Overview

The World Bank

The World Bank, December 1, 2004

Contents

Introduction

"If the PA shows firm commitment to security and economic reform and if Israel seriously addresses closure, another major donor effort definitely would be justified. Under these circumstances an additional US$500 million each year could help the Palestinian economy to turn the corner."

James D. Wolfensohn, President, the World Bank, June 23, 2004

----

1. **The World Bank's June 23 report, *Disengagement, the Palestinian Economy and the Settlements*, warns of the potential disintegration of the Palestinian economy under the sustained pressures of conflict and Israeli closure policies.** The report describes a society which has, in the space of four years, lost all economic dynamism and experienced a recession of historic proportions. As a result, the strong social cohesion that characterizes Palestinian life has begun to crack, while the Palestinian Authority has lost credibility and effective control in several parts of Gaza and the West Bank. This is a situation which is potentially ruinous for both Palestinians and Israelis.

2. **Today there is hope that the Israeli and Palestinian governments are once again ready to discuss their shared future.** They would do so at a time when Israel is preparing, for the first time, to evacuate settlements established in Gaza and theWest Bank after the 1967 war, and when President Bush has just reminded the world of his wish to see the emergence of a "truly free" and democratic Palestinian state before the end of his second term. The PA's decision to hold presidential elections in line with the provisions of the Basic Law and to follow them in May with parliamentary elections are very encouraging steps; and so too are indications from the Government of Israel of a new interest in holding direct discussions with the Palestinian Authority.

3. **No state can be truly free with its economy in chaos and with the majority of its population living below the poverty line.** While prosperity is no guarantee of tranquility, history teaches that the opposite is too often true – that destitution, political instability and violence are constant companions.

4. **At this juncture, it is vital that policy-makers focus on stabilizing and reviving the economy as part of any new political process.** For the PA to play an effective political role, it must preside over a period in which the Palestinian population experiences positive change in their daily lives – in their the ability to move freely, to trade, to find work, to earn a living for their families.

5. **While money, and in particular donor money, has an important role to play in reviving the economy, it is not the determining factor.** The last four years exemplify how little donor assistance can achieve in the absence of a positive policy environment – while donor disbursements doubled to almost US$1 billion per annum, real personal incomes fell by almost 40 percent in the same period.

6. **To change this frustrating dynamic, the underlying causes of economic decline need to be addressed.** It is important to emphasize this at a time of new hope, since it would be a mistake to respond to today's potential opening by efforts to raise large sums of money *without* addressing the root causes of today's economic crisis.

7. **For a recovery to take place, the Government of Israel needs to roll back**

the system of restrictions on the movement of people and goods imposed since the beginning of the *intifada* – it is these various closure measures that are the proximate cause of four years of Palestinian economic distress. Accordingly, much of the work of the Bank and donor team over the course of this summer focused on the various facets of closure, with the team benefiting from intensive, professional interaction with both parties. The Government of Israel's willingness to engage with the donors on these issues spoke of a strategic reappraisal of the importance of Palestinian economic stability to Israel's own security – while the work of the Bank and its partners shows that there are solutions that permit a significant dismantling of closure measures without endangering Israeli security.

8. **The Government of Israel has given encouraging signs of a willingness to reform the management of border gateways, to enable a much faster and more reliable throughput of cargo and people. Unless a number of other key areas of the closure system are addressed, however, these improvements will have only limited impact.** Of particular concern are the likely persistence of the back-to-back cargo handling system, the continuation of internal closures throughout the West Bank, the lack of adequate connections between Gaza and the West Bank, and Israel's stated intention to terminate Palestinian labor permits by 2008 and to abrogate the Customs Union in Gaza after withdrawal from Philadelphi.

9. **For its part, the Palestinian Authority faces two sets of challenges if it is to play its part in bringing about revival. First is the need to demonstrate strong commitment to security reform, politically risky though this may be.** Without a visible and effective effort, the case for persisting with certain closure measures is hard to refute.

10. **The PA also needs to reinvigorate its program of governance reforms in order to create an internal environment more attractive to private investors.** Doing this will require that the PA complete the cycle of popular elections it has embarked on, control lawlessness, develop a solid judicial system and address concerns about transparency and corruption. The acquisition of the settlement areas offers the PA an opportunity to demonstrate a new spirit of openness in planning the disposal of these assets.

11. **On the basis of what is on offer today, economic revival is a distant prospect, and it would be hard to justify a major new donor financing drive –** the challenge, rather, will be to preserve existing aid levels of c. US$900 million per annum and thereby ensure that basic budget support, humanitarian and infrastructure development needs continue to be met.

12. **Chapter Six lays out an agenda of actions that the Bank believes would lay the basis for economic regeneration.** It is suggested that this agenda be further refined after the December AHLC meeting in December, if possible through direct discussion between GOI and the PA.

13. **It is further proposed that the donor community track progress by the parties in tackling these key preconditions for economic revival.** If significant progress is made against a set of agreed indicators, a major new donor effort would then be justified – and a donor pledging conference should be called. Calling such a conference in the absence of adequate progress would be counterproductive, however, and should not be considered.

Figure 1
Economic Scenarios, West Bank and Gaza

	Nominal GDP per capita, US$	Nominal GDI per capita, US$	Unemployment Rate (percent)	Poverty Rate (percent)	
				West Bank	Gaza Strip
As at end 2004	934	1,393	27%	38%	65%
Scenario	**Projected Outcomes by 2008**				
1. "Status Quo"	807	1,156	37%	53%	76%
2. "Disengagement Plus"	878	1,227	31%	45%	70%
3. "Economic Recovery"	1,090	1,484	19%	31%	58%
4. "Economic Recovery" with extra US$1.7 billion from donors over period 2005-2008	1,180	1,643	13%	24%	49%

Note: **Scenarios 1 and 2** assume a decline in Palestinian workers in Israel and Israeli settlements, from 37,700 currently (excluding East Jerusalem residents) to 12,400 in 2008. **Scenarios 3 and 4** assume employment of Palestinians (excluding East Jerusalem residents) in Israel and Israeli settlements remains constant at current level.

All four scenarios assume donor contributions of US$900 million in 2004. **Scenario 1** assumes contributions of US$900 million in 2005 and 2006 and US$800 million in 2007 and 2008, a total of $3.4 billion over the period 2005-2008. **Scenarios 2 and 3** assume an additional contribution of US$200 million in 2005 (total that year of US$1.1 billion), for a total of US$3.6 billion over the period 2005-2008. **Scenario 4** assumes donor contributions of US$1.3 billion in 2005, US$1.5 billion in 2006, US$1.4 billion in 2007, and US$1.1 billion in 2008, for a total of US$5.3 billion over the period 2005-2008; this represents an increase in donor contributions of US$1.7 billion compared to Scenarios 2 and 3.

1 – The Context

I – Introduction

14. **The World Bank report of June 23, 2004, *Disengagement, the Palestinian Economy and the Settlements*, argues that the Palestinian economy is not viable under today's political *status quo***, and that its continued deterioration will "impoverish and alienate a generation of young Palestinians…(undermining) the credibility of the Palestinian Authority (PA), increasing the appeal of militant factions and threatening Israel's security"[1]. The report demonstrates that the Government of Israel's (GOI) Modified Disengagement Plan of June 6 alone "will not alter this dangerous, unsustainable situation. If implemented with wisdom and foresight, however, it could make a real difference." This will only happen if GOI and the PA can break out of the current policy impasse – GOI by dismantling the system of closures stifling the Palestinian economy, and the PA by combating terrorism and re-launching the halting process of Palestinian reform. If the parties show they are prepared to carry out these difficult actions, then - and only then - an additional major donor financing effort is justifiable. With a growth-enhancing environment in place, a large additional injection of donor capital would "enable the Palestinian economy to turn the corner". The basic thesis in the Bank's report was accepted by both parties.

15. **The Bank report proposed an analytical work program intended to help define "what can be done to address closure and kick-start the Palestinian economy"**[2]. At a meeting of the Quartet Envoys on July 6, the Bank was asked to oversee this work program in preparation for an Ad Hoc Liaison Committee (AHLC) meeting in late 2004. Both GOI (in a meeting between the Bank and the Israeli National Security Council (INSC) and the Ministry of Foreign Affairs (MOFA) on July 21), and the PA (in a letter from the Prime Minister to President Wolfensohn on July 18) indicated that they wished to work closely with the donor community on this analytical work program. Over the course of the past four months, therefore, a donor team led by the Bank and including experts from USAID, the European Commission, the IMF, the UN family[3] and DFID prepared the four **Technical Papers** attached to this report.

II – The Process

16. **In order to better understand the views of both parties and the extent to which policy changes might be forthcoming, the donor team worked in close consultation with GOI and PA "reference groups"** – an Israeli group co-chaired by the INSC and MOFA, and a Palestinian group chaired by the PA's Minister for National Economy[4]. In addition, the donors' Local Task Force on Palestinian Reform has since late September been interacting with the PA's National Reform Committee to support the definition of a core package of Palestinian reform initiatives for 2005.

17. **The Bank/donor dialogue with GOI and with the PA took place in an environment of mistrust between the parties**, with the PA and GOI holding divergent perceptions of the work of the donor team.

- **GOI expectations.** For GOI, the disengagement initiative is "not dependent on cooperation with the Palestinians", since "the State of Israel has reached the conclusion that there is currently no partner on the Palestinian side with whom progress can be made on a bilateral peace process"[5]. GOI was not prepared to discuss its response to the Bank's June 23 paper directly with the PA, but instead chose to interact with the donor team and to convey its views to the PA through the donors.

- **PA reservations.** Unhappy with GOI's wish to deal with Palestinian economic issues by proxy, the PA was concerned lest the GOI/donor dialogue should encourage donors to forge understandings with GOI which would negate or diminish the bilateral economic agreements concluded in the pre-*intifada* "Oslo" era. The PA "reference group" underlined the need to link any discussion of the terms of disengagement with the Roadmap, and called on the donor team to take account of the provisions of the Oslo Accords as applicable to the movement of goods and people, the operation of passages and crossing points, the territorial link between Gaza and the West Bank and the quasi-Customs Union.

18. **In view of the potential for misunderstanding, the Bank clarified to the parties and to donors that these consultations were *not* intended to substitute for bilateral negotiations**, and that the Bank would take final responsibility for the analysis and the conclusions drawn from it. Though technical and economic in intent, these papers would reference the broader frameworks within which the donor community continues to operate:

- **The Roadmap**[6]**.** The political context underpinning this report is provided by the Roadmap, which has to been formally accepted by the PA and the international community, and with some caveats by GOI. Although the Roadmap is not under substantive implementation by either party, it embodies an assumption that neither has disowned - President Bush's vision of an end of Israel's 37-year occupation of the West Bank and Gaza, and of "the emergence of an independent, democratic, and viable Palestinian state living side by side in peace and security with Israel and its other neighbors"[7]. The actions proposed in the Bank's June 23 report, it was noted, "conform to what the Aix Group calls a "rescue phase", consistent with Phase I of the Roadmap (Ending Terror and Violence, Normalizing Palestinian Life and Building Palestinian Institutions)"[8].

- **Legal agreements defining economic relations between Israel and the Palestinian Territories**. The various interim agreements negotiated between mid-1993 and 1995, collectively known as the Oslo Accords[9], continue to provide a framework for bilateral economic relations and for donor support to the PA. Many provisions are not currently under implementation - some never were[10], while others (such as security cooperation of various kinds and the operation of the "safe passage" between Gaza and the West Bank) were suspended after the outbreak of the *intifada*. Statements from GOI suggest that Israel is not inclined to activate lapsed provisions, and that parts of Oslo will become irrelevant with the implementation of the Disengagement Plan[11]. Nonetheless, no part of the Oslo Accords has been formally declared invalid by either party. All of the measures recommended in the June 23 report and expanded upon in this paper are compatible with the Oslo economic agreements.

III – Economic Implications of Israel's Disengagement Plan

19. **A number of proposals in GOI's Plan have significant economic implications for the Palestinian population.**

- **Evacuation from settlements in Gaza and the northern West Bank**. Most domestic Israeli and international attention has focused on GOI's plan to relinquish 21 settlements in Gaza and the northern West Bank. The Plan should result in a lifting of closures in the vacated areas, and would enable Palestinians to make use of the land and economic assets left behind. The Israeli domestic political risks involved in pursuing the evacuation are apparent to all observers.

- **Physical and economic separation**. Israeli policy makers have stressed the need for separation between Israelis and Palestinians[12]. A security-driven concept of separation permeates many aspects of Israeli disengagement policy – the intended completion of the Separation Barrier in the West Bank, the prohibition on Israelis entering industrial parks in areas not under Israeli security control, the planned termination of work permits for Palestinians in Israel by the end of 2008 and the proposed revocation of the quasi-Customs union between Israel and Gaza (see paragraphs 63ff.).

- **Continued Israeli settlement in parts of the West Bank**. The Disengagement Plan states that "it is clear that some parts of Judea and Samaria (including key concentrations of Jewish settlements, civilian communities, security zones and areas in which Israel has a vested interest) will remain part of the State of Israel"[13]. The continued presence of 128 settlements and approximately 230,000 settlers in the West Bank[14] has significant implications for the Palestinian economy. Not only do the settlement areas command natural resources that are thereby unavailable to the Palestinian population; the donor team was also informed that internal closures in the West Bank are intended in part to protect the access of Israelis to these settlements. In addition, GOI has indicated that it does not for the moment plan to reclassify evacuated areas in the West Bank, now Area C, to either Area A or Area B; this will limit the legal competence of the PA to govern in these areas, since under the Oslo Accords the PA has no civil or security jurisdiction in Area C[15].

