Office of the Quartet

OFFICE OF THE QUARTET
(OQ)

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

30 September 2015, New York

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AHLC Report, 30 September 2015

This report provides an update on developments relevant to the work of the Office of the Quartet (OQ). It highlights areas of OQ's work that are supporting Palestinian economic growth and institution building, focusing on issues concerning movement and trade, as well as infrastructure issues, and the impact they have on shaping the Palestinian economy.

Since the last AHLC, the Office of the Quartet Representative (OQR) has transitioned to the Office of the Quartet (OQ). The mandate of OQ remains unchanged, continuing to focus on economic and institutional development in the West Bank and Gaza, addressing issues related to strengthening investment in the Palestinian private sector, rule of law, and movement and access. OQ continues to focus its priorities on bringing about tangible improvements to help advance the Palestinian economy, thereby helping to preserve the viability of a two-state solution.

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1. Executive Summary

Twenty years after the signing of the interim agreements, we are at a perilous juncture. Palestinian-Israeli negotiations have not resumed since they were suspended in April 2014. There is uncertainty over political transitions in the Palestinian Authority and the PLO. The Hamas-Fatah reconciliation process has not advanced, leaving Gaza and the West Bank disconnected. Gaza is no closer to the basic infrastructure it needs to support its redevelopment. Escalating tension in East Jerusalem further threatens an already precarious status quo. The absence of a clear political horizon presents an increasingly challenging context within which to sustain the Palestinian economy.

The Palestinian Authority (PA) has managed its fiscal situation despite a prolonged period of crises. The PA is coping with dramatic reductions in budget support and increasing demand for public services, while trying to advance its reform agenda. Low investment in productive assets, underdevelopment of infrastructure, and declines in net exports exacerbate an already large balance of payment deficit. The West Bank is experiencing declining income per capita, rising unemployment, and higher poverty, while Gaza continues to endure recurrent humanitarian and economic catastrophes.

In the absence of a political solution, there are meaningful steps that can be taken to shift the status quo and work to build the institutions and economy of a viable state. Growth in the Palestinian economy will remain severely limited as long as disproportionate Israeli administrative and security measures continue. Concrete actions must be taken to bring about positive change throughout the West Bank, including East Jerusalem, and Gaza. Improvements in movement and access, as well as other economic empowerment measures, will help boost private sector activity, create more employment opportunities, and promote stability. Actions should focus on both structural issues – in particular the economic relations between the Palestinian Authority and Israel – as well as the promotion of key projects that can bring about economic and institutional development. Such actions are not intended to be a replacement for a two-state solution but rather to create an environment conducive to restarting a negotiations process.

Our key messages are summarized below:

〉 **Economic empowerment starts with better implementation of existing agreements**

The partial and selective application of the economic and trade arrangements between the parties (based on Annex V of the Interim Agreement, also known as the Paris Protocol) combined with restrictions associated with Israeli administrative and security measures, continues to have a significant negative effect on Palestinian economic growth. The Interim Agreement was intended to be transitional, lasting for a period of five years (ending in 1999) while the parties negotiated and agreed on a comprehensive peace treaty. Over the years, with successive negotiations falling short of a final status agreement, the parties continued to apply this agreement, albeit selectively, inconsistently, and often poorly. Presently, more than two decades since the start of the Oslo process and in the absence of an achievable alternative, the parties remain tied to this framework. This has led to unnecessary inefficiencies and restraints on Palestinian economic, trade and fiscal policy, as well as cumbersome institutional and jurisdictional constraints that hamper the PA's capacity to govern effectively.

The unsustainability of the status quo is clear. Economic viability and fiscal sustainability under the current economic regime has been lost; practical measures are needed that will trigger a substantial and transformative change for the future of the Palestinian economy.

As a first step, a range of specific and feasible measures for more effective implementation of the Paris Protocol should be explored to address its main shortfalls and pave the way for a transition to an improved and sustainable trade regime between the parties. A number of pressing and structural issues need to be addressed, including import policy, tax clearance procedures, bilateral trade regulations, and cooperation and dispute settlement. None of this can be accomplished without a robust and sustained dialogue between the parties through the reactivation of the Joint Economic Committee (JEC). The goal must be to amend agreements where conditions have changed and reform in areas where all parties can agree.

Economic empowerment comes with responsibility and requires a firm commitment from the PA to build the effective institutions required to be self-sufficient. It is imperative that the international community also commits financial and technical support to help the PA in building the necessary capacity.

Recommendations:

- *GoI and PA political leaders, with support from the international community, meet and address reform of the Paris Protocol. Through reactivation of the JEC, the parties should seek to implement measures which have already been agreed and amend measures where conditions have changed.*
- *GoI and PA agree to enhance the arrangements for sharing of revenues and to increase Palestinian ability to set and administer an independent trade and economic policy.*

〉 **The removal or reduction of restrictions on Palestinian movement, trade, and access is essential to economic growth**

The anemic performance of Palestinian exports is at the heart of the Palestinian economy's structural weaknesses. The share of total exports of goods and services as a percentage of GDP is approximately 17 percent, less than half of the GDP percentage in neighboring Jordan. This GDP figure, however, is reduced to less than 3 percent if exports to Israel are subtracted; exports to Israel currently represent a sizeable 87 percent of total Palestinian exports.

The balance of payment deficit is more than 30 percent of GDP, making the Palestinian economy overwhelmingly dependent on external resources. Palestinian manufacturers suffer from a lack of reliable access to the imports that are necessary to build productive capacity and manage supply chains. In addition, transaction costs of importing and exporting are significantly higher and the process takes longer and is subjected to greater uncertainty than regional peers, hurting competitiveness.

The removal or reduction of restrictions on Palestinian movement, trade and access remain essential to the development of the economy. A fundamental review of the dual-use goods lists and procedures to better focus the contents of the lists, in order to make the processes transparent and readily available to Palestinian importers, is a critical first step. A system needs to be agreed that differentiates "known traders" and addresses the challenges of large scale projects that may take years before completion and cannot be held hostage to unpredictable changes or idiosyncratic implementation of dual-use restrictions. The process for standards approvals is opaque and unpredictable, and together, dual-use approvals and standards approvals largely explain why Palestinian importers spend three times as much as Israeli importers when importing a container.

Recommendations:

- *The GoI, with support from the international community, defines clear strategic parameters for the dual-use goods lists, reforms the dual-use goods lists in line with these parameters, streamlines the processing of dual-use goods approvals, and makes all trade procedures transparent, in a way that meets and balances both Israel's security criteria and Palestinian trade efficiency.*

- *The GoI agrees to a goods transfer system which recognizes traders with an established secure trading history and which addresses the unique challenges of large-scale multi-year projects.*

- *The PA immediately reduces the bureaucratic delays and costs in the processes involved in approvals of shipments for export.*

〉 **Reinforcing the Jordan Valley trade route increases trade diversification to and from markets to the east, providing a catalyst for acceleration of an export strategy**

Allenby Bridge is currently the only international crossing point between the West Bank and Jordan that serves both passengers and trade. Upgrading the Allenby crossing to include special scanners that quickly process containers will spur wider development of the Palestinian economy. In particular, the containerization of Allenby trade would reduce costs for Palestinian businesses, increase potential for imports and exports, and open new markets for Palestinian products. There has been significant progress on this project in recent months, with interim measures expected to come into force before year's end, but long-term planning is vital to ensure that the process of containerization goes beyond simply handling the current demand.

Recommendation:

- *We call upon all parties (Government of Jordan, Government of Israel, Palestinian Authority) to maintain their current levels of engagement on this important project, to ensure continued resourcing, political support, and technical results.*

〉 **The rehabilitation of Gaza's commercial sector and export markets is essential to recovery**

The ongoing effects of the conflicts (especially the 2012 and 2014 conflicts), and close to 10 years of closures and restrictions, continue to take their toll on the population of Gaza, with the economy stifled and few opportunities for growth.

Despite progress enabled by the Gaza Reconstruction Mechanism (GRM), the value chain for exports out of Gaza is severely constrained by a number of factors, including:

- Atrophied business systems and technical capacity due to constraints on movement of people.
- Lack of contact with markets outside Gaza due to (a) constraints on movement of people at Erez and Rafah, and (b) inactive business relationships, leading to isolation and out-of-date product design.
- Run-down and damaged production capacity, energy and water limitations, war damage and Israeli constraints on the import of machinery and parts.
- Expense and constraints on moving goods to, through and from Kerem Shalom crossing due to the procedures imposed there by Israel, exacerbated by the absence of PA authorities at the crossing.
- Absence of containerized trade for cold, fragile products or products destined to or from Ashdod port, and packing/height limits on export goods on pallets.
- Reliance on Kerem Shalom as the only goods crossing which closes periodically for security reasons with no alternative channel.

