

POTENTIAL ALTERNATIVES FOR PALESTINIAN TRADE:

DEVELOPING THE RAFAH TRADE CORRIDOR

Executive Summary

i. Beginning in December 2004, when all parties (including the Government of Israel (GoI) and the Palestinian Authority (PA)) agreed that Palestinian economic revival was essential, that it required a major dismantling of today's closure regime and that closure needed to be addressed from several perspectives at once, the World Bank has played a leading role in providing balanced analysis and proposals which draw on the Bank's worldwide experience in trade facilitation, but are realistic in the context of the Israeli-Palestinian situation. In today's environment of confrontation and heightened risk, movement and access controls have increased and earlier relaxations have been reversed. However, the relationship between Palestinian economic revival and stability and Israeli security remain unarguable and of fundamental importance to both societies' well-being. This paper explores the need and viability of opening up alternative trade routes for the Palestinian economy beyond those controlled by GoI with an analysis of the economic, logistical and political feasibility of using the Rafah border crossing in Gaza as part of a new trade corridor for the transit of Palestinian exports through Egypt.

ii. The Bank believes that using Rafah as a trade corridor to ship goods from Gaza to Egypt's efficient and privately managed container terminal at the entrance to the Suez Canal and to Cairo International Airport can provide competitive trade logistics in terms of performance and at a cost generally equivalent to or less than Israel's ports and airports. The legal underpinnings for using Rafah for transit trade are in place including the *Agreement on Movement and Access* approved by GoI, the PA and US which specifically allows for Rafah to be used for exports immediately and the *Arab League Agreement on Transit* which allows for duty-free transit of Palestinian goods through Egypt. To make the corridor operational requires relatively straightforward procedures for a secure supply chain at the Rafah terminal and transit protocols to be agreed between the Palestinian and Egyptian Governments, with the support of the European border monitors currently at Rafah.

iii. Critically, this trade corridor would offer the Palestinians direct access to the Gulf and Europe which are potentially the most lucrative markets for Palestinian exports. Given the significant contraction of Palestinian exports since 2000, WBG's relatively high cost structure and the competitive nature of global trade, only by accessing these markets directly and making full use of the generous trade agreements provided to WBG by Europe and the Arab League, will Palestinian producers capture enough value-added to grow the economy even if the borders with Israel become more efficient and transparent.

iv. The development of the trade route through Egypt is also expected to provide both short and long term benefits for the Egyptian economy. In the short term, there will be an increase in the demand for trucking and other transport and logistics services to service the transit cargo. As the trade corridor develops, the trading activities will generate related economic activity in northern Sinai including the possibility of joint production and processing activities along this corridor.

v. Opening the Rafah Corridor is complimentary to ongoing efforts to improve the border crossings with Israel, particularly at Karni. An effective Rafah corridor is likely, in fact, to help speed improvements at Karni since it will introduce competition to what has been a fully monopolistic border operation. Producers in Gaza can then decide on which crossing to use depending on market needs or in

response to when a specific security threat at a crossing may dictate its temporary closure. The West Bank economy is larger than the Gazan economy and producers there also need direct access to the world market. An efficient and reliable crossing and trade corridor through Jordan would provide similar advantages of direct market access from the West Bank.¹ Likewise, progress on the Palestinian port and airport as provided for under the *AMA* should begin in order to provide other alternatives for reaching third country markets.

vi. It is suggested that the development of the Rafah corridor take a phased approach beginning with specially arranged demonstration shipments to jump start operations and then expanding these activities as systems and procedures are instituted and improved. Necessary infrastructure and construction would proceed apace to support the agreed procedures and to appropriately meet demand as it grows. At the start, Rafah would be used only for exports in transit. Such operations have very limited security issues and do not impact the existing quasi-Customs union between WBG and Israel as embodied in the Oslo Accords. The independent EU monitors at Rafah, EUBAM, have expressed willingness to include the handling of goods in their third party mandate. Egyptian authorities have also indicated their support for Palestinian transit trade.

vii. The success of the Rafah corridor is dependent on establishing practices and procedures which, while sensitive to legitimate security and economic concerns and minimizing risks, are appropriate and focused on facilitating efficient and reliable trade. Ample expertise in putting in place international best practice is available and the World Bank and the EC, among others, are prepared to assist in this regard. An immediate reopening of Rafah for passengers, and a return to normal and reliable operations at the crossing, as mandated by the *AMA* and practiced from November 2005 to June 2006, must be restored and respected. The border crossing should be a conflict-free zone where all parties in the region recognize the importance to the Palestinian and Egyptian economies and the well-being of the Gazan population of maintaining an efficient, reliable and corruption free trade corridor.

viii. This paper covers the following four key issues: (i) Palestinian Trade Against the Background of Global Trade Expansion; (ii) Trade Logistics and Performance Using Egyptian Gateways; (iii) Establishing the Border Terminal Operations and Transit Protocols, and (iv) Conclusions and Next Steps. The paper incorporates views and feedback provided to the authors during a series of presentations and discussions of the main concepts with a wide range of private sector, government and donor stakeholders in WBG and Israel in January and March 2007.

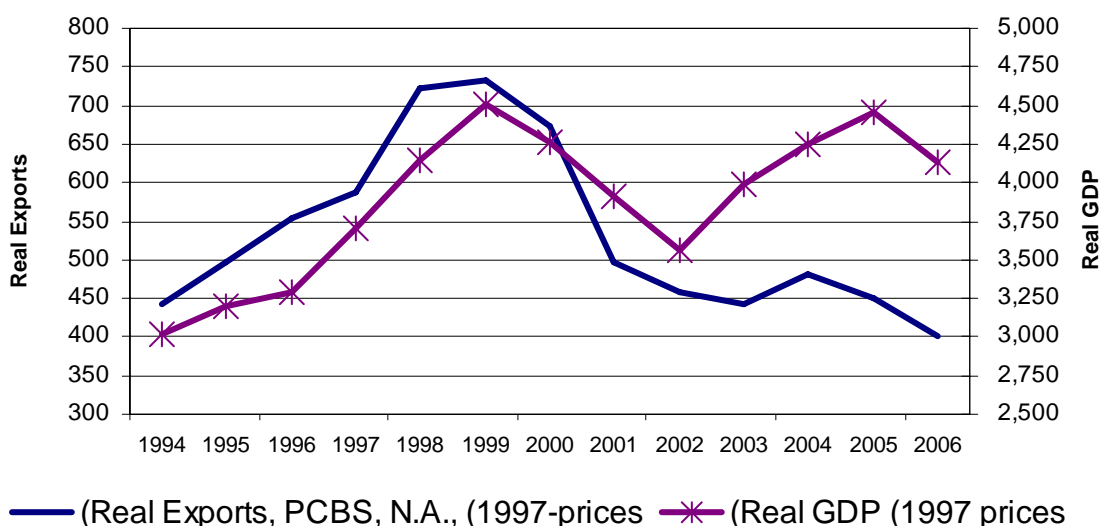
¹ For a Jordanian Corridor to be successful it is crucial that Israel reverse the current policy of restricting access of the Palestinian population to the Jordan Valley since this would add significant uncertainty in reaching a Jordan transit corridor.