IV – The Palestinian Economy After 4 Years of *Intifada*

20. **After a steep decline in 2001 and 2002, the Palestinian economy stabilized in 2003.** In those two years, Palestinian real GDP per capita shrunk by almost 40 percent. This trend was halted in 2003, and mild positive growth returned (see **Annex Table 1**). Real GDP per capita increased by one percentage point, but real GDI[16] – which includes remittances from abroad and foreign assistance – increased by over 11 percent per capita. This rebound resulted from a lull in violence and less intense curfews/closures than in 2002 (the year of Operation Defensive Shield), an increase in labor flows to Israel and a resumption by GOI of revenue transfers (plus the return of US$178 million in withheld revenues[17]). Almost 100,000 jobs were created, albeit many of them of poor quality[18], and investment grew by 14 percent (though at c. US$840 million amounting to less than a half of 1999 levels, and most in residential housing). Unemployment and poverty and rates declined by 5 and 4 percentage points respectively.

21. **This fragile recovery has stalled in 2004, mainly as a result of events in Gaza.** The Israeli Defense Forces (IDF) mounted several extended operations in Gaza in 2004[19]. The operations were accompanied by segmentation of the Gaza Strip and stiff restrictions on movements of goods and people across the borders with Israel and Egypt. This led to a sharp reduction in the volume of Gaza's exports[20], as well as a temporary curtailment of humanitarian assistance[21]. The fighting resulted in significant damage to public infrastructure, private buildings[22]. Worker access to the Erez Industrial Estate and to Israel declined to a daily average of less than 1,000 in the second and third quarters (compared with 6,000 the previous year). Compared with 2003, 8,000 jobs have been lost within Gaza. In the West Bank, domestic job growth in 2004 has been positive but anemic (2.4 percent during the first three quarters). Unem-

ployment rates stand at 27 percent overall, and 35 percent in Gaza, and poverty is comparable to 2003 – 48 percent overall, 65 percent in Gaza[23].

22. **If the political and economic status quo persist, the medium-term outlook for the West Bank and Gaza is bleak, as Box 1 explains.**

Box 1 – *"Status Quo"* Scenario

Assumptions: The Bank's *Status Quo* scenario embodies the following key assumptions: no appreciable change in the current system of closures, with the Separation Barrier completed in 2005; a gradual decline in the number of Palestinian workers in Israel and the settlements from 37,700 today to 12,400 in 2008; and donor assistance of US$900 million in 2005 and 2006, falling to US$800 million in 2007 and 2008. Total donor assistance during the four years 2005-2008 would amount to US$3.4 billion, for an average of US$850 million per annum.

Projections: With closures continuing to stifle private sector activity, investment will remain flat, and the Palestinian economy's ability to create jobs will be outstripped by a rapidly growing labor force. Dwindling levels of Palestinian workers in Israel and the settlements, combined with declining levels of donor support, would further dampen economic activity. Under such conditions unemployment would reach 37% in 2008 (49% in Gaza). Real GDP and GDI per capita would decline by a further 17% and 20% respectively by 2008, with poverty afflicting 62% of the population, and 76% of those in Gaza. Fiscally, economically and socially this scenario is not viable; it could lead to a breakdown of governance, the virtual evaporation of the PA and increasing social desperation.

2 – Disengagement Plus: Israel's Proposals for Easing Closure

23. **Over the course of the last four months, GOI engaged with the Bank-led donor team in an wide-ranging series of discussions of Israeli security policies as they impact on the Palestinian economy.** In responding to the Bank's June 23 report, the INSC/MOFA team made clear that fostering Palestinian economic development is in Israel's strategic interest[24], and that GOI is "ready to take far-reaching measures to assist in the recovery of the Palestinian economy" - while noting that "Israel will not ignore its security needs, of which it is the ultimate judge"[25].

24. **The Bank's 23 June report argues that "the precipitator of [Palestinian] economic crisis has been closure"** and that in addition to the intended removal of internal movement restrictions in Gaza and the northern West Bank, "Palestinian economic recovery depends on a radical easing of internal closures throughout the West Bank, the opening of Palestinian external borders to commodity trade, and sustaining a reasonable flow of labor into Israel"[26].

25. **Discussions with the INSC/MOFA team centered on these three domains of closure policy. In addition, the future of the customs envelope emerged as a fourth key topic.**

I – Internal Movement

26. **Internal movement is vital to the health of the Palestinian economy and economic governance.** In May 2003 the Bank wrote "As long as Palestinian internal economic space remains as fragmented as it is today, and as long as the economy remains subject to extreme unpredictability and burdensome transaction costs, the revival of domestic activity will remain a distant prospect, and Palestinian welfare will continue to decay"[27]. In the Bank's most recent economic report, it is estimated that a removal of internal closure alone could lead to real GDP growth of 3.6% in 2005[28].

27. **Israel's Disengagement Plan would restore full internal movement in Gaza and should significantly reduce closure in the north-western part of the West Bank.** Although several small settlements are slated to remain in the Jenin/Tulkarm/Nablus 'triangle', the IDF would not maintain a "permanent" presence in the area. This should lead to a meaningful restoration of internal movement, helping to stimulate local goods and labor markets and permit people to travel more freely within these governorates. It will not, however, address the need to re-connect the area with the rest of the West Bank.

Mobility in the West Bank has been seriously affected by the construction of the Separation Barrier, particularly in the seam zone areas[29]. This will worsen with further Barrier construction, particularly as East Jerusalem becomes disconnected from the economic fabric of the remaining West Bank. Other economic consequences include loss of land for Barrier construction and restricted access to land and other investments located in the seam zone (agricultural GDP could decline as much as 17%, contributing to a 2% drop in overall GDP), losses of income from commercial relations with Israeli customers, and elimination of (illegal) access to Israeli labor markets. Upon completion, the estimated reduction in Palestinian gross national income (GNI) could range from 3-5%. A full treatment of the economic impact of the Barrier can be found in *Impact of Israel's Separation Barrier on West Bank Communities: Economic and Legal Developments*[30].

28. **The Disengagement Plan indicates that restrictions on internal movement in the remainder of the West Bank**

will continue[31]. The donor team was briefed by INSC/MOFA team counterparts on Israel's proposals for restoring a measure of "continuous movement" in the West Bank. The proposed actions are of two kinds:

- **A reduction of the number of check-points, earth mounds, ditches etc. as the Separation Barrier is completed** – The Plan indicates that Israel "will work to reduce the number of checkpoints throughout the West Bank." In the northern West Bank, since the completion of Barrier Stage B in July 2004, the number of checkpoints in Jenin, Tulkarm, Nablus, Tubas, Salfit, and Qalqilia governorates has increased from 20 to 22, while the number of unmanned obstacles has decreased from 242 to 212[32]. For the West Bank as a whole, recent trends do not suggest any rapid improvement. In March 2004 a total of 743 obstacles were in place; today's total is 723[33]. As an example, **Map 3c** shows the network of movement restrictions in operation in the Hebron area in November, 2004.

- **The refurbishment/construction of a coordinated package of roads and junctions.** The INSC/MOFA team proposed that the donor community consider financing 52 roads (totaling approximately 500 kilometers) and 16 under/overpasses in locations throughout the West Bank – stressing that this should be seen as a practical suggestion intended to deal with the realities on the ground. The proposal is illustrated in **Map 2**. To better appreciate the context for GOI's proposal, **Maps 3a/b/c** identify Areas A, B and C, settlements in the West Bank not currently slated for evacuation, and various roads on which Palestinian movement has been restricted (the Israeli human rights organization B'Tselem reports that the combination of checkpoints, physical barriers and the arbitrary confiscation of vehicles has resulted in restricted movement on roughly 732 kilometers of roads in the West Bank[34]). A number of the 52 roads and all of the under/overpasses bear an apparent relation *either* to the Separation Barrier (restoring access interrupted by its actual or potential construction) *or* to settlements and access routes to them.

29. **The PA has made it clear that it does not find GOI's roads and junction proposal an acceptable alternative to the lifting of internal closure in the West Bank**. In October, the PA Cabinet discussed the proposal and rejected it. The PA has established an inter-ministerial committee to prepare screening criteria which would apply on a case-by-case basis to the selection of road projects in the West Bank. Roads and other structures perceived to be helping create a separate transport system, or which contour the Separation Barrier or any settlements, would be turned down[35]. The application of these criteria is likely to permit the construction of a number of the 52 roads, but this would not bring any fundamental improvement.

30. **Israel's "continuous movement" proposal is not acceptable to the donor community**[36]. Donor concerns have been influenced by the recent International Court of Justice (ICJ) Advisory Opinion on the Separation Barrier[37], which states that the Barrier, its associated regime (which includes the seam zone) and the settlements contravene international law, and warns against providing international assistance that would serve to maintain the current status quo[38].

31. **The incompatibility of GOI's continuous movement proposal with donor and PA funding criteria, allied with GOI's commitment to protecting access to Israeli settlements, translate to a continuing high level of restriction on Palestinian movement throughout much of the West Bank.** Apart from the appreciable social friction this causes, internal markets will remain fragmented and prone to distortion. Case studies of internal

movement in the West Bank cited in work done by The Services Group (TSG) as an input for **Technical Paper I** show that internal closures can add 50-100 percent to the cost of transporting goods along the main West Bank truck routes[39]. Persistence of this situation will significantly undermine the improvements to border cargo management in the West Bank which GOI has proposed.

32. **Attention therefore needs to return to ways of dismantling restrictions on *existing* roads.**

II – Borders and Trade Facilitation

Border Crossings

33. **The economic objective in reforming today's border regime is to permit the market to once again determine import and export flows.** The Bank's June 23 report states that "there are a number of steps which can be taken to maintain or even enhance Israeli security while greatly improving cross-border security while greatly improving cross-border cargo management"[40], a position that the INSC/MOFA team accepted.

34. **The safe and efficient operation of border crossings[41] is, by definition, a cooperative effort.** The difficulty of proposing improvements to two parties in conflict is obvious. While a neutral, technical analysis of options has its place, it is no substitute for the renewal of shared understandings, their translation into transparent operating procedures, and a mutually supportive effort to monitor and enforce them. With this caveat, the following conclusions can be drawn from the donor team's extensive interaction with GOI and the PA on the subject. A fuller treatment of the issues is to be found in **Technical Paper I.**

35. **Israel is proposing to upgrade the border crossings. This could make a significant contribution to restoring cargo movements to pre-*intifada* levels, and laying a basis for future expansion.** The potential benefit from the proposed upgrades, though, may be significantly undermined if a number of key issues are not adequately addressed.

36. **As detailed in Technical Paper I, needed improvements are of two types** – i) physical improvements, specifically terminal reconfiguration and expansion, the introduction of up-to-date security technologies, and the expansion of the Israeli railway network; and ii) procedural reforms, featuring the introduction and monitoring of sound commercial management methods.

37. **The PA welcomes "efforts to guarantee a steady volume and flow of cargo"[42], but has emphasized that any enhancements should be consistent with the provisions of the Paris Protocol and other applicable bilateral agreements, and should not detract from the Roadmap's call for a normalization of Palestinian life and return to the September 28, 2000 *status quo ante*.** The PA has in particular stressed that security incidents need to be handled in a manner both proportional to the event, and coordinated between the two parties[43]. The PA also advocates the use of published principles and rules for border crossings, and the introduction of binding dispute settlement mechanisms[44].

Proposed Physical Improvements

38. **GOI is proposing to reconstruct/upgrade several terminals located between West Bank/Gaza and Israel**, to improve traffic flow and berthing facilities as well as the facilities for travelers. The program would include the relocation of the Erez terminal to the Israeli side of the border and its expansion to accommodate cargo as well as people, with a planned completion date of August 2005. Initial estimates suggest that these enhancements would cost about US$59 million[45].

39. **An unresolved issue relates to the number and location of border crossings between the West Bank and Israel**[46]. The Oslo Accords do not specify border crossings for persons and goods between Israel and the West Bank[47], but refer only to movement being controlled by applicable laws and regulations. Israel is proposing five border crossings (see **Map 5b**); of the five, however, three are situated on the alignment of the Separation Barrier where it deviates east from the Green Line. Neither the PA nor the majority of donors will support these proposed locations, particularly in view of the International Court of Justice's Advisory Opinion[48]. An alternative that would satisfy both the PA and the donor community would be to locate all five crossing terminals on the Green Line. The ongoing realignment of the Separation Barrier, pursuant to the Israeli High Court's decision on the petitions filed by residents of Beit Sourik contesting the route of the Separation Barrier north-west of Jerusalem[49], should facilitate this.

40. **GOI is proposing to introduce major technological upgrades,** to include the purchase and installation of modern electronic systems that would permit much faster and more secure scanning of cargoes and people passing through the border crossings. The menu of technologies would vary in accordance with the projected usage of a particular crossing and the funds available. Initial estimates for an optimal technology upgrading of the 9 crossings and terminals under consideration by GOI[50] amount to some US$76 million.

41. **GOI is also considering two railway projects.**

- The first would be a 4 km. spur to link Erez with the national grid and thereby connect to Ashdod and Haifa ports. The project would likely take about two years to complete[51]. The estimated cost of the rail line, a terminal in Erez and the train would be approximately US$ 21 million[52].
- The second project would connect Sha'ar Efraim (near Tulkarm) to the Israeli national railway grid via a spur to join the Eastern Railway. A short rail link an a tunnel would be needed once the main line is built (at present the Eastern Railway is planned for construction only after 2010). This, it is intended, would permit a cargo connection to Ashdod and a passenger connection between the northern West Bank and Gaza. The project's anticipated cost is around US$18 million.

42. **The PA has indicated that it would in principle welcome the two railway projects, while noting that this new mode of transport should complement, not replace existing modes**[53]**.** The Bank agrees with this position, since this would help foster competition. The PA has indicated that it would also welcome this project as an alternate transport mode.

43. **Israel is seeking an external financing contribution to the capital costs of the terminal infrastructure/equipment program**, currently estimated at US$135 million[54].

New Procedures

44. **While reconstructing and re-equipping border terminals paves the way for secure, rapid and predictable cargo handling, this will not occur without a significant adjustment in facility management policies; without them in fact, the net result could be higher levels of restriction**. GOI has proposed four significant improvements:

- *Extending terminal operating hours.*
- *Adoption of the 'redundancy principle'.* The INSC/MOFA team stated that "an alternative passage will be made available if a primary passage is closed"[55]. This position acknowledges a need to avoid imposing blanket closures in response to specific incidents or threats, and is evidenced in plans to reconfigure Erez and

Karni to handle both people and goods[56] – though its meaning and application in the West Bank have yet to be worked out. It will be important to clarify GOI's policy position to transport operators; a clear written statement would have a significant impact on investors' and shippers' risk perceptions[57].

