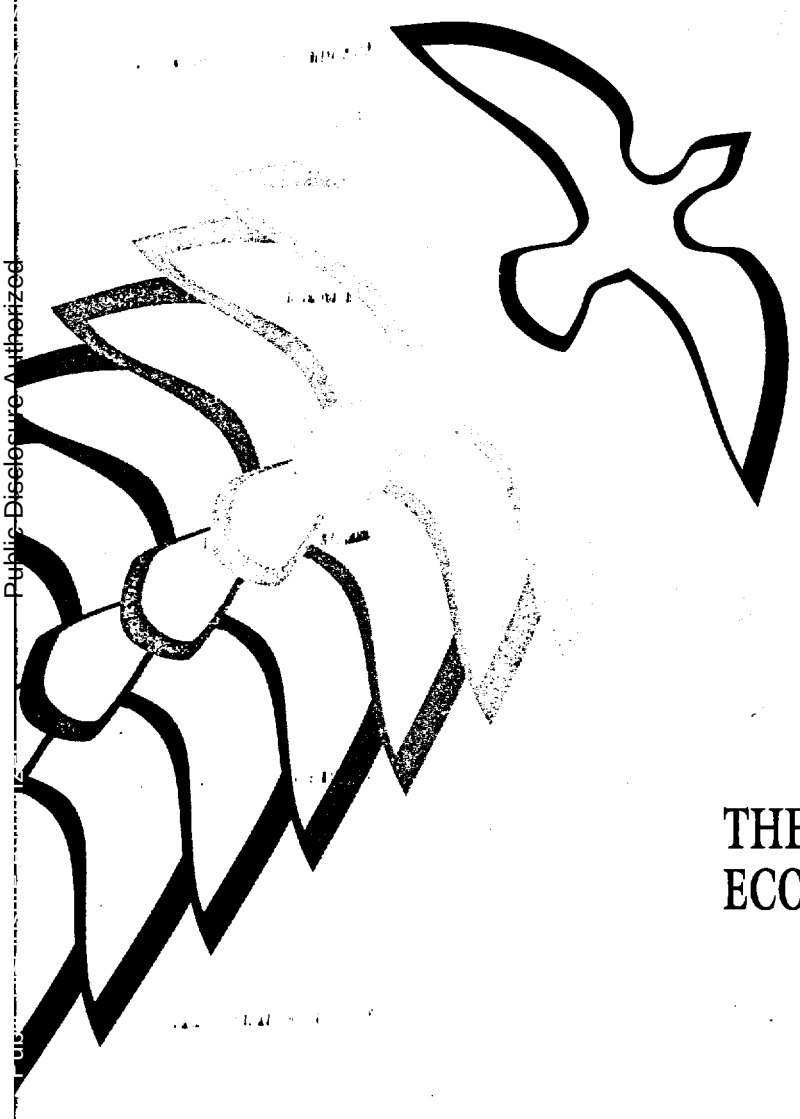
DEVELOPING THE OCCUPIED TERRITORIES



THE ECONOMY

DEVELOPING THE OCCUPIED TERRITORIES

AN INVESTMENT IN PEACE

Volume 2: The Economy

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GLOSSARY OF ABBREVIATIONS

CB	Currency Board
CBS	Central Bureau of Statistics
CFA	Central Franc Area
CU	Currency Union
EC	European Community
EFTA	European Free Trade Association
FTA	Free Trade Area
GDP	Gross Domestic Product
GNP	Gross National Product
ILO	International Labour Organization
JD	Jordanian Dinar
JPC	Jordanian-Palestinian Committee for the Steadfastness of the Palestinian People in the Occupied Homeland
NAFTA	North American Free Trade Area
NGO	Non-Governmental Organization
NIS	New Israeli Shekel
OECD	Organization for Economic Cooperation and Development
PLO	Palestine Liberation Organization
ROW	Rest of the world
TFP	Total Factor Productivity
UNDP	United Nations Development Project
UNRWA	United Nations Relief and Works Agency
VAT	Value-Added Tax
WBG	West Bank and Gaza
WHO	World Health Organization

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PREFACE

1. At the request of the sponsors and organizers of the Middle East Peace Talks, the World Bank has been supporting the work of the Multilateral Working Group on Economic Development and Regional Cooperation by providing analyses of the key economic issues and developmental challenges facing the Middle East region. At its second meeting in Paris in October 1992, the Working Group requested the Bank to expand its contribution to include, *inter alia*, an assessment of the development needs and prospects of the economies of the West Bank and the Gaza Strip (commonly referred to as the Occupied Territories). In response to this request, a Bank mission visited the Occupied Territories during the period January 21-February 24, 1993. The mission comprised five teams focusing on the following areas: Private Sector Development, Agriculture, Human Resources, Infrastructure and Macroeconomics. Each team was in the field for about two weeks. The mission was led by Prem Garg who, together with Samir El-Khouri, stayed in the field throughout to provide continuity and guidance to the five teams. The staffing of the five teams was as follows:

Macroeconomics:	Michael Walton (Team Leader) Samir El-Khouri (Fiscal Analyst) Ishac Diwan (Macroeconomist)
Private Sector Development:	Albert Martinez (Team Leader) Robert Mertz (Financial Sector Specialist) Joseph Saba (Legal Specialist) Dileep Hurry[1] (Regulatory Environment and Tourism Specialist)
Agriculture:	Gert van Santen (Team Leader) Ulrich Kuffner (Water Resource Engineer) Merle Jensen[1] (Horticulture Specialist)
Infrastructure:	Alastair McKechnie (Team Leader) Ulrich Kuffner (Water Resource Engineer) Lawrence Hannah (Urban Specialist) Nail Cengiz Yucel (Transport Sector Specialist) Ted Moore[1] (Power Engineer)
Human Resources:	Fredrick Golladay (Team Leader) Maureen Field[1] (Education Specialist) Radwan Ali Shaban[1] (Human Resource Economist)

2. Mission members travelled extensively in the West Bank and Gaza, visiting municipalities, farms, businesses, industries, academic institutions, refugee camps and NGO-run facilities. Mission members also travelled in Israel, as needed, and paid several visits to Amman. The representatives of the key bilateral and multilateral donors in Jerusalem, Tel Aviv and Amman responsible for the Occupied Territories were kept briefed about the work of the mission. Close contact was also maintained with the field staff of UN agencies.

1/ Bank consultant.

3. The Bank mission was received warmly by all sides, who took keen interest in the work of the mission and provided superb logistical and counterpart support for the field work. The main counterparts on the Israeli side were the Bank of Israel and the Civil Administration in charge of the Occupied Territories. On the Palestinian side, the main counterparts were the Technical Committees of the Palestinian Team to the Peace Conference, consisting mainly of Palestinians who are members of the bilateral or multilateral peace teams. The Ministry of Planning was the main contact on the Jordanian side. The Bank would like to thank all concerned parties, especially the Israeli, Jordanian and Palestinian hosts, for the excellent support and cooperation that the Bank mission received for this field work.

4. This report is based on the findings of the above mission. The report is in six volumes:

- **Volume I** provides a summary ***overview*** of the key findings and recommendations of the study. After commenting selectively on the current socioeconomic situation in the OT and its evolution over time, it discusses prospects for sustainable development in the future and outlines the priority agenda of policies and programs needed to promote such development.

- **Volume II** explores the strategic choices at the ***macro*** level that will be faced by the OT in the future and the implications for economic relations between the OT and the rest of the region. The study looks at the current situation and its evolution over the past 25 years. The study then examines several policy choices for the future affecting the structure of development in the OT. Finally, it outlines some illustrative scenarios for the future, focussing on the consequences of current developments in the region.

- **Volume III** reviews the performance of the ***private sector*** (including, in particular, the industry and tourism sectors) in the OT. The study assesses the environment in which the private sector operates and its future prospects and makes recommendations for accelerating private sector development in the future.

- **Volume IV** reviews the evolution and structure of the ***agricultural*** sector in the OT; analyzes its current characteristics; assesses OT competitiveness in the immediate and longer term; outlines the main policy options and their implications; and provides a preliminary assessment of sectoral financial and technical assistance (TA) needs.

- **Volume V** assesses the current situation in the ***infrastructure*** sectors (electricity, water supply and sanitation, transport, housing and solid waste services) in the OT; identifies the major issues confronting these sectors; and outlines priorities for TA and investment needs. As local authorities are major institutions in the delivery of public services in these sectors, the study also includes a review of their current situation and makes recommendations for improving the functioning of municipalities.

- **Volume VI** reviews the current status as regards ***human resource*** development; analyzes options for enhancing individual welfare and labor productivity in the OT; and outlines investment and TA priorities for strengthening existing programs and for laying the foundation for later reforms.

5. It is worth highlighting two limitations of this study right at the outset. First, a number of key issues bearing upon the future development of the OT (e.g., the allocation of land and water resources, the disposition of Israeli settlements in the OT, the future status of expatriate Palestinians, the territorial issues surrounding Jerusalem and, most importantly, the nature of the proposed "self-governing" arrangements for the OT) are the subject of ongoing bilateral negotiations between the Israelis and the Palestinians. The resolution of these issues is likely to be based primarily on political and security considerations. As the Bank mission to the OT was a *technical mission*, with neither the mandate nor the expertise to deal with political or security aspects, this study does not take any positions on issues that are on the agenda for bilateral negotiations. The focus instead is on policies, institutions and investments--where optimal choices are largely invariant to the eventual political arrangements to be agreed at the bilateral negotiations. Thus, for example, while analysing, where appropriate, the economic links between East Jerusalem and the West Bank and Gaza, the report avoids making any judgements regarding the future status of East Jerusalem.

6. Second, the study has had to cope with very serious *data gaps and inconsistencies*. Much of the data on the OT are, directly or indirectly, from official Israeli sources. There are, however, serious gaps in the OT data base. A population census has not been carried out in the OT for more than 25 years. As a result, most of the demographic and labor force data are based on extrapolations and on sample surveys, the reliability of which are undermined by problems of nonresponse, especially since the onset of the *Intifada* (popular uprising) in 1987. Data on East Jerusalem and on Israeli settlements in the OT, both of which are treated as part of Israel by the official Israeli sources, are mostly unavailable. Data available on trade between the OT and Israel and on the profitability and competitiveness of the agricultural, industrial and service enterprises are also very limited. Data on the OT from Palestinian and Israeli nonofficial sources are sparse and selective. Also, Palestinian data, when they exist, are often based on *ad hoc* surveys that do not lend themselves easily to cross-sectional or longitudinal comparisons. In many instances, data differ between sources, and, even when the same source is used, there are gaps and apparent inconsistencies. Given these data problems, the report uses estimates that appear most plausible in light of the mission's field observations. In cases where the data differences among various sources are particularly sharp (e.g., population, unemployment and social indicators), the report attempts, where possible, to examine the reasons for these differences and to indicate the implications of alternative estimates for the results of the analysis.

7. In view of the limitations on the mission mandate, the data difficulties and the time and resource constraints, this study can only be considered a beginning. The analysis in the study, especially for the longer term, is necessarily incomplete; as, and when, progress is made in the bilateral negotiations, the study will need to be updated and expanded to take account of the agreements reached. Also, notwithstanding the care exercised in locating and interpreting the data from various sources, the empirical underpinnings of this study leave something to be desired, and, therefore, the conclusions of the study should be treated only as indicative of broad trends and priorities. Further, in-depth studies and project feasibility work will be required before the findings of this report could be used to make operational decisions.

8. An earlier draft of this report was discussed with the Israeli, Jordanian and Palestinian authorities by a Bank mission to the region during July 12-26, 1993. Where appropriate, the report has been revised to incorporate the comments received by the mission during the July discussions.

I. OVERVIEW AND SUMMARY

A. Introduction

1.1 The economy of the West Bank and Gaza is presently in a state of crisis. Following the Gulf war in January 1991 there was a substantial reduction in Palestinian employment in most Gulf states. With the partial closure of the border in March 1993 employment in Israel fell drastically and in June was still less than half of previous levels. Municipalities are starved of cash. Many public services are in disarray: power outages are frequent, drinking water is often below WHO health standards, and garbage rots on the streets in refugee camps in Gaza. Meanwhile, urban land prices have gone through the roof in West Bank towns and Gaza City.

1.2 The present crisis in the Occupied Territories is in sharp contrast to a history of large increases in incomes, which are now about three times the level of 25 years ago. Household conditions improved substantially, with a many-fold rise in possession of consumer durables (albeit many second hand) and in water and electricity connections, including in relatively disadvantaged refugee camps and villages. There was also a substantial reduction in infant mortality and rise in school enrollments. Since unskilled labor played a central role in past growth, it is almost certainly the case that the poor participated in the gains implying a large reduction in poverty.

1.3 This report attempts to analyze the issues and choices thrown up by the current state of development in the OT and the economic agreements that could emerge from the on-going peace negotiations. The report attempts to adhere to a strictly economic perspective, recognizing that many of the questions will be subject to bilateral negotiations between the Israelis and Palestinians. The companion volumes on economic infrastructure, human resources and social services, private sector development and agriculture examine sectoral conditions and policy choices. As with the other volumes, this report must contend with uncertainty surrounding the outcomes of present and future negotiations.

B. Past Pattern of Development in the Occupied Territories

1.4 Chapter 2 of the report analyzes the economic history of the OT during the past 25 years and relates the present crisis to the uneven pace and somewhat distorted nature of growth in the past. Throughout the 1970s growth was extraordinarily fast, and most of the gains in incomes occurred then. The burst of growth in the 1970s was largely due to two phenomena: the economic gains from a sudden opening up of opportunities in Israel--especially for labor employment, but also for trade in many (but not all) goods; and the growing employment opportunities for Palestinians in the booming Gulf countries during the second half of the decade. These developments contributed to rapidly rising money incomes, strong demand-led growth in some domestic economic activities, and high savings, with a large portion of savings financing investment in housing.

1.5 Growth stalled in the early 1980s, and decline set in during the second half of the 1980's. These changes reflected changes in the external environment, some of which were associated with the region-wide slowdown in growth. Chapter 2 surveys the sequence of adverse economic shocks experienced by the West Bank and Gaza during the 1980s. Some of these were temporary or once-and-for-all: the Israeli high inflation and related devaluations, the border closure during the Gulf war, and the devaluation of the Jordanian dinar. More important for the future are the apparently permanent shocks, that add up to a cumulative and rising loss in past sources of income and growth. Gulf labor demand slackened with

the weakening of the oil market in the mid-1980s, contributing to the decline in employment opportunities for skilled Palestinians. Israeli demand for Palestinian employment leveled off in the 1980s--and after the *Intifada* would have declined further if large falls in employment in manufacturing and in services had not been offset by rising construction employment, boosted by the boom in housing for immigrants to Israel.

1.6 Incomes appear to have held up surprisingly well given the scale of these shocks. Two factors explain this: first, domestic production was reasonably robust, and to some extent substituted for incomes from abroad; and second, there is evidence of large drawdowns of savings held domestically and abroad, especially in 1991 and 1992. Drawing down savings is not sustainable of course and additional capital inflows were generated by returnees from the Gulf, partially motivated by expectations of peace in 1992. Indeed this appears to have generated a mini-boom in some parts of the OT during this period, especially in domestic construction.

1.7 In addition to an uneven pace of growth, the Occupied Territories display an unusual, skewed pattern of development in comparison with other economies. Investment has been high, at 25 percent of GNP in the West Bank, at some points up to 40 percent in Gaza, but this investment created no new jobs until the late 1980s--an unusually high proportion went into investment in housing. Private investment in directly productive activities has been low, and industrialization, at 7 percent of GDP in the West Bank and 10 percent in Gaza, is way below other economies of the same income level. Trade in goods is highly concentrated on Israel, as a result of the abnormal conditions associated with the occupation and the Arab boycott. And there is an enormous trade imbalance, of the order of 28 percent of GNP.

1.8 There are also imbalances in the provision of public goods. Public investment in economic and social infrastructure has been unusually low at less than 3 percent of GDP. Some of the imbalance in social services was made up by UNRWA and, especially in health, by unusually high spending by the private and non-governmental sectors, but this has been at the cost of a proliferation of disparate services, without any overall sectoral framework.

1.9 Many factors explain the past pattern of development. Political uncertainty over the long-run future of the West Bank and Gaza undoubtedly played a role: investment in human capital is more secure than investment in machines when the economic future looks uncertain; and large investment in housing seems related to the lack of other savings instruments, and possibly to the urge to establish stronger property rights on land. In addition, four features of the policy environment (including the structure of international economic relations) appear to have been of major importance:

- asymmetric trading relations
- regulatory constraints
- fiscal compression
- declining access to natural resources.

1.10 Trading opportunities were distorted, in large part by the regional political situation. Manual labor and manufactures had fairly free access to Israel, as did skilled labor elsewhere; but both agriculture and the *expansion* of manufactures were restricted. All goods had restricted access to much of the region, because of the Arab boycott, restrictions on trade with Jordan (from both sides), practical difficulties of trading through Israel and inadequate trading infrastructure. There are no restrictions on imports of Israeli goods into the Occupied Territories, but for imports from the rest of the world the economy

operates under the quite protectionist Israeli trade regime. Israel has, however, embarked on an ambitious program of trade liberalization.

1.11 An adverse regulatory environment, especially in terms of investment approvals, and an uncertain legal and tax framework inhibited the expansion of parts of the private sector, for example of medium and large scale industrial firms. (The regulatory framework has been recently liberalized, but it is too early to assess the effects.) The lack of a strong formal financial system did not help. It is notable, however, that where the private sector did grow--in agriculture and small-scale manufactures, the impressionistic evidence is of a productive private sector with substantial rises in labor productivity. In the period of rapid growth in the 1970s total factor productivity growth was very high, at around 5 percent per annum, accounting for almost two-thirds of total growth.

1.12 Low spending on public goods has been due to fiscal compression, which was in turn a consequence of low tax receipts, a close to balanced budget practice for the civil administration and municipalities, and the inability of utilities to borrow to invest (in contrast to international practice). Low public sector revenues compared with other economies--at 16 percent of GDP and 11 percent of GNP--are due in part to the fact that some tax payments by Palestinians accrue to the Israeli treasury (tentatively estimated at 8 percent of GDP for 1991). Even after including the gross estimates of taxes accruing to the Israeli treasury, the tax effort is still relatively low.

1.13 Current restrictions on access to water, including administrative limitations on surface and aquifer water harvesting, and the high costs of water caused by difficulties to renew inefficient and worn-out wells have meant stagnation of the amount of water used for Palestinian cultivation. In selected areas, notably in the Gaza, increasing salinity levels caused by excessive extraction have virtually halted agricultural production. Loss of land to settlements has increased during 1980s and early 1990s. In addition to built-up areas, this involves some traditionally irrigated land in the Jordan Valley, and areas which are currently irrigated in the West Bank and Gaza. The lack of clear zoning regulations and public land utilization policy has also created uncertainty and has become a barrier to industrial expansion. The freeze on the building of housing on land beyond the municipal boundaries has acted to distort land prices.

C. Post-Peace Economic Strategy

1.14 The peace agreement is expected to lead to a transition period of several years. This will open up new options for the West Bank and Gaza. Some will become choices for the self-governing authority, which is expected to take over from the Civil Administration. Others will be the product of present and future negotiations between the Palestinians and governments in the region. However we assume that in the interim period there will be one integrated economy, that implementation of economic strategy will be by a self-governing authority with command over economy-wide and sectoral decision-making, but that, in some areas (e.g. trade policy), economic conditions will be a function of joint decisions with Israel, Jordan and other parties (notably Arab and OECD states for trade options).

1.15 Within these parameters there are a broad range of possibilities. Chapter 3 of the report examines how policy options affect the structure of development. Should the West Bank and Gaza be moving to disengagement from Israel or continued integration on different terms? What would be required to get economic growth going in the wake of the series of adverse shocks the economies have received? Is it

desirable (and feasible) to have an independent trade and tax policy? How can public spending be financed? Would a separate currency help or hinder macroeconomic stability and the environment for growth? And what is the role of official and private foreign resources in financing development? While it would be premature to make definite prescriptions, Chapter 3 attempts to explore some of the benefits, costs and implications of these choices as summarized below.

1.16 In addition to setting the basis for recovery and sustainable growth, there is also a need for measures to tackle short-run crisis conditions, especially if the restricted employment in Israel continues. The present crisis has short and longer-term dimensions. The short-run cutoff in employment, if maintained, would require emergency measures (such as employment schemes) to prevent significant drops in incomes. In the medium to longer-term, there is a need to effect a reorientation of economic activity to rectify current imbalances, and develop new sources of growth. This will depend critically on private investment -- from within and from abroad -- and especially investment in productive activities. International experience indicates that such private investment does not occur in situations of strategic uncertainty, but can respond swiftly once conditions are supportive, as in much of Latin America in the early 1990s, or more recently in Lebanon. Some measures can be undertaken in the short run, but the resolution of economic issues is unlikely to be possible without a peace agreement.

1.17 The reduced political uncertainty that should follow a peace agreement would provide the preconditions for a sustainable recovery. As the 1992 boom illustrates, private money quickly followed expectations of peace, though it probably went mainly into real estate. Resolution of strategic uncertainty will require policy changes to support the kind of adjustment and restructuring required for future growth. Each of the four areas noted above would need to be tackled: asymmetric trading relations; the regulatory environment; fiscal compression; and declining natural resources. A start has already been made by the civil administration in the significant deregulation and improvement in the investment environment introduced in 1992. The companion volume on private sector development concludes that effects on business activity has, so far, been limited and outlines what more would be necessary to provide a sound legal and business environment. Equally important will be redressal of some of the shortages of public goods: for example in power, in water supply and sewerage, in industrial land and in education. As the volumes on economic and social infrastructure discuss, these will require rehabilitation programs, new investments, and establishment of the institutional framework for sound sectoral policy.

D. Trade and Structural Policy Options

1.18 While action on the regulatory framework and availability of public goods will be necessary to lift economic activity under any circumstances, the reorientation of economic activity will be conditioned by choices over the structure of international economic relations and domestic incentives. Some changes have already been made for the Palestinians, with the loss of employment in the Gulf and Israel. Trade in goods will have to substitute for movement in labor for sustained growth. What approach should be adopted on the direction of economic activity? The West Bank and Gaza face, in principle, a range of choices, from free trade with neighboring countries, to running a much more closed import regime to attempt to foster domestic industry. (Some of these choices will, of course, be subject to the ongoing negotiations).

1.19 Chapter 4 of this report lays out some of the alternatives for trade and incentive policy. There are two guiding principles. First, the small size and location of the West Bank and Gaza strongly support the desirability of a strategy based on trade expansion rather than restriction. There is especial interest

in trade expansion to Jordan and the rest of the Arab world. Second, while a major reorientation in trade -- to the region and to the rest of the world -- would be expected to occur over the medium term, any sharp cut in trade in goods to Israel could have large short-run costs, because of Israel's predominance as a trading partner. From the perspective of the West Bank and Gaza a strategy that attempted to open up opportunities elsewhere whilst maintaining quite open trade relations with the Israeli market would make sense.

1.20 An approach that might meet these principles is a free trade area with Israel linked with a significant opening of trade to Jordan. A free trade area with Israel would differ from the present (partial) customs union in allowing the West Bank and Gaza to have different tariffs from Israel with third countries. It would maintain open trading relations with Israel, but would potentially avoid protectionist aspects of Israel's trade regime that are ill-suited to the economic structure of the economy of the Occupied Territories. This should be linked with an opening up of trade with Jordan, including the possibility of a free trade area with Jordan as well. From Israel's point of view, the trade diversion that is likely to take place would be compensated by trade creation linked to the termination of the Arab boycott. The success of any trade strategy would ultimately depend on how far new markets can be opened up: in the region, in the OECD, and in Israel. Opening of regional markets will depend both on the overall process of negotiations (since it is unlikely that trade with the West Bank and Gaza can be politically separated from trade with Israel, even if it can technically). An important issue for OECD markets concerns how far the Occupied Territories can participate in the current free trade agreements Israel has with the EC, EFTA and the US. (The EC agreement is already applicable to the Occupied Territories). The key issue in the Israeli market is agriculture, which remains protected, but where Palestinian producers have significant comparative advantage.

1.21 While a free trade area, perhaps involving Jordan, is attractive in principle, there may be problems in practice. First, there is no agreement on the location of a border between the West Bank and Israel. Second, any border will be leaky, and while an "invisible" border based on company accounts is feasible in principle, it may be costly to implement. Leakiness is likely to be of concern to Israel on grounds of lost revenue and lost protection, if the Occupied Territories were to have lower tax rates. Some of these practical difficulties are primarily of importance for an interim period. In the longer term, a border will presumably be agreed. Also protection should matter less to Israel if it sticks to its planned liberalization. By contrast, any changes in relations with the West Bank and Gaza that increases the risk of evasion of VAT would remain an issue of important concern for Israel, in view of the importance of this tax instrument. There may need to be closer harmonization of VAT rates than customs tariffs. Third, there is the question of the level-playing field in terms of ability of OT products to compete in markets where locally-produced goods are subsidized.

1.22 An approach that seeks to utilize the potential gains from interdependence also influences policy on infrastructure. In power, transport and telecommunications, as in trade, the West Bank and Gaza probably stand to gain most, and to acquire greater security, not through seeking economic "independence" in an autarkic sense, but through playing a role in interdependent networks in the region--linking both to Israel and the Arab World. Similarly, maintenance of investment in human capital will remain crucial to support the traditional comparative advantage of Palestinians in the region.

1.23 Although in some areas pursuit of an independent macroeconomic policy is likely to be fruitless--e.g., attempts to have independent interest rates, given the degree of capital mobility--there are a number of other areas where macroeconomic policy makes sense: to deal with real and nominal shocks; to gain seignorage revenues; and to facilitate financial sector development and borrowing by governments and

companies. Some of these require an independent currency and monetary policy, e.g., avoiding imported nominal shocks from other members of a currency union, facilitating real wage declines and perhaps, exceptionally, defaulting. There are, however, advantages and disadvantages associated with a separate currency. It provides additional discretion in some areas of policy, but is only likely to be effective once both the currency and overall macroeconomic policy acquire credibility. In a second set of areas independent policy is desirable and is commonly associated with a separate currency, but such a link is by no means necessary, e.g., managing "excessive" capital inflows, borrowing at home and abroad, and supervising/providing liquidity to banks, all of which can be managed by other instruments or without an independent currency. Seignorage is traditionally large in the region, but is unlikely to be so for the West Bank and Gaza (especially initially), because of the likely initial low level of credibility of a new currency, and high capital mobility.

1.24 The most precious commodity of macroeconomic management is credibility, something that is hard to earn, but can be obtained by being in a currency union(s) with a disciplined core or by establishing a track record of prudent macroeconomic, and especially fiscal, management. The Occupied Territories do not have such a history, and new institutions of macroeconomic management are likely to be both fragile and under pressure. If a currency is chosen, it could be desirable to start with a relatively restricted version, as in a Currency Board. This could gradually evolve to a fully fledged currency that brought greater discretion once discipline, and the associated demand for the currency, was well established.

1.25 The introduction of a currency would be an issue of concern for both Israel and Jordan, given the substantial holdings of Shekels and Jordanian Dinars by Palestinians. As Palestinians purchase a new currency with the two existing currencies, a new monetary authority or currency board would acquire potentially large quantities of Shekels and JDs, probably way in excess of the amounts that it would make sense to hold as foreign exchange. Yet redeeming these for other currencies would be a large shock (for monetary and foreign exchange management), especially for Jordan, given the estimated size of Palestinian holdings of JDs relatively to both total money and foreign exchange holdings in Jordan. The phasing and terms of any such large-scale conversion would have to be worked in the context of any currency reform.

1.26 Decisions over the role of the public sector will cut across many policy areas. There will be a need for a substantial strengthening of public action in many areas, including macroeconomic management, tax administration, the regulatory framework, the supervision of the banking system, the direct provision of public services and the design and implementation of sectoral policies. This will require strong support for institutional development in the public sector.

1.27 Strengthening of the public sector should not, however, imply pursuit of a highly interventionist strategy for economic development. International experience indicates that differentiated patterns of protection, activist industrial policy or public channelling of money via the financial system too frequently lead to economic disaster. In East Asia, where interventions were relatively common, they were bounded by a strong commitment to exporting and strong public sector institutions. And even in East Asian countries, the evidence suggests industrial policy failed to increase the share of promoted industries. Elsewhere promotion has rather led to a higher share of rents from protected inefficient activities. The private sector volume discusses the desirable reforms in the legal, regulatory and financial systems to support strong private sector growth.

1.28 A further lesson of international experience is the centrality of fiscal discipline. Fast-growing East Asian economies are again distinguished by fiscal management that is prudent and pragmatic. Loss of fiscal discipline elsewhere has invariably led, sooner or later, to macroeconomic difficulties. Public spending is likely to be under great pressure to expand (notably for public employment), to avoid tough tax administration issues and, at least for a while, may face a soft budget constraint due to external capital inflows.

E. Scenarios for the Interim Period and Beyond

1.29 Chapter 5 of the report presents a range of scenarios that were developed to explore the potential trajectory of the economy in the future. These are illustrative, since little is known both about future conditions and economic responses. A critical factor in the scenarios is overall "policy": this encompasses a range of likely influences on future development. Good "policy" would include: a peace settlement that sufficiently resolves strategic uncertainty to provide the basis for private capital inflows and private investment in economic activities; relaxation of supply-side constraints, including deregulation, improvements in supply of economic infrastructure and industrial land and, over the long term, technical training; trade arrangements that allow substantial trade expansion (in the region and elsewhere); and a strong public finance framework with substantially expanded revenues (including taxes now accruing to the Israeli treasury) that both finance expanded public services and support rising public savings.

1.30 Under conditions of good "policy", gradual reduction of employment in Israel and adequate external public and private capital inflows, a growth rate in excess of 3 percent in per capita incomes is sustainable, with a total rise in incomes of the order of 40 percent in a decade. This requires initial inflows of $300 million per annum of official money in the first five years, declining to $200 million in the second half of the decade. Even with a low grant content of new money, debt indicators show no signs of problems of solvency.

1.31 If there is an abrupt labor cutoff with Israel--for example if employment were to stay at the 45,000 prevailing in June 1993 (it had risen slightly to 49,000 in July), the short-run situation is much worse, with potentially large rises in unemployment and falls in wages and incomes. This would justify short-run action, in terms of additional external inflows and poverty-related spending by the public sector, to moderate welfare declines. However, if policy conditions are strong, the economy could recover and again get onto a steady growth path in the medium term, with a rise in per capita incomes of the order of 3 percent per annum.

1.32 By contrast, if policy conditions are not resolved the outlook is grim. There could easily be declines in income per capita--of the order of 20 percent in a decade--even with smooth labor return, with a worse outlook, especially in the short run, if there is an abrupt labor cutoff. Such a growth scenario would undoubtedly be associated with rises in poverty, worsening social conditions, and, potentially, rising violence. Poor "policy" could be offset by official capital inflows, but only for a while, since private capital is unlikely to flow in when the political and policy conditions are uncertain or weak and little more than stagnation appears feasible.

1.33 The scenarios should be treated as indicative. But they help illustrate the main implication of much of the analysis in these volumes: the West Bank and Gaza have the potential to recover from both the loss in past sources of growth and from distortions in the pattern of development, and to become viable, growing economies, provided that the policy and structural conditions are right. In the absence

of sound domestic policy, adequate trading opportunities with other economies or foreign capital, they could enter a period of sustained decline in incomes, employment and welfare.

F. Implementation

1.34 In order to translate the broad-brush policy recommendations contained in this report into workable solutions, it will be necessary to carry out further detailed studies in a number of areas to establish the practical, technical implications of economic reform and to deepen and expand local capabilities in economic policy-making as well as data-collection and statistical analysis.

1.35 The following list identifies seven areas requiring further in-depth analysis:

i) The technical and economic implications of alternative trade choices between Israel, the Occupied Territories and Jordan. This could be combined with the study of agricultural trade options among the three economies recommended in volume IV: The Agriculture Sector.

ii) The design and development of economic management capabilities (institutions and personnel) in the areas of a) current and development budgets, b) development policy and, possibly, c) central banking.

iii) Tax options and tax administration.

iv) Monetary and financial sector management issues. This could be combined with the study on financial sector institutional development proposed in volume III: Private Sector Development.

v) The design of borrowing instruments (e.g., bond issues) and overall borrowing strategy for the external and public sector, including donor coordination and the appropriate mix of concessional and market borrowing.

vi) The design of short-run safety net measures to ease adjustment within the labor market. These might include public works schemes and their linkage to a rehabilitation program.

vii) Techniques of data-collection and statistical analysis at the macro-, sectoral and household levels.

1.36 In order to meet the goal of deepening local capabilities in these seven areas, it is essential that the analysis be carried out by local experts supported by international technical assistance. It is also important that the experience already possessed by those Palestinians working for the Israeli statistical offices in the West Bank and Gaza as well as various non-governmental research centers be used as a foundation on which to build.

1.37 In addition to close and sustained collaboration between local and foreign experts, the process of acquiring and deepening expertise in the various areas should include study tours abroad exhibiting desirable economic and statistical practice in the relevant areas, exposure to international survey techniques (such as the Living Standards Measurement Survey, appropriate labor survey techniques, etc.), as well as other forms of "on-the-job" training.

1.38 The coordination and smooth execution of this program would be greatly enhanced by the existence of a single institution based in the West Bank and/or Gaza with a mandate to supervise the collection and publication of economic data and coordinate research into the relevant areas of economic policy.

II. ECONOMIC HISTORY SINCE 1967

2.1 The economies of the West Bank and Gaza are in a state of crisis. Real per capita income levels in 1990-91 were only marginally higher than a decade earlier. Economic difficulties started in the early 1980s and intensified after 1987. Following an apparent recovery in 1992, the present year of 1993 appears to be witnessing renewed decline due mainly to the restriction of entry into Israel. Economy-wide economic difficulties affect many households via the labor market[1]. The available labor supply rose by 10 percent between 1987 and 1991 while employment has grown by only 3 percent. Unemployment (using a narrow definition) rose from 2-3 percent in the 1980s to 10 percent in the West Bank before dropping back in 1992. Open unemployment in Gaza is less severe, at 4 percent according to CBS numbers, but underemployment is probably much worse.[2] Hours worked per day fell by about 20 percent (See Figure 1). The premium on skills has virtually vanished: many well-educated Palestinians are paid no more than unskilled workers, and graduate unemployment is rising fast.[3] Many public services are in disarray: municipalities are starved of cash; power outages are frequent; public water supply is below WHO quality standards; and garbage rots on the streets in refugee camps in Gaza. Meanwhile land prices have gone through the roof (notably in the Ramallah industrial estate and other West Bank towns and in the wealthier parts of Gaza city) making new industrial investment immensely costly.

2.2 The vulnerability of the economies to relations with Israel is vividly shown by the consequences of the border closures of March/April 1993. In 1991, nearly 40 percent of Gaza's labor force and over 30 percent of the West Bank's labor force worked in Israel. Every day of complete closure to labor and products leads to a loss in income of almost $700,000 in labor earnings and $250,000 in exports for Gaza, out of a daily national income of $3 million. For the West Bank, every day of closure leads to a loss of income of $1.1 million in labor earnings and almost $600,000 in exports, out of a daily national income of $7 million. Currently, the closure is only partial, but its impact is still severe.

2.3 This picture of crisis contrasts sharply with a longer-term view of past development. The Occupied Territories were among the top ten fastest growing economies in the world during the 1970s period when measured in terms of GNP growth (Figure 2). The expansion in GDP per capita was somewhat lower, but was still large by international standards.

2.4 There has also been rapid progress in other factors affecting living standards. In Gaza, the refugee camps are relatively disadvantaged, yet 95 percent of households had running water and 100 percent had electricity in 1992, compared with 3 percent with water and 14 percent with electricity in 1974. Similarly, in 1992, 91 percent of all households in Gaza had television sets, 95 percent had radios

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[1] There are cases where there is evidence of statistical bias in the reported data: population data may well underestimate actual population levels, and unemployment rates may be understated, though much of the difference may be definitional (see Shaban, 1993). These possible biases should not, however, affect analysis of changes over time.

[2] This is based on the ILO definition of unemployment used in the CBS labor force surveys. Some observers find higher unemployment rates (for example, Abu Shokor, 1990 found a rate of unemployment of 10 percent from a small survey in 1985, substantially higher than that found in the labor force surveys), though much of the difference could be definitional.

[3] See Angrist (1992) for an analysis of the premium on skills.

and 17 percent had cars, as opposed to 8 percent with televisions, 85 percent with radios and 2 percent with cars in 1972. In the West Bank, 79 percent of households had running water and 75 percent electricity (for the whole day) in 1992, compared with 24 percent with water and 46 percent with electricity in 1974. Likewise, in 1992, 89 percent had television sets, 82 percent had radios and 16 percent had cars, compared to 10 percent with televisions, 75 percent with radios and 2 percent with cars in 1972. While much of the durable ownership is of second hand goods this still represents gains in welfare.

2.5 The Palestinians have traditionally enjoyed higher educational and health standards. Child mortality statistics are subject to some controversy in the Occupied Territories and it is difficult to quantify trends over time precisely given the range of estimates. (See the companion volume on Human Resources and Social Policy for further details on health and education.) Nevertheless the available evidence does suggest that mortality rates fell by more than two thirds between 1970 and 1990. The current overall infant mortality rate is estimated to be about 45 deaths per thousand live births in Gaza and 40-45 in the West Bank.[4] As regards education, the absolute position improved substantially in the past 25 years with large increases in primary and secondary enrollments. The gross enrollment ratio for basic education (grades 1-8) is about 102 percent and about 46 percent of children aged 15-19 were enrolled in post-primary schools in 1990. Illiteracy remains a significant problem with 28.5 percent of women within the age group 35-44 illiterate, compared to 7.4 percent of men in the same age group. There are now eight universities.

A. The Past Pattern of Growth

2.6 The above two descriptions look like two different economies, yet both are correct. At first sight, it might be tempting to attribute the current malaise to the *Intifada*, which began in December 1987, but this would be a mistake. The *Intifada* certainly led to disruptions in economic relations with Israel. Whether due to periodic border closures or strikes, curfews or shop closures, employment and trading activity has been adversely affected. Exports from Gaza fell by 37.5 percent between 1987 and 1988 and have not yet recovered, and, as noted above, there was a roughly 20 percent decline in employment in terms of hours worked, in both domestic and Israeli employment. Yet growth had already stalled in the early 1980s. The pattern illustrated in Figure 3 actually throws up two questions: Why was growth so fast in the 1970s? And why did it then slow so much from the early 1980s? (The highly cyclical character of the West Bank's growth displayed in Figure 3 is due to the biannual olive cycle.) The following paragraphs examine these questions as well as two other aspects of past development: unusual features in the structure of growth and the likely relationship with poverty.

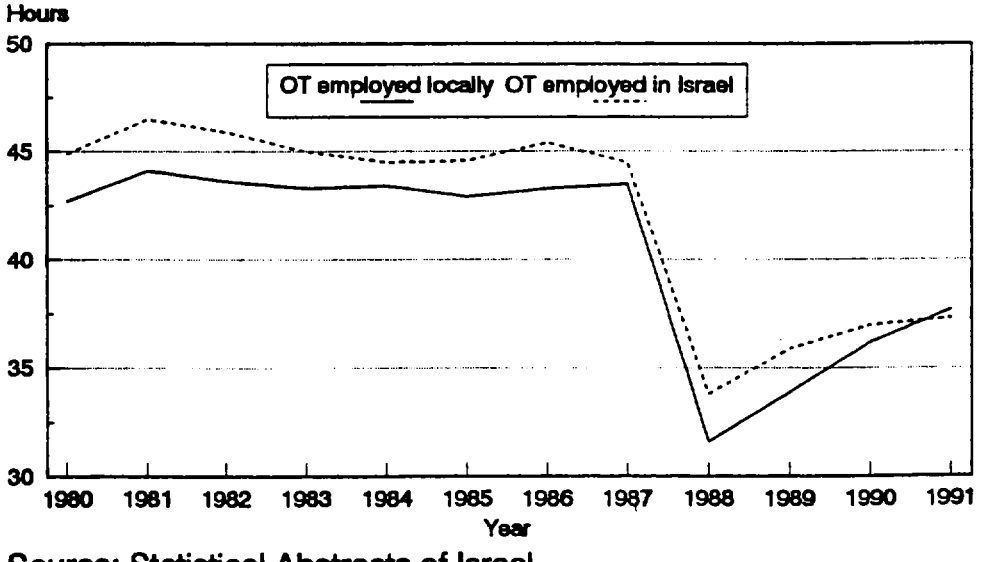
Overall Growth: High in the 1970s, Stalled in the 1980s

2.7 Broadly speaking, the pattern of growth since 1967 can be broken into four phases: very rapid growth to the mid-1970s; slightly less rapid growth to the early eighties; stagnation until the onset

[4] Average of 1989 and 1990 figures.

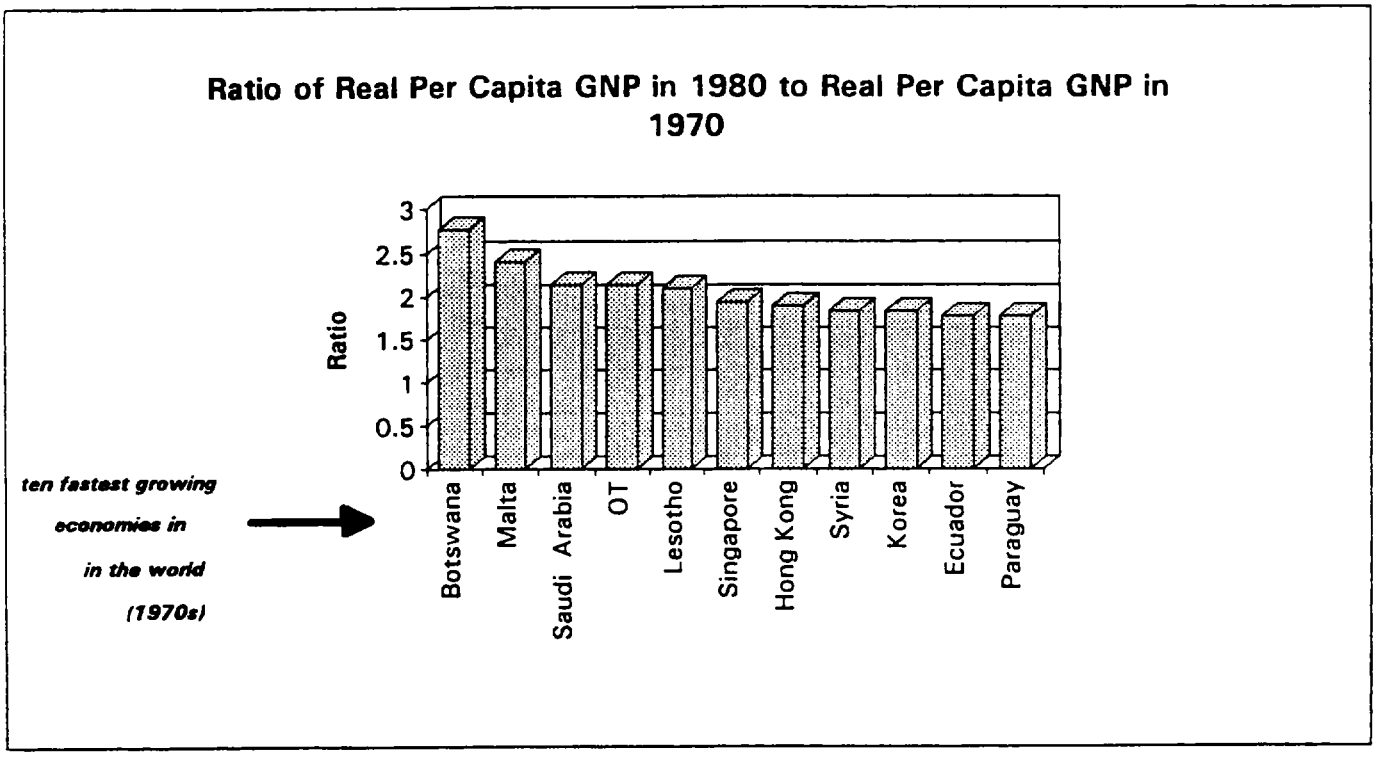
Figure 1: Occupied Territory Unemployment

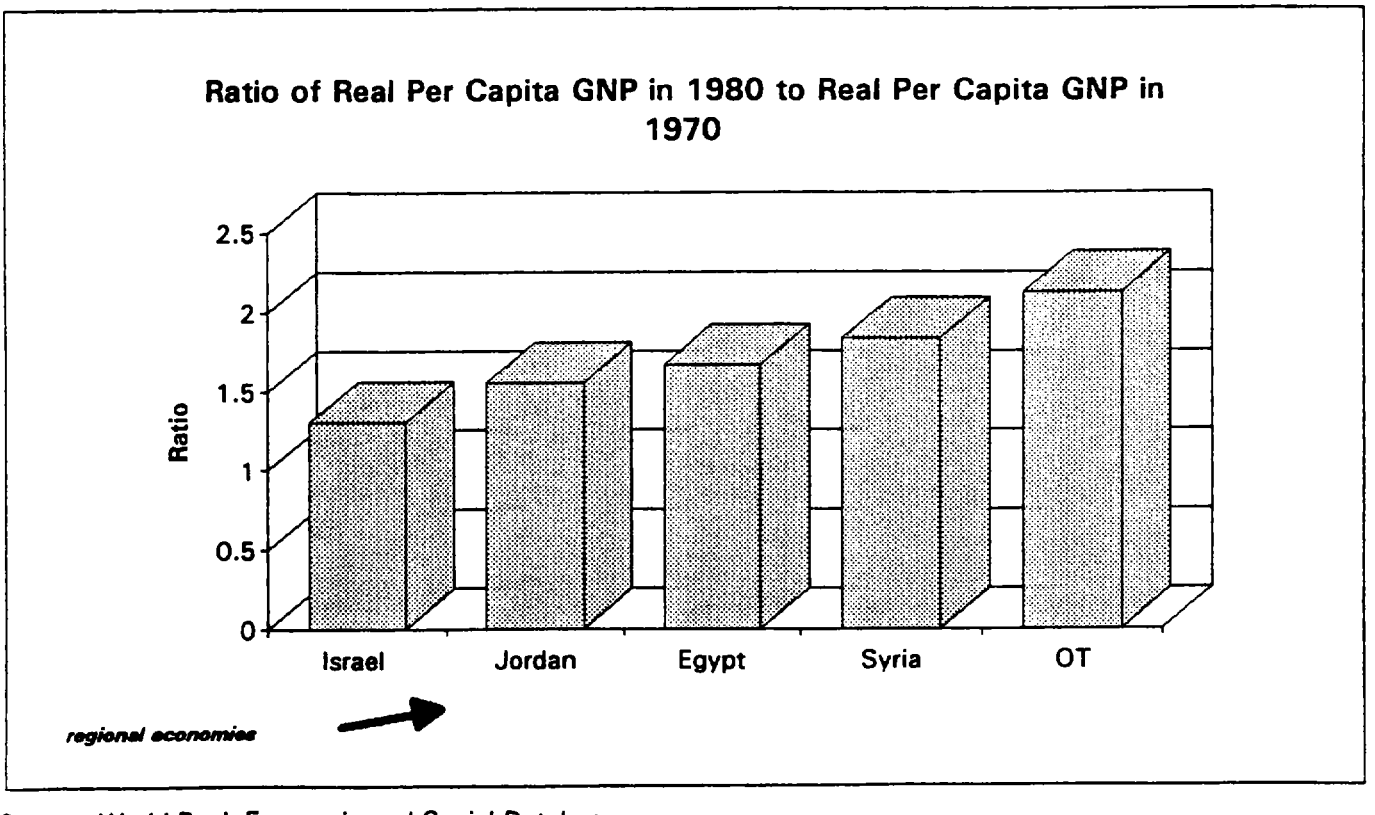
Average Weekly Hours
per Palestinian Employee, by Place of Work.



Source: Statistical Abstracts of Israel,
1981-1992, Central Bureau of Statistics.

Figure 2: Growth in the 1970s





Source: World Bank Economic and Social Database

of the *Intifada* in 1987; and a decline thereafter (see Figure 3).[5] During the initial phase, growth in the Occupied Territories was driven by two major new sources of income growth: the consequences of integration with Israel, and the beginnings of the Gulf boom. The opening of the Israeli market to manual Palestinian labor brought a huge expansion in employment in Israeli firms. New trade and technological opportunities and reallocation of factors, helped generate almost equally rapid growth in domestic production. A reduction in low productivity agricultural employment (and cyclical unemployment) as well as more intensive marketization, especially in rural areas, further contributed to the fast growth rates.

2.8 The second phase which lasted till the early eighties also saw rapid growth. Remittances from the Gulf, together with foreign official transfers, continued to be buoyant: Gaza achieved a 1979 peak in per capita income which, with the exception of 1987, it has never recaptured. However a number of factors acted as a restraint on the previously very high rates of growth: slower growth in Israel following the 1979 oil shock negatively affected Palestinian growth; and the process of labor substitution away from low productivity agriculture toward employment in Israel was slowing down.

2.9 Overall, growth in output in the Occupied Territories during the first two phases was rapid, substantially exceeding growth in Israel during this period (Figure 4). Such rapid growth is a predictable consequence of sudden integration with a larger, richer, and technologically more advanced, neighbor.[6] (It is, however, worth noting that there remain large differences in levels, of about 8 times, between per capita GNP in Israel and that in the Occupied Territories. While growth in Israel slowed in the mid-1970s, growth in incomes and output in the Occupied Territories continued because skilled Palestinians were increasingly finding employment in the Gulf. International employment was well-diversified for the changing regional labor market: when the oil price rose, this hurt the Israeli economy, but boosted remittances from Palestinian workers and transfers from oil-rich Arab countries, offsetting weaker economic opportunities in oil-dependent Israel.[7]

2.10 The third phase lasted from the early eighties until 1987 during which growth stagnated. Although the data is weak here, the collapse of the regional oil boom almost certainly prompted a decline in worker remittances from the Gulf.[8] Other factors were also at work. While continued growth in Israel (Figure 4) actually provided some cushioning from the regional slowdown, the once-off gains from integration were already achieved, and employment growth in Israel was virtually flat from the mid-1980s. After the start of the *Intifada*, employment in manufacturing and services declined significantly, but this was offset by a rise in construction employment due to the housing boom in Israel associated with a surge of

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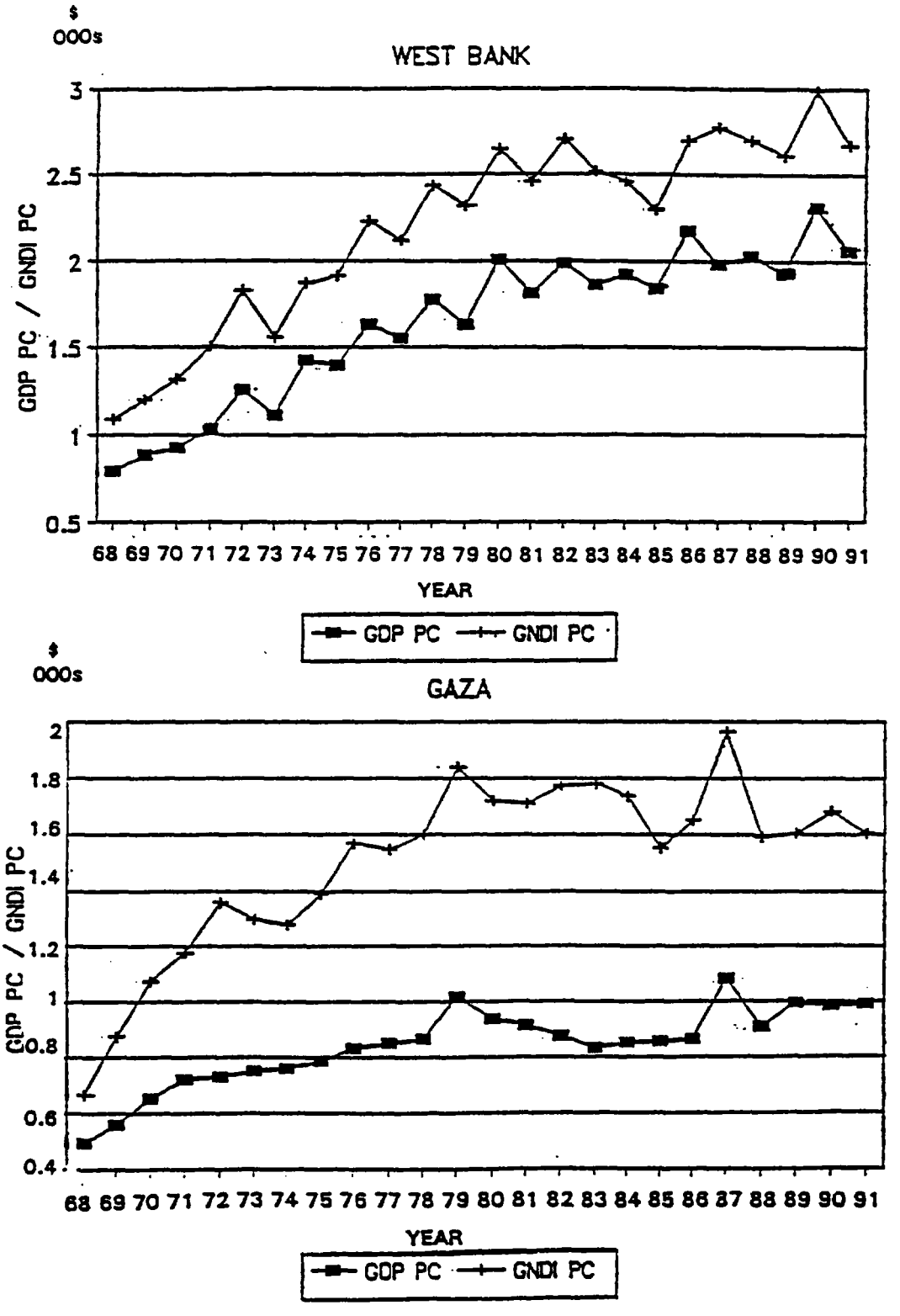
[5] Note that growth in 1991 was negatively affected by the Gulf War and the extended closure of the Occupied Territories. See Samir Abdallah Saleh (1993) for further discussion of patterns of growth in the Occupied Territories since 1967. See also Ephraim Kleiman (1991) for a general review.

[6] It is noteworthy that Lesotho was another fast-growing economy: it is a small labor-reserve economy, relatively well-educated in the African context, totally dependent on South Africa, in a customs and currency union with its large, dominant neighbor. Like the Occupied Territories, it grew significantly faster than its richer neighbor.

[7] See UNDP (1993) for further information on levels of official Arab transfers.

[8] See further Zakai (1986) for data on the decline in remittance.

Figure 3: Per Capita Gross Domestic Product & National Disposable Income



Source: Statistical Abstracts of Israel, 1981-1992, Central Bureau of Statistics

immigration. Recession and near hyperinflation in Israel had a serious impact now that a large proportion, 35 percent, of the Palestinian labor force worked in Israel and the major part of Palestinian trade was linked to the Israeli economy. It is also reported that the regulatory framework for production in the West Bank and Gaza was more restrictive in the 1980s than in the 1970s. There is indeed plenty of anecdotal evidence that the regulatory environment has not been supportive of private sector production (see the companion volume on the private sector). While it is difficult to document whether changes in the regulatory framework contributed to a slowing in growth, it is likely that internal constraints became more binding once work opportunities abroad declined, leading to increased pressures to employ workers at home.

