as well as promote stability.

The Palestinian Authority must for its part promote stability by ensuring responsible fiscal policies, including contingency planning, and encouraging outside investments where possible. The PA will also need to display leadership in promoting a swift and comprehensive reintegration process that results in Gaza and the West Bank under one, united rule, to put an end to years of separation and uncertainty. A successful and carefully planned reintegration process will boost donors' confidence, as well as enabling vital upgrades to Gaza infrastructure, and ultimately job creation and economic growth.

OQR will support positive economic and institutional development in the Palestinian Territory by securing tangible progress in the areas outlined above. Despite the highly unstable situation and uncertainties on the ground, it remains imperative that the international community works with Israel and the Palestinian Authority to bring about significant, positive change on the ground.

Office of the Quartet Representative
P.O. Box 55384, JERUSALEM, 95908
www.quartetrep.org
Twitter: @QuartetRep