Containerization of commercial cargo through the Kerem Shalom crossing (through which all trade to and from Gaza must currently traverse) leads to direct cost savings of approximately USD 400-500 per shipment. These savings are generated by streamlining several steps along the value-chain, less damage through the physical handling of goods, and increased security when a container is in transit from a port to Gaza. About half the 9,000 truckloads entering Gaza per month are commodities that could be containerized, which could save traders up to USD 1.8 million monthly. In addition, installing a conveyor at this crossing would enable faster and cheaper import of essential construction inputs, supporting the ongoing reconstruction efforts in Gaza.

Recommendations:

- *The GoI takes a strategic decision to fundamentally change the approach taken to controlling the movement of people and goods across Gaza's borders. We call for an approach which recognizes that the need for re-development of Gaza's commercial, business, technical and academic sectors has strategic benefits for Israel, and to put in place a system and processes that balance these needs fairly and transparently against Israel's immediate security criteria. The PA and international community must work with and support the GoI to develop and build such a system which meets and balances the imperatives of security, free movement, and free trade.*
- *The GoI and PA significantly accelerate efforts to increase efficiency and reduce the cost of goods at Kerem Shalom crossing.*
- *The PA to facilitate issuance of (P) VAT invoices for those Gazan companies interested in selling products to the Israeli market.*

〉 **Reliable infrastructure is critical to any meaningful growth in the West Bank and to recovery in Gaza**

Insufficient investment in large-scale infrastructure – power, water, telecommunications – is a serious inhibitor to economic growth throughout the West Bank and Gaza. This lack of investment can be attributed to a wide range of political and economic factors.

Addressing the interim and long-term energy and water needs in Gaza must be an unconditional priority for the Palestinian Authority, the Government of Israel and the international community. There can be no major rehabilitation in Gaza – humanitarian, social, economic, or political – without a permanent solution to the energy and water crises.

Two major multi-year projects are at a critical juncture in 2015-16, and have the potential to transform Gaza's energy and water deficit: embarking on the connection of Gaza to a reliable natural gas supply via a pipeline; and the construction of large-scale water desalination plant. The direct economic impact of a more than USD 500+ million desalination project would be profound in terms of construction-related employment; the broader economic impact of the project could be as high as USD 3.1 billion. The active mobilization of local stakeholders as well as the international community in support of these two projects is of vital importance to Gaza's future prospects.

Urgent interim energy and water measures in Gaza (including electricity grid upgrades, additional electricity from Israel and Egypt, additional supplies of diesel for the Gaza Power Plant, allowing import of machinery and spare parts to complete repair of the plant, solar PV, increased water imports from Israel, and the construction of short-term low-volume water desalination plants) are of high priority to help Gaza meet current electricity and water demands during the transition period to natural gas and large-scale desalinated water.

Reliable telecommunications infrastructure is also vital for the development of a modern economy. With the revival of the Joint Technical Committee in August, negotiations are ongoing regarding "technology-neutral" allocation of the spectrum. If successful, these negotiations will allow Palestinian wireless companies to upgrade their service capacity in the West Bank to 3G/4G. A separate but related negotiation involves the long-awaited release of 2G equipment necessary to build Wataniya's network in Gaza. Deployment of new mobile communications technologies in the West Bank and Gaza would be a significant driver for Palestinian commerce, and we encourage the parties to find a way to move forward without delay.

Recommendations:

- *The GoI unequivocally supports a comprehensive solution to Gaza's energy crisis, including urgent interim measures, and the ultimate long-term solution of enabling the supply of natural gas to Gaza.*

- *With the finalization by the European Investment Bank of tender documents relating to the Water Desalination Plant in Gaza, the international community commits to completing the financing of this project in partnership with the Arab Gulf States (who have already committed to match 50 percent of the total costs).*

- *To create an enabling environment for this investment, the international community makes a clear and strong statement of expectation from the Government of Israel to commit to facilitating the access of material for and sustained operation of the desalination project, free of impediment or destruction of the desalination project's infrastructure.*

- *All parties continue to prioritize and to provide support to the ongoing negotiations regarding the deployment of mobile communication technologies in the West Bank and Gaza. We also call on GI to finalize, with a clear commitment, the allocation of spectrum to the Palestinian side and approve the entry of all needed equipment before the end of October 2015 to enable full deployment of technologies in the West Bank and Gaza in the first half of 2016.*

〉 Unblocking access to land resources is key to realizing economic potential

Access to land is critical to realizing the potential in the Palestinian economy. The PA and international community must pursue the untapped land resources in areas A and B. A well-functioning Palestinian Land Authority, with the capacity to manage and register new land, is a key enabler for this. Area C is, however, where the real economic potential lies. Specific proposals for industrial zones, housing, and agricultural projects may be able to unlock some potential, in advance of a broader resolution of the politics around Area C.

Industrial zones can be a powerful private sector mechanism to boost economic development, as long as they have unfettered access to markets - both for import and export purposes. Export-oriented businesses can take advantage of such strategic locations, with good access to trade routes. Industrial zones will provide integrated infrastructure in one location and provide incentives and facilities that would help contain costs, improving inventory efficiency and facilitating entry to foreign markets. The successful development and financial viability of new industrial zones in the West Bank is highly dependent on the ability to develop parts of Area C.

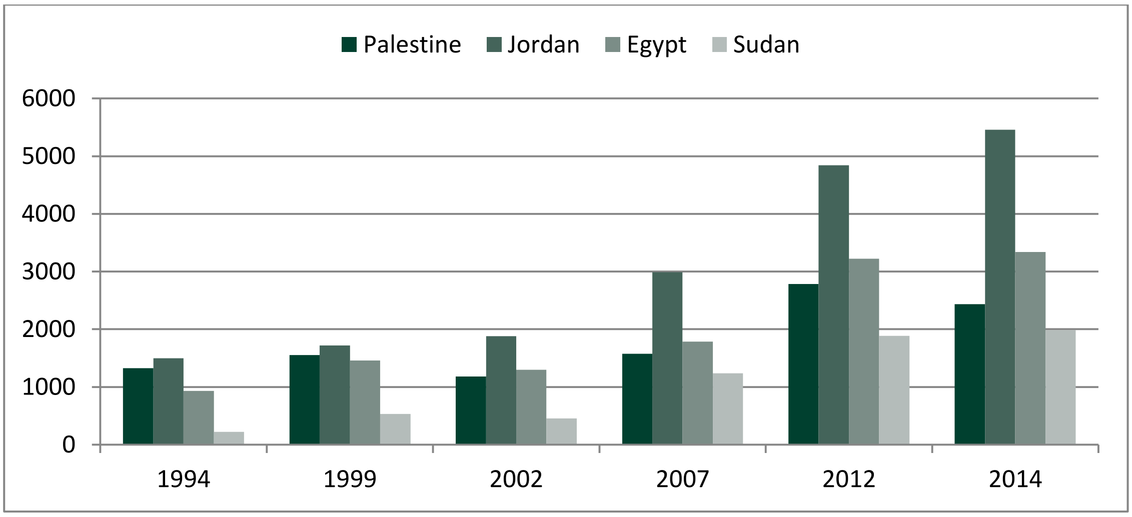
Recommendations:

- *In the absence of a broader political resolution on Area C, the GoI increases and accelerates practical support for the development of specific Palestinian high-impact projects and infrastructure in Area C.*
- *To improve Palestinian access to land in Area A and B – and eventually Area C – the PA dramatically accelerates land registration and improves land management capabilities, by institutionally strengthening the Palestinian Land Authority.*

2. Economic Context and Fiscal Stability

Today's economic status quo can be interpreted as the direct consequence of two overlapping systems of governance: (1) Annex V of the Interim Agreement (also known as the Paris Protocol), which has been in effect since 1994, yet originally designed to last only five years; and (2) the elaborate matrix of Israeli administrative and security restrictions. A June 2015 report[1] co-authored by OQ, together with the Palestinian International Business Forum (PIBF) and the International Council of Swedish Industry (NIR), examines the significant limitations of the current trade regime between Israel and the Palestinians. It outlines how the limitations of the Paris Protocol, combined with the restrictions of the Israeli administrative and security measures, have raised Palestinian transaction costs, denied economies of scale, lowered total factor productivity, and undermined Palestinian competitiveness at home and abroad. The report estimates that the current economic regime has resulted in lost Palestinian GDP of up to USD 15 billion annually.

Figure 1: Palestinian GDP Per Capita in Regional Comparison 1994 – 2004 (current prices in US dollars)



Source: Palestinian-Israeli Economic Relation: Trade and Economic Regime (June 2015)

OQ is set to publish a follow up report to assess the "real" Palestinian economy – looking beyond the formal macro-economic indicators that reflect the major effect of huge inflows of external resources into the Palestinian economy – mainly donor aid and labor remittances. The analysis shows that since 2007, donor aid and Palestinian labor remittances from Israel have contributed to roughly two thirds of formal GDP growth in the West Bank and roughly half of the total GDP of Gaza. It also shows that external aid contributed to around half of the new jobs generated in the West Bank and Gaza over the 2000s. If not for

[1] *Palestinian-Israeli Economic Relations, see www.quartetrep.org for the full report.*

this contribution, the formal unemployment rate in the West Bank would have reached around 35 percent.