2.11 During the fourth phase, following the outbreak of the *Intifada* in 1987, a decline in output set in due to commercial and labor strikes and repression of economic activity. Political and economic uncertainty prevailed. Meanwhile with the return of 25,000 workers from the Gulf, remittances collapsed. A recovery in 1992, apparently fueled by drawdowns of savings and expectations of peace appears to have been followed by renewed decline in 1993.

2.12 It is important to view the changes in past growth in a regional context. In the 1970s, growth in GNP per capita was over double that in Israel, but only slightly faster than in neighboring Arab countries (Figure 4). All economies slowed in the 1980s. The difference in growth rates between the two periods was about 6 percentage points for the Occupied Territories as well as its Arab neighbors. Although growth in Israel slowed earlier (in 1973), the fall-off was less pronounced than in the other economies, and its income growth exceeded that of its neighbors in the 1980s.

The Structure of Growth: Patterns and Productivity

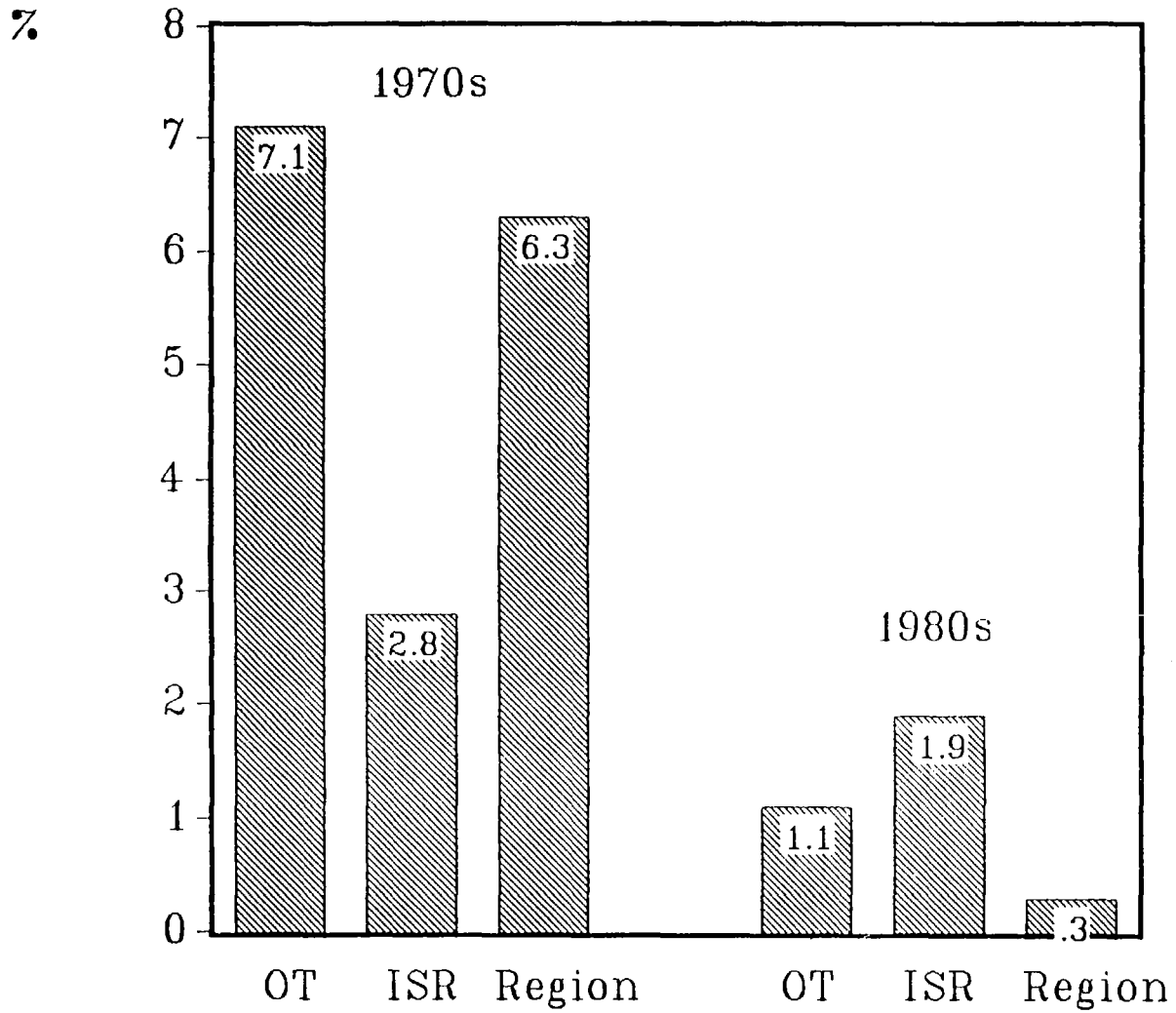
2.13 The rise and fall in the overall growth rate is one notable feature of the past. There are also a number of striking characteristics of the pattern of growth.

- The Occupied Territories enjoyed investment and savings rates worthy of fast-growing East Asian economies. Investment was around 30 percent of GDP in the West Bank and exceeded 40 percent of GDP in Gaza in the mid-1980s, before a decline in the late 1980s (Figure 5).

- Investment is low in machines and high in houses. Investment in machinery and equipment declined from 12 percent of GDP in the West Bank in 1970 to 4 percent after 1975, while in Gaza it hovered around 4 percent of GDP throughout the period until dropping to 1 percent after 1987. Even if an adjustment is made for industrial and commercial building, the preponderance of investment in residential housing is high and has risen in the late 1980s. (See Figure 6--"other" investment is equal to the sum of investment in equipment and machinery and in industrial and commercial buildings.)

- Industrialization is unusually low. Industries did indeed grow in response to overall growth, especially in Gaza in the 1970s. But the share of industrial production in output of 10 percent in Gaza and 7 percent in the West Bank is way below other economies of a similar income level (Figure 7). Mauritius, like the Occupied Territories, is a small open economy with a significant agricultural sector. It had almost exactly the same

Figure 4: Growth Rates of Per Capita GNP in the 1970s and 1980s: Occupied Territories, Israel and Region



Region: Weighted average of growth rates of Egypt, Jordan, & Syria

Source: Bank Economic and Social Database

income level as the Occupied Territories, but a share of industry in GDP over three times as high.

- The level of provision of government services is substantially below that in economies of a comparable income level. Provision of water, sanitation, roads and electric power are all below expected levels in quality and/or quantity (see the infrastructure report). Public investment at 3 percent of GDP is remarkably low, and especially so in the context of an overall investment rate of 30-odd percent of GDP.

- Domestic fiscal deficits have traditionally been small, but the external trade deficit was immense, at 26 percent of GNP in the 1985-87 period.

2.14 These patterns reflect, in large part, the sources of growth in the past. Fast growth in money incomes spurred savings and investment. Palestinians specialized in manual labor in Israel and skilled labor in the Gulf rather than in industries in the West Bank and Gaza. Labor income from Israel and remittances from elsewhere financed imports greatly in excess of exports. The current account deficit was largely in balance for most of the period (though this may have changed in the early 1990s--see Chapter 3). In Chapter 2 we examine some of the policy and structural factors that contributed to the skewed pattern of past growth.

2.15 Growth in production has been unusual and led by incomes from employment abroad. Industrialization is low, which might be expected to lead to low productivity growth. However, the evidence suggests the opposite was true, at least until growth stalled. There were certainly large increases in labor productivity, in agriculture, manufacturing and construction (Figure 8). This was consistent with rising wages, as employment was drawn outside, and high domestic investment rates. There is also evidence of rapid increase in total factor productivity growth (TFP) in the 1970s, that is the growth in output over and above that explained by an expansion in the factors of production. This is based on some preliminary work, but the results, shown in Table 1, are consistent with some of the stylized facts. Total factor productivity growth was actually the major contributor to total growth in the 1970s in both the West Bank and Gaza. This can be interpreted as a mixture of technological catch-up, and the gains from factor reallocations to different lines of production. In the 1980s, by contrast, the contribution to growth declined to less than one percent per annum in the West Bank (that is close to international norms) and actually turned negative in Gaza, which was harder hit by the overall slowdown and probably had lower capacity utilization.

2.16 This picture of the sources of growth in the West Bank and Gaza complements that of the rise and fall of growth rates. When growth was very rapid, including the integration phase, there were large rises in productivity. When it stalled, so did productivity growth. Throughout the period the pattern of growth displays relatively low levels of industrialization and of provision of public goods.[9]

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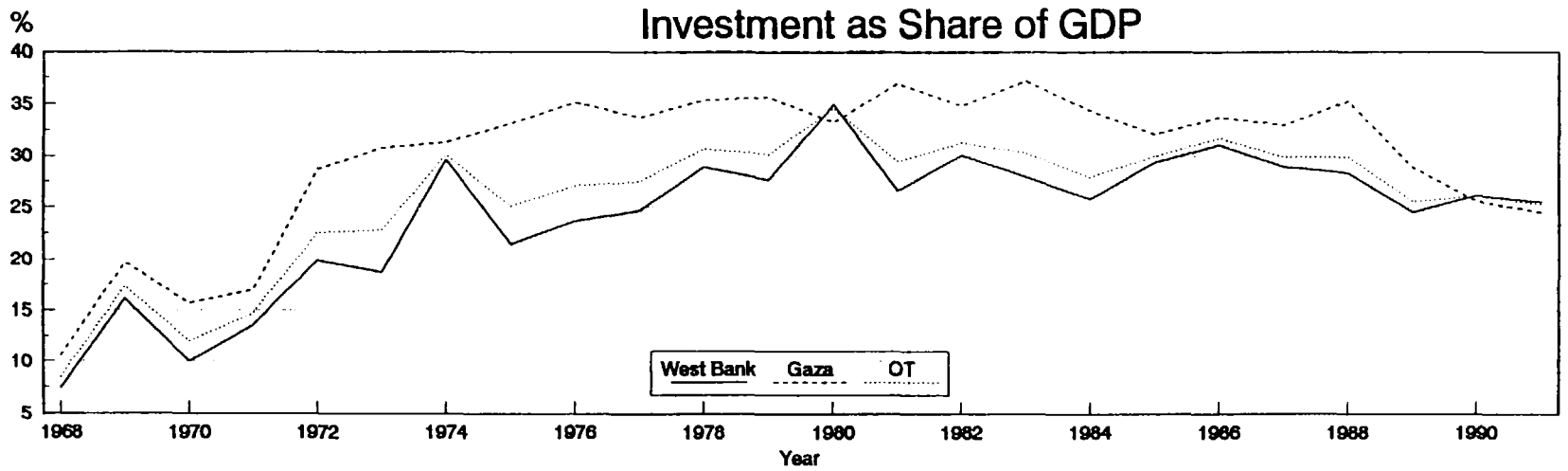
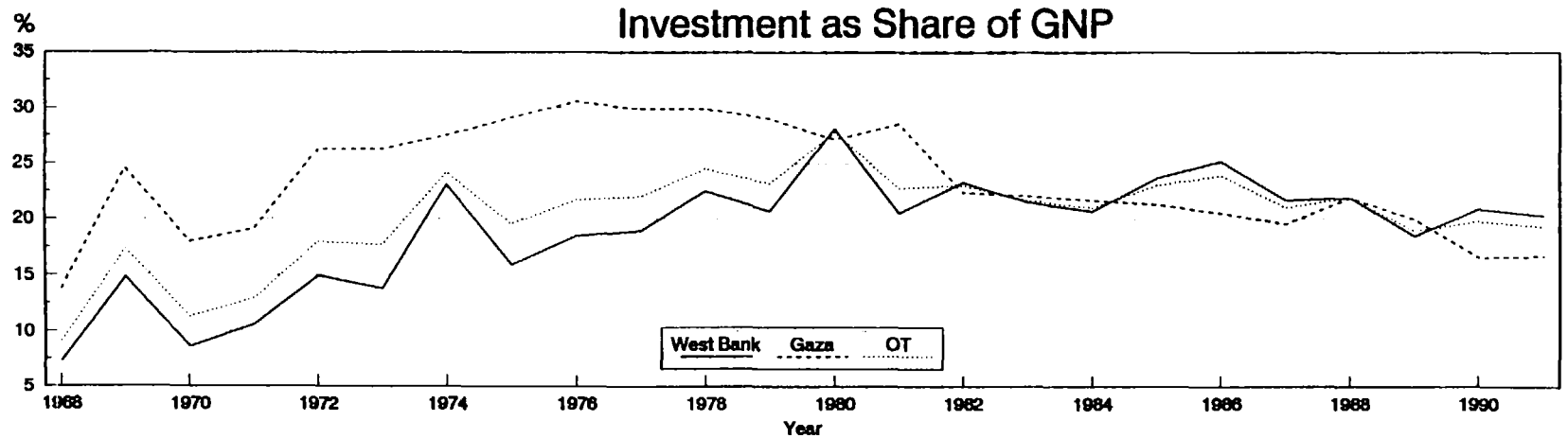
[9] Metzer (1992) has estimated TFP for the period 1972-82 at 0.5% (contributing 8.1% to growth), i.e., considerably lower than the estimates computed in this report. One possible explanation for the discrepancy is the different periods considered: growth was particularly marked in the short period between 1967 and 1972 whereas it slowed down dramatically after 1980. A further explanation may lie in the use of different capital stock series. In this report, the capital stock series was derived from investment data using the standard perpetual inventory method.

Figure 5: Investment as Share of GDP, GNP for 1968-1991.

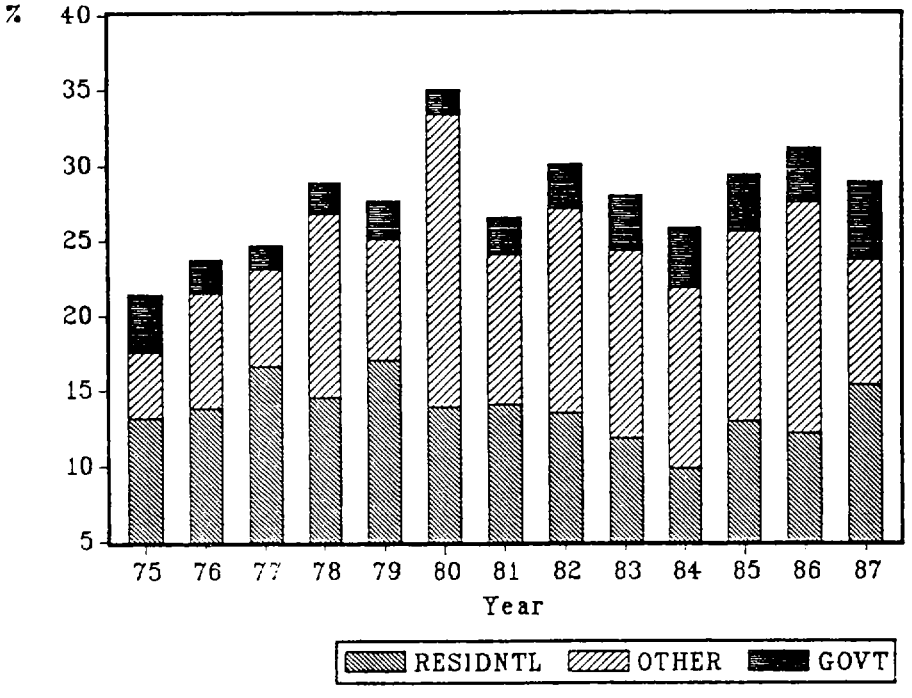




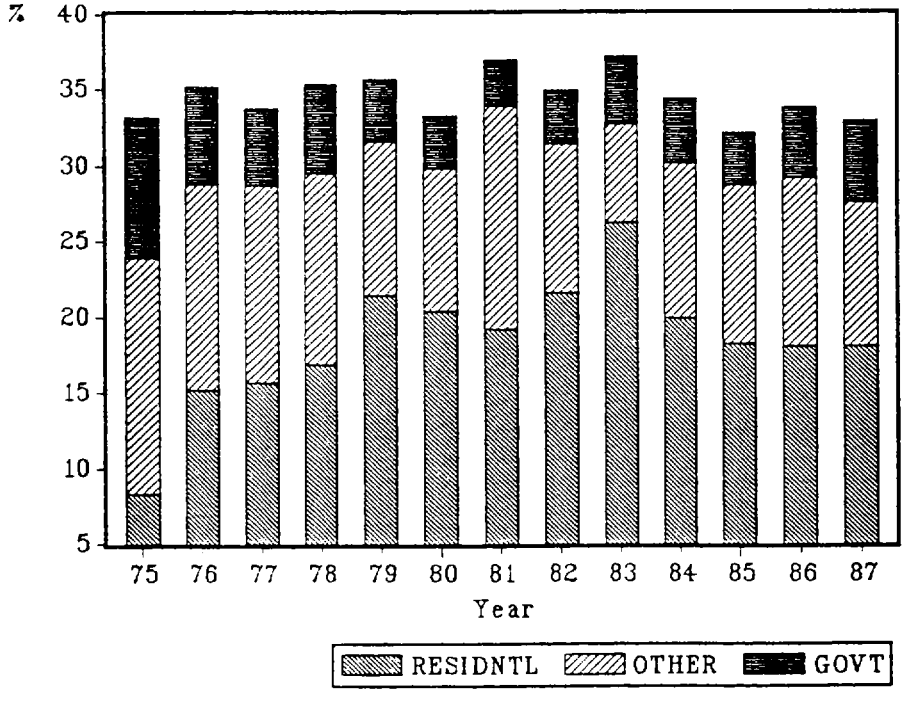
Source: based on Statistical Abstracts of Israel 1972-1992,Central Bureau of Statistics

Figure 6: Composition of Fixed Capital Formation

West Bank: Residential, government and other (private productive) investment as % of GDP

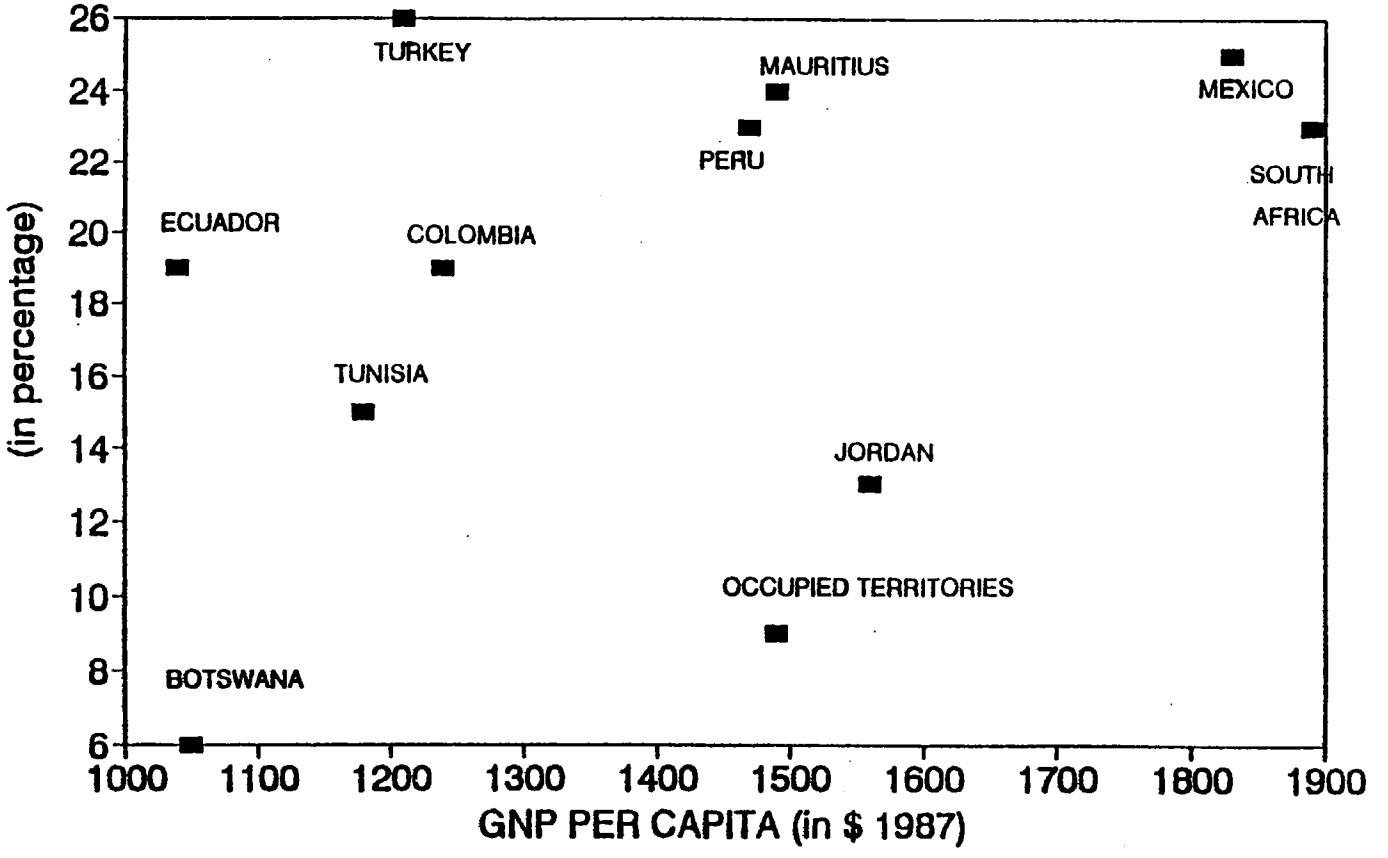


Gaza: Residential, government and other (private productive) investment as % of GDP



Source: Statistical Abstracts of Israel, 1972-1992, Central Bureau of Statistics

Figure 7: Share of Manufacturing in GDP



SOURCE : WORLD DEVELOPMENT REPORT 1987

Table 1: Growth in GDP, Factors and Total Factor Productivity (in percent per annum)

	West Bank		Gaza	
	1970-79	1980-87	1970-79	1980-87
Annual growth:				
GDP	8.54	3.56	6.27	1.57
Capital a/	8.87	7.95	6.07	6.09
Labor	-0.63	-0.95	-0.74	-0.45
Contribution to GDP growth of:				
Capital	3.55	3.18	2.43	2.44
Labor	-0.38	-0.57	-0.44	0.27
TFP b/	5.37	0.95	4.29	-0.60
TFP as a percent of growth in GDP	63	27	69	-38

a/ Based on a series constructed from national accounts statistics on investment.
b/ This is the residual of the growth accounting equation, assuming a 40 percent capital share.

Source: Mission estimates.

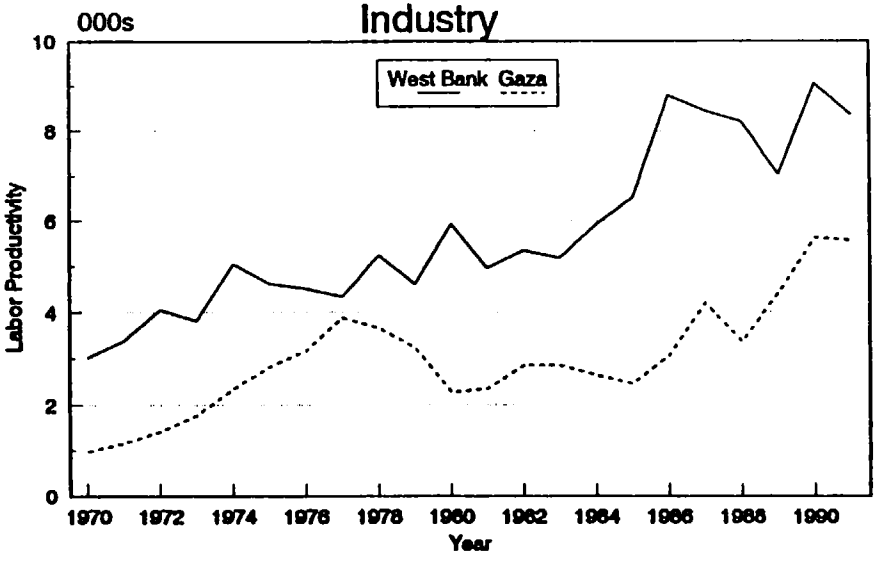
Poverty and Growth

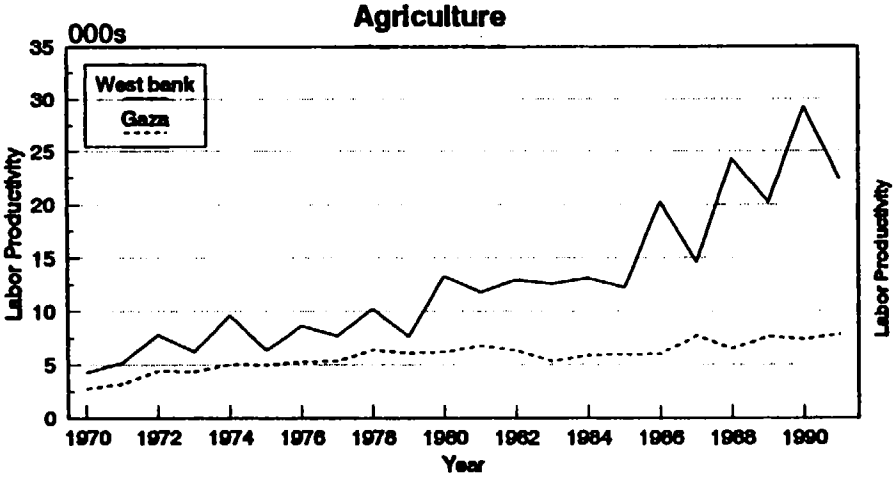
2.17 There are no comprehensive surveys of incomes or expenditure in the Occupied Territories, so it is difficult to assess the severity of poverty and changes over time. Qualitative impressions suggest that both the West Bank and Gaza have always had large differences between the rich and poor: traditionally landowners, merchants and a few industrialists have been amongst the rich, while land-poor rural households and households dependent on unskilled labor have accounted for the bulk of the relatively poor. The large number of refugee households is an additional important factor. One small, but valuable, survey (by Abu Shokor in 1985) found a level of inequality roughly in the middle of developing countries: less unequal than in Latin America and Africa, but more unequal than in countries such as Indonesia or formerly socialist countries.[10] This survey also found that most of the poor were from laboring and farming households, with the latter often having members working in the wage sector in addition to farm work. Unemployment tended to be concentrated amongst the poor, but was not severe, at about 11 percent (compared with 10 percent overall--a higher level than from the labor force surveys, perhaps due to definitional issues). Poverty did not seem to be significantly higher in refugee camps, a finding consistent with the results of the household survey of durables that finds households in refugee camps have roughly comparable levels of household wealth.

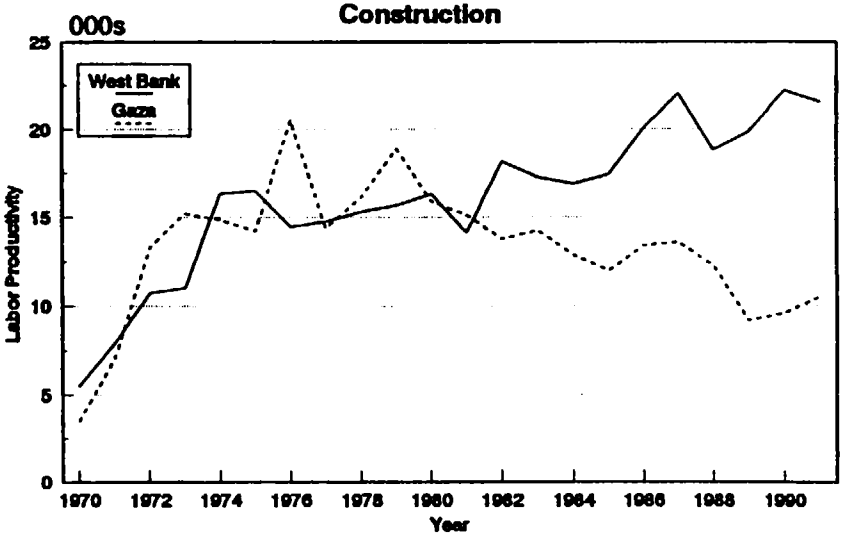
[10] See Abu Shokor (1990). He calculated a Gini coefficient of 0.42 for the West Bank and 0.45 for the Gaza Strip.

Figure 8: Labor Productivity (1970-1991)

(in NIS at 1986 prices)







Source: Calculations based on data extracted from the Statistical Abstracts of Israel, 73-92 Central Bureau of Statistics.

2.18 Assessing changes in poverty is even riskier than assessing levels since the existing small-scale surveys are not comparable over time. However, some preliminary conclusions can be drawn from examining the characteristics of the poor as well as the course of development. First, in every country (for which data is available) where there has been substantial growth there has been substantial poverty reduction. Income distributions tend to be highly stable over time. There is no reason to expect that income distribution worsened in the West Bank and Gaza (more likely the opposite occurred). This implies that the more than doubling in incomes illustrated in Figure 3 between 1970 and 1990 almost certainly brought a large reduction in poverty. It also suggests that the stalling in income growth since the 1980s led to a stalling in progress in poverty reduction.

2.19 Second, the fact that the primary structural change in earnings was the rise in the demand for unskilled labor (due to growth in employment in Israel and the associated rise in unskilled wages within the Occupied Territories), provides further indirect support for the view that poor households participated in the growth process. Indeed, for those Palestinians who stayed and worked in the Occupied Territories and Israel, there was probably a relatively compressed distribution of earnings, though better educated households were able to gain from high earnings in the Gulf (and indeed many emigrated to even greater wealth throughout the world).

2.20 Third, potentially vulnerable households would, until recently, have been disproportionately those without access to the predominantly male unskilled labor markets--that is those without able bodied young men, including families that had lost the male breadwinner. If there is now a generalized reduction in labor demand, a much broader group of working households could be vulnerable to falling into poverty.

2.21 Fourth, all the qualitative impressions, and some quantitative evidence, indicates that Palestinian society is a high transfer one, with the relatively needy being assisted through transfers from the better off, often within extended family networks. The labor force surveys finds that the unemployed and those outside the labor force disproportionately receive transfers.[11] This is exactly what happens in Jordan, which is reasonably similar culturally and in economic structure: households with low earnings receive much higher proportions of their income in terms of inter-household transfers than do non-poor and/or wealthier working households.[12]

2.22 Much more work is needed on poverty, including surveys of household living standards and expenditures. Coping mechanisms are probably strong, but the stalling in growth in incomes and employment is almost certainly leading to rises in poverty. This should be an important focus of the economic management in the interim period.

Conclusion

2.23 The above analysis suggests that the past course of growth did indeed bring large income gains for most Palestinians, but it both had built-in distortions and is not sustainable in the economic environment likely to be faced in the 1990s. The most striking aspects of economic specialization of Palestinian labor over the past 25 years have been in two areas: manual work in Israel; and in higher-skill

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[11] See Shaban (1993).

[12] This is based on preliminary analysis of household survey data from Jordan in the early 1990s.

services throughout the world, but most especially in the Gulf. While the past pattern of specialization constituted a powerful spur to economic growth in the past it has left a problematic heritage. Future growth potential on the historical path now looks very limited--Gulf demand is gone, Israeli labor demand may be substantially cut, and in any case the rise in Israeli construction demand is likely to fade after the current immigration wave subsides. Without growth in domestic production the future outlook for incomes and employment will be grim, while labor supply will be surging ahead. The remainder of this chapter examines the policy and structural reasons behind the past pattern of growth in terms of structural relations with other economies and policy choices, followed by a discussion of past external shocks that contributed to the stalling of growth.

B. Economic Relations, Policies and the Pattern of Development

2.24 Growth in the Occupied Territories was rapid in the 1970s; it is now stalled. Investment has been unusually high, but with a high concentration in housing and a relatively low payoff in growth after the 1980s. Changes in the pattern of specialization in employment and production, and rising wages, were an unavoidable consequence of integration with Israel; these were the mechanisms behind the growth spurt of the 1970s. It is, however, highly unlikely that the West Bank and Gaza economies would have experienced such a skewed pattern of development if it were not for four unusual features of their policy environment:

- Asymmetric market relations with Israel and other countries that caused a bias towards export of labor (and raised domestic wages);
- Regulatory restrictions that held back the expansion of the private productive sector;
- Fiscal compression that led to under-provision of public goods.
- A declining natural resource base.

2.25 These four factors in the policy environment were mutually reinforcing. Difficulties in getting permits for industries potentially competitive with Israeli firms (until the recent liberalization), problems of electricity supply and biases in trade relations all contributed to the character of past development: the dependence on outside sources for employment and the relatively weak development of domestic production whether in measured terms of public capital or private investment in productive activity.

2.26 The skewed pattern of investment--toward housing and with little in machinery and equipment (Figure 6)--is another aspect of the same story. The policy factors also interacted with other features of the economy: high savings due to rapidly growing money incomes and remittances; lack of alternative investment opportunities for households due to the underdeveloped state of the financial system; and overall political uncertainty. The latter may have been central to the picture, though is difficult to evaluate: it is plausible that strategic uncertainty over the political future of the Occupied Territories was a major deterrent to productive investment. On the other hand, housing was relatively secure, and rising demand was a natural consequence of rapid population growth. Jordan also has a large level of investment in housing (10 percent of GDP in the early 1990s), suggesting that the skewed pattern is only partly due to the unusual political and policy circumstances of the West Bank and Gaza. While the overall political uncertainty is clearly important, we focus here on the areas relating to policy and relations since it is in these areas that there could be future policy choices.

Trade in Labor and Goods

2.27 Palestinians have been free to sell unskilled labor and manufactured goods to Israel and skilled labor to the Gulf, but they have faced difficulties in other trade, due to the Arab boycott, restrictions on agricultural exports to Israel and weak trading networks to the rest of the world. In 1967 the West Bank and Gaza had no relations with Israel. The June 1967 war was severely disruptive, of course, and was followed by the outward migration of some 300,000 people, mostly to Jordan, out of a population of 1.3 million prior to the occupation. After the occupation, a completely different set of economic opportunities opened up with access to the much larger economy of Israel. This brought huge increases in the movement of both labor and goods.

2.28 The number of Palestinians working in Israel rose from zero to 66,000 in 1975 and 109,000 by 1987, accounting for 35 percent of the employed population in the West Bank and 45 percent in Gaza. (Figure 9). Amongst Palestinians who stayed in the Occupied Territories, this source of growth accounted for all the growth in the labor force until the *Intifada*. (A roughly equal number also emigrated to work abroad.) Palestinians from the Occupied Territories accounted for 7 percent of total employment in Israel by the mid-1970s--a share that has been fairly stable ever since. Employment was overwhelmingly in unskilled and semi-skilled work. Construction has always been the largest sector of employment.

2.29 Palestinian wages in Israel are about $450 per month, in the neighborhood of the Israeli minimum wage. Earnings vary from a third of earnings of Israelis in industry and construction to over 40 percent in agriculture (Figure 10). Wages in Israel are also above those within the Occupied Territories--the domestic average wage is about $310 per month. However, much of the difference is offset by the costs of transportation to Israel in transportation and taxes. The long-run trend was toward convergence, such that by the mid-1980s there was little difference in average wages between net earnings from work in Israel and within the Occupied Territories (especially the West Bank); this similarity, however, almost certainly hides a continuing divergence for work at the same skill level since the average skill level of Palestinians within the Occupied Territories is higher. Since the mid-1980s the ratio has tended to widen again, under the dual pressure of returnees from the Gulf and lower demand in Israel (Figure 11).

2.30 Patterns of movement amongst skilled Palestinians were completely different. Very few work in Israel: only 2 percent in professional, technical and clerical occupations compared with about 10 percent in the Occupied Territories. Market factors probably worked in tandem with preferences. Skilled labor is relatively abundant in Israel, so Palestinian skilled workers are much more likely to substitute for Israelis. During the eighties educated Palestinians lost the wage premium they previously enjoyed. While in the first half of the eighties, men with 13-15 years schooling enjoyed a daily wage premium of about 15 percent, by 1987 this had been eliminated. Men with 16 years of schooling or more also experienced a marked decline (over 50%) in their wage premium over the same period.[13] The mid-eighties recession and hyperinflation in Israel were probable causes, as well as the excess supply of new graduates. In addition, it is probable that Israeli employers are relatively reluctant to hire Palestinians for higher positions. Things were quite different in the Gulf states. There the highest demand was for skills, and many Palestinians worked there, earning substantially higher salaries than those in the West Bank and Gaza. Data in this area is weaker. It is, however, apparent that there have been substantial fluctuations in Gulf demand.

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[13] Angrist (1992)

2.31 Trade also expanded hugely. Much of this was financed, of course, by wage payments to Palestinian workers in Israel and elsewhere. But exports also expanded. There are two particularly striking aspects of the pattern of trade: its orientation toward Israel (90 percent of imports and 70 plus percent of exports) and its concentration in industrial products: the share of industrial products in trade is unusually high for its income level, way above Mauritius, which is a successful manufacturing exporter (Figure 12). The dependence of trade with Israel is a function of both trade diversion and trade creation. Trade diversion occurred from Jordan and Egypt through the imposition of a customs union in 1967: imports of manufactured goods from all countries except Israel became subject to a more than fourfold increase in duties in that year. Israel has also come to dominate other countries as a direct market for West Bank and Gaza goods. Trade creation between Israel and the West Bank and Gaza was the result of cheap transportation costs and the absence of customs on goods passing into the West Bank and Gaza.[14]

2.32 The patterns are clear: export of manual labor to Israel; of skilled labor to the Gulf; and trade in manufactures predominantly with Israel. These patterns correspond to the pattern of restrictions: some agricultural goods and skilled labor don't go to Israel; skilled labor used to be able to go to the Gulf, but has largely lost that market; and almost all goods face barriers or costs in going anywhere else. As discussed in Chapter 3, the pattern of trade that would have occurred without restrictions looks very different.

2.33 Central to the functioning of the Occupied Territories is the workings of labor market interactions with Israel. This study's interpretation of the facts leads to the following account of how the labor market functions. Wages for Palestinians in Israel are held up by (or close to) the minimum wage; but they are lower than Israeli wages, even at the same skill level, because employers consider that the employment of Palestinians comes with a cost. Kleiman (1992) finds an overall differential between Israelis and Palestinians working in Israel of 50 percent, but an "unexplained" wedge of 20 percent, after attempting to allow for occupation and skill differences. This could, for example, be due to security fears or concerns over disruptions of supply (especially post-*Intifada*). The wage exceeds the domestic wage in the West Bank or Gaza for the same work, even after transportation and other costs are taken into account, so Palestinians are rationed in their employment in Israel. Thus employment in Israel has been determined by demand at the prevailing wage, and employment within the Occupied Territories has been a residual. Only when the domestic wage (net of costs to workers) rises to the Israeli level, will increased domestic labor demand be a source of reduced employment in Israel. In some of the scenarios explored in Chapter 5 there is some convergence, but in none do the Occupied Territories reach a point of equalization and pulling back of labor from Israel (as opposed to Israeli reduction in demand).

Regulatory Restrictions

2.34 The regulatory environment for private sector activity is discussed in detail in the companion report on private sector development. Restrictions on permits for industry, the legal framework for conducting business and on the growth in the financial sector has seriously constrained the expansion of private business (probably especially in areas potentially competitive with Israeli production, until the recent liberalization). Here we note how this fits in with the overall pattern of asymmetric integration. With respect to investment, large scale expansion has been held back both by the difficulty in getting

[14] See Ephraim Kleiman (1991) for further discussion of the issue of trade diversion versus trade creation.

permits for activities competitive with Israeli producers, and the lack of business support services. Uncertain legal conditions and sharply rising prices of industrial land have added to the disincentives for expansion of productive activities. There has been significant entrepreneurial dynamism, but this has been largely in the small-scale sector.

2.35 In 1992 the Civil Administration introduced a quite significant liberalization of the regulatory framework, including the encouragement of applications for permits, the dropping of the *de facto* difficulties of receiving permits for industrial activities competitive with Israeli firms and the introduction of new tax incentives. There has indeed been a surge in permit approvals, though the bulk of this appears to be for existing (technically illegal) businesses. It is too early to assess whether there have been significant real effects.

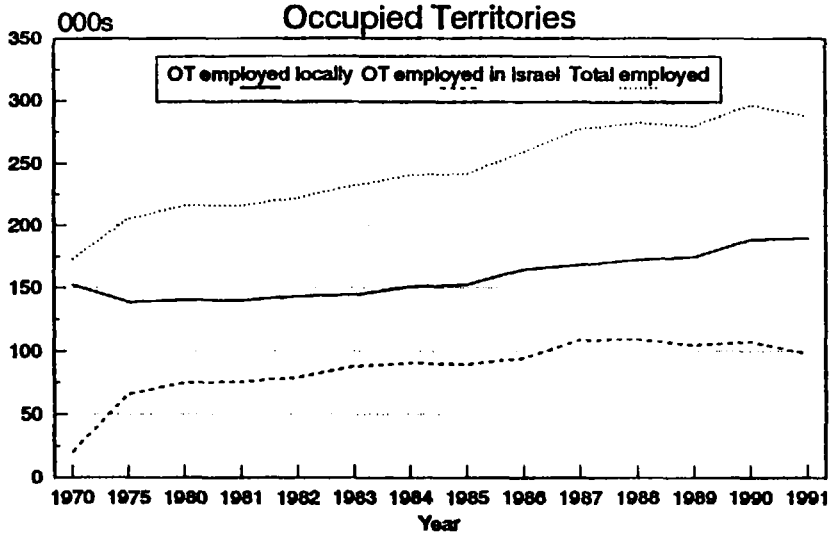
Fiscal Compression

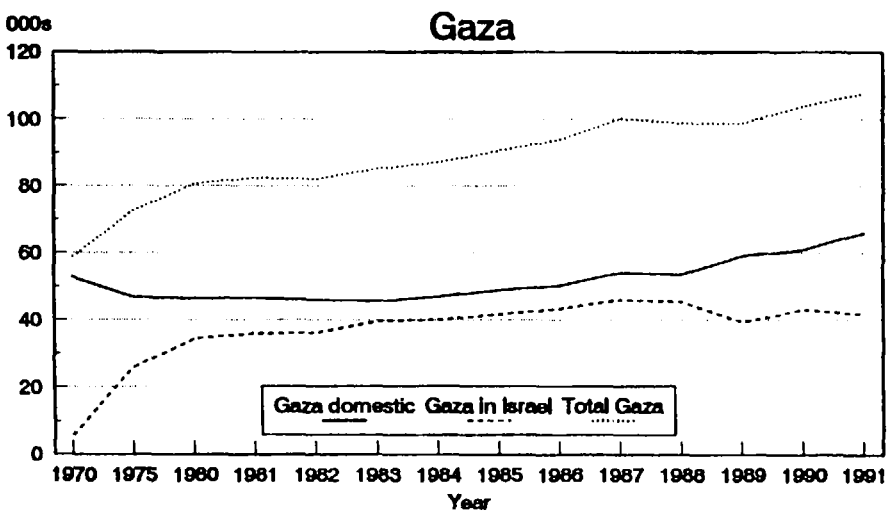
2.36 Public provision of services has been broadly limited to available revenues: to taxes and fees collected by, or assigned to, the Civil Administration and municipalities for government activities; and, at most, to retained earnings for the public utilities that are owned by the municipalities. Deficits have been negligible (though they appear to have been much higher in the 1970s). Low revenues and the inability to borrow have been the primary reason for the low levels of service provision. Annex 2 develops detailed consolidated accounts for the public finances of the Occupied Territories since 1987.

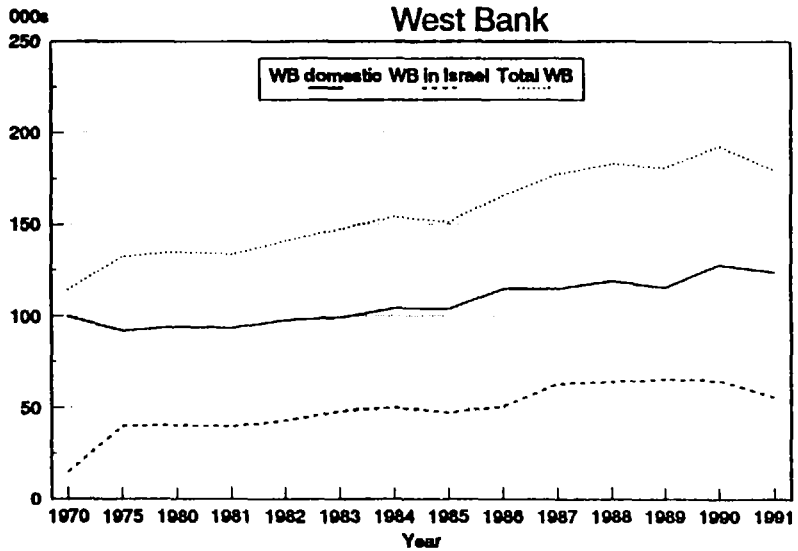
2.37 Both revenues and spending by the Civil Administration and the municipalities are low by international standards, at about 16 percent of GDP or a mere 12 percent of GNP in the 1987-91 period, with no clear trend. On the other hand, statutory income tax rates are significantly higher in the Occupied Territories than in Israel (see the discussion in the private sector report). There are two major adjustments that have be made to revenue and spending levels by the Civil Administration and the municipalities. First, other agencies, both official and private, have responded to fill the gaps left by the weak governmental effort. Second, there are complex interrelations, on both the revenue and spending side, with the Israeli government. We take up each in turn (Table 2 summarizes the results).

2.38 Many organizations operating in the Occupied Territories provide quasi-public services. Foremost amongst these is the United Nations Relief and Works Agency (UNRWA), which provides basic services to the approximately 40 percent of West Bank and 60 percent of Gaza residents that have refugee status. UNRWA has spent US$100 million annually in the recent past, equivalent to 4.5 percent of GDP, of which 85 percent went on education and health. Jordanian aid amounted to an estimated $50 million per annum until 1988, dropping to $15 million thereafter; identified aid by other Arab governments provided an estimated $15 million per annum in 1988-89; and other Arab non-government agencies, UNDP, EC and a large number of non-Arab NGOs, also provided resources or services. These funds are treated as near-government capital inflows and spending.

Figure 9: Number of Employed West Bank and Gaza Residents by Place of Employment, 1970-1991

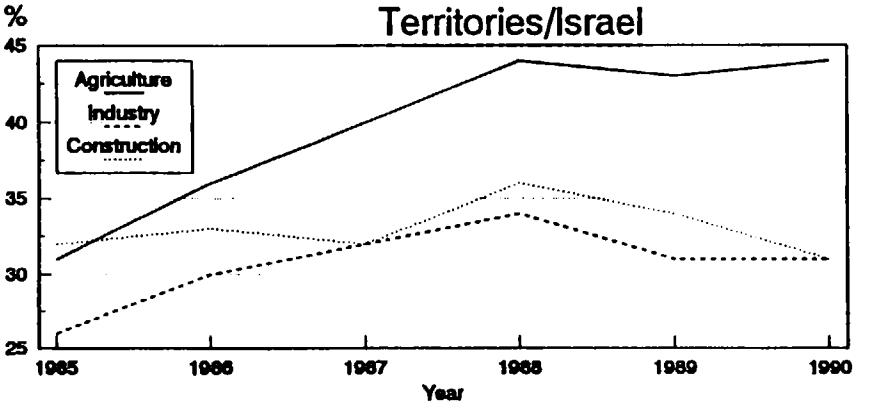


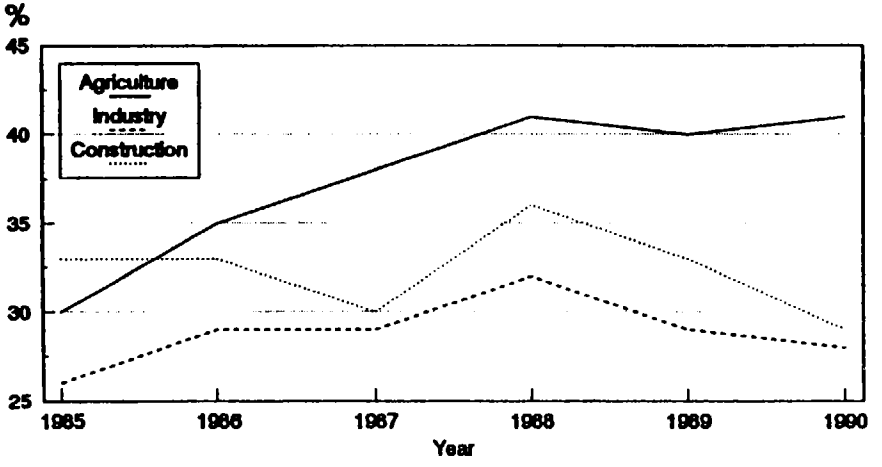


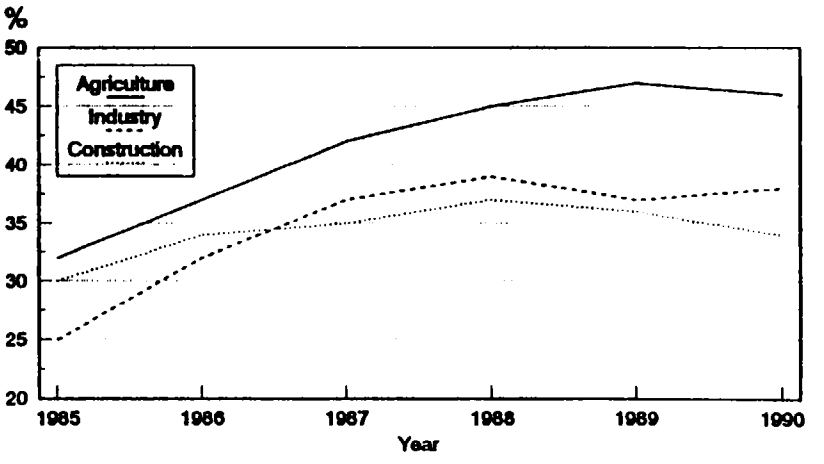


Source: Statistical Abstracts of Israel, 1983-1992, Central Bureau of Statistics, Jerusalem.

Figure 10: Palestinian Daily Wage as a Percentage of Israeli Daily Wage by Selected Economic Branches

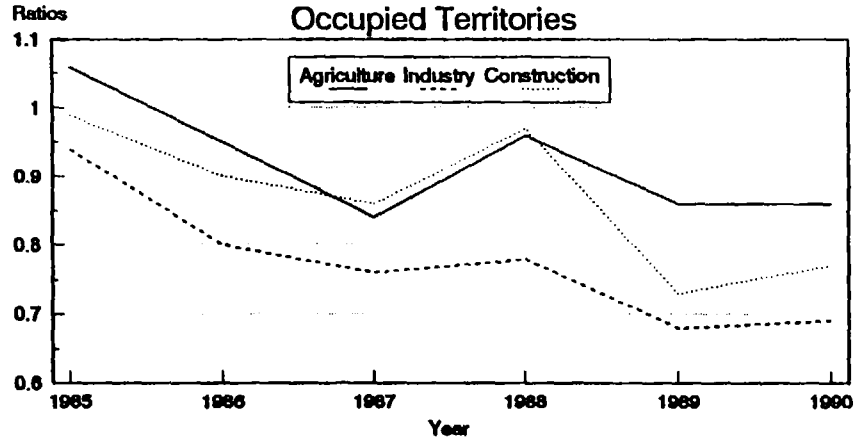


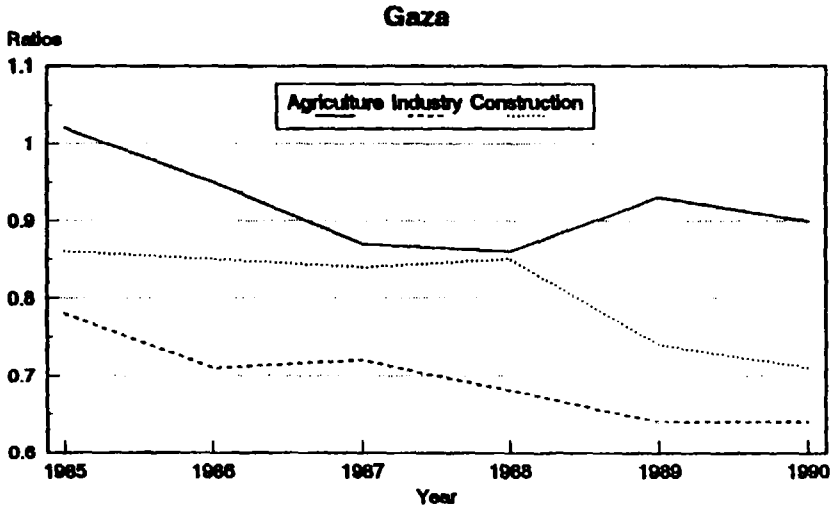


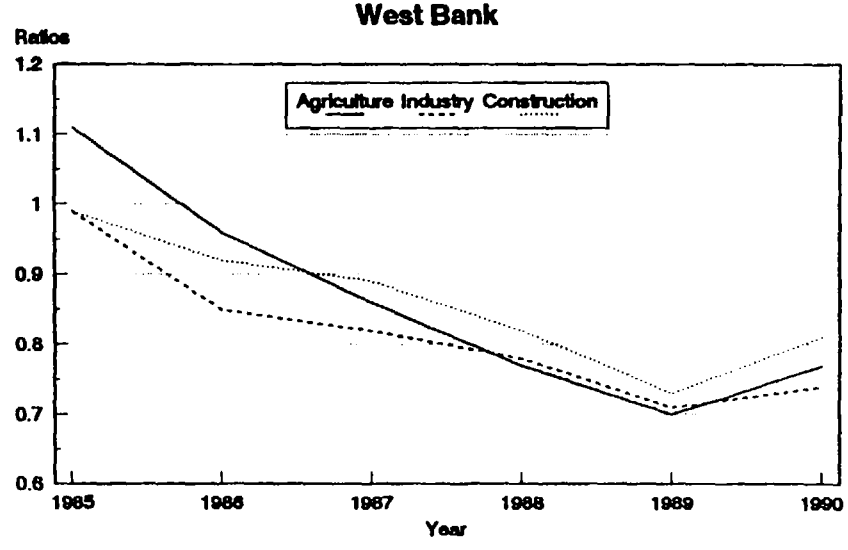


Source: based on Statistical Abstracts of Israel 1971-1991, Central Bureau of Statistics, Jerusalem.