I. PALESTINIAN TRADE AGAINST THE BACKGROUND OF GLOBAL TRADE EXPANSION

1. WBG is a small, resource-poor country with a well educated, but rapidly growing population. As such, it has been and will continue to be reliant on maintaining an open trading economy as the basis for economic growth. Historically, trade in goods and services, and the export of labor to Israel, have been the main sources of growth in Palestinian GDP. Trade accounts for some 85-90% of Palestinian GDP -- with imports of goods and services representing about 70% and exports of goods and services representing some 15-20% of GDP. Under the Paris Protocol², WBG entered a quasi-customs union with Israel, harmonizing its trade policies and agreeing to Israeli collection of all duties and taxes due to the PA resulting from trade. Some 90% of all imports and exports now come from or through Israel. Israel also retains total control over the movement of people and goods in and out of WBG.

2. Unfortunately, the cycle of violence and closure that took hold at the start of the second *intifada* resulted in progressively more uncertainty, higher costs and a restrictive regime for transferring border cargo that has contributed to a significant decline in trade from 2000. Except for some growth in 2004, the decline has continued to the present (See Graph 1). Given the unprecedented level of closure affecting Gaza since January 2006, as well as the economic decline resulting from the withholding of tax revenue and donor assistance which accompanied the election of a Hamas government, Palestinian exports have declined to their lowest rate since the signing of the Oslo Accords in 1994.

Graph 1: Palestinian GDP and Exports, US\$ mill



3. Looked at from a global perspective, this period of decline in Palestinian trade is even more troubling. While the value of Palestinian exports in 2006 was nearly 30% below the level reached ten years ago, and down some 46% from the peak reached in 1999, global merchandise trade grew on average by 4.2% in real terms over the past ten years. Trade has also become increasingly competitive. New entrants and improved logistics mean that existing exporters can no longer take for granted long-established relationships and markets. Not only manufactured products, but agricultural and horticultural

² The Paris Protocol sets out the economic arrangements between the Palestinian Authority and Israel and is a part of the Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip signed in 1994 and commonly known as the "Oslo Accords".

goods are now shipped to markets from much greater distances.³ As trade barriers have fallen, imports from low priced producers have captured significant market share from domestic producers, even in developing countries. Thus, the Palestinian economy is being left further and further behind other trading economies.

4. In economic terms, the restrictions on the movement of Palestinian people and goods arising from closure have not only increased transaction costs, but have also led to a level of uncertainty and inefficiency which has stymied growth and investment. Bank estimates suggest that movement and access restrictions may have accounted for about half of the decline in Palestinian GDP in recent years. Although Palestinian enterprises are aware that they need to invest in their businesses to increase productivity and improve the quality of their products, they are not doing so as long as restrictions on accessing markets both domestically and for exports make such investments highly risky. This is confirmed by a recent Investment Climate Survey carried out by the Bank⁴ which showed that, in 2005, more than 83 percent of Gaza-based exporters in the industrial sector ranked movement and access among their top-three obstacles to the growth of their business.⁵ There is little that private investors or donors can do in support of the private sector which will provide sustainable improvement unless progress is made in reducing the uncertainty and inefficiency inherent in the current regime of movement and access restrictions.

5. The economy in the Gaza Strip, particularly since Israel's departure from the settlements in August 2005, has been particularly hard hit by a contraction in external access. With the exception of cement and gravel, Gazans have only a single entry and exit point at the Karni/Al-Mountar Border Crossing for the export and import of all goods needed to sustain an economy of nearly 1.5 million people.⁶

6. From a trade perspective, the operation of Karni is unacceptable. It was closed for the majority of time in 2006 and even when open, operates haphazardly with varying operating hours, inefficient and unpredictable screening procedures, and lack of transparency. While the AMA called for continuous border terminal operations and for the number of daily export trucks from Gaza to reach 150 a day by January 2006 and 400 a day by end 2006, on average only some 20 trucks crossed on a daily basis in 2006. As of end January, the average had increased to 46 a day⁷, but this still is only just over 11% of the number committed to under the AMA (see Graph 2).

³ For example, products from South America, Africa and the Middle East now compete in the European wholesale food markets.

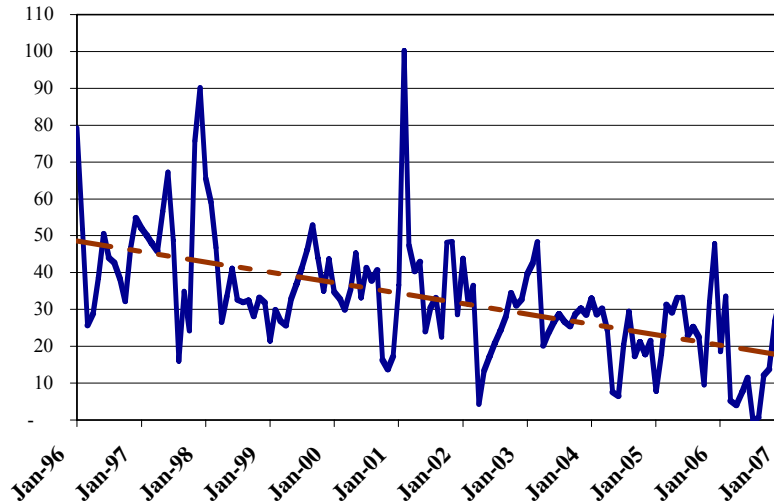
⁴ See WBG Investment Climate Assessment, World Bank, March 2007 (pending)

⁵ The survey covered the period to 2005. If asked today when faced with closure policies in 2006 which have been more restrictive than any time since the start of the second intifada, it can be assumed that nearly every firm, especially in Gaza, would list this as the key obstacle.

⁶ Gravel and other aggregates are normally moved between Israel and Gaza at the Sufa Crossing which is at the southern edge of the Gaza-Israel border. Although Israel has built a large facility for the passage of people between Gaza and Israel at Erez (on the northern Gaza-Israel border), this passage has remained closed for nearly a year to all except internationals, high level government officials, and a limited number of businessmen and traders who have obtained special permits from GoI and whose travel is coordinated in advance with the military authorities at the passage. Rafah, located between southern Gaza and Egypt, was turned over to Palestinian control, with third party monitoring, in November 2005. Unlike the crossing between WBG and Israeli, there are no provisions in the AMA for Israel to close this crossing between Gaza and Egypt. In practice, however, Israel has since June 2006 dictated the opening and closing of Rafah.