The lifeline of a small economy is trade and its ability to adapt quickly to globalization and technological change. Economic restrictions, coupled with the lack of political horizon for investors, have cut off the Palestinian economy's lifeline at four levels:

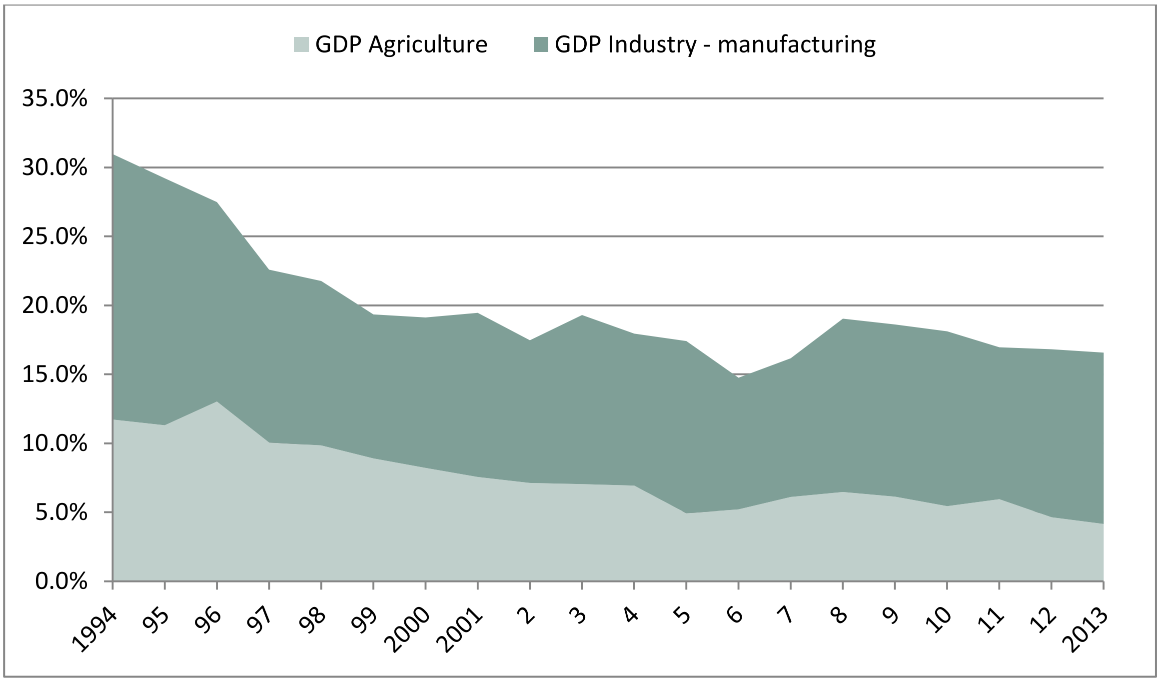
- Distorted the production structure towards retail trade, construction and government;
- Suppressed exports and skewed trade relations to a dependence on trade with Israel;
- Repressed economic growth generating a large output gap;
- Undermined fiscal sustainability and generated a dependence on external budget support and remittances[2].

Over the past fifteen years, investments in manufacturing and equipment has more than halved as a share of GDP – falling from nearly 13 percent in 1999 to under 5 percent in 2013. At present there is little sign of this rate increasing[3]. Today's investment levels are not sufficient for Palestinian businesses to maintain and replace existing equipment. This is mirrored by a similar trend of declining Foreign Direct Investment (FDI), with an almost negligible level below one percent of GDP in recent years[4]. If these trends are not reversed, businesses will see a decrease in productivity and output over the coming years, losing further ground to their competitors in Israel, Jordan, Egypt, and the Gulf. The Palestinian agricultural and manufacturing base has already declined considerably, down to 15 percent of GDP today from a high of 30 percent in 1994.

[2] *It is estimated that 15 percent of the West Bank labor force is currently employed in Israel*.
[3] *Source: PCBS*
[4] *The Palestinian Economy 20 years after Oslo, 2015*

Figure 2: Declining manufacturing and agricultural base

Share of Agriculture and Manufacturing Industry in the Palestinian GDP 1994 – 2013 (percentage of total GDP, computed from the GDP in constant 2004 prices)

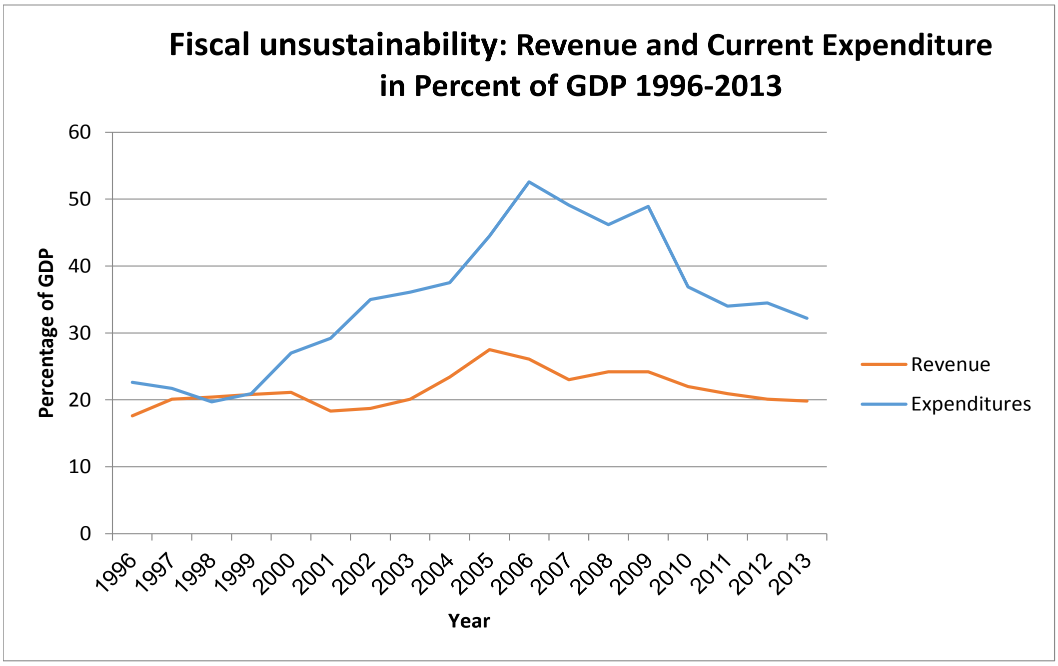


Source: PCBS National Accounts Statistics 1994 – 2012 (amended series published September 2014), 2013

Weakening performance in the West Bank, coupled with the collapse of Gaza's economy, has shifted the Palestinian production structure towards sectors with low tax compliance, undermining the growth of public revenues and widening budget deficits. As a result, the PA has few levers within its control to provide economic stimulus.

A fundamental change in the trade and economic regime must take place, supported by a new Israeli policy to undertake real actions and measures that will advance the Palestinian economy, and a Palestinian government commitment to coordinate the sequence and implementation of these measures. A critical mass of measures taken collectively will send a strong signal to the business and international community that there is a serious intention to move forward and generate a turnaround in Palestinian economic growth prospects.

Figure 3: Fiscal Unsustainability 1996-2013



Source: Palestinian Public Finance Under Crisis Management: Restoring Fiscal Sustainability, UNDP (2015).

Addressing Israeli-Palestinian economic relations, including more effective trade regimes such as implementation of and potential improvements to the Paris Protocol, is vital to ensure Palestinian economic security. Better tax clearance procedures, bilateral trade regulations, and the introduction of cooperation and dispute settlement mechanisms are just some of the steps that the sides could take to promote economic stability.

Moreover, since Israel controls the collection of the tax, and the information base, the PA does not have an independent source of information that allows it to calculate the exact amount of any tax leakage. A report by UNCTAD from 2013 estimates the leakage on import taxes and VAT on bilateral trade alone to be USD 300 million/ year.

Apparent points of leakage include the transfer to the PA of additional taxes as required under the agreement, including: national insurance, health taxes and pension payments levied by Israel from Palestinian labor in Israel, taxes collected by Israel in Area C of the West Bank (e.g. property tax from Palestinians and income tax and VAT from Israeli businesses).

Box 1: Examples of specific possible actions and amendments to Annex V/the Paris Protocol to address its main shortcomings

Import Policy

1. Increase Palestinian responsibility to set an independent import policy

Background - The Protocol requires the PA to apply Israeli import policies (licensing, standards and taxation) for most imported goods except for defined lists of products (Lists A1, A2 and B) limited in type and quantity. This has led to high costs of living in the West Bank and Gaza. A comparison by the World Bank of Egyptian, Jordan and Palestinian GDP PPP (Purchase Power Parity) indicates that Palestinian price levels are two times higher than in Egypt and 1.5 times higher than in Jordan.

In June 2000, Israel and the PA agreed to add items to List A1 (expanding the list from 56 items to approximately 1,300 items[5]). However, the outbreak of the second intifada prevented the implementation of this agreement.