Figure 11: Daily Wage Ratios of Palestinian Employees Working Domestically to Palestinian Employees Working in Israel

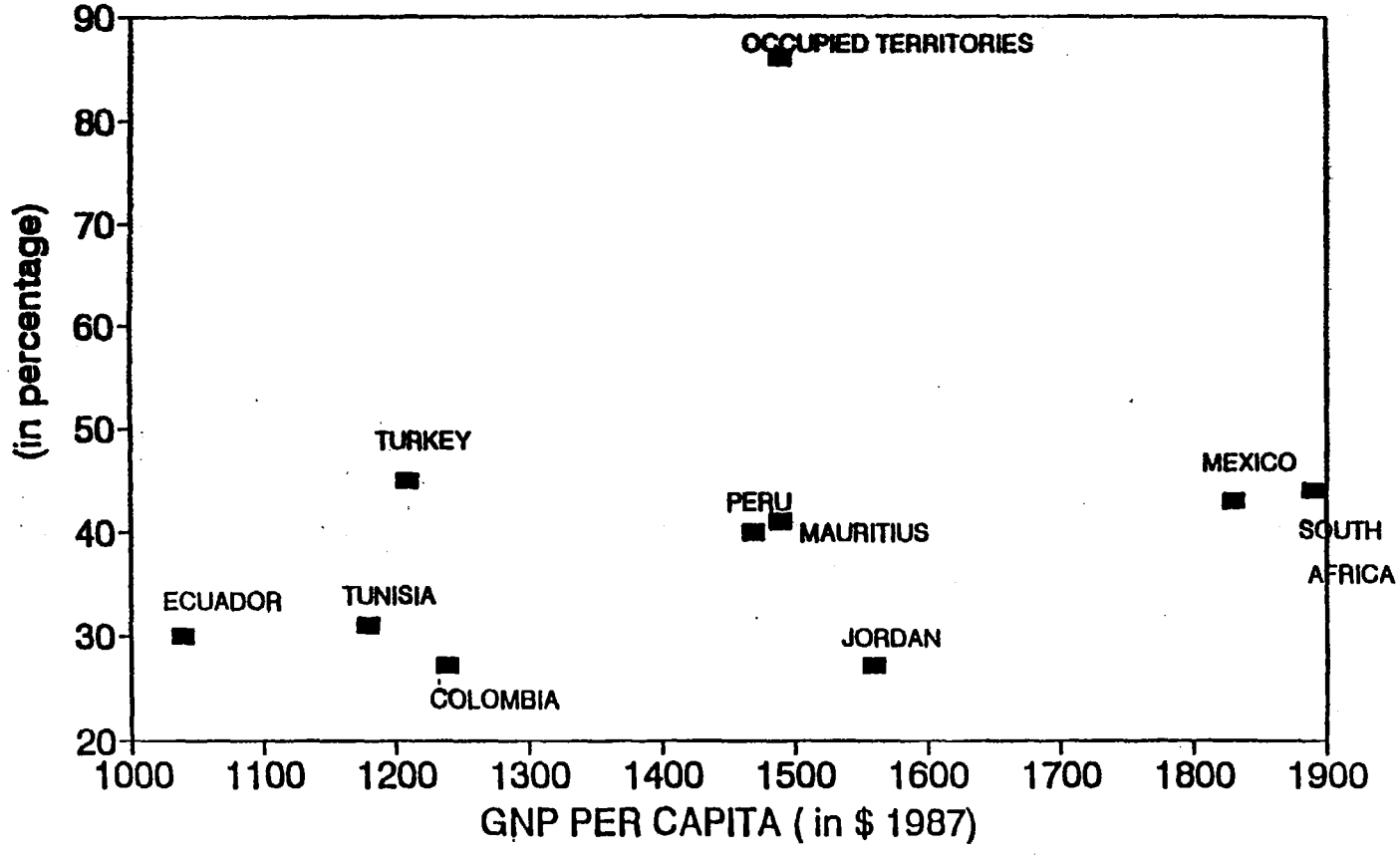






Source: Statistical Abstracts of Israel, 1985-90
Central Bureau of Statistics, Jerusalem.

Figure 12: Share of Industrial Product in Trade



SOURCE: WORLD DEVELOPMEN REPORT 1987

2.39 More controversial are the fiscal transfers between the Occupied Territories and Israel. Palestinians pay some taxes that accrue to the Israeli treasury, and Israel provides services. There are no available statistics on these transfers. This report made direct estimates of indirect taxes paid by Palestinians that were not passed back to the Civil Administration budget--mainly due to the VAT, tariffs, excises, fuel taxes and purchase taxes. On reasonably conservative estimates of the base and of rates,these amounted to some NIS 400 million in 1991, equivalent to 8 percent of GDP (Annex 2). This does not include income tax paid by Palestinians working in Israel since it is the usual international practice for this to accrue to the treasury of the territory in which a person works. Nor does it include any indirect costs, such as the price-raising effects of tariff protection on Israeli production. By contrast, in the Southern African Customs Union, the sharing formula for customs revenues between the Republic of South Africa and the other members of the union (including Lesotho and Swaziland) *does* include such an adjustment.

2.40 Palestinian consumption of Israeli services is even more difficult to assess: the estimates of the Israeli Government are included in the appendix. Defense and security spending is estimated by the Israeli Government at NIS 1 billion, or 20 percent of GDP. We include outlays on subsidized goods and the use of public hospitals, in which there is a direct fiscal outlay that would not have otherwise occurred--these amount to some NIS 65 million, or 1.2 percent of GDP. In addition, some direct capital spending comes from the Israeli budget and is included. This is estimated at 0.8 percent of GDP. Thus, the Israeli non-security contribution is estimated at 2 percent of GDP.

2.41 The consolidated picture is of significantly higher revenues paid by Palestinians (24 percent of GDP, or 22 percent if the receipts of utilities are taken out as is done in most countries) and higher spending (26 percent of GDP, 24 percent if current outlays of utilities are deducted). At 22 percent of GDP, revenues look only moderately below those in other economies Egypt's revenues were 23 percent of GDP; Jordan's were 27 percent; and a sample of 43 developing countries revenues amounted to 22 percent of GDP; Israel's, however, were much larger at 39 percent. (See Table 3; note that for the larger sample the information is limited to the central government.) As a share of GNP, revenues are only 16 percent for the Occupied Territories, far below that of the other economies Which is the more appropriate for comparison depends on the tax: for indirect taxes, it is GNP (which will determine spending), while for direct taxes it is GDP, since these taxes are levied on domestic labor earnings.

2.42 Spending is much lower than international norms because of the absence of normal deficit finance. Total non-defense spending amounted to 24 percent of GDP (and 18 percent of GNP), compared with 37 percent for both Egypt and Israel; 31 percent for Jordan; and 26 percent for the same sample of developing economies. While this figure may be somewhat low with respect to current spending, the radical differences lie in development (i.e., investment-related) spending. The 3.5 percent of GDP allocated to this item in the Occupied Territories is a small fraction of the spending levels in the other economies (with the partial exception of Israel).

2.43 Both revenues paid by Palestinians and spending on public services are higher than the accounts of the Civil Administration and the municipalities. But some of the revenues paid accrue to the Israeli treasury, and some services are there from quasi or non-government sources. Even if everything is included, a picture remains of current spending that is somewhat low for the income level of the population and development spending that is extremely low. This is completely consistent with the picture that emerges from the sectoral reviews (especially of economic infrastructure) of inadequate service levels.

Table 2: Integrated Public Sector Finances, 1987-91
(in percent of GDP)

	Public Sector Average 1987-91	Integrated Public Sector Average 1987-91
Revenue	16.1	24.1
Expenditure excluding defense	16.3	25.8
Current Expenditure	14.1	22.3
of which: UNRWA	-	4.5
Other quasi-government	-	2.5
Israeli budget	-	1.2
Development Expenditure	2.2	3.5
of which: Israeli budget		0.8
Other quasi-government		0.5
Overall deficit (-)/surplus(+)	-0.2	-1.7
Financing	0.2	1.7
Israel	0.2	2.2
UNRWA	--	4.5
Other external sources	0.1	3.1
Increase in cash balances (-)	-0.1	-8.1[a/]

a/ This increase basically reflects the revenue foregone by the Civil Administration.

Declining Natural Resource Base

2.44 A fourth constraint which has acted to distort the pattern of development is the stagnation or shrinking of the land and water resources base in the face of a large population increase over the past 25 years. Annually renewable groundwater resources in the West Bank and Gaza amount to about 750 million cubic meters, while annual use by the Palestinians has remained capped at about 200 million cubic meters--the pre-1973 level. Current restrictions on access to water, including administrative limitations on surface water harvesting, and the high costs of water caused by difficulties to renew inefficient and worn-out wells have meant a modest expansion of the irrigated area under Palestinian cultivation. In selected areas, notably in some areas in Gaza, increasing salinity levels in wells caused by excessive extraction have virtually halted agricultural production. Loss of land to settlements has increased during 1980s and early 1990s. Access of Palestinian sheep and goat farmers to military land and land declared nature reserve has been restricted.

Table 3: Revenue and Expenditure Comparisons: Egypt, Israel, Jordan, Occupied Territories and Developing Countries

Average: 1987-91

	Egypt	Israel	Jordan	OT	OT a/ Adjusted	Developing Countries
			(In percent of GDP)			
Revenue	23.1	38.6	27.2	24.1	21.7	22.1
Tax revenue	15.2	33.9	14.3	16.1	16.1	17.5
Direct taxes	5.7	17.5	3.4	4.2	4.2	5.4
Indirect taxes	9.5	16.4	10.9	11.9	11.9	12.1
Nontax revenue	7.9	4.7	12.9	8.0	5.6	4.6
Expenditure	42.2	50.2	46.4			28.0
Current expenditure	28.9	45.7	37.2			21.0
Development expenditure	13.3	4.5	9.2			7.0
Expenditure excluding defense	37.2	36.8	30.5	25.8	23.6	25.6
Current expenditure	23.9	32.3	21.3	22.3	20.1	18.6
excluding defense	13.3	4.5	9.2	3.5	3.5	7.0
Development expenditure						
			(In percent of GNP)			
Memorandum Items	21.7	39.4	28.9	17.8	16.2	23.3
Revenue	8.9	16.7	11.6	8.9	8.9	12.7
of which: Indirect taxes						

a/ Excludes revenues and spending of utilities.

While the area cultivated by Israeli settlers in the West Bank is unknown, in Gaza settlers occupy about 10 percent of the cultivated area. The lack of clear zoning regulations and public land utilization policy has also created uncertainty and has become a barrier to industrial expansion. The freeze on the building of housing on land beyond the municipal boundaries has acted to distort land prices. Security-related restrictions affecting the fishing areas in which Gaza fishermen can operate, (recently increased from 12 to 20 miles) have been limiting fish production to a fraction of the pre-1967 levels.

C. Shocks and Responses

2.45 In addition to the structural factors described above, economic performance of the West Bank and Gaza has been heavily influenced by a sequence of external shocks. The post-1967 change in regional economic relations was of course the largest shock to the OT economy, which provided the backdrop for all subsequent changes. As small open economies, the West Bank and Gaza are highly prone to imported shocks, both real and nominal. In particular, the structural distortions described in the previous section have rendered the Occupied Territories economy very susceptible to economic conditions in Israel, the

Gulf states, Jordan and other countries in the Middle East (which are important markets for Occupied Territories exports and its labor), and to the effects of political protest and military action. The following is a list of some of the main shocks (positive as well as negative) that have affected the Occupied Territories since 1967:

- the slowdown in Israeli growth in the mid-1970s after the first oil shock led to weaker demand in the dominant market for both labor and goods.

- the Gulf oil boom led to both strong demand for skilled Palestinian labor (and a steady stream of remittances) and contributed to substantial levels of transfers from Palestinian and other Arab sources overseas; this helped pick up the slack from Israel's poorer economic condition.

- the subsequent collapse of oil prices contributed to the first period of stagnation in the Occupied Territories in the early 1980s.

- Israeli high inflation was almost completely imported into the Occupied Territories (Figure 13).

- the *Intifada* had a pervasive influence on the Occupied Territories: it contributed to reduced labor demand in Israel outside construction, reduced labor supply and economic activity due to strikes, periodic border closures (and higher costs of movement), and the increased enforcement of firms for taxes, all of which slowed growth.

- the Jordanian withdrawal of public sector salary payments after 1988 and the devaluation of the Jordanian Dinar during 1988-90 were linked shocks that hit many Palestinians in the West Bank hard, many of whom traditionally have used Jordanian Dinars for savings.

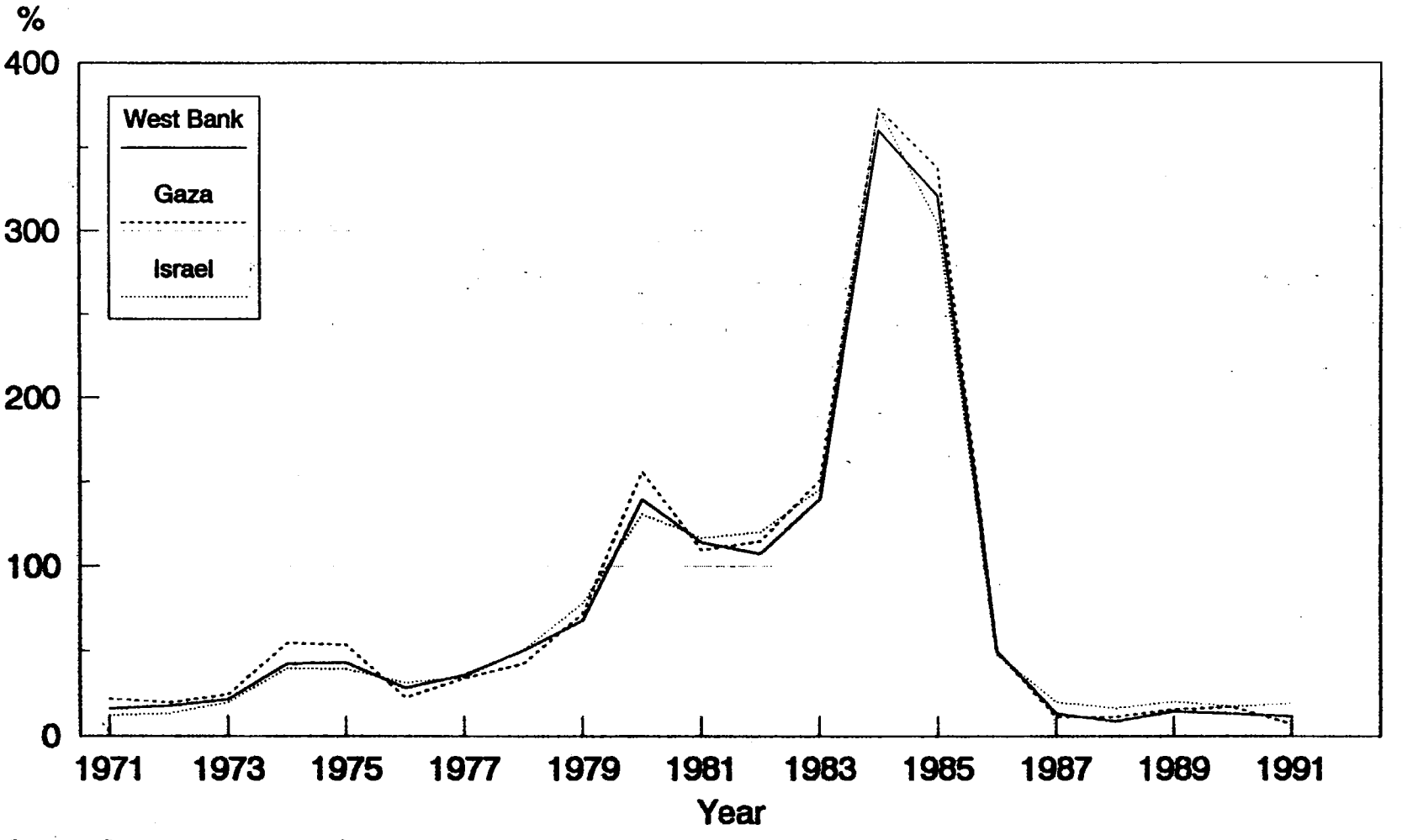
- the Gulf war with Iraq led to drastic short-run effects through the closure of the border for 40 days in early 1991, followed by permanent losses due to the expulsion of Palestinians from several Gulf states, the loss of Arab grants and reduced transfers from a cash-starved PLO.

- Immigration to Israel was a large positive influence on the demand for Palestinian construction employment (new immigrants need houses but usually aren't good at construction), totally offsetting the reduced demand in industry and services.

- expectations of a peace settlement in 1992 fueled a small boom, especially in property, generally reckoned to be financed by drawdowns in savings of Palestinian families with household members returning from the Gulf. Savings repatriation may have been facilitated by relaxed restrictions by the Civil Administration.

- the March 1993 cut in employment in Israel is causing a sharp reduction in labor incomes.

Figure 13: Inflation for West Bank, Gaza, and Israel for 1971-1991



Source: Statistical Abstracts of Israel 1972-1992, Central Bureau of Statistics.
Inflation is rates of change in the CPI.

2.46 In addition to the above, the West Bank is prone to agricultural shocks, especially for olive crops. While the olive crop usually rises in even years and drops in odd years, the exact nature of the variation is more complex. The variations in the olive crop are huge and have aggregate effects. However, ofmuch greater importance for future economic policy are the other, potentially permanent shocks such as loss in external employment earnings opportunities. We examine the shocks from the viewpoint of the macroeconomy, households and money using the shocks to explore some of the monetary history of the economies.

Shocks and the Macroeconomy

2.47 These shocks have resulted in a serious instability in incomes, both of a cyclical character, as in the olive cycle, and in the form of a permanent slowdown, as with the *intifada* and Gulf war. At an aggregate level, three mechanisms can be used to help moderate the influence of the shocks: income diversification, changes in net transfers from abroad and domestic adjustments.

2.48 The Occupied Territories have, fortuitously, done reasonably well through income diversification during many periods. Having part of the labor force in oil-importing Israel and part in the oil-exporting Gulf was an important source of risk-spreading and helps explain the continuation of growth in the late 1970s after the Israeli economy slowed. However, adverse shocks to external income sources have tended to pile on top of each other since the late 1980s. The *Intifada's* tendency to reduce income from Israel (from labor and exports), the decline in Gulf labor income and the recent sharp cutoff in employment have all hit hard. The weak diversification of trade beyond Israel make the economy highly vulnerable to this restriction.

2.49 External transfers, by contrast, have probably only weakly offset the effects of these shocks. The Occupied Territories have not been able to have an active policy in this area (though it should be added that the evidence is mixed on how successful governments elsewhere have used external transfers counter cyclically--some use higher borrowing capacity in boom times to exacerbate rather than dampen the influence of shocks). Many of the transfers also tend to be associated with other shocks. Defense apart, Israel has not increased transfers to the Occupied Territories to offset the post-*Intifada* slowing of economic activity. Arab aid (JPC)[15] declined sharply after 1985. Aid from Jordan amounted to about US$ 25 million annually, rose to an average of about US$ 50 million during 1987-88, and then dropped sharply afterwards following the disengagement in mid-1988. Aid from the Gulf States was discontinued after 1990. Aid from the US rose during 1983-87 but declined afterwards; and aid from the EEC had been modest but picked up considerably after the Gulf War. Transfers from the PLO have also certainly tailed off since the Gulf war because of a lack of funds. Overall, the total amount of grants has been quite variable and appears to have been on a declining path since the late 1980s.

2.50 Finally, domestic adjustment has borne a large part of the burden of adjustment. While there are neither cyclical stabilizers nor national insurance schemes, there are some significant adjustment mechanisms. This is clearly seen for the most predictable source of income variability: the olive cycle. Despite quite large annual changes in GDP, consumption follows a smooth path. Changes in income are smoothed through changes in inventories (Figure 14) and in savings.

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[15] Jordanian-Palestinian Committee for the Steadfastness of the Palestinian People in the Occupied Homeland.

2.51 The picture is less clear for the recent sequence of adverse shocks. Declines in investment (and probably domestic savings, though the data is not available) in the initial post-*Intifada* period helped maintain consumption. The substantial drawdown of savings held abroad - spurred by the return of Palestinians from the Gulf - appears to have given an important positive impulse to the West Bank and Gaza economies in 1991 and 1992.

Shocks and Households

2.52 The economic shocks of recent years have had pervasive effects on Palestinian households. Of particular importance are the effects of adverse labor market shocks, especially the loss of employment in the Gulf and Israel. Because of the preponderance of unskilled workers employed in Israel, the recent reduction in employment is likely to hit poorer households relatively hard. It will, in the short run, also have significant multiplier effects throughout the economies.

2.53 There is no formal social security system, but at least three coping mechanisms appear to be important in the West Bank and Gaza:

(a) Alternative employment: workers move back into agriculture or construction. There is some evidence that domestic construction activity moves counter cyclically to employment in Israel, suggesting that when construction labor is more plentiful, there is greater domestic spending on housing.

(b) Running down savings: households have traditionally had high savings, a consequence of the fast growth in money incomes and the uncertainty over future incomes. These are drawn down in bad years; indeed, reduced savings in 1992 appears to have contributed to an actual expansion in activity, especially in the construction sector.

(c) Transfers: as discussed above, transfers are significant and especially for households suffering from unemployment or without active labor force participants.

Shocks and money

2.54 It is useful to review the recent monetary history of the Occupied Territories. It provides a good context in which to review the effects of the recent shocks, and it is possible to develop a picture of the role of money balances in smoothing these shocks. The West Bank and Gaza have neither their own currency, nor a central bank. The New Israeli Shekel and the Jordanian Dinar are legal tender, while the US dollar and some European currencies circulate widely as a more secure store of value. Cash seems to be the primary means of payment, and monetary savings are primarily in foreign currency (some of which is held abroad) and precious metals.

2.55 In the absence of a monetary authority and an active banking system, the money supply is primarily determined by capital inflows and outflows related to foreign trade, net factor income and net transfers. Because these sources have been very unstable in the past, the money supply must have fluctuated widely over time. At the same time, circumstances in the Occupied Territories necessitate large cash balances: cash in advance transactions predominate; large precautionary cash balances are held as shock absorbers because of the difficulties in securing short-term credit; and investment is mostly self-financed, requiring the accumulation of cash savings.

2.56 The size of monetary holdings in the West Bank and Gaza is not known. For the sake of comparison, M1 (which includes currency in circulation and sight deposits) is 57 percent of GDP in Jordan (of which 32 percent of GDP was currency in circulation and the remainder, demand deposits); 6.3 percent in Israel (of which 2.5 percent in currency); 15 percent in Lebanon (o/w 10 percent in currency); and 22 percent in Egypt (o/w 11 percent in currency). Clearly, the size of both the ratios of M1 to GDP and currency to GDP make Jordan an outlier in the region. The principal explanation for this anomaly is that the residents of the West Bank hold Dinar balances, especially in the form of currency. We explored the implications of a range of assumptions for Palestinian holdings of Shekels and Jordanian Dinars (from similar holdings relative to GDP shares to a third more in relative terms, given the relative scarcity of alternative financial assets). This produces a range of the ratio of M1 to GDP of 30-55 percent and an adjusted ratio for Jordan of 30 to 45 percent.

2.57 One could, in principle, get a better sense of the way in which the Occupied Territories reacted to the various monetary and real shocks between 1985 and today by looking at the changes in money supply over time. For an economy without a central bank, this can be achieved by estimating capital movements from the balance of payments. We attempt such an exercise in spite of the severe data limitations. We estimate the total residual from the balance of payments to try and develop some picture of the flow of funds between the Occupied Territories and the rest of the world.

2.58 Starting from the balance of goods, services and identifiable transfers and capital flows (factor income, and transfers from UNRWA, EEC, USA, Jordan, JPC, and Islamic organizations), any residual surplus (deficit) must be offset by unrecorded capital outflows or reserve accumulation (capital inflows and reserve depletions). Other possible deviations can be due to the under-reporting of trade (especially with Israel) and of labor income (from Israel and especially from the Gulf), and changes in supplier credit (especially from Israeli suppliers). The analysis of the available information suggests the following results (see Figure 15 for a presentation of changes in the key variables):

(a) The current account (including official and private net transfers) of the Occupied Territories has traditionally recorded a surplus with Jordan and a deficit with Israel and the rest of the world. The overall position was usually in surplus, at least until the mid-1980s, reflecting the domestic accumulation of foreign cash balances. The estimates also reveal that the JD holdings to GNP ratio was consistently over 50 percent, a large ratio by international standards.

(b) During the Israeli high inflation episode of 1983-85, real money balances fell, probably with an increased substitution away from the Israeli Shekel and towards the Jordanian Dinar (note that unrecorded capital flows cannot have been large in this period since the regional oil boom had collapsed by 1983). The fall in cash holdings can be explained by several factors. First, coming on the heels of a prolonged period of growth, the level of reserves must have been high in 1985, and portfolio rebalancing could not, in the aggregate, be accommodated with a net shift from Israeli Shekel to Jordanian Dinar, given that neither currency was easily convertible into foreign currencies. Second, transfers from abroad started declining as real wages fell in Israel, employment stagnated in the Gulf and the Iran-Iraq and Lebanese wars raged in the region. Third, the slowdown of the economies of Israel and Jordan made it difficult to increase exports, while imports, especially of consumer goods, continued to trend upwards. Fourth, because economic activity was stagnating, the need for real balances may have declined. While it is not possible to estimate the real losses suffered by Palestinians as a result of

the Israeli Shekel inflation, it is unlikely that this loss was great for West Bank residents because they had started shifting to other currencies since the early 1980s.[16] The residents of Gaza, however, where the scope for shifting may have been less since the Jordanian Dinar is not legal tender, may have suffered larger losses. In any event, this episode must have eroded and unbalanced cash balances. In the following two years, households replenished their balances substantially.

(c) The available evidence indicates that the Jordanian Dinar devaluation in the second half of 1988 and in early 1989 must have come as a surprise to the residents of the Occupied Territories. In the past, the Jordanian Dinar had been the preferred store of value in the West Bank because of its historic stability, which was reinforced by the Israeli high inflation of 1983-85. (See Figure 16 for the relative stability of the JD.)

(d) During 1990-92, cash balances seem to have fallen considerably in spite of large transfers of savings from Kuwait. In 1991, the last year with reasonably good data, reserve drawdowns and unrecorded private sector capital inflow were about 10% of GNP. This was probably a major source of the short-run smoothing of the adverse shocks of the early 1990s. They provided the financial basis for what appears to have been a minor boom in 1992, but they are unlikely to be sustainable. A similar phenomenon occurred in Jordan and Yemen.

Conclusion

2.59 The economies of the Occupied Territories are characterized by an unusual dependence on external sources of economic growth. As a result, they are also vulnerable to external shocks, although the net effect of past shocks has not been to generate large fluctuations in the overall level of economic activity since the shocks have often worked in opposite senses. Nevertheless the changes that have occurred in the past several years--from the Gulf to Israel--all add up to a large and probably permanent adverse change in these external sources of income growth. To offset adverse external developments, future income growth will have to depend on an expansion of production based in domestic centers of economic activity. This was clearly true prior to the sharp reduction in employment in Israel in March 1993. If this reduction is permanent, the need to reorient the economy will be much more urgent. In the past, the economy has not had the structural policy options to support such a reorientation of the pattern of development. Indeed all the underlying policies and structural realities have pulled in the opposite direction, and the economy has not had the macroeconomic policy instruments to manage shocks. In the future, policies will be central to a reorientation in the pattern of development.

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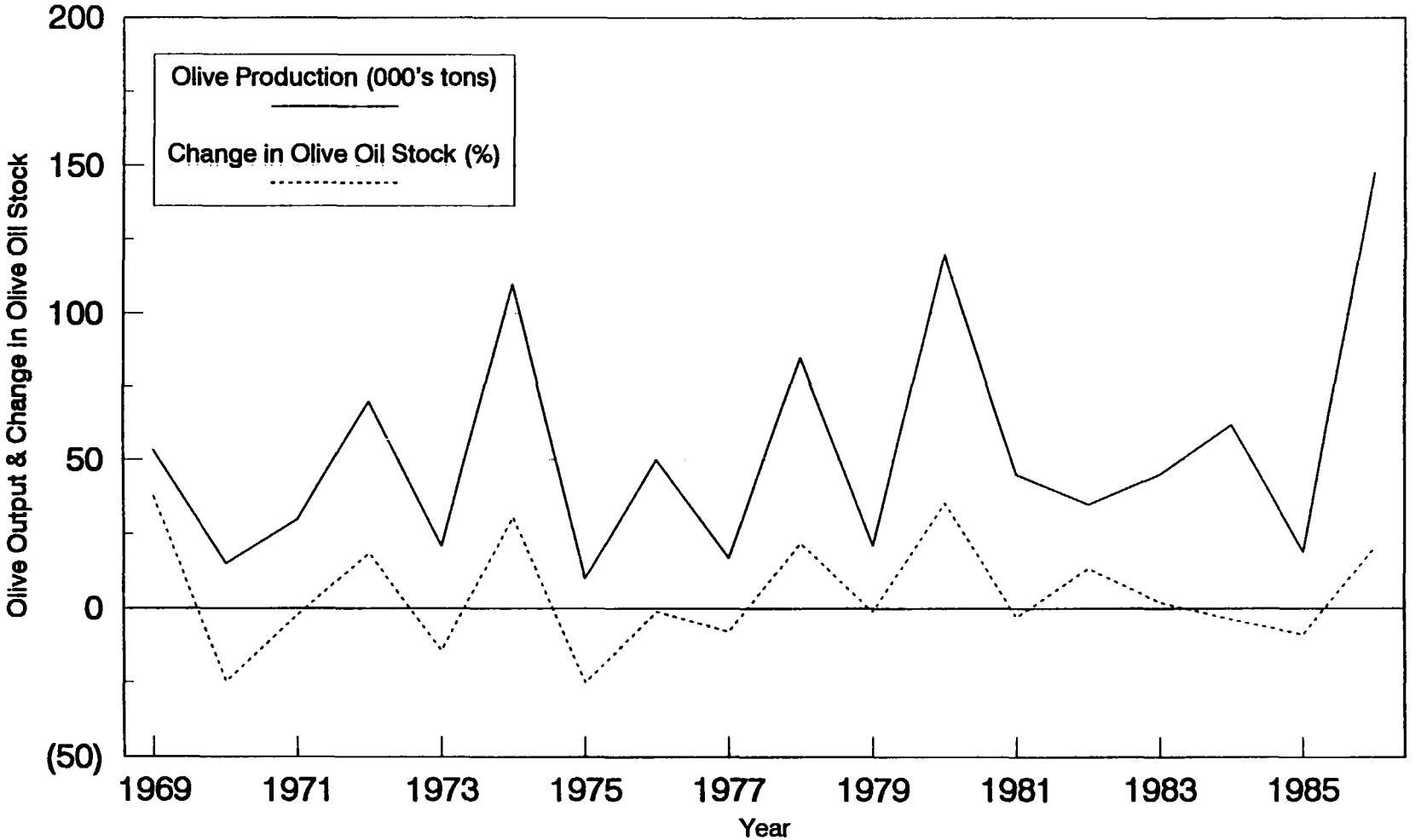
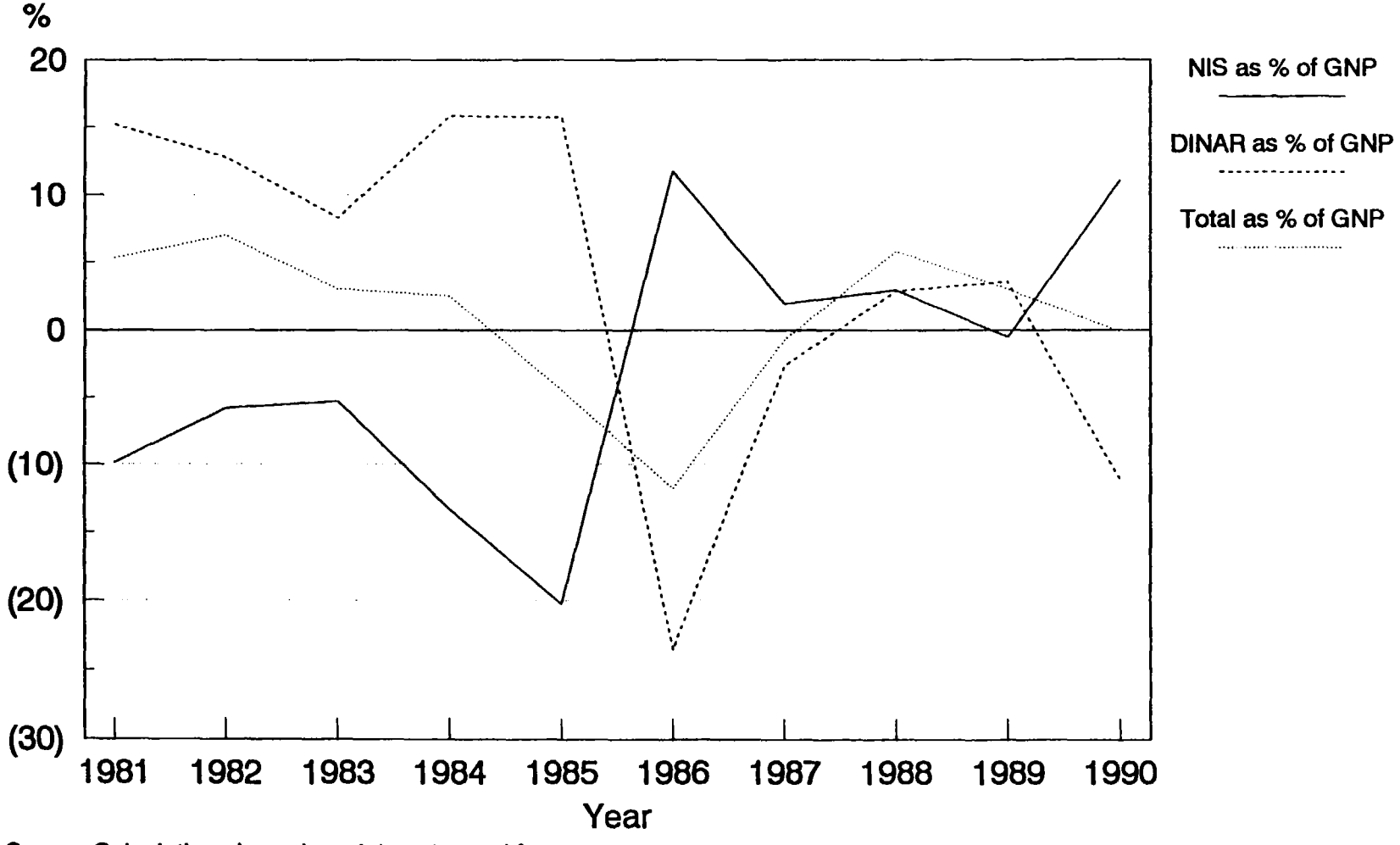
[16] Hamed and Shaban (1992) calculate that--in the absence of currency substitution--seignorage on Shekel holdings would have amounted to about 5 percent of GDP during 1984-85. Since there clearly was currency substitution, actual seignorage would have been lower. On the other hand, seignorage on JD holdings could have been substantial.

Figure 14: West Bank Olive Production and Change in Olive Oil Stock for 1968-1986



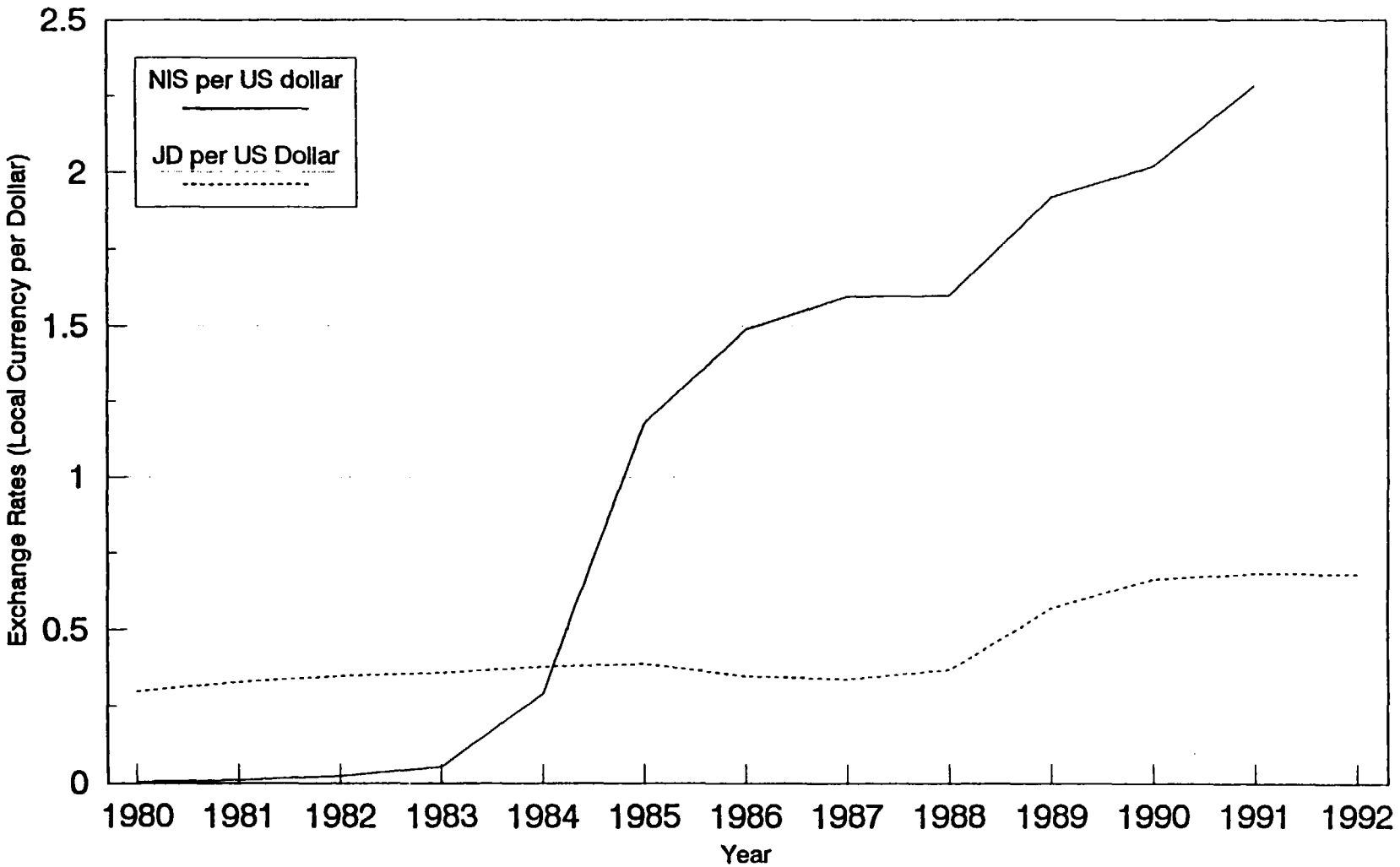
Source: National Accounts of Judea, Samaria and Gaza Area, 1968-1986
Central Bureau of Statistics,Special Series 818

Figure 15: Change in Money Balances in Occupied Territories as a Percentage of GNP (1981-1990)



Source:Calculations based on data extracted from
Statistical Abstracts of Israel, 1970-92.
Central Bureau of Statistics.

Figure 16: NIS: $US and JD: $US Exchange Rates 1980-1992



Source: International Financial Statistics, IMF, 1992.

III. STRUCTURAL POLICY CHOICES FOR THE FUTURE

3.1 In Chapter II it was argued that the past pattern of development for the Occupied Territories was conditioned by four factors: asymmetric trade relations (with Israel and the rest of the world); regulatory constraints that restricted private sector activity; fiscal compression that reduced the public provision of social and economic infrastructure; and a declining access to natural resources. Structural policy reform is about change in each of these areas. The primary focus here is on the first: on policies affecting relations with Israel and other countries. The second is discussed in detail in the private sector development report, the third in the reports on social development and economic infrastructure and the last in the report on agriculture. We briefly outline the issues covered in those reports to place them in the overall context of economic growth and development.

A. Trade Without Restrictions

3.2 If trade in the Middle East were not governed heavily by restrictions, what might the pattern look like? Would there be a major reorientation of Israeli and Occupied Territories trade? To explore potential trade patterns, a simple approach (a gravity model) was employed to explain trading patterns in terms of a few key variables: the size of economies; the economic distance between them; and other variables, such as common language. (See Annex 3 for a description of the model and empirical estimation.) Results should be treated only as indicative. The model probably does a relatively poor job of catching the consequences of very short trading distances to Israel of almost all locations in the Occupied Territories. The model does not also address the question of what happens to overall trade levels, but simply trade shares. It does not examine relative competitiveness, and it is almost entirely policy-free: the exception is that indications of the consequences of free trade areas can be given based on experience elsewhere. However, it is the only model with any success in explaining international trading flows. (It has been used, for example, to examine whether Eastern European trading patterns would be expected to be very different after the quantitative ties within Comecon were released).

3.3 The results indicate that the extent to which the Occupied Territories are oriented toward Israel in their trading patterns is way above what would have been expected from international experience. Even under a scenario that assumes a common "language" (that is interpreted here as a proxy for the persistence of the history of economic interaction) and a free trade area (for all goods), the West Bank and Gaza would only purchase 36 percent of total imports from Israel and have 20 percent of its exports, compared with 90 percent of imports and 75 percent of exports in the mid-1980s.[1] (See Table 4) As might be expected, trade with the rest of the Arab World would be expected to be proportionately much higher at 40 percent of total exports, but a rise in trade with Europe, to 15 percent of total exports, would also occur. This assumes, in effect, that Arab countries had a trade regime similar to that of other countries of similar income level.

3.4 A measure of what might have happened in the absence of the post-1967 integration with Israel is given by the share of trade assuming neither a common "language" nor a free trade area (but still a common border). International experience suggests that the share of both exports and imports with Israel

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[1] This is based on Israeli statistics that may underestimate trade that passes through Israel to the rest of the world.

Table 4: Predicted Shares of Occupied Territory Trade Under Alternative Assumptions				
	Sharing Border & "Language" & FTA with Israel		Sharing Only Common Border with Israel	
Partner	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)
Israel	36.2	20.2	2.3	1.5
Egypt	4.5	6.8	4.5	6.3
Jordan	2.2	3.9	5.8	6.4
Other Arab	10.4	28.8	18.3	36.3
Europe	16.3	15.6	26.0	18.3
North America	14.9	6.2	20.8	9.9
Other	15.5	18.5	22.3	21.3
Total	100.0	100.0	100.0	100.0

would have been a mere 2 percent under these assumptions (see the second column of Table 3.) To the extent there is an "immediate neighbor" effect, for example if such proximity avoids fixed costs of trading above a certain distance, this may understate likely trade. Yet it illustrates that trade patterns would be expected to be substantially different. Experience of other near-neighbors is mixed: The Benelux countries have 56% of their trade with non-neighbors; Singapore has 86%. The orientation toward the region is stronger, but under this scenario over 50 percent of total trade would be outside the region, with a high share with Europe.

3.5 A comparable exercise was undertaken from Israel's perspective (Table 5). The consequences of opening the Occupied Territories to trade with the Arab World extends to its effects on the Israeli economy. If Israel and the Occupied Territories stay in a common customs area, then opening the Occupied Territories borders is virtually synonymous with opening Israel's borders in the same direction. Indeed, under almost any scenario, the implications of opening the Occupied Territories borders is likely to extend to the Israeli economy. In this exercise, actual distances were used, but the assumption of a common language with other countries was not made, since there has been so little interchange in the past. The results suggest that in the absence of restrictions, Arab economies (excluding the Occupied Territories) would account for over 6 percent of Israel's exports and over 7 percent of imports, compared with zero now. This is a substantial, but hardly overwhelming, reorientation of trade. Israel would continue to be mainly oriented to developed countries, with 50 percent of exports and 70 percent of imports to or from Europe and the USA.

3.6 These results should be interpreted with caution. They represent a plausible picture of how trading patterns might look in the long term, if trade behaved as it does in other economies with similar income levels. They do, nevertheless, strongly support the intuition that Palestinian trade would be much

more diversified in the absence of historical restrictions on trade. They also suggest that the hopes (or fears) that Israeli goods would have a large impact on regional trade if the boycott were lifted are exaggerated. This is consistent with the view that Arab countries would continue to import their manufactured goods largely from more efficient developed or developing countries and shows the potentially powerful influence of free trade arrangements in fostering trade. What will actually happen is influenced by policy, to which we now turn.

B. Trade Policy Choices

3.7 The movement in labor and the trade in goods are intimately associated for the Occupied Territories. As discussed in Part A, the West Bank and Gaza exported labor in the place of goods, partly because of an asymmetric structure of incentives. This, in combination with explicit trading restrictions to some markets and the high costs of trade to others, also contributed to the extraordinarily high orientation of trade toward Israel just analyzed and to the unusually low level of production of industrial goods illustrated in Figure 6.

3.8 The illustrative vision of the *direction* of trade in goods we have just shown would most certainly be associated with a substantially higher *level* of exports of goods, lower exports of labor and shifts in the *structure* of trade. Such changes in the trading structure would also involve, over time, substantial changes in the structure of production, with most probably a relative expansion in industry in some services (notably tourism) and in some agricultural goods. (As noted in Chapter II, the share of agricultural goods in both exports and total trade was unusually low by international standards.) While

Table 5: Actual and Predicted Export and Import Shares for Israel

	Imports		Exports	
Partner	Actual Share (%)	Predicted Share (%)	Actual Share (%)	Predicted Share (%)
Egypt	0.0	3.1	0.0	1.2
Occupied Territories	2.6	2.2	9.3	4.3
Jordan	0.0	0.5	0.0	0.4
Other Arab	0.0	3.9	0.0	4.8
Europe	68.0	63.8	37.1	34.5
North America	20.5	14.5	33.1	16.2
Other	8.9	12.0	20.5	38.6
Total	100.0	100.0	100.0	100.0

it is neither possible nor particularly useful to predict the actual future composition of trade and production, it is clear that this type of reorientation is entirely in line with the strategic objective of shifting to domestic sources of economic growth.

3.9 Exploring trade options for the Occupied Territories is an activity that has a feeling of paradox. On the one hand there is a bewildering range of choices of trade options, ranging from the status quo of an incomplete customs union with Israel, to alternatives with Jordan, with or without Israel, to Free Trade Areas as variants of these, to going it alone with an independent trade and industrial policy. On the other hand, actual choices will at any point of time be highly restricted, by the political outcomes of the negotiations and (at least for now) by the costs and difficulties of having a customs border between Israel and the West Bank.

3.10 In this report we lay out a number of the alternatives that could become available in principle, and outline some of the issues associated with them. From an economic perspective, these alternatives should be evaluated with respect to four objectives:

- building on the base of the established major market of Israel;
- the aggressive pursuit of new markets (in the region and elsewhere);
- movement toward a more rational price structure than now prevails, largely imported from the Israel incentive regime, and
- the longer term impetus to growth and development.

3.11 Figure 17 presents a number of alternatives, which should be analyzed in the context of the objectives. The various alternatives focus especially on relations with Israel and relations with Jordan, as the two principal other actors for trade relations. For each, the costs, benefits and some practical issues or implications are outlined. Most could apply, in differing degrees, either under a scenario of sudden reduction of employment in Israel or smooth decline.

3.12 Scenarios (1) to (2) focus on relations with Israel within two alternative forms of preferential trading arrangement--a customs union and a free trading area. Both have the advantage of maintaining access to the dominant present market and both could in principle facilitate access to the EC, EFTA and the USA on the back of Israel's free-trade arrangements. (Access to the EC already exists for Palestinian production, but use is still low). The customs union is closest to present arrangements. It would be most advantageous if extended to include agricultural goods. It has the disadvantage of continuing to involve operating within the relatively differentiated Israeli trade regime--though this would decline if Israel keeps to its ambitious liberalization schedule.

3.13 Converting the customs union to a free trade area has the potential advantage of combining access to the Israeli market (subject, perhaps, to continued restrictions on agricultural products) whilst allowing the West Bank and Gaza to have a different trade and tax regime, as Mexico would have a different regime from the United States in NAFTA. Just as Mexico's trade regime is probably more rational than that of the United States, so the West Bank and Gaza would then be able to put in place a simpler and more uniform system of protection. The key question is whether an independent trade and tax policy is feasible.

3.14 Scenarios (3) and (4) turn to the issue of opening up to trade relations with Jordan--an issue that could be even more important, for example, if some form of confederation were chosen in a political settlement. In principle, it would be possible to either have some form of open trading arrangement (customs union or FTA) without a confederation, or a confederation without open trade--but it is likely that political and economic directions will move together.

3.15 The key issue is whether the option involves a three-way preferential trading area involving Israel, the Occupied Territories and Jordan, or one that was only two-way, and involved the Occupied Territories leaving the Israeli area. The former is potentially more economically attractive from the perspective of the Occupied Territories, since it would bring opening to Jordan without the economic costs of any loss of the Israeli market. It would involve, however, significant issues of adjustment over time. It would involve, eventually, free or near-free movement of goods between Israel and Jordan. Because of the restricted interactions between the economies, this could raise larger transitional issues for adjustment of producers in either economy. It is likely that interim arrangements would be preferred, with a transitional period maintaining economic border controls. Finally, under either option, but especially a two-way one between the Occupied Territories and Jordan, the economic attractiveness would depend on the extent to which Jordan has a rational price structure. Since this report did not assess the Jordanian trade regime or other forms of interventions, we can only raise this as an issue, without drawing any firm conclusions.

3.16 Scenarios (5) and (6) involve leaving the union with Israel and having an independent trade policy (e.g., lower tariffs to all countries). This is most in line with trade reorientation but leads to the loss of duty-free access to the Israeli market and probably increases the probability of lower access to the Israeli labor market. It again raises the practical issue of running a different tariff/tax regime. One version of this would be differential tariffs to run a proactive industrial policy, e.g., having a tariff regime that targets certain lines of activity, but other instruments, such as domestic tax/subsidy policy, are also available. The case for some activism in the West Bank and Gaza is that a push is needed after decades of adverse incentives; the potential problems are of protecting inefficient activities (particularly costly for a small, open economy) and the fiscal burden of a "favorable" tax-subsidy policy. International experience suggests that most attempts at activist industrial policy produce inefficient industries rather than dynamic industrialization - and a small, open economy with hardly any administrative tradition will be particularly ill-placed to get onto a desirable path.

Does the Incentive Regime Have to be Harmonized with Israel's?

3.17 In many of these areas there is a question of how far the Occupied Territories can have an incentive regime that is different from the one in Israel. One view is that this is impossible: the open border implies that the West Bank and Gaza would have to have the same tariff and indirect tax structure as Israel. A review of experience elsewhere (notably in the European Community where there is an ongoing debate on the issue) suggests that a border is feasible but has difficulties. First, it is feasible to have customs gates, and although there is no overwhelming practical reason why this should not be done, there may well be political reasons especially during the interim period of self-governing arrangements. Second, it is possible to have an invisible border for tax purposes, and the VAT infrastructure, which is already based on company accounts, could be used to manage this. However, it would be costly to do this for small farms. Third, direct taxes can be used as an alternative instrument for some purposes. There are, of course, limits to non-harmonization: any border, visible or invisible, is subject to a degree of leakage, and some movement will occur (as it does now in agricultural goods). This is a cost for Israel if the Occupied Territories were to have lower tax rates.

Figure 17. Alternative Options for International Economic Relations

Policy	Advantages	Disadvantages	Issues/Implications
(1) Customs union with Israel	Access to Occupied Territories's biggest market (about 90% of its imports and 70% of its exports). Potential to join Israel in its preferential access to EC, US and EFTA markets.	Trade diversion because of Israeli trade regime, buying expensive Israeli rather than cheaper ROW (at least until 1998). Israeli competition may make it harder for industries to get started, though some industries may gain from complementary production with Israeli industry.	- How to insure access to EC, US and EFTA markets. - Link with Israel could push up wages; though competitiveness of OT industry will depend more on macro and labor policies. - Potential advantage depends in part on access to Israeli agricultural market;
(2) Reconstruction of current (partial) customs union as a free trade area, with differential external tariffs.	Could, in principle, combine free trade with Israel and avoidance of areas of excessive Israeli industrial protection.	Scope for independent action will be constrained by conditions of free trade area. Administrative difficulties with respect to border controls and rules of certificates of origin.	- Requires a non-harmonized incentive regime to lead to gains over customs union. - Potential advantage depends in part on access to Israeli agricultural market;
(3) Preferential trading area (customs union or FTA) with Israel & Jordan.	Preserves access to Israel while opening to Jordan, encouraging integration with a close neighbor.	Jordanian competition could lead to short-run costs to some Palestinian producers.	- Implies free flow of goods between Israel and Jordan; convergence to CU or FTA may have to be gradual. - Need for harmonization with Jordan of direct tax/subsidy policy.

Figure 17. Alternative Options for International Economic Relations (continued)

Policy	Advantages	Disadvantages	Issues/Implications
(4) CU or FTA solely with Jordan.	Increased integration with a close neighbor.	Some loss of larger Israeli market. Possible greater loss of labor access to Israel. Especially with a CU, greater likelihood than (3) of having Jordanian incentive policies.	- Requires a non-harmonized incentive regime with Israel.
(5) Leave union; moderate tariffs with ROW.	Cheaper ROW imports, but not by much after 1998 if Israeli liberalization stays on track. Infant industries would get moderate protection from Israeli competitors.	Access to Israeli market reduced, though not by much after 1998. Possible loss of access to Israeli labor market. Industrial protection may be a cost more than a benefit.	- Requires a non-harmonized incentive regime with Israel.
(6) Industrial protection policy.	Assuming externalities, protection will help internalize them and will help the sector develop.	Possible retaliation by Israel. Possible loss of access to Israeli labor market. Temporary protection may be co-opted by interested parties and may lead to inefficient industries and wasteful rent-seeking.	- In principle industrial policy can be affected by direct taxes and subsidies, but weak administrative capability to run any industrial policy makes it problematic.

3.18 If administrative feasibility is not a constraint, how should these choices be assessed? There is no clear-cut answer, in part because it depends on what Israel and other parties may be willing to offer and, in part, because some questions still need to be answered: Does the present wage structure render the productive sectors significantly uncompetitive in world markets, or are relatively high wages offset by high productivity? Also, is there a need for a push, beyond market opening and deregulation, to initiate the growth and reorientation of the productive sectors after decades of operating under a particular set of biases?

Is There Going to be a Problem of Competitiveness?

3.19 One of the features of past development was a sharp rise in wages, especially in the early period of integration with Israel. Employment in Israel helped pull up wages within the Occupied Territories, through reducing the supply of labor to the domestic market. By 1980, wages in agriculture, industry and construction were substantially above those prevailing in 1970. (Figure 18) Wages in the West Bank and Gaza probably now fall in the upper part of the regional wage structure: below Israel's wages, but significantly above Jordanian wages, which are, in turn, much higher than Egyptian wages. Palestinian unskilled labor was exceptional in having access to the relatively high-paying Israeli market. Low-cost Egyptian labor was also highly mobile but to other Arab states, including Jordan. Palestinian industries and farmers would have to compete with cheaper labor elsewhere, if there is an opening to the regional market.

3.20 Simple wage comparisons can be highly misleading since wage costs only account for part of the cost of production (well under half for most industries), and there can be huge differences in productivity and product quality. Italian wages in garments are a multiple of wages of garment producers in Hong Kong that are, in turn, a multiple of those in Bangladesh even though all produce garments for the international market. We have insufficient information to assess whether competitiveness is a problem. Too much emphasis on studying the present situation to assess competitiveness would in any case be inappropriate since firms adjust when faced with new markets or competitors; the process of opening up would itself lead to dynamic change. However, two pieces of indirect information suggest that the West Bank and Gaza economies have not gone seriously off course.

3.21 First, there is no evidence that the Occupied Territories developed a severe Dutch Disease [2]. A key indicator is not the real wage but changes in unit labor costs--wages adjusted for the growth of labor productivity. Over the 1970-90 period, unit labor costs show, if anything, a downward trend for industry in the West Bank and Gaza and for agriculture in the West Bank and no long-run trend for agriculture is evident for Gaza (Figure 19). Rises in labor productivity (See Figure 7 in Chapter II) offset rises in wages. The only sector with evidence of a large increase is Gaza construction, which is relatively unimportant for international competitiveness. This evidence needs to be treated with some caution: in particular, it assumes that wages in the market (for which we have information) equal implicit wages in household enterprises, where a significant part of employment occurs. However, a serious adverse change would be expected to show up in the indicator constructed here.