⁷ Daily monitoring of trade flows through Karni is provided by Paltrade under a grant by the World Bank's Post Conflict Fund. See Paltrade's website www.paltrade.org for additional information.

Karni Truck Movement: 1994 to present



7. Many of the procedures and much of the infrastructure design at Karni started from a security perspective or in response to specific threats at the crossing.⁸ However, a number of practices and procedures appear to be exercised as a form of non-tariff barrier to restrict trade. The Bank and others have written many papers on the functioning of Karni that document the frequent and extended closures, poor design, inefficient use of existing equipment, lack of service standards, absence of published procedures and fees, and failure to meet agreed performance targets.⁹ The US Security Coordinator (USSC) has been working actively to address legitimate Israeli security concerns about the crossing¹⁰, but the key issues related to Karni's processes and procedures remain fundamentally unchanged. The result is that the crossing is plagued by excessive costs, insufficient throughput and lack of reliability. Moreover, as may be expected when so much demand is unmet and no other option for the movement of goods is available for the entire population of Gaza, Karni has also attracted large scale corruption, with payments to transport goods to/from the Israeli side of the border running on the order of \$2,000-\$6,000 per truck. This corruption also renders the crossing more fundamentally insecure.

8. Even without the problems at the border, Palestinian exporters face additional challenges and costs in moving their goods through Israel. Because Palestinian traders and firms experience significant problems when trying to access Israel or Israeli ports directly, they are forced to turn to Israeli middlemen and service providers to facilitate the movement of imports and exports. In the past these ties may have been positive in terms of expanding both Israeli and Palestinian trade, but now have left the Palestinian economy extremely vulnerable to changes in Israeli policy and border regimes and without the diversity necessary to compete in the modern global trading system. Recent changes introduced at Ashdod port, for example, dictate that goods originating in the Palestinian territories be held for 48 hours at the port. This delay is often enough to miss a sailing – causing the goods to remain at the port for several

⁸ The crossing was subject to one particularly lethal attack in January 2005 when militants drove up to the wall from the Palestinian side and used explosives to blow a hole in the wall, killing several workers on the Israeli side before being killed themselves by Israeli soldiers. There was also an instance when militants smuggled themselves through Karni in an empty container to Ashdod port where they killed a number of workers.

⁹ See World Bank's West Bank and Gaza website for more information.

¹⁰ GoI has claimed that its inability to keep Karni open is because of security issues on the Palestinian side of the border including suspected tunneling or other activity. USSC has therefore worked with the Palestinian government on both physical improvements as well as improved procedures and risk management techniques related to those who access the crossing from Gaza.

additional days. Air cargo originating in WBG is prohibited from being shipped on passenger airlines out of Ben Gurion, thereby limiting the available capacity and frequency of services for high-value, time-sensitive goods. Furthermore, as reported in the ICA, Palestinian firms also have very little certainty in terms of their imported goods clearing customs at the port. On average, it takes a West Bank firm nearly 10 days to clear customs and a Gazan firm 30 days. But it may also take as many as 30 days for goods destined for the West Bank and 60 days for goods destined for Gaza to clear. In comparison, goods imported by Israeli firms normally clear customs within a day or two. With such a degree of uncertainty, Palestinian enterprises are forced to keep large stocks of imported inputs on hand, making their final products more expensive and less competitive.

9. As difficult as the border regime is, Palestinian firms also face market changes which are negatively impacting Palestinian export performance. As explained at some length in the ICA, Palestinian trade has been tightly linked with the Israeli economy for the past 40 years. Palestinian firms developed by producing labor intensive, low value-added goods which were sold into what had been a heavily protected Israeli consumer market. However, as Israel's economy developed and producers moved into the production of higher value goods and services, it needed to lower the level of protection on its domestic market in order to gain markets for its high value exports. This drop in protection meant that Palestinian goods, which had enjoyed a protected market in Israel and WBG, faced increased competition from countries such as Turkey, China and Vietnam which could produce similar goods at lower costs. While production costs are lower in Palestine than in Israel because of significantly lower Palestinian wages, Palestinian wages are too high to be competitive globally in low-end textiles and footwear.

10. Competitive advantage, however, is no longer dependent only on low-cost production. While countries with the lowest labor costs will continue to attract outsourcing, low costs alone cannot maintain markets in the global economy. Increasingly, particularly for higher value goods, the focus is on predictability and successful exporters are those that can provide reliable and time sensitive delivery. This is especially true for smaller producers whom, in order to survive in the face of the large producers of China and India, compete in regional niche markets by offering better quality and service to their buyers.

11. Reliable and time sensitive delivery is particularly important for the kind of products which can be produced in WBG. Clothing sold to hypermarkets and national retail chains require reliable trade logistics to provide "just in time" delivery. Fresh fruit and vegetables must be transported in an uninterrupted "cold chain" in order to reach the standard required for high-value European Union produce and supermarkets. Fresh herbs and flowers, which have been successfully exported from WBG and Israel in the past, are the most demanding in terms of delivery time. These products need to reach their markets from the packing houses within 1-2 days. Even producers of less time sensitive exports such as furniture are coming under increasing pressure to meet tighter delivery times to keep up with global competitors. In highly competitive export markets, fulfillment rates (deliveries on time and in good condition) are expected to exceed 95%.¹¹ Exporters pay heavy penalties for late or damaged shipments.

12. To meet the demand for faster and more reliable deliveries, successful exporters must develop alternative supply chains and utilize multiple trade routes to meet the differing requirements of their buyers with regards to cost and time. Under normal circumstances, exporters will make use of the most cost-effective routes to meet normal delivery schedules. However, they are also prepared to use higher cost, but faster routes on occasions when there are unexpected delays in production or other events

¹¹ The implications of variations in performance on trade are sometimes difficult to put in perspective. An analogy would be a restaurant in which the time to serve food varies from ten minutes to two hours, and sometime the food is not served at all. It is difficult to imagine that such a restaurant could remain open. If an exporter cannot be sure of on time delivery, then the importer is being asked to accept this same open-ended proposition.

leading to missed shipment dates. This is necessary for both the import of inputs necessary to produce exports as well as for the shipment of final products. The development of alternative routes has been especially important in countries that are landlocked or lack seaports since exports and imports can be easily disrupted by developments in neighboring countries and by the behavior of various national border authorities. In the case of WBG, all of these problems are particularly acute.