Benefit - Israel applies high customs purchase tax rates on a wide range of consumer goods, and restrictive standards on the import of many products (especially food products) to protect local Israeli industries. Palestinian traders are unable to import good quality, less expensive products from other countries. Adding these products to the lists would better meet Palestinian economic needs, create competition, lower consumer prices and potentially increase import tax revenues.

2. Recognition by GI of Palestinian Trade Agreements

Background - Currently Israel does not recognize PA trade agreements with third parties.

Benefit - This would allow the PA to use existing trade agreements with the EU, EFTA and other countries, opening up markets and decreasing its dependence on Israel for exports and imports.

Tax Clearance Procedures

3. Improvement of Tax Clearance Procedures

Background - The existing tax collection and sharing mechanism generates losses to both parties but mainly to the PA. In July 2012, the parties agreed to form a technical committee to agree on new arrangements to limit tax losses and evasion. The committee meetings were suspended in November 2012 and have not been resumed.

[5] *Recommendation of the Ad Hoc Economic Committee of June 2000*

However, the PA signed an agreement with the Israeli company MALAM to receive customs information on all Palestinian imports that are processed electronically by Israeli Customs on a daily basis. This information allows the PA to counter tax evasion and increase its import tax revenues.

Benefit - The new agreed measures will increase PA tax revenues from import taxes and VAT on purchases made by Palestinian dealers in Israel. If properly functioning, it should reduce the burden on private sector working capital requirements, which will provide a boost to investment in capacity.

4. Israeli Deductions from Tax Clearance

Background - Israel unilaterally deducts payments that it determines are owed by the PA and/or Palestinian utility companies to Israel and to Israeli companies from the tax clearance payments without prior PA agreement. In June 2000, the parties signed an agreement that set arrangements for payment of outstanding PA debts to Israel at that time.

Benefit – A new agreement between the parties on a mechanism for deductions would create certainty as to the payment and amounts that Israel can deduct from the PA tax clearance revenues.

<u>Bilateral Trade</u>

5. Lifting Non-Tariff Barriers to Trade

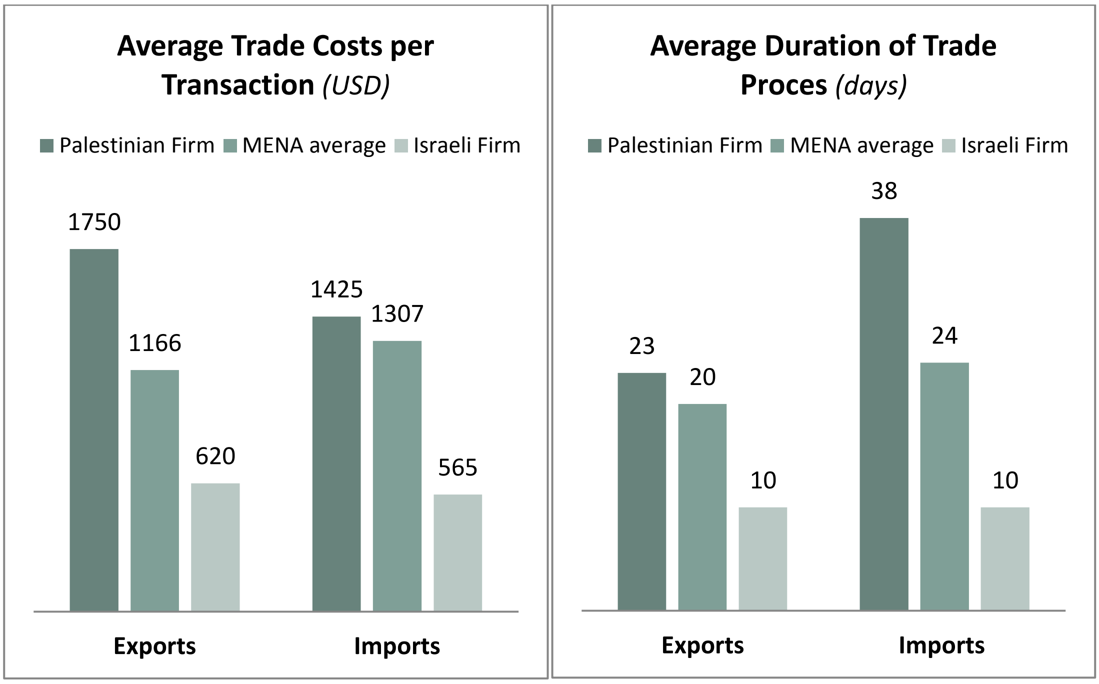
Background - Israel restricts the import of Palestinian agricultural (e.g. dairy and meat) and industrial products (e.g. pharmaceuticals) that require licensing by Israeli Authorities to Israel and East Jerusalem. PA companies are unable to receive the required licenses since Israel restricts the entry of Israeli inspectors to areas under PA Jurisdiction.

Benefit - Lifting these restrictions would allow Palestinian companies to receive the necessary licenses to sell their products in Israel and East Jerusalem.

3. Movement and Trade and the Palestinian Economy

The significant trade imbalance that has emerged over the past fifteen years must be addressed urgently. Palestinian imports now exceed exports by a ratio of more than 3:1. The level of this deficit is undesirable and unsustainable. Processing Palestinian trade costs significantly more due to highly prohibitive non-tariff costs and takes significantly longer than their immediate competitors. In 2013, imports of goods[6] totaled USD 4.6 billion and exports of goods were USD 900 million annually in an economy with a GDP of USD 12.5 billion. Imports from Israel at USD 3.2 billion were equal to 69 percent of all imports, and exports to Israel of USD 786 million were equal to 87 percent of all exports.[7] Future growth relies on increasing the volume, value and market diversification of exports.

Figure 4: Comparing Trade Costs & Process Duration



Source (Data): World Bank's Doing Business 2015 database

To boost Palestinian economic growth in both Gaza and West Bank, it is vital to secure greater freedom for the movement of people. Restrictions on visas for investors and business travelers, particularly those from the Gulf and other Arab states inhibit investment and trade. Restrictions on the movement of people between Gaza and West Bank impede

[6] *Excluding pipelines and networks*
[7] *Sources: 2013 Current Prices, PCBS; World Bank Data Indicators.*

domestic trade, by separating producers from potential customers in internal markets. The absence of normal operations at the Rafah crossing adds to the limitations on the movement of business people into and out of Gaza.

Removing most Israeli restrictions on movement, access and trade are critical elements to enabling the PA to implement a cohesive export strategy. Reliable access to imports, including relaxing and revising the dual-use list and processes, would increase business confidence, predictability of management of supply chains and reduce demands on inventory levels and working capital that would otherwise be reinvested in building operating capacity. Implementing containerization at all crossings would increase the ability of Palestinian firms to compete more effectively in regional markets. The introduction of containerized trade at the Allenby Bridge border crossing and the Kerem Abu Salem / Kerem Shalom border crossing between Gaza and Israel will boost long-term economic growth.

Box 2: National Export Strategy

Source: The State of Palestine National Export Strategy 2014-2018

A considerable improvement in the movement of goods and people and in trade facilitation lies at the heart of the National Export Strategy (NES), which is now in the initial phases of implementation.

The Palestinian Prime Minister's Office has supported the formulation of the NES and the cabinet endorsed it in September 2014. The strategy details priority sectors, selected based on their capacity to contribute to export growth, trade deficit reduction and employment generation. The NES also identifies target metrics for implementation, such as:

- Increase the value of Palestinian exports over the next five years by approximately USD 722 million;
- Generate USD 483 million in exports of products from priority NES sectors;
- Grow exports of services from priority NES sectors by USD 239 million;
- Develop the export sector (products) at an average of 13 percent per year;
- Generate an overall growth of the export sector (products) of 67 percent.

The NES describes plans for a Palestinian Export Council (PEC) to be established and operationalized to act as an independent entity and spearhead the NES implementation to ensure its sustainability.

The NES is a key priority for the PA and Ministry of National Economy and central to the economic agenda.

A successful implementation of the NES is key to sustainably boosting Palestinian exports and developing the Palestinian economy. The international community, including OQ, will play a key role in supporting the PA in its implementation efforts.

Improving Police Movement and Access

The ability of the Palestinian police to operate effectively throughout PA territory is also crucial to creating an attractive environment for business development, investment and trade. OQ has worked closely with Palestinian and Israeli authorities, with assistance from the U.S. Security Coordinator and EUPOL COPPS, to facilitate improved movement and access for PA police in the West Bank. Significant progress has been achieved in recent months, and this work is ongoing.

3.1 Dual-use Lists

The dual-use lists and the procedures by which they are put into practice create numerous complications that delay import times and raise costs for Palestinian importers. A fundamental review of the dual-use goods lists and procedures is needed. The existing dual-use lists and procedures reflect a lack of balance between the legitimate security concerns of Israel and the legitimate economic needs of the Palestinians.