3.22 Second, the private sector report undertook some comparisons of efficiency of production of selected industries. These were also reassuring: the price and efficiency comparisons suggest much of

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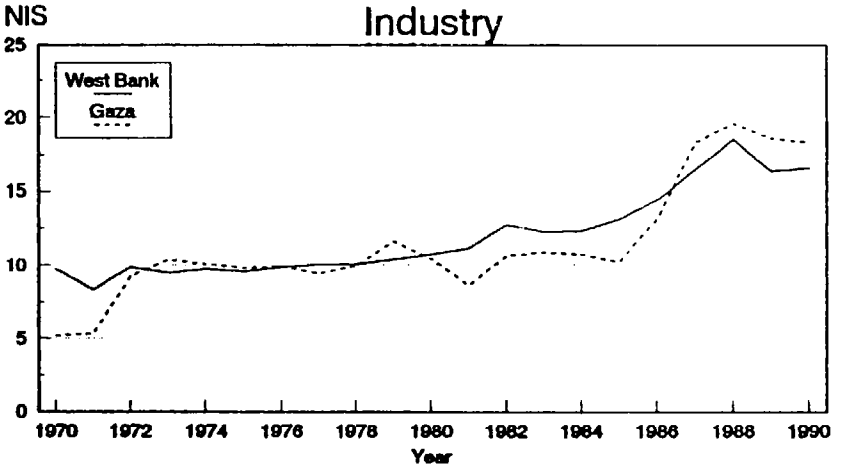
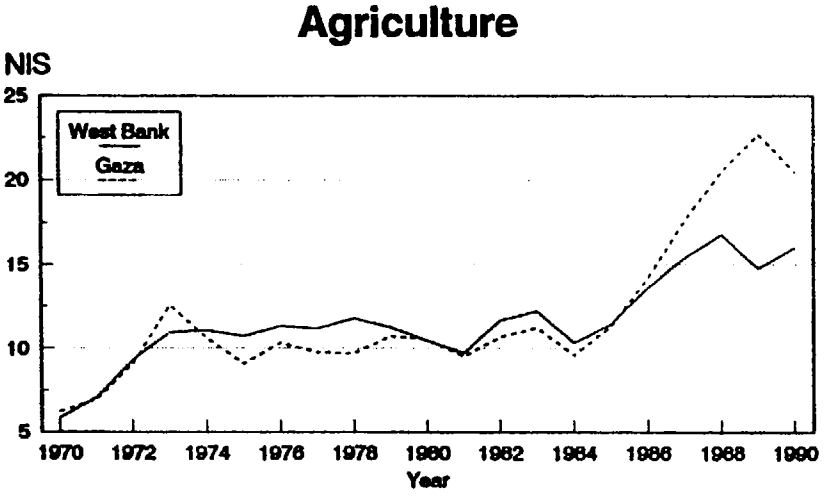
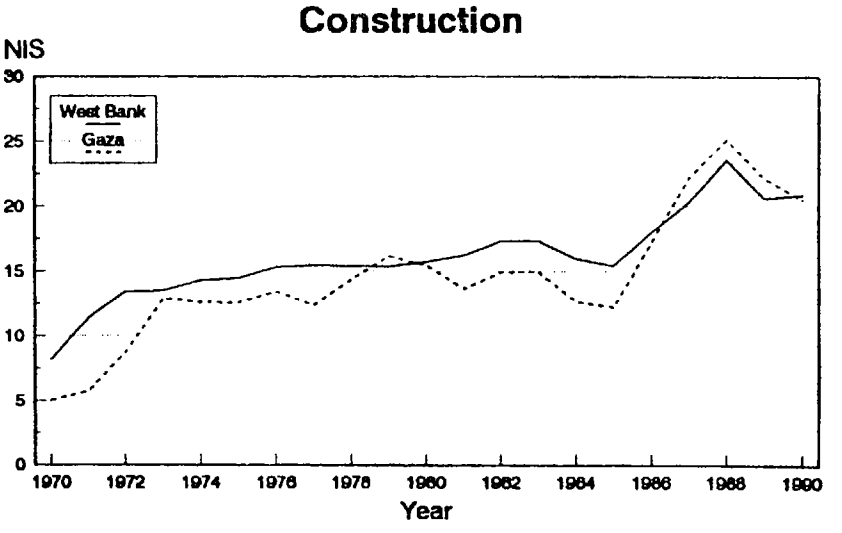
[2] Oil exporters, having enjoyed an exchange rate appreciation and real wage increases in the boom phase, are left with uncompetitive tradeable goods after the oil starts running out.

Figure 18: West Bank, Gaza Daily Average Real Wage Levels, 1970-1990 (NIS at 1986 prices) by Sector

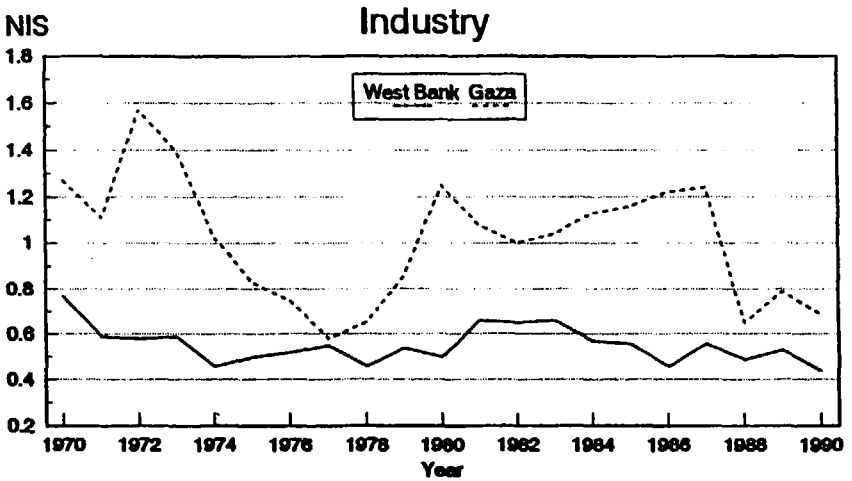


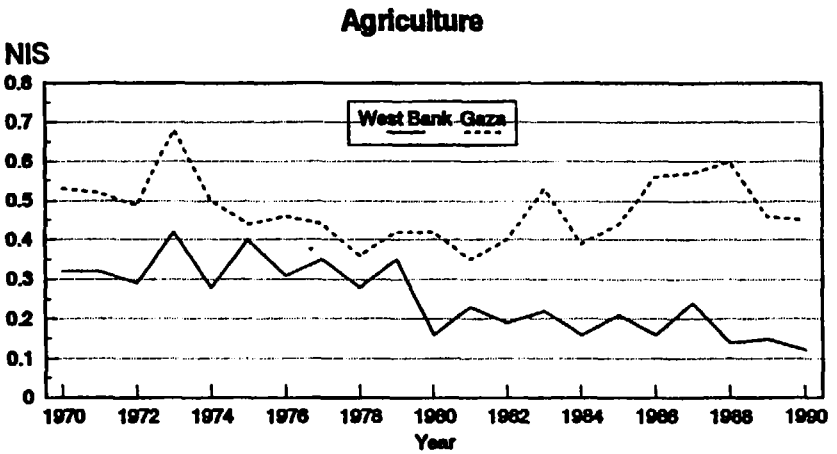


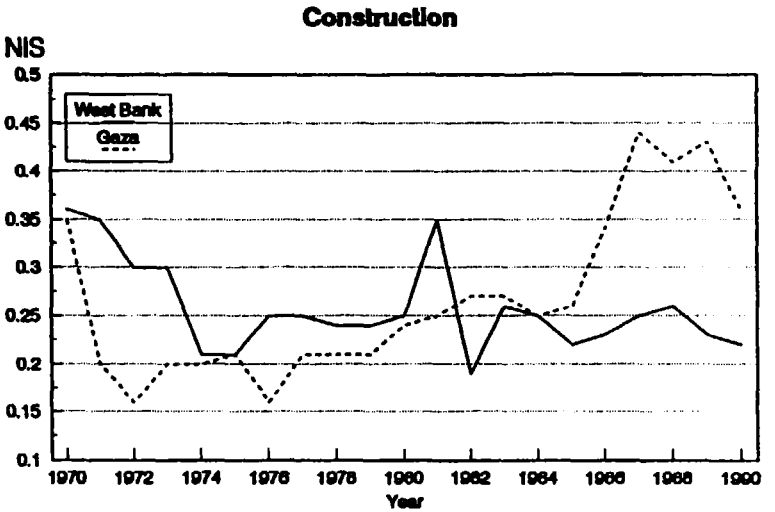


Source: Statistical Abstracts of Israel 1975-92
Central Bureau of Statistics

Figure 19: Unit Labor Costs 1970-1990, by Sector (in NIS at 1986 prices)







Source:Calculations based on constant prices wages & value Added figures.Total monthly work-days are assumed to be 20 days/month.
Statistical Abstracts of Israel,CBS.

Palestinian industry is reasonably efficient and could, in principle, compete on international markets. Questions have been raised as to whether Palestinian farmers can compete with Jordanian farmers (discussed in the agriculture report), but at this stage we have too little empirical information to form a clear view on this.

3.23 Of equal importance to the issue of current efficiency is the question of whether the economies will adjust easily or with difficulty to greater openness to non-Israeli markets. The labor market appears to be quite flexible, and firms appear to be responsive to changes in economic circumstances. This would suggest that wages would adjust and that firms and farmers would respond to changes in market conditions, increased openness to the outside world or a cutoff in labor. Flexibility may prove to be a necessary part of adjustment if the cutoff in labor is maintained (though the projections in Chapter VI suggest there could be a recovery in wages with good policy and adequate capital inflows). The extent of this flexibility has not, however, been tested in the past, and it is quite possible that the labor market will initially respond with a large rise in unemployment and a small fall in wages. In countries with an independent currency, adjustment can be facilitated by exchange rate devaluation - this may or may not be an option in the future for the West and Bank and Gaza (see Chapter V). Option (e) above is an alternative strategy for ensuring greater competitiveness through lower domestic wages, whether through taxing labor exports or allowing inflows of cheap unskilled labor. There would be distributional issues to assess: while the economy as a whole would likely benefit under either of these strategies, Palestinians with few skills may suffer relative to entrepreneurs and skilled workers. It is also recognized that even temporary inflows of labor are likely to be a politically sensitive issue for many of the parties involved.

Which Approach is Best?

3.24 In this section we have avoided a definite ranking of alternatives since too little is known and much must still be determined at the negotiating table. However, a few conclusions can be drawn. First, an appropriate overall strategy is to maximize new trading opportunities without causing significant losses in the principal market of Israel. Second, it is not clear that either the harmonization or the competitiveness issue is an overarching constraint--though a border may not be feasible in the interim period and there will remain significant administrative implications and bounds on incentive choices in the long term. Third, the extent to which it is advantageous to remain in a union or free trade area with Israel depends on two questions: (a) how far Israel will adhere to the basic principle of symmetry in such an arrangement by allowing free competition in labor-intensive activities, including both new industries and agriculture; and (b) whether Israel stays on course with its ambitious liberalization plans. Fourth, international experience raises a number of warning signs regarding the pursuit of an activist industrial policy, such as highly differentiated tariffs; broad support for exports is likely to make more sense. A free trade area (if it becomes an option), with an incentive regime somewhat more uniform than Israel's but converging together by 1998, looks an attractive option in light of these considerations. Some of the actions on the labor market may be an additional option, although this does not look to be a pressing issue now, if reduced employment in Israel is maintained.

3.25 Another possibility is to extend either the customs union or free trade area to other countries, notably Jordan, possibly Lebanon. International experience suggests this would give a substantial boost to trade with Jordan. This is desirable and may foster regional cooperation and reduce the probability of future conflict.

C. Lifting the Regulatory Burden

3.26 Changing the structure of market opportunities is essential to economic reorientation, but structural changes will not occur if the private sector does not respond. A theme of the past pattern of development, which is expanded in the companion report on private sector development - is that a range of features of the business environment have held back private entrepreneurs, especially in the medium- to large-scale sectors. These include an uncertain legal framework, restrictions on investing, uncertain tax liabilities, limited financial services and poor access to trading networks that link into the international economy.

3.27 The kinds of policies that can be changed to improve the business environment can be usefully divided into two: lifting regulatory burdens and building institutions. Lifting regulatory burdens can often be undertaken swiftly. As noted already, the Civil Administration has taken action to reduce the burden through a streamlined approval of investment permits, dropping the *de facto* difficulties in getting approval for industrial activities that compete with Israeli firms and providing tax incentives for investment. Considerable uncertainty remains, and a new self-governing authority would need to take further steps to solidify these initial moves, as discussed in the private sector development report. Building institutions, by contrast, takes time (see Vol. III). In particular, sound financial systems need to be carefully fostered. Absence of financial services will be a short-run constraint on activity. Some checking services are already being provided with apparent efficiency by money lenders, and almost everywhere in the world, equity is the primary source of finance for expansion. However, a sound banking system is of great importance to future development, to support the mobilization of household deposits and provide working capital and other financial services to an expanding business community.

D. Public Spending and the Regional Pattern of Comparative Advantage

3.28 Providing a strong basis for recovery on the supply side will also require redressing some of the shortages of public goods: for example in power, in water supply and sewerage, in industrial land and in education (perhaps especially in technical education expense). As discussed in the reports on economic and social infrastructure, this will require the rehabilitation and expansion of investments and the establishment of the institutional framework for sound sectoral policy. In the short run, action on economic infrastructure will play a vital role in removing constraints or costs to business expansion, e.g., in expanding industrial land and in making electric power, roads and water available to the business sector. This may require policy changes (e.g., on land allocation decisions) or a crash investment program.

3.29 In the medium to longer term, *both* economic infrastructure and social development are central in maintaining the historical comparative advantages of Palestinians (in skills, entrepreneurship) and in supporting the steady reorientation of comparative advantage in favor of greater interdependence. There is a parallel between infrastructure and trade. The West Bank and Gaza economies can potentially exploit their geographic and, to some extent, political position in between Israel and the major Arab states. The technical analysis of the infrastructure team suggests that for some infrastructure sectors (notably regional transport and electric power) the rational economic strategy would be to exploit this intermediary location, for example linking into power networks in Jordan and Egypt, in addition to Israel, as well as taking advantage of some peaking capacity within the West Bank. This would also tend to increase the degree of mutual interdependence amongst economies, which would increase the security of the West Bank and Gaza. For social services, Palestinians are probably ahead now in skills within the Arab world; it is important that this advantage be maintained by promoting a sensible education strategy.

E. Mobilizing taxes.

3.30 If the additional public spending to strengthen the physical and social infrastructure is to be undertaken, the question arises as to how is it going to be financed and in particular whether the domestic tax effort needs to be strengthened. As pointed out earlier, some of the taxes paid by the Palestinians currently accrue to the Israeli treasury and these need to be explicitly recognized as part of the domestic tax effort. The reason for the present leakage is that, in the absence of customs borders between the Occupied Territories and Israel, the "origin principle" of indirect taxation is applied with respect to trade between the two, whereby taxes are collected where goods are produced rather than consumed. Since the Occupied Territories have a large trade deficit with Israel, there is a net revenue loss. In the transitional period, agreement would have to be reached with Israel on how the budget of the new self-governing entity would capture these taxes. If a customs border between the Occupied Territories and Israel is both desirable and feasible, then the "destination principle" could be applied to trade between the two, and the revenues would automatically accrue to the budgets of the taxpayers. If a customs border cannot, for one reason or the other, be maintained, then agreement should be reached between the two parties on how to compensate for any tax leakage either based on company accounts or estimation of trade flows. It should be noted, however, that the availability of such revenues to the new self-governing entity is contingent on the entity having a trade deficit with Israel. If this is not the case, then alternative revenue sources would need to be mobilized.

3.31 As has been pointed out earlier, even under conditions of trade deficit with Israel and proper accounting for all taxes paid by Palestinians, the Occupied Territories economy does not appear to be overly taxed. The revenue/GDP ratio is lower than in Israel or in Jordan (and the revenue/GNP ratio much more so), both with respect to direct taxes and indirect taxes. With respect to the income tax, the personal income tax rates are higher in the Occupied Territories than in Israel or Jordan. With respect to indirect taxes, the rates for the VAT, purchase and excise taxes are the same in the Occupied Territories as in Israel, while Jordan has an independent tax structure. Depending on the trade arrangements in the interim period, there might be some scope for increasing revenues from trade taxes. Another avenue for strengthening the revenue effort is through boosting non-tax revenues (fees, charges, etc.) by instituting cost recovery mechanisms for covering the operations and maintenance costs and debt servicing associated with the new public sector investments.

3.32 The substantially lower indirect tax/GDP ratio in the Occupied Territories compared with Israel despite the general closeness of the tax structures may be partly due to the non-application of taxes to agricultural production, (which constitutes a much larger proportion of the GDP in the West Bank than in Israel), but also suggests that tax evasion might be a problem facing the Occupied Territories at the present time. There is probably an underground economy that goes untaxed, and a major challenge for the emerging self-governing entity would be to widen the tax base. This is an even bigger challenge considering that the new entity would have almost no experience in the methods of tax administration and collection as the Israeli-led Civil Administration currently undertakes this effort. In these circumstances, a critical task for the new entity would be setting up a strong system of tax administration to ensure that adequate revenues are being collected. Foreign official upflows should complement, not substitute for, domestic tax effort. Unless there is progress on the domestic front to mobilize resources for development, there will be little chance that external finance in the interim could set the Occupied Territories in a path of external dependency (and vulnerability to debt crises) and not sustainable development.

F. Natural Resources

3.33 Current Israeli policies on natural resources are being perceived by the Palestinians as key factors in determining the performance of the agricultural and to a lesser extent other sectors. However, although the use of natural resources has been constrained, agricultural growth has been considerable. Nevertheless, improved access to traditional grazing areas would allow extensive animal husbandry operations to expand beyond current levels. Increased access to water resources could allow expansion of high value, irrigated agriculture. Liberalization of constraints on fishing operations would allow increase in fisheries catch.

3.34 However, the situation with respect to natural resources cannot be separated from the broad picture involving limited natural resources. For water the riparian rights of countries, the sources of surface and ground water and various categories of users over time need to be taken into account. In the long run, absolute shortages will largely determine the costs of water, its real price, and its most effective application. Consequently water users will have to continue to maximize returns from the increasingly costly water available. While land resources are limited, land may be not be as critical a variable as water. Nevertheless, with considerable areas of land in the OT having no or only restricted Palestinian access, increased access to land would assist future economic performance. A long term vision is also needed for fish resources management; access to fish resources in international waters to OT fishermen has recently been expanded, but further relaxation of regulations, and control based on sustainable resource exploitation may be considered. Forests have a particular role to play in the fragile ecosystem of the OT, and their expansion in combination with selected forms of rain-fed agriculture could substantially assist erosion control and aquifer replenishment.

G. Conclusion

3.35 Increasing economic autonomy and self-sustaining development in the Occupied Territories means diversifying trading patterns and relations, shifting from dependence on a few external sources of growth, that are now in decline, to a broader interdependence with other parts of the region and the world. The West Bank and Gaza have potentially large advantages in their geographic location and intermediary position in the Middle East. Turning inward is clearly a non-starter for a small, open economy. The choices range from remaining predominantly linked to Israel in trading terms to severing links to Israel and turning elsewhere. An assessment of the options suggests that all have costs and benefits. However, it is likely that extreme options have high costs and, therefore, that some form of intermediate position will be both preferable and feasible. Even if the loss of substantial labor access to Israel is permanent, it makes sense to maintain trade access to the most important market (and if possible to expand this to agricultural goods). It also makes good sense to open the Occupied Territories to the region, and especially Jordan, and to the rest of the world, especially Europe. Doing this will involve tackling some of the trade policy choices laid out in this chapter for trade. If it is possible to shift from a customs union to a free trade area, this could combine the advantage of maintaining duty-free access to Israel (for most goods) with some discretion for different incentive policies. Of equal importance to the structure of economic opportunities is the urgent need to tackle some of the regulatory, legal, economic infrastructure and social development issues that are described in greater depth in the companion reports.

IV. MACROECONOMIC POLICIES FOR THE FUTURE

4.1 In this section we explore the scope and desirability of an independent macroeconomic policy in the Occupied Territories. There are several reasons why macro policy can be useful:

(a) to smooth real shocks, and avoid the nominal shocks of imported inflation and devaluation; and

(b) to obtain revenue from seignorage and the inflation tax.

In addition, the institutions generally involved in macro policy play important roles in:

(c) supervising the financial system and acting as lender of last resort,

(d) facilitating access to external borrowing by the public and private sectors.

4.2 These objectives can be carried out with diverse institutional arrangements. The choices are linked to the question of an independent currency. Some of the functions can be carried out irrespective of whether the Occupied Territories issue a domestic currency, but others necessitate the ability to issue reserve money. Still others may be achieved better in the absence of a domestic currency. In this context, we explore the usefulness and desirability of various types of monetary arrangements and compare the current currency arrangements (with the residents of the West Bank, at least, allowed a rather free choice between the Israeli Shekel, the Jordanian Dinar; and in both the West Bank and Gaza relatively easy use of other foreign currencies) and the costs and benefits of introducing a separate currency. We also explore the mechanics of independent fiscal policy and the potential for borrowing by public entities from the Israeli capital market and the international capital market.

4.3 This section examines each of the four policy objectives in turn, assessing the case for a macropolicy, alternative instruments and a separate currency. A special type of fixed exchange rate arrangement, that of a Currency Board, is then described and analyzed because of its potential interest to the Occupied Territories, especially during the transition period of self-government.

A. The Scope for Public Policy Action on the Real Side

4.4 Could the public sector smooth the shocks described in Chapter II better than households did? How would an independent stabilization policy have operated? Shedding some light on these questions will help in formulating what is feasible for the future.

4.5 Predictable variations, such as the olive cycle, are generally smoothed effectively by households and firms. However, it is important to note first the limits of household adjustment to shocks. National accounts data suggest that households have high savings rates, diversification of migrants also diversifies risks, and that there are probably extensive inter-household transfers, especially within extended families. However, these mechanisms have costs: the carrying of large inventories of liquid foreign assets is costly in efficiency terms since these are resources that could have been invested productively instead; and the migration of household members leads to the dislocations of families and to hardship. More fundamentally, such mechanisms break down precisely when they are needed most, when there are widespread coincident and permanent shocks--i.e., shocks that hit large numbers of households (such as the collapse of the Israeli and Gulf labor markets).

4.6 In retrospect, government intervention could have taken many useful forms, even in the absence of an independent monetary policy. Aggregate but temporary shocks, such as those affecting grants to Non-Governmental Organizations (NGOs), could have been smoothed with fiscal policy had a government been able to borrow abroad (especially since local residents did not have access to external credit). The negative effects of the new Israeli Shekel and Jordanian Dinar devaluations could have been moderated with a more sophisticated financial system that allowed for more diversified portfolios (and reduced the need for large money balances). The recent Gulf shock would have required the increased provision of social services, as well as measures to encourage the productive employment of accumulated savings (as happened in Jordan, for example, and, to a much lesser extent, in Yemen). However, in each of these cases, the goals of stabilization could have been achieved by other means than an independent currency.

4.7 Let us compare now how effective an independent monetary policy would be if it could be used as a stabilization tool. In general, monetary policy can be useful in maintaining a stable price level and stabilizing the business cycle. In the context of the Occupied Territories, monetary policy has potentially three specific roles to play: (i) helping to get activity going by lowering domestic interest rates; (ii) facilitating adjustment to a negative shock by lowering real wages (through devaluation); and (iii) defending against appreciation of the currency in the case of large capital inflows. Note at the outset that the time span and effectiveness of monetary policy in controlling prices is directly related to the existence of adjustment costs on the part of these factors. But monetary policy is unable to achieve any of these goals for prolonged periods in an environment of free factor mobility (in particular, capital and labor mobility). With these principles in mind, we explore the feasibility of each of these goals in turn.

Interest Rates and Domestic Activity

4.8 Under perfect capital mobility, attempts to lower local interest rates will result in capital outflows rather than in the availability of cheaper domestic credit. While capital mobility can be restrained with capital controls, this is almost certainly neither feasible nor desirable for the Occupied Territories, given the accumulated know-how of financial operators used to moving money in between the West Bank, Gaza, Jordan, Israel and many other parts of the region and world. Thus, unless economic integration within the region and the rest of the world is sharply reduced, and capital controls imposed and enforced, the potential of monetary policy to affect local interest rates is likely to remain low.

Wages

4.9 With perfect labor mobility, unexpected inflation would not lead to permanent changes in real wages, since labor would move until wages equalized. Thus, with an open labor market characterized by small adjustment costs, exchange rate policy could only be independent in the short run. However, as argued in Annex 1, it appears to be more accurate to characterize the labor market in the West Bank and Gaza as operating with a different wage-setting regime than in Israel, with rationing of employment opportunities in Israel. This is clearly the case if the March 1993 restrictions are maintained. It is difficult to assess how flexible the domestic labor market is: the general impression is of a high degree of flexibility, but this has not been proven through significant real (let alone nominal) wage declines in the past. Devaluation can be a useful tool in speeding adjustment in the case of large shock to the labor market (as happens with a large increase in the labor supply, whether from reduced employment in Israel or returnees, either of which could require a sizable wage drop to equilibrate the labor market).

The Scope for Sterilization

4.10 Typically, large inflows of resources into a country (i.e., a large current account deficit) lead to an increase in the prices of non-tradables relative to those of tradable goods (i.e, to a real appreciation of the real exchange rate). Land prices in particular are likely to rise (they already fluctuate widely with the ups and down of the peace process). The phenomena can occur even in the absence of a domestic currency. Sterilization's aim is then to delay real investment, if the economy is perceived to be overheating, or to neutralize it if it is perceived to be speculative and temporary.

4.11 In particular, one can easily imagine a perverse post-peace scenario where excessive optimism leads initially to a boom in land prices, which then deters real investment and industrialization, ultimately leading to a collapse in prices and a sharp contraction in business activity. Another possibility is that wages would rise too fast and get stuck at a too high real level, reducing the competitiveness of production.

4.12 Given the potential size of the inflows relative to the size of the economy and the adjustments required on the real side before the capacity of the Occupied Territories to absorb investment rises, intervention can be useful. Large speculative flows are not unusual in the region, given the very large amounts of capital accumulated abroad by residents. For example, about $2 billion rushed into Lebanese pound denominated assets during the two weeks after the appointment of a new government in 1992. Larger amounts entered Egypt in 1991 when the capital markets were liberalized and debt relief granted. In both cases, sterilization was helpful in preventing a sharp appreciation in the exchange rate.

4.13 Sterilization, however, is useful only when the public sector possesses an information advantage over the private sector. In addition, sterilization cannot permanently keep asset prices below their long-term level because the fiscal costs of doing so soon become excessive. Finally, delaying tactics would be very expensive when capital is very mobile, which is likely to be the case for the Occupied Territories.

4.14 Two possible strategies can be followed to stabilize inflows without inordinate costs, neither of which requires the existence of a domestic currency.

(a) Intervention can be targeted to the appreciating asset, rather than conducted at the macro level. This can be done by taxing destination investments of short-term capital flows while, at the same time, encouraging long term investment. For example, land sales can be taxed, but real investment can receive tax credits. This would reduce the likelihood of sudden reversals of capital flows.

(b) Compensating action can be taken elsewhere to prevent rapid growth in the relative prices of particular assets. For example, land can be made more abundant through relaxing supply-side restrictions, or labor can be made more abundant if there is a higher return of Palestinian labor, now working in Israel or elsewhere.

4.15 The possibility exists that the gains in monetary independence to help manage shocks would be dwarfed by the new sources of instability related to discretionary monetary policy. For macro policy to be successfully independent, it requires independent credibility, and there is the potential for a significant trade-off with discipline. With so much uncertainty about the ultimate future of the Occupied Territories, and so little domestic expertise in governmental aspects of finance, it is difficult to imagine a Palestinian

currency solidifying quickly without drastic limits on monetary discretion. Even if the authorities were willing to exercise discretion wisely, they could find it enormously difficult to gain public confidence in the crucial initial period at a time when reconstruction needs are enormous. More likely, investors would demand a hefty risk premium. At the same time, financial stability and capital inflows will be crucial to ensure rapid growth since most Palestinian savings are presently abroad.

B. The Potential for Seignorage Revenues

4.16 Seignorage revenue is revenue that can be raised by the ability of government to issue high-powered money. Money issued is also a liability of the central bank, and, as such, it is not truly a source of revenue since operators can decide to reduce their monetary holdings. Nevertheless, in a stable monetary environment, seignorage can generate a stable cash-flow to the central bank. In addition, reserves generally do not earn interest, and, thus the foregone interest on reserves is a true source of revenue to the central bank (which in effect pays for the liquidity service that is provided by demand deposits accounts, which are themselves backed by reserves deposited at the central bank). Finally, inflation acts as a tax on nominal balances by eroding their real value, and this can be considered a true source of revenue (subject to the usual Laffer curve effects).

4.17 In order not to be purely inflationary, the nominal supply of money must be desired as real balances in portfolios. In general, the real demand for money (currency in circulation and sight deposits, or M1) depends on a multitude of factors. It usually drops during inflationary periods, when real interest rates are high, and with innovations in the financial system because the alternative return on resources is then higher. To the extent that the economy grows, real money balances can also be expected to grow, allowing for the issuance of additional high-powered money. Real balances typically get depleted in periods of inflation and then rise when there is credible disinflation, as agents replenish their balances back to their desired levels. The international experience suggests that seignorage is a small, but not insignificant, source of public sector revenue (1 percent on average for the OECD countries and 2 percent on average for developing economies).

4.18 Table 6 summarizes the main aggregates for Israel, Jordan, Egypt and Lebanon. Clearly, the experience with inflation, the extent of financial repression and the sophistication of the financial system have affected money supply differently in these countries. However, seignorage has been an important source of finance in the region, especially in years of high inflation (or devaluations). This is not unrelated to the fact that devaluations, when they occur, come in a large burst, rather than slowly and over time. As a result, they have often taken agents by surprise. In Lebanon, monetary revenues have been sometimes low when large devaluations took place (as in 1987) but not always (e.g., 1992). In Israel, seignorage was significant only in 1985 when the success of a sharp stabilization convinced agents to rebuild their balances.

4.19 A second observation is that real monetary holdings (M1/GDP) tend to shrink after periods of inflation. This is clearest in Israel and Lebanon, two countries that have experienced periods of high inflation and that have a sophisticated financial system. For example, M1/GDP increased by 70 percent in Israel between 1985, when inflation was at its height, and 1992. In Lebanon, M1/GDP more than tripled between 1987 and 1989 (there was a large devaluation in 1987), and it went down in 1990 and 1992, two years in which the pound depreciated markedly. Such a phenomenon can be also observed in Egypt (e.g., in 1987) although there also seems to be a secular reduction in the money ratio. This is most likely related to the development of the financial system and the increased availability of saving

deposit accounts paying positive real interest rates. Somewhat surprisingly, however, the money ratio has remained high and has even increased in Jordan after its large devaluations of 1988-89.

4.20 What do these observations imply for seignorage as a potential source of revenue for the Occupied Territories? Assume that M1 stabilizes at 20 percent of GDP in the Occupied Territories (somewhere between the corrected Jordanian figures and the Lebanese figure). This represents the upper bound of the one-shot revenue that can be collected by the central bank. At the same time, such a build-up of domestic currency balances is unlikely to occur immediately in the absence of substantial foreign exchange reserve holdings by the central bank to back the domestic currency. The presence of foreign exchange reserves will reduce seignorage revenues by their amount, minus the interest earned on these reserves. On the other hand, in the absence of large foreign exchange reserves, it is unlikely that domestic money holdings will be very large until the central bank and the treasury build some track record, and money demand would remain low in the short term, reducing seignorage revenues. Overall, it is unlikely that the one-shot stock-related revenue can be very large, even under favorable conditions. Assuming conservatively that all of the reserves are backed by foreign exchange, and that the international interest rates average 6 percent, the overall stock effect is reduced to about 1.2 percent of GDP.

4.21 Seignorage revenues may be a more important source of revenue over time as the economy expands and the real demand for money grows. In particular, in a growing economy, the public sector can obtain seignorage without creating inflation. For example, with a growth rate of 5 percent a year and an inflation rate of 10 percent on average, the flow revenue would be 3 percent of GDP with zero foreign exchange reserve backup. In the presence of foreign exchange backup, smaller growth, or lower inflation, the flow revenue would be smaller. Of course, additional revenues may be collected temporarily if inflation increases unexpectedly, but this would tend to reduce the future ability to collect seignorage.

C. Facilitating the Mobilization of Resources

Domestic Borrowings

4.22 The absence of a domestic currency does not prevent the raising of funds by the public sector. In fact, it may even reinforce the ability of the public sector to borrow domestically since this is then accompanied by a commitment not to inflate these claims away. The other side of the coin, however, is that inflation can be a useful and flexible tool to tax money holders and to default partially on domestic public borrowing following negative shocks. The alternative, an outright default on obligations denominated in a foreign currency, can be more costly in terms of penalties. The example of Lebanon is instructive in this respect. During a prolonged period where government control and revenues collapsed (1980-90), the state was able to finance parts of its activity on the domestic market and without major recourse to external debt. Large inflation ultimately eroded these debts substantially. While such behavior should not to be encouraged on an ex-ante basis (domestic finance would dry up), in retrospect this added flexibility has allowed the government to deal with a difficult situation. Monetization does come at a cost--it reduces money demand and leads to high risk premia on government securities. Such costs can be minimized if inflation is kept low in normal circumstances and inflationary episodes only occur in periods of unusual strain.

Table 6: Seignorage in the Middle East

Monetary Developments in the Region: 83-92

	1983	1985	1987	1988	1989	1990	1991	1992
Israel								
M1-FXD/GDP	4.4%	3.7%	5.9%	5.4%	6.9%	6.8%	6.9%	6.9%
Cur./GDP	1.6%	1.7%	2.4%	2.4%	2.6%	2.7%	2.5%	2.5%
Inflation	120.0%	305.0%	20.3%	15.7%	20.4%	17.3%	11.8%	11.8%
Devaluation	219.9%	134.8%	4.1%	9.1%	16.7%	4.1%	16.0%	16.0%
Monetary revenues	2.1%	6.7%	2.2%	-1.4%	0.7%	0.5%	1.2%	1.2%
Jordan								
M1/GDP	61.1%	53.9%	45.9%	52.2%	54.2%	54.4%	58.7%	55.0%
Cur./GDP	36.3%	33.8%	30.7%	36.3%	36.2%	38.4%	35.4%	32.9%
Inflation	5.2%	3.2%	-0.2%	6.6%	25.8%	16.1%	8.2%	2.9%
Devaluation	-3.9%	10.2%	4.5%	-31.0%	-26.3%	-2.6%	-1.3%	-2.7%
Monetary revenues	4.7%	1.6%	2.3%	7.1%	7.2%	5.5%	13.4%	-1.7%
Lebanon								
M1/GDP	75.9%	n.a	4.3%	9.6%	15.4%	14.1%	19.1%	15.2%
Cur./GDP	41.4%	n.a	2.5%	6.1%	10.3%	10.4%	13.4%	10.1%
Devaluation	44.7%	n.a	423.0%	15.5%	-4.7%	66.7%	4.4%	109.1%
GDP in dollars	310.0%	n.a	350.0%	360.0%	370.0%	380.0%	410.0%	430.0%
Monetary revenues	8.4%	n.a	2.0%	2.0%	7.3%	5.5%	8.1%	9.1%
Egypt								
M1/GDP	44.1%	43.0%	29.3%	33.6%	31.2%	29.9%	25.8%	22.6%
Cur./GDP	25.8%	24.0%	15.3%	17.0%	15.2%	14.1%	12.2%	11.2%
Inflation	16.7%	13.4%	19.4%	17.6%	21.3%	17.1%	19.8%	13.5%
Devaluation	0.0%	-41.7%	0.0%	0.0%	57.1%	81.8%	65.0%	0.0%
Monetary revenues	10.5%	6.7%	1.8%	1.1%	2.2%	7.0%	4.7%	2.5%

Borrowing Abroad

4.23 The ability of the public sector to borrow abroad is ultimately determined by its ability to tax in the future: the ability of the private sector to borrow externally is determined by the financial credibility of private firms and the credibility of the government in guaranteeing that it will neither interfere with external loan payments not expropriate private property. Neither for the public nor private sector is external borrowing necessarily linked to a separate currency. There are, however, two sets of issues to be considered: the external borrowing strategy and relations with Israel and Jordan.

Financial Strategy

4.24 In terms of instruments for attracting foreign inflows, it is likely that the public sector will initially tend to be strongly oriented toward bilateral and multilateral borrowings; the private sector will probably favor foreign banks (especially for trade credit) and direct foreign investment. There is almost certainly a case for central management and rationing for public borrowings--which should be conducted with careful attention to debt servicing implications, especially in the initial years when debt burdens are very low and some borrowing agencies (e.g., public utilities) are financially inexperienced. For the

private sector, central management and rationing is probably neither desirable nor feasible. It will also be important to prepare for borrowings and explore new instruments as new governments (e.g., Zimbabwe in 1980) have been disappointed at how commitments, especially from official sources, fail to turn quickly into disbursements and have been puzzled at the lengthy procedures of different agencies. Moreover, alternative instruments, such as Palestinian bonds targeted at the Palestinian diaspora, could prove a useful means of mobilizing foreign resources.

Relations with Israel and Jordan

4.25 If the future economy does not have a separate currency, trading relations with Israel (and possibly Jordan) would be facilitated, but relations with the Israeli and Jordanian monetary authorities would be complicated. If the West Bank and Gaza enter in a trading agreement with Israel, Jordan, or both, the absence of an independent currency will make it more difficult to impose sudden trade restrictions with these countries. The private production of goods for these markets will be enhanced since the expectation of a trade breakdown is minimized. Although public and private sector entities will be borrowing NIS and JD, Israeli and Jordanian monetary authorities need not be concerned about monitoring and restricting lending to agents in the Occupied Territories. The market is not going to be unduly eager to lend to future entities in the West Bank and Gaza: if anything, the opposite is true now. Such concerns as might arise can be dealt with through standard instruments of financial management (e.g. the risk classification of assets in the West Bank and Gaza).

4.26 The lack of a domestic currency may, however, restrict external borrowing for other reasons. Large capital flows and fast growth in the Occupied Territories are bound to affect the Israeli and Jordanian economies. However, growth is directly related to future developments on the real side, rather than on the monetary side--and will occur irrespective of the existing monetary arrangements. Presently, while the relative size of the economy of the Occupied Territories is much higher in relation to Jordan than in relation to Israel, it has sizable trading relations with Israel and not with Jordan. If a large boom was to occur now, both the Jordanian and Israeli economies would not be seriously affected. However, if trade relations with Jordan expanded significantly, a boom in the Occupied Territories would certainly have an impact in Jordan; if present trade relations with Israel were to continue, but the capital inflow was very large (say $500 million a year over current flows), then some aggregate effects would also be felt in Israel.

4.27 Dutch disease type problems--if important--may prompt the Israeli and/or Jordanian authorities to intervene in an attempt to prevent their economy from overheating. If the Occupied Territories were part of the same currency union, it would be directly affected by such (sterilization) operations since the cost of funds would rise. In addition, the leverage exercised by the controlling monetary authorities, especially if they were also to regulate domestic banks, could also directly affect the Occupied Territories. For example, Israel or Jordan may want to impose restrictions on external transactions of entities in exchange for allowing the West Bank and Gaza to use its own currency. A related issue concerning borrowing abroad by the West Bank and Gaza is that it may increase the country risk of the country that is perceived to be the ultimate backer of these credits. In the presence of a quid pro quo, the only credible way for Jordan or Israel to commit not to intervene in the case of a failure to repay may well be the existence of a Palestinian independent currency.

D. Provision of Liquidity and Supervision

4.28 It is often assumed that providing liquidity and supervising a financial system require an independent central bank. In fact, these functions can be carried out, to some extent, irrespective of the type of monetary arrangement chosen. Regulators can be empowered with the supervision of the financial sector, even in the absence of a domestic currency. Supervision would include ensuring that financial operators investing the resources of the public had a sufficient stake in the success of the operations they undertook (imposing reserve requirements and capital adequacy requirements) and ensuring the smooth functioning of a bankruptcy system.

4.29 Temporary assistance to a troubled institution can be in the form of foreign exchange. This can be provided by some large financial institution (domestic or foreign), by a regulatory body that can borrow on the domestic and international markets and use part of the reserves levied on foreign exchange accounts, or directly by the treasury. The problem, however, is that foreign borrowers would be unwilling to lend when country risk was perceived to be too great. An international credit crunch could arise, for example, if the political situation deteriorates or if external debt became too high. In such circumstances, it would be very difficult for a government to play the role of a lender of last resort if access to money creation was not available because of the small size of the domestic financial market. These difficulties would be exacerbated if the liquidity crisis was due to an aggregate shock that hit large segments of the economy, as for example would occur in the midst of political upheaval. On the other hand, since most banks would be new, they would probably be well capitalized. This makes the role of lender of last resort initially less crucial, but the need for good supervision more so. In addition, if private inflows of capital came in a boom, it would be imperative to tighten the banking regulatory framework and prudential regulation in order to reduce the risks associated with excessive liquidity, such as increased leverage by firms and increased risk-taking by banks.

4.30 The Jordanian or Israeli monetary authorities could also assume the lender-of-last-resort function. In this case, they would likely also want to supervise the financial system. Clearly, a commitment from these institutions to play such a role could go a long way in preventing bank runs on and, thus, the emergence of liquidity crises. The question, however, is whether these institutions would feel compelled to play this role in case of a financial crisis in the Occupied Territories, and whether the markets would take seriously their commitment to do so. The role of lender-of-last-resort comes at a cost. The dividing line between illiquidity and solvency is often blurred, and, while a domestic agency may want to take risks in the short term in order to save institutions that may turn out to be solvent once an in-depth analysis of their balance sheet is conducted, an external agency may prefer to allow failure more often. This may be good from a disciplinary point of view, but it can also lead to unnecessary financial instability. In addition, political considerations may complicate this relation further. Finally, the Jordanian or Israeli monetary authorities may simply refuse to play this role in order to reduce their potential liabilities.

E. Speculating on the Choice of an Exchange Rate Regime

4.31 The current exchange system with a free choice between currencies has its merits, especially if the financial system is allowed to develop. With the good information flows and financial knowhow that a sophisticated financial system provides, such a liberal environment could be an important factor in attracting the private capital accumulated abroad by the Palestinian diaspora. We have seen that in each of the four areas--smoothing shocks, securing seignorage, facilitating borrowing and supervising the

financial system--a separate currency may be useful, but it is not essential. Figure 20 summarizes the discussion.

Figure 20: Macro Policy With and Without and Independent Currency

Policy Area	With an Independent Currency	Without an Independent Currency
Enhancing Capital Inflows	Issue domestic and foreign debt without interference by other governments; can raise some (initially limited) revenues through seignorage.	Greater commitment to fiscal discipline because deficits cannot be monetized.
Managing Capital Flows	Can sterilize flows which may be useful in the short term if the government has an informational advantage over the private sector.	Structural policy can achieve similar results in a more substantial way.
Dealing with Shocks	Useful in the short term to reduce real wages when nominal wages are rigid, or to default partially on domestic government debts if creditworthiness is eroded.	Can use fiscal policy only.
Enhancing Trade	Policy of devaluation can improve competitiveness.	Greater commitment to remain in common trade area, which increases private incentives for long-term investments in the production of goods in demand in trading bloc partners.
Regulating the Financial System	Role of lender of last resort improved.	May have to abandon the supervision role to Israeli or Jordanian authorities.

4.32 The introduction of a domestic currency in the Occupied Territories may still become desirable, or even necessary, in the future. The question then is what type of exchange rate arrangement to choose. The pros and cons of different regimes are summarized in Figure 21 and discussed below. We also discuss the important issue of implications for Jordan and Israel. A system of freely floating exchange rates is unwarranted in the short and medium term, unless no reserves can be found to back the new currency. And if such a situation arose, the advantages of creating a separate currency would be severely undermined. A freely floating exchange rate would generate large uncertainties given the volatile

environment and the smallness and unsophisticated nature of the financial market. The recent example of Bulgaria is instructive in this respect. The market-determined exchange rate devaluation overshot, because of the inability of the country to provide sufficient backing to their currency. This can be related to self-fulfilling prophesies about reversal in the current account or capital account convertibility. In contrast, the exchange rate in Poland, where a sizable stabilization fund was put in place with the assistance of the international community, was more stable. This stability helped fuel prolonged export expansion and served as a useful nominal anchor to combat inflation.

4.33 We are, thus, led to examine the choice of a pegged exchange rate, which can be fixed with respect to a basket of currencies at reasonable levels that can be defended. Such a system would need to be backed by a stabilization fund. Within the family of pegged exchange rates, a Currency Board may be an interesting option for the Occupied Territories, at least as a transitory arrangement, for several reasons: (i) it is easy to manage and can be established very quickly; (ii) as long as it remains in operation, it forces financial discipline; (iii) while discretionary monetary policy becomes impossible, its scope is limited, in any case, given the circumstances of the Occupied Territories; (iv) it allows for some seignorage; and (v) it can evolve towards a more flexible system as the economy matures and the financial system grows.

Currency Boards

4.34 Currency Boards, once a common arrangement, are being considered again (Hong Kong and Singapore have had a board for some time; Estonia's is less than a year old). Under a Currency Board arrangement, the monetary institution agrees to supply or redeem local currency bank notes (and possibly, reserve deposits of commercial banks held at the Currency Board) for another currency at an established exchange rate and without limitation. Moreover, the Currency Board will exchange local currency at no other terms (such as against local claims on other institutions).

4.35 A Currency Board is easy to administer. In a sense, the foreign reserves become the domestic currency, but the Currency Board intercepts the seignorage and retains flexibility for a future change in the exchange rate or the expansion into a full-fledged central bank. However, for a Currency Board to work, the government must relinquish its discretionary right to print money, and the banking system must retain adequate reserves of foreign exchange assets. This is not too costly since the initial reserves of new banks are bound to come largely from abroad (or to be in the form of foreign exchange). The sacrificed exchange rate flexibility, a useful first defense mechanism against unexpected shocks, is likely to pale next to the potential loss implied by a weak and volatile currency.

4.36 The decision to set up a Currency Board involves four main issues:

(i) What liabilities to back, only bank notes, or more? In Hong Kong, the Currency Board has no role in commercial bank clearing operations. In contrast, the coverage extends to reserve deposits in Estonia where such deposits, being the liability of the Bank of Estonia and interchangeable with cash, have to be backed in the same way as cash. In the Occupied Territories, while it may not be necessary for a Currency Board to develop a system of interbank clearing immediately, reserve requirements for new banks are likely to be necessary, and, thus, deposits with the Currency Board should also be backed. But this is not necessary. In Singapore, for example, a separate monetary agency has been set up alongside the Currency Board to monitor commercial banks and provide a discount window (it does not, however, engage in open market operations).

(ii) How much backing to provide? To instill confidence that it can honor its pledge of convertibility, the Currency Board should start with sufficient foreign exchange reserves to back a significant portion of the liabilities at the relevant exchange rate.[1]

(iii) What to back with and peg to? This will depend mostly on prospective trading relationships. In principle, the exchange rate could be adjusted, but this rarely occurs under the stricter Currency Board. Once the certainty of the exchange rate is removed, the integrity of the exchange rate would be compromised. Thus, domestic interest rates would rise above the international rates to include a devaluation-related risk premium. In Singapore, the Currency Board retains the authority to appreciate but not to depreciate.

(iv) Who can have access to the board? In Hong Kong only banks with note-issuing authority can convert cash into foreign exchange. Individuals and enterprises must rely on a competitive banking system to ensure equivalent rates. In the Occupied Territories, the system would probably have to be open to all until the banking sector developed sufficiently (as in Estonia).

Implications for Jordan and Israel

4.37 The introduction of a currency would be an issue of concern for both Jordan and Israel, given the substantial holdings of Jordanian Dinars and Shekels by Palestinians. If a new currency were introduced, Palestinians would purchase it in exchange for the two existing currencies, and a new monetary authority or currency board would acquire potentially large quantities of JDs and Shekels. These could, in principle, be used to back the Palestinian currency, but they would probably be way in excess of the amounts that it would make sense to hold as foreign exchange: the monetary authority would undoubtedly prefer to hold a high proportion of currencies of OECD countries. Yet if these were redeemed automatically for foreign exchange by the Jordanian and Israeli monetary authorities it would be a shock to both monetary and foreign exchange management--and potentially a large shock for Jordan, given the estimated size of Palestinian holdings of JDs relatively to both total money and foreign exchange holdings in Jordan. The phasing and terms of any such large-scale conversion would have to be worked out in the context of any currency reform. The international community may also have a role to play.

Other Implications

4.38 Supervision of the financial system. Currency Boards can vary from relatively pure systems (as in Hong Kong), where there is no central bank, to more hybrid schemes that retain some limited central bank functions. However, the two functions must be clearly delineated.[2] To maintain the integrity of

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[1] The Hong Kong and Estonia systems started with 100 percent backing; Argentina backs only the new issues of high-powered money.

[2] For example, the Bank of Estonia was divided into two departments: the issue department, which operates the CB and a banking department, which represent the policy side of the CB (but which cannot lend more than its own reserves in order not to compromise the CB). The seignorage earned by the issue department (as interest on reserves) is transferred to the banking department.

Figure 21: Choice of an Exchange Rate Regime			
Exchange Rate Regime	**Advantage**	**Disadvantage**	**Examples**
Currency Union	Fiscal discipline enhanced; encourages capital inflows and investments; and reduces risk premia on government issued debt.	Risk associated with active monetary policies of other countries where shocks may be unrelated to policy needs at home; inability to conduct independent monetary policy.	Panama uses the US dollar. Members of the CFA zone pegged to the French franc. This contributed to greater stability until the 1980s when the appreciation of the French Franc with respect to the dollar contributed to a sharp reduction in competitiveness.
Free Floating	Reflects short-run scarcities best.	Leads to high exchange rate instability in the absence of a well-developed financial system.	Bulgaria, Latvia.
Pegged to Basket	Enhances the stability of the economy in the face of speculative attacks and short-term instability.	Needs the backing of a stabilization fund; lads to inefficient resource allocation if a "wrong" peg is used.	Poland.
Currency Board	Fiscal discipline is enhanced, encouraging capital inflows and investments and reducing risk premia on government issued debt.	Precludes the use of monetary policy.	Hong Kong, Singapore, Estonia.

the Currency Board, it must be prevented from general discretionary lending. Occasional intervention to offset exceptional fluctuations in liquidity or to provide temporary assistance to a bank are feasible if confined to those resources available to the authorities (and in excess of the requirement of the Currency Board). The difficulty in influencing interest rates also limits the ability of the authorities as guarantors of the banking system. Any assistance to weak banks must be confined to the amount of excess foreign reserves. In a sense, this becomes a fiscal responsibility.

4.39 Growth. As the economy grows, so would the demand for real balances. This does not mean, however, that a current account surplus must be achieved to increase domestic liquidity, since liquidity can be supplied through the capital account as well as the current account. For Hong Kong, one of the principal financial centers of the Pacific, capital is very mobile, and the economy is always assured sufficient liquidity by the international capital market. For the Occupied Territories, such conditions are also expected to prevail, at least until a large external debt is accumulated and creditworthiness deteriorates. In Estonia, to take another extreme case, capital is not at all mobile. This implies a severe financial squeeze as the price level is forced to adjust to the note issue, rather than the other way around.[3]

4.40 Monetary Policy. A Currency Board can be viewed as a pegged exchange rate where open market operations are prohibited. One of the basic conditions of a Currency Board is that it cannot lend to the government. If this were to happen, the Currency Board would find its liabilities backed by domestic claims, which would undermine the viability of the peg. This deprives the authorities of any meaningful ability to sterilize foreign exchange flows and, thus, inflation and interest rates (although the system could evolve over time and become more flexible).

4.41 Administrative Price Controls. Control through administrative action is also ruled out under a Currency Board arrangement. Any attempt by the government to control interest rates would quickly lead to the collapse of the system. If interest rates are too low, for example, banks would be subject to excess withdrawal, leading eventually to their collapse.

F. Conclusion

4.42 We have surveyed a range of areas where independent policy action at a macroeconomic level could be desirable and have structured the analysis over when this might require an independent currency. The results can be summarized as follows:

- In some areas, the pursuit of an independent macroeconomic policy is likely to be fruitless, e.g., attempts to have independent interest rates, given the degree of capital mobility.

- In other areas independent policy is desirable, and is commonly associated with a separate currency, but such a link is by no means necessary, e.g., managing "excessive" capital inflows, borrowing at home and abroad and supervising/providing liquidity to banks.

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[3] However, it is important to note that it is only the growth of base money that is restricted under a CB; since cash is only one component of the money supply, a decline in the ratio of cash to money ratio would allow money to increase via the money multiplier.

- Seignorage is traditionally large in the region, but it is unlikely to be so for the West Bank and Gaza (especially initially) because of the likely initial low level of credibility of a new currency and the high capital mobility.

- There are areas for which a domestic currency is necessary, e.g., avoiding imported nominal shocks from other members of a currency union, facilitating real wage declines and, under extraordinary circumstances, defaulting.

- If a currency were introduced, there would need to be attention to the impact on Jordan and Israel; special arrangements may need to be worked out.

4.43 All this has to be set in the context of discipline, something that is hard to earn but that can be obtained by being in a currency union(s) with a disciplined core. We conclude by suggesting that if a domestic currency is chosen, it could be desirable to start with a relatively restricted version, as in a Currency Board, which could gradually evolve to a fully fledged currency that brought greater discretion once discipline, and the associated demand for the currency, was well established.

V. SCENARIOS FOR THE 1990S

5.1 Three factors will have a determining influence on the economic welfare of Palestinians in the 1990s: the level of wages; the level and allocation of private capital; and the provision of public services. Concerns over employment prospects and problems with the provision of services have been at the center of the economic crisis in the past few years. Fears of a severe worsening in employment came to a head with the border closure of March 1993; many now expect that future employment prospects in Israel will be much more tightly rationed than in the past. Will unemployment soar and wages collapse, or can alternative domestic employment opportunities be found? Will private capital--from within and without the West Bank and Gaza--be invested in employment creating activities? And what level of public resources--from domestic and foreign sources--are desirable to improve service levels and provide the infrastructural basis for private sector growth?

5.2 We conclude by developing scenarios for the West Bank and Gaza, based on alternative assumptions for external factors, domestic policy choices and foreign private and official financial flows. These are based on an analysis of the workings of the economy now, but they should be treated as illustrative: too little is known about how a rapidly changing economy will respond to large changes in both its environment and policy direction. The focus is on the transition to the medium term, starting not with a specific year but with the signing of an agreement that gives some form of economic autonomy to a new Palestinian entity. Rather than attempt to construct what has happened in 1992 and 1993 we compare the future with economic conditions in 1991, that is the last year for which we have reasonably precise data. A description of the model is given in Annex 4.

5.3 While the primary focus is on the medium term, writing this in 1993 makes it impossible to avoid the issue of the short-run dynamics for Palestinians of an abrupt reduction in employment in Israel. The chapter first discusses this issue to set the stage for the examination of medium-term issues. It then describes alternative scenarios based on different assumptions for relations with Israel and Jordan, the international community and domestic conditions; including aggregate financing needs. And it finally presents an indicative scenario for public finance and foreign official financing.

A. What Happens When Employment in Israel is Lost?

5.4 The movement of labor to Israel has been central to the economic functioning of the Occupied Territories, as Part A has documented. Severing this tie will have important consequences. At present, it is unclear how far employment will be allowed to rise, following the closure of the border in March 1993, but much tighter rationing of employment numbers has now become one of the probable scenarios. This has a radical impact on assessments of the future: up to the beginning of 1993, it would have been reasonable to take the view that reduction in employment in Israel was a likely, and perhaps desirable, prospect for the medium term but that an abrupt cessation was highly undesirable because of the severe disruptions to incomes in the West Bank and Gaza.