- *The application of service standards.* The introduction of published norms has improved border cargo management in many countries[58]. Under such a program, an individual shipper is made aware of the procedures applicable to his shipment, and the terminal agrees to abide by a set of performance measures (such as average time per inspection, and the percentage of shipments subjected to various levels of inspection). Service standards should be applied to both security and customs inspections, and to both Israeli and Palestinian terminal managers. The INSC/MOFA team shared with the donor team a set of service standards which have been agreed for Israeli terminals (see **Technical Paper I**); this is promising evidence of a new approach to managing Palestinian cargo[59]. It is proposed that these service standards be further refined in discussion with Israeli and Palestinian commercial operators, and that they be invited to help GOI monitor their implementation.
- *GOI is considering placing the management of all terminals in the hands of civilian contractors.*

45. **An important unresolved issue is GOI's position that "at this time, the "back-to-back" regime will continue to apply with regard to the movement of goods"**[60]. The back-to-back system involves the transfer of goods from one truck/container to another, and results in extensive delays, damage and additional cost; it is motivated in part by a prohibition on Palestinian trucks from entering Israel, and on Israeli trucks from entering Gaza (though not, at present, the West Bank[61]). The application of this system is incompatible with an efficient flow of imports and exports. The Bank's view is that a combination of the following measures will allow GOI to do away with mandatory back-to-back transfer without appreciable additional security risk.

- *Containerization/sealing.* With the exception of bulk cargoes such as sand and building aggregates (which are not especially time-sensitive), all cargoes should be transported in containers or trailers that can be sealed. This can be facilitated by establishing consolidation areas on the Palestinian side of border crossings.
- *Scanners.* Full truck/container scanners would be used to perform inspections with subsequent physical inspections limited to situations where anomalies are observed during the scanning.
- *One-Stop Inspection.* Containers can be fitted with tamper-proof seals at the point of shipment or the entry port (for imports), or at the border terminal (for exports). Once sealed, subsequent inspections would be limited to ensuring the seals are intact.
- *Trailer Circulation.* Back-to-back procedures can be avoided if container trailers are permitted free circulation between Israel and West Bank/Gaza, exchanging tractors and drivers in the process. Scanning of the container would be combined with a simple chassis inspection. New trailer chasses could be custom-built without compartments or other features that can be used for illicit purposes. GOI has indicated that it is willing to test this concept.
- *Order and Selectivity in the Inspections System.* The number of inspections can, as a result of the measures listed above, be reduced to a combination of risk-driven and random interventions. Systematizing this reduced inspection regime will require that GOI introduce an on-line cargo risk management system (combining basic information on manufacturers and shippers with specific security intelligence) in order to identify threats and build histories of reliability. Such risk

management systems are commonly used by customs and port authorities worldwide.

46. **Another issue for further discussion is the institution of a commercial dispute resolution mechanism[62].** To ensure full commercial confidence, a system for mediating claims made by shippers against unreasonable delay and/or cargo spoilage, subject to impartial and binding resolution, is the international norm. The PA believes such a mechanism is necessary (see paragraph 38), though GOI has indicated this may be impractical in today's security context[63]. In an improving bilateral environment, however, the subject should be reviewed once again. Models that can provide indicative guidance include the WTO Agreements and the TIR Convention[64].

Piloting Change

47. **The combination of commitments, intentions and possible solutions related to border crossings should now be tested in the field.** It is therefore recommended that integrated cargo management programs be developed as a matter of urgency at Karni Terminal (Gaza) and Jalame Terminal (northern West Bank). These pilots, it is suggested, should feature i) terminal infrastructure upgrades on both sides of the border; ii) the introduction of electronic and biometric security equipment on the Israeli side; iii) the development of on-line information systems, with data links between GOI and the PA; iv) the abolition of back-to-back procedures for containers; and v) the development, in consultation with Israeli and Palestinian shippers, of terminal service standards and recourse methods. The pilot should be closely coordinated between GOI and the PA. It is further proposed that an independent service provider with recognized international credentials observe the progress of the pilot and report on it to the two parties and to interested donors. An early and successful implementation of this pilot program would be very important in demonstrating to investors and to donors that a border regime responsive to the needs of the Palestinian economy is under development, and merits consideration of donor financial support.

Gaza Sea and Air Connections

48. **The Palestinian economy needs direct access to international markets. In this context, sea and air facilities in Gaza assume significant importance.**

49. **GOI has shown interest in supporting the early construction of a Roll-On, Roll-Off cargo port in Gaza, but has not made any commitments so far.** In view of uncertainties about how quickly commercial demand for a Gaza port will grow, the RoRo approach offers a relatively rapid and cost-effective way to initiate the development of a full-service seaport. GOI has suggested that this projects may not after all need to await Israeli withdrawal from Philadelphi[65]. For its part, the PA would "welcome a RoRo facility with Port Said which will lead to the opening of a fully functional Gaza port in the near future". The RoRo concept is described in more detail in **Technical Paper I**.

50. **Air services are also important, and preference should be given to reconstruction of the airport and a resumption of fixed-wing air services.** The Bank has suggested beginning the restoration of Gaza's air services with a helicopter connection to Amman[66], again arguing that this offers a rapid first step in enabling business connections. The PA insists that the airport should be reopened quickly, since a helicopter service alone is not considered adequate for Gaza's current air transport needs[67]. For its part, GOI has indicated that it is not in favor of fixed-wing services on security grounds, but has said it would consider a helicopter service with Amman[68].

51. **For sea and air services to proceed, credible security arrangements need to be in place in Gaza.** The Gov-

ernment of Egypt has indicated that it is willing to receive vessels and cargoes from Gaza[69], and would perform security inspections on incoming and outgoing cargoes. This would not insulate a vessel against interference on the high seas, however. Since Israel is committed to evacuating all Israeli citizens from Gaza, and since PA security inspections alone are unlikely to satisfy Israeli requirements at this time, rapid development of the RoRo initiative and of air services would require a third party security involvement. One potentially workable approach would combine the use of a specialized border security firm and the active sponsorship of one or more concerned countries. The PA would not in principle be averse to this, as long as the third party works in partnership with the PA[70]. For Israel, third party involvement in matters pertaining to Israeli security would break new ground, and requires further consideration.

Linking Gaza and the West Bank

52. **Building a strong transport connection between Gaza and the West Bank is vital – but finding a mutually acceptable solution has not been possible to date**. An unfettered flow of people and goods between Gaza and the West Bank is needed to link the two territorial elements of the Palestinian economy, and to lay the basis for viable statehood. A functioning link would create a larger effective internal market, help trigger price and income convergence between Gaza and the West Bank (by directing factors of production more efficiently), and provide a pathway from the economy of the West Bank to a future seaport in Gaza. Both GOI and the PA have taken strong positions on the issue. GOI is not willing to re-instate the "safe passage" arrangements provided for in the Oslo Accords[71]. For its part, the PA has indicated that "in the immediate term, a territorial link (TL) must be devised which will address the immediate economic (and other) needs of the Palestinians, without prejudicing any permanent arrangements regarding the TL. Also key is that any arrangements made must safeguard the spirit of the safe passage arrangements in Oslo"[72]

53. **Today's arrangements do not even satisfy minimal economic requirements.** The number of trucks crossing between the West Bank and Gaza is far fewer than in the pre-*intifada* period and cargoes are subject to long en-route inspection delays and low priority status at Karni, disadvantaging them relative to cargoes from Israel[73].

54. **International experience in establishing and maintaining an efficient passage for people and goods has increased dramatically in recent years.** Significant progress has been made in the design of protocols, procedures and protection to facilitate the movement of goods and people through such corridors. Such experience could be brought to bear in the local context.

55. **The link between Gaza and the West Bank should permit flexible and low-cost transport compatible with improved Palestinian market competitiveness.** A simple road connection offers the best solution. Border security can be assured using a combination of container scanning and sealing technologies, combined with vehicle tracking devices to monitor movement across Israel[74]. As a practical measure, it is proposed to pilot such an arrangement on one designated route as soon as the Karni and Tarkumiya border crossings have been equipped with the required technology. In the meantime, and without prejudice to a return to the provisions of previous agreements, an escorted convoy system could be reinstated[75].

56. **Options for a dedicated link are technically problematic.** These would require the construction of permanent infrastructure; rail connections, elevated roads, fenced roads and tunnels have all been suggested. GOI has proposed a rail connection, initially for people, between Tulkarm and Ashdod (see paragraph 42). The short dis-

tances and limited volume of bulk cargo would likely make this more costly and less convenient than road transport, however. An elevated road or tunnel would be expensive to build because of the civil works involved; furthermore, the traffic volumes under the most optimistic recovery scenario may make such an investment hard to justify. A structure of this kind could also be vulnerable from a security perspective.

III – Labor Flows to Israel

57. **GOI is proposing to stop issuing work permits to Palestinians by the end of 2008**. In the Bank's view, this would have serious negative impacts on Palestinian incomes and on the prospects for Palestinian economic recovery.

58. **Few economists would dispute the wisdom of moving away from a dependency on labor exports to Israel to a growth-path based on the export of goods and services to Israel and to other countries.** This policy shift was advocated by the Bank in early 2003[76]. An adjustment of this kind has in reality been underway for some time. On the eve of the *intifada*, the daily average of Palestinian workers entering Israel stood at 116,000 workers. By 2004, these numbers had fallen to 37,700[77]. Due to continued conflict, political uncertainty and a weak commercial enabling environment, this loss of work has not been counterbalanced by adequate export growth. Palestinian real incomes have fallen steeply, and would have fallen much further were it not for the cushion afforded by donor assistance.

59. **Managing this structural transition, though, will be key.** The Palestinian economy is weak, with unemployment dangerously high and private investment severely depressed. With a reversal of the closure regime, a sustained effort to reform Palestinian institutions and generous additional donor assistance, it is possible to envisage a transition to growth.. It will, however, take time for the West Bank and Gaza to develop a genuine competitive edge (see **Technical Paper III**). During this period, priority must be given to preserving employment. Phasing out permits would result in a loss of 9,000 of today's jobs – but in addition, most of the approximately 20,000 illegal workers still crossing the Green Line each day would lose their jobs if the Separation Barrier is completed in 2005. This amounts to a net loss of nearly 30,000 jobs by the end of 2008.

60. **A reinvigorated industrial estates program can create employment and can seed an export-based transition, but prospects appear modest over the coming few years.** (see **Technical Paper II**). Analysis carried out by The Services Group (TSG) on behalf of USAID and by the Bank shows that an open border regime could create perhaps 8,500 new jobs by the end of 2008 – but only if GOI changes its current stance and allows Israeli investors to enter areas over which it does not exercise security control[78].

61. **GOI is urged to be flexible on the issue of Palestinian labor**[79]. With Palestinian economic stability a shared objective, it is recommended that Israel at least maintain current Palestinian labor access over the next several years. Doing so would involve replacing illegal labor with additional permitted labor if the Separation Barrier is completed in 2005. If illegal work is thereby eliminated, Israel's security clearance of Palestinian workers would be much more assured than today.

IV – The Future of the quasi-Customs Union

62. **During the course of the summer, GOI opposition to the maintenance of the quasi-Customs Union (qCU) with the West Bank and Gaza emerged.** The June 6 Modified Disengagement Plan indicates that "in general, the economic arrangements that are currently in effect between Israel and the Palestinians will remain valid. These arrangements include …. taxa-

tion arrangements and the customs envelope"[80]. As of November 14, though, the INSC/MOFA position was that "if and when Israel withdraws from the Philadelphi corridor, it will not be possible to maintain the customs union with Gaza (although it will continue to apply in the West Bank)"[81]. It is further understood that "adjustments" might be in time be implemented in the West Bank[82].

63. **Many economists believe it makes sense to move away from the qCU *in due course.*** A more independent, non-discriminatory trade policy vis-à-vis third countries would help diversify Palestinian trade. The qCU has advantages for the West Bank and Gaza, including preferential access to the Israeli market, and reduced PA customs administration costs – at the same time, however, the provisions of the Paris Protocol do not provide for the collection/remittance of taxes on *indirect* imports. The Bank has estimated that this omission results in fiscal losses to the PA of about US$175 million each year[83].

64. **The World Bank and the IMF both believe that a rapid and uncoordinated abolition of the qCU would disrupt any recovery of the Palestinian economy.** There are three reasons for this.

- **There is a risk of significant Palestinian revenue loss.** Trade taxes are currently collected by Israel and remitted to the PA through the clearance system; these clearance revenues make up almost two thirds of total PA revenues[84]. PA customs capacity is weak, and time is needed to equip it to take over from GOI[85]. The PA cannot afford transitional revenue losses at this stage.

- **Abolition of the qCU would hurt Palestinian (and Israeli) trade in the short run.** Palestinian exporters would lose their preferential access to the Israeli market at a time when jump-starting Palestinian exports is critical.

- **Maintaining the common customs and tariff envelope in one part of the Palestinian territories while abrogating it in the other would further fragment the Palestinian economy**. Under such a scenario, goods and services traded between the West Bank and the Gaza Strip would need to be cleared by customs in both directions, since the tax regimes would be different in the two jurisdictions. This would add another layer of controls, increasing transaction costs that are already very high, and would exacerbate the division of the two parts of the Palestinian economy.

65. **The technical case for the qCU's abrogation is questionable.** GOI is concerned that the PA would not protect the common customs envelope once Israel evacuates Philadelphi, and if and when direct sea access to Gaza is established. As an interim measure, though, the PA could contract a private organization to manage the customs function on the Egyptian border – an arrangement for which there are many useful precedents[86]. In addition, the IMF would be willing to oversee technical assistance to upgrade Palestinian customs capacity, and could monitor the effectiveness of collection activities under its current monthly reviews of budget execution, fiscal revenues and PA expenditures. Together these measures should be sufficient to ensure that existing customs policies continue to be implemented in accordance with the Paris Protocol.