A number of positive measures could be undertaken, without endangering Israel's security, which could make a difference to Palestinian businesses. This includes:

1. Refine the dual-use lists to exclude items that are already easily available. Examples include office equipment, personal computers, phone devices, compasses and GPS devices, and aggregate (now in plentiful supply in Gaza from rubble crushing).
2. Refine the dual-use lists so that definitions are more precise. For example, "telecommunications equipment" is a category that includes innocuous items such as phone chargers. Greater precision would help save both Palestinian importers and the Civil Administration or Coordination and Liaison Administration for Gaza days of unnecessary and expensive work.
3. Ensure that only items on the dual-use lists require special permits for entry. Other items should not be added ad-hoc to the dual-use process. Standard solar panels are not on any dual-use list but are periodically prevented from entering Gaza, for example.
4. Make the process, as well as the various lists, more transparent and readily available to Palestinian importers.

3.2 The Jordan Valley Trade Route

Allenby Bridge is the only crossing point between the West Bank and Jordan. It serves both passengers and trade, and can play a key role in the development and diversification of trade.

Demand at Allenby Bridge

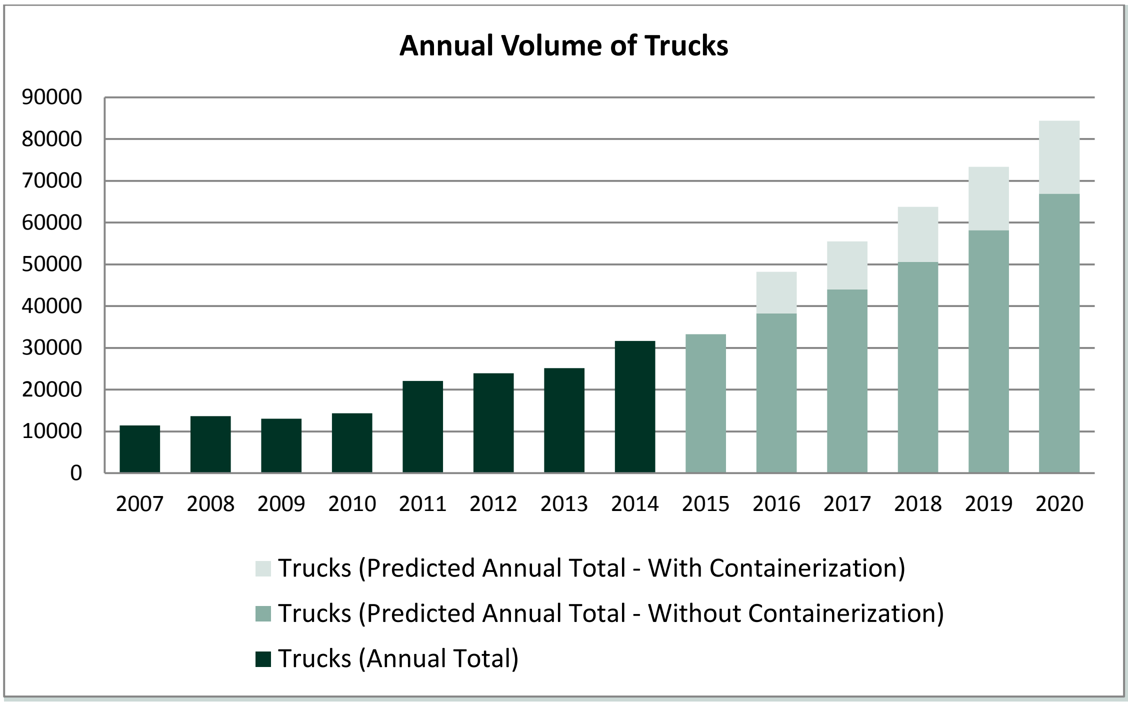
The Allenby Bridge is already under heavy demand with around 1.8 million passenger crossings and nearly 30,000 truckloads of goods in 2014. Demand has increased by 6 percent per year over the last six years for passengers, and by an average 15 percent per year for goods.

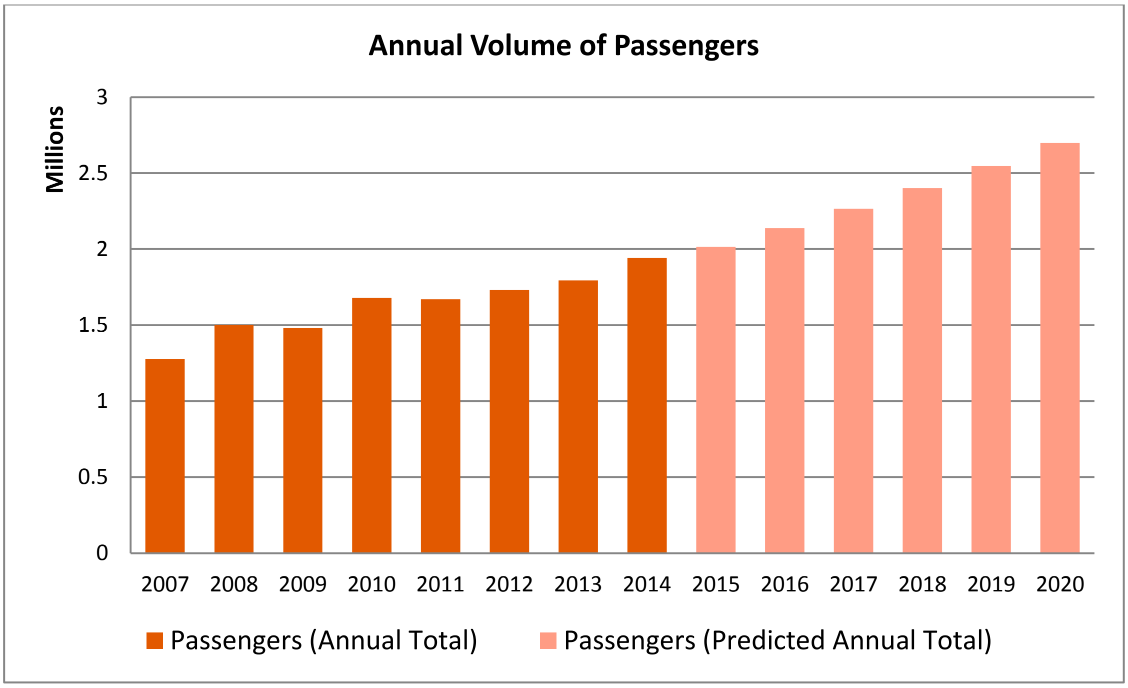
The current four lane bridge at the crossing was constructed in 2002 by the Government of Japan. However, development of facilities and processes for both goods and passengers on both sides of the bridge has lagged behind demand.

The three authorities with an interest in the crossing (Palestinian Authority, Government of Jordan and Government of Israel) all recognize that demand at the bridge will continue to rise in the coming years, and that the facilities and system of operations in place need to be improved.

Figure 5: Volume of Trade - Projected Increasing Demand at Allenby

A 2012 study conducted for OQ predicted an *<u>additional 30 percent increase in volumes with containerization</u>**, based on companies then using the bridge.*





Source (Data): Israeli Airport Authority

The simplest way to increase the number of trucks or passengers that can cross in a day is to extend operating hours. Opening the bridge for the full 24 hours has the advantage of spreading the load throughout the day, so there is less demand at peak times and less congestion. However, longer opening hours do not increase the processing speed of each truckload or each passenger in the system, and operational solutions are required to make sustainable improvements in efficiency.

Containerization

The containerization of commercial trade at Allenby offers potential for wider development of Palestinian commerce by reducing costs and opening new markets. Shipping containers are universally recognized as one of the most important logistical factors capable of increasing overall trade volumes and efficiency in the value chain, especially at ports and border crossings.

There are two key arguments for container trade:

1. *Economy and efficiency*: Containerization has its biggest advantage in long-distance trade when the goods involved are perishable or fragile, if freight includes bulky items such as furniture, or if items are sensitive to damage by environmental conditions (such as heat and dust). Container trade at Allenby will reduce supply-chain costs for Palestinian import/export companies, reduce handling times at each side of the crossing, improve speed of transit at the port of Aqaba, and increase the variety of goods that can be carried, including trade in refrigerated containers, thus increasing market access.

2. *Security*: Containers increase security for all parties. Shippers can better protect cargo from theft or damage, and the risk of smuggling is reduced with deployment of advanced inspection techniques such as those in operation at the Israeli ports and in Aqaba. In addition, containers in transit can be sealed between inspection points.

Current Developments at Allenby

Following extensive consultation by OQ with the Governments of Israel, Jordan, and the Palestinian Authority, several measures are being taken to resolve some of the congestion issues at Allenby. The PA has already opened a new passenger facility in Jericho where Palestinian ID holders have their passage recorded by the PA, en route to the bridge.

Israel controls the West Bank end of the bridge, and has committed NIS 38 million for a new building to house a scanner, a working area, and loading inspection dock as part of its efforts to upgrade the crossing. Construction commenced in September 2015. A cargo scanner donated by the Government of the Netherlands will be installed in the new building in mid-2016. The area is expected to be operational from late August 2016 and Israel should then be ready to process imported containers.