5.5 Incomes will be affected both directly and indirectly. The easiest part to assess is the impact of sharp cuts in employment in Israel. This amounts to 30 percent of total employment and over 16 percent of GNP for the West Bank; and almost 40 percent of employment and 23 percent of GNP for Gaza. The total effect then depends on the consequences for domestic production and incomes. Two patterns of change are likely to occur, working in opposite directions:

- Internal multiplier effects--the lost labor income leads to lower spending on domestic goods that then multiplies through lower incomes for the sellers of these domestic goods, further losses in spending and *reduced* domestic output.

- The reallocation of labor to domestic production--with the loss of labor opportunities in Israel, workers shift to work in domestic activities. This leads to *expanded* domestic production but a lower income, at least initially, since the value added of the reallocated workers is less than their previous earnings in Israel (that is why they migrated there in the first place). The initial shortfall in income would be mitigated in the short run by consumption-smoothing by households through running down savings.

5.6 A closely related issue concerns how the labor market adjusts: do wages fall to clear the market (so encouraging fast, short-run adjustments in employment and, therefore, small initial falls in incomes) or does unemployment rise, as workers hold out for the wages they were earning before (whether in Israel or the Occupied Territories)? The importance of this is that unemployment magnifies the effects of the shock: in addition to an initial loss of income equal to the productivity differentials between jobs at home and in Israel, the whole potential output of the unemployed is lost as long as unemployment persists.

5.7 Even if the economy ultimately reaches full employment, the initial magnification of the shock is likely to have lasting effects. Domestic savings also decrease initially, and, as a result, capital stocks are accumulated at a slower speed. Long spells of unemployment leave scars on displaced workers, reducing their productivity. These effects make it likely that transitory unemployment would pull the whole intertemporal income stream down.

5.8 The past is only a weak guide to what will happen if labor opportunities in Israel are lost since there has been no "long" episode in which there was the prospect of a major, permanent decline in employment in Israel. After the *Intifida* broke out, the numbers of Palestinians employed in Israel stayed constant at about 109,000 between 1987 and 1988. Hours worked dropped significantly (see Figure 1), but this was probably primarily due to labor supply effects, as strikes reduced the availability of workers (as opposed to the availability of work).[1] In the first three months after the Gulf war broke out, there was near total closure for 40 days, with Palestinian employment in Israel dropping drastically, but this was an exceptional situation, quite different from the prospect of a major, permanent decline in employment.

5.9 While direct evidence is lacking, there are some partial indications from the past as to how the economies will react to lost labor opportunities in Israel:

(a) The overall picture of the labor market reflects a high degree of flexibility but some short-run sluggishness. Open unemployment rates are low, at 1-2 percent of the labor force when times are good, and at 3-4 percent when demand is slack. However, at the turn of the decade, unemployment rose substantially in the West Bank, peaking at 10 percent before dropping to 5 percent in 1992 (preliminary); changes have been much

[1] The fall in hours worked in the Occupied Territories was similar for workers in the Occupied Territories and for Palestinians in Israel.

lower in Gaza, despite the greater reduction in income. (See Figure 1 in Chapter II.) At the same time daily wages have shown a high degree of stability.

(b) There is also evidence of short-run resilience and of the West Bank and Gaza economies operating, to some degree, counter cyclically to the incomes from Israel. In the early 1980s labor income from abroad slowed, but GDP slowed by less than the remitted earnings. Construction employment in the Occupied Territories is somewhat contra cyclical to construction employment in Israel, suggesting availability of construction workers influences the pace of activity in the sector. There was an increase in employment in the occupied territories after the *Intifada,* with hardly any fall in daily wages, and a substantial expansion in agricultural production in both the West Bank and Gaza.

5.10 As a working basis for examining the future we take the following view. The economies of the West Bank and Gaza are reasonably flexible, and as economic opportunities in Israel are cut there will be reallocations to domestic activities. This is likely to be underwritten by consumption-smoothing: savings appear to be high in the aggregate and will be run down to smooth income shocks at the household level (just as they were run down to invest in land and housing in 1992, supporting an apparently large expansion in employment within the Occupied Territories). The prevailing view is that extended family and kinship networks are strong, so inter-household transfers would be expected to rise to help those hardest hit. Both effects will help sustain domestic demand. However, labor market adjustment will certainly not be instantaneous, and we would expect temporary rises in unemployment, followed by declines (as in the West Bank in 1991 to 1992) as wages move slowly to a new, market-clearing position.

5.11 The scale of any decline will of course be heavily influenced by two other factors. In the short run, the availability of spending from other sources--especially official spending by the new self-governing authority, the municipalities and by agencies such as UNRWA--can have an important Keynesian influence on labor demand and incomes. In the medium to long term, both inflows of productive capital and improvement in productivity--due to the availability of trading options abroad, a freer regulatory regime, or a good set of policy actions--will speed the process of creating new permanent jobs and will have a powerful influence on wages, unemployment and welfare. We now turn to illustrative scenarios.

B. Alternative Scenarios After a Peace Agreement

5.12 The scenarios are developed around alternative assumptions in three areas: production possibilities, as influenced by policy and structural conditions; employment in Israel; and capital inflows. The key welfare variables are the unskilled wage rate, the rate of unemployment, and the level of per capita income. The alternative assumptions are as follows.

Economic Functioning and Production Possibilities

5.13 The labor market functions in line with our interpretation of the past (see Chapter II and Annex 1). Employment in Israel is rationed and Palestinians working in Israel are paid close to the Israeli minimum wage (that is higher than the domestic wage). The domestic labor market is flexible, but wages

move to a market-clearing position only over time, leading to temporary rises in unemployment if labor demand falls. We then explore two alternatives for the potential efficiency of production:

(a) Continued strategic uncertainty, slow progress on opening up trading opportunities or worsening internal social conditions leads to no shift in production possibilities;

(b) A convincing peace agreement, removal of supply side restrictions and opening of markets to the Arab world and the rest of World allows a one-time outward shift in production potential, assumed to be 20 percent, that is spread over a number of years, following by growth of productivity at 1 percent per annum (that is consistent with international norms). The extent of this shift depends, of course, on both the efficacy of domestic policy change on the supply side (as discussed in the companion piece on private sector development) and the extent to which foreign market possibilities are opened up (as discussed in Chapter III).

Relations with Israel

5.14 We explore two alternative sets of assumptions:

(a) the early-1993 restrictions in labor movement are converted into a permanent arrangement with much lower levels of Palestinian employment in Israel--we assume 45,000 workers in the first year;

(b) the early-1993 restrictions are lifted; immigration into Israel continues at about the 1992 pace for the next five years, and Palestinian labor maintains its strong comparative advantage in Israeli construction; other manufacturing and services industries continue to substitute away from Palestinian labor, and the net effect is a gradual reduction in Palestinian employment in Israel; current trading relations in goods are improved.

Capital Inflows

5.15 In the absence of strategic resolution, official flows continue at past levels. With a peace agreement, however, the international community responds with substantial additional flows of capital, that supports investment in public infrastructural and social services by the new self-government (as discussed in the companion pieces on infrastructure and social development). Technical assistance in setting institutions, formulating policies, and implementing programs is also provided.

5.16 The extent to which private capital responds will be a function of both domestic policy and external conditions. Here we explore two possibilities:

(a) A strong response from both domestic and foreign (including expatriate Palestinian) investors, with a strong orientation toward productive investment;

(b) A large initial response, but with a bias toward land and housing, that tapers off because of the absence of a strong policy environment for growth.

Model Structure

5.17 The simulation models are built around several blocks (see Annex 4).

(a) A work-force module projects population growth, and changes in demographics with associated changes in labor participation (these are all taken from the human development report).

(b) Domestic production is modelled using an estimated aggregate production function with two factors of production--labor and capital--and a shift factor to control for the quality of the incentive framework (or more loosely, the quality of "policy").

(c) A labor module incorporates several possible regimes associated with the different ways the labor market can function, depending on internal and external circumstances. When there is no unemployment and the labor demand is known, a labor market equation computes wages at home for a given combination of capital stocks (as the marginal productivity of labor). When wages are expected to be above their full employment, market-clearing levels, the unemployment rate that equilibrates the labor market is computed given exogenous assumptions about the likely behavior of wages. When labor productivity at home reaches the minimum wage in Israel and there are no binding restrictions on labor movement, the model solves for the share of the labor-force that must work at home to achieve wage equalization.

(d) A consolidated government budget module constrains public consumption and investment to the level of fiscal resources that are expected to be available. When expenditures (including public debt service) exceed government revenues, the budget deficit must be financed with external grants and loans, and with domestic borrowing.

(e) A private sector saving/investment module closes the model. The private's sector disposable income is taken to be the Gross National Product (which includes the remittances from Palestinian workers in Israel and further abroad), plus external transfers accruing to the private sector (including from private reserves), minus domestic transfers to the government (taxes and loans). Private income is allocated between consumption and investment according to a private saving rate, which is assumed to adjust so as to smooth consumption over time and circumstances. Some of the external transfers are taken to be inflows of capital from the Palestinian diaspora and other foreign direct investors seeking to finance domestic projects (including housing), or the purchase of land.

Overview of the Scenarios

5.18 The scenario analysis suggests that the future evolution of the economy of the Occupied Territories could be reasonably bright or it could be bleak (see Figures 22 and 23). We first outline the good policy scenarios. Securing a combination of improvement in "policy" (that encompasses expanded opportunities for trade) with international capital inflows could set the economy on to a path of sustained growth over the medium to long term. This applies to both the scenario of smooth labor reduction in Israel and the scenario of abrupt cut-off in employment opportunities to 45,000 workers. In both it appears to be feasible to achieve medium-term growth rates in income per capita excess of 3 percent per annum (Table 7). The short run is much worse under the abrupt labor cutoff scenario, and significant

falls in GNP per capita are projected and lower total financing of the trade deficit, that includes labor income from work in Israel ("remittances", see Figure 23). Growth then recovers as the economy adjusts, but from a lower base. After ten years, income per head rise by over 40 percent in the smooth labor reduction case, and by 36 percent in the abrupt labor cutoff case, compared with the baseline income estimate US$1715 (the level in 1991). Under both scenarios, growth is associated with steady rise in investment and quite large net transfers of foreign resources, that decline steadily over time. In both cases, declining labor income form Israel is compensated by substantial inflows of external finance, going to both the public and private sector. Over time the sum or remittances and net transfers of external capital falls, as growth in exports allows the trade balance to decline. (See below for the public and external finance numbers).

5.19 We next turn to the bad scenarios. Failure to tackle the policy conditions for growth leads to a very different outlook. Under the assumption that there is not even enough progress on a peace agreement to get any additional capital inflows, there is a significant initial decline in incomes, even with smooth reduction of employment in Israel, followed by steady, further decline. After a decade, incomes per head have fallen by 12 percent. The initial decline is a consequence of the delayed effects of the shock of the loss in employment in the Gulf. Growth was financed in part by what is estimated to be a large repatriation of savings abroad (of over 10 percent of GDP) and it is assumed that this is not sustainable. Slow medium to long-term growth is associated with stagnant investment, weak productivity growth and low inflows of external capital (Figure 22). Under a situation of abrupt labor cut-off the situation is even worse, owing to a sharper reduction in initial incomes per capita. The initial fall under this scenario is only moderately worse than in the favorable policy case, but the growth paths subsequently diverge greatly (Figure 23).

5.20 The scenarios of "bad policy and faltering capital" represent potentially important intermediate cases. These could be thought of in terms of a sufficiently convincing Peace agreement to secure an initial inflow of foreign capital--from both official and private sources--but a failure, on the part of the new self-government the international community or Israel, to put in place the policy and structural conditions that would sustain rapid growth. There are many ways in which this could occur, as the discussion of the previous chapters and the companion volumes illustrates. There could be inadequate resolution of the supply-side constraints on growth, whether in the form of the legal framework for private sector activity or tackling the infrastructural bottlenecks. Trading opportunities might remain restricted, whether due to failures to improve access in the Arab world, the OECD or Israel, or to an attempt to spur industrialization through high protection by a Palestinian governmental entity. Public savings could stall, owing to failures in revenue mobilization or excessive current spending rises, and there could be public investment in inefficient and unproductive activities. The model is not designed to distinguish amongst the wide range of alternative ways the economy could go off course, but represents such a possibility in terms of a failure to reap the productivity increases assumed in the good "policy" scenarios. This is also reflected in the behavior of private capital that is treated as being responsive to both the overall rate of growth and the policy environment. A plausible scenario is for quite substantial initial inflows that mainly go into real estate (as appears to have occurred in 1992) with little into productivity-enhancing capital. With a combination of weaker economic opportunities and lower growth, private capital falters over the medium term, leading to lower total financing in the second five years, as shown in Figures 22 and 23.

5.21 The scenarios illustrate an important result. For the medium term, the most powerful determinant of growth in incomes is the extent to which the economy succeeds in getting on to a growth path that encourages accumulation in productive capital (both physical and, over the longer term, human capital)

and provides the environment for productivity growth. Failure to achieve this can lead to sustained decline. Increased capital alone will help in the short run, but only temporarily, especially as private capital will only keep flowing if economic conditions are good.

The Labor Market and the Composition of Capital Inflows and Investment.

5.22 The scenarios are associated with significant changes in the labor market. This is illustrated here for the two good "policy" cases (Figures 24 and 25). Under both scenarios there is, over time, a large absolute and relative rise in employment within the domestic economy--faster, of course in the abrupt scenario, but also true of the smooth cut-off scenario. With a growing supply of labor to the domestic market, wages are virtually constant, or falling slightly, in the smooth case, before rising gradually in the medium to long term. A fall of wages of the order of 10 percent occurs with abrupt labor cutoff, spread over time, on the assumption that there is sluggishness in wage adjustment. The other side of this is a sharp, short run rise in the unemployment rate to a peak of about 15 percent of the labor force, with a gradual subsequent decline as wages adjust downwards and the economy grows. Under the scenarios of poor policy (not shown) the labor market situation deteriorates much more drastically, with large rises in unemployment in the short run, and large declines in wages over the medium term.

5.23 The key determinant of the pace of income and employment growth is investment. It is expected that growth in public investment will play an important part in the short run. This plays a dual role: catching up on neglected investments in social and economic infrastructure and providing an impulse for income and employment growth. Over the medium term private investment would rise steadily and account for a large part of total investment. Foreign finance and remittances fall in both scenario, i.e., there is a steady decline in the trade balance as exports rise. Remittances from work in Israel fall in line with the change in employment. Finance going to the public sector rises sharply in the short-run peaks in year five and then declines--quite significantly in real terms. Private finance is expected to follow a different path, with a moderate initial increase after a peace agreement that then tapers off, but is followed by a second rise in the medium term as growth in private investment is perceived to be robust. It then drops in the long term, in line with the dynamics of net transfers (i.e. as debt service increases).

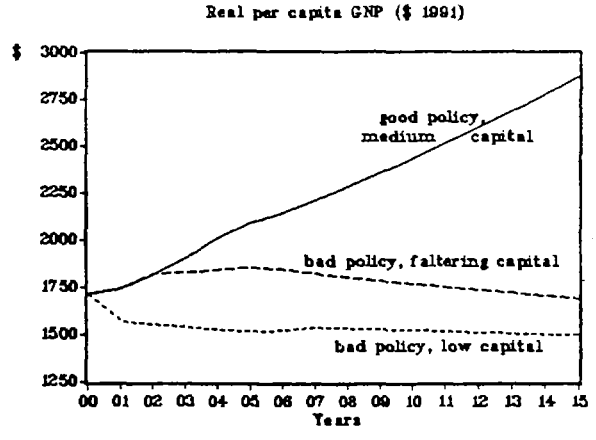
Managing the Transition Under an Abrupt Labor Cutoff

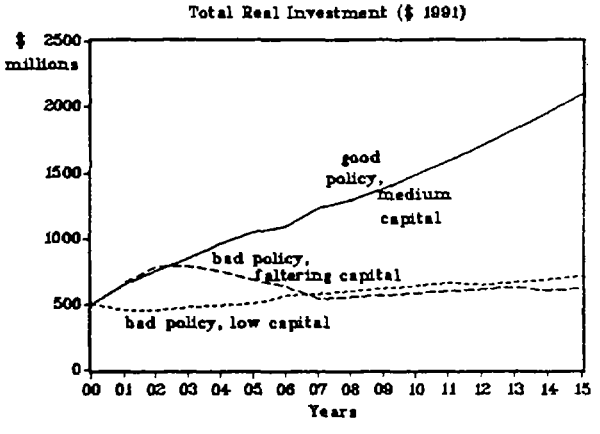
5.24 If policy and trading relations are good the medium term outlook looks hopeful even under a scenario of abrupt labor cut-off. However, managing the transition could be critical to success. Rising unemployment and falling wages could itself jeopardize the formation of the conditions necessary for growth, through the potential consequences for social unrest and violence, and the risks that it will encourage short-run policies that hamper long-run growth, such as an excessive expansion of civil service employment or inefficient "employment-creating" industries. What kinds of action would be open to a new self-government and the international community to try and offset the shock of the labor cutoff? There are two alternative strategies, that could be complementary to each other. First, it could be desirable to increase public spending on labor-intensive construction activities or other mechanisms to transfer income to households, for example through accelerating catch-up spending in rehabilitation of social and economic infrastructure, to smooth the shock and reduce poverty increases. Such spending would have to be financed by grants and borrowing--primarily from abroad. Second, there may be potential for accelerating the process of improving the quality of the "policy" regime, through greater opening of trading opportunities that could form part of the negotiation process (e.g. enhanced access to

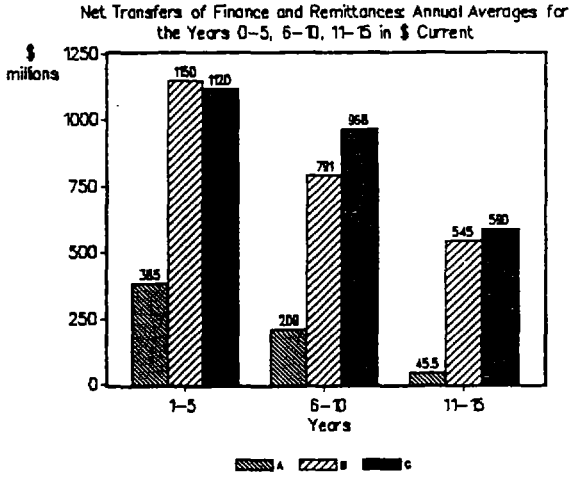
Table 7: Growth in GNP per capita under alternative scenarios (in percent per annum)

	Av. annual growth in per capita GNP, years 0-5	Av. annual growth in per capita GNP, years 6-10	Av. annual growth in per capita GNP years 11-15	Real Per capita GNP after 10 years (1991: $1715)
Smooth Labor Cut-Off Scenarios				
Good policy, medium capital	4.0%	3.1%	3.4%	2436
Bad policy, faltering capital	1.6%	-1.0%	-0.9%	1768
Bad policy, low capital	-2.4%	0.1%	-0.3%	1523
Abrupt Labor Cut-Off Scenarios				
Good policy, medium capital	2.4%	3.8%	3.6%	2331
Bad policy, faltering capital	0.4%	-0.3%	-0.8%	1718
Bad policy, low capital	-3.0%	-0.1%	-1.1%	1462

Figure 22: Overview of Scenarios: SMOOTH Labor Cut-Off

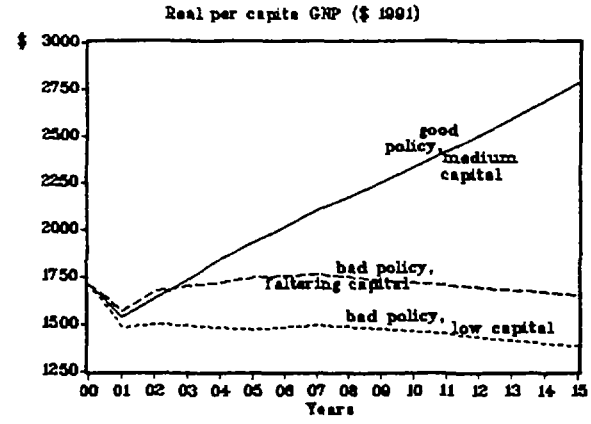


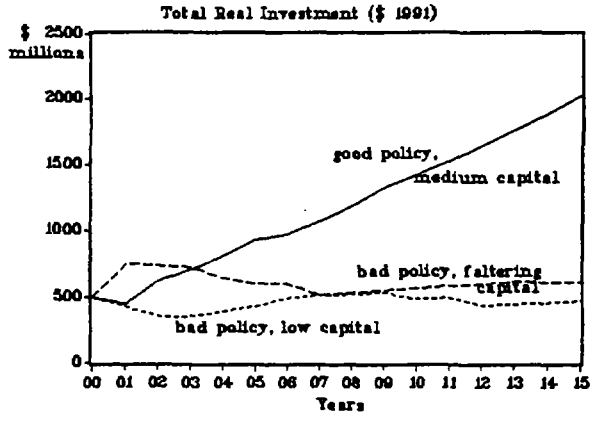


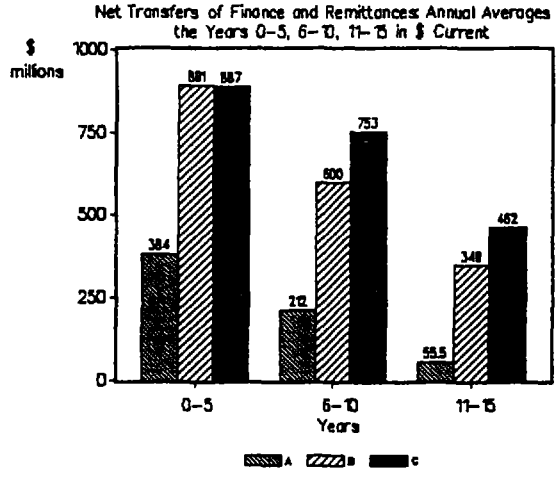


A: bad "policy", low capital B: bad "policy", faltering capital
C: good "policy", medium capital

Figure 23: Overview of Scenarios: ABRUPT Labor Cut-Off







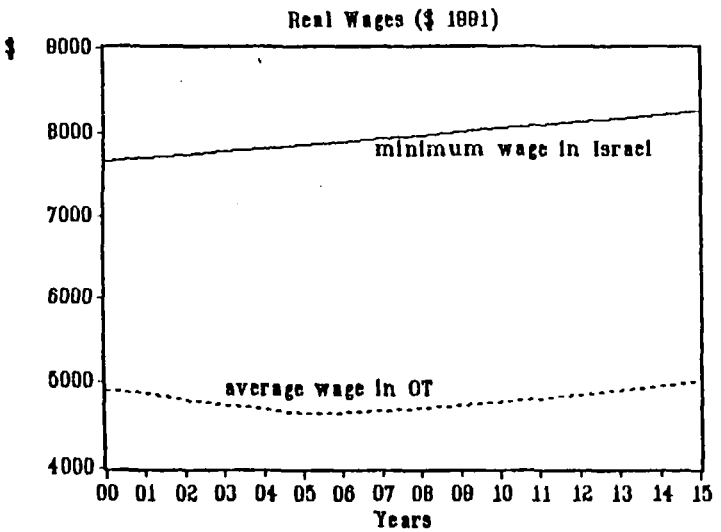
A: bad "policy", low capital B: bad "policy", faltering capital
C: good "policy", medium capital

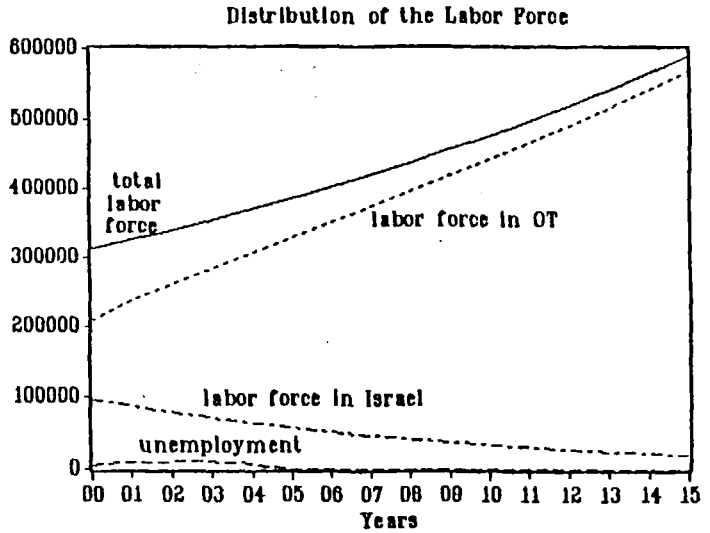
Europe or US, faster opening of Israeli agricultural markets). In the absence of strong policy money alone cannot realistically take care of the problem of labor cut-off. For example, limiting the decline in wages in such a situation to no more than 10 percent would require an implausibly high inflow of US$800 million per annum, compared with of the order of US$ 500 million under the good policy cases developed here.

The Issue of Returnees

5.25 Large numbers of Palestinians from the West Bank and Gaza now live abroad. Some have maintained residence rights and are, in principle, free to return (some 13 thousand returned in 1990 and 1991, net of outflows), while the return of others will be subject to the bilateral negotiations between Israel and the Palestinians. This report takes no view on the outcome of these, but it is nevertheless of interest to ask what the impact would be on growth and the labor market if there were to be a substantial return migration in the future. From the labor market perspective this is directly analogous to the question of labor cutoff examined above, since both amount to an increased labor supply to the domestic market. Whether this leads to unemployment and labor market problems or a spur to growth depends crucially on whether increased labor is accompanied by productive capital, sound domestic policies and market opening abroad. Unlike workers who lose jobs in Israel, returnees have demands for social services and other public goods. Success here depends on complementary action with respect to public capital investment (and adequate progress on public institutional capabilities). To avoid labor market adjustment problems, there is a case for attracting back relatively unskilled Palestinians only as the economy recovers and takes off.

Figure 24: Baseline Scenario: SMOOTH Labor Cut-Off, Medium Capital, Good "Policy"





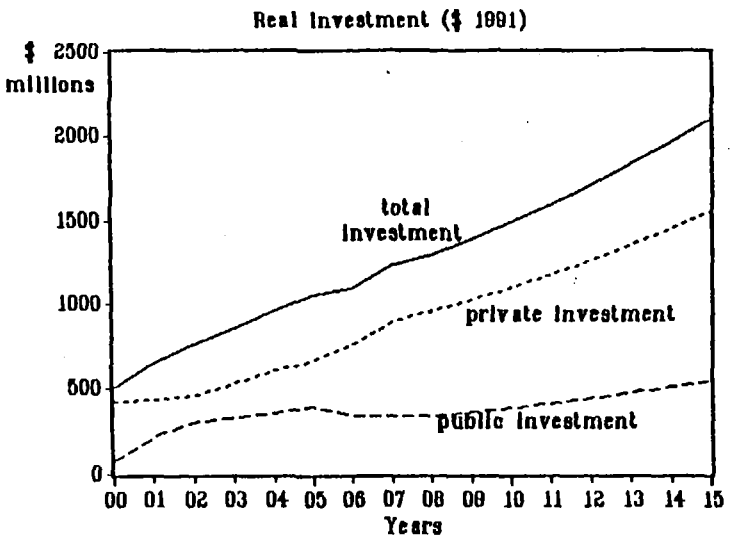
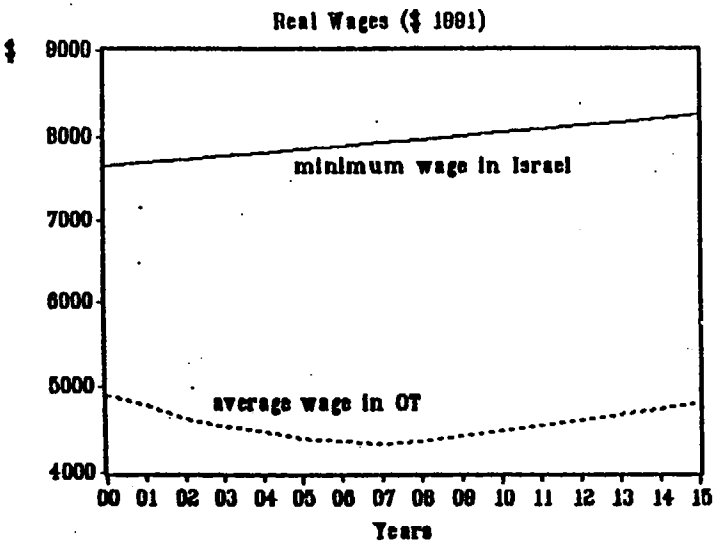
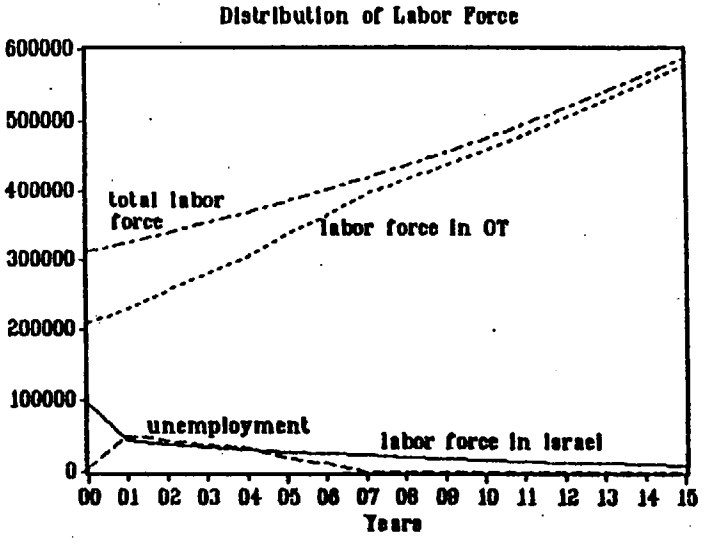
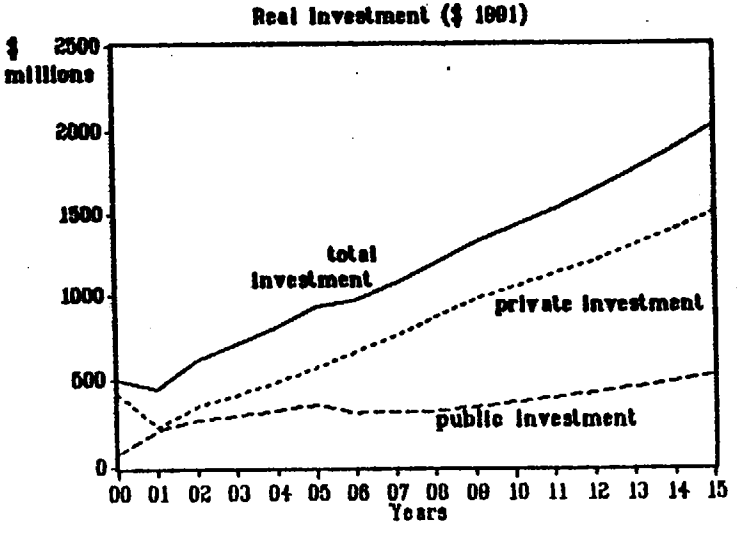


Figure 25: Baseline Scenario: ABRUPT Labor Cut-Off, Medium Capital, Good "Policy"







C. Public Finance and Official Financing Requirements

5.26 The scenarios presented above illustrate overall developments for incomes, labor and capital. Within any scenario for the future, public finance will play a central role. The biggest shortfall now lies in the provision of public goods, not in the consumption of private goods. However, while there is potential for ample private inflows--if the conditions are right--securing adequate public resources could be tougher, especially for current spending needs. There may be important tradeoffs here: there has been some discussion of having a low tax economy, as a means of getting growth going, but this may be in conflict with adequate finance for public services. Even if all taxes paid by Palestinians are included (including those accruing to the Israeli government) the Occupied Territories do not appear to be highly taxed; the tax effort is sharply lower than in Israel and also lower than in Jordan (see Chapter II). While it would almost certainly make sense to have a lower tax effort than Israel--the scale of fiscal redistribution is probably neither feasible nor desirable given the income levels of the West Bank and Gaza--the need to expand and maintain public services make it imperative that domestic revenue mobilization be improved.

5.27 The point of departure for the public finance scenarios is the integrated picture of public finances discussed in Chapter II (see Table 2). This includes both the civil administration and municipalities and the near-government activities of UNRWA. It also includes an estimate of taxes paid by Palestinians accruing to the Israeli Treasury. We take the view that these should form part of the revenue base of the Occupied Territories. But as noted earlier, the availability of such revenues depends on the trade outcome with Israel. There are also undoubtedly issues of the extent to which a self-governing entity should pay Israel for services consumed by Palestinians, as discussed in Annex 2, but this is an issue for the negotiations that we do not take a position on. In this presentation, we adopt the figure of net transfers of 6 percent of GDP (or 4.5 percent of GNP) representing the difference between revenues accruing to the Israeli Treasury (8 percent of GDP) and payments for services rendered by Israel (2 percent of GDP), and assume it to extend to the future. The public finance scenarios were developed under the assumptions of "good policy", and medium capital inflows outlined above: the first scenario relates to a smooth reduction in Palestinian employment in Israel and the second to an abrupt cutoff to an initial level of 45,000 workers. These correspond to the two good "policy" cases shown in the previous section. To support such development scenarios, both the analysis of the sector teams and simple international comparisons indicates the necessity for a significant expansion in public spending, including:

- A large increase in development spending, to catch up with past neglect in transport, water and sanitation, electric power, and schools in particular;

- An increase in current spending, to support the gradual expansion in service levels, to improve maintenance levels and (more tentatively) to allow some catch up in skilled wages (e.g. of teachers). Under the scenario where only 45,000 workers are allowed to work in Israel, additional current spending is contemplated to smooth the shock on private incomes and help in reduce poverty increases.

5.28 The projections were done in relation to GNP for the years 1994, 1998 and 2003 (See Table 8 for a summary). Development spending is projected to rise significantly under both scenarios based on the indicative estimates of needs from the agricultural, human resources and physical infrastructure teams. Under the abrupt labor cutoff scenario, development spending will be accelerated in the initial years.

5.29 Current spending, including UNRWA, is projected to rise gradually under the "smooth labor" scenario. This, however, only takes account of non-security related spending. With the takeover of law and order related activities, the self-government would face additional spending needs. This would require further analysis. Under the abrupt cutoff scenario, there would be a temporarily faster rise in current spending oriented toward moderated the scale of the shock of employment reduction. The instruments for this would have to be worked out: it could, for example, take the form of transfers via public employment schemes, as utilized in Chile in its period of unusually high employment. Any such scheme would, of course, have to be carefully assessed with respect to administrative capability and risks of leakage. Under both scenarios current spending will then stabilize in later years.

5.30 These are only indicative estimates of desirable spending levels, but the scale of increase--to the tune of 7-10 percent of GNP during the first five years--is immense. This raises the questions of whether it can it be financed. There are three potential sources of finance:

- Increased taxes. The need to maintain and improve tax effort is clear. It is assumed that the revenue/GNP ratio would rise significantly but gradually over the next ten years as administrative capabilities are built and as tax reform programs are implemented.

Table 8: Public Sector Finances, 1994-2003
(in percent of GNP at current prices)

	Average 1987-91	Smooth Labor Reduction 1994	1998	2003
Revenue [a]	17.9	19	20	24
Expenditures [a]				
excluding defense and security	19.1	24	28	26
Current Expenditure	16.5	17	19	19
of which: UNRWA	(3.3)	(3)	(2)	(0)
Development Expenditure	2.6	7	9	7
Overall Deficit	-1.2	-5	-8	-2
Financing (net)	1.2	5	8	2
UNRWA	3.3	3	2	0
Other external	-2.1	2	6	2

[a] Includes an estimate of tax payments by Palestinians now accruing to the Israeli Treasury and contributions by the Israeli treasury to expenditures.

- Domestic borrowing. There is some scope for domestic borrowing by a self-government (including a moderate amount of seignorage, should a new currency be introduced), but this is unlikely to be large in the transition period, until the government develops the credibility and the institutions to manage this. No assumptions have been made on this, but it could become a significant source of finance over the long term.

- Foreign inflows. There is no question that the international community will play a role in the transition. The prospect of an expansion in UNRWA resources is low, and it is assumed that UNRWA spending will amount to US$ 100 million annually in the interim and disappear afterwards. This leaves a total public financing requirement from abroad of 6 percent of GNP in 1998 to decline afterwards to 2 percent of GNP in 2003.

5.31 Foreign financing for the budget will form part of the overall foreign inflows that is a critical part of the growth and labor market scenarios developed above. In current prices it is estimated that the medium capital inflow cases would involve inflows (on a gross disbursement basis) of the order of US$500 million annually in the first five years, and US$560 million in the following five years (Table 9). Of this total, public sector financing requirements (including UNRWA) would average million annually in the first five years, and about the same, at current prices, in the next five years. Some of the external financing for the public sector might also come from private sources, such as "Palestinian bonds".

Table 9: Gross External Financing Requirements, 1994-2003 [a/]
(in current prices)

	Average 1994-98	Average 1999-2003
(in percent of GNP)		
Total external financing	12.6	7.5
Public Sector Financing Requirements	7.2	3.8
UNRWA [b]	(2.4)	(-)
Other	(4.8)	(3.8)
Private Sector Financing	5.4	3.7
(in millions of U.S. Dollars)		
Total external financing	500	560
		(-)
Public Sector Financing Requirement	300	(290)
UNRWA [b]	(100)	
Other	(200)	290
Private Sector Financing	200	270

[a/] The required gross disbursements have been estimated after repayments.

[b/] No assumption was made on the continuation of UNRWA after the transition period.

5.32 Private sector financing is assumed to run at US$200 million in the first five years, rising to US$270 million in the next five years. This would be in addition to labor income from Israel and would include such items as remittances from Palestinians in the Arab and OECD countries, equity investment and other private capital inflows and transfers.

D. Conclusion

5.33 The West Bank and Gaza could shift to a pattern of autonomous growth based on expansion of domestic production, increased trade in goods and reduced exports of labor. Over time there is the potential for steady growth in labor earnings--a key indicator of private welfare of the population--combined with the expansion of both economic infrastructure and social services. But this scenario depends on securing the domestic environment and international trading opportunities that will provide the institutional basis for a large expansion in the public sector and adequate incentives and security to encourage major investments in productive activities by the private sector. Failures could lead the economies to go off course, with a post-peace boom quickly fizzling out. The situation is more difficult with a sudden cutoff in labor opportunities in Israel. This leads to an immediate reduction in welfare. Subsequent growth is still feasible, provided, again, there is a convincing overall agreement, sound domestic policies, expanded trading opportunities and official capital inflows. But there are even larger risks of the process of recovery and expansion unravelling under these conditions.

Annex 1. The Workings of the Labor Market in the Occupied Territories

The following is a framework which characterizes, in a simplified form, the functioning of the Palestinian labor market. The possibilities of working in Israel are integrated in the analysis. We take as given that skilled jobs in Israel are not open for Palestinian workers and we expect that to continue to be the case in the future. The segment of the Israeli labor market which is relevant for Palestinian workers is mainly agricultural, construction and some jobs in the industrial and service sectors.

Let $D^p(T, K, F, R)$ be the domestic demand function for labor, which is defined for particular given trade regime (T), capital stock (K), structure of financial institutions (F) and various existing regulations and exogenous factors (R). The total Palestinian labor supply function is denoted by $S^p(E_0)$ where E is a vector of exogenous variables affecting the supply of labor. The effective domestic supply, S^{pd}, is the residual supply over the ones employed in Israel (Q^{pi}).

The Israeli labor market of the relevant sectors (agricultural, construction industry and services) is characterized by the labor demand function D^i (I, E_1) defined for a given level of immigration, I (mainly from the former Soviet Union), various monetary and fiscal policies, developments in relevant world markets and any other exogenous factors affecting the labor demand all are captured by E_1. The immigration variable affects the demand for labor in these sectors through its effect on the demand for housing, textile, agricultural and other goods. The Israeli labor supply to these relevant sectors is denoted by S^i (I, U, E_2) where I is the level of immigration U is the total Israeli unemployment rate and E_2 is a vector of exogenous factors affecting the supply of labor. The reason for including the overall Israeli unemployment rate is that many Israelis, even unemployed ones, do not wish to work in agricultural, construction and in some tasks in the industrial sector and services. However, for high levels of unemployment there will not be much choice and, therefore, supply of Israeli labor to these sectors will increase, and vice-versa.

We will discuss two cases of labor market integration. The first, the constrained case, is depicted in Figure 1, where the Israeli minimum wage leads to endogenous "rationing" of Palestinian employment in Israel. The second case we consider is the non-binding constraint, where every Palestinian who wishes to work in Israel, is able to find a job. The current form of labor market integration is better represented by the first case. The second case reflects the form of integration to occur in the future if the domestic market expands substantially. This may occur as enough capital flows into the domestic market, regulations on trade are lifted, etc.

Case 1: Binding Constraint

Figure 1 presents the first form of labor market integration. The domestic labor market is characterized by a significant lower value of marginal product of labor (due, for example, to lower level of capital) and by a lower value of workers reservation wage (due, for example, to lack of a social safety net), than the Israeli market. In particular, we assume the maximum value of the marginal product of labor to be below the Israeli minimum wage. Under these conditions the ones who are able to get a job, work in Israel while the rest offer their services domestically. This is demonstrated in Figure 1, where $S^t(S^i, S^p (T, C) W_{min})$ is the total supply of labor to the relevant Israeli sectors. This supply is obtained by horizontal aggregation of the Israeli supply of labor (S^i (I, U, E_2)) with the Palestinian labor supply which is adjusted for two key factors: (1) Various costs involved in employing a Palestinian worker compared to an Israeli one. These costs are captured by the parameter T, and reflect, for example, risk

premium (which is expected to be high during tense periods). (2) Transportation costs to Israel, C. Thus, the total supply of labor to the Israeli market is $S^t(S^i, S^p(T,C)\ W_{min})$, which is the bold line in Figure 1, where W_{min} is the institutionally imposed minimum wage in Israel.

The equilibrium in the Israeli market is denoted by (Q^i, W^i; Q^{pi}, W^{pi}) which is the employment-wage combination of Israelis and Palestinian workers in Israel respectively. Note that W^{pi} is the wage paid for Palestinians working in Israel but their effective wage is lower by C, the transportation costs. The domestic labor market equilibrium is denoted by (Q^{pd}, W^{pd}). The model implies an internal employment solution for Palestinians in both markets and three wage levels can be sustained where $w^i \geq w^{pi} \geq w^{pd} + C$; the average wage in Israel per sector for Israeli worker is equal to, or above, the wage for Palestinians who are working in Israel whereas the latter is equal to, or above, the respective domestic Palestinian wage, even when adjusted for transportation costs.

The wage gap between Israelis and Palestinians working in Israel (the same skills and in the same economic branch) is mainly determined by T, the added costs from the employer's perspective, of hiring a Palestinian worker rather than an Israeli. The larger is T, as is expected in period of political and military tension, the larger is the wage gap (although note that the costs to the employer are the same).

There are several key factors that determine the wage gap between Palestinians working domestically and in Israel:

(1) The institutionally determined minimum wage - W_m. The Israeli minimum wage is the only source for a consistently sustained wage gap in the model. If there had not been an institutionally set minimum wage, then all Palestinians wishing to work in Israel would be employed. Flow of Palestinian workers to Israel would continue until the domestic and Israeli effective wage for Palestinians (appropriately adjusted for transportation costs) would equalize (using the aggregate supply as we are doing here would not be appropriate in such a case). Existence of an effective minimum wage results in rationing of Palestinian employment in Israel. Not all of the ones who wish to work at this wage can get a job. (We assume that the ones who are employed are a faithful sample of the total supply.) As long as the minimum wage is high enough to be effective, then the higher it is, the higher is the wage gap between the Israeli and the domestic wage for Palestinian workers.

(2) The transportation costs - C. As long as the minimum wage is effective, the actual wage gap (statistically measured) is independent of the transportation costs. The gap in the effective wage, however, is smaller the more costly it becomes to get to work in Israel.

(3) Changes in the domestic economy. For given transportation costs and minimum wage, demand shocks (e.g., change in foreign investment) and supply shocks (e.g., change in migration to other Arab countries) directly affect the wage gap as they change the domestic wage without affecting the wage paid to Palestinians working in Israel (as long as the minimum wage remains an effective constraint).

Using this framework one can also look at the workers from the West Bank separately from those from Gaza. Differences in T between the groups, different transportation costs and different domestic conditions will lead to differences between the two groups of workers in the wages paid in Israel and in their respective domestic wages as well as in their respective employment.

Case 2: Non-binding Constraint

We analyze this case by focusing on changes in capital inflow. However, opening of new trade possibilities, less restrictive regulations, etc., would have a similar dynamic effect as they change labor demand vis-à-vis their effect on the product market. As capital inflow increases, the marginal productivity of labor increases, shifting outward the domestic demand of labor.

As capital increases, but not yet to the point where the marginal productivity of labor reaches the minimum wage, the economy is at a stage of transition from the constrained to the unconstrained state, during which there is a gradual increase in both wage and employment in the domestic market, but no change in the Palestinian employment level and wage in Israel. As domestic capital increases further, we reach the point of wage equalization. Here, there is first a range where additional capital will not affect the wage. At that point the wage is equal to the Israeli minimum wage both domestically and in Israel. However, at that range any increase in capital is accompanied by a flow of Palestinian workers from Israel back to the territories. This trend will continue until the Israeli minimum wage is not an effective constraint any longer in the Israeli labor market; from that point there is no rationing and every Palestinian who wishes to work in Israel can get a job. As domestic capital continues to increase, the domestic wage continues to rise, more labor flows back from Israel to the domestic market, putting some pressure on wage to fall while the wage Palestinians are getting in Israel rises, so that it equalizes across the two regions -- but at a wage which is above the minimum wage level. This trend continues as capital increases. At the extreme, the domestic capital is reaching such high levels as to imply a marginal productivity of labor in the territories (in autarky) equal to, or above, the Israeli wage (in autarky). At that point all Palestinian labor is employed domestically.

The Facts (for 1990)

The availability of wage data of Palestinians working domestically, Palestinians working in Israel, and Israeli workers, by selected economic branch, enable us to locate (partially) the state of the current form of labor market integration, within the context of our conceptual framework. It is only partial since the wage data does not account for differences in occupational mix within the economic branch selected. Since Israelis work in more skilled jobs (see Tables 4.b and 4.c) the "true" wage ratio between Palestinians working in Israel and Israelis, by sectors, is clearly above the one reported (in Figure 6). Accounting for that bias, the data suggest that the state of labor market integration can be approximated by Case 1 - the binding constraint:

The average wage Palestinians earn in Israel is about $450 which is in the neighborhood of the Israeli minimum wage. The domestic average Palestinian wage is about $310. This is an overestimate of the relevant wage since the workers employed domestically are more skilled than the ones who work in Israel (Tables 4.a and 4.c). Thus the "true" wage gap is even larger than reported. Such a significant gap cannot be explained merely by transportation costs. We suggest that the Israeli minimum wage is an effective constraint, the employment of Palestinian labor in Israel is demand driven, and the current form of labor market integration is as presented in case 1.[1]

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1. The average Israeli wage is significantly above the wage Palestinians get in Israel, which supports the case as well. However, as stated previously, that reflects the different skill composition, as well as the added costs incurred by Israeli employers from employing a Palestinian rather than the equivalent Israeli worker.

Analysis

The present framework is used as a simple tool to analyze the qualitative effects of changes in economic scenarios and various shocks, on wage and employment of Palestinians. The events to be considered include both ones that occurred already (e.g. intifada, Gulf war, recession in Israel, beginning of mass migration to Israel). It formed the basis for the framework for analyzing future scenarios described in Chapter 6 and Annex 4.

Past Shocks

II.1 Intifada

The *Intifada*, which started in December 1987, involved a general deterioration in security, frequent strikes, demonstrations and curfews. It had the direct effect of an increase in T, the parameter which captures the added costs, from the Israeli employer's perspective, of hiring a Palestinian worker rather than an Israeli.

Transportation costs to work in Israel, C, increased as well, as time to get to work increased mainly due to imposed road checks. The combined effect is a shift upward of the adjusted labor supply of Palestinians to the Israeli market. The resulting changes are a decline in effective employment, which is the number employed adjusted by the average number of hours worked (see Figure 2 for the number employed and Figure 3 for average weekly work hours); an increase in the wage paid to Israelis; a decrease in the wage of Palestinians employed in Israel relative to that of Israelis and an increase in employers' costs. In the domestic market, the effective supply shifts outward - leading to an increase in effective employment, lower domestic wages and a decrease in the relative wage between Palestinians working domestically and those working in Israel (Figure 7). Strikes and demonstrations imposed work interruptions too and these may have dominated the net effect on both employment and wage.

The effect of the *Intifada* is expected to be transitory, and its extent is closely linked to the extent of the political-military disturbances. The data (Figures 2 and 3) behave as expected with respect to employment. Although the number of employed in Israel in the period following the outbreak of the *Intifada* fell only slightly, the weekly work hours per Palestinian employee in Israel decreased sharply. Domestic employment during that period went up, although domestic weekly work hours per employee went down by as much as in Israel. With respect to wages, Figure 6 shows the ratio, over time, of Palestinian daily wages in Israel to Israeli daily wages by selected economic branches. This ratio is declining in the period following the beginning of the *Intifada*, in all major economic branches. Note, however, that this data remains pertinent only if there is no significant change in the skill mix between Palestinians and Israelis within the selected economic branches. The reason is that the reported wage ratio does not control for a different occupational mix within the branches. For that same reason, one should not consider the reported wage ratio to represent the true one. Still, since we only look at the change of the wage ratio over time, it is appropriate to do so as long as the occupational mix within the branch did not change over that period. The occupational data reported in tables 4.b and 4.c (although not by branch) lead us to believe that indeed there was not a significant change in the skill mix.

Figure 7 provides the pattern of the wage ratios of Palestinian employees working domestically to the ones working in Israel, by selected economic branch. As expected, the wage ratio is declining following the start of the Intifada. Angrist's finding (1992), that the premium paid for working in Israel rose steeply in the late 1980s, is consistent with the qualitative analysis.

II.2 The Gulf War

The Gulf war affected Palestinian labor through several internal channels. First, as in the case of the *Intifada*, it increased T, and shifted the effective supply to the Israeli market, while the residual supply to the local market increased. That tended to reduce the domestic wage and increased the Palestinian wage in Israel. Second, the employment possibilities for Palestinians in the Gulf states diminished considerably, leading to an increase in Palestinian labor force. That increased the effective supply to Israel, which at least partially offset the first effect (and, perhaps, more than offset it), and also increased the domestic labor supply, which enhances the first effect. Thus, the net effect on the domestic market is an increase in employment and reduction in wage, whereas the effect on Palestinian employment and wages in Israel is ambiguous. Unlike the *Intifada* which seems to have mainly a transitory effect, the Gulf war is likely to have lasting effects on the domestic labor market -- mainly because the current situation, where there are many fewer employment possibilities in the Gulf than before the war, is likely to continue.

The empirical effect of the Gulf War on Palestinian labor cannot be established at this stage of the analysis since the Gulf War occurred while mass immigration in Israel was already occurring. The data at that period reflect the effects of both shocks. Since, as we discuss next, the aggregate effect of the immigration is ambiguous - as it affects Palestinian labor both through an increased demand for goods and an increased labor supply - more detailed empirical analysis is required in order to differentiate between the effects of the two shocks and to verify the analytical predictions presented.

II.3 Immigration

The end of 1989 marked the beginning of a mass wave of migration to Israel from the former Soviet Republics, reaching about 200,000 by the end of 1991, or about 8 percent of the Israeli population. The massive immigration has had, and will continue to have, a profound and permanent effect on both the Israeli and the Palestinian markets. The immigration affects Palestinian labor via dual changes in Israeli labor demand and supply, within the relevant sectors. The net effect on Palestinian wages and employment depends on the relative increase in the supply of, and demand for, labor and on the extent to which the immigrants are substitutes for, or complements to, Palestinian workers in the Israeli labor market.

Table 5 presents quarterly data for 1990 and 1991, a period which covers both the Gulf war and the acceleration in immigration. After a steep drop in the fourth quarter of 1990, and in the first quarter of 1991, the number and proportion of employed persons from the Occupied Territories, began to rise until reaching the same point as before the Gulf crisis. The entry of immigrants into the labor force affected the sectoral distribution of workers from the Occupied Territories rather than their number. In particular, construction remains the main source of employment, and in this sector the number and proportion of employed workers from the territories has not fallen. The proportion of the workers from the territories employed in the trade, hotel industry and services did fall. They were replaced, in part, by Israelis and new immigrants. It thus appears that the workers from the territories and the immigrants are substitutes in the industrial sector, and trade and services industries, but not in construction. Therefore, the labor market opportunities of workers from the territories in Israel depend almost entirely on one sector -- construction. With expectations for continuing immigration, and with the agricultural sector shrinking, employment prospects in the remaining sectors that used to employ workers from the territories -- services, industry, agriculture, trade and hotels -- seem poor for the future. However,

increased demand for housing due to the immigration suggests that, at least in the short run, demand in the construction sector for workers from the territories will continue to be high.

Complements or Substitutes?

Within the context of an aggregate production function, Palestinian workers compete with low-skilled Israeli workers as substitutes, while they are complements to more skilled workers. As long as there is an expansion in the sectors which primarily employ workers from the territories -- construction, agriculture and services - more Palestinians are hired, and unskilled Israelis are improving their relative position. If there is contraction, the reverse occurs. Thus, the employment situation of Palestinians is very much dependent on the Israeli unemployment level and specific demand in agriculture and construction. The 1991 data, which already utilize information on the new immigrant workers (from the former Soviet Union) reveals this situation. The new immigrants have preferences for work in the industrial sector and in the service industry, while they object to working in construction and agriculture. Looking at quarterly data, it is evident that the immigrants substituted for Palestinian workers in industry and services while the share of Palestinian workers in construction and agriculture did not go down. At the aggregate level, as Figure 4 reveals, there is a negative correlation, as expected, between the Israeli unemployment rate and the share of Palestinians in total employment in Israel.

This analysis is fairly general. In order to establish substitutability/complementarity relationships a comprehensive econometric analysis would be needed where wage and employment effects are analyzed; such an analysis, however, extends beyond the scope of the present report.