13. If Palestinian producers can guarantee access to their customers, there are potentially lucrative markets beyond Israel. WBG enjoys generous trade arrangements with the EU and improvements in the “Rule of Origin” regulations will further enhance the ability of Palestinians to directly sell to customers in Europe. Under the Arab Free Trade Area Agreement, Palestinian goods have duty-free access to this burgeoning market. According to a recent study by the Peres Center and Paltrade, merchandise imports into this zone amounted to \$170 billion in 2005 and are projected to reach over \$500 billion by 2015¹². Since Palestinian trade is almost exclusively through Israel, Palestinian exporters have not been able to adequately tap this market. However, with alternative trade routes, Palestinian products, starting with goods such as produce and furniture, would be particularly well placed to penetrate this lucrative and growing market.

14. For these three reasons: (i) the absence of reliability and efficiency in moving goods through the border with Israel, (ii) the loss of some Israeli markets to more competitive imports and its relatively high costs of production compared to other developing countries and (iii) the demand from the global economy for on-time and undamaged delivery of goods, Palestinian firms will need to find new ways of doing business. This will require a transition to the production of higher-value goods and services, accessing final markets directly so as to avoid the costs incurred by a dependency on middlemen, and ensuring that exporters have the means to meet contractual obligations for delivery on time and at the agreed price. To do this, WBG must have competitive and reliable trade corridors that offer direct access to its traditional and new markets.

II. TRADE LOGISTICS AND PERFORMANCE USING EGYPTIAN GATEWAYS

15. In November 2005, following the disengagement of Israel from the Gaza Strip and as provided for under the *Agreement on Movement and Access (AMA)*, the Rafah border crossing between southern Gaza and Egypt was turned over to operation by the PA, with third party monitoring provided by the EU (EUBAM) and additional scrutiny through the operation of CCTV cameras by Israeli security. Although the operation of the crossing has become marred in recent months, the experience of Rafah as a passenger border terminal was extremely positive until the disruption caused by the kidnapping of an Israeli soldier near the Gazan border and the subsequent closure of the Rafah crossing by GoI. Prior to the closure, the crossing’s performance represented a dramatic improvement over the period of Israeli control¹³. There was appropriate coordination between customs and Palestinian security forces at the crossing and the PA Customs Department successfully introduced electronic customs reporting for goods carried in passenger’s baggage (using the UN’s ASYCUDA ++ system).¹⁴ The presence of EU monitors and CCTV used by Israeli security services at nearby Kerem Shalom, ensured that the crossing was run appropriately and safely in order to assuage legitimate concerns about the security and safety of the crossing and the goods and people who passed through it. In terms of performing a thorough and efficient

¹² See “The Untapped Potential”, December 2006 by the Peres Center for Peace and Paltrade.

¹³ Prior to the Israeli withdrawal from Gaza in August/September 2005, Rafah was notorious for security related closures, long passenger queues, and poor communication and coordination with the Egyptian side. This led to long periods when hundreds of Palestinians were left trapped on the Egyptian side for days and weeks waiting to return to Gaza. Since the handover to PA control, the Rafah crossing remained open, expanded and normalized its operating hours and provided the capacity to cross all passengers. With the border closed most days since the summer, familiar scenes of Palestinians trapped at the borders have reoccurred.

¹⁴ ASYCUDA is currently employed in over 80 countries worldwide.

inspection of passengers and luggage and fully meeting demand, experts stated that Rafah ranked among the best passenger-only terminals¹⁵.

16. This initial success provides the natural starting point for developing a new trade corridor through Rafah for Palestinian exports for several key reasons:

- The political agreements that underpin the expansion of Rafah from passengers only to passengers and goods are already in place. The AMA provides for the crossing to be used for exports immediately (i.e. as of November 2005), and allows it to be used for imports following assessment after the first year of operation (i.e. as of December 2006). In terms of moving goods through Egypt, the Arab League Agreement on Transit provides a starting point for duty-free movement of Palestinian goods through Egypt for ongoing shipment from Egypt's ports and airports.
- A phased approach can be easily initiated, starting with exports moving in transit under a customs bond to third countries. This movement would not involve security issues for Israel nor would it have any implications for the Paris Protocol. The movement can be arranged directly between WBG and Egypt with relatively simple procedures to ensure that there is no leakage into the Egyptian economy. EU BAM has expressed willingness to expand its monitoring operations to include the passage of goods. Once procedures are established and the transit route operates with some regularity, this arrangement could be expanded to improve efficiency and then to allow imports.
- As explained in the following paragraphs, the trade corridor from Rafah to Egypt's ports at the mouth of the Suez Canal (including the new SCCT), to the international airport in Cairo, and over land and across the Gulf of Aqaba to the Gulf countries, provides competitive trade logistics in terms of time, performance and cost for Palestinian exporters to access key markets.
- The development of the trade route through Egypt is also expected to provide both short and long term benefits for the Egyptian economy. In the short term, there will be an increase in the demand for trucking and other transport and logistics services to service the transit cargo. While the initial volumes of exports will be relatively small, this will grow and will eventually be complemented by much larger volumes of imports to supply the Gazan economy. As the trade corridor develops, the trading activities will generate complementary economic activity in northern Sinai. This can be expected to result in a substantial volume of bilateral trade leading to joint production and processing activities along the corridor.
- This activity would not preclude other initiatives to deal with movement and access restrictions including ongoing efforts to improve trade routes to/through Israel as well as internal and external restrictions in the West Bank. Rather, if successful, Rafah would provide a replicable model for opening up other corridors including a Palestinian-Jordan route from the West Bank which is essential for growing the economy in the West Bank.

Trade Logistics: Road, Sea and Air

17. The viability of the Rafah corridor will depend on the ability to move goods quickly, reliably and at low cost between Gaza and the various Egyptian gateways. The selection of an appropriate gateway will depend largely on the type of commodity and the relative importance of time and cost which its delivery demands. Table 1 gives an indication of the modes of transport and therefore the gateways that are most likely to be used for products from Gaza exported via Egypt.

¹⁵ 100% of passengers and baggage is checked going through Rafah, yet there were minimal delays and the crossing fully met demands.

Table 1: Trade Logistics: Mode of Transport

| Product for Export | Road | Sea | Air |
|--------------------|------|-----|-----|
| Oranges | √ | √ | |
| Strawberries | √ | | √ |
| Tomatoes | √ | √ | |
| Herbs | | | √ |
| Carnations | | | √ |
| Apparel | | √ | √ |
| Furniture | √ | √ | |
| Leather Goods | | √ | |

18. Figure 1 shows how goods would move along each of the road corridors: (i) to Egypt’s ports at the mouth of the Suez Canal, (ii) to Cairo International Airport (and the small regional airport at Al Arish) and (iii) to the Gulf of Aqaba and across to destinations in the Gulf states.