66. **New customs arrangements should not be imposed unilaterally.** Writing of the transition to statehood, the Aix Group has stressed the importance of fiscal cooperation, and warns against any precipitate transfer of functions: "The Group recommends that both parties closely coordinate indirect taxation policies and their administration, in order to avoid smuggling … the cost of neglect in this case would be immense for the [future] Palestinian state as well as Israel, as the stability of both tax systems would be threatened"[87].

67. **During the coming period, a preferable approach would be to improve the implementation of the Paris Protocol.** In particular, the revenue losses to the Palestinian budget from indirect imports should be addressed[88]. In addition to this, the PA would like to see the creation of an effective dispute resolution mechanism, and a revision of lists A1, A2 and B[89]. Under today's changing circumstances, consideration should also be given to reviving the Joint Economic Committee[90].

3 – Palestinian Plans to Revive the Economy

68. **Israel's withdrawal from the Gaza Strip and the northern West Bank – be it unilateral, coordinated or negotiated – presents the PA with an opportunity to show how well it can exercise political, security and economic leadership, and to demonstrate how smoothly it can assume control over and disposes of the assets that Israel leaves behind.** Palestinian, Israeli and international attention will focus intensively on PA performance in the coming months. Success in these areas should lead to a much more forthcoming attitude by GOI to bilateral cooperation, as well as creating donor and investor confidence.

I – The PA's Strategy for Recovery and Growth

69. **The PA is finalizing the *Medium-Term Development Plan (MTDP) 2005-7*.** Like the SESP before it[91], the MTDP seeks a balance between short-term relief requirements and the policies and investments intended to spark an economic revival.
The Plan places heavy reliance on the private sector, coupled with efforts to protect the poor and vulnerable. The MTDP's overall strategy is sound, and its estimates of potential donor contributions are based on an assessment of what is probable, rather than what is desirable – consistent with the SESP's pragmatic approach.

- **The recovery strategy focuses on actions to address unemployment in a sustainable manner**, recognizing that this can only be done in a context of private sector growth. This in turn will require that GOI restore greater Palestinian freedom of movement, both within the West Bank and Gaza and across borders. The MTDP private sector support strategy stresses policy and technical support to agriculture, tourism and industry, along with the provision of loan guarantees to encourage commercial banks to participate in capital formation. The need to build human capital through technical and vocational education is also given high priority.

- **The Plan recognizes the entrenched nature of Palestinian poverty**, and the need for a sustained and targeted effort to cater to those who have lost their ability to participate meaningfully in the economy without assistance.

- **Improving the effectiveness of PNA governance by building capacity and accelerating reform is an overarching Plan objective.** The MTDP builds on the PA's *One-Year Reform Action Plan (September 2004-September 2005)* – see paragraph 76.

70. **The Plan employs two economic scenarios.** The more cautious "delayed progress" scenario estimates likely donor disbursements at US$900 million each year during 2005-2007[92], while the "rapid progress" scenario assumes that donors would disburse US$1.05 billion in 2005, US$1.25 billion in 2006 and US$1.45 billion in 2007[93]. In 2005, disbursements for budget support and projected at US$419 million under "delayed progress" and US$359 million under "rapid progress"[94].

II – Palestinian Reform

71. **It is imperative that the Palestinian leadership revitalize the Palestinian reform process.** The Bank's June 23 report, reflecting PA and donor analysis, listed eight areas of reform with particular importance to the economy[95]. These include gaining control of the domestic security environment, renewing the legitimacy of the PA through national and local elections, maintaining fiscal stability, and combating longstanding resistance to legal and judicial reform. Since June some progress has been

made, but the overall pace of reform over the last year has been slow. The Bank's report pointed out that "an easing of closures alone….will not attract investors back to the Palestinian economy. A reinvigorated program of Palestinian reform, designed around measures that will create an investor-friendly business environment, is essential. There is no reason for the PA to delay implementation of such a program".

72. **Reforms in public financial management continued in 2004.** Important milestones over the past year include[96]

- *The payment of PA security staff salaries through direct deposit* to personal bank accounts rather than in cash paid through force commanders;
- *International auditing of the Palestine Investment Fund*;
- *Establishment of a Department of Supplies and Tenders in the Ministry of Finance*, with full jurisdiction for all PA purchases, including those of the security agencies;
- *Preparation of legislation to create a new public audit institution*, approved by the PLC and now before the President for signature;
- *Passage of a revised income tax law*, consistent with international best practice.

73. **Progress has also been made in the area of election reform.** A Central Electoral Commission was established, and a successful voter registration process was set in motion – a development that will make it possible to conduct presidential elections in January 2005. Importantly, PLC elections are now planned for May 15 2005.

74. **Public awareness of the reform process has also improved.** The PLC has become actively engaged, and earlier this year established a committee to investigate the underlying causes of internal fragmentation within the PA. The committee's findings included a number of specific recommendations on internal reform measures, including the passage of legislation defining the role and the authorities of the security forces

Public awareness of the reform process has also improved with increasing internal calls for reform. In June 2004, the PLC established a 14 member Committee to investigate the underlying causes of internal fragmentation within the PA. In the third quarter of 2004, the Committee released its report, calling for a reorganized and empwered government and for the appointment of a parliamentarian mechanism to monitor the implementation of reforms. In protest to the Executive's reluctance to honor its promises, to approve laws earlier presented by the Committee for signature, and to push the reform process forward, the PLC suspended its plenary sessions for one month until October, 2004[97].

75. **On September 27, 2004, the PA Cabinet adopted a *One-Year Reform Action Plan (September 2004-2005).*** This document, like previous PA reform statements, is very broad – it consists of eight main areas, 46 sub-areas, a further 58 specific items, and at least 26 pieces of needed legislation. A comprehensive listing of this kind is unlikely to spark much progress unless the PA uses the Action Plan to articulate a focused "reform map" – which should identify a priority set of *specific* reform measures, a time-bound plan for their implementation, and clearly assigned responsibilities.

76. **The donor reform support structure may have contributed to a dispersion of Palestinian effort.** Seven donor "Reform Support Groups" were created in mid-2002 as a way to engage with the PA during the siege of the Muqata[98]. They have done much solid analytical work, but today's need for accelerated action suggests that a light, agile structure in which donors interact constantly with the PA may be more appropriate.

77. **In today's changed environment, three reform areas call out for rapid, concerted effort.**

Security and the Rule of Law

78. **The Bank's June 23 paper observed that "a maximum PA effort to fulfill its security obligations under the Roadmap is needed if the donor community is to argue for a major easing of today's closure regime."** While it is beyond the Bank's competence to advise on how to approach security reform, it is clear that a revival of the private sector will not take place in an environment plagued by conflict with Israel and by domestic lawlessness. It is also clear that far-reaching changes in the security and police services are needed. Some progress has been achieved since the beginning of 2004, with the National Security Council now holding responsibility for all security forces – but much remains to be done to ensure that the security services operate within a structure of administrative and legal accountability[99].

79. **An impartial and responsive courts system is essential to a healthy investment climate, but progress in establishing it has languished for many years.** A fully functioning court system would instill a higher level of commercial trust in the PA. However, a number of fundamental problems remain unresolved, including the lack of clear delineation of the respective responsibilities of the Ministry of Justice and the Supreme Judicial Council, the continued absence of a Supreme Court, and the ambiguous role played by the *Diwan al Fatwa*[100] in the legislative process. These factors have hindered the timely appointment of judges, impaired court administration and created a large backlog of cases in the courts. The judicial system's credibility has been undermined, and needs to be restored. Creating a fully functional, professional and sustainable judicial/court apparatus involves establishing clear mandates for the selection of court personnel, enhanced judicial training and attention to the administration of the courts. Criteria for the appointment and promotion of judges also need to be specified and enforced.

80. **Equally necessary for the rule of law is a sound legislative process and a solid corpus of relevant law.** In July the Council Affairs Committee produced a *General Framework of the Reform and Development Program of the Palestinian Legislative Council,* a positive step towards improving the efficiency of the PLC[101]. From a commercial perspective several core pieces of legislation are missing or outdated, lack regulations or remain unsigned[102], or unimplemented[103] – while the quality of some legislation is questionable[104]. Commercial laws differ in the West Bank and Gaza, and need harmonization in order to reduce the transaction costs for firms doing business in both jurisdictions[105]. Procedures, particularly those relating to the issuance of licenses and permits, require further simplification.

Fiscal Stabilization

81. **The fiscal position of the PA remains very tenuous.** Excessive growth in the PA's wage bill in recent years has compounded the problems caused by closure and the erosion of the tax-base[106], and the PA has become too dependent on erratic and uncertain donor budget support.

82. **It is essential that the PA adhere to the Wage Bill Containment Plan developed by MOF and approved by the Cabinet in June 2004[107].** The PA's annual wage bill this year is some US$125 million greater than in 2003 (an increase of 17 percent), mostly as a result of large public sector salary increases granted in 2003[108]. In the face of declining donor support[109], the PA has been forced to squeeze non-wage expenditures 17% below budget in the first nine months of the year, but still faces month-to-month crises to pay salaries[110]. The PA can not afford to grant any further salary increases to public employees until the fiscal situation has manifestly stabilized. Under today's conditions, in which opportunities for employment in the private sector are limited, large scale retrenchment of public servants is not a viable option; as soon as political and economic conditions make it

feasible, though, the size of the public service should be reduced in line with what is needed and what is affordable – with a particular emphasis on the security services, where unmanaged recruitment has been most evident.

83. **The current public sector pension schemes are unsustainable and would, if not comprehensively reformed, trigger a severe fiscal crisis**[111]**.** The stock of public sector pension liabilities resulting from these generous and under-funded schemes is currently estimated at over 50% of GDP[112]. Without reform the current Gaza system will go bankrupt in 2-3 years, and the PA will either have to default on pensions or make all payments from the budget. The PA is committed to comprehensive reform, and a solid draft law creating a unified pension system for all public sector employees is now before the PLC. If passed in its current form, it will establish a scheme for sustainable and equitable pension benefits for all public sector employees, and will also establish an independent pension agency with governance mechanisms able to protect pension assets from political interference and fraud. For the reform to succeed, the PLC will need to resist pressure from various interest groups to provide them with excessive benefits[113]. After reform, PA pension expenditures will amount to US$78-80 million annually[114]. The PA will need to pay all contributions in full if the integrity of the new system is to be maintained[115].

Transparency and Accountability

84. **The PA needs to take steps to counter widespread perceptions of systemic corruption.** Polling data shows that such perceptions are shared by ordinary Palestinians[116] as well as businessmen. Such perceptions, compounded by PA shortcomings in performing its regulatory functions, can dampen entrepreneurs' willingness to invest[117]. The PA would do well to

- **Actively publicize the considerable progress it is making in developing effective public financial management systems** (see paragraph 73) – progress that enabled the Bank to state in early 2004 that "the Palestinian public financial management system is judged to be adequate insofar as the World Bank's criteria and standards for approval of a general budget support operation are concerned"[118].

- **Articulate a comprehensive anticorruption strategy which addresses prevention, prosecution, and public sensitization**. This strategy should look at the existing institutions now charged with combating corruption (including the external public audit institution, see below) to assess how their independence can be strengthened. It should also develop anti-corruption regulations for PA ministries and agencies with major revenue, expenditure or regulatory functions, and should require senior PA officials to sign conflict of interest and financial disclosure provisions[119].

85. A visible, sincere effort to prevent corruption and to punish offenders would pay enormous dividends for the incoming PA administration, both domestically and abroad.

86. **A number of other key areas bearing on PA institutional accountability also need to be addressed.**

- **The lack of an independent public audit function.** The PLC is considering legislation which will create a new external audit institution to replace the General Control Institute. The new institution would report both to the PLC and the President, would cover all PA entities, and would be tasked with auditing the PA's financial statements according to international auditing standards. To complement this encouraging draft law, a major capacity building program will be needed to create an institution capable of fulfilling this important role.

- **Anti-competitive bias in several practices of the Palestinian Authority.** This takes two forms – direct PA involvement in productive activities, and indirect equity participation in private firms. The PA has taken welcome steps to ensure public disclosure of the financial data of the Palestine Investment Fund, the holding company for its investments[120]. Nevertheless, further increases in transparency and accountability are desirable, including publishing the terms of exclusive licenses to firms, and creating regulatory bodies that are independent of policy ministries.

- **Strengthening public procurement.** A significant recent improvement was the abolition of the Al Sahra Company's monopoly on supplying basic essentials to the security services. However, public procurement remains weak overall. The laws that exist for the procurement of goods and works are only partially enforced, and many spending units have developed their own independent procurement practices – not least because many purchases are funded by donors who insist that their particular practices be adhered to. A PA Procurement Action Plan is currently being developed and could make a significant difference. Proposed actions include establishing an independent Oversight Procurement Authority to monitor all public procurement, drafting a Unified Procurement Law and developing standard bidding documents to simplify and harmonize procedures across ministries and donor-funded projects.

4 – The Settlement Assets

87. **Data about settlement assets remain scarce.** No firm decision has yet been taken by GOI on which assets it will transfer, or by the PA on how they will be used. Detailed preparatory work for the transfer, management and disposal (TMD) of settlement assets has therefore not been possible. Nevertheless, both GOI and the PA have advanced their planning. GOI has set up an office dealing with the evacuation, and a compensation law has passed its first reading in the Knesset. The PA is finalizing its *Medium-Term Development Plan 2005-7*, in which the proposed Palestinian use of relinquished settlement assets is discussed.