FIGURE 1(1): LABOR MARKET INTEGRATION

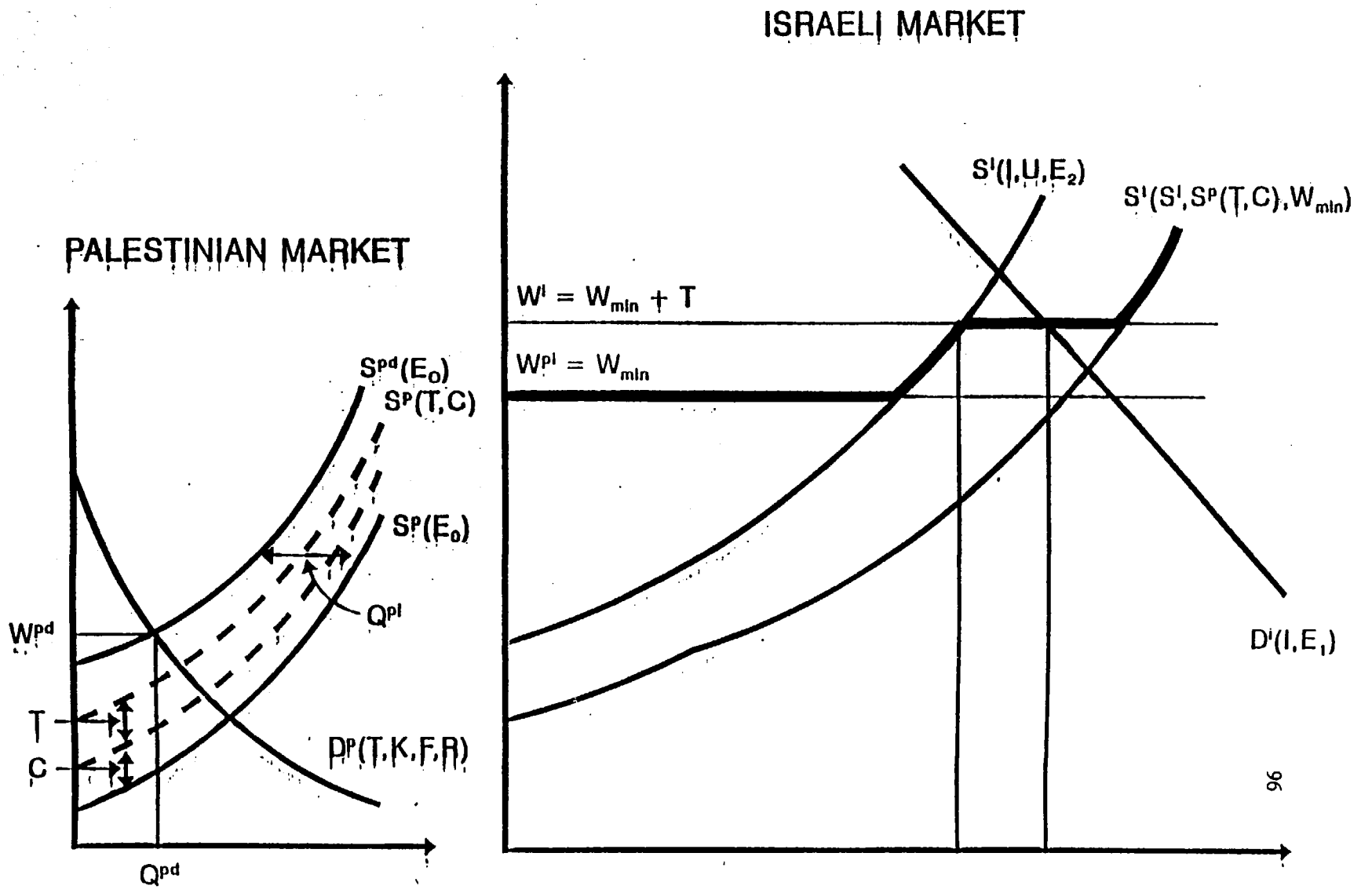
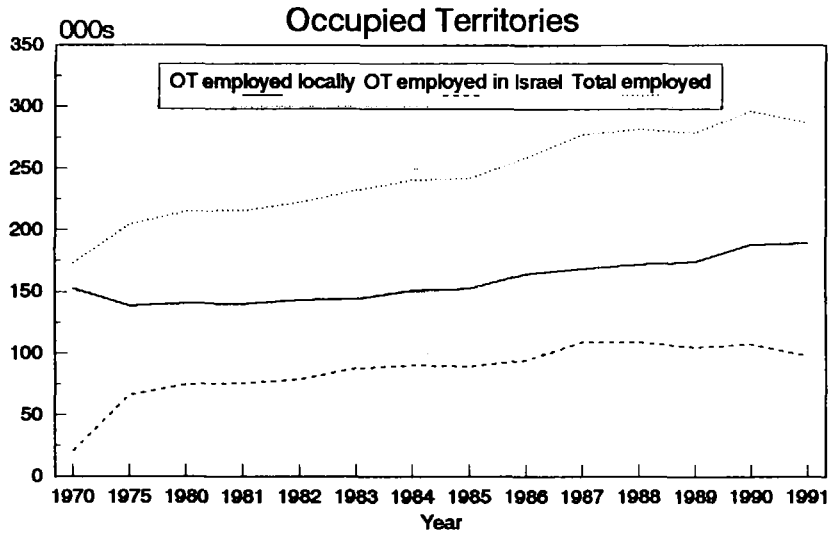
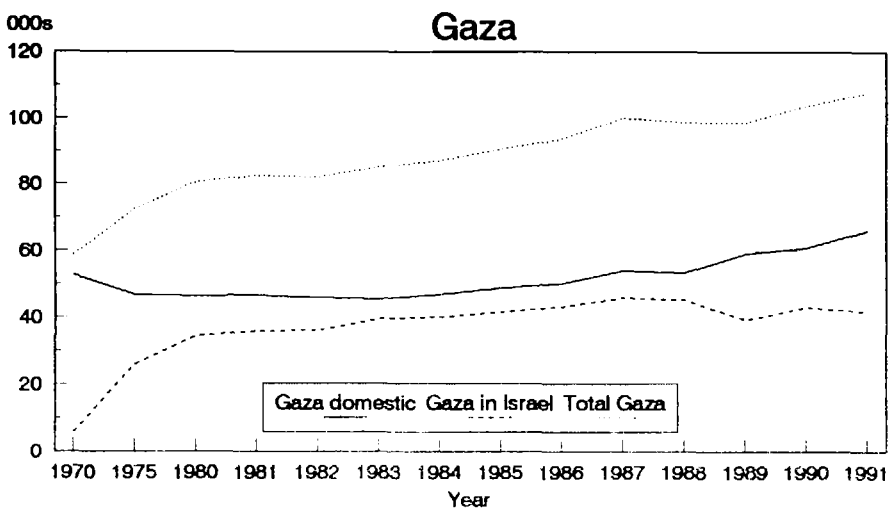
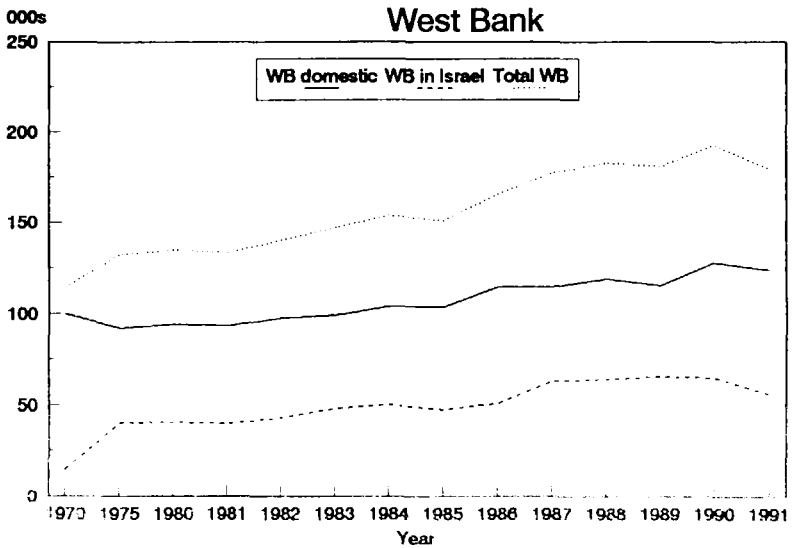


Figure 1(2): Number of Employed West Bank and Gaza Residents by Place of Employment, 1970-91

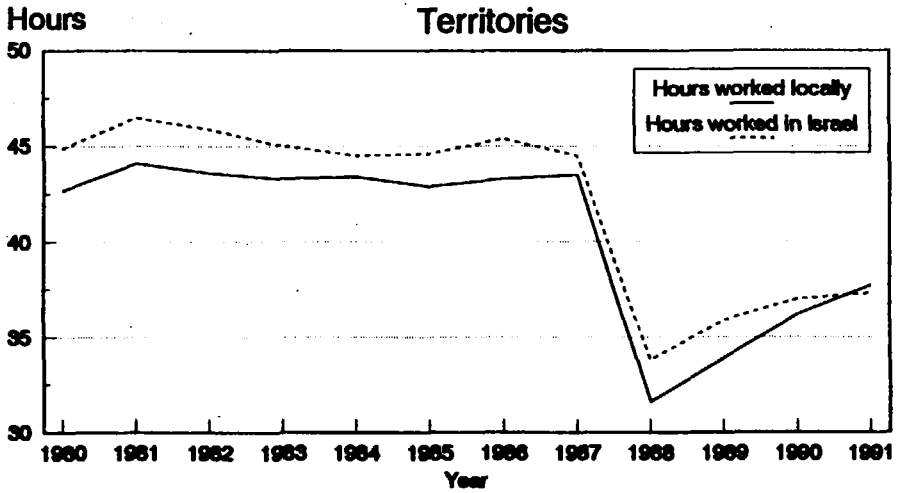


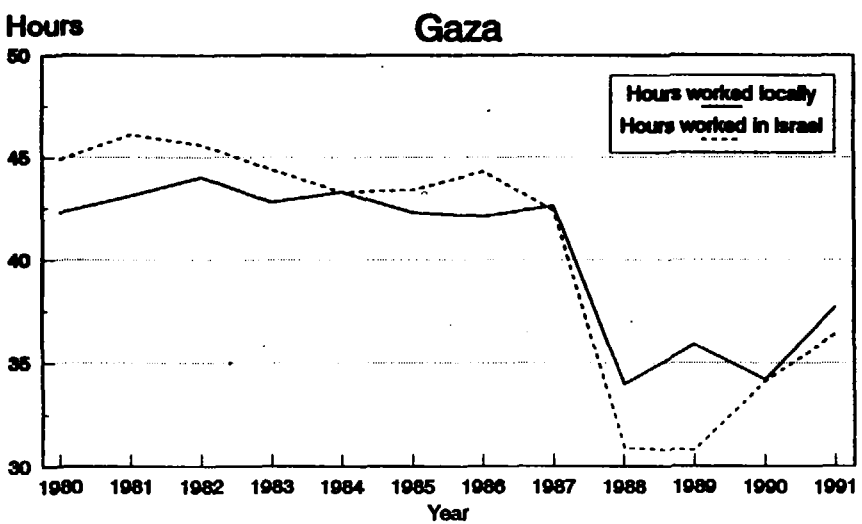


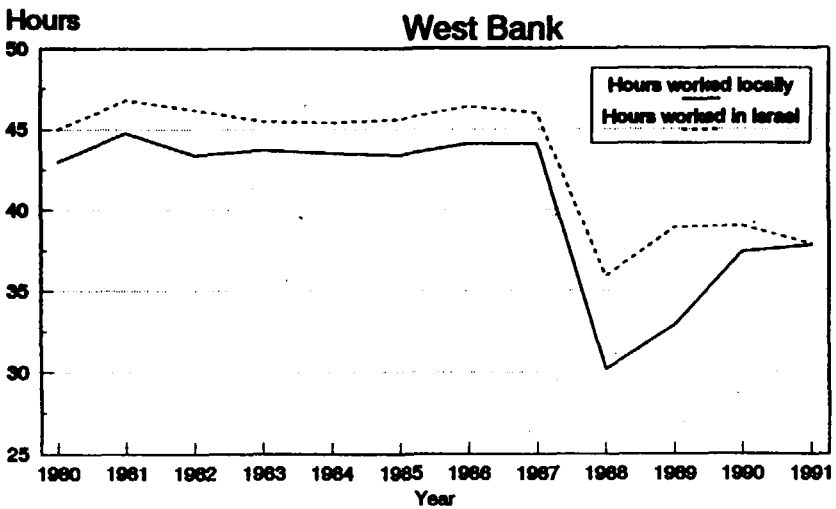


Source: Statistical Abstracts of Israel, 1983-1992, Central Bureau of Statistics, Jerusalem.

Figure 1(3): Average Weekly Hours per Palestinian Employee, by Place of Work.

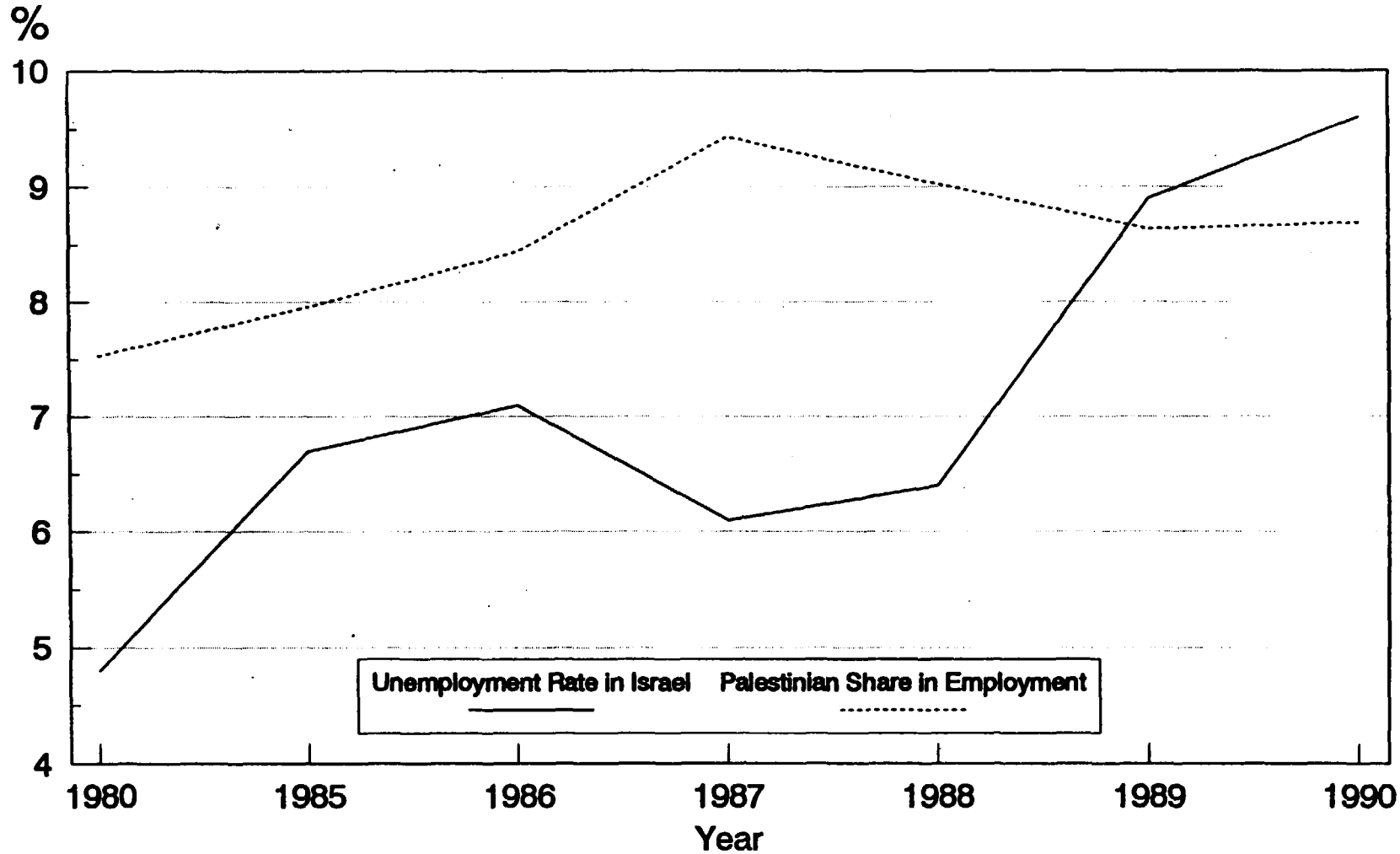






Source: Statistical Abstracts of Israel, 1985-92
Central Bureau of Statistics, Jerusalem.

Figure 1(4): Israeli Unemployment Rate and Palestinian Share in Total Employment.

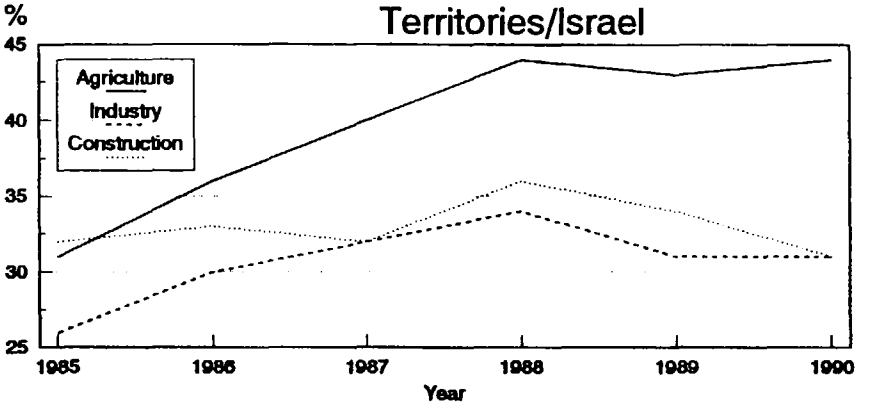


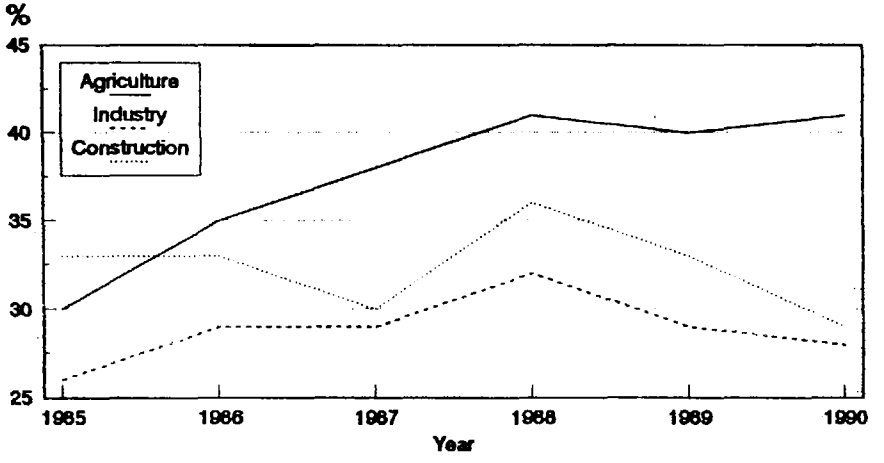
Source: Statistical Abstracts of Israel,1970-91, Central Bureau of Statistics, Jerusalem.

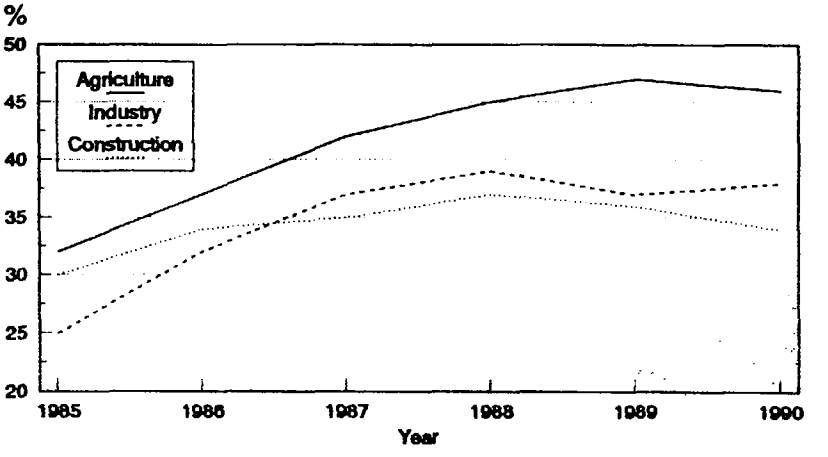
Figure 1(5): Employed West Bank and Gaza Residents by Sector and Place of Employment

Source: Statistical Abstracts of Israel, 1986-1992, Central Bureau of Statistics, Jerusalem.

Figure 1(6): Palestinian Daily Wage as a Percentage of Israeli Daily Wage by Selected Economic Branches

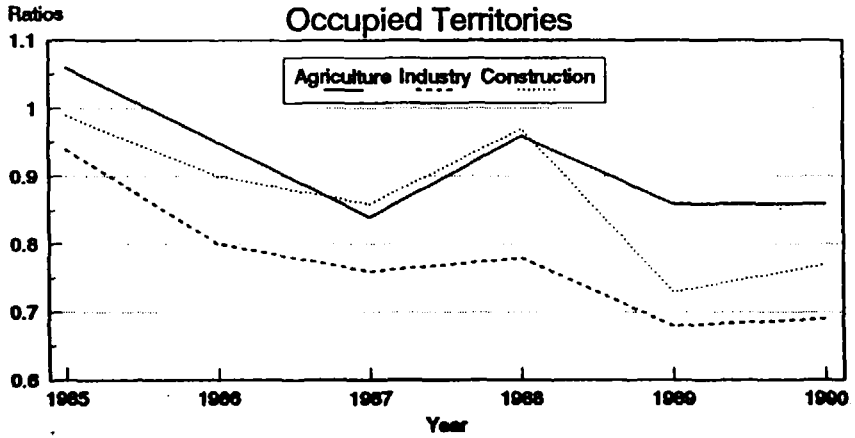


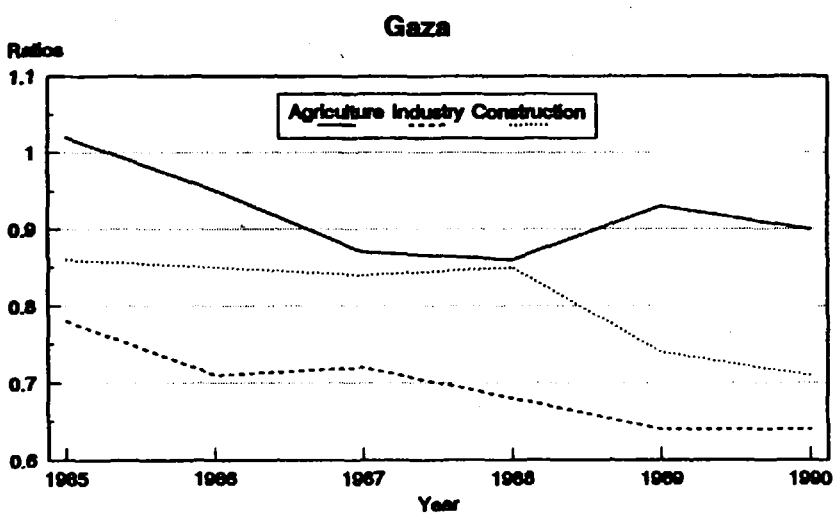


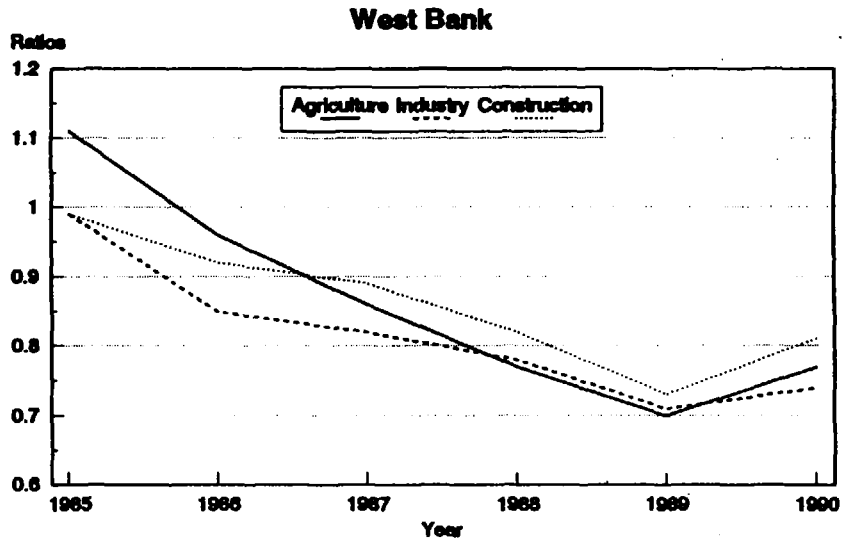


Source: based on Statistical Abstracts of Israel 1971-1991, Central Bureau of Statistics, Jerusalem.

Figure 1(7): Daily Wage Ratios of Palestinian Employees Working Domestically to Palestinian Employees Working in Israel







Source: Statistical Abstracts of Israel, 1985-90
Central Bureau of Statistics, Jerusalem.

Annex 2: Public Finances in the Occupied Territories

I. Budgetary Operations of the Public Sector

1. The public sector in the Occupied Territories consists of the Civil Administration and the municipalities. The budget for the Civil Administration does not include expenditures on security or expenditures on Israeli settlers in the Occupied Territories. The budget is prepared on an annual basis and has to be approved by the Israeli Kenneset. At the time the budget is being prepared, forecasts are made for revenues and expenditures in each of the west Bank and Gaza, and the two are then combined into one budget (hereafter referred to as the Civil Administration Budget). The municipalities and village councils are also required to prepare annual budgets. Since 1992, the fiscal year coincided with the calendar year; prior to that, the fiscal year ended March 31. An interim budget was prepared for the period April-December 1991.

2. In what follows below, the structure of the Civil Administration Budget as well as actual budgetary developments during the period 1987/88-1991, are analyzed. A similar analysis is then conducted for the municipalities, after which a picture for the public sector as a whole is presented.

A. Civil Administration Budget

3. The actual outcome for the Civil Administration Budget for 1987/88-91 as well as the budgets for 1992 and 1993 are presented in Table 1. According to the available presentation, revenues are broken into receipts from the income tax, the Value Added Tax (VAT), customs and excise duties and purchase taxes, health fees, other fees and charges, as well as receipts from the "deduction fund". The income tax consists of a tax on individuals and a tax on corporations. The individual income tax is progressive with the highest rate being 45 percent. The income tax brackets are adjusted upwards twice a year according to the inflation rate. The corporate tax rate is 38 percent. Data is not available on the breakdown on income tax receipts between the individual income tax and the corporate income tax, nor is any information available on the number of taxpayers at either the individual or corporate level. The VAT tax is applied at the same rate as in Israel (currently, the rate is 17 percent). Sales of agricultural products by producers is not subject to the VAT tax, nor are the services provided in touristic establishments. A zero rate is applicable to exports. Customs duties are the same as those applicable in Israel, and so are the excise duties on domestic production (mainly tobacco and beverages) and the purchase taxes (applicable to a number of domestically-produced and imported goods). No information is available on the breakdown of receipts between these various kinds of taxes.

4. Regarding non-tax revenue, receipts are broken into health fees and other fees and charges. Health fees represent fees paid by employees of the Civil Administration as well as by whoever wants to join on a voluntary basis the health plan of the Civil Administration. The fee is currently NIS 64/month. Other fees and charges comprise a large variety of levies on things such as bridge crossings, car registration, departure fees, etc. Some of those fees are in fact in the nature of taxes such as the motor vehicle taxes, but no data is available on the breakdown of these receipts.

5. Receipts from the "deduction fund" are related to the social security payments made in connection with the Palestinian workers working in Israel and the benefits they are entitled to. The total employer and employee social security contribution is 12.7 percent of salary, broken down into 7.4 percent for the employer and 5.3 percent for the employee. The Palestinian workers in Israel are entitled to benefits worth 0.9 percent of salary, and the remainder 11.8 percent that he is not entitled to is remitted back to

the Civil Administration. These amounts remitted back constitute the receipts of the "deduction fund". A detailed description of the system of benefits is provided in Attachment I .

6. Expenditures are classified into two main categories: current and developmental. Current expenditures are broken separately into expenditures on health, education and welfare, and other current expenditure, but no breakdown of the latter is available. There is also no economic classification available of current expenditure (e.g. wages and salaries, transfers, etc.). The only separate category provided under development expenditure relates to transfers to the budgets of the municipalities.

7. Overall budgetary developments. As can be seen from Table 1 , the overall position of budget of the Civil Administration fluctuated between a deficit of 1.0 percent of GDP in 1987/88 and an (annualized) surplus of 1.6 percent of GDP in 1991. While revenues stagnated in relation to GDP in 1988/89 following the start of the Intifada, development expenditures declined sharply and the overall budgetary position reached a virtual balance. The budgetary position strengthened further in both 1989/90 and 1991, while in 1990/91 it was in balance. Thus, recourse to financing by the Israeli Treasury was resorted to only in 1987/88.

8. Revenue developments. Over the period 1987/88-91, the revenue/GDP ratio fluctuated between 12.2 and 13.5 percent of GDP. Receipts from the income tax and the VAT exhibited generally rising trends and averaged 3.7 percent and 2 percent of GDP, respectively. Revenues from customs and excises were relatively stable at 1.5 percent of GDP while those from fees and charges fluctuated considerably. Revenues from the "deduction fund" averaged about 1.2 percent of GDP.

9. Expenditure developments. The expenditure/GDP ratio remained in the 12-13 percent range during the 1987/88-91 period. Current expenditures averaged 10.5 percent of GDP, with expenditures on education averaging 3.3 percent and those on health 2.3 percent. Development expenditures declined in 1988/89, but started rising afterwards. On average, development expenditures exceeded slightly 2.0 percent of GDP.

B. Budgets of Municipalities

10. The budgets for the municipalities include the revenues and expenditures of the electricity and water utilities. The consolidated budget for the municipalities is broken into ordinary and extraordinary budgets. The ordinary budget consists of current revenues and expenditures, while the extraordinary budget covers mainly development expenditures and their sources of financing. Current revenues can be divided into three main categories: taxes (property and fuel) and fees; water charges; and electricity charges. Similarly, current expenditures consist of expenditures on general services as well as expenditures by the water and electricity utilities. The main source of financing for the development expenditures are loans and grants from the civil administration, while financing from external sources is small.

11. As can be seen from Table 2, the budgets of the municipalities experienced deficits ranging between 0.5 percent and 1.2 percent of GDP during the period 1987/88-1991. Revenues averaged about 3.5 percent of GDP, with more than 60 percent of revenues emanating from electricity charges, 25 percent from taxes and fees, and the remaining 15 percent from water charges. Similarly, about 50 percent of current expenditures were by the electric utilities, 15 percent by the water utilities, and the remaining 35 percent on general government services. Development expenditures averaged slightly below 0.5 percent of GDP.

C. Consolidated Budget for the Public Sector

12. When the budget for the Civil Administration is incorporated with that for the municipalities and eliminating the transfers between the two, the following picture emerges for the public sector finances during the period 1987/88-91 (Table 3): an overall budgetary position which is virtually balanced over the five-year period with an overall deficit of 1.2 percent of GDP in 1987/88 followed by alternating very small deficits or surpluses; financing from the Israeli Treasury which averaged 0.2 percent of GDP; and financing from external sources which was even lower averaging only 0.1 percent of GDP.

13. On the revenue side, the revenue/GDP ratio fluctuated between 15 and 17 percent of GDP and averaged about 16.1 percent. Revenues were almost equally split between tax and non-tax (fees and charges including those related to electricity and water) revenue, with each accounting for about 8 percent of GDP. On the other hand, tax revenue was also almost equally split between direct taxes (taxes on income and property, and indirect taxes (customs duties, excise duties and purchase taxes). On the expenditure side, the average expenditure/GDP ratio during the period was 16.1 percent, with a current expenditure/GDP ratio of 13.9 percent and a development expenditure/GDP ratio of only 2.2 percent.

II. Expenditures by UNRWA and Other Organizations

14. The United Nations Refugee and Works Agency (UNRWA) is a major provider of health, education and other social services to residents of the Occupied Territories. About 40 percent of residents of the West Bank and 60 percent of the residents of Gaza have the status of "refugees" and therefore entitled to the benefits provided by UNRWA. Over the period 1987-91, UNRWA expenditures in the West Bank and Gaza averaged US$ 100 million annually, representing about 4.5 percent of the GDP of the Occupied Territories; expenditures in Gaza were about 60 percent of the total. About 50 percent of total UNRWA expenditures was on education, 20 percent on health, and the remainder on other activities.

15. Several other organizations, including the United Nations Development Program (UNDP), the European Community(EC), Arab countries and organizations, as well as various Western non-governmental organizations (NGOs) have also extended assistance to the Occupied Territories. UNDP expenditures averaged about US$ 7 million annually over the five year period 1987-91, and EC aid averaged about US$ 15 million during the same period. Assistance from Jordan, mainly in the form of salaries to civil servants was high up to 1988 (averaging about US$ 50 million a year during 1987-88), but declined sharply afterwards to about US$ 15 million annually as a result of the disengagement in June 1988. Other identifiable Arab government aid averaged about US$ 15 million annually during 1988-89, but no figures are available after that. No figures are also available on Arab non-government aid (for e.g. aid from the PLO and various Arab organizations). Western governments extend assistance mainly through a variety of non-governmental organizations, but no precise data are available on such disbursements.

16. In sum, there are various organizations that extend assistance to the Occupied Territories, which is used to provide services to residents of the type which are usually provided by governments. Foremost among these is UNRWA, which has a special status because of the refugee problem. In the aftermath of the Gulf war, the EC has increased sharply its assistance, but this might have only partly offset a possible large decline in Arab aid.

III. Fiscal Transfers between the Occupied Territories and Israel

17. This section deals with the issue of the fiscal transfers between the Occupied Territories and Israel. First, we will try to estimate the magnitude of the taxes paid by the residents of the Occupied Territories and which do not accrue to the budget of the Civil Administration. Second, we present estimates by the Israeli authorities of the benefits accruing to the Palestinian residents of the Occupied Territories from interaction with Israel. Finally, some issues regarding fiscal transfers are presented.

A. Tax Payments by Palestinians Accruing to Israel

18. There are no economic boundaries between Israel and the occupied territories. Goods produced in Israel and purchased by residents of the occupied territories are subject to tax in Israel, while goods produced in the occupied territories and purchased by residents of Israel are subject to tax in the occupied territories. Goods exported out of Israel and the occupied territories to third parties are zero-rated, while those imported to them from third parties are taxed (at the same rates) at the point of entry. The following represents an estimation of the revenues which should have been returned to the benefit of the Palestinians (calculations are for 1991):

19. **Revenue from taxes on imports via Israel.** Imports by the Occupied Territories via Israel amounted to NIS 105 million in 1991. Assuming that these goods are consumer goods, the amount of the various taxes on these imports (i.e. customs duties, surcharges, purchase taxes, and VAT) would be equivalent to 62 percent of the value of these imports, or NIS 65 million. As only revenues from taxes on imports of cars (estimated at NIS 5 million in 1991) accrue to the budget of the Civil Administration, the loss from this source is estimated at NIS 60 million.

20. **Revenue from taxes on "trade" with Israel.** There are several losses which are enumerated below. As noted earlier, the VAT on good produced in Israel and purchased by residents of the territories is paid into the Israeli Treasury, while the VAT on goods produced in the occupied territories and purchased by Israel's residents accrues to the budget of the Civil Administration. Some of the trade between the occupied territories and Israel, such as agricultural and second hand goods, is not subject to VAT. According to 1987 data, imports of agricultural goods constituted about 15 percent of the imports of the occupied territories from Israel, but no details on the other imports which are not subject to VAT are available. Assuming another 20 percent of the trade between the Occupied Territories and Israel is not subject to VAT, the budgetary loss to the civil administration from the VAT tax on trade with Israel would be equivalent to the VAT tax rate multiplied by 65 percent of the magnitude of trade deficit of the occupied territories with Israel. Data on trade between the West Bank and Israel is not available after 1987. However, in Israel's balance of payments, an estimate is provided for trade with the occupied territories. For 1991, the trade deficit with Israel was estimated at NIS 1790 million which, although it might be an overestimate, is the only figure that can be presently used. Applying an 18 percent VAT rate (the rate applicable in 1991) on 65 percent of the trade deficit means a revenue loss to the budget of the Civil Administration of NIS 210 million. Another revenue loss in this connection would be the import duties (customs duties and purchase taxes) on the imported inputs that enter into the Israeli goods that are being purchased by residents of the territories. The ratio of imports of production inputs to GDP in Israel was about 20 percent in 1991 and the ratio of customs duties and purchase taxes to imports of intermediate goods is estimated at about 5 percent; the resulting duties therefore constitute about 1 percent of the value of the goods. Applying the 1 percent rate to the trade deficit with Israel results in an additional revenue loss of about NIS 17 million.

21. Revenue from fuel taxes, excise taxes (mainly tobacco, beverages and cement) and purchase taxes on domestic production. These goods are again taxed at the source. In Israel's budget, revenues from fuel taxes were estimated at NIS 1650 in 1991, those from excise duties at NIS 450 million, and those from purchase taxes at NIS 800 million. The economy of the occupied territories is about 5 percent of the size of the economy of Israel. As far as fuel taxes are concerned, the intensity of energy use in the Occupied Territories is lower than that in Israel. Assuming 3 percent of the fuel use is by the occupied territories, and allowing for the fact that a small amount of revenues from the fuel tax (NIS 5-10 million) accrues to the budgets of the municipalities, the revenue loss from the fuel tax source would be about NIS 40 million. Regarding excise duties, only a part of the production of goods subject to these taxes constitutes alcoholic drinks. Given that the consumption of alcoholic drinks in the Occupied Territories is generally lower than that in Israel, it can be assumed that the revenue loss relating to the excise duties is about 4 percent of the revenues from excise duties collected in Israel, or about NIS 18 million. As far as purchase taxes are concerned, it can be assumed that 5 percent of the purchase taxes collected on domestic production in Israel (i.e. NIS 40 million) represents a revenue loss to the Civil Administration.

22. Revenue from electricity. Expenditures by the municipalities on electricity amounted to about NIS 80 million in 1991. Assuming 95 percent of the electricity is bought from the Israeli electricity company, and applying the 18 percent VAT rate would mean an additional revenue loss of about NIS 15 million. Table 4 gives a summary of these revenue losses.

23. Adding-up the losses from all these sources (60+210+17+40+18+40+15) results in a total loss of NIS 400 million to the budget of the civil administration in 1991. Had these accrued to the Civil Administration budget, they would have resulted in a significant increase in 1991 revenue. Even if the GDP figure is adjusted upwards to reflect the higher amount of indirect taxes, the revenue loss would still have amounted to over 8 percent of 1991 GDP.

B. Benefits Accruing to Residents of Occupied Territories from Interaction with Israel

24. The Israeli authorities have provided the Bank staff with estimates of the benefits accruing to residents of the Occupied Territories as a result of the interaction of the two economies. The following represents a summary of the Israeli presentation:

25. Expenditures on security. According to the Israelis, under international law, the occupying power may require the local population to defray the cost of governing it. Since the Intifada, the cost of security operations have increased sharply. The expenses incurred by the Israeli army in connection with the uprising amounted to NIS 600 million annually. Additional expenses not associated with the uprising, and expenses incurred by other security organizations have brought the total security expenditures to about NIS 1 billion annually in recent years.

26. Use of roads. There are 150 kilometers of roads in the occupied territories whose construction has been financed by the Israeli budget at a cost of NIS 500 million. The annual cost of capital is 8 percent and the volume of traffic of Palestinians using them is estimated at 80 percent of total use. The value of their annual use by Palestinians is therefore estimated at about NIS 30 million. Furthermore, using the same methodology, the annual value of the use by Palestinians of Israel's road network of 15,000 kilometers had been estimated at NIS 180 million (assuming Palestinian use is about 5 percent of total use).

27. Movement of manpower. Each day about 120,000 workers from the territories enter Israel and about 80,000 of them are employed on a regular basis. According to the Israelis, in effect, the export of labor services from the represents the import of unemployment into Israel. Assuming the rate of substitution of workers from the territories for Israelis is two to one, payment of unemployment benefit to some 60,000 persons arises from the export of unemployment from the territories into Israel. The resulting cost to the Israeli budget is NIS 90 million annually.

28. Benefits from Israeli-subsidized goods. Goods that are subsidized by Israel are also available to the residents of the occupied territories. Subsidies on basic commodities and agricultural produce amount to about 1.2 billion annually in Israel. Assuming that the residents of the occupied territories consume about 5 percent of such goods, the benefits accruing to them are estimated at NIS 60 million annually.

29. Technology and know-how. According to the Israelis, as a result of the contact with Israel, the occupied territories have acquired new technologies of production. Expenditures on research and development in Israel is estimated at NIS 1.2 billion annually, and the benefits to the residents of the occupied territories from Israeli R&D was estimated at NIS 40 million annually.

30. Additional benefits. Several other benefits accrue to the residents of the occupied territories from services provided by Israel: (a) use of subsidized health services: NIS 5 million; (b) use of Israel's sea and airports for international trade: NIS 6 million; (c) benefits of Israel's protective tariff system: NIS 9 million; and (d) consumption of agricultural goods subsidized through Israeli-government investment in agricultural capital:NIS 6 million.

31. Income tax credit points. By law, only residents of Israel are entitled to credit points against their income tax. However, under the government decision of October 8, 1970 regarding the equalization of employment conditions and net and gross wages between workers from the occupied territories and from Israel, the workers from the occupied territories were regarded as if they were residents of Israel and therefore were entitled to credit points. Assuming that 80,000 workers constitute registered workers and that each worker receives on average 3.25 credit points at a value of NIS 1,080 per credit point, it is estimated that the workers from the occupied territories who work in Israel receive about NIS 250 million annually as a result of credit points.

32. When the benefits to the territories from the use of the infrastructure and services provided by Israel are added up, they amount to NIS 1,426 million annually. To this would be added the income tax credit points of NIS 250 million annually.

C. Issues Regarding Fiscal Transfers

33. The above presentations are made not to dwell on the magnitude of fiscal transfers in the past but to highlight some of the issues that will undoubtedly be raised in the bilateral negotiations regarding the interim self-governing arrangements. In this context, the following points can be made. First, as far as the revenue losses are concerned, there seems to be no doubt that agreement should be reached between the two sides about the magnitude of these losses and on a formula for revenue-sharing or revenue transfers. More will be said on this point in a later section. Second, there is no doubt that expenditures on security in the Occupied Territories had constituted a burden on the Israeli budget. However, how much needs to be spent on security in the interim period and who is going to spend it, is a subject for negotiations at the bilateral level and the Bank is not taking a position on this issue.

34. Third, although residents of the Occupied Territories are benefiting from the use of Israeli infrastructure, this use does not result in itself in an incremental direct fiscal transfer from the Israeli Treasury to the Occupied Territories. The same applies to things like transfer of know-how and technology. Fourth, in so far as the unemployment benefits being paid to Israeli workers is concerned, this argument presupposes that the Palestinian labor has replaced Israeli labor, i.e. that the employment of Palestinians has resulted in increased unemployment in Israel. There is no empirical evidence to prove this hypothesis. In fact, past employment figures show that new immigrants to Israel, for example, tended to shy away from working in the construction and agricultural sectors where most of the Palestinian workers are employed. Therefore, Palestinian labor should be viewed as a complement rather than a substitute for Israeli labor. Fifth, while the availability of income tax credit points to Palestinian workers represents a loss of revenue for Israel, it is part of the Israeli decision of 1970 to equalize the employment conditions between Israeli labor and Palestinian labor, by imposing the same income tax and social security systems to both. The whole issue regarding the treatment of Palestinian labor versus Israeli labor is also a matter to be discussed in the negotiations. In this connection, the Israeli calculation that income tax credit points to Palestinian workers costs about NIS 250 million annually is based on the assumption that two-thirds of the Palestinian labor is registered. However, as pointed out in Attachment I, the percentage of registered workers --at least up to 1991-- was only about 30 percent. The cost of income tax credit points in 1991 would then be only about NIS 100 million.

35. For the above reasons, and for the sake of the analysis that follows below, it will be assumed that the current incremental non-security related fiscal transfers from the Israeli budget consist of the expenditures on consumer subsidies (NIS 60 million) and on medical services (NIS 5 million) provided to residents of the Occupied Territories. These expenditures amount to 1.2 percent of GDP. Furthermore, capital expenditures in the Occupied Territories financed by Israel are estimated at 0.8 percent of GDP (this being the difference between the figures from the national accounts and the figures from the Civil Administration and the municipalities). Altogether, the direct non-security related transfers amount to 2 percent of GDP. On the revenue side, it would be assumed that the revenues foregone amount to 8 percent of GDP. However, as explained earlier, these figures should be treated only as illustrative, and not as indicative of any position taken by the Bank regarding the negotiations between the various parties on these issues.

IV. Toward an Integrated View of Public Sector Finances

36. In light of the discussion in the previous sections, it is clear that the magnitude of the public sector finances in the Occupied Territories cannot be evaluated by simply taking the consolidated budgetary position of the Civil Administration and the municipalities. As indicated previously, the fiscal transfers between the Occupied Territories and Israel, especially on the revenue side, constitute an important element in the analysis of the fiscal stance. Furthermore, UNRWA, and some other multilateral, regional and bilateral donors have been partly financing activities that are usually undertaken by the public sector. These elements need to be merged to arrive at an integrated position of the public sector. While precise data on UNRWA operations is available, the magnitude of the operations of other organizations performing quasi-governmental activities is not known with any significant degree of precision. It will be arbitrarily assumed here that non-UNRWA quasi-governmental expenditures averaged annually 3 percent of GDP during 1987-91, divided into 2.5 percent of GDP as current expenditure and 0.5 percent of GDP as capital expenditure (other than those capital expenditures undertaken through the municipalities). These numbers would need to be ascertained during subsequent discussions.

37. Table 5 shows the position of the public sector finances before and after integrating the various fiscal elements indicated above. The revenue/GDP ratio would rise by 8 percentage points to 24.1 percent reflecting the addition of the estimated revenue losses of 8 percent of GDP. Current expenditures excluding security would rise by 8.2 percent of GDP, reflecting UNRWA operations of 4.5 percent of GDP, other operations of a quasi-governmental nature of 2.5 percent of GDP, and transfers from Israel of 1.2 percent of GDP. Regarding capital expenditure, they would rise by 1.3 percent of GDP to 3.5 percent reflecting Israel's contribution of 0.8 percent of GDP and other contributions of 0.5 percent of GDP.

38. While this integrated approach shows an increase in cash balances which goes to the Israeli Treasury, it should be kept in mind that such an approach does not take into account expenditures by Israel on security in the Occupied Territories. According to the Israeli authorities, such expenditures amounted to about 1 billion shekels a year since the beginning of the Intifada, which is well over 20 percent of GDP.

Annex 2
Attachment 1
Page 1 of 2

Palestinian Workers in Israel:
Social Security Payments and Benefits

This note discusses some issues related to social security payments made with respect to Palestinian workers in Israel, the benefits that these workers are entitled to, and the concept of the "deduction fund".

An Israeli government decision was taken in October 8, 1970 to try to equalize employment conditions between Israeli workers and Palestinian laborers working in Israel. The aim of the decision was in fact to remove the incentive of Israeli businesses to employ Palestinian workers over Israeli workers by requiring that social security payments be made towards Palestinian workers as well as Israeli workers. The total employer and employee contributions toward social security amount presently to 12.7 percent of salary, divided into 7.4 percent for the employer and 5.3 percent for the employee. The palestinian worker is entitled to benefits amounting to 0.9 percent of salary. The remaining 11.8 percent that he is not entitled to constitutes the "deduction fund" which is remitted to the Civil Administration. The Civil Administration uses these receipts to finance general expenditure, and not specific services directed towards the workers from whose salaries the deductions are made.

While the Israeli worker is entitled to all these benefits, the Palestinian worker in Israel is entitled to only the last three benefits, namely maternity benefits, benefits if an accident takes place in the work place, and benefits in case the employer goes into bankruptcy. As mentioned earlier, the contributions made towards those benefits that the workers are not entitled to receive are remitted to the budget of the Civil Administration. It should be noted, however, that this system of payments and benefits applies only to registered workers. If one takes into account the amounts that had been in fact remitted to the Civil Administration during 1987-91 and the estimated earnings by Palestinian workers (both registered and unregistered) in Israel during that period, one reaches the conclusion that only 30 percent of the workers had been registered. The Israeli authorities have said that enforcement of the regulations requiring the registration of workers in the recent past have been tightened significantly in the recent past especially in the aftermath of the Gulf war, and that receipts from the deduction fund should show a large increase.

It should also be noted that Palestinian workers in Israel pay income taxes on their earnings in accordance with Israeli income tax law. For that purpose, they are also considered as residents of Israel and are entitled to the income tax credit points which helps them reduce their income tax liability. The income tax payments which accrue to the Israeli Treasury, amounted to NIS 32 million in 1992.

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The following represents a listing of the various benefits and the corresponding employer and employee contributions:

Type of Benefit	Employer Contribution	Employee Contribution	Total
Old Age and Minor Pension	0.67	2.70	3.30
Family Allowance	0.81	--	0.81
Accidents Outside the Work Place	0.04	0.15	0.19
Unemployment Benefits	0.04	0.15	0.19
Disability Benefits	0.10	1.30	1.40
Reserve Benefits	0.47	0.45	0.92
Geriatric Services	0.02	0.10	0.12
Health Insurance in Israel	4.95	--	4.95
Maternity Benefits	0.04	0.60	0.64
Accidents in Work Place	0.23	--	0.23
Bankruptcy of Employer	0.02	--	0.02
Total	7.35	5.35	12.70

Annex 2
Attachment II
Page 1 of 1

Individual Income Tax: Occupied Territories and Israel

1. Both the Occupied Territories and Israel have income tax schedules that are indexed to inflation. For the sake of comparison, we will take the schedules that had been prevailing in January 1992, and compare the amount of tax that an individual wage earner with a non-working wife and three children would have to pay on annual salaries of (a) NIS 12,000; (b) NIS 30,000.; and (c) NIS 48,000.

2. The tax schedules are shown in Tables 8 and 9. In Israel, the taxpayer first computes the amount of tax to be paid according to the tax schedule and before taking any deductions. The taxpayer then reduces his tax liability through a crediting mechanism, as given in the schedule which is also shown in Table 8. The taxpayer also then reduces his tax liability by taking additional credit points as follows: 2 credit points for being resident and 1 credit point for a non-working wife. Each credit point is worth (annually) NIS 1,128 (1992).

3. In the Occupied Territories, the taxpayer is entitled to the following deductions before arriving at the taxable income base: a fixed annual deduction of NIS 1,300; a resident annual deduction of NIS 3,100; deduction for non-working wife of NIS 1,550; and deductions per child of NIS 250 up to 5 children. After the taxable income is arrived at, the tax liability is calculated from the schedule.

4. A wage earner in Israel with a nonworking wife and three children with an annual income of NIS 12,000 pays no income tax, while in the Occupied Territories, he pays NIS 464, or about 4 percent of salary. On a salary of NIS 30,000, the Israeli taxpayer pays NIS 1,999, or about 7 percent of salary, while in the Occupied Territories, he pays NIS 5,088, or 17 percent of salary. With an NIS 48,000 salary, the Israeli taxpayer pays NIS 7,180 or about 15 percent of salary, while a resident of the Occupied Territories pays NIS 13,285, or about 28 percent of salary.

Table 1. Civil Administration Budget, 1987/88-1992

	Actuals					Budget
	1987/88	1988/89	1989/90	1990/91	II-IV, 91	1992
	(In millions of New Israeli Shekels)					
Revenue	345	368	462	546	577	727
Income tax	56	73	109	134	125	175
VAT	52	55	69	89	106	285
Customs and excises	44	43	55	73	72	0
Health fees	16	23	31	28	38	61
Other fees and charges	135	123	158	188	192	150
Deduction fund	42	51	40	34	44	56
Current expenditure	286	325	381	471	410	649
Health	67	73	84	96	91	130
Education	103	93	116	146	124	198
Welfare	22	15	14	17	18	28
Other	93	144	167	212	177	293
Development expenditure	86	41	49	75	87	119
Total expenditure	372	366	430	546	497	768
Overall deficit(-) or surplus	-27	2	32	0	80	-41
Financing	27	-2	-32	0	-80	41
Israeli Treasury	27	0	0	0	0	41
Increase in cash balances(-)	0	-2	-32	0	-80	
GDP at market prices	2837	3025	3442	4477	4884	
			(In percent of GDP)[1]			
Revenue	12.2	12.2	13.4	12.2	13.5	
Income tax	2.0	2.4	3.2	3.0	3.2	
VAT	1.8	1.8	2.0	2.0	2.6	
Customs and excises	1.6	1.8	1.6	1.6	1.8	
Health fees	0.6	0.8	0.9	0.6	1.0	
Other fees and charges	4.8	4.1	4.6	4.2	4.8	
Deduction fund	1.5	1.7	1.2	0.8	1.1	
Current expenditure	10.1	10.7	11.1	10.5	10.8	
Health	2.4	2.4	2.4	2.1	2.4	
Education	3.6	3.1	3.4	3.3	3.3	
Welfare	0.8	0.5	0.4	0.4	0.4	
Other	3.3	4.8	4.9	4.7	4.7	
Development expenditure	3.0	1.4	1.4	1.7	2.2	
Total expenditure	13.1	12.1	12.5	12.2	13.0	
Overall deficit(-) or surplus	-1.0	0.1	0.9	0.0	1.6	

Source: Civil Administration

1/ Anualized for 1991.

Table 2. Budgets of the Municipalities, 1987/88-1992

	Actuals				
	1987/88	1988/89	1989/90	1990/91	II-IV, 91
	(In millions of New Israeli Shekels)				
Revenues	127	90	110	134	134
Taxes and fees	59	27	30	33	38
Water and sewarage charges	15	14	15	18	19
Electricity charges	53	49	65	83	84
Current expenditure	118	94	124	142	138
General services	56	39	43	46	41
Water sewerage	14	12	17	19	14
Electricity	48	43	64	77	83
Development expenditure	44	16	14	16	19
Total expenditure	162	110	138	158	157
Overall deficit(-), surplus	-35	-20	-28	-24	-16
Financing	35	20	28	24	16
From civil administration	24	10	11	14	16
From external financing	4	1	3	5	2
Self-financing	10	3	3	3	1
Other	-3	6	11	2	-3
GDP at market prices	2837	3025	3442	4477	4884
	(In percent of GDP)				
Revenues	4.5	3.0	3.2	3.0	3.6
Taxes and fees	2.1	0.9	0.9	0.7	0.9
Water and sewarage charges	0.5	0.5	0.4	0.4	0.5
Electricity charges	1.9	1.6	1.9	1.9	2.1
Current expenditure	4.2	3.1	3.6	3.2	3.5
General services	2.0	1.3	1.2	1.0	1.1
Water and sewarage	0.5	0.4	0.5	0.4	0.4
Electricity	1.7	1.4	1.9	1.7	2.0
Development expenditure	1.6	0.5	0.4	0.4	0.5
Total expenditure	5.7	3.6	4.0	3.5	4.0
Overall deficit, surplus	-1.2	-0.7	-0.8	-0.5	-0.4

Source: Statistical Abstract of Israel, various issues

Table 3. Budgetary Operations of the Public Sector, 1987/88-91

	Actuals					
	1987/88	1988/89	1989/90	1990/91	II-IV,91	Average 1987-91
	(In percent of GDP)					
Revenue	16.7	15.2	16.6	15.2	17.1	16.2
Total expenditure	17.9	15.4	16.2	15.5	16.6	16.3
Current expenditure	14.2	13.8	14.7	13.7	14.3	14.1
Development expenditure	3.7	1.6	1.5	1.8	2.3	2.2
Overall budget surplus or deficit	-1.2	-0.2	0.4	-0.3	0.5	-0.2
Financing	1.2	0.2	-0.4	0.3	-0.5	0.2
From Israeli Treasury	0.9	0.0	0.0	0.0	0.0	0.2
From external sources	0.1	0.1	0.1	0.1	0.1	0.1
Change in balances	0.2	0.1	-0.5	0.2	-0.6	-0.1

Sources: Tables 1 and 2; and staff calculations.

Table 4. Losses from Tax Payments by Palestinians, 1991
(In millions of New Israeli Shekels)

Item	Loss
Taxes on imports via Israel	60
Taxes on trade with Israel	340
Value Added Tax	210
Customs duties on import content	17
Fuel taxes	40
Excise taxes	18
Purchase taxes	40
Electricity purchases	15
Total	400
Memorandum item:	
In percent of 1991 GDP	8

Source: Staff calculations

Table 5. Integrated Public Sector Finances, 1987-91

	Public Sector	Integrated Public Sector
	Average 1987-91	Average 1987-91
	(In percent of GDP)	
Revenue	16.1	24.1
Expenditure excluding defense	16.3	25.8
Current expenditure	14.1	22.3
Of which: UNRWA		4.5
Other quasi-government		2.5
Israeli budget		1.2
Development expenditure	2.2	3.5
Of which: Israeli budget		0.8
Other quasi-government		0.5
Overall deficit (-)/ surplus (+)	-0.2	-1.7
Financing	0.2	1.7
Israel	0.2	2.2
UNRWA	--	4.5
Other external sources	0.1	3.1
Increase in cash balances	-0.1	-8.1[1]

Sources: Tables 3 and 4; and staff calculations

1/ This increase, basically reflecting the revenue foregone by the Civil Administration, is more than offset by substantial expenditures by Israel on security in the Occupied Territories.