Figure 1: Alternate Routes



19. **Road Connections:** The road from Rafah through the Sinai to Cairo provides a good transport link. The road is primarily a four lane road (two lanes in each direction) with some wider sections with relatively little traffic until it reaches the outskirts of Cairo. There are relatively few towns along this route and trucks can average 80 km per hour except for the last few kilometers approaching the International Airport on the eastern edge of Cairo. The road between Rafah and the Suez Canal is relatively new and the entire length is in good condition. Since the distances to the port and airport are reasonable, even allowing for loading time, a truck originating in Egypt can pick up a load at Rafah and deliver it to the port/airport in a single day. Indicative travel times and distance are shown in Table 2

Table 2: Indicative Road distances and Times from Rafah Border Crossing

| | Port (SCCT) | Airport (Cairo Intl) | Nuweiba | To UAE |
|-------------------------------|------------------------|---------------------------------|------------------|-------------------|
| Distance (km) | 235 | 355 | 350 (approx.) | 3000 (approx.) |
| Approx time (hrs.) | 3-4 | 6-8 | 5-6 | 4-5 (days) |

Source: World Bank staff estimates

20. **Air Links:** Cairo International Airport has ample cargo capacity on passenger and air freighter services to handle Palestinian transit trade. It has dual runways capable of operating in all weather conditions. Its current traffic level, some 10 million passengers and approximately 200 thousand tons of cargo annually, is roughly equivalent to the traffic at Tel Aviv's Ben Gurion airport, through which Palestinian air freight currently travels. Moreover, Cairo has a new cargo terminal under construction which will be privately operated and will allow for growth in air freight. There is good connectivity to Europe and, importantly, frequent, direct access to Gulf markets. Finally, it can be expected that there would be no prohibition to transporting Palestinian cargo in the hold of passenger aircrafts from Cairo as is the case at Tel Aviv.

21. A small airport, Al Arish, is located some 40 km from Rafah. It is rarely used, but has a 3000 m runway and a small passenger terminal that is maintained. While there are no regular operations, Palestinian Airways has been using the airport for flights to Jordan since the airport in Gaza was put out of operation by GoI during the second intifada. Al Arish can handle charter air freight operations if market conditions dictate (for example, for large consolidated shipments of strawberries for sale in Gulf markets, a charter flight could be arranged).

22. **Sea:** In recent years, Egypt has made enormous strides in the quality of its port operations. The container terminals at the north end of the Suez Canal act as transshipment hubs for all of the major shipping lines serving European, Gulf and Asian trade. In particular, these terminals provide the point of transfer for containers that feed into/from the Eastern Mediterranean to the mainline shipping services traveling between Europe and Asia.

23. The newest terminal, SCCT, is privately operated and services two of the three largest container lines, Maersk and CMA-CGM. Currently it has 4 berths and some 80 hectare of storage and the most up-to-date cargo handling equipment. Although operating for only slightly more than one year, it has already surpassed the threshold of handling 1 million TEU¹⁶ per year and will have a capacity for 2.5 million TEU per year under current expansion plans. As such, it offers superior capacity and sailing frequency to Europe, the Gulf, and the markets of Asia.

Logistics Performance and Cost

24. As described above, the Egyptian gateways offer a competitive service relative to the Israeli ports and airport in terms of connectivity, quality of service, and capacity. However, it is also necessary to determine whether the routes via Rafah offer a competitive alternative in terms of time to market, cost, and reliability required to meet the demands of the global economy. For perishable agricultural exports, it

¹⁶ TEUs are a standard measure of shipping – twenty foot equivalent units.

will also be necessary that the trade corridor provide secure cold chains. Table 3 looks at the relative importance of these factors for goods that are currently exported from Gaza.

Table 3: Logistics Service Requirements

| Product for Export | Time to Market | Cost of Transport | Temperature Control (maintain cold chain) | Reliability |
|--------------------|----------------|-------------------|---|-------------|
| Oranges | √ | √√ | √ | √ |
| Strawberries | √√ | √ | √√ | √√ |
| Tomatoes | √ | √√ | √√ | √√ |
| Herbs | √√√ | | √√√ | √√√ |
| Carnations | √ | √√ | √ | |
| | | | | |
| Apparel | √√ | √ | n/a | √√ |
| Furniture | √ | √√ | n/a | √ |
| Leather Goods | √ | √√ | n/a | √ |

25. **Time to Port:** As shown in Table 4 although the distance from Gaza to Egypt’s gateways is considerably further than to Ashdod port or to the airport in Tel Aviv, in terms of cost, transit through Egypt is likely to be equivalent. This is a result of the lower cost of Egyptian trucking which benefits from cheaper labor costs and more competition (relative to the limited number of Israeli trucking companies transporting goods to and from Karni). It should be noted that, at present, estimates show that Rafah would provide tremendous savings over Karni where costs, including informal payments, are currently in the range of \$2000-\$6000 for the 40 km trip to Ashdod port. A similar trip on the Rafah corridor would cost \$450 from Rafah to SCCT.¹⁷ However, since the Karni costs are inflated by the high level of informal payments, for the purpose of evaluating the viability of the Rafah corridor, it is more useful to consider the expected costs (i.e. without informal payments) of using both trade routes. Even if, over the longer-term, these informal payments could be significantly reduced, the route through Rafah still appears to offer a competitive option.

Table 4: Indicative Freight Rates-Road Transport

| Route | Rafah - Cairo Airport | Rafah-East/West Said | Karni - Ashdod |
|------------|-----------------------|----------------------|----------------|
| Vehicle | Refrigerated Truck | Marine Container | Fixed Axle |
| Cargo | 5 – 10 Tons | 40’ (2 – 20’) | 40’ (2 – 20’) |
| Rate (USD) | \$500 / Truck | \$450 | \$450* |

*exclusive of charges associated with obtaining a slot and other informal payments at Karni which are currently estimated at around \$2000-\$6000 (based on World Bank estimates)

26. **Time to Market:** For high value, short shelf-life agricultural goods, getting to market quickly and, in most cases maintaining the cold chain, is of critical importance. Without this, products quickly lose much or all of their value. This has proved one of the most difficult problems for Gaza’s strawberry and flower growers given the near total uncertainty of the time it takes to cross Karni. With no ability to ensure the through movement of goods to customers beyond Israel, Palestinian producers are fully dependent on Israeli firms to market, pack and ship their goods. It is not unusual under such arrangements for Israeli consolidators to refuse to take Gazan exports when there is a glut of supply from

¹⁷ Since there is currently no route through Egypt, it is impossible to compare rates inclusive of “informal payments” if these were to occur on the Egyptian/Palestinian border. However, learning from the lessons of Karni, it will be important to minimize any opportunities for corruption through an effective and transparent regime for transit movements as explained in Section III.