Israel plans to spend a total of NIS 140 million over 2016-2018 on a new passenger facility, improved road access and a single security checkpoint at the entrance of the area, as well as other steps to reduce congestion. Once complete, the Israeli controlled-side of the crossing is expected to have a capacity for three million passenger crossings and 50,000 truckloads of goods per year.

The Government of Jordan is also upgrading its side of the crossing. A truck-mounted mobile scanner capable of scanning goods on trucks, including containers, is due to be deployed and operational in November 2015. This important step has been facilitated by the U.S. Government. The Government of Israel has committed to facilitate export trade as soon as the new Jordanian arrangements are in place.

The Jordanian government is also planning development of a much needed new passenger and cargo facility. The government has acquired 2,000 dunams (500 acres) for this development, with the Dutch and German Embassies in Amman providing skilled technical assistance to the Ministry of Public Works and Housing to ensure the design is up to international standards of efficiency. The project should be completed in late 2018, depending on funding.

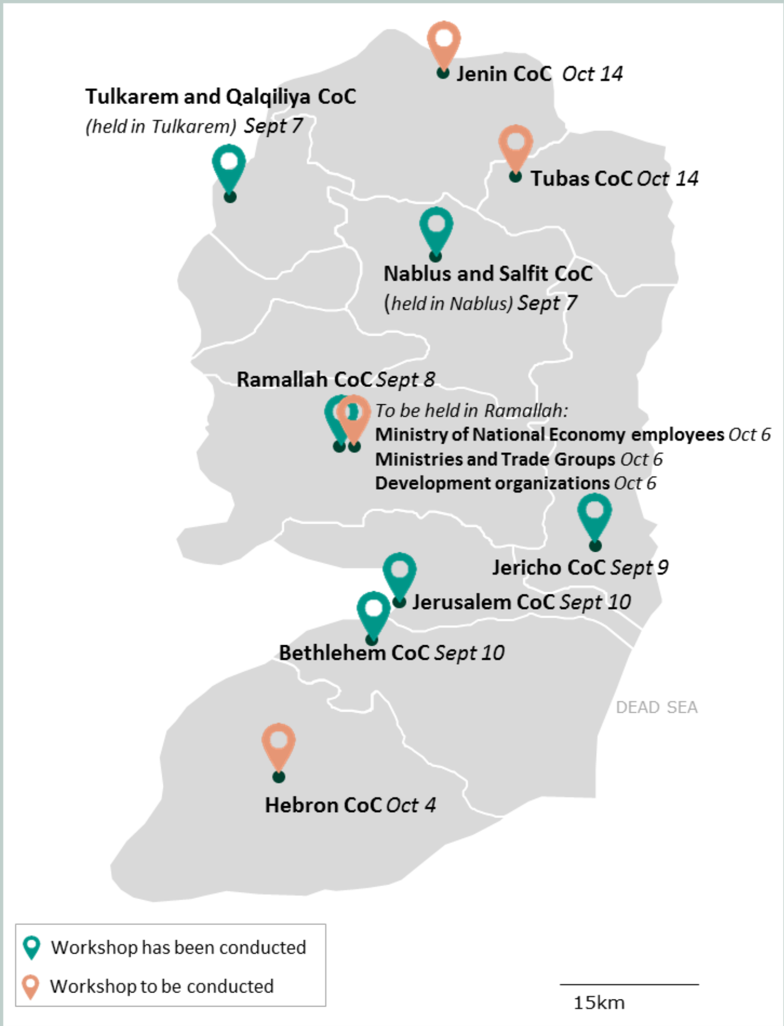
The developments on the Jordanian side and parallel developments by the Government of Israel have been planned in consultation with, and are fully supported by, the Palestinian Authority border agency, the General Authority on Borders and Crossings.

Trade in bulk goods, building sand, cement and clinker (cement raw material), is increasing rapidly, prompting Israel to propose a plan for a bulk goods conveyor and bulk cement pipe to run parallel to the bridge. An engineering design is in development, but there has not yet been an inter-governmental conclusion on this proposal. This measure would mean a reduction in congestion on the bridge itself, as well as an increase in efficiency of handling these goods.

Raising Awareness among the Palestinian Private Sector

Palestinian firms using the Jordan Valley trade route for exports either trade with Jordan, or send transit goods to Saudi Arabia, the Gulf States and beyond by road or via the Aqaba port. To ensure that Palestinian businesses understand the business potential and operational requirements of changes at Allenby Bridge, OQ has worked with the Federation of Chambers of Commerce and the Palestinian Shippers Council on a series of workshops throughout the West Bank. Workshops will also be held in Gaza.

Figure 6: Office of the Quartet – Movement and Trade Workshops in the West Bank (September & October 2015)



__Beyond Containerization__

Containerization of Allenby is predicted to increase trade volume at this crossing by 30 percent, and diversify markets and goods traded. While it will provide a relief of pressure on the crossing, consideration should also be given now to future increases in demand. Over the next 5-10 years consideration and concept planning for new capacity at an additional crossing of the Jordan River must be undertaken.

In parallel, efficiency processes such as the "known trader" system can be introduced. Individual traders who are acquainted with the crossing management, who export large volumes, and who have shown high levels of security in their factories get special treatment for their goods. At Tarqumiya crossing, west of Hebron, this process has been established and maintains the same level of security while introducing efficiencies. Typically this means faster and cheaper handling.

The “known trader” system should be applied in an equal and systematic way at all West Bank-Israel crossings, in a way that is objective and not dependent on personal relationship. The system should have transparent requirements and conditions so that any Palestinian business person knows how to apply. There is potential to apply a similar transparent and efficient system of “known traders” at Allenby Bridge.

3.3 Gaza Trade

Until 2007, and particularly before the second intifada, the Gazan economy was based on relatively high levels of export income from sectors such as agriculture, garments, furniture and light industry such as metal fabrication. Around 90 percent of exports were destined for Israel at an annual value in the range of approximately USD 35-40 million.

From 2007 and up until 2010, Israel did not allow exports out of Gaza, and an unknown volume of goods were exported illegally through the tunnels to Egypt. From 2010, Israel allowed a trickle of exports (110 truckloads in all of 2010), and export values and volumes have increased somewhat over the past few years. In 2014, the total value of recorded exports was USD 1.5 million.

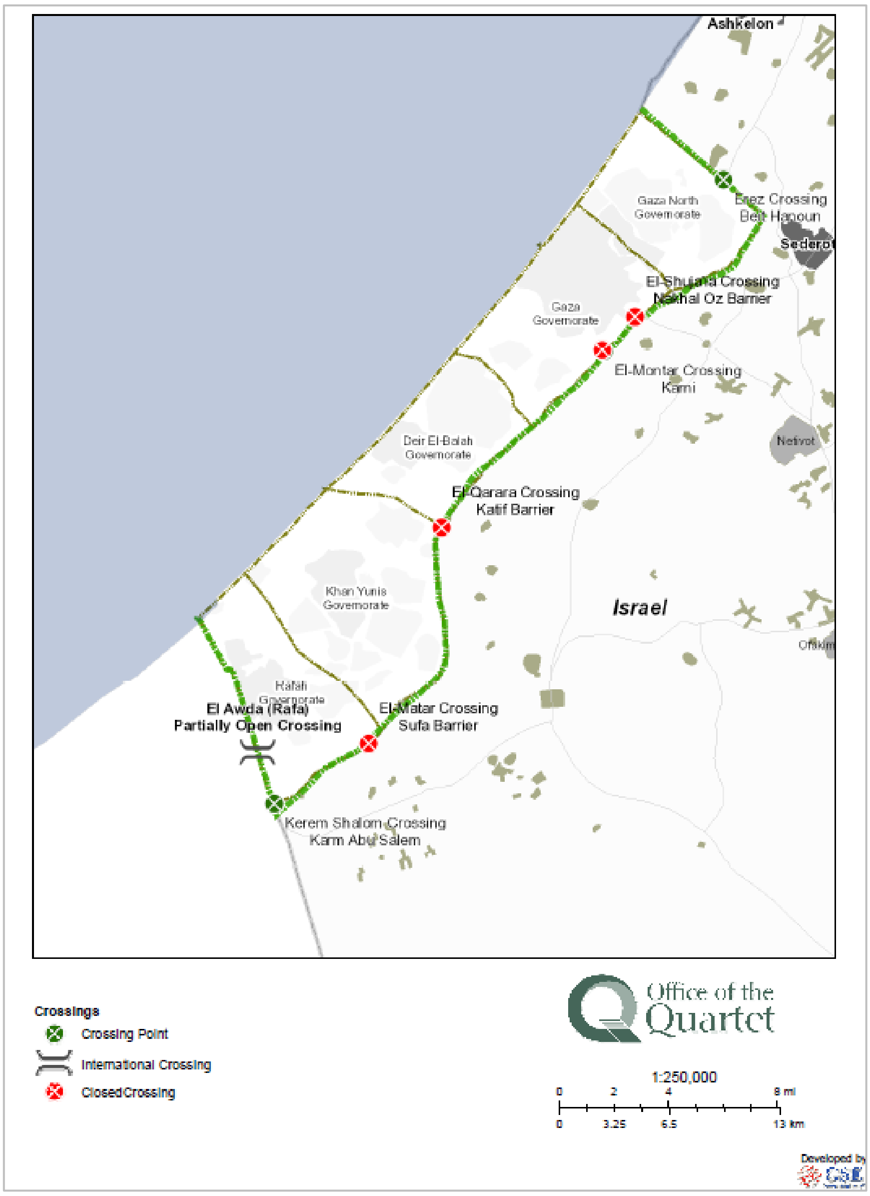
Israeli restrictions on access to raw materials and technical equipment, restrictions impacting Gazan exports (in 2014 Gazan exports and trade with the West Bank amounted to 0.02 percent of imports by volume), and limits on business travel in and out of Gaza, have all contributed directly to the collapse of the Gazan productive sectors (including agriculture and manufacturing). This low level of trade directly impacts Gaza’s unemployment and poverty rates.