88. **Some assets will not fit Palestinian developmental needs; these should be dismantled and the debris should be removed.** In reviewing available information, the Bank has assessed the most appropriate uses of settlement assets. While such decisions will and should be taken by Palestinians themselves, the Bank's advice is that public infrastructure can be transferred to the relevant Palestinian entities and integrated into Palestinian systems. Public buildings could be maintained if the surrounding population density and demand for social services justify their use. Productive assets would ideally be handed over as going concerns, but both technical and legal reasons complicate such transfer. Details are provided in **Technical Paper IV.**

89. **Since land is likely to contribute more to the Palestinian economy than all other remaining assets combined, its proper use is key.** The PA should establish clear policies to determine whether land should be restored to its owners, or whether they should be compensated and the land used for the public benefit. The establishment of a special administrative process for resolving ownership claims is recommended; claims would be received and resolved based on clear criteria for assessing ownership rights. It would also be advisable to separate land claims and dispute adjudication from the disposal of other assets.

90. **In order to ensure the transparency of the TMD process, clear rules and procedures should be formalized and agreed upon in advance.** An informal, *ad hoc* process with ambiguous responsibilities, rules and procedures could be very damaging – both to the reputation of the PA and in terms of missed economic opportunities.

91. **GOI has clarified a number of issues related to the transfer of settlement assets.** GOI may consider the transfer of some houses intact if the PA were to propose uses not inimical to Israeli interests. Nor would GOI object to the preparation of a manual of procedures, for use by both parties, explaining the TMD process in detail. Israeli utility companies will continue to provide electricity, water, gas, fuel, and telecommunications to Gaza and the West Bank under current agreements – and will provide services to the settlement sites if arrangements can be put into place which offer adequate repayment guarantees.

92. **The PA's position is that under international law decisions on the disposition and use of the settlement assets must be taken by them[121], and it is currently assessing the possible integration of the assets into updated Gaza and West Bank regional development plans.** These plans take into account the need for additional urban or agricultural land and the protection of natural resources (particularly water). The PA has indicated that GOI should dismantle any settlement assets that do not fit into the regional plans, and that any rubble should be removed and disposed of outside Palestinian territory.

93. **The PA is advised to establish a dedicated institutional structure to plan and implement the TMD process.** Decisions on this structure need to be taken

soon – and well in advance of actual disengagement, since additional capacity will be needed irrespective of the detailed setup, and because establishing any structure will take time. Building on international experience, a three-tiered approach is recommended

- The PLC should pass enabling legislation and should provide parliamentary oversight;
- A multi-stakeholder Supervisory Board under PA leadership and assisted by donor-financed expertise should direct the TMD process;
- An existing or new PA body should be responsible for TMD implementation.

94. **The involvement of the general public in decisions on how the received assets will be disposed of, and to whom, is essential – as is the need to keep the public closely informed of TMD implementation.**

95. **In the Bank's opinion, a small, light special agency structure, without special budget authority and provided with dedicated technical assistance, would be the preferred set-up.** Compared to a "business as usual" approach whereby PA entities assume responsibility for assets under their respective jurisdiction, such an arrangement is more likely to bring to bear the necessary focus and sense of institutional accountability. Any special PA structure must not, however, evolve into an alternative power center in Gaza or add bureaucratic dead-weight.

96. **Both GOI and the PA have indicated an interest in coordinating the TMD process at a technical level, possibly with the involvement of a third party.** GOI does not currently intend to hand assets directly to the PA; at the same time, an acceptable third party to which GOI could transfer the assets as a "custodian" is unlikely to emerge.

To make any coordination more productive, GOI needs to furnish detailed information about the settlement assets to the PA. At the same time, the PA should formally indicate which assets it wishes to receive intact, based on current information, and for which purposes.

97. **A first step would be for the PA to set up a formal working group** to assess institutional options, review applicable laws and regulations and draft an enabling law, determine how claims will be handled and develop a strategy for consulting the public on all aspects of the TMD process.

5 – The Economic Outlook

98. **GOI's proposals for enhanced border cargo management will make a difference, as can be seen from a comparison of the Bank's "Disengagement Plus" scenario with the "Disengagement" scenario presented in the June 23 report. However, the difference is not enough to trigger a Palestinian economic recovery.** GOI is proposing to implement some important measures – terminal reconstruction and re-equipment, the introduction of the redundancy principle and of service standards. In addition, under the Disengagement Plan, Palestinians will gain access to valuable settlement assets and would benefit from a reduction in internal closures in Gaza and the northern West Bank. These positive measures would be undercut, however, by several key constraining factors – maintenance of the back-to-back cargo handling system, continued internal closure in the central and southern West Bank, completion of the Separation Barrier, continued poor access between Gaza and the West Bank, the termination of work permits by end-2008 and the abrogation of the quasi-Customs Union in Gaza. The collective weight of these factors would overwhelm other positive developments.

99. **An emphatic doctrine of physical and economic separation cannot be expected to encourage private investment – particularly since the immediate potential for Palestinian economic recovery lies in rebuilding trading links with Israel**. While it is likely that donors would support the emergence of new Palestinian leadership and a renewal of bilateral contact with additional funding in the short-term, it is hard to envisage donors making a major, sustained financial effort if the preconditions for economic recovery are absent. In the "Disengagement Plus" scenario, therefore, after a brief surge in real GDP and GDI per capita in 2005, real incomes would resume their decline and would be lower in 2008 than today (see **Box 2** and **Annex Table 2**).

Box 2 – *"Disengagement Plus"* Scenario

Assumptions: The assumptions underlying this scenario reflect GOI's stated intention of separating Israelis and Palestinians while effecting improvements in movement and access, particularly for goods. Specifically, internal closures are assumed to be removed in Gaza and the northern West Bank, but to remain in place (at a slightly reduced level) in other parts of the West Bank. The Separation Barrier is assumed to be completed in 2005. Access between Gaza and the West Bank improves somewhat but is still difficult, though the inauguration of a Gaza/Tulkarm rail link by end-2007 results in improved flows of people. Transitional revenue and trade losses from the abrogation of the quasi-Customs Union in Gaza are assumed from the end of 2006. The number of Palestinian workers in Israel would decline gradually until permits cease to be issued in 2008. Moderate progress is assumed on Palestinian reform. Donor assistance in 2005 is estimated at US$200 million higher than under the status quo scenario, and amounts to US$3.6 billion from 2005-2008, an average of US$900 million per annum.

Projections: In this scenario, after a mild improvement in key indicators in 2005, long-term decline would resume, albeit it less rapidly than under the status quo scenario. By 2008, real GDP per capita would be 9% percent lower than in 2004, and real GDI 14% less. Unemployment would reach 31% in 2008 (44% percent in Gaza), while 55% would be living below the poverty line (70% in Gaza).

6 – How to Turn the Corner

"Today, I wish to address our Arab neighbors…....In this ongoing war, many among the civilian population, among the innocent, were killed. And tears met tears. I would like you to know that we did not seek to build our lives in this homeland on your ruins"

Ariel Sharon, Speech on Israel's Disengagement Plan to the Knesset, October 25, 2004

I – Additional Measures Will Make the Difference

100. **As the "Disengagement Plus" Scenario shows, the basis for vibrant economic recovery does not yet exist.**

101. **Recovery depends above all on a comprehensive Israeli approach to lifting closure.** If GOI addresses only some components of the closure system, the impact of such initiatives will be muted by other remaining constraints. Economic life cannot recover if people and goods cannot move between cities and towns within the West Bank. If a truck carrying export goods from Hebron to Ashdod Port is delayed for an unpredictable periods of time en route to Tarkumiya, and is then subject to back-to-back unloading procedures, improved terminal layout and screening equipment will not make an appreciable difference. If goods produced in Ramallah cannot be transported through Israel to Gaza without long delays and multiple inspections, the feasibility of an otherwise attractive Gaza container port will be in doubt.

102. **Israel is urged to re-examine the concept of "economic separation".** If labor permits are no longer issued from 2008 and if the quasi-Customs Union in Gaza is abrogated once Israel withdraws from Philadelphi, Palestinian economic recovery may stop in its tracks. In each case, there are ways to protect Israel's interests. With illegal labor flows disappearing, virtually all Palestinian laborers will be permit holders, which greatly increases Israel's security control. In the case of the Rafah customs border, a judicious mix of international customs management expertise, IMF oversight and PA capacity building would be adequate to meet the challenge of securing the common customs border. Israel could also inspect goods exiting from Gaza as a form of verification. Both parts of the Palestinian economic entity – Gaza and the West Bank – should have the same customs treatment.

103. **To accelerate the dismantling of internal closures in the West Bank, the PA will need to demonstrate strong and sustained commitment to security reform.** If a vigorous PA effort to enforce law and order further reduces the frequency of attacks on Israelis[122], the case for maintaining today's complex and invasive set of restrictions will no longer resonate.

104. **The other PA governance priorities identified in this report – early elections, legal and judicial reform, fiscal containment, deeper transparency – are relevant to the internal health of Palestinian society and to the creation of an attractive environment for the private sector**; they should not be seen as constituting preconditions for GOI action on dismantling closures.

105. **The following paragraphs summarize key measures which, if implemented, will lay the basis for the economic revival of the West Bank and Gaza.** The Bank hopes that these measures, which derive from an intensive process of donor analysis and interaction with both the

parties, will be of assistance to them in individual and joint deliberations over the coming months.

The Government of Israel

Borders and Trade Logistics

- **In light of PA and donor objections to their location inside the West Bank, it is recommended that all West Bank border terminals be located on the 1949 Armistice (Green) Line.**

- **The back-to-back system should be rapidly abolished.** A new approach should be tested, as a matter of urgency, in two locations (Karni and Jalame). These pilot projects should feature terminal infrastructure upgrades, the introduction of security technology, the adoption of terminal service standards, the introduction of risk-management systems and the development of a commercial recourse mechanism. The pilots should be jointly designed by GOI and the PA, with strong involvement by Palestinian and Israeli businessmen. Needed investments by both parties (infrastructure, equipment and technical services) could be financed by the donor community. Assessment of the progress of the pilot can be contracted out to experts acceptable to both parties. If successful, the program could be generalized out to all border terminals. It is important that these pilots be launched immediately; they can reach full development as and when new infrastructure and equipment become available.

- **Israel should permit the construction of a RoRo terminal in Gaza as the first stage of a full-service harbor; in addition, air services should be restored.** Israel's legitimate security concerns must be catered to if these projects are to proceed, and GOI and the PA are both urged to consider the use of third-party security oversight under the sponsorship of a country or an institution in which they both have confidence.

- **A secure, efficient and reliable Gaza – West Bank transport link should be re-established.** The parties hold strongly divergent views on this issue. From an economic perspective, without prejudice to legal and political arguments, a quick, reliable and cheap flow of people and goods between the two parts of the Territories is needed to promote economic efficiency and good government – and technical solutions that can ensure this without undue risk are available (see paragraph 53 and **Technical Paper I**). This is an issue which the two parties need deal with face-to-face. They should take as their point of departure the logic of the Interim Agreement – "The two sides view the West Bank and Gaza as a single territorial unit, the integrity and status of which will be preserved during the interim period"[123].

Internal Movement in the West Bank

- **The system of over 700 checkpoints and barriers in the West Bank should be re-evaluated, and progressively dismantled**.

- **Those areas of the West Bank from which Israel withdraws should be redesignated as Area A.** This would constitute GOI recognition of the nature of the jurisdiction that the PA will then exercise.

Labor

- **Israel's willingness to maintain, as a minimum, current Palestinian labor levels in Israel beyond this decade would make an important and positive contribution to economic and social stability.**

The quasi-Customs Union

- **Current trade, tariff and customs procedures should be maintained in both Gaza and the West Bank until re-negotiated by the two sides.** The current arrangements should not be abrogated unilaterally. Nor should GOI treat Gaza and the West Bank differently in terms of the qCU. Doing so would cause serious damage to the Palestinian economy, compromising both revenues and trade. The Bank believes that Israel's customs interests can be protected with a combination of international management expertise, Palestinian customs capacity building and IMF monitoring.

- **The emphasis in the coming period should instead be on improving the implementation of the Paris Protocol**, with a particular emphasis on capturing the revenues lost to the PA due to untaxed indirect imports.

Other Issues

- **GOI should provide to the PA detailed information on the assets it intends to leave behind in the settlements**, to enable the PA's planning process to go forward, and as a first step in initiating technical contact between the two sides on this issue.

- **GOI needs to pay more serious attention to facilitating the work of the donor and aid agencies.** The conditions facing the aid community on the ground, and in particular humanitarian agencies and their contractors have continued to deteriorate in 2004, as the Task Force on Project Implementation (TFPI)'s submission to the AHLC describes. This is at odds with the commitment in the Disengagement Plan that Israel will "coordinate with the international organizations the arrangements that will make [their] activity easier." As things stand, donors have no functional point of coordination with GOI, and for the past two months have been virtually denied access to Gaza. The TFPI has suspended its regular meetings with COGAT due to this channel's ineffectiveness. This impasse makes no sense at a time when Israel is seeking international support for the Disengagement Plan.

- **GOI needs to play its part in facilitating Palestinian reform.** Above all in the coming months, this will involve enabling Palestinians to move freely within the West Bank to register and to vote in the presidential, parliamentary and local elections planned during 2005. In addition, GOI should continue to provide long-term permits to reformers, but should aim to accelerate what has proven to be a slow and uncertain process.

The Palestinian Authority

Security and the Rule of Law

- **Security reform needs to be accorded top priority.** As the Bank's June 23 report points out, "Easing internal closures throughout the West Bank must be accompanied by a credible Palestinian security effort; as long as Palestinian violence persist, the case for dismantling closures will be contestable"[124].

- **A court system that delivers impartial justice within reasonable timeframes has to be developed without further delay.** The stand-off between the Supreme Judicial Council and the Ministry of Law and Justice should be resolved by amendments to the Judicial Authority Law. This would then open the way to a program of accelerated court development, such as the Judicial Training Institute project planned by the EC, and maximize the benefits of past projects funded by USAID and the World Bank.

Fiscal Management

- **The PA needs to maintain control over recurrent spending.** The economic crisis of the past four years has brought chronic revenue starvation. Despite commendable domestic revenue performance, recurrent spending has increased excessively, leading to month-to-month crises which force the Minister of Finance to devote much of his energy to securing PA salary payments. The PA needs to freeze public sector wages and adhere rigorously to the Wage Bill Containment Plan.