Israeli suppliers or when prices are low in the final markets. Lacking any alternatives for exports, Gazan producers are then left with no market for their highly perishable produce. High value apparel, with demanding delivery schedules, creates similar challenges in terms of just-in-time delivery.

27. With good connectivity to markets in Europe and the Gulf/Middle East using scheduled flights from Cairo International Airport, or possibly charter services from Al Arish, the Rafah corridor can provide delivery by air between 1-2 days to most locations. As shown in Table 5, in terms of both time and cost, services through Egypt are comparable to those available through Israel. Importantly, however, Egypt also offers direct service to Gulf markets.

Table 5: Air Freight Comparability: Indicative Rates*
(based on World Bank estimate)

| \$/kg | Ben Gurion | Cairo Intl |
|--------------|-------------------|-------------------|
| London | \$1.18 - \$1.22 | \$1.25-1.40 |
| Dubai | n/a** | \$1.50-1.70 |
| Singapore | \$1.75 - \$2.00 | \$1.75-2.20 |

*Note: Rates are indicative only as costs are often negotiated with shippers and are dependent on amount of cargo, routings selected, etc.

**Direct flights to Gulf countries from Israel are not possible.

28. **Sea and Road Transport:** For products which are less time sensitive, road and sea freight provide significant cost savings compared to air freight. As shown in the tables below, the Rafah corridor using SCCT and overland routes to the Gulf, provides very competitive options in terms of cost and reliability. The estimates are based on shipping time and indicative freight rates – actual costs will differ as they are often based on specific routings, space availability, reductions for larger shippers, etc. The time and cost related to the additional requirements of the handling of Palestinian goods at Israeli ports, including a minimum 48 hour holding period for exports at Ashdod, are not included in Table 6 but will tend to extend the shipping times for Palestinian goods using the Israeli gateways.

Table 6: Indicative Sea Freight Rates *
(based on World Bank estimates)

| | SCCT – Port Said | Haifa / Ashdod |
|--------------------------|-------------------------|-----------------------|
| Singapore | | |
| Time (days) | 9 - 12 | 14 – 15 |
| Rate USD/TEU | \$535 | \$515 |
| Rotterdam | | |
| Time (days) | 9 | 9 |
| Rate USD/TEU | \$670 | \$802 |
| Jebel Ali (Dubai) | | |
| Time (days) | 3-4 | 6-8** |
| Rate USD/TEU | \$970 | \$1126 |

*Note: Rates are indicative only as shipping costs vary depending on cargo, amount of goods being handled, whether a particular ship has an empty backhaul, etc.

**Direct shipments from Israel to Gulf countries are not possible. Therefore, time is estimated based on the need to transship good sent from Israel’s ports to a third country for reshipment.

29. In summary, in terms of performance, the Rafah corridor offers a viable competitive option to the routes currently available to Palestinian exporters. By air, it has the additional attraction of providing direct services to the Gulf and other Middle East locations as well as offering greater frequency by

permitting the use of cargo capacity on passenger aircraft. In terms of sea freight, the Rafah corridor offers comparable services in time and cost to Europe, faster times to Asia and less expensive and faster service to the Gulf. More importantly, it offers greater frequency of service to all destinations and greater choice in shipping lines and terminal operators. By land, the Rafah corridor offers the possibility of trucking goods directly to Gulf countries in 4-5 days. Finally, while the distance from Rafah to the Egyptian gateways is further than to Israel's, in terms of cost and time it is expected to offer comparable and more reliable service when the border crossing and procedures at the gateways are taken into account. It is then a question of establishing an efficient transit route from the border to the gateways. This is discussed in Section III below.

III. BORDER TERMINAL OPERATIONS AND TRANSIT PROTOCOLS

30. To establish a viable Rafah transit corridor, it is necessary to have an efficient border terminal operation at Rafah and a relatively simple, transparent transit protocol between Egypt and WBG governing the movement of Palestinian goods to Egyptian gateways. Overall, these operations should be based on a simple set of principles: (i) practices established at Rafah should be consistent with the revised Kyoto Convention, (ii) border inspection and document handling should be a one-stop/single inspection operation in order to ensure efficient, but secure handling; (iii) minimal additional documentation should be required for the transit of goods and (iv) cargo, once sealed at the border should have no further inspections.¹⁸ Each of these concepts is described in more detail below.

Proposed Operations at the Border Terminal

31. **Cross-docking:** Given that Egyptian trucking can provide an economically viable option for the movement of goods to Egyptian gateways, and taking into account Israeli security concerns related to movement of Palestinian trucks across the Rafah border, it is proposed that an efficient cross-docking arrangement be made at Rafah. This would consist of Egyptian trucks entering the secure Rafah terminal and moving to a loading area where Palestinian goods would be transferred across a loading dock into sealable Egyptian trucks or trailers. Palestinian labor would be used to handle the cargo and operate the forklifts. The inspection of cargo would take place visually as the goods moved across the loading dock from Palestinian to Egyptian truck. The security arrangements, already in place for passenger baggage could be enhanced to provide adequate security and monitoring for the movement of commercial goods. This includes the presence of EU monitors and CCTV cameras connected to Israeli security operating at nearby Kerem Shalom, as well as the presence of the Palestinian Presidential Guard. Palestinian customs agents would be present as would Egyptian custom agents with the approval of the Egyptian government.

32. Operations could begin even before the construction of the loading docks although simple docks can be prepared in a matter of weeks. Once a minimal level of trade has been reached, covered cross-docking facility should be constructed. The current configuration of the Rafah terminal provides ample space for these facilities. A separate covered and cooled facility could also be built to handle agricultural goods that need to remain in a cold chain in order to meet higher standards and preserve the quality of the goods. The movement of goods in containers or through trailer exchange could follow in time. Because construction of appropriate facilities can be handled relatively quickly, they should move ahead only in a coordinated fashion as procedures and processes are agreed and as market demand grows. This will help avoid some of the problems with inappropriate design and technology that are seen at other border terminals.