Making Trade Viable

Over the last 12 months, Israel has taken several positive steps to improve movement and access for Gaza, including allowing trade of agricultural produce as well as furniture and textiles between Gaza and the West Bank for the first time since 2007, and (though much more limited) some lines of produce to exit Gaza for the Israeli market. Israel should extend and expand these steps, in particular allowing agricultural trade to Israel to continue beyond the end of *Shmita* (Jewish year of rest that occurs every seven years and restricts agricultural production) in late 2015.

All trade in and out of Gaza currently goes through Kerem Shalom, including movement of goods between Gaza and the West Bank. Kerem Shalom already has a container-capable scanner, yet it is currently used only for non-containerized goods. Containerized trade is not permitted, most of the necessary supporting infrastructure is present, but procedures are not yet developed to bring it into full use. Containerization of Kerem Shalom would have a significant impact on the stagnant Gaza economy. In addition, the Government of Israel has proposed a conveyor at this crossing which would enable faster, cheaper, import of essential construction inputs, thereby supporting the ongoing reconstruction efforts in Gaza.

Figure 7: Gaza Crossings



In parallel, normal operations at the Rafah crossing between Gaza and Egypt (controlled by the Government of Egypt), should be restored to allow for the movement of both people and goods across this border.

To make their trade commercially viable and sustainable, producers and manufacturers in Gaza need a number of concerns to be addressed. The Office of the Quartet is working with key partners on various issues around Gaza trade, including:

- Redevelopment of business practices and quality production.
  OQ is working with relevant PA agencies and development organizations to return Gaza businesses to quality and volume of production and match production to market opportunities.

- Reliable supply of raw materials and replacement machinery.
  OQ is in discussion on how to improve reliable and effective access to industrial goods (e.g. raw materials and machinery) for Gazan businesses.

- Assurances that access to markets (including Israel) for goods will be reliable and without politically-based quotas, restrictions or interruptions.
  OQ is working toward eliminating the export height restriction and other cost inefficiencies at Kerem Shalom. We will continue to work closely with all relevant agencies, especially the Dutch Government, towards containerization of goods trade at Kerem Shalom. Beyond the crossing, OQ will work for improvement of the existing logistics chain that is currently used for trade with the West Bank, trade to Israel, and exports to third countries in Europe and the Gulf.

- Transparent, effective and cost-efficient movement of goods.
  OQ is working with both the Israeli and PA administrations to deliver effective, clear, and transparent export procedures, cash transfer systems, certifications, and tax invoices. OQ is also working with relevant trade organizations to provide potential Gaza exporters with the information they need to be effective and competitive traders in regional markets. We will work with the PA on the Issuance of Proof of Tax documentation for exports to Israel.

- Reliable access to and through Israel and Egypt for traders to restore business relationships.
  OQ is working to connect Gazan exporters with their former West Bank and Israeli customers as well as providing assistance to relevant trade organizations and PA Trade Representatives (when these are in place) to connect Gaza businesses to new markets.

4. Access to Reliable Infrastructure

A precondition to all economic development is access to reliable infrastructure. Insufficient build-out of planned large-scale infrastructure remains a serious problem throughout the West Bank and Gaza. There has been seen some positive movement on energy and water issues, but particularly for Gaza, far-reaching steps by Israel and the PA are needed to achieve tangible progress on building infrastructure that is reliable, fit for purpose, and that can serve future generations.

4.1 Energy

Gaza is suffering an acute energy crisis. With Gaza receiving less than 50 percent of its basic electricity needs (at the best of times), the crisis is impacting all areas of life – from basic domestic electricity to energy requirements for water supply, industry and economic development. This crisis requires urgent interim measures as well as long-term solutions.

With diesel fuel being significantly more costly than natural gas, the current cost of electricity generation is prohibitive. The PA spends over USD 100 million annually on diesel for running the Gaza Power Plant, which is enough diesel for the plant to run at half of its full capacity. The availability of natural gas will allow the Gaza Power Plant to convert to gas and significantly expand its electricity generating capacity. Natural gas can be used for water projects, industry, and even transportation and will serve as a strong basis for major economic development. Solving Gaza's water crisis is dependent on a viable and durable energy solution, initially via interim measures, but ultimately only by way of natural gas.

With a long-term natural gas solution in place, interim measures become viable. OQ has worked closely with the relevant stakeholders to help shape the interim energy landscape.

Specifically, the importance to Gaza of the provision of additional electricity from Israel and Egypt through high voltage lines (in the medium term) and the immediate provision of reliable low-medium voltage lines cannot be overstated. In addition, financial support from the international community for a regular and adequate supply of diesel for the Gaza Power Plant (pending a gas supply) is key, along with investment in solar PV projects. It is important that efforts to upgrade the electricity grid in Gaza continue, as do efforts to improve collection of electricity fees in Gaza.

The Gas for Gaza (G4G) project is intended to solve Gaza's energy crisis in the long-term by facilitating the planning and construction of a natural gas pipeline to Gaza. OQ has initiated a feasibility study, supported by the Dutch Government, for a natural gas pipeline to Gaza.

This study will take the project from the conceptual stage to the implementation stage. A completed feasibility study will equip all parties with the information required (including the preferred pipeline route) to develop detailed project implementation plans and cost estimates. OQ has launched and is chairing the G4G Task Force (working closely with the Dutch Government) to provide all relevant stakeholders with information coming out of the feasibility study as it progresses, and to provide a platform for all stakeholders to coordinate and work together until the project is implemented. The Qatari Government has played a very constructive role supporting this project, and OQ continues to work closely with them.

With respect to the West Bank, it is important that additional electricity is supplied to meet growing demand. It is crucial that the Government of Israel and the PA finally resolve the IEC debt issue and agree on a new commercial framework for the sale of electricity to the Palestinian Territory. The international community can play a constructive role here. In addition, both electricity and gas pipeline connectivity need to be supported by the relevant stakeholders in a timely manner in order for the Jenin Power Plant project to progress. OQ is working with the relevant parties to facilitate this project.

Furthermore, renewable energy and in particular (given their potential high impact in the West Bank) solar PV projects should be supported.

4.2 Water

Without a sustainable, comprehensive, and cost efficient solution to energy there will be no solution to the water crisis (whether in terms of availability of domestic water, waste water treatment and re-use for irrigation, or other sources of water for agriculture, etc.). The G4G project can help facilitate financial viability of a large-scale desalination plant.

OQ is engaging with the major stakeholders on all issues and options related to water and sanitation, including coordination with international institutions working to advance the Desalination Facility, and funding for the project. A large-scale desalination plant and associated works remains the best long-term solution for an adequate supply of water. This has been confirmed in a number of technical assessments beginning with the USAID funded Coastal Aquifer Management Program (1999-2004), through to the 2014 European Investment Bank's "The Concept Design Report for Central Gaza Desalination Plant". Construction of this project would also have a profound economic impact in terms of construction-related employment, and contribute to a healthier workforce with a reduction in lost man-days and decrease in related healthcare costs.

A consortium of international partners, including the Islamic Development Bank, the Union for the Mediterranean, and the United Nations are working to support the PA to advance the project. This support includes technical preparations under the supervision of the European Investment Bank (EIB) and the World Bank. Following a two-year program of technical preparation funded by the European Commission, the EIB is ready to present to the PA final tender documents for the Engineering, Procurement and Construction, and the Operation and Maintenance contracts at the end of October 2015. The World Bank is planning to award a parallel consultancy for the associated works (a north-south water carrier and non-revenue water improvement program) in the coming months.

We are at a critical juncture in the viability of the project. While the European Commission and other donors are highly engaged, they want to see progress on the technical preparations and resolution of outstanding issues before making a financial commitment. It is the resolution of these outstanding issues, most critically a reliable energy supply solution, as well as a commitment letter from the Government of Israel, which are key action points for OQ, working in concert with UNSCO and other partners.