- **The PA should make every effort to ensure that a sustainable Unified Pensions Law is quickly enacted.** Not only is this important in order to avoid an impending pensions crisis, but it will also enable the PA to carry out an appropriate downsizing of the public sector once the economy recovers and unemployment falls to more manageable levels.

Transparency and Accountability

- **The PA needs to address perceptions of corruption. T**his can be done through a combination of measures. First, the PA needs to do a better job of explaining to its own public and to Israel the measures that have been taken to improve public financial management. Second, in order to confront public perception head-on, the PA should develop a proactive anti-corruption strategy, drawing on successful approaches used elsewhere. Third, the PA should accelerate efforts to extend control measures into the sphere of public audit and procurement reform.

The Settlement Assets

- **The PA needs to decide how it will handle the TMD of the settlement assets.** The Bank has advocated a three-tier structure involving the PLC, a Supervisory Board and an existing or small new agency to handle implementation, while the Medium-Term Development Plan discusses the best use of these assets. A process of consultation with the public should be initiated without delay – to discuss both what should be done with the assets, and how the process should be conducted.

II – Economic Recovery

106. **If the package of measures detailed above is implemented with commitment, the foundations for economic recovery will be laid.** Under these circumstances, with donor funding levels at US$3.6 billion over four years (the same level as for the "Disengagement Plus" Scenario), the improvement in the business environment resulting from mutually reinforcing actions by the PA and the GOI would generate significant increases in investment, employment and consumption, leading to measurable positive income growth. By 2008, GDP per capita could be 10 percent higher than this year – and 24 percent higher than under "Disengagement Plus" (see **Box 3** and **Annex Table 2**). An improving economy would help stabilize the PA's fiscal situation and would allow donors to reprogram assistance away from budget support and humanitarian assistance into development activities, further solidifying the recovery.

Box 3 – *"Economic Recovery"* Scenario

Assumptions: In addition to the border cargo facilitation measures already proposed, the back-to back system is abolished, internal closures are dismantled, the flow of goods and people between Gaza and the West Bank is significantly improved, a Gaza RoRo port comes into operation at the end of 2007, Israelis are permitted to enter border-industrial estates (triggering appreciable job creation in the Erez, Karni and Jenin industrial estates by 2008), and the quasi-Customs Union is maintained through the period, with enhancements. Palestinian employment in Israel and settlements remains at current levels (37,700 excluding East Jerusalem residents). With closures largely dismantled, economic transaction costs return to pre-*intifada* levels. Donors contribute US$3.6 billion during 2005-2008, or US$900 million per annum.

Projections: In this baseline recovery scenario, the combination of positive developments outlined above would increase consumption, evoke a strong investor response and lift exports to pre-*intifada* volumes by mid-2007. Real GDP per capita would increase 10% from current levels by 2008. However, real GDI per capital would grow by only 1%. Poverty levels would fall by 7 percentage points to 41% (still 58% in Gaza) and unemployment would decline to 19% (34% in Gaza).

III – The Donor Response

107. **The experience of the past four years has shown that high levels of donor assistance cannot substitute for a positive economic environment**[125], and the "Disengagement Plus" scenario reconfirms this message – even with donors contributing an average of US$900 million per annum[126], economic decline is not arrested.

108. **Under the base case "Disengagement Plus" scenario, there is not justification for donors to increase funding dramatically, though a limited additional response can be expected in 2005 if the PA leadership transition is smooth and the PA presses ahead with PLC elections.** The Bank has therefore assumed that disbursements in 2005 could rise to US$1.1 billion. IN this instance, priority should be given to

- **Supporting the PA Budget.** According to the IMF, the external budget gap for 2005 is likely to be "close to US$500 million"[127]. The total for donor budget support in 2004 will likely amount to about US$345 million. Exceeding this in 2005 will be difficult unless Arab League donors honor past pledges and increase their level of disbursements[128]. Other donors in 2004 routed budget support through the multi-donor, Bank-managed Public Financial Reform Fund, an important instrument for promoting and supporting Palestinian reform. All donors are advised to route budget support contributions through this instrument[129].

- **Providing timely technical and financial support to a revitalized Palestinian reform program,** including support for elections and for the TMD process in relation to the settlement assets.

- **Financing essential humanitarian requirements.** With almost half the population living below the poverty line and 16%, or 600,000 people mired in deep poverty and unable to make ends meet[130], donor-financed humanitarian expenditures have become an essential part of the Palestinian social safety net. In 2003, donor contributions equivalent to US$264 million were devoted to humanitarian and other emergency expenditures, and emerging 2004 figures look comparable[131]. For 2005, the MTDP is seeking between US$251 –267 million (depending on scenario) to ensure that an adequate safety net is provided to the poorest and most vulnerable.

109. **Under the high case "Economic Recovery" scenario, though, donors should be encouraged to make a <u>major</u> additional effort, since the economic benefits of additional donor funds under such circumstances would be considerable.** An additional US$1.7 billion in 2005-2008 could be used to upgrade Palestinian basic and social infrastructure and workforce skills, creating short-term employment and improving the operating environment for industrialists and traders (see **Box 4** and **Annex Table 3**).

110. **If, and only if the parties take sufficient steps to move the economy back onto a path of sustainable growth, a donor funding conference would be justified**, with donors expected to pledge substantial additional funds for developmental purposes.

Box 4 – *"Economic Recovery"* Scenario with an additional US$1.7 billion of donor assistance over 4 years

Assumptions: As for the baseline "Economic Recovery" scenario above, but donors under this scenario provide US$5.3 billion during 2005-2008, or US$1.325 billion per annum on average.

Projections: Exports would exceed their pre-*intifada* levels by one third, real GDP per capita and real GDI per capita would increase by 22% and 14% percent, respectively, from their 2004 levels. Unemployment would drop to 13% (29% in Gaza), equivalent to the pre-*intifada* situation. Poverty levels would fall to 33%, though they would remain at about 50% in Gaza (see **Annex Table 3** for more detail on the impact of this additional US$1.7 billion).

111. **If it becomes clear that substantial progress *is* emerging, preparations for the conference can commence.** As a foundation for such a meeting, the Bank and other donors should work with the PA to prepare a Palestinian Reconstruction Program; this program should be based on the PA's Medium Term Development Plan.

112. **In order to assess the case for such a conference on an continuing basis, it is recommended that every three months the AHLC Chair and Secretariat should review progress by the parties, and should report to the donor community on their findings.** This review would need to be based on a set of indicators that should be agreed between GOI, the PA and the donor community, and which could be drawn from the actions recommended in this paper.

Tables

Annex Table 1. Recent Macroeconomic Indicators	1999	2000	2001	2002	2003	2004
Gross Domestic Product (GDP), US$ million	4,179	4,116	3,329	2,831	3,144	3,336
West Bank	*2,874*	*2,811*	*2,228*	*1,924*	*2,172*	*2,320*
Gaza Strip	*1,304*	*1,305*	*1,101*	*907*	*973*	*1,016*
GDP per capita, US$	1,493	1,409	1,087	879	925	934
West Bank	*1,681*	*1,576*	*1,193*	*983*	*1,052*	*1,072*
Gaza Strip	*1,199*	*1,147*	*920*	*717*	*729*	*722*
Real GDP growth rate (West Bank and Gaza)	9%	-6%	-15%	-10%	6%	3%
Real GDP per capita growth rate (West Bank and Gaza)	4%	-10%	-19%	-15%	1%	-2%
Cumulative Real GDP per capita change since 1999		-10%	-27%	-37%	-37%	-38%
GDI per capita, US$	1,896	1,839	1,513	1,326	1,467	1,393
West Bank	*2,113*	*2,035*	*1,662*	*1,452*	*1,621*	*1,557*
Gaza Strip	*1,555*	*1,532*	*1,282*	*1,130*	*1,227*	*1,140*
Real GDI growth rate (West Bank and Gaza)	9%	-3%	-9%	-3%	11%	-3%
Real GDI per capita growth rate (West Bank and Gaza)	4%	-7%	-13%	-7%	6%	-8%
Cumulative Real GDI per capita change since 1999		-7%	-19%	-25%	-21%	-27%
Poverty Rate	20%	27%	37%	51%	47%	48%
West Bank	*13%*	*18%*	*27%*	*41%*	*37%*	*38%*
Gaza Strip	*32%*	*42%*	*54%*	*68%*	*64%*	*65%*
Unemployment Rate	12%	14%	26%	31%	26%	27%
West Bank	*10%*	*12%*	*22%*	*28%*	*24%*	*23%*
Gaza Strip	*17%*	*19%*	*34%*	*38%*	*29%*	*35%*
Population (million)	2.8	2.9	3.1	3.2	3.4	3.6
West Bank	*1.7*	*1.8*	*1.9*	*2.0*	*2.1*	*2.2*
Gaza Strip	*1.1*	*1.1*	*1.2*	*1.3*	*1.3*	*1.4*

Annex Table 2. Macroeconomic Indicators Under Various Scenarios		**"Status Quo"**				**"Disengagement Plus"**				**"Economic Recovery"**			
	2004	**2005**	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**
Gross Domestic Product (GDP), US$ million	3,336	3,390	3,405	3,432	3,472	3,726	3,566	3,655	3,778	3,731	3,817	4,239	4,687
West Bank	*2,320*	*2,374*	*2,402*	*2,437*	*2,483*	*2,610*	*2,515*	*2,596*	*2,702*	*2,614*	*2,693*	*3,011*	*3,352*
Gaza Strip	*1,016*	*1,015*	*1,003*	*994*	*989*	*1,116*	*1,051*	*1,059*	*1,076*	*1,118*	*1,125*	*1,228*	*1,335*
GDP per capita, US$	934	904	867	834	807	994	908	889	878	996	972	1,031	1,090
West Bank	*1,072*	*1,047*	*1,013*	*985*	*962*	*1,151*	*1,061*	*1,049*	*1,047*	*1,153*	*1,136*	*1,216*	*1,299*
Gaza Strip	*722*	*686*	*644*	*607*	*575*	*754*	*674*	*647*	*626*	*755*	*722*	*750*	*776*
Real GDP growth rate (West Bank and Gaza)	3%	2%	-1%	-1%	0%	7%	-2%	2%	2%	8%	3%	8%	11%
Real GDP per capita growth rate (West Bank and Gaza)	-2%	-3%	-5%	-6%	-4%	2%	-6%	-3%	-2%	3%	-2%	3%	6%
Cumulative Real GDP per capita change since 2004		-3%	-8%	-13%	-17%	2%	-4%	-6%	-9%	3%	1%	4%	10%
Gross Disposable Income (GDI) per capita, US$	1,393	1,333	1,270	1,192	1,156	1,494	1,324	1,257	1,227	1,497	1,408	1,433	1,484
West Bank	*1,557*	*1,499*	*1,436*	*1,359*	*1,327*	*1,678*	*1,500*	*1,437*	*1,411*	*1,682*	*1,600*	*1,647*	*1,721*
Gaza Strip	*1,140*	*1,080*	*1,019*	*941*	*900*	*1,212*	*1,057*	*987*	*950*	*1,215*	*1,117*	*1,110*	*1,128*
Real GDI growth rate (West Bank and Gaza)	-3%	1%	-1%	-4%	0%	8%	-5%	-1%	1%	9%	-1%	4%	8%
Real GDI per capita growth rate (West Bank and Gaza)	-8%	-4%	-6%	-8%	-4%	3%	-9%	-5%	-4%	3%	-5%	-1%	4%
Cumulative Real GDI per capita change since 2004		-4%	-10%	-17%	-20%	3%	-6%	-11%	-14%	3%	-2%	-3%	1%
Poverty Rate	48%	50%	54%	59%	62%	46%	51%	52%	55%	46%	48%	45%	41%
West Bank	*38%*	*41%*	*44%*	*49%*	*53%*	*36%*	*41%*	*43%*	*45%*	*36%*	*38%*	*35%*	*31%*
Gaza Strip	*65%*	*66%*	*70%*	*74%*	*76%*	*64%*	*68%*	*69%*	*70%*	*64%*	*64%*	*62%*	*58%*
Unemployment Rate	27%	28%	32%	35%	37%	25%	28%	30%	31%	24%	25%	22%	19%
West Bank	*23%*	*24%*	*27%*	*30%*	*32%*	*21%*	*23%*	*24%*	*25%*	*20%*	*19%*	*16%*	*12%*
Gaza Strip	*35%*	*38%*	*42%*	*45%*	*49%*	*35%*	*38%*	*41%*	*44%*	*34%*	*36%*	*35%*	*34%*
Population (million)	3.6	3.7	3.9	4.1	4.3	3.7	3.9	4.1	4.3	3.7	3.9	4.1	4.3
West Bank	*2.2*	*2.3*	*2.4*	*2.5*	*2.6*	*2.3*	*2.4*	*2.5*	*2.6*	*2.3*	*2.4*	*2.5*	*2.6*
Gaza Strip	*1.4*	*1.5*	*1.6*	*1.6*	*1.7*	*1.5*	*1.6*	*1.6*	*1.7*	*1.5*	*1.6*	*1.6*	*1.7*