33. **Joint Palestinian-Egyptian Customs Procedures:** In order to ensure efficiency and minimize opportunities for informal payments, all customs checking would be handled at Rafah at the time of the cross docking. Documents would be checked and inspection would take place visually as goods moved

¹⁸ With the usual allowance for random inspections and inspections based on reliable intelligence activities.

between Palestinian and Egyptian trucks. Additional inspection would only be required on a random basis based on risk profiling or in cases where an anomaly was detected during normal operations. The Egyptian truck would then be sealed and an appropriate transit permit issued. Palestinian goods would move through Egypt without paying duty (under customs bond) on the basis of existing agreements including the Arab League Transit Agreement as well as the Arab League Free Trade Agreement to which both Egypt and PLO are parties.

34. **Movement of Goods in Transit:** It is suggested that a separate transit protocol be negotiated between Egypt and WBG that incorporates a simple guarantee system to cover the liability for duty on the goods if they fail to exit the country. The TIR system for providing such a guarantee has worked well in Europe and is being used increasingly in Central Asia and has made limited inroads in the Middle East¹⁹. However, there already exists a system for providing Egyptian truckers with a performance bond that should be adequate. The only difficulty is that the bond, which is offered by the private sector, is considered relatively expensive. An alternative mechanism for providing this bond might be considered in order to reduce the cost. Support from donors may be helpful in this regard.

35. In terms of security, the transit protocol should provide for monitoring the movement of the goods in transit but with the need for minimal surveillance. The first line of security would be provided by the cross-docking operation which dictates that the cargo changes hands from the Palestinian exporter to an independent trucker and with added supervision by customs and EUBAM. Second, because the distance that the truck needs to cover to reach the port or airport is relatively short, a time-bound movement requirement could be put in place. In practice, this would mean that a truck would be given a fixed time within which to reach the port or airport once it exits the Egyptian side of the Rafah terminal. If the truck arrived within the allocated time, and the seal was intact, then the cargo would not be inspected upon arrival except to the extent that all cargoes are security-inspected at the gateway (such as standard scanning of containers at the port or airport prior to loading). If Egyptian custom inspectors noted that the truck arrived with a broken seal or outside of the allocated time, then they would be free to inspect the goods. Under this system, no costly GPS, convoy or escort system would be required.

Smart Intelligence Procedures for a Secure Supply Chain

36. The Rafah trade corridor offers an opportunity to put in place best practices in terms of trade facilitation in order to avoid the cumbersome procedures and history of confrontation that has marred the movement of people and goods on the Gaza-Israel border. These practices, which are well established in many countries, would be based on using risk analysis to maximize detection while minimizing physical inspection. They would incorporate a system that differentiated among cargoes and shippers on the basis of perceived risk and would match this to the required level of inspection. Risk-based inspection would be supplemented by random, rather than arbitrary, inspections but with an appropriately low rate of sampling. Procedures should be transparent and published so that shippers can conform to requirements. Opening hours and fees should be set, published and respected in order to reduce opportunities for informal payments.

37. The private sector, both users of the facilities and those that provide services, should be integrated into the security process and terminal operations. This would include:

¹⁹ The TIR system is an insurance program for trucks carrying cargo under customs bond. Local transport or trade associations arrange for insurance cover which is then coordinated through the IRU (International Routiers Union). A carnet is issued for each truckload and is shown at the border along with the weigh-bill. In the event that the cargo does not exit the country, or is not cleared by customs at an inland point, then the duties and taxes on the missing cargo are paid to customs by the insurance arranged by the association in the country where the cargo was lost and the amount is recovered from the insurer in the issuing country. The TIR carnet is used in Turkey, Lebanon, Syria and Jordan.

- Incorporating high volume exporters into the secure supply chain. These exporters who voluntarily subscribe to certain security protocols at their factories and in their shipping arrangements would be designated as Authorized Economic Operators and would, in turn, gain better and faster movement through the border terminal.
- In addition to Authorized Economic Operators, a broader initiative by private sector industrial organizations which are well established in the major exporting industries in Gaza, would apply business to business enforcement of transit rules to ensure that the corridor worked efficiently for all exporters.
- Non-regulatory operations at the terminal should be outsourced using competitively and transparently bid contracts for cargo handling and, as the facility expands, for other operations such as cold storage areas, consolidation warehouses, etc.
- A robust dispute resolution mechanism should be put in place including private sector and government representatives from both WBG and Egypt. This would not only ensure better management of the facility, but would limit opportunities for informal payments and corrupt practices.

Challenges in Establishing the Rafah Trade Corridor

38. Despite the obvious promise that the Rafah corridor represents, there are significant challenges which will have to be overcome in order to ensure an efficient and reliable trade route.

- **Security:** Although the Rafah corridor avoids some of the more obvious security concerns related to movement at the Karni border, security procedures will need to be mindful of both Israeli and Egyptian security concerns. The use of Egyptian trucks should assuage Israeli concerns related to the movement of Gazan trucks back and forth across the border. Until the corridor expands to allow imports, there should be little other Israeli concerns related to transit trade. Egypt, however, may have other security and economic concerns and therefore careful attention should be paid to the operations at Rafah and the transit protocol in order to minimize risks, but at the same time ensuring that procedures are appropriate and facilitate trade given the very significant economic benefits to both the Palestinian and Egyptian economies of a well functioning trade corridor. Taking a phased approach will allow small scale operations to begin quickly while procedures are put in place for expanded operations.
- **Reestablishing Normal Operations:** It bears repeating that the practices and procedures at Rafah must be aimed solely at securing the border crossing and the safe transit of people and goods and *not* at securing the Palestinian/Egyptian/Israeli border. An immediate reopening of Rafah for passengers, and a return to normal and reliable operations, as mandated by the AMA and practiced from November 2005-June 2006, must be restored and respected. It behooves all parties to avoid using the operation of the Rafah corridor as a source of pressure on other political issues. The border crossing should be a conflict-free zone where all parties recognize the importance of maintaining an efficient, reliable and corruption free trade corridor to the Palestinian and Egyptian economies and the well-being of the Gazan population.
- **Practicalities of the Transit Protocol:** Historically, Egyptian customs has been one of the more difficult agencies in terms of transparency and efficiency. Transit rules within the country need clarification and Egypt is not a signatory to the revised Kyoto Convention. However, in recent years, a concerted effort has been made by the Egyptian authorities to upgrade and enhance customs and definite progress has been made. The extremely efficient and modern facilities operating at Al-Sokhna port provides an encouraging example. With sufficient commitment on

the part of both Egypt and WBG, it should be possible to devise a simple, transparent and efficient transit protocol drawing on best international practice. Such a protocol would greatly benefit both economies – with Palestinian exporters having low-cost and reliable access to markets and the Egyptian private sector (trucking, port and airport operations, and supporting industries) benefiting from the movement of Palestinian goods first as exports and eventually as suppliers of imports.