Furthermore, OQ continues to advocate to the Government of Israel the importance of the short-term interventions identified under the 2011 Comparative Study of Water Supply to Gaza. These short-term interventions include increasing the Mekorot (Israel National Water Co.) supplied water up to twenty million cubic meters per year (20 MCM/year), the maximum that current connections would allow, as well as facilitation of three new short-term low volume desalination plants, which would begin to address the water crisis. Current water demand exceeds the aquifer’s ability to sustainably recharge by nearly four times, and most critically 96 percent of abstracted water currently fails WHO standards.

4.3 Telecommunications

Reliable telecommunications infrastructure is vital for the development of a modern economy.

- It is a significant contributor to the GDP, with high growth potential.
- It is a sector that has been largely developed through private investments, and does not depend on donor support.
- Telecom services are core infrastructure for other sectors including health, education, and commerce.

Deployment of new mobile communications technologies (3G and 4G) in the West Bank and Gaza, as well as the deployment of the Wataniya 2G network in Gaza, would be a significant driver for the Palestinian economy. OQ is working with the Palestinians and Israel to address outstanding issues that would finally enable the deployment of new technologies. This includes access for the necessary hardware and infrastructure into the West Bank and Gaza and allocation of needed spectrum.

In August 2015, the Palestinian Israeli Joint Technical Committee was revived, and while this is in itself a positive development, a number of substantive issues are still outstanding, including:

1. Use of spectrum by Palestinian operators that enables full Palestinian coverage in the West Bank and Gaza independent of the Israeli cellular communication operations in the settlements.
2. Deployment of technologies in Gaza.
3. A clear timeline for the deployment of technologies in Gaza and the West Bank is required for:
    a. Allocation of spectrum and;
    b. Approval of the entry of the equipment into the West Bank and Gaza, and construction of infrastructure in Area C of the West Bank

The parties agreed to sign an MoU to document points of mutual agreement to date. This MoU should be executed by the end of October 2015. However, progress to reach an agreement has been fluctuating.

There is a considerable digital gap between the West Bank and Gaza and the rest of the world, including Israel, which undermines the telecom sector's economic growth. The difference between the deployed mobile communications technologies that are provided by Israeli operators and Palestinian operators puts the Palestinian telecom operators at a disadvantage, making it difficult for them to compete with the more advanced technologies deployed by Israeli unlicensed operators in the West Bank and Gaza.

Based on the signing and implementation of the MoU, new technologies including 3G/4G could be deployed in the West Bank in the first half of 2016. Wataniya 2G deployment in Gaza is an important step that should be achieved before the end of the first quarter of 2016. Wataniya 2G deployment was agreed upon in December 2013, and currently the Israeli authorities need to grant approval for the use of the allocated spectrum in Gaza and entry of the remaining civil works equipment that is needed to start building the network.

While 2G deployment in Gaza is important for the economic development of Gaza, it is also critical for Wataniya’s commercial stability and ability to deploy new technologies.

5. Access to Land

Limited access to land remains one of the major obstacles to the development of the Palestinian economy.

Over 60 percent of the West Bank is classified as Area C – where Israel (through the Civil Administration) continues to have powers and responsibilities related to security and territory (e.g. planning and zoning, issuing building permits and land registration). Much of Area C land includes prime land for economic development, including for agriculture, tourism, housing, and industry. Specific proposals for industrial zones, agricultural projects, and housing may be able to unlock this potential in advance of a broader resolution of the politics around Area C.

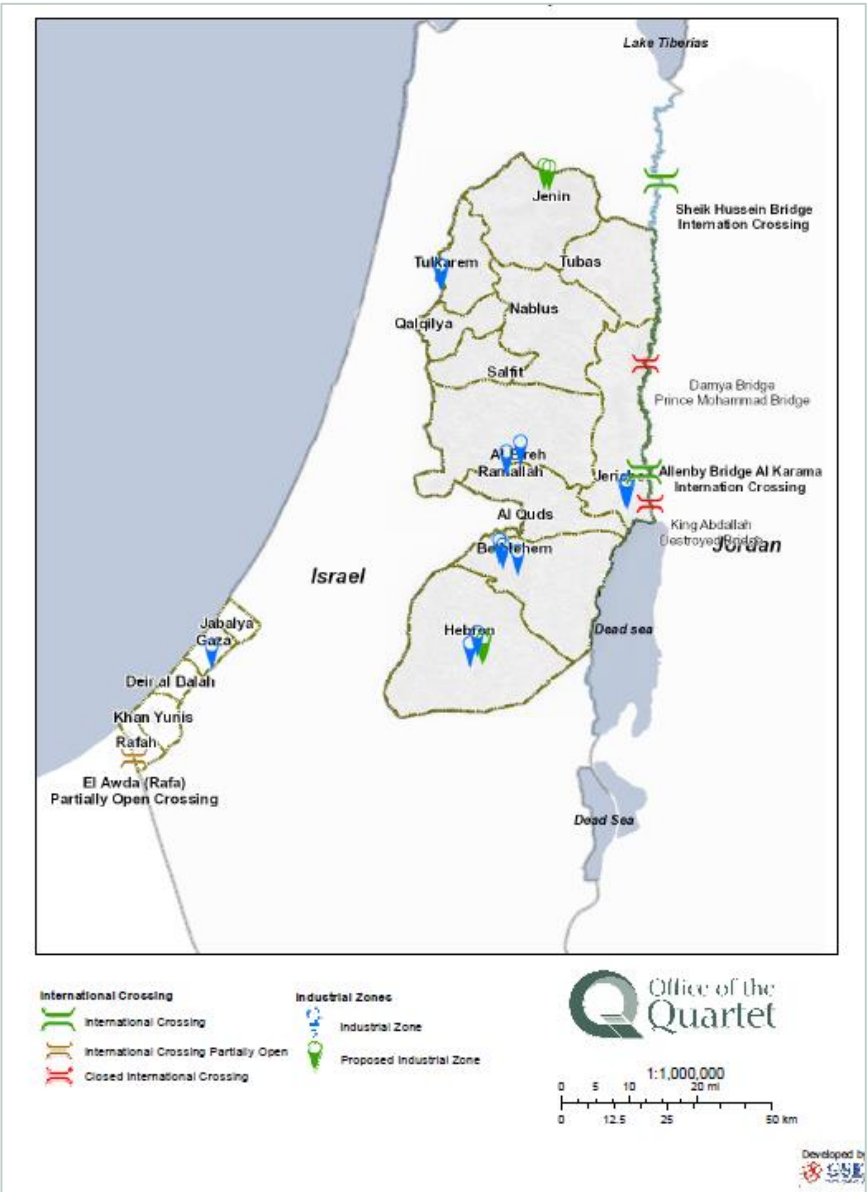
In parallel, the PA's management of Area A and B land can be improved by strengthening the Palestinian Land Authority, accelerating land registration, and creating the regulatory environment that encourages private-sector led – and PA-supported – use of land for high-value projects.

5.1 Industrial Zones

Industrial zones can be a powerful private sector mechanism to boost economic development, as long as they have unfettered access to markets - both for import and export purposes.

Efforts to develop major new industrial-zone projects – such as the Jenin Industrial Free Zone being developed by the Turkish company TOBB-BIS, and plans for an industrial zone in Hebron – have the potential to create tens of thousands of new jobs and boost manufacturing, GDP and exports. By taking advantage of strategic locations, with good access to trade routes, export-oriented businesses can be attracted. Industrial zones will provide integrated infrastructure in one location and provide incentives and facilities that would help with cutting costs, improving inventory efficiency and facilitating entry to foreign markets.

Figure 8: West Bank Industrial Zones



The construction of industrial zones may be dependent on access to or through Area C. The enabling of the development of industrial zones will require the designation of land in Area C for these zones. It will also be essential to ensure effective movement and access to the zone, for equipment, goods, labor, and Palestinian security forces.

6. Conclusion

This is a crucial period for all those individuals and institutions dedicated to a two-state solution – we must form a resolute center. In the absence of an optimistic political horizon, it is essential to deliver concrete progress that is immediate, material, and tangible. Such progress can create drivers for renewed political dialogue, and help move the political direction away from the "old politics" of violence, recrimination, and polarization.

It is with this intention that we move forward in definitive spheres of activity, particularly around the issues of movement, trade, and infrastructure, which are gaining traction among key decision-makers and underpin economic development. OQ is encouraged to see that many of our partners among the Israeli, Palestinian, and international community are determined to search for new ways forward. To make lasting progress we must come together and work as a community. It is time for a new period, one in which we strengthen dialogue and cooperation in support of Palestinian economic growth and translate good words and fine intentions into actions that transform lives.

The Office of the Quartet works to support the Palestinian people on economic development, rule of law and improved movement and access for goods and people, as they build the institutions and economy of a viable and peaceful state in Gaza and the West Bank, including East Jerusalem.

The mandate of OQ focuses on economic and institutional development in the Palestinian Territory, addressing issues related to strengthening investment in the Palestinian private sector, rule of law, and movement and access. OQ works in coordination and complementarity with bilateral and multilateral partners that implement technical assistance programs in the Palestinian Territory. As such, OQ plays an important role in advancing tangible steps on the ground to advance the Palestinian economy, and preserve the possibility of a two-state solution.

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