Annex Table 3. Selected Macroeconomic Indicators Under "Economic Recovery" Scenario with Different Aid Assumptions Over 2005-2008 Illustrating Impact of Increasing Donor Support by $1.7 billion		**$3.6 billion in Total Donor Assistance Over Period 2005-2008**				**$5.3 billion in Total Donor Assistance Over Period 2005-2008**				**Impact of Increasing Donor Support through**
		Amount of Donor Support:				**Amount of Donor Support:**				
		$1.1 bil.	**$0.9 bil.**	**$0.8 bil.**	**$0.8 bil.**	**$1.3 bil.**	**$1.5 bil.**	**$1.4 bil.**	**$1.1 bil.**	
	2004	**2005**	**2006**	**2007**	**2008**	**2005**	**2006**	**2007**	**2008**	**2008**
Gross Domestic Product (GDP), US$ million	3,336	3,731	3,817	4,239	4,687	3,946	4,454	4,860	5,074	+ 387
West Bank	*2,320*	*2,614*	*2,693*	*3,011*	*3,352*	*2,764*	*3,141*	*3,452*	*3,629*	*+ 277*
Gaza Strip	*1,016*	*1,118*	*1,125*	*1,228*	*1,335*	*1,182*	*1,312*	*1,408*	*1,445*	*+ 110*
GDP per capita, US$	934	996	972	1,031	1,090	1,053	1,134	1,182	1,180	+ 90
West Bank	*1,072*	*1,153*	*1,136*	*1,216*	*1,299*	*1,219*	*1,325*	*1,395*	*1,406*	*+ 107*
Gaza Strip	*722*	*755*	*722*	*750*	*776*	*798*	*842*	*860*	*840*	*+ 64*
Real GDP growth rate (West Bank and Gaza)	3%	8%	3%	8%	11%	11%	15%	9%	5%	
Real GDP per capita growth rate (West Bank and Gaza)	-2%	3%	-2%	3%	6%	6%	10%	4%	1%	
Cumulative Real GDP per capita change since 2004		3%	1%	4%	10%	6%	17%	21%	22%	+ 12 pts.
GDI per capita, US$	1,393	1,497	1,408	1,433	1,484	1,608	1,723	1,730	1,643	+ 159
West Bank	*1,557*	*1,682*	*1,600*	*1,647*	*1,721*	*1,802*	*1,942*	*1,971*	*1,897*	+ 176
Gaza Strip	*1,140*	*1,215*	*1,117*	*1,110*	*1,128*	*1,312*	*1,389*	*1,365*	*1,260*	+ 133
Real GDI growth rate (West Bank and Gaza)	-3%	9%	-1%	4%	8%	14%	15%	5%	0%	
Real GDI per capita growth rate (West Bank and Gaza)	-8%	3%	-5%	-1%	4%	9%	9%	0%	-4%	
Cumulative Real GDI per capita change since 2004		3%	-2%	-3%	1%	9%	19%	19%	14%	+ 13 pts.
Poverty Rate	48%	46%	48%	45%	41%	44%	37%	34%	33%	- 8 pts.
West Bank	*38%*	*36%*	*38%*	*35%*	*31%*	*33%*	*27%*	*24%*	*24%*	*- 7 pts.*
Gaza Strip	*65%*	*64%*	*64%*	*62%*	*58%*	*62%*	*53%*	*50%*	*49%*	*- 9 pts.*
Unemployment Rate	27%	24%	25%	22%	19%	22%	17%	15%	13%	- 6 pts.
West Bank	*23%*	*20%*	*19%*	*16%*	*12%*	*17%*	*11%*	*8%*	*6%*	*- 6 pts.*
Gaza Strip	*35%*	*34%*	*36%*	*35%*	*34%*	*32%*	*30%*	*29%*	*29%*	*- 6 pts.*
Population (million)	3.6	3.7	3.9	4.1	4.3	3.7	3.9	4.1	4.3	
West Bank	*2.2*	*2.3*	*2.4*	*2.5*	*2.6*	*2.3*	*2.4*	*2.5*	*2.6*	
Gaza Strip	*1.4*	*1.5*	*1.6*	*1.6*	*1.7*	*1.5*	*1.6*	*1.6*	*1.7*	

Endnotes

[1] See the *Disengagement, the Palestinian Economy and the Settlements*, World Bank, June 2004.
[2] *Disengagement, the Palestinian Economy and the Settlements*, op. cit*.,* paragraph 85.
[3] UNSCO, UNRWA, WFP and UNCTAD.
[4] The Israeli team included officials from the INSC, the Ministries of Trade, Defense (including the IDF, the Security Services and the office of the Coordinator of Government Activities in the Territories, COGAT), Foreign Affairs, Finance and Justice. The PA team was composed of officials from the Ministries of National Economy, Planning, Finance and Foreign Affairs, PECDAR and the PLO's Negotiations Affairs Department, as well as private sector representatives from Paltrade and from the Palestinian Federation of Industries. Meetings were also held with a group of six Cabinet Ministers, chaired by the Prime Minister.
[5] *Israel's Modified Disengagement Plan*, June 6, 2004 (see *Disengagement, the Palestinian Economy and the Settlements*, Annex I).
[6] *A Performance-Based Roadmap to a Permanent Two-State Solution to the Israeli-Palestinian Conflict*, Office of the Spokesman, US Government, April 30, 2003.
[7] In November 2004, President Bush indicated his commitment to the establishment of a Palestinian state by 2009. "I believe we've got a great chance to establish a Palestinian state, and I intend to use the next four years to spend the capital of the United States on such a state," Bush said in an East Room news conference with Blair, his closest ally. "I believe it is in the interest of the world that a truly free state develop." Washington Post, November 13, 2004.
[8] *Disengagement, the Palestinian Economy and the Settlements*, op. cit, paragraph 36. Salient features of Phase I are a cessation of Palestinian violence accompanied by Palestinian security reform, a freeze on Israeli settlement activity (including 'natural growth'), an easing of restrictions on the movement of persons and goods, progressive Israeli withdrawal from areas occupied since September 28, 2000 and Palestinian elections and institutional reform.
[9] Economic arrangements are covered comprehensively in annexes to the Israeli-Palestinian Interim Agreement for the West Bank and the Gaza Strip (Oslo Interim Agreement, September 25 1995), particularly in Annex V (Protocol on Economic Relations), which is based on the Protocol on Economic Relations between the Government of the State of Israel and the PLO, representing the Palestinian people, Paris, April 19,1994 (the Paris Protocol). See also http://almashriq.hiof.no/general/300/320/327/oslo.html.
[10] For example, the provisions covering safe passage of goods and persons have never been fully implemented, and there have been problems with the import of certain goods. In addition, the agreed gradual trade liberalization of agricultural produce never materialized.
[11] "While Israel has declared that in principle, existing agreements continue to be in force, it is obvious that the Disengagement Plan renders some parts of these agreements irrelevant" *Economic Aspects of the Israeli Disengagement Plan, Meeting with the World Bank*, INSC, November 14, 2004, PowerPoint presentation.
[12] For example, in a recent address to the Israeli Manufacturers Association, the Chairman of the INSC is reported as saying that disengagement "is meant to separate Israel from the Palestinians both politically and for security purposes, and this requires economic separation as well". *Eiland: Full Economic Disengagement, Too*, Ora Cohen, Ha'aretz, November 1, 2004.
[13] *Israel's Modified Disengagement Plan*, June 6, 2004 – see Annex 1 of *Disengagement, the Palestinian Economy and the Settlements*, op. cit.
[14] Source: *Peace Now Website*, November 2004. This excludes 97 "outposts".
[15] Discussions between INSC and the World Bank, November 2004. Under the Interim Agreement, land in the West Bank and Gaza was divided into three categories: Areas A, B and C. Areas A and B correspond to land in populated areas, primarily cities and larger towns. Land in Areas A and B immediately came under the jurisdiction of the PA for civil matters, including zoning and planning. Responsibility for security in Area B is shared by the GOI and PA. Area C constitutes all of the land outside of Areas A and B. Jurisdiction for Area C was to be gradually transferred to the PA. At this time, full jurisdiction for civil and security matters in Area C remains with GOI.
[16] Gross Domestic Product is a measure of domestic output. Disposable Income, or GDI, measures all sources of income, including remittances and foreign assistance. In the West Bank and Gaza in 2003, these factors added 59% to average incomes (real GDP per capita stood at US$925, and real GDI per capita at US$1,467).
[17] In gross terms, US$294 million. US$116 million was deducted for utility bills owed to Israeli companies.
[18] More than half were classified as self-employed or as unpaid family labor.
[19] As of October 1, 2004, a total of 453 Palestinians had been killed as a result of fighting in Gaza, while 32 Israelis had been killed in Gaza and 4 in the nearby Israeli town of Sderot as a result of Qassam rocket attacks. Source: UN Office for the Coordination of Humanitarian Affairs, OCHA.

[20] In January 2004, the volumetric ratio of exports to imports was approximately 1:3. This fell to 1:12 in June and remained at this level until early November. Source: OCHA.

[21] On 1 April 2004, UNRWA halted its emergency food distribution activities, which benefit c. 600,000 Gazans. Some food distribution was restarted on 20 April 2004, but at a much lower rate than planned or needed, due to restrictions on movement of goods (including humanitarian) through Karni. Food distribution reverted to previous levels only in October 2004.

[22] Approximately 10,000 people were made homeless by house demolitions, and about 6 square kilometers of agricultural land were razed between January and early November. Source: OCHA.

[23] A November 2004 report by Israel's National Insurance Institute warns that poverty levels in Israel reached a worrying 22 percent of the population in 2003 (using a 2002 poverty line of NIS1,763 per month for a single person and NIS2,777 monthly income for a couple). If the same poverty line was applied to the West Bank and Gaza, 88 percent of Palestinians would fall below the poverty line.

[24] For example, "Economic stability and growth for the Palestinians is a strategic stabilizer for Israel" -- *Continuous Movement in the West Bank – An Economic Component to the Disengagement Plan*, office of the Coordinator Of Government Activity in the Territories, July 2004, PowerPoint presentation.

[25] *Israeli Disengagement Plan – Dialogue with the World Bank – Status Report,* op. cit.
August 29, 2004, PowerPoint presentation.

[26] Disengagement, the Palestinian Economy and the Settlements, op. cit, paras. f) and 1.

[27] Twenty-Seven Months – Intifada, Closures and Palestinian Economic Crisis, World Bank, May 2003.

[28] Four Years – Intifada, Closures and Palestinian Economic Crisis, World Bank, November 2004.

[29] Seam zone residents require permits to continue living in the zone, and non-residents, including international and national staff of international organizations, must obtain permits to enter the zone.

[30] Assessing the current and future macroeconomic impact of the Separation Barrier is a difficult undertaking, for at least two reasons. First, the final course of the Barrier continues to evolve, particularly in light of the June 30, 2004 decision of Israel's High Court (*Beit Sourik Village Council vs. 1.The Government of Israel and 2. Commander of IDF Forces in the West Bank)* which ordered reconsideration of a 30 km stretch northwest of Jerusalem; the Court decision forced IDF planners to reevaluate the planned southern route as well, and as consequence to move the planned Barrier closer, if not up to, the Green Line. To this date, the Israeli Cabinet has not formally endorsed its ultimate routing; nor have final decisions been reached in areas around several large Israeli settlement blocs located deep within the West Bank – notably Ariel (east of Qalqilya), Ma'aleh Adumim (east of Jerusalem), Gush Etzion (southwest of Bethlehem), and Kiryat Arba (east of Hebron). The official IDF map of the Barrier currently posted on its website predates the June High Court decision. Nor are the arrangements for passage through (or access to Palestinian land west of the Barrier) finalized, even in areas in the northwestern West Bank where the Barrier has been completed for nearly 18 months. Second, the situation which would prevail in the absence of the Barrier – the counterfactual which would serve to measure, by difference, the impact of the Barrier – is subject to controversy. As for the impact of the Barrier on internal movement, three alternative scenarios are logically possible: 1) the Barrier would compliment and strengthen the existing system of movement restrictions (both internal and external closure), hence aggravating their severity and further increasing transportation costs; 2) the Barrier, because of its success as an impediment to transit into Israel, allows for the relaxation of internal closures, thereby lowering transportation and transaction costs within the West Bank; 3) overall transportation and transaction costs are unchanged. Nevertheless, based on its current alignment (and current operational practices regarding gates, crossings, permits, etc.) and publicly available IDF projections for future construction, analysis suggests that the loss of agricultural output due to land confiscations and access restrictions would be equivalent to approximately US$320 million; this translates into a reduction of agricultural value-added of approximately US$55 million – and a 2% reduction in GDP overall with the introduction of multiplier effects. The other significant impact of the Separation Barrier is its potential for limiting un-documented labor flows to Israel. The elimination of all "clandestine" labor would mean a reduction in Palestinian annual income on the order of US$87 million annually when the Barrier is completed. Combined with lost agricultural production, the elimination of clandestine labor would mean that the reduction in gross national income (GNI) would be on the order of US$300-US$350 million annually, equivalent to a 8-10% decline. This estimate is certainly an upper bound; furthermore, the decline in workers' remittances from Israel and in agricultural income would exert downward pressure on prices overall – hence in real terms the decline would be even less, ranging from 3-5%. See *Impact of Israel's Separation Barrier on West Bank Communities: Economic and Legal Development,* The World Bank, December 2004, forthcoming.

[31] "Military activity will remain in its current framework in the rest of the West Bank." Israel's Modified Disengagement Plan, op. cit.

[32] These data exclude observation towers.

[33] Data exclude observation towers. Source *Occupied Palestinian Territories, West Bank Closure Map*, OCHA, July and November 2004.