- **Developing New Markets:** The Palestinian private sector will have to adjust its products and its marketing to find and supply new customers. As explained in Section I, this will entail a significant change from past practices where Israeli middlemen and partners provided the main conduits to markets outside of Israel. Rather, Palestinian producers will need to seek out customers directly and/or with new Egyptian partners, and ensure that they deliver goods as required at a price and in a condition that keeps them competitive in the global economy.

Phased Approach

39. Because of these challenges, it is suggested that the development of the Rafah corridor take a phased approach beginning with limited truck operations and expanding these activities as systems and procedures are improved.

40. **Special Arrangement:** In the beginning, trade through Rafah will need to be by “Special Arrangement” as occurred in 2006 when three truckloads of goods from Gaza were sent through Rafah to a Cairo trade show. In this case, special efforts were made by the Palestinian and Egyptian authorities (including the top levels of Government), the customs departments of both countries, the EU monitors at Rafah as well as the Palestinian private sector, to ensure that the cargo moved as planned. It can be expected that similar “special arrangements” will be necessary to move the first few cargos. These movements will provide a demonstration effect and more regular movement should follow shortly thereafter. Nothing is needed to initiate this first phase beyond a commitment by the Governments of WBG and Egypt to support transit trade and the agreement of EU BAM to oversee operations at Rafah. Israel should not impede the normal operations and opening of the crossing. Private sector exporters from Gaza are prepared to take on the necessary commercial arrangements. Donor funded programs have also expressed willingness to help finance initial shipments.²⁰

41. **Outbound Transit:** Simultaneously with “special arrangement”, the governments of WBG and Egypt should agree on a straight-forward transit protocol along the lines outlined above. Agreement with EU BAM on the cargo handling procedures at the crossing should also be sought. Technical assistance can be provided by the World Bank, the EC or other international experts as required. Operations could begin quickly. Construction of the cross-docking facility could proceed apace. Expansion to include cold handling facilities would take place when warranted by demand.

42. **Inbound Cargo:** While Rafah will solve the problems related to the export of goods, Palestinian producers will continue to suffer if the importation of goods is uncertain. As discussed in Section 1, the results of the ICA indicate that Palestinian producers experience long delays in clearing their goods through Israeli ports and as a result have to maintain expensive inventories. As soon as practicable, Rafah should be expanded to allow imports so that producers in Gaza have an alternative route through which to receive inputs and Palestinian consumers have greater choice and more competitive options for imported goods. As long as the Paris Protocol is in effect, and in line with the *AMA*, it is necessary to have an agreement among the Governments of Egypt, Israel and WBG, as well as the support of EUBAM, in order to open Rafah for imports. Appropriate protocols and facilities could then be put in place as

²⁰ USAID and the Dutch Government each have substantial agricultural support projects in WBG and have expressed willingness to support the transit of agricultural goods through the Rafah corridor.

required. In the short-term, and in accordance with the terms of the AMA, the nearby Kerem Shalom crossing, which is under Israeli control, can be used for imports from or transiting through Egypt to Gaza. As agreed to in the AMA, Palestinian and Israeli customs officials would work together at Kerem Shalom to help develop capacity for Palestinian controlled import operations at Rafah.

43. **Free Trade Zone at Border:** Rafah has the potential to become a free trade zone if the trade corridor develops as an efficient and reliable link between Gaza and Egypt. This would have a positive impact not only in Gaza, but along the border in Egypt where support facilities would be needed. Al Arish airport could then provide an important hub for transport.

IV. CONCLUSIONS AND NEXT STEPS

44. As is true in all open economies, the Palestinian private sector needs to have alternative trade routes to directly access its customers in order to successfully compete in the global economy. The world market demands that producers guarantee on time delivery at a competitive price.

45. As described above, the Rafah Trade Corridor provides a viable alternative trade route initially for transit trade through Egyptian gateways and eventually for imports. It is not a substitute for improved trade with and through Israel, but the Rafah crossing can provide an essential alternative route with potentially high returns for the Palestinian and Egyptian private sectors. The crossing was efficiently and securely operated for travelers for eight months until it was closed by GoI at the end of June 2006. The normal crossing operation should be reinstated immediately for passengers in accordance with the AMA, and then its operations expanded to allow the movement of goods in transit. Not only would this route provide competitive trade logistics in terms of performance and at a cost generally equivalent to and sometimes lower than Israel's ports and airports, but it would provide Palestinians, for the first time, direct access to Europe and the Gulf which are potentially the most lucrative markets for Palestinian exports. Given WBG's relatively high cost structure and the competitive nature of global trade, even if Israel becomes more accessible, higher growth rates can only be achieved if Palestinian producers capture additional value-added by accessing these markets directly and making full use of the generous trade agreements provided by Europe and the Arab League.

46. Given the current political situation, the Rafah corridor has the best chance of success if its operations are expanded in phases with the first being operation for transit trade. The Palestinian, GoI, and US approved AMA allows for immediate operation of Rafah for exports. In the first instance, these cargoes will need to be handled by "special arrangements" –that is with special attention by Palestinian and Egyptian officials and the private sector to ensure that “red tape” and uncertainty does not impede the movement of cargo and perhaps with donors active in the region providing additional financing for the costs of shipment which can be expected to be relatively high at the start. Simultaneously, the Palestinian and Egyptian governments, along with EUBAM, should begin immediate discussions on the processes at the Rafah border terminal for goods in transit to regularize transit operations. As outlined above, this should be based on a simple, secure transit movement using Egyptian trucks. The World Bank and the EC are prepared to provide technical assistance in this regard. Construction of efficient cross-docking facilities and other infrastructure to support the movement of goods is not a lengthy process and can begin once general procedures are in train. In time, the Rafah trade corridor would also handle imported goods.

47. Finally, it is important that opening the Rafah Corridor is not seen as an “either/or”. Rather, the Rafah Corridor is complimentary to ongoing efforts to improve the border crossings with Israel, particularly at Karni. An effective Rafah corridor is likely, in fact, to help speed improvements at Karni since it will introduce competition to what has been a fully monopolistic border operation. Producers in Gaza can then decide on which crossing to use depending on market needs or in response to when a specific security threat at a crossing may dictate its temporary closure.. The West Bank economy is larger than the Gazan economy and producers there also need direct access to the world market. An

efficient and reliable crossing and trade corridor through Jordan can be expected to provide similar advantages of direct market access from the West Bank. Likewise, progress on the Palestinian port and airport as provided for under the *AMA* should begin in order to provide other alternatives for reaching third country markets.

48. Simply put, Palestinian producers require opportunities for direct market access, reliable and efficient services and a choice of transportation modes to ensure they reach their customers and fulfill their contractual obligations. This necessitates trade route alternatives, rather than a single gateway.