Table 6. Revenue and Expenditure Comparisons: Egypt, Israel, Jordan, OT and Developing Countries.

	Average: 1987-91					1989
	Egypt	Israel	Jordan	OT	OT Adjusted	Developing countries
				(In percent of GDP)		
Revenue	23.1	38.6	27.2	24.1	21.7	22.1
Tax revenue	15.2	33.9	14.3	16.1	16.1	17.5
Direct taxes	5.7	17.5	3.4	4.2	4.2	5.4
Indirect taxes	9.5	16.4	10.9	11.9	11.9	12.1
Nontax revenue	7.9	4.7	12.9	8.0	8.0	4.6
Expenditure	42.2	50.2	46.4			28.0
Current expenditure	28.9	45.7	37.2			21.0
Developemnt expenditure	13.3	4.5	9.2			7.0
Expenditure excluding defense	37.2	36.8	30.5	25.8	23.6	25.6
Current expenditure excluding defense	23.9	32.3	21.3	22.8	20.1	18.6
Development expenditure	13.3	4.5	9.2	3.5	3.5	7.0
				(In percent of GNP)		
Memorandum items						
Revenue	21.7	39.4	28.9	17.8	16.2	23.3
Of which: Indirect taxes	8.9	16.7	11.6	8.9	8.9	12.7

Table 7. Israel: Individual Income Tax, January 1992

Monthly Taxable Income (New Israeli Shekels)	Rate/Credit (percent)
Tax Rate	
0 - 2,050	21.00
2,051 - 3,380	31.50
3,381 - 4,820	36.75
4,821 - 7,480	47.25
Over 7,480	50.40
Tax Credit	
0 - 2,050	4.30
2,051 - 2,098	35.00
2,099 - 3,380	3.40
3,381 - 3,468	32.00
3,469 - 4,820	2.50
4,821 - 4,957	27.00
4,958 - 10,080	1.70
10,081 - 10,739	26.00
Over 10,739	NIL

Source: Kesselman and Kesselman Guide to Investment in Israel, 1992/3

Table 8. Occupied Territories: Individual Income Tax, January 1992

Monthly Taxable Income (New Israeli Shekels)	Tax Rate (Percent)
0 - 600	0
601 - 1,000	8
1,001 - 1,667	16
1,668 - 2,500	32
2,501 - 3,750	45
3,751 and up	48

Source: Civil Administration

Annex 3: Trading Patterns in a Less Restricted World
Results from a Gravity Model

Impact, Gravity Flow Estimation

As countries in the region move toward normalization of relations, it is natural to ask how their trading patterns will change. Our approach is based on a best-case scenario, in which the fundamental determinants of trade flows among the countries in the region become similar to those of present-day market economies. To that end, we rely on a gravity-type equation.[1] In its basic form, the equation is written as:

$$T_{ij}=\{TP_i, TP_j, TA_{ij}\}$$

where TP_{ij} refers to the trade potential of countries i and j, and TA_{ij} is the trade attraction between them. The gravity model specifies that a country's trade potential depends on its total output and the trade intensity of that output. Trade intensity depends on economic as well as geographic features of a country. The share of a particular partner depends on the partner's trade potential and the trade attraction. The trade attraction is a function of geographic proximity, economic similarity, the existence of preferential trading arrangements, and cultural similarities. In order to capture these factors, we specify the following equation:

$$\begin{aligned} T_{ij}=&\beta_1(dist_{ij})+\beta_2(bord_{ij})+\beta_3\{|LGDPPC_i-LGDPPC_j|\} \\ &\delta_1 LGDP_i+\delta_2 LGDPPC_i+\delta_3 Size_i+\delta_4 Island_i+ \\ &\gamma_1 LGDP_j+\gamma_2 LGDPPC_j+\gamma_3 Size_j+\gamma_4 Island_j+ \\ &\sum_{k=1}^{3}\alpha^k Region_k+\sum_{l=1}^{4}\lambda^l Language_l \end{aligned}$$

where T_{ij} refers to bilateral non-fuel import and export values in US$. The US$ per capita GDPs at purchasing power parity for the reporter and the partner countries are included in order to capture the effects of each country's level of development. The variables for distance between countries and the corresponding absolute difference in per capita GDPs (at purchasing power parity) capture the Linder hypothesis (1961).[2] The former refers to the distance between the economic centers of the two countries, and the latter is a proxy for economic similarity. The size of each country is measured by area in square kilometers, and separate dummy variables are included for islands and the existence of a common border.

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[1]Gravity models have been applied successfully to different types of flows, such as migration, commuting, recreational traffic, and interregional and international trade.

[2]Linder (1961) postulates that the intensity of bilateral trade in manufactures is determined by similarities in demand structures (captured through similarities in per capita incomes), and geographical distance between importing and exporting countries.

Separate dummy variables are also included when necessary for the EEC, LAFTA, and ASEAN.[3] Finally, a language dummy variable is included to proxy for cultural similarities. It assumes the value of one if the countries share a common language, otherwise its value is set to zero; separate dummy variables are included for English, Spanish, Portuguese and Arabic. Finally, it was assumed that all English-speaking reporter countries share the language with Israel.

Equation 2 has been estimated using data for 15 middle- to upper- income economies with substantial non-primary exports. The estimated coefficients for imports and exports along with other statistics are presented in Tables 1 and 2.[4] Nearly all the variables (with the exception of the per capita GDPs for the reporter and partner countries) have the expected sign and are quite significant. Trade increases with the level of GDP of the reporter and partner, and decreases with size. Sharing a common border or a common language enhances trade, while distance restrains it.

The estimated coefficients are then used along with the actual data for Israel and the Occupied Territories (OT) to project the direction of their trade. The results for Israel are presented in Tables 3 and 4 below. For the OT, four different scenarios are postulated, and their results are reported in Table 5. The first scenario assumes that the two countries share a common language in addition (Arabic). Scenario 3 adds to the second the assumption of a free trade area (FTA) between Israel and the OT. Finally, under scenario 4, Jordan is assumed to be a third member of the FTA.

The first two columns of Tables 3 and 4 indicate the actual 1989 volume of non-fuel trade and the corresponding partner's share, while the third column reports the predicted shares which are obtained from the simulation exercise. The last column shows what the predicted share represents for the partner countries' 1989 share in non-fuel trade assuming zero transport costs. In the case where the OT is the partner, actual trade figures refer to 1987, the latest year for which trade data were available. Due to lack of comprehensive partner country data for the OT, Table 5 reports only the predicted shares.

Finally, since our goal in this exercise is to simulate the redirection of trade of these two economies, rather than their trade potential, the predicted amounts of trade of Israel and the OT have been normalized to their actual levels.

On the import side, despite the fact that Israel's overall non-fuel import bill has been kept constant, the predicted changes in its redirection are quite significant. Israel is predicted to more than triple its import shares from its Arab neighbors (Table 3). This is anticipated to come at the expense of both the United States and the EEC. Egypt and the OT are project to supply more than half of Israel's imports that originate from the Arab Middle Eastern countries. With a 3% import share, Egypt is projected to emerge as Israel's most important import partner in the area. This translates into one-fifty of Egypt's total non-fuel 1989 exports. The OT are projected to follow with a 2.2% share in Israel's

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[3]For example, Aitken (1973) found European trade to be significantly influenced by membership in the EEC or EFTA and by being neighbors. Srivastava and Green (1986) found cultural similarity, political circumstances, economic union and former colonial status to be significant determinants of trade between nations.

[4]Variables with an "L" prefix have been converted to natural logarithms. Moreover, since the values of bilateral trade are only observed for non-negative values, ordinary least squares estimates will be inconsistent. Therefore, we use maximum likelihood estimation technique.

import bill (down from an actual of 2.6%). This translates into more than 67% of total 1987 OT's exports. This high share can be attributed to the OT's relatively small 1987 export base of $385 million. On the export side, the redirection of Israel's trade appears to be less dramatic. It is estimated that the Arab countries would combine to absorb only about 11% of Israel's exports, versus an actual figure of 9.3%. This results from intra-regional trade diversion--away from the OT and towards the other Arab countries in the region. The share of the OT in Israel's exports, while remaining the largest in the region, is projected to drop from 9.3% to 4.3%, with much of the slack being picked up mainly by the relatively small-sized countries in the region (Lebanon, Jordan and Syria).

Finally, applying the predicted trade shares of Israel to its actual non-fuel trade results in Israel experiencing, on balance, a trade deficit of about $50 million with the Arab countries. This result is largely driven by a projected $243 million deficit with Egypt,[5] and a $183 million surplus with the OT. Israel is project to run bilateral trade surpluses with countries like Lebanon, Jordan and Syria, while at the same time experiencing deficit with the rest of the Arab countries (mainly the Gulf Cooperating Council (GCC) and Maghreb countries).

Under the assumption that the OT and Israel would only share a common border with each other, it is project that the OT would be sourcing some 31% of their imports from their neighbors who, in their turn, are projected to absorb more than 50% of OT's total exports. Under this scenario, Jordan and Egypt are projected to be the single most important regional trading partners of the OT, and the GCC the most important trading bloc in the region. Under this scenario, Israel's share in OT's trade is projected to be the smallest in the region.

Adding the assumption of a common language between Israel and the OT would more than double their bilateral trade shares. However, Jordan and Egypt still emerge as the most valuable single partners for the OT, while the role of the GCC bloc remains basically unchanged.

Scenario 3 assesses the potential importance of creating an FTA between Israel and the OT. It does so by relying on the trade-weighted coefficient of integration reported in Tables 1 and 2 for the EEC, LAFTA, and ASEAN.[6] Under this scenario, Israel re-emerges to dominate OT's trade, while the position of Jordan in the OT's trade and to a lesser extent the GCC bloc are dramatically eroded. Finally, under the fourth scenario where Jordan is now assumed to have become a third member of the FTA, Israel is projected to cede its leading role in the OT's trade to Jordan. More than half of the OT's trade is projected to take place with its FTA partners. The OT's trade with the GCC bloc would suffer, and so would trade with North America and the EEC. Trade with Egypt appears to be resilient to change under differing scenarios.

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[5]This results in mainly due to two factors. Firstly, note from Tables 1 and 2 that trade is inversely related to size, with the coefficient estimate on the import side equal in absolute value to approximately one-fourth of the corresponding estimate on the export side. Secondly, and as is reported in Tables 1 and 2, the trade potential between any two countries is inversely related to the differences in their per capita income. The coefficient estimate on the import side is much larger than the corresponding export estimates. These two factors combine to create the noted deficit.

[6]Trade shares with the countries in the EEC. LAFTA and ASEAN are those of Israel.

Table 1: Regression results using imports as dependent variable and 14 mid to upper income economies as sample

Maximum Likelihood Estimates

Log-Likelihood..... -2940.0

Variable	Coefficient	Std. Error	T-ratio	Prob|t|≥x	Mean of X	Std.D.of X
INTERCEPT	.899480	.650426	1.383	.16669	1.0000	.00000
LDSTIJ	-1.08914	.160483	-6.787	.00000	1.5830	.70121
BORDIJ	.641652	.553652	1.159	.24648	.28571E-01	.16664
LGDPI	1.00517	.151708	6.626	.00000	3.7083	1.0262
LGDPP	2.16734	.881077E-01	24.599	.00000	2.9076	1.7830
LGDPPCI	-.111740	.218105	-.512	.60843	.90250	.60032
LGDPPCP	.110293	.115853	.952	.34109	.57479	1.3385
IDEEC	.685357	.875976	.782	.43398	.12030E-01	.10906
IDLAFTA	2.23842	.671386	3.334	.00086	.30075E-01	.17086
IDASEAN	2.56435	1.26306	2.030	.04233	.60150E-02	.77352E-01
IENGLISH	1.62835	.785639	2.073	.03820	.15038E-01	.12175
ISPANISH	1.81507	.498464	3.641	.00027	.51128E-01	.22034
IPORTUG	1.09457	1.71185	.639	.52256	.30075E-02	.54779E-01
IARABIC	.148882	.950750	.157	.87556	.11278E-01	.10564
LADYPC	-.690041E-01	.347906E-01	-1.983	.04732	3.3222	3.0526
LSIZEI	-.250774	.119872	-2.092	.03644	5.6807	1.4719
LSIZEP	-.514593	.639710E-01	-8.044	.00000	5.4759	1.9882
ISLDI	.501866	.309396	1.622	.10479	.14286	.35006
ISLDP	.238707E-02	.270401	.009	.99296	.19850	.39902
σ	3.33184	.776335E-01	42.918	.0000		

Table 2: Regression results using exports as dependent variable and 14 mid to upper income economies as sample

Maximum Likelihood Estimates

Log-Likelihood..... -3067.4

Variable	Coefficient	Std. Error	T-ratio	Prob|t|≥x	Mean of X	Std.D.of X
INTERCEPT	2.89202	.549115	5.267	.00000	1.0000	.00000
LDSTIJ	-1.26950	.137294	-9.247	.00000	1.5830	.70121
BORDIJ	.703754	.523980	1.343	.17924	.28571E-01	.16664
LGDPI	2.30660	.128827	17.905	.00000	3.7083	1.0262
LGDPP	1.28051	.739157E-01	17.324	.00000	2.9076	1.7830
LGDPPCI	-.535192	.184015	-2.908	.00363	.90250	.60032
LGDPPCP	.859836E-01	.986857E-01	.871	.38360	.57479	1.3385
IDEEC	.654495	.757953	.864	.38786	.12030E-01	.10906
IDLAFTA	2.37628	.579658	4.099	.00004	.30075E-01	.17086
IDASEAN	1.89703	1.09295	1.736	.08262	.60150E-02	.77352E-01
IENGLISH	2.77048	.668256	4.146	.00003	.15038E-01	.12175
ISPANISH	1.74838	.427547	4.089	.00004	.51128E-01	.22034
IPORTUG	3.90030	1.45074	2.688	.00718	.30075E-02	.54779E-01
IARABIC	2.02706	.784447	2.584	.00976	.11278E-01	.10564
LADYPC	.207566E-01	.297633E-01	.697	.48556	3.3222	3.0526
LSIZEI	-.923003	.100862	-9.151	.00000	5.6807	1.4719
LSIZEP	-.237825	.543952E-01	-4.372	.00001	5.4759	1.9882
ISLDI	1.44240	.260571	5.536	.00000	.14286	.35006
ISLDP	-.265673	.229746	-1.156	.24753	.19850	.39902
σ	2.88713	.621701E-01	46.439	.0000		

Finally, and as would be expected from the simulation results at hand, the OT is expected in general to run a trade deficit with countries characterized by a relatively high per capita income, and the reverse with relatively lower per capita income countries.

Table 3: Actual and Predicted Non-Fuel Import Shares of Israel.

Partner	Actual Imports (US$ 000)	Actual Share (%)	Predicted Share (%)	Israel's Share in Partner (%)
Egypt	4,873	0.0	3.1	19.98
Occupied Territories[1]	303,700	2.6	2.2	67.76
Syria	0	0.0	1.1	9.71
Lebanon	0	0.0	0.3	8.72
Jordan	0	0.0	0.5	6.41
GCC[2]	0	0.0	0.9	2.11
Other Middle East[3]	0	0.0	0.5	N.A.
Other North Africa[4]	0	0.0	1.1	2.18
All Arab Countries	308,573	2.6	9.7	—
Iran	0	0.0	0.8	0.39
North America[5]	2,436,041	20.5	14.5	0.54
European Community	6,622,028	55.8	49.3	0.36
EFTA	1,451,675	12.2	5.3	0.46
Other Developed[6]	431,554	3.6	12.4	0.20
South & Central America	168,195	1.4	1.4	N.A.
Sub-Saharan Africa	30,247	0.3	0.8	0.23
Asia & Pacific	417,813	3.5	5.8	—
TOTAL	11,866,126	100.0	100.0	

[1]Includes both the West Bank and Gaza Strip.

[2]Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3]Includes Yemen, Sudan, and Iraq.

[4]Includes Yemen, Sudan and Iraq.

[5]Includes the United States and Canada.

[6]Includes Australia, Japan, New Zealand, South Africa and Turkey.

Table 4: Actual and Predicted Non-Fuel Export Shares of Israel.

Partner	Actual Exports (US$ 000)	Actual Share (%)	Predicted Share (%)	Israel's Share in Partner (%)
Egypt	4,480	0.0	1.2	1.70
Occupied Territories[1]	961,200	9.3	4.3	42.27
Syria	0	0.0	0.7	2.66
Lebanon	0	0.0	0.3	2.16
Jordan	0	0.0	0.4	2.40
GCC[2]	0	0.0	1.3	0.47
Other Middle East[3]	0	0.0	0.9	N.A.
Other North Africa[4]	0	0.0	1.6	0.94
All Arab Countries	965,680	9.3	10.7	----
Iran	0	0.0	0.7	N.A.
North America[5]	3,423,388	33.1	16.2	0.31
European Community	3,389,944	32.8	30.0	0.29
EFTA	447,908	4.3	4.5	0.25
Other Developed[6]	956,357	9.3	14.1	0.65
South & Central America	209,415	2.0	4.5	0.69
Sub-Saharan Africa	42,427	0.4	5.2	N.A.
Asia & Pacific	897,493	8.7	14.1	0.43
TOTAL	10,332,612	100.0	100.0	----

[1]Includes both the West Bank and Gaza Strip.

[2]Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3]Includes Yemen, Sudan, and Iraq.

[4]Includes Yemen, Sudan and Iraq.

[5]Includes the United States and Canada.

[6]Includes Australia, Japan, New Zealand, South Africa and Turkey.

Table 5: Predicted Non-Fuel Import & Export Shares of the Occupied Territories Under the Different Scenarios[1]

	Sharing Only Common Border with Israel		Sharing Border & Language with Israel		Sharing Border & Language & FTA with Israel		Sharing Border, Language & FTA with Israel & Jordan	
Partner	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)
Egypt	4.5	6.3	4.3	5.9	4.5	6.8	3.2	5.9
Israel	2.3	1.5	4.7	3.6	36.2	20.2	24.1	16.6
Syria	3.3	5.3	3.2	5.2	1.8	4.1	1.2	3.4
Lebanon	1.2	2.5	1.2	2.4	0.5	1.9	0.3	1.6
Jordan	5.8	6.4	5.7	5.3	2.2	3.9	34.2	20.5
GCC[2]	5.6	10.8	5.3	11.2	3.2	8.8	2.6	7.6
Other Middle East[3]	2.8	6.4	2.9	6.9	1.8	5.3	1.2	4.4
Other North Africa[4]	5.4	11.3	5.5	10.9	3.1	8.7	2.1	7.1
All Arab Countries	30.9	50.5	32.8	51.4	53.3	59.7	68.9	67.1
Iran	0.5	0.7	0.5	0.8	0.4	0.6	0.3	0.5
North America[5]	20.8	9.9	20.2	9.7	14.9	12.3	9.4	10.1
European Community	22.5	15.1	21.6	14.9	14.1	12.3	9.4	10.1
EFTA	3.5	3.2	2.9	2.8	2.2	3.3	1.5	2.7
Other Developed[6]	12.8	6.3	12.6	6.5	8.9	5.4	5.9	4.4
South & Central America	3.9	5.7	4.1	5.6	2.7	4.9	1.8	4.1
Sub-Saharan Africa	0.7	2.5	1.1	2.4	0.5	2.3	0.3	1.8
Asia & Pacific	4.4	6.1	4.3	5.9	3.1	5.3	2.1	4.3
TOTAL	100.0	100.0	100.0	100.0	100.1	100.0	100.1	100.1

[1] The predictions are based on the assumption that the West Bank is the "center of gravity" of the Occupied Territories. Again, Occupied Territories includes both the West Bank and Gaza Strip.

[2] Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3] Includes Yemen, Sudan and Iraq.

[4] Includes Morocco, Tunisia, Algeria and Libya.

[5] Includes the United States and Canada.

[6] Includes Australia, Japan, New Zealand.

Data Sources and Description

Trade

T is the average annual 1987-1989 US$ value of total non-fuel (SITC 0 through 9 less 3) imports or exports. The data were extracted from the UNSO COMTRADE data base.

Geography

Distance is the straightline distance between the economic centers of gravity of the respective countries, from Linneman (1966).

Border is equal to one if the countries share a border, zero otherwise.

Economic Activity

GDP is US$ GDP taken from the World Bank Atlas. The Atlas method uses a conversion factor other than the official rate when the latter is wildly distorted.

GDPPC is US$ GDP per capita from the World Bank Atlas.

Area is the land area in thousand square kilometers.

Island is equal to one if the country is an island, zero otherwise.

Trade Preference Arrangements

Region is equal to one if both countries are party to a preferential trading arrangement, zero otherwise. The arrangements included are: ASEAN, EEC, and LAFTA.

Cultural

Language is equal to one of both countries share a common language. The languages included are: Arabic, English, Portuguese, and Spanish.

The Sample

The partner countries used in both samples are 95 non-socialist economies with total imports of at least $450 million in 1987. The reporter economies chosen were: Greece, Ireland, Korea, Portugal, Spain, Uruguay, Venezuela, Singapore, Hong Kong, Taiwan, Italy, Austria, Tunisia and Morocco.

Annex 4: Simulation Models

The simulation models are built around several blocks which are described here.

1. **Population.** In line with the human resources chapter, population is assumed to grow at a rate of 3.5 percent a year in the West Bank, and 4.0 percent in Gaza. The overall labor participation ratio is assumed to start at 20 percent and to increase over time to 21 percent.

2. **Work in Israel.** Initially, labor working in Israel is taken to be 97,000, its level in 1991. In the base case scenarios with smooth labor cut-off, we assume that the labor force working in Israel shrinks by 10 percent a year. In the labor cut-off scenarios, we assume that the labor force in Israel drops to 50 percent of its 1991 level in year 1, and shrinks by 10 percent a year afterwards. The minimum wage in Israel, which is the wage earned on average by Palestinian working in Israel, is taken to be $7660 per year in 1991, and we assume that it grows at a average rate of half a percent a year.

3. **Aggregate domestic production and aggregate income** is modelled using a Cobb-Douglas production function of the form: $F = AK^aL^{(1-a)}$, where L is the labor force at work, and K is the total capital stock, which should be taken in this context as a measure of the total productive capital stock, including machinery, inventories, land, and real estate. The calibration is done to fit the situation in the base year, 1991, and is taken to be the solution to a system of three equations:

(i) we set the actual domestic product per worker ($9958) equal to F/L.

(ii) we set the actual average domestic yearly wage rate ($4900) equal to the first derivative of the production function with respect to labor, $A(1-a)k^a$, where k is the capital to labor ratio, $k = \frac{K}{L}$

(iii) we estimate independently the shadow cost of capital at 15 percent, and set it equal to the first derivative of the production function with respect to capital, $Aak^{(1-a)}$.

The three equations are solved for A, k, and a. The solution to this system yields: $a=0.5$, $A=50$, and $k=\$33,000$.

GDP is defined as the value of domestic production F. GNP is defined as GDP plus workers remittances.

4. **Productivity Gains.** In the scenarios that assume future productivity gains, we increase A over time. In the scenarios with "good policy", A is increased by 5 percent a year for four years in a row and by 1% per year thereafter. In the scenarios with "medium policy", A is increased by 5 percent a year for two years in a row only.

5. **Labor and Unemployment.** Let TL be total labor force, L(H) and L(I) be labor demand at home, and Israeli demand for Palestinian workers, and U be the number of unemployed. Technically, the projections require the use of one of two procedures:

(I) labor demand is taken as given, and the wage rate is computed as the marginal productivity of labor $A(1-a)k^a$;

(II) the wage rate is taken as given, and the labor demand at this wage is computed by solving $A(1-a)k^a = w$ for L.

We consider several possible regimes.

a. Constrained labor mobility with flexible wages at home (full employment). In this case, technique (I) is used, with labor demand at home set to TL-L(I).

b. Constrained labor mobility with inflexible wages at home (unemployment). In this case, the unemployment rate is set exogenously (so that after the occurrence of a negative shock, the initial wage drop is deemed realistic) and labor demand at home is set to TL-L(I)-U.

c. Unconstrained labor mobility. In this case, II is used to compute the pair [L(H), L(I)] that make the domestic wage equal to the Israeli minimum wage. In case L(I) is negative, it is set to zero, and the regime shifts to one with full employment of the total labor force at home, with wages determined by technique I.

6. **Savings and Investment.** A consolidated government budget module constrains public consumption and investment to the level of fiscal resources that are expected to be available. When expenditures (including public debt service) exceed government revenues, the budget deficit must be financed with external grants and loans, and with domestic borrowing.

A private sector saving/investment module closes the model. The private sector's disposable income is taken to be the Gross National Product (which includes the remittances from Palestinian workers in Israel and further abroad), plus external transfers accruing to the provate sector (including from private reserves), minus domestic transfers to the government (taxes and loans). Private income is allocated between consumption and investment according to a private saving rate, which is assumed to adjust so as to smooth consumption over time and circumstances. Some of the external transfers are taken to be inflows of capital from the Palestinian diaspora and other foreign direct investors seeking to finance domestic projects (including housing), or the purchase of land.

Annex 5: Statistical Appendix
List of Tables

OCCUPIED TERRITORIES: STATISTICAL APPENDIX

Explanatory Notes

1) Credibility of the Data

In view of the difficulties in data acquisitions and availability, it is important to clarify and emphasize the limitations of the Data produced in the appendix.

According to the Central Bureau of Statistics of Israel and in reference to its publication relating to Judea, Samaria and Gaza area statistics, Vol. XX, 1991.

The "free" movement of residents and goods and the close ties between the Israeli economy and those of Judea, Samaria and the Gaza area, make it difficult to measure the volume of transactions between the residents of those regions and residents of Israel. Furthermore, there are no comprehensive statistics throughout the Accounts. Consequently, some of the estimates are based on partial data and evaluation.

The low reliability of the following items should be particularly noted: imports and exports of goods and services from Israel; private consumption of goods and services from Israel; payments to employees from Judea, Samaria and the Gaza Area working in Israel; consumption of services of non-profit institutions; revenue from industry and data on the construction branch."

Other Publications of the CBS (such as the statistical Abstracts of Israel and National Accounts of Judea, Samaria and Gaza area 1968-1986) do refer to the low reliability of the data. However, in view of these problems, the staff found it necessary to use its best judgement and make estimates (particularly for the period 1987-1991).

2) Methodology

In reference to Table 1 of the appendix, and particularly to GNP at 1991 prices in US$
The following rebasing method was applied.

* Using a series of current GNP (in NIS) for the period of 1968-1991.

(a) a deflator series (for 1986) was developed; dividing the current series of GNP by the GNP at 1986 prices in NIS.

(b) a new deflator series (for 1991) was developed; dividing the 1986 deflator series by the value of the deflator 86 series in the year 1991.

(c) a new 1991 GNP series in NIS was developed dividing the current GNP series by the new deflator 91 series.

(d) the 1991 GNP series in NIS was converted into dollars by using the NIS per $ value of 1991.

Table 1: Occupied Territories, National Accounts Statistics, Selected Indicators (1968-1991).

	Population (in 000's)	G.N.P Current (US$ million)	GNP at 91 prices (US$ million)	GNP/Capita 91 prices (US$)	GDP/Capita 91 prices (US$)	GNP 86 prices (NIS million)	GNP/Capita 86 prices (NIS)	GDP 86 prices (NIS million)	GDP/Capita 86 prices (NIS)
1968	939900.0	136.3	518.60	551.7	573.50	640.7	681.7	689.3	733.4
1969	961800.0	172.6	622.40	647.2	628.50	769.0	799.5	773.0	803.7
1970	977800.0	208.0	734.30	751.0	686.10	907.2	927.8	857.9	877.4
1971	1001400.0	283.2	900.10	838.9	763.00	1121.1	1110.5	977.1	975.7
1972	1020500.0	391.9	164.80	1141.4	875.60	1433.1	1410.2	1142.7	1119.7
1973	1053900.0	494.8	1146.80	1088.2	814.30	1416.3	1344.4	1097.4	1041.3
1974	1083700.0	752.2	1346.40	1242.5	967.00	1663.5	1535.0	1340.1	1236.6
1975	1100700.0	786.3	1409.20	1280.3	962.70	1741.0	1581.7	1355.1	1231.1
1976	1120700.0	899.1	1576.60	1406.8	1090.00	1947.8	1738.0	1562.1	1393.9
1977	1146500.0	929.3	1565.00	1365.0	1054.60	1933.5	1686.4	1546.2	1348.6
1978	1171000.0	965.5	1769.50	1511.1	1165.30	2186.2	1867.0	1744.9	1490.1
1979	1163300.0	1182.5	1810.70	1556.5	1154.40	2237.1	1923.1	1717.3	1476.2
1980	1180800.0	1448.8	1980.00	1676.9	1303.30	2446.3	2071.7	1968.0	1666.7
1981	1200700.0	1404.3	1935.90	1612.3	1201.60	2391.7	1991.9	1845.0	1536.6
1982	1226600.0	1504.0	2201.40	1794.7	1277.40	2719.8	2217.3	2003.6	1633.5
1983	1266300.0	1601.5	2180.30	1721.8	1190.10	2693.7	2127.2	1927.1	1521.8
1984	1303300.0	1431.6	2185.40	1676.8	1214.70	2700.0	2071.7	2024.4	1553.3
1985	1342500.0	1370.1	2126.60	1584.0	1171.50	2627.3	1957.0	2011.1	1498.0
1986	1382700.0	2143.2	2580.90	1866.5	1357.10	3188.6	2306.1	2399.6	1735.4
1987	1433700.0	2503.1	2671-2700	1863-1883	1274.40	3335.5	2326.5	2336.4	1629.6
1988	1483900.0	2552-2597	2535-2601	1708-1753	1212-1242	3158-3221	2134-2165	2300-2360	1550-1590
1989	1526400.0	2439-2489	2538-2608	1663-1709	1186-1220	3160-3232	2077-2111	2315-2385	1517-1563
1990	1599700.0	2356-3027	2964-3037	1853-1899	1360-1402	3682-3773	2314-2346	2781-2872	1739-1795
1991	1681700.0	2822-2898	2822-2898	1678-1723	1237-1282	3504-3602	2096-2129	2660-2760	1582-1641
1992			3578-3675	2068-2124	1504-1559	4443-4568	2568-2641	3327-3453	1993-1996

Source: based on data extracted from the Statistical Abstracts of Israel (1970-92), and the National Accounts of Judea, Samaria and Gaza Area (1968-1986), special series No. 818 of 1988, Central Bureau of Statistics, Israel.

**All Statistics published after 1986, in the Statistical Abstracts of Israel, are Estimations.

National accounts for a988-1992 are partly based on incomplete statistical series and evaluations.

Table 2: Occupied Territories, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+) Exports of goods & services	(-) Imports of goods & services	Total GDP
1968	740.10	121.70	58.30	162.10	394.70	689.30
1969	881.80	138.36	133.40	153.20	512.10	773.00
1970	1001.50	161.00	102.60	159.60	539.10	857.90
1971	1099.00	168.70	143.60	227.70	659.90	977.10
1972	1329.70	179.20	258.50	272.90	880.00	1142.70
1973	1383.20	182.60	250.50	263.00	957.70	1097.40
1974	1507.80	185.90	403.20	319.10	1050.80	1340.10
1975	1640.00	182.20	340.10	401.20	1202.70	1355.10
1976	1748.70	187.30	422.90	461.60	1260.40	1562.10
1977	1839.00	188.30	425.20	475.60	1383.40	1546.20
1978	1870.20	192.20	536.30	535.20	1394.10	1744.90
1979	1961.30	197.60	519.20	502.90	1450.30	1717.30
1980	1966.60	193.70	680.40	547.20	1435.70	1968.00
1981	2036.90	196.20	544.90	631.20	1591.80	1845.00
1982	2100.90	196.10	626.70	609.10	1557.20	2003.60
1983	2125.90	201.30	584.20	583.20	1578.90	1927.10
1984	2206.20	207.70	565.80	540.80	1507.10	2024.40
1985	2203.60	208.50	604.10	522.20	1530.40	2011.10
1986	2543.10	233.10	761.50	620.10	1758.10	2399.60
1987	2727.60	252.30	698.20	594.20	1936.00	2336.40
1988	2447.00	223.00	676.00	305.00	1291-1351	2300-2360
1989	2521.00	238.30	607.00	255.20	1247-1311	2315-2385
1990	2886.00	303.40	743.00	340.70	1409-1493	2781-2872
1991	3175.00	295.20	692.00	378.30	1781-1874	2660-2760

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992 Central Bureau of Statistics

Table 3: West Bank, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels, at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+)Exports of goods & services	(-)Imports of goods & services	Total GDP
1968	517.50	79.70	33.70	125.10	290.50	456.30
1969	618.40	87.50	84.30	115.30	363.10	524.20
1970	691.50	100.00	55.40	106.70	364.40	556.70
1971	766.60	107.70	86.00	136.50	431.30	639.00
1972	918.10	115.40	157.30	176.10	557.20	790.00
1973	949.90	116.50	135.20	158.20	610.40	723.00
1974	1032.90	119.80	280.90	201.50	654.90	949.60
1975	1108.20	118.20	200.60	245.20	715.00	935.10
1976	1216.90	121.40	262.70	279.60	749.90	1107.00
1977	1223.20	123.30	263.60	268.00	781.90	1067.80
1978	1255.30	124.00	360.20	330.70	802.10	1246.80
1979	1345.80	131.10	322.20	307.70	905.00	1165.20
1980	1358.60	130.40	506.50	339.80	881.30	1445.20
1981	1419.80	133.30	350.60	377.40	954.10	1319.20
1982	1470.10	133.30	450.10	374.20	931.30	1497.80
1983	1471.20	138.40	404.60	360.70	925.60	1444.40
1984	1521.00	142.10	394.30	352.60	889.90	1526.20
1985	1501.30	145.40	439.80	321.90	908.60	1499.70
1986	1767.30	165.10	577.80	388.30	1042.40	1856.10
1987	1894.60	177.90	496.90	349.00	1192.70	1725.70
1988	1762.00	151.00	514.00	215.00	829.00	1767-1819
1989	1771.00	163.00	431.00	199.00	802.00	1709-1768
1990	2077.00	226.00	580.00	264.00	935.80	2150-2218
1991	2229.00	213.00	527.00	265.00	1171.00	1993-2069
1992 Estimate	--	--	--	--	--	2538-2630

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992, Central Bureau of Statistics

Table 4: Gaza Strip, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+)Exports of goods & services	(-)Imports of goods & services	Total GDP
1968	222.60	42.00	24.60	37.00	104.20	233.00
1969	263.40	50.86	49.10	37.90	149.00	248.80
1970	310.00	61.00	47.20	52.90	174.70	301.20
1971	332.40	61.00	57.60	91.20	228.60	338.10
1972	411.60	63.80	101.20	96.80	322.80	352.70
1973	433.30	66.10	115.30	104.80	347.30	374.40
1974	474.90	66.10	122.30	117.60	395.90	390.50
1975	531.80	64.00	139.50	156.00	487.70	420.00
1976	531.80	65.90	160.20	182.00	510.50	455.10
1977	615.80	65.00	161.60	207.60	601.50	478.40
1978	614.90	68.20	176.10	204.50	592.00	498.10
1979	615.50	66.50	197.00	195.20	545.30	552.10
1980	608.00	63.30	173.90	207.40	554.40	522.80
1981	617.10	62.90	194.30	253.80	637.70	525.80
1982	630.80	62.80	176.60	234.90	625.90	505.80
1983	654.70	62.90	179.60	222.50	653.30	482.70
1984	685.20	65.60	171.50	188.20	617.20	498.20
1985	702.30	63.10	164.30	200.30	621.80	511.40
1986	775.80	68.00	183.70	231.80	715.70	543.50
1987	833.00	74.40	201.30	245.20	743.30	610.70
1988	685.00	72.00	162.00	90.00	468-476	533-541
1989	750.00	75.30	176.00	56.20	451-456	606-617
1990	808.00	77.40	163.00	76.70	480-496	631-654
1991	946.00	82.20	165.00	113.30	616-633	667-691
1992						794-823

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992, Central Bureau of Statistics

Table 5: Occupied Territories, National Disposable Income (in millions of NIS at 1986 prices), 1968-1991.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	Natio Dispo Incom
1968	689.300	23.300	16.600	6.700	640.7	216.500	873.4
1969	773.000	70.000	20.800	49.200	769.0	219.200	1007.2
1970	857.900	128.400	22.900	105.500	307.2	240.600	1168.6
1971	977.100	217.100	26.700	190.400	1112.1	222.800	1352.3
1972	1142.700	360.000	26.700	333.300	1439.1	194.200	1648.4
1973	1098.100	379.400	28.300	351.100	1416.3	71.700	1500.6
1974	1340.100	381.900	28.300	353.600	1663.5	70.300	1747.6
1975	1355.100	447.500	24.500	423.000	1741.0	94.200	1845.9
1976	1562.100	448.000	22.600	425.400	1947.8	275.200	2227.3
1977	1546.200	452.400	20.000	432.400	1333.5	263.800	2201.6
1978	1744.900	504.800	19.900	484.900	2186.2	345.900	2538.6
1979	1717.300	582.800	20.000	562.800	2237.1	301.800	2550.0
1980	1968.000	539.700	20.000	519.700	2446.3	296.700	2754.4
1981	1845.000	594.900	21.100	573.800	2391.7	213.900	2618.7
1982	2003.600	729.900	19.600	710.300	2719.8	246.900	2978.1
1983	1927.100	775.700	20.800	754.900	2693.7	212.200	2312.5
1984	2024.400	702.500	24.100	678.400	2700.0	190.900	2892.5
1985	2011.100	639.000	17.200	621.800	2627.3	152.700	2780.9
1986	2399.600	804.800	15.900	788.900	3188.6	174.300	3362.9
1987	2336.100	1018.300	19.700	999.300	3335.5	221.700	3557.4
1988	2300-2360	876.900	21.500	855.300	3158-3221	160.900	3323-3385
1989	2315-2385	864.600	24.600	840.100	3160-3232	163.000	3328-3398
1990	2781-2872	933.500	32.100	901.600	3682-3773	188.500	3877-3967
1991	2660-2760	868.700	26.000	842.800	3504-3602	190.300	3703-3800
1992	3327-3453	1134.000	27.000	1107.000	4443-4568		4190-4767

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.

* Figures for the period 1987-91 are estimations.

Table 6: West Bank, National Disposable Income (in millions of NIS at 1986 prices), 1968-91.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	Natio Dispo Incom
1968	456.300	21.600	12.600	9.000	462.900	162.000	636.
1969	524.200	62.300	16.800	45.500	569.700	137.000	716.
1970	556.700	104.700	16.800	87.900	645.200	144.300	799.
1971	639.000	184.600	18.600	166.000	809.900	120.500	936.
1972	790.000	278.000	18.600	259.400	1054.200	97.200	1157.
1973	723.700	269.600	20.200	249.400	978.300	31.500	1015.
1974	949.600	277.400	18.900	258.500	1218.600	27.700	1253.
1975	935.100	335.600	16.000	319.600	1262.300	23.200	1292.
1976	1107.000	323.200	15.400	307.800	1423.700	116.700	1551.
1977	1067.800	329.700	13.300	316.400	1392.600	105.600	1509.
1978	1246.800	356.600	12.900	343.700	1598.200	165.100	1778.
1979	1165.200	397.600	12.800	384.800	1558.500	146.300	1718.
1980	1445.200	364.100	12.800	351.300	1803.700	141.900	1360.
1981	1319.200	391.600	14.200	377.400	1709.900	111.000	1832.
1982	1497.800	433.100	14.200	418.900	1930.700	116.400	2058.
1983	1444.400	435.500	15.300	420.200	1881.100	89.100	1976.
1984	1526.200	389.700	16.500	373.200	1901.700	67.000	1969.
1985	1499.700	369.100	12.000	357.100	1857.500	65.400	1924.
1986	1856.100	447.200	11.100	436.100	2292.200	71.400	2363.
1987	1725.700	590.800	13.500	577.000	2303.000	121.300	2424.
1988	1767-1819	545.400	13.900	531.800	2301-2356	68.3	2373-2
1989	1709-1768	585.600	16.000	570.100	2282-2344	54.1	2340-2
1990	2150-2218	583.500	22.600	561.500	2705-2776	83.1	2794-2
1991	1993-2069	548.800	18.500	530.600	2521-2598	86.0	2614-2
1992	2533-2630	783.000	19.000	764.000	3303-3403		3396-3

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.

*. Figures for the period 1987-92 are estimations.

Table 7: Gaza, National Disposable Income (in millions of NIS at 1986 prices), 1968-1991.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	Natio Dispo Incom
1968	233.000	1.700	4.000	-2.300	177.8	54.500	237.3
1969	248.800	7.700	4.000	3.700	199.3	82.200	291.1
1970	301.200	23.800	6.100	17.700	262.0	96.300	369.1
1971	338.100	32.500	8.100	24.400	302.2	102.300	415.4
1972	352.700	82.000	8.100	73.900	384.9	97.000	491.2
1973	374.400	109.800	8.100	101.700	438.6	40.200	485.4
1974	390.500	104.500	9.400	95.100	444.9	42.600	493.9
1975	420.000	111.900	8.500	103.400	478.7	71.000	553.0
1976	455.100	124.800	7.200	117.600	524.1	158.500	675.4
1977	478.400	122.700	6.700	116.000	540.9	158.200	632.6
1978	498.100	148.200	7.000	141.200	588.0	180.800	760.4
1979	552.100	185.200	7.200	178.000	678.6	155.500	831.1
1980	522.800	175.600	7.200	168.400	642.6	154.800	793.7
1981	525.800	203.300	6.900	196.400	681.8	102.900	786.6
1982	505.800	296.800	5.400	291.400	789.1	130.500	920.7
1983	482.700	340.200	5.500	334.700	812.6	123.100	936.2
1984	498.200	312.800	7.600	305.200	798.3	123.900	922.8
1985	511.400	269.900	5.200	264.700	769.8	87.300	856.9
1986	543.500	357.600	4.800	352.800	896.4	102.900	999.2
1987	610.400	428.100	6.200	421.900	1032.5	100.400	1133.1
1988	533-541	331.500	7.600	323.600	857-865	92.600	950-958
1989	606-617	279.000	8.600	270.200	878-888	108.900	988-998
1990	631-654	350.000	9.500	340.200	977-997	105.400	1083-1104
1991	667-691	319.900	7.500	312.300	983-1004	104.300	1089-1111
1992	794-823	351.000	8.000	344.000	1140-1165		1249-1274

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.
@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.
*. Figures for the period 1987-92 are estimations.

Table 8: West Bank, Balance of Payments 1970-1991, (in million of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	76.3	42.8	33.5	115.2	93.2	22.0	-50.3	22.1	63.1	24.2
1971	83.3	35.6	47.6	9.2	67.7	24.5	-32.0	38.4	27.8	18.8
1972	130.7	52.8	77.9	135.6	100.6	35.0	-47.8	66.9	28.1	23.2
1973	156.0	60.2	95.8	174.8	130.0	44.8	-69.8	83.5	12.7	-6.1
1974	219.1	94.7	124.4	264.1	196.6	67.5	-102.0	108.1	11.9	-33.1
1975	245.1	109.4	135.6	295.9	229.4	66.4	-120.0	116.0	2.0	-48.8
1976	280.2	128.5	151.7	335.3	247.7	87.6	-119.3	134.9	40.2	-14.9
1977	286.1	124.5	161.4	365.9	269.6	96.3	-145.1	143.1	35.2	-44.7
1978	305.7	144.1	161.6	346.5	253.2	93.4	-109.1	144.7	49.0	8.2
1979	371.2	154.9	216.4	476.9	356.9	120.0	-202.0	192.6	53.3	-52.4
1980	438.3	198.4	239.8	553.9	409.9	144.0	-211.5	211.7	60.2	-55.5
1981	469.1	217.4	251.7	586.9	436.8	150.1	-219.4	223.4	57.5	-60.4
1982	495.7	206.9	288.8	578.9	423.7	155.2	-216.8	263.8	55.8	-27.4
1983	540.5	211.1	329.4	620.3	459.4	160.9	-248.3	299.4	54.4	-25.4
1984	476.3	190.1	286.2	555.2	410.6	144.6	-220.5	259.1	44.7	-34.2
1985	405.4	172.0	233.4	529.7	389.4	140.3	-217.4	207.6	31.5	-92.8
1986	560.9	244.6	316.3	680.7	513.3	167.4	-268.7	286.1	34.4	-85.4
1987	670.1	234.7	435.4	841.9	639.8	202.1	-405.1	410.6	86.1	-85.7
1988	592.0	142.0	451.0	662.0	453.0	209.0	-311.0	411.0	55.2	-22.0
1989	607.0	125.0	482.0	644.0	432.0	212.0	-307.0	444.0	43.7	3.0
1990	699.0	180.0	520.0	816.0	574.0	242.0	-394.0	474.0	72.5	-46.0
1991	664.0	173.0	491.0	1000.0	777.0	222.0	-604.0	444.0	74.7	-263.0

Source: Based on Statistical Abstracts of Israel, 1969-1992, Central Bureau of statistics, Jerusalem. Statistics for 1968 and 1969 are not available (only Global BOP are available for these years). All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 9: Gaza Strip, Balance of Payments 1970-1991, (in million of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	23.8	14.7	9.1	42.5	34.7	7.8	-20.0	6.7	28.4	9.7
1971	35.4	23.5	11.9	49.5	40.6	8.9	-17.0	9.0	26.1	12.1
1972	68.1	34.8	33.2	81.6	67.2	14.4	-32.4	28.9	26.3	12.7
1973	100.2	43.1	57.1	103.7	83.5	20.3	-40.3	50.9	11.3	7.8
1974	130.5	61.1	69.4	167.3	136.3	31.0	-75.2	59.6	18.2	-18.5
1975	154.9	82.7	72.2	206.5	175.3	31.3	-92.5	62.1	13.9	-37.7
1976	188.4	104.0	84.4	224.5	186.5	38.0	-82.6	76.3	52.3	16.2
1977	220.9	133.6	87.4	277.9	237.2	40.7	-103.7	78.1	52.0	-5.0
1978	218.0	122.6	95.4	248.8	205.8	43.0	-83.2	86.0	42.0	11.2
1979	264.6	122.2	142.4	277.2	221.0	56.2	-98.7	130.0	41.6	29.0
1980	318.6	155.0	163.5	339.8	269.5	70.4	-114.4	148.3	50.8	29.6
1981	379.5	191.8	187.6	387.9	313.3	74.7	-121.5	172.1	54.0	45.6
1982	393.8	191.6	202.6	388.7	310.6	78.1	-119.0	191.4	50.8	55.9
1983	447.2	182.3	264.9	427.1	332.4	34.7	-150.1	247.5	45.9	66.0
1984	349.3	116.6	232.7	365.2	279.7	85.5	-163.1	217.3	45.0	29.1
1985	276.3	109.1	167.2	364.2	281.6	82.6	-172.5	150.9	39.3	-48.6
1986	393.8	142.8	251.0	484.2	378.2	106.0	-235.4	230.4	42.5	-47.9
1987	492.6	160.3	332.3	528.8	412.4	116.4	-252.1	314.0	76.8	40.6
1988	358.0	67.0	291.0	343.0	223.0	120.0	-156.0	264.0	80.1	84.0
1989	278.0	32.0	246.0	302.0	200.0	102.0	-168.0	219.0	79.8	50.0
1990	375.0	51.0	324.0	386.0	269.0	120.0	-218.0	293.0	81.7	66.0
1991	378.0	75.0	303.0	500.0	371.0	130.0	-296.0	271.0	81.8	-44.0

Source: Statistical Abstracts of Israel, 1971-1992, Central Bureau of Statitics, Jerusalem, Statistics for 1968 and 1969 are not available (only Global BOP are available for these Years)
Statistics from 1970 to 1980 are for Gaza and Sinai. All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 10: Occupied Territories, Balance of Payments, 1970-1991, (in millions of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	100.1	57.5	42.6	157.7	127.8	29.8	-70.3	6.7	91.5	34.0
1971	118.7	59.2	59.5	141.6	108.3	33.4	-49.1	9.0	53.9	30.9
1972	198.8	87.6	111.1	217.2	167.8	49.4	-80.2	28.9	54.3	35.9
1973	256.2	103.3	152.9	278.5	213.5	65.0	-110.1	50.9	24.0	1.7
1974	349.6	155.8	193.8	431.4	333.0	98.4	-177.2	59.6	30.2	-51.6
1975	400.0	192.2	207.8	502.4	404.7	97.7	-212.6	62.1	15.9	-86.6
1976	468.6	232.4	236.2	559.8	434.3	125.6	-201.8	76.3	92.6	1.3
1977	507.0	258.1	248.8	643.8	506.8	137.0	-248.8	78.1	87.2	-49.7
1978	523.7	266.6	257.1	595.3	459.0	136.3	-192.3	86.0	91.0	19.4
1979	635.8	277.1	358.8	754.1	577.8	176.3	-300.7	130.0	94.9	-23.4
1980	756.8	353.5	403.4	893.7	679.4	214.4	-325.9	148.3	111.0	-25.9
1981	848.6	409.2	439.3	974.8	750.1	224.8	-340.9	172.1	111.5	-14.8
1982	889.5	398.5	491.4	967.6	734.3	233.3	-335.8	191.4	106.6	28.5
1983	987.7	393.4	594.3	1047.4	791.8	195.6	-398.4	546.9	100.3	40.6
1984	825.6	306.7	518.9	920.4	690.3	230.1	-383.6	476.4	89.7	-5.1
1985	681.7	281.1	400.6	893.9	671.0	222.9	-389.9	358.5	70.8	-141.4
1986	954.7	387.4	567.3	1164.9	891.5	273.4	-504.1	516.5	76.9	-133.3
1987	1162.7	395.0	767.7	1370.7	1052.2	318.5	-657.2	314.0	162.9	-45.2
1988	950.0	209.0	742.0	1005.0	676.0	329.0	-467.0	675.0	135.3	62.0
1989	885.0	157.0	728.0	946.0	632.0	314.0	-475.0	663.0	123.6	53.0
1990	1074.0	231.0	844.0	1202.0	843.0	362.0	-612.0	767.0	154.2	20.0
1991	1042.0	248.0	794.0	1500.0	1148.0	352.0	-900.0	715.0	156.5	-307.0

Source: Statistical Abstracts of Israel. 1971-1992. Central Bureau of Statitics, Jerusalem
Statistics for 1968 and 1969 are not available (only Global BOP are available for these Years)
Statistics from 1970 to 1980 are for Gaza and Sinai. All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 11: Occupied Territories, Inflation Rates (1971-1991) (in percent).

	West Bank (%)	Gaza (%)	Israel (%)
1971	16.1	21.9	12.0
1972	17.6	19.5	12.9
1973	21.5	24.3	20.0
1974	42.6	54.7	39.7
1975	43.2	53.8	39.3
1976	28.1	22.3	31.3
1977	36.0	33.8	34.6
1978	50.4	42.8	50.6
1979	68.1	72.4	78.3
1980	139.4	156.0	131.0
1981	114.0	109.5	116.8
1982	107.4	114.6	120.3
1983	139.8	151.2	145.7
1984	360.3	373.0	373.8
1985	320.9	337.6	304.6
1986	50.0	49.6	48.1
1987	13.1	11.0	19.9
1988	8.7	11.1	16.3
1989	14.5	15.7	20.2
1990	13.0	16.9	17.2
1991	11.5	7.0	19.0
1992	13.9	14.1	12.0

Source: calculations based on data extracted from the Statistical Abstracts of Israel, 1974-1992. Central Bureau of Statistics
*.inflation Rates refer to the change Rate in the CPI.

Table 12: Gross Domestic Capital Formation in Gaza, by Sector and type of Asset at 1986 prices (in N Million).

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total
1968	9.40	6.30	21.20	5.20	24.60	24.60
1969	7.50	10.50	23.80	19.60	49.10	49.10
1970	9.40	8.70	23.80	18.30	47.20	47.20
1971	13.20	11.20	31.80	20.70	57.60	57.60
1972	41.40	17.30	68.80	28.30	101.20	101.20
1973	61.30	17.30	85.00	27.30	115.30	115.30
1974	63.40	18.80	89.60	29.40	122.30	122.30
1975	69.90	18.40	95.00	39.10	139.50	139.50
1976	109.10	17.70	129.00	29.10	160.20	160.20
1977	110.40	21.50	136.30	24.30	161.60	161.60
1978	127.40	17.80	145.50	29.10	176.10	176.10
1979	163.10	14.80	174.20	22.80	197.00	197.00
1980	145.80	13.60	156.20	18.10	173.90	173.90
1981	167.80	15.50	179.70	16.00	194.30	194.30
1982	147.40	14.90	159.60	17.60	176.60	176.60
1983	144.50	15.60	157.70	21.70	179.60	179.60
1984	134.90	16.70	150.00	21.20	171.50	171.50
1985	126.90	20.70	147.20	17.60	164.30	164.30
1986	134.30	24.50	158.80	25.00	183.70	183.70
1987	129.00	39.60	168.70	32.60	201.30	201.30
1988	122.00	n/a	n/a	24.00	n/a	n/a
1989	142.00	12.00	155.00	20.00	176.00	176.00
1990	134.00	11.00	147.00	15.00	163.00	163.00
1991	132.00	15.00	149.00	14.00	165.00	165.00

Source: Statistical Abstracts of Israel, Various Issues Judea, Samaria and Gaza Area Statistics 1992 Central Bureau of Statistics.

Table 13: Gross Domestic Capital Formation in the West Bank, by Sector and type of Asset at 1986 pri (in NIS, Million).

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total@
1968	10.40	22.70	23.50	16.20	45.30	33.70
1969	22.00	68.20	57.90	20.80	83.80	84.30
1970	25.70	80.90	68.10	19.70	91.70	55.40
1971	42.40	80.90	90.70	17.80	110.10	86.00
1972	77.80	83.80	137.40	19.50	156.60	157.30
1973	107.40	48.20	154.00	21.10	174.30	135.20
1974	156.10	47.30	202.80	27.80	229.60	280.90
1975	186.30	42.10	227.60	36.20	263.60	200.60
1976	208.50	34.50	241.00	24.90	263.30	262.70
1977	236.00	39.30	273.10	17.20	285.20	263.60
1978	248.30	62.40	310.90	26.40	332.80	360.20
1979	274.60	71.50	346.50	29.70	371.30	322.20
1980	264.80	60.90	325.40	24.90	345.00	506.50
1981	250.40	48.60	298.50	32.90	328.70	350.60
1982	277.40	55.20	332.10	44.70	375.30	450.10
1983	251.70	63.50	315.00	54.10	370.30	404.60
1984	242.20	54.10	296.30	61.70	361.40	394.30
1985	284.50	57.10	341.00	56.00	397.00	439.80
1986	333.70	78.40	412.10	67.40	479.60	577.80
1987	344.50	91.70	436.10	89.30	525.40	496.90
1988	n/a	n/a	n/a	43.00	n/a	514.00
1989	n/a	n/a	n/a	34.00	n/a	431.00
1990	n/a	n/a	n/a	42.00	n/a	527.00
1991	n/a	n/a	n/a	69.00	n/a	

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-92,Central Bureau of statistics @:F capital formation and increase in stocks of olive oil in the West Bank
No estimate was made for other stock components.

Table 14: Occupied Territories, Gross Domestic Capital Formation, by sector and type of asset; at 19 prices (in NIS, Million).

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total@
1968	19.80	29.00	44.70	21.40	69.90	58.30
1969	29.50	78.70	81.70	40.40	132.90	133.40
1970	35.10	89.60	91.90	38.00	138.90	102.60
1971	55.60	92.10	122.50	38.50	167.70	143.60
1972	119.20	101.10	206.20	47.80	257.80	258.50
1973	168.70	65.50	239.00	48.40	289.60	250.50
1974	219.50	66.10	292.40	57.20	351.90	403.20
1975	256.20	60.50	322.60	75.30	403.10	340.10
1976	317.60	52.20	370.00	54.00	423.50	422.90
1977	346.40	60.80	409.40	41.50	446.80	425.20
1978	375.70	80.20	456.40	55.50	508.90	536.30
1979	437.70	86.30	520.70	52.50	568.30	519.20
1980	410.60	74.50	481.60	43.00	518.90	680.40
1981	418.20	64.10	478.20	48.90	523.00	544.90
1982	424.80	70.10	491.70	62.30	551.90	626.70
1983	396.20	79.10	472.70	75.80	549.90	584.20
1984	377.10	70.80	446.30	82.90	532.90	565.80
1985	411.40	77.80	488.20	73.60	561.30	604.10
1986	468.00	102.90	570.90	92.40	663.30	761.50
1987	473.50	131.30	604.80	121.90	726.70	698.20
1988	142.20	n/a	n/a	67.00	n/a	n/a
1989	n/a	n/a	n/a	54.00	n/a	607.00
1990	n/a	n/a	n/a	57.00	n/a	743.00
1991	n/a	n/a	n/a	83.00	n/a	692.00

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-92
Central Bureau of statistics
@:Fixed capital formation and increase in stocks of olive oil in the West Bank
No estimate was made for other stock components, 1988-90 construction figures are for Gaza only; 1989-90 machinery figures are for G only, 1989-90 total private sector figures are for Gaza only,and 1989-90 total & grand total figures are for Gaza only.

Table 15: West Bank, Contribution of Main Economic Branches to GDP (at Factor Cost) 1968-1991 at 1986 Prices (in NIS Million and in Percentage).

	Gross Domestic Product	Agriculture Forestry & Fishing		Industry		Construction Building & Public Works		Public & Community Services		Other Services	
		NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent
1968	436.9	163.1	37.3	30.9	7.1	25.8	5.9	n/a	n/a	n/a	n/a
1969	501.7	205.7	41.0	40.4	8.1	42.2	8.4	n/a	n/a	n/a	n/a
1970	533.3	185.4	34.8	44.1	8.3	46.4	8.7	n/a	n/a	n/a	n/a
1971	612.6	211.7	34.6	49.9	8.1	48.2	7.9	n/a	n/a	n/a	n/a
1972	757.5	298.2	39.4	59.2	7.8	77.4	10.2	n/a	n/a	n/a	n/a
1973	693.7	214.7	30.9	62.7	9.0	83.9	12.1	n/a	n/a	n/a	n/a
1974	910.5	364.9	40.1	76.4	8.4	114.4	12.6	n/a	n/a	n/a	n/a
1975	896.8	220.5	24.6	73.2	8.2	138.3	15.4	n/a	n/a	n/a	n/a
1976	1061.7	293.7	27.7	67.3	6.3	145.0	13.7	n/a	n/a	n/a	n/a
1977	1024.1	258.3	25.2	65.6	6.4	153.8	15.0	132.7	13.0	413.7	40.4
1978	1195.7	353.3	29.5	79.9	6.7	167.2	14.0	144.0	12.0	450.6	37.7
1979	1117.6	241.9	21.6	73.5	6.6	184.9	16.5	145.1	13.0	472.4	42.3
1980	1386.1	442.4	31.9	90.3	6.5	174.3	12.6	140.7	10.2	538.4	38.8
1981	1267.4	359.2	28.3	78.1	6.2	168.4	13.3	142.4	11.2	519.3	41.0
1982	1439.9	415.6	28.9	85.4	5.9	192.2	13.3	145.8	10.1	600.9	41.7
1983	1388.5	371.5	26.8	83.7	6.0	189.6	13.7	150.3	9.5	593.2	42.7
1984	1467.1	373.6	25.5	94.3	6.4	190.9	13.0	157.4	10.7	650.9	44.4
1985	1441.6	333.3	22.3	105.4	7.3	215.8	15.0	158.7	11.0	631.1	43.8
1986	1784.1	575.0	32.2	138.2	7.7	256.7	14.4	165.1	8.9	649.1	36.4
1987	1658.7	379.4	22.9	140.4	8.5	268.6	16.2	167.4	9.7	702.9	42.4
1988	1699-1748	757.5	43-45	130.6	7-8	182-201	11-12	117.2	6.5	511.7	30.1
1989	1644-1699	534.0	31-32	121.0	7.0	198-218	12-13	138.0	7.8	653.0	39.7
1990	2068-2131	865.1	41-42	143.3	7.0	219-242	11.0	184.8	8.4	655.8	31.7
1991	1917-1988	629.8	32-33	141.5	7.0	203-226	11.0	186.8	9.1	755.9	39.4
1992	2437-2526	1087.00	43-45	185.00	7-8	250-278	10-11	214.0	8.6	701.0	28.8

Source: Statistical Abstracts of Israel, 1970-1992 Central Bureau of Statistics

*.Other Services include: Transport, Trade and other services (including ownership of Dwellings and errors & ommissions)

Figures for the period 1987-92 are estimates.

Table 16: Gaza, Contribution of Main Economic Branches to GDP (at Factor Cost) 1968-1991 at 1986 Prices, NIS Million and in percentage

	Gross Domestic Product	Agriculture Forestry & Fishing		Industry		Construction Building & Public Works		Public & Community Services		Other Services	
		NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent
1968	217.2	67.3	31.0	4.3	2.0	14.9	6.9	n/a	n/a	n/a	n/a
1969	232.3	76.7	33.0	6.5	2.8	29.8	12.8	n/a	n/a	n/a	n/a
1970	280.6	88.5	31.5	11.9	4.2	29.8	10.6	n/a	n/a	n/a	n/a
1971	315.7	100.6	31.9	14.1	4.5	32.3	10.2	n/a	n/a	n/a	n/a
1972	329.7	110.3	33.5	17.8	5.4	54.5	16.5	n/a	n/a	n/a	n/a
1973	350.5	113.4	32.4	22.5	6.4	59.3	16.9	n/a	n/a	n/a	n/a
1974	365.8	126.1	34.5	28.6	7.8	61.1	16.7	n/a	n/a	n/a	n/a
1975	393.6	131.8	33.5	34.0	8.6	72.5	18.4	n/a	n/a	n/a	n/a
1976	326.5	141.8	43.4	42.8	10.0	94.6	29.0	n/a	n/a	n/a	n/a
1977	448.3	135.1	30.1	48.5	10.8	96.6	21.5	102.0	22.8	74.3	16.6
1978	466.7	136.1	29.2	56.3	12.1	113.0	24.2	101.7	21.8	72.2	15.5
1979	517.3	129.1	25.0	59.0	11.4	132.1	25.5	88.3	17.1	115.0	22.2
1980	489.8	117.4	24.0	42.5	8.7	115.9	23.7	90.2	18.4	129.3	26.4
1981	494.9	122.2	24.7	38.7	7.8	127.3	25.7	93.2	18.8	122.4	24.7
1982	476.1	114.0	23.9	42.3	8.9	117.1	24.6	93.5	19.6	116.0	24.4
1983	454.1	103.2	22.7	43.4	9.6	117.0	25.8	95.1	20.9	100.7	22.2
1984	469.6	98.6	21.0	45.3	9.6	109.6	23.3	101.4	21.6	114.5	24.4
1985	481.9	108.3	22.5	39.9	8.3	100.9	20.9	104.0	21.6	130.4	27.1
1986	513.9	102.5	20.0	54.0	10.5	111.3	21.7	106.7	20.8	138.9	27.1
1987	578.7	123.4	21.3	71.0	12.3	113.8	19.7	109.6	18.9	160.9	27.8
1988	504-512	122.1	24.0	53.0	10-11	102.8	20.0	99.3	19-20	131-133	26-27
1989	573-583	140.8	24-25	57.8	10.0	115.3	20.0	104.9	18.0	162-172	28-30
1990	597-617	151.7	25.0	62-65	10-11	107-112	18.0	111.6	18-19	176-187	30.0
1991	631-652	170.0	26-27	69-72	11.0	105-110	17.0	117.2	18-19	185-197	29-30
1992	751-777	198.0	25-26	83-86	11.0	155-162	21.0	125	16-17	207-221	28.0

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

*.. Figures for Public & Community Services are not available for the period 68-76(for these years,they are included in other services)

Figures for the period 1987-1992 are estimates.

Table 17: Occupied Territories, Contribution of Main Economic Branches to GDP (at Factor Cost), 1968-1991 at 1986 Prices, (in NIS Million and in Percentage).

	Gross Domestic Product	Agriculture Forestry & Fishing		Industry		Construction Building & Public Works		Public & Community Services		Other Services	
		NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent
1968	654.1	230.4	35.2	35.2	5.4	40.7	6.2	n/a	n/a	n/a	n/a
1969	734.0	282.4	38.5	46.9	6.4	72.0	9.8	n/a	n/a	n/a	n/a
1970	813.9	273.9	33.7	56.0	6.9	76.2	9.4	n/a	n/a	n/a	n/a
1971	928.3	312.3	33.6	64.0	6.9	80.5	8.7	n/a	n/a	n/a	n/a
1972	1087.2	408.5	37.6	77.0	7.1	131.9	12.1	n/a	n/a	n/a	n/a
1973	1044.2	328.1	31.4	85.2	8.2	143.2	13.7	n/a	n/a	n/a	n/a
1974	1276.3	491.0	38.5	105.0	8.2	175.5	13.8	n/a	n/a	n/a	n/a
1975	1290.4	352.3	27.3	107.2	8.3	210.8	16.3	n/a	n/a	n/a	n/a
1976	1388.2	435.5	31.4	110.1	7.9	239.6	17.3	n/a	n/a	n/a	n/a
1977	1472.4	393.4	26.7	114.1	7.7	250.4	17.0	234.7	15.9	516.9	35.1
1978	1662.4	489.4	29.4	136.2	8.2	280.2	16.9	245.7	14.8	541.5	32.6
1979	1634.9	371.0	22.7	132.5	8.1	317.0	19.4	233.4	14.3	633.4	38.7
1980	1875.9	559.8	29.8	132.8	7.1	290.2	15.5	230.9	12.3	626.6	33.4
1981	1762.3	481.4	27.3	114.8	6.5	295.7	16.8	235.6	13.4	616.5	35.0
1982	1916.0	529.6	27.6	127.7	6.7	309.3	16.1	239.3	12.5	693.3	36.2
1983	1842.6	474.7	25.8	127.1	6.9	306.6	15.0	245.4	13.3	670.6	36.4
1984	1936.7	472.2	24.4	139.6	7.2	300.5	15.5	258.8	13.4	764.3	39.5
1985	1923.5	441.6	22.8	145.3	7.6	316.7	16.5	262.7	13.7	739.5	38.4
1986	2297.5	677.5	29.5	192.2	8.4	368.0	15.3	271.8	11.3	788.1	34.3
1987	2237.4	502.8	22.5	211.4	9.4	382.4	16.4	277.0	12.4	863.8	38.6
1988	2203-2260	879.6	39.9	183.6	8.3	285-304	13.0	216.5	10.0	720-757	32.7-32.5
1989	2217-2282	674.8	30.4	178.8	8.1	313-333	14-15	242.9	11.0	801-844	36.1-37
1990	2665-2748	1016.8	38.2	205-208	8.0	326-354	12-13	296.4	11.0	909-959	34.1-34.9
1991	2548-2640	799.8	31.4	211-214	8.0	308-336	12-13	304.0	12.0	918-975	36-37
1992	3188-3303	123.5	39-40	268-271	8.0	405-440	13.0	333.0	10-11	1050-1116	32.9-33.8

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

*Figures for Public & Community Services from 68-76 are only for the West Bank

*.Other Services include: Transport, Trade and other services (including ownership of Dwellings and errors & ommissions)

Table 18: West Bank, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	218.8	159.9	171.1	541.6	1.0	517.5
1969	240.2	192.4	185.0	613.4	-21.6	618.4
1970	289.6	206.2	193.3	680.7	-27.7	691.5
1971	329.5	234.3	206.3	762.0	-25.8	766.6
1972	380.3	288.9	224.6	891.1	-45.2	918.1
1973	367.6	298.3	227.0	893.1	-66.4	949.9
1974	429.5	298.3	236.2	957.2	-82.1	1032.9
1975	432.8	330.2	248.5	1010.4	-100.7	1108.2
1976	503.8	345.6	260.2	1102.3	-116.5	1216.9
1977	472.1	352.6	277.7	1098.0	-125.4	1223.2
1978	511.2	318.8	302.4	1115.7	-137.9	1255.3
1979	484.5	401.9	218.2	1199.8	-144.9	1345.8
1980	496.6	387.7	324.7	1203.0	-153.1	1358.6
1981	543.2	374.0	337.9	1246.6	-169.3	1419.8
1982	529.0	406.8	356.9	1286.4	-179.1	1470.1
1983	528.9	398.1	376.9	1297.2	-170.7	1471.2
1984	559.9	407.2	396.2	1354.7	-164.3	1521.0
1985	519.4	417.3	404.4	1339.9	-159.5	1501.3
1986	651.6	527.1	423.0	1601.7	-165.5	1767.3
1987	642.1	634.4	445.2	1721.7	-172.9	1894.6
1988	n/a	n/a	n/a	n/a	n/a	1762.0
1989	n/a	n/a	n/a	n/a	n/a	1771.0
1990	n/a	n/a	n/a	n/a	n/a	2077.0
1991	n/a	n/a	n/a	n/a	n/a	2229.0

Source: Statistical Abstracts of Israel, Various Issues
Judea, Samaria and Gaza Area Statistics 1988-1992
Central Bureau of Statistics

Table 19: Gaza, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	99.0	71.8	79.7	239.4	2.0	222.6
1969	99.0	90.7	79.7	264.1	-5.2	263.4
1970	108.9	108.4	92.6	306.1	-9.4	310.0
1971	112.8	122.3	90.8	326.0	-11.7	332.4
1972	129.7	158.5	104.7	397.2	-18.9	411.6
1973	134.7	164.3	107.1	410.6	-25.2	433.3
1974	141.7	182.9	113.5	443.7	-32.2	474.9
1975	175.6	195.7	117.8	491.9	-40.0	531.8
1976	174.6	188.4	123.1	487.8	-43.2	531.8
1977	175.4	243.3	127.9	556.5	-56.6	615.8
1978	184.9	216.6	136.9	541.7	-71.4	614.9
1979	173.8	220.0	136.5	536.1	-77.6	615.5
1980	170.8	208.2	141.3	524.0	-82.2	608.0
1981	192.5	187.8	146.1	521.8	-94.5	617.1
1982	193.8	190.6	152.9	533.0	-97.0	630.8
1983	203.0	204.6	155.3	559.0	-94.8	654.7
1984	222.0	209.7	163.6	589.2	-95.4	685.2
1985	236.0	216.0	167.5	612.1	-90.1	702.3
1986	229.0	275.8	175.0	679.8	-96.0	775.8
1987	268.8	294.8	181.5	745.1	-88.0	833.0
1988	n/a	n/a	n/a	n/a	n/a	685.0
1989	309.0	192.0	190.0	685.0	-66.0	750.0
1990	315.0	219.0	203.0	740.0	-77.0	809.0
1991	414.0	262.0	211.0	873.0	-74.0	946.0

Source:Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992

Table 20: Occupied Territories, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	317.8	231.7	250.8	781.0	3.0	740.1
1969	339.2	283.1	264.7	877.5	-26.8	881.8
1970	398.5	314.6	285.9	986.8	-37.1	1001.5
1971	442.3	356.6	297.1	1088.0	-37.5	1099.0
1972	510.0	447.4	329.3	1288.3	-64.1	1329.7
1973	502.3	462.6	334.1	1303.7	-91.6	1383.2
1974	571.2	481.2	349.7	1400.9	-114.3	1507.8
1975	608.4	525.9	366.3	1502.3	-140.7	1640.0
1976	678.4	534.0	383.3	1590.1	-159.7	1748.7
1977	647.5	595.9	405.6	1654.5	-182.0	1839.0
1978	696.1	535.4	439.3	1657.4	-209.3	1870.2
1979	658.3	621.9	354.7	1735.9	-222.5	1961.3
1980	667.4	595.9	466.0	1727.0	-235.3	1966.6
1981	735.7	561.8	484.0	1768.4	-263.8	2036.9
1982	722.8	597.4	509.8	1819.4	-276.1	2100.9
1983	731.9	602.7	532.2	1856.2	-265.5	2125.9
1984	781.9	616.9	559.8	1943.9	-259.7	2206.2
1985	755.4	633.3	571.9	1952.0	-249.6	2203.6
1986	880.6	802.9	598.0	2281.5	-261.5	2543.1
1987	910.9	929.2	626.7	2466.8	-260.9	2727.6
1988	n/a	n/a	n/a	n/a	n/a	2447.0
1989	n/a	n/a	n/a	n/a	n/a	2521.0
1990	n/a	n/a	n/a	n/a	n/a	2886.0
1991	n/a	n/a	n/a	n/a	n/a	3175.0

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992
*. 1989-1991 figures are for Gaza only.

Table 21: West Bank, GDP (at factor cost), by Economic Branch and Disposable Private Income in NIS Million at current prices.

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Agriculture	2.50	5.30	10.90	43.40	166.70	575.00	384.20	650.00	463.00	736.00	583.00
Industry	0.50	1.10	2.60	15.20	65.40	138.20	163.80	153.00	157.00	205.00	229.00
Construction	1.20	3.00	7.30	34.50	137.40	256.70	341.50	308.00	369.00	468.30	489.60
Public and Community Services	1.00	2.30	6.20	36.20	115.90	165.10	205.70	188.00	250.00	314.00	380.00
Transport, Trade and Other Services	2.40	5.90	9.60	84.00	344.40	649.10	945.70	871-939	1117-1205	1451-1569	1634-1767
GDP: Total	7.60	17.60	36.60	213.60	829.80	1784.10	2040.90	2170-2238	2356-2444	3174-3292	3306-3449
Factor payments from abroad	2.70	6.70	17.00	72.90	257.00	447.20	670.00	705.00	908.00	1027.00	1087.00
Less:factor payments to abroad	0.10	0.20	0.60	3.10	8.40	11.10	15.30	18.00	25.00	40.00	37.00
Gross National Income	10.30	24.10	58.50	283.40	1078.50	2220.20	2695.50	2857-2925	3239-3327	4162-4279	4357-4500
Transfers from Gvt and Local authorities	0.1	0.2	0.3	1.3	4.2	7.4	23.4	7.0	11.0	19.0	20.0
Less:Income Tax and transfers to the Government	0.40	1.00	2.80	16.30	48.70	69.50	96.40	93.00	114.00	132.00	201.00
Gross Disposable Private Income from Domestic Sources	9.90	23.30	50.50	268.40	1034.00	2158.20	2622.50	2771-2839	3136-3224	4049-4166	4176-4319
Transfers to private persons from abroad	0.70	1.20	2.80	11.70	49.70	85.10	85.60	78.00	99.00	109.00	155.00
Gross Disposable Private Income from all sources	10.60	24.50	53.30	280.10	1083.70	2243.30	2708.1	2849-2917	3235-3323	4158-4275	4331-4474

Source: Statistical Abstracts of Israel, 1982-1992
Central Buraeu of Statistics

Table 22: Gaza, GDP (at factor cost), by Economic Branch and Disposable Private Income in NIS Million at current prices.

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Agriculture	0.70	1.10	2.80	10.60	54.50	102.50	121.60	135.00	152.00	167.00	200.00
Industry	0.30	0.60	1.50	7.40	25.80	54.00	95.10	80.00	103.00	125-132	157-165
Construction	0.80	1.60	3.90	16.90	55.50	1113.00	151.80	163.00	197.00	201-211	216-227
Public and Community Services	0.70	1.60	4.20	24.00	78.10	106.70	135.70	160.00	196.00	237.00	272.00
Transport, Trade and Other Services	0.80	2.00	4.50	18.70	68.70	138.90	180.00	174-179	244-252	310-319	354-364
GDP: Total	3.30	6.90	16.90	77.60	282.60	513.40	684.20	712-717	892-900	1040-1066	1199-1228
Factor payments from abroad	2.10	4.50	12.40	53.20	185.50	357.60	508.10	446.00	451.00	629.00	657.00
Less:factor payments to abroad	0.00	0.10	0.20	1.30	3.60	4.80	7.40	10.00	14.00	17.00	15.00
Gross National Income	5.40	11.30	29.00	129.60	866.30	868.30	1148-1153	1329-1336	1652-1678	1840-1870	1840-1870
Transfers from Gvt and Local authorities	0.10	0.10	0.20	1.10	3.90	7.90	14.30	12.00	14.00	24.00	24.00
Less:Income Tax and transfers to the Government	0.30	0.60	1.50	8.80	25.60	45.10	55.90	66.00	84.00	92.00	124.00
Gross Disposable Private Income from Domestic Sources	5.10	10.80	27.60	121.80	442.80	829.10	1143.30	1094-1099	1257-1264	1574-1600	1740-1770
Transfers to private persons from abroad	0.90	1.80	4.00	17.20	66.20	115.80	113.00	115.00	142.00	148.00	186.00
Gross Disposable Private Income from all sources	6.0	12.60	31.60	139.00	509.00	944.90	1256.30	1209-1214	1399-1406	1722-1748	1926-1956

Source: Statistical Abstracts of Israel, 1982-1992, Central Buraeu of Statistics

Table 23: West Bank, Disposable Private Income, at current prices (NIS Million)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
GDP at Market Prices	2.0	5.2	10.6	25.1	60.5	304.6	1131.6	2292.2	2774.2	2901-2969	3316-3404	4331-4390	4533-4676
Net Indirect Taxes on Domestic Production	1.0	0.1	0.4	1.0	7.5	21.2	53.1	72.0	78.7	44.0	77.0	111.0	176.0
Gross National Income at factor cost	2.0	5.0	10.3	24.1	53.0	283.4	1078.5	2220.2	2695.5	2857-2925	3239-3327	4162-4279	4357-4500
Transfers from Gvt and Local Authorities	0.0	0.0	0.1	0.2	0.3	1.3	4.2	7.4	23.4	7.0	11.0	19.0	20.0
Income Tax and Transfers to the Government	0.1	0.2	0.4	1.0	2.8	16.3	48.7	69.5	96.4	93.0	114.0	132.0	201.0
Gross Disposable private Income from Domestic Sources	1.9	4.9	9.9	23.3	50.5	268.4	1034.0	2158.2	2622.5	2771-2839	3136-3224	4049-4166	4176-4319
Private Transfers from Abroad	0.2	0.4	0.7	1.2	2.8	11.7	49.7	85.1	85.6	78.0	99.0	109.0	155.0
Gross Disposable private Income from All Sources	2.1	5.2	10.6	24.5	53.3	280.1	1083.7	2243.3	2708.1	2849-2917	3235-3323	4158-4275	4331-4474
Private Savings	0.4	1.2	1.6	5.5	6.1	38.8	132.4	476.1	471.2	--	--	--	--
Gross Disposable private Income per Capita (NIS)	2.9	7.3	14.6	33.1	70.1	357.9	1347.0	2713.6	3175.2	3232-3309	3575-3672	4445-4570	4418-4564
Gross Disposable private Income per Capita at 86 prices (NIS)	2354.2	2445.8	2303.7	2557.8	2186.2	2256.6	2125.9	2713.6	2689.3	--	--	--	--
GDPI/Capita (in current US$)	1140.4	1424.4	1277.2	1364.0	1246.6	1220.6	1142.6	1823.3	1991.2	2021-2070	1865-1916	2205-2267	1938-2003
GDPI/Capita (in US $ at 86 prices)	1582.3	1643.3	1548.2	1719.0	1469.2	1516.7	1428.3	1823.3	1807.3	--	--	--	--

Source: Statistical Abstracts of Israel 1982-1992, & Judea, Samaria and Gaza Area Statistics, 1988-1992
Central bureau of Statistics.

Table 24: Gaza, Disposable Private Income, at current prices (NIS Million)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
GNP at Market Prices	1.0	2.3	5.4	11.4	29.5	132.8	483.6	896.4	1217.2	1179-1184	1358-1365	1686-1712	1899-1929
Net Indirect Taxes on Domestic Production	0.0	0.0	0.0	0.1	0.5	3.2	19.1	30.1	32.3	31.0	29.0	34.0	59.0
Gross National Income at factor cost	1.0	2.2	5.4	11.3	29.0	129.6	464.5	866.3	1184.9	1148-1153	1329-1336	1652-1678	1840-1870
Transfers from Gvt and Local Authorities	0.0	0.0	0.1	0.1	0.2	1.1	3.9	7.9	14.3	12.0	12.0	14.0	24.0
Income Tax and Transfers to the Government	0.1	0.1	0.3	0.6	1.6	8.8	25.6	45.1	55.9	66.0	84.0	92.0	124.0
Gross Disposable private Income from Domestic Sources	0.9	2.1	5.1	10.8	27.6	121.8	442.8	829.1	1143.3	1094-1099	1257-1264	1574-1600	1740-1770
Private Transfers from Abroad	0.2	0.4	0.9	1.8	4.0	17.2	66.2	115.8	113.0	115.0	142.0	148.0	186.0
Gross Disposable private Income from All Sources	1.1	2.6	6.0	12.6	31.6	139.0	509.0	944.9	1256.3	1211.5	1402.5	1735.0	1941.0
Private Savings	0.4	0.9	2.3	4.6	10.3	32.9	60.5	169.2	291.4	--	336.5	409.0	244.0
Gross Disposable private Income per Capita (NIS)	2.5	5.7	13.0	26.5	65.1	276.8	981.8	1762.9	2262.4	2094-2102	2329-2341	2744-2785	2917-2962
Gross Disposable private Income per Capita at 86 prices (NIS)	2236.5	2114.1	2177.8	2106.5	1998.9	1787.6	1537.2	1762.9	1953.2	--	1634-1642	1671-1696	1622-1647
GDPI/Capita (in current US $)	983.9	1112.2	1137.8	1092.0	1157.7	944.0	832.7	1184.7	1418.8	1310-1315	1215-1222	1361-1381	1280-1300
GDPI/Capita (in US $ at 86 prices)	1503.2	1421.0	1463.6	1415.7	1343.5	1201.3	1033.1	1184.9	1312.6	--	1098-1104	1123-1140	1090-1107

Source: Statistical Abstracts of Israel 1982-1992 & Judea, Samaria and Gaza Area Statistics, 1988-1992, Central bureau of Statistics.

Table 25: Occupied Territories (West Bank and Gaza Strip), Value of Merchandise Trade. 1968-1991, (Millions of US Dollars)

Year	Imports	Exports	Balance
1968	69.90	35.50	-34.40
1969	90.80	41.00	-49.80
1970	99.50	45.20	-54.30
1971	124.90	68.20	-56.70
1972	162.80	83.50	-79.30
1973	215.80	100.90	-114.90
1974	322.00	146.90	-175.10
1975	406.90	192.90	-214.00
1976	433.90	227.30	-206.60
1977	507.10	255.30	-251.80
1978	455.80	263.10	-192.70
1979	567.80	271.50	-296.30
1980	664.60	343.20	-321.40
1981	737.20	403.00	-334.20
1982	728.90	390.60	-338.30
1983	784.80	381.60	-403.20
1984	686.20	289.00	-397.20
1985	668.00	272.40	-395.60
1986	890.00	379.80	-510.20
1987	1060.10	385.30	-674.80
1988	676.00	209.00	-467.00
1989	632.00	157.00	-475.00
1990	843.00	231.00	-612.00
1991	1148.00	248.00	-900.00

Source: Statistical Abstract of Israel, 1992, No. 43, Central Bureau of Statistics.
Notes: Data for 1989, 1990 & 1991 are only estimates.

Table 26: Occupied Territories (West Bank and Gaza Strip), Trade by Destination, 1968-1991 (Millions of US Dollars).

	Trade with Israel			Trade with Jordan			Trade with Other Countries		
	Imports	Exports	Balance	Imports	Exports	Balance	Imports	Exports	Balance
1968	53.50	15.30	-38.20	5.20	15.50	10.30	11.20	4.70	-6.50
1969	72.80	15.00	-57.80	7.20	19.70	12.50	10.80	6.30	-4.50
1970	83.20	20.90	-62.30	3.70	17.20	13.50	12.60	7.10	-5.50
1971	102.00	30.40	-71.60	3.90	22.30	18.40	19.00	15.50	-3.50
1972	138.30	40.80	-97.50	4.60	28.80	24.20	19.90	13.90	-6.00
1973	194.40	66.70	-127.70	4.00	20.30	16.30	17.40	13.90	-3.50
1974	287.60	98.40	-189.20	4.90	35.60	30.70	29.80	12.90	-16.90
1975	371.20	123.30	-247.90	5.20	51.70	46.50	30.50	17.90	-12.60
1976	391.90	143.20	-248.70	3.80	67.70	63.90	38.20	16.40	-21.80
1977	463.40	154.10	-309.30	4.70	88.20	83.50	39.00	13.00	-26.00
1978	403.80	157.80	-246.00	5.00	95.30	90.30	47.00	10.00	-37.00
1979	492.90	169.00	-323.90	5.00	92.10	87.10	69.90	10.40	-59.50
1980	582.40	226.40	-356.00	5.50	107.30	101.80	76.70	11.50	-65.20
1981	664.40	288.70	-375.70	7.30	105.40	98.10	65.50	8.90	-56.60
1982	648.40	258.50	-389.90	8.90	125.00	116.10	71.60	7.10	-64.50
1983	712.60	285.10	-427.50	6.80	88.40	81.60	65.40	8.10	-57.30
1984	619.90	185.30	-434.60	8.20	98.40	90.20	58.10	5.30	-52.80
1985	598.00	181.30	-416.70	8.70	85.40	76.70	61.20	5.70	-55.50
1986	797.80	274.60	-523.20	10.90	102.10	91.20	81.30	3.10	-78.20
1987	961.20	303.70	-657.50	9.40	78.20	68.80	80.60	3.40	-77.20
1988	596.00	148.00	-448.00	9.50	52.40	42.90	69.10	2.30	-66.80
1989	515.80	108.80	-143.90	8.50	40.40	31.90	102.40	3.90	-98.50
1990	709.20	181.00	-193.40	9.30	32.20	22.90	118.70	8.60	-110.10
1991	976.40	189.90	-255.20	9.20	38.50	29.30	134.20	9.50	-124.7
1992	1103.60	248.80	854.80	9.50	37.5	28.00	117.50	5.10	-112.4

Source:Statistical Abstract of Israel,1992, Central Bureau of Statistics, figures,for 1988-1991, are estimated.
Figures for the period 1987-92 are estimates.

Table 27: Occupied Territories, (West Bank and Gaza Strip). Industrial Exports by Market and commodity composition 1977, 1980-1986 (Million of current US dollars).

INDUSTRIAL EXPORTS.

	JORDAN						ISRAEL	OTHER COUNTRIES	
	Olive Oil & Olives	Stone and Marble	Samna Soap	and Dairy	Other	Total	Total	Total	TOTAL
1977	2.2	2.1	4.1	9.8	4.7	22.9	120.9	1.0	144.8
1980	31.00	4.80	4.40	15.10	3.10	58.4	177.30	1.60	237.30
1981	25.50	6.30	4.10	13.90	2.90	52.7	243.00	1.50	297.20
1982	37.00	8.00	4.90	22.60	6.60	79.1	226.60	0.80	306.50
1983	15.80	7.90	3.60	13.70	2.20	43.2	244.90	1.10	289.20
1984	28.50	10.60	3.50	17.70	1.80	62.1	171.80	1.10	235.00
1985	0.70	12.00	3.40	18.70	2.10	36.9	167.20	1.00	205.10
1986	24.70	11.80	3.60	15.80	2.10	58	258.40	0.90	317.30

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip). UNCTAD, United Nations, 1989.

Table 28: Occupied Territories, (West Bank and Gaza Strip). Agricultural Exports by Market and commodity composition 1977, 1980-1986 (Million of current US dollars).

	JORDAN					ISRAEL	OTHER COUNTRIES	
	Vegetables	Citrus Fruit	Other Fruit	Others	Total	Total	(All Citrus) Total	TOTAL
1977	4.0	52.8	4.5	0.4	61.7	33.3	12.4	107.4
1980	3.20	37.40	7.50	0.10	48.20	50.70	9.50	108.40
1981	5.20	34.50	10.10	0.50	50.20	45.30	7.00	102.50
1982	8.20	39.30	12.60	0.30	60.40	34.10	5.20	99.70
1983	4.00	25.70	12.90	0.60	43.10	40.20	7.00	90.30
1984	5.20	17.80	12.60	0.60	36.30	23.90	4.20	64.40
1985	8.30	24.20	15.80	0.50	48.80	25.00	4.70	78.50
1986	4.90	23.10	13.50	1.10	42.60	30.60	2.20	75.40

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip). UNCTAD, United Nations,1989.

Table 29: Occupied Territories, (West Bank and Gaza Strip), Agricultural Imports by Market. 1977, 1980-1986 (Million of current US dollars).

AGRICULTURAL IMPORTS

	JORDAN	ISRAEL	OTHER COUNTRIES	TOTAL
1977	0.3	74.0	14.9	89.2
1980	0.5	90.4	5.9	96.8
1981	0.2	91.3	5.0	96.5
1982	0.4	75.3	10.9	86.6
1983	0.3	89.6	12.1	102.0
1984	0.1	98.2	10.0	108.3
1985	0.3	87.8	14.0	102.1
1986	0.2	114.4	15.6	130.2

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory,(West Bank and Gaza Strip).UNCTAD, United Nations, 1989.

Table 30: Occupied Territories, (West Bank and Gaza Strip). Industrial Imports by Market and commodity composition, 1980-1986 (Million of current US dollars).

INDUSTRIAL IMPORTS

	Jordan					Israel	Other Countries Via Israel								Total
	Oils Dairy Prod.	Paper and Printing	Text. and Cotton	Iron & Steel Prod.	Total		Oils	Food Prod.	Soap & Plastic	Wood, Paper & Card-board	Textiles	Iron & Steel Prod.	Mach. Electr. Equip.	Total	Total
1980	4.3	0.2	0.1	0.2	4.9	506.8	12.9	18.8	1.8	2.0	5.0	4.3	12.1	76.7	588.4
1981	6.0	0.3	0.3	0.3	7.0	581.3	8.8	11.3	2.5	2.3	5.8	2.8	8.1	65.5	653.8
1982	7.8	0.2	0.1	0.3	8.5	573.1	8.5	14.6	2.3	3.6	4.6	2.5	10.7	71.6	653.2
1983	5.5	0.2	0.2	0.3	6.5	623.0	5.4	8.5	3.0	4.8	4.5	2.9	10.0	65.4	694.9
1984	7.4	0.2	0.1	0.3	8.1	521.7	6.0	11.6	2.7	4.8	3.3	1.8	8.0	58.1	587.9
1985	7.3	0.3	0.1	0.5	8.3	510.2	10.1	10.6	2.0	5.2	3.7	2.1	7.7	61.2	579.7
1986	9.1	0.5	0.3	0.6	10.8	665.9	7.1	12.6	3.8	3.1	4.5	3.2	15.7	81.0	757.7

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip), UNCTAD, United Nations, 1989.

Table 31: Occupied Territories. Labor Force, Selected Data, 1970, 75, 80, 85-1991.

Total for Occupied Territories

	1970	1975	1980	1985	1986	1987	1988	1989	1990	1991	1992
Total (000s)											
Working-age population	519.7	591.9	643.7	722.7	718.3	738.3	751.5	770.7	804.0	833.9	851.8
Labor force	180.8	206.0	218.5	251.5	267.3	284.0	289.4	290.3	307.8	312.1	333.3
Employed persons	173.3	204.3	215.7	242.2	259.4	277.8	281.9	279.3	296.5	287.4	219.2
Unemployed	7.5	1.7	9.1	9.1	7.9	6.2	7.5	10.8	11.2	24.7	14.1
Percentages											
Participation rate	34.8	34.9	34.8	34.8	37.2	38.5	38.5	37.7	38.3	37.4	38.2
Unemployment rate	4.1	0.8	3.6	3.6	3.0	2.2	2.6	3.7	3.7	7.9	4.2
Employment rate	33.3	34.5	33.5	33.5	36.1	37.6	37.5	37.0	37.0	34.5	37.2
Men (000s)											
Working-age population	255.6	282.5	309.1	349.4	347.7	358.4	364.7	376.3	394.4	408.3	420.2
Labor force	151.4	177.3	187.3	225.4	238.3	257.4	261.2	266.9	280.3	286.5	303.3
Employed persons	145.6	176.0	185.3	217,8	238.3	252.2	254.5	257.0	270.3	262.5	289.3
Unemployed	5.8	1.3	2.0	7.6	6.0	5.1	6.7	9.9	10.3	24.0	13.5
Percentages											
Participation rate	62.0	62.9	60.6	64.5	68.5	71.8	71.6	70.9	71.1	70.2	72.2
Unemployment rate	3.8	0.7	1.1	3.4	2.5	2.0	2.6	3.7	3.7	8.4	4.4
Employment rate	57.0	62.3	59.5	62.3	66.8	70.4	69.8	68.3	68.5	64.3	69.0
Women (000s)											
Working-age population	275.6	309.9	334.4	373.3	370.6	379.9	386.4	394.4	409.6	425.6	437.6
Labor force	29.4	28.7	29.9	25.9	29.0	26.7	28.2	23.5	27.5	25.6	30.0
Employed persons	27.7	28.3	29.9	24.4	27.1	25.6	27.4	22.5	26.5	24.6	29.4
Unemployed	1.7	0.4	0.5	1.5	1.9	1.1	0.8	0.9	0.9	0.7	0.6
Percentages											
Participation rate	10.7	9.3	8.9	6.9	7.8	7.0	7.3	5.9	6.7	6.0	6.9
Unemployment rate	5.8	1.4	1.7	5.8	6.6	4.1	2.8	3.8	3.7	2.7	2.0
Employment rate	10.1	9.1	8.9	6.5	7.3	6.7	7.1	5.7	6.5	5.9	6.7

Source: Judea, Samaria, and Gaza Area Statistics; Volumes XVIII,XIX and XX for 1988,1989-90,1991, Israel Central Bureau of Statistics, Jerusalem.

*. Working Age population is age 15+ from 1986-1990.

Data for 1992 are estimates.

Table 32: Occupied Territories, Employees by Place of Work and Selected Economic Branches.

	WEST BANK/EMPLOYEES			GAZA/EMPLOYEES			TOTAL/OCCUPIED TERRITORIES		
	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION
1970	7700	8600	6600	2500	10600	4300	10200	19200	10900
1971	7800	6700	3900	2800	10400	2200	10600	17100	6100
1972	7500	5600	4300	2900	7500	1600	10400	13100	6000
1973	7100	3900	4300	2300	7100	1500	9300	11000	5900
1974	7900	3500	5100	2000	6200	1400	9900	9700	6400
1975	7500	3000	6000	2700	6700	1800	10200	9700	7800
1976	7800	2500	7000	3500	5800	1800	11300	8300	8800
1977	7900	2400	7700	3000	5300	2300	10900	7700	10000
1978	8400	1800	8200	3400	3100	2200	11800	4900	10200
1979	8500	1800	8400	3400	2000	1800	11900	3800	9800
1980	8200	2400	7500	3500	1700	2000	11700	4100	9500
1981	7900	2400	7900	3300	1900	2500	11200	4300	10400
1982	9100	2300	10300	3100	2300	2600	12200	4600	12900
1983	8800	2100	8200	2800	1900	1900	11600	4000	10100
1984	9700	2200	9400	3400	1800	1900	13100	4000	11300
1985	9925	2470	9900	3502	2080	1800	13427	4550	11700
1986	11000	2300	11300	4200	1900	2500	15200	4200	13800
1987	11800	2700	10600	4700	1500	2100	16500	4200	12700
1988	11500	2500	8900	4000	2000	2000	15500	4500	10900
1989	12300	1800	9300	3300	3200	4300	15600	5000	13600
1990	12700	1800	10700	2900	3700	3900	15600	5500	14600
1991	12200	2200	10000	4400	4200	3800	16400	6400	13800
1992	13700	2600	10800	4800	2900	5500	18500	5500	16300

Source: Statistical Abstracts of Israel, Various Issues, Central Bureau of Statistics.
Data for 1992 are estimates.

Table 33: Occupied Territories, Employed by Place of Work and Selected Economic Branches.

	WEST BANK/EMPLOYEES			GAZA/EMPLOYEES			TOTAL/OCCUPIED TERRITORIES		
	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION
1970	14600	42500	8400	12100	31600	8500	26700	74100	16900
1971	14700	40200	6100	12200	31100	4600	26900	71300	10700
1972	14600	38000	7200	12600	24800	4100	27200	62800	11300
1973	16400	34200	7600	12700	25700	3900	29100	59900	11500
1974	15100	37900	7000	12200	24800	4100	27300	62700	11100
1975	15800	34600	8400	12000	26300	5100	27800	60900	13500
1976	14900	33900	10000	13500	26500	4600	28400	60400	14600
1977	15100	33400	10400	12500	25100	6700	27600	58500	17100
1978	15200	34400	10900	15400	21100	7000	30600	55500	17900
1979	15900	31500	11800	18200	21100	7000	34100	52600	18800
1980	15200	33200	10700	18600	18800	7300	33800	52000	18000
1981	15700	30500	11900	16500	18000	8400	32200	48500	20300
1982	15900	32100	10600	14800	17900	8500	30700	50000	19100
1983	16100	29500	11000	15200	19200	8200	31300	48700	19200
1984	15900	28500	11300	17100	16500	8500	33000	45000	19800
1985	16200	27300	12400	16200	18000	8400	32400	45300	20800
1986	15700	28400	12800	17600	16900	8300	33300	45300	21100
1987	16600	26000	12200	17500	16000	8400	34100	42000	20600
1988	15900	31200	10700	16300	18600	8400	32200	49800	19100
1989	17200	26400	11000	13500	18400	12600	30700	44800	23600
1990	15800	29500	10900	11300	20400	11100	27100	49900	22000
1991	16900	28100	10500	12700	21600	10000	29600	49700	20500

Source: Statistical Abstracts of Israel, Various Issues. Central Bureau of Statistics.

*.Employed include Employees and Self employed.

Table 34: Average Daily Wage of Employees of the West Bank and Gaza Area by place of work and selected economic branches.

Average Daily Wage per Employee (NIS, at current prices), Occupied Territories.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (*mining* & manufacturing)	0.17	0.42	2.06	8.60	14.05	19.07	24.47	23.66	27.00
Agriculture, Forestry & Fishing	0.16	0.41	1.66	7.76	13.91	18.30	27.04	27.44	30.41
Construction (building & public works)	0.24	0.62	2.73	10.39	17.85	23.30	34.62	29.75	33.40
Public Services	0.28	0.63	3.37	12.07	18.73	22.91	25.76	25.20	29.13
Other Branches	0.18	0.43	2.20	8.41	13.35	16.24	26.21	20.78	22.80
Total	0.22	0.54	2.74	10.24	16.67	21.16	29.40	25.37	28.85

Average Daily Wage per Employee (NIS, at current prices), West Bank.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.18	0.43	2.15	9.14	14.41	18.57	22.82	23.05	26.32
Agriculture, Forestry & Fishing	0.17	0.43	1.80	7.82	13.64	17.48	20.64	20.83	25.49
Construction (building & public works)	0.25	0.64	2.82	10.76	18.00	23.02	29.01	29.11	33.22
Public Services	0.24	0.57	3.03	11.26	17.81	21.86	23.88	22.48	26.97
Other Branches	0.18	0.45	2.07	7.19	14.64	16.23	19.99	19.28	22.29
Total	0.22	0.53	2.64	10.17	16.49	20.50	24.02	23.56	27.45

Average Daily Wage per Employee (NIS, at current prices), Gaza Area.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.15	0.39	1.82	7.10	13.15	20.34	24.10	26.37	30.45
Agriculture, Forestry & Fishing	0.16	0.38	1.51	7.68	14.23	19.66	25.25	32.29	34.07
Construction (building & public works)	0.22	0.58	2.32	8.58	17.21	24.70	30.95	31.52	34.09
Public Services	0.30	0.73	4.00	13.38	20.28	24.63	28.08	29.77	32.98
Other Branches	0.17	0.38	1.76	5.19	10.83	17.37	22.19	24.97	24.10
Total	0.24	0.58	2.97	10.41	17.08	22.65	26.91	29.47	32.29

Source: Judea, Samaria and Gaza Area Statistics, Vol XVI, XVIII, XIX and XX, Israel Central Bureau of Statistics, 1986, 1988, 1989-90, and 1991.

*.Comparison with data from previous years should be treated with caution. Other Branches include:Electricity, Water, Financing, Business Services and Personal Services, they were presented together due to the low number of employed persons in these branches.

Table 35: Employment of Palestinians in Israel by Selected Economic Branches. 1970, 1975, 1980-1991 (in 000's)

	EMPLOYEES FROM THE WEST BANK				EMPLOYEES FROM GAZA				TOTAL EMPLOYEES FROM O.T.			
	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other
1970	2.6	1.9	8.0	1.5	2.4	0.5	2.8	0.1	5.0	2.41	0.8	1.6
1975	4.2	7.3	21.5	5.3	5.0	4.6	13.7	2.3	9.2	11.9	35.2	7.6
1980	3.9	8.4	19.9	7.0	6.3	7.2	15.2	5.3	10.2	15.6	35.1	12.3
1981	3.7	7.1	20.3	7.3	5.7	6.6	17.9	5.3	9.4	13.7	38.2	12.6
1982	3.9	7.5	22.5	7.3	6.0	6.3	18.5	4.6	9.9	13.8	41.0	11.9
1983	3.9	8.5	24.8	8.4	6.6	7.5	18.5	6.1	10.5	16.0	43.3	14.5
1984	4.8	8.8	24.8	9.1	7.8	7.3	18.0	6.3	12.6	16.1	42.8	15.4
1985	4.9	7.8	23.9	8.6	9.0	7.9	17.4	6.6	13.9	15.7	41.3	15.2
1986	5.3	8.9	25.3	9.4	9.4	7.4	19.1	6.6	14.7	16.3	44.4	16.0
1987	6.1	11.0	29.6	13.2	9.5	8.6	18.8	7.8	15.6	19.6	48.4	21.0
1988	6.5	10.2	31.4	12.7	9.7	6.3	20.6	6.3	16.2	16.5	52.0	19.0
1989	6.6	9.0	34.1	12.8	7.4	4.4	20.6	5.9	14.0	13.4	54.7	18.7
1990	5.5	7.3	36.7	12.4	6.8	3.8	26.1	5.1	12.3	11.1	62.8	17.5
1991	4.4	4.9	37.2	7.5	7.2	2.4	28.9	2.4	11.6	7.3	66.1	9.9
1992	4.0	4.0	52.8	8.6	6.4	1.8	31.5	2.0	10.3	6.8	84.3	10.3

	EMPLOYEES FROM THE WEST BANK				EMPLOYEES FROM GAZA				TOTAL EMPLOYEES FROM O.T.			
	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other
1970	2.6	1.9	8.3	1.8	2.4	0.5	2.8	0.2	5.0	2.4	11.1	2.0
1975	4.4	7.5	22.2	6.3	4.8	4.7	13.8	2.6	9.2	12.2	36.0	8.9
1980	4.0	8.5	20.3	7.7	6.3	7.2	15.2	5.8	10.3	15.7	35.5	13.5
1981	3.7	7.2	21.0	7.9	5.8	6.6	17.8	5.7	9.5	13.8	38.8	13.6
1982	4.0	7.7	23.3	8.0	6.1	6.3	18.5	5.2	10.1	14.0	41.7	13.2
1983	4.0	8.8	25.7	9.6	6.6	7.6	18.6	6.9	10.7	16.3	44.3	16.5
1984	4.9	9.0	25.6	10.7	7.9	7.3	18.1	6.9	12.8	16.2	43.7	17.6
1985	5.1	7.9	24.8	9.7	9.0	7.9	17.6	7.1	14.1	15.8	42.5	16.8
1986	5.3	9.1	26.1	10.6	9.5	7.4	19.4	7.1	14.8	16.5	45.5	17.7
1987	6.2	11.1	30.4	15.2	9.7	8.6	19.3	8.5	15.8	19.7	49.7	23.6
1988	6.6	10.3	32.4	14.7	10.1	6.5	21.7	7.0	16.7	16.8	54.2	21.7
1989	6.7	9.1	35.0	14.6	7.5	4.5	21.1	6.4	14.2	13.6	56.1	21.0
1990	5.6	7.4	37.6	14.0	7.0	3.9	26.5	5.6	12.6	11.2	64.1	19.7
1991	4.4	5.0	37.6	8.8	7.3	2.5	29.3	2.8	11.7	7.5	66.9	11.6
1992	4.0	5.0	53.4	10.0	6.4	(1.8)	32.5	2.3	10.4	6.8	85.9	12.3

Source: Statistical Abstracts of Israel, 1986, 1988, 1989, 1991, and 1992 Central Bureau of Statistics.
*.Until 1985 data refer to persons aged 14+

Table 36: Average Daily Wage of Employees of the West Bank and Gaza Area who work in Israel, by selected economic branches.

Average Daily Wage per Employee (NIS,at current prices), from the Occupied Territories.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.24	0.58	2.31	9.15	17.65	25.01	31.55	34.83	39.20
Agriculture, Forestry & Fishing	0.19	0.48	1.68	7.35	14.65	21.76	28.31	31.97	35.52
Construction (building & public works)	0.27	0.65	2.56	10.47	19.85	27.17	35.78	40.86	43.52
Other Branches	0.23	0.57	2.37	9.59	17.95	24.18	30.05	33.43	36.91
Total	0.25	0.60	2.36	9.59	18.30	25.37	32.81	37.36	40.91

Average Daily Wage per Employee (NIS, at current prices), from the West Bank.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.23	0.55	2.27	9.24	16.97	22.63	29.41	32.40	35.58
Agriculture, Forestry & Fishing	0.19	0.47	1.66	7.05	14.16	20.41	26.79	29.69	33.22
Construction (building & public works)	0.27	0.66	2.61	10.84	19.60	25.82	35.34	40.07	40.87
Other Branches	0.23	0.58	2.44	10.13	17.72	22.75	28.33	31.20	34.42
Total	0.25	0.61	2.42	10.04	18.18	24.00	31.81	35.90	38.15

Average Daily Wage per Employee (NIS,at current prices), from the Gaza Area.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.25	0.61	2.36	9.06	18.45	28.19	35.45	41.35	47.87
Agriculture, Forestry & Fishing	0.19	0.49	1.69	7.51	14.91	22.62	29.37	34.64	37.82
Construction (building & public works)	0.27	0.64	2.50	9.96	20.18	29.37	36.53	42.63	48.19
Other Branches	0.24	0.57	2.27	8.85	18.28	26.79	34.20	40.15	44.82
Total	0.25	0.60	2.28	9.10	18.43	27.30	34.42	40.61	46.13

Source: Judea, Samaria and Gaza Area Statistics, Vol XVI,XVIII,XIX and XX, Israel Central Bureau of Statistics, 1986, 1988, 1988-90 and 1991.

*.Comparison with data from previous years should be treated with caution. Other Branches include:Electricity, Water, Financing, Business Services and Personal Services, they were presented together due to the low number of employed persons in these branches.

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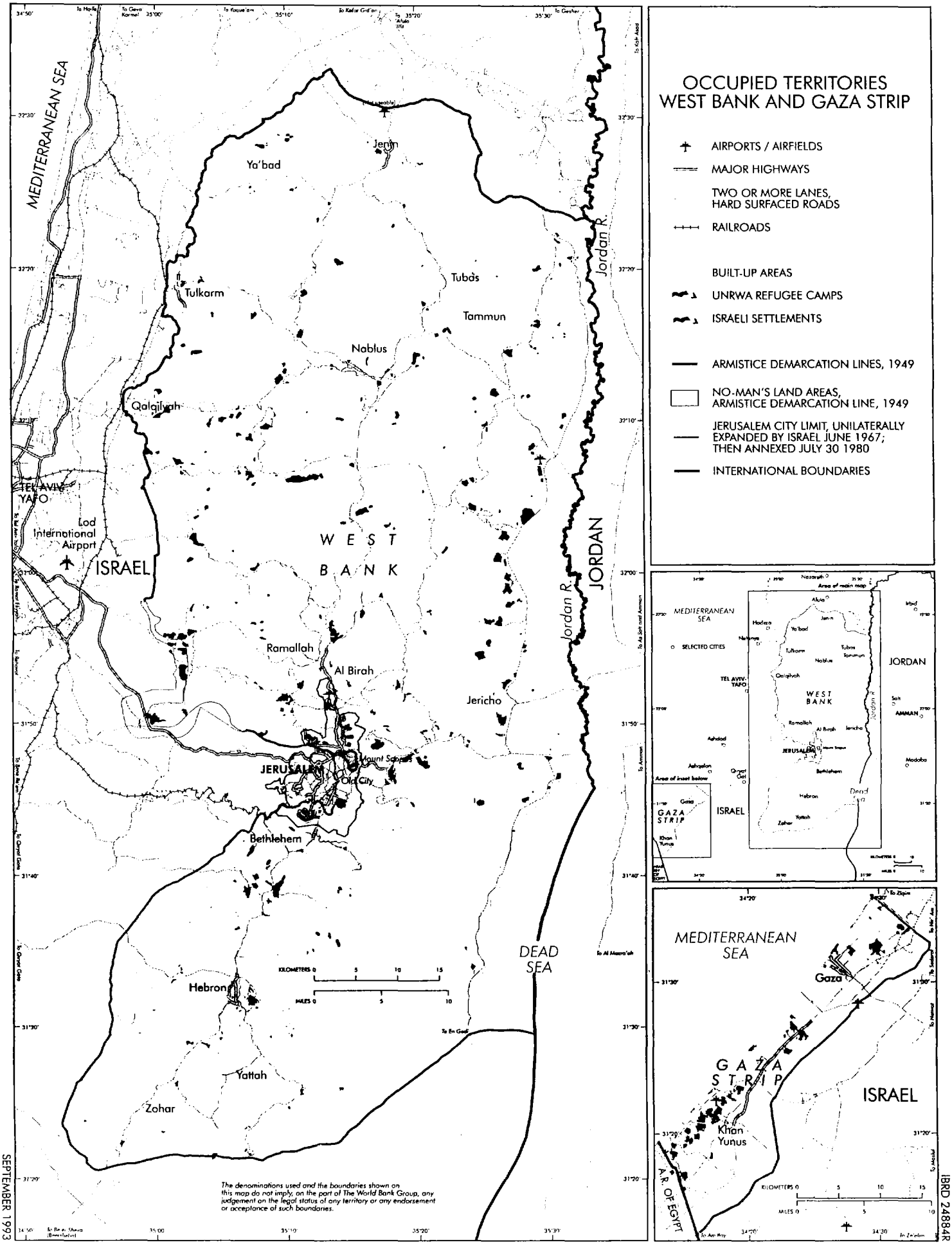

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