[34] Research by B'Tselem (*Forbidden Roads: The Discriminatory West Bank Road Regime*, August 2004) describes three levels of restriction: a) completely prohibited, meaning those on which Palestinian travel is completely forbidden, accounting for roughly 124 kilometers of road at the time the research was carried out, with restrictions enforced by checkpoints; b) partially prohibited, where use requires a permit, accounting for some 244 kilometers of road, and c) restricted use, with frequent IDF checks of vehicles and persons, accounting for roughly 364 kilometers of road. There are no written orders on road usage by Palestinian residents of the West Bank; restrictions are based on verbal orders from Israeli army and police commanders pursuant to the General Order Regarding Defense Regulations. The restrictions are mainly applicable in Area C, which accounts for roughly sixty percent of the West Bank. According to the IDF's International Law Department, only Highway 443 (connecting Jerusalem with Tel Aviv via Modi'in), is formally closed to Palestinians, although it is acknowledged that security measures can slow travel times.
[35] It is understood that projects considered "borderline" from a political perspective, but which serve important humanitarian needs, could be approved.
[36] The subject was discussed at a meeting of the donors' Humanitarian and Emergency Policy Group (HEPG) in September 2004, and at the Local Aid Coordinating Committee in October. See also *US Won't Fund Separate Roads for Palestinians*, Ha'aretz, November 30, 2004.
[37] *Legal Consequences of the Construction of a Wall in the Occupied Palestinian Territory*, Advisory Opinion, International Court of Justice, The Hague (General List No. 131, 9 July 2004).
[38] In a recent note prepared for the donor Humanitarian and Emergency Policy Group (HEPG), it is argued that "As an Occupying Power under international humanitarian law, the GoI is responsible for providing an adequate road system. It also is obligated to allow for freedom of movement under Article 12 of the International Covenant on Civil and Political Rights. In addition, Article 11of the Oslo Accords recognizes the territorial integrity of the West Bank", *Roads in the West Bank*, HEPG, November 2004.
[39] *Critical Commercial Transport Routes and Border Cargo Management*, The Services Group, September 2004.
[40] *Disengagement, the Palestinian Economy and the Settlements*, op. cit. paragraph 34.
[41] These are of five kinds – i) between West Bank/Gaza and Israel, ii) transit gateways (Ashdod, Haifa, Ben Gurion Airport); iii) between West Bank/Gaza and third countries (Gaza and Egypt, West Bank and Jordan), iii) sea and air connections from Gaza; and v) between Gaza and the West Bank.
[42] *Border Regime: Response to World Bank Presentation*, PA/Negotiations Support Unit, August 6, 2004, informal paper.
[43] "Any response to a specific and actual threat [should] be dealt with in an individualistic, proportional, and transparent fashion based on necessity. We insist that any such response not ever result in the closure of an entire crossing point, and any partial closure must be regulated, coordinated and not exceed a specific time agreed between the two parties in advance as appropriate for the specific threat posed." *Border Regime: Response to World Bank Presentation*, op. cit.
[44] *Principles Guiding Palestinian Perspectives*, Negotiations Support Unit, remarks on August 16 meeting with the donor team, informal paper.
[45] INSC note, November 30, 2004.
[46] For Gaza, Israel proposed retaining Erez and Karni, but closing Sufa and Rafah in favor of a combined terminal at Kerem Shalom on Israeli soil in the Egypt/Israel/Gaza "triangle". GOI argued that relocation away from Rafah, which is violence-prone and therefore risky for Israeli terminal operatives, and thus subject to frequent closure, would offer the prospect of much-increased flows of cargo and people; after disengagement, it would then be up to the PA and the Government of Egypt to agree border arrangements. The PA pointed out to the donor team that the Gaza border crossings were agreed bilaterally, and that any new arrangements should also be subject to bilateral agreement. The PA specifically objected to the Kerem Shalom proposal out of concern that this move would perpetuate Israeli control over Gaza by reducing Israel's motivation to evacuate Philadelphi ("After the creation of the tri-point crossing point, Israel would have no incentive to cede control, and as such the tri-point is likely to perpetuate such control." *Border Regime: Response to World Bank Presentation,* op. cit). The Government of Egypt also informed the World Bank in September 2004 that it was opposed to moving the terminal to Kerem Shalom. On November 14, the INSC/MOFA team informed the donor team that the Kerem Shalom idea had been dropped for now.
[47] Other than in the "safe passage" context – for which the crossing points from the West Bank to Gaza are Tarkumiya and Mevo Horon.
[48] "The Advisory Opinion of the ICJ has particular implications for donors, as it specifically declares that all States are under an obligation not to recognize the illegal situation resulting from the construction of the Barrier and that they are under an obligation not to render aid or assistance in maintaining the situation created by such construction…..Such a declaration by the ICJ is most likely aimed at assistance that would directly aid Israel in maintaining the Barrier in operation, for instance contributing to the construction or servicing of the Barrier within the West Bank." *Impact of Israel's Separation Barrier on Affected West Bank Communities: Economic*

Impacts and Legal Developments. Follow-Up Report to the Humanitarian and emergency Policy Group (HEPG) and the Local Aid Coordination Committee (LACC), December 2004.

[49] *Beit Sourik Village Council vs. 1. The Government of Israel and 2. Commander of IDF Forces in the West Bank*, The Supreme Court of Israel Sitting as the High Court of Justice, HCJ 2056/04 (February 29, 2004; March 11, 2004; March 17, 2004; March 31, 2004; April 16; 2004; April 21, 2004; May 2, 2004). In this case the Court ruled that a certain portion of the Separation Barrier (30-40 kilometers) violated international humanitarian law on the basis that it resulted in disproportionate harm to Palestinians in the area, and that construction should be halted until a new route is proposed. The reasoning provided by the Court included the following: more that 13,000 farmers would be cut off from land, which is the source of their livelihood; no attempts were made to provide the farmers with alternative land; and the system of gates would create considerable difficulties for farmers trying to tend to their land. This would compound the already difficult situation, in particular the high rate of unemployment, of residents of the area; thus the proposed route violates their rights to property and freedom of movement. The Court noted that an alternate route that does not separate residents from their land, or which separates them to a lesser degree, would provide proportionality.

[50] Gaza: Karni, Rafah, Sufa, Erez; West Bank: Jalame, Sha'ar Efraim, Tarkumiya, Allenby; Israel: Ashdod Port.

[51] This extension would be added to a larger project (the Ashdod – Yad Mordechai rail link) which is currently planned for 2008.

[52] Or NIS 95 million. This consists of NIS 80 Million for 4km of rail, the terminal and security technology (including scanners), plus NIS 15 million for the train. Source: INSC.

[53] *Notes on the Territorial Link*, PA/Negotiations Support Unit, 16 September 2004, informal paper.

[54] "Israel will not be able to bear the full costs associated with such improvements. To meet the desired goals, there would have to be some other form of sharing of the financial burden." *Economic Aspects of the Israeli Disengagement Plan, Meeting with the World Bank*, INSC, op. cit. Incremental operating costs associated with managing these various expansions and upgrades, including the costs associated with extra shifts, total some US$5 million per annum; these would be borne by GOI.

[55] *Israeli Disengagement Plan – Dialogue with the World Bank – Status Report*, INSC, op. cit.

[56] Currently, Karni handles goods alone, and Erez only people. Under the Oslo Accords, passage between Gaza and Israel is provided through Erez (persons and vehicles, not goods) and Nahal Oz, Sufa and Karni (for commercial goods, not people).

[57] This is not to imply that sensitive security information should be shared with commercial operators.

[58] The World Bank's Trade and Transport Facilitation for South Europe project features the use of performance standards; such standards have measurably benefited border cargo management in a number of Eastern European and Central Asian countries.

[59] "The setting of standards of service, together with the dedication of alternative passages, reflect the goal of enabling the efficient and continuous operation of the passages, but for exceptional security concerns." *Economic Aspects of the Israeli Disengagement Plan, Meeting with the World Bank*, INSC, op. cit.

[60] *Israeli Disengagement Plan – Dialogue with the World Bank – Status Report,* op. cit.

[61] At present, Israeli-registered trucks are not allowed into Gaza, and it is understood that this restriction would be extended to the northern West Bank after disengagement.

[62] The dispute resolution mechanisms envisioned under the Oslo Accords deal with disputes arising from the implementation of the Accords, and are thus not directly applicable to commercial disagreements.

[63] Conversation between the donor team and the INSC team, November 14, 2004.

[64] General Agreement on Tariffs and Trade. GATT's 1994 integrated dispute resolution procedures, as revised and strengthened by the Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes, provides a possible model, as does Article 8.9 of the Free Trade Agreement Between the Government of Canada and the Government of the State of Israel (January 1, 1997). The latter provides for binding arbitration.

[65] "If and when the conditions permit the evacuation of [the Philadelphi Route], the State of Israel will be willing to consider the possibility of setting up an airport and a seaport in the Gaza Strip, subject to arrangements agreed upon with the State of Israel." See *Israel's Modified Disengagement Plan* ,Annex 1 of *Disengagement, the Palestinian Economy and the Settlements*, op. cit.

[66] These proposals are discussed in detail in Annex 2 of *Disengagement, the Palestinian Economy and the Settlements*, op. cit. Proposed security and customs procedures at these international Palestinian gateways are described in **Technical Paper I**.

[67] *Border Regime: Response to World Bank Presentation*, op. cit.

[68] "Israel objects to arrangements for fixed-wing services." *Israeli Disengagement Plan – Dialogue with the World Bank*, INSC, op. cit.

[69] Discussions with the World Bank, August-September 2004.

[70] *Border Regime: Response to World Bank Presentation*, op. cit.

[71] Under the Accords the safe passage of goods and persons was supposed to take place on designated routes during designated times. Permits were to be provided to persons and vehicles, and even those denied permits could travel via escorted public vehicles. While GOI has restricted safe passage for security reasons, the PA is arguing for changes in the safe passage regime that would permit less restrictive movement than that provided under the Oslo Accords. In particular, the PA has recommended that persons be presumed to access safe passage unless the Israelis provide specific security concerns, as opposed to persons having to first apply for permits. The PA has proposed a possible role for third party involvement in ensuring and administering safe passage in order to help address Israeli security concerns.

[72] "The spirit of the safe passage arrangements in the Oslo Agreements provide for movement which is a) guaranteed to all people at all times, irrespective of their security status, b) safe from Israeli arrests/attacks, c) for public and private Palestinian vehicles, d) for goods and people, e) by multiple routes." *Notes on the Territorial Link*, op. cit.

[73] Bank interviews with exporters and importers in Gaza indicate that cargoes from the West Bank are often subject to extensive delays, sometimes up to 3 weeks, when entering Gaza. With daily costs for Israeli trucks of US$150 per day, such delays make West Bank goods being sold in Gaza significantly more expensive than equivalent goods coming from Israel.

[74] Properly equipped tractor-trailers could travel on their own initiative rather than in convoy. This could be accomplished using a GPS system or transponder to monitor movement along fixed routes. These systems are costly and data intensive, however, and given the short distance and transit time an alternative would be to record the times of departure and arrival, and to sanction shippers that exceed acceptable norms. Since the vehicles would be security inspected when departing and then sealed, there is no reason to perform more than a cursory examination of the transit documents and seals at the other end of the journey.

[75] Prior to the *intifada*, escorted truck convoys made daily runs between the West Bank and Gaza. Although there were delays associated with organizing the vehicles, with the back-to-back transfers to the special-purpose vehicles that operated within Israel, with securing escorts and traveling at the speed of the slowest vehicle, the convoys provided reliable movement. Transit times, on the order of one day, were greatly superior to today's times.

[76] See *Twenty-Seven Months of Intifada, Closures and Palestinian Economic Crisis*, World Bank, May 2003, paras. 4.10 – 4.16.

[77] Excluding East Jerusalem residents holding Israeli identity cards. Source: Palestinian Central Bureau of Statistics and Word Bank staff estimates.

[78] See **Technical Paper II**.

[79] The INSC/MOFA team proposed that 15,000 permits be provided to Gazans, and 20,000 to West Bank residents, to be phased out to zero, albeit not in a linear manner, by end-2008. Apart from the need to prolong the transition beyond 2008, a permit *per se* does not guarantee employment. Market demand can fluctuate – but more importantly, day-to-day security measures frequently prevent workers from being able to make use of such permits; authorized levels of permits have consistently exceeded the number issued during the intifada.

[80] See *Disengagement, the Palestinian Economy and the Settlements*, op. cit., Annex 1, paragraph XI.

[81] *Economic Aspects of the Israeli Disengagement Plan, Meeting with the World Bank*, INSC, November 14, 2004, PowerPoint. "In Gaza, the customs union will remain in force as long as Israel retains control over the Philadelphi Road, on the Egyptian border, and therefore over the border crossings. Once Israel quits Philadelphi, [Eiland] said, the customs union will end and trade relations with Gaza will…be based on trade agreements", Ora Cohen, Ha'aretz, *op. cit.*

[82] Conversation with INSC, November 14, 2004.

[83] According to the Paris Protocol, trade taxes are remitted according to the so-called destination principle, i.e. only the taxes on goods explicitly destined for West Bank and Gaza are remitted to the PA. Taxes on goods nominally imported into Israel but subsequently re-exported to the West Bank and Gaza are not remitted. The magnitude of indirect imports is difficult to measure – but in *Long-Term Policy Options for the Palestinian Economy*, July 2002, the World Bank estimated that US$174 million was lost each year (based on 1998 data).

[84] Excluding donor support. In 2004, through August, gross clearance revenues amounted to US$394 million, of which 38 percent came from taxes levied on Palestinian imports from third countries. Total PA fiscal revenues amounted to US$612 million. Source: IMF and PA Ministry of Finance.

[85] "PA customs is rapidly becoming de-skilled due to lack of real work." *Critical Commercial Transport Routes and Border Cargo Management*, The Services Group, op. cit. UNCTAD and GTZ have been working with the PA to introduce the Automated System for Customs Data, ASYCUDA; this work is well-advanced. To exploit the system's full potential, however, significant investments are needed for infrastructure, institutional development and training.

[86] Firms such as the Crown Agents (UK) and SGS (Switzerland) have provided such services, either on a fee-for-service basis or for an agreed proportion of the revenue collected, in a number of countries (e.g. Mexico, the Philippines and Kenya). Activities performed would normally include inspection to verify the quantity, weight

and quality of traded goods; testing product quality and performance against various health, safety and regulatory standards; and certification that systems or services meet the requirements of standards set by government, standardization bodies or customers. It would be most important that the terms of reference for the firm should include training and skills transfer – should the firm merely substituted for the Palestinian customs service, there would be a high risk of demotivation leading to and further institutional weakening.

[87] *Economic Road Map – An Israeli-Palestinian Perspective on Permanent Status*, The Aix Group, January 2004.

[88] This can either be done using a macro formula, or tailored surveys.

[89] The Aix Group's *Economic Road Map* elaborates on these issues in the context of transition from Phase I and II to Phase III of the Roadmap.

[90] The Joint Economic Committee was created under the Paris Protocol to discuss and solve issues pertaining to the implementation of agreed economic arrangements. It ceased to function with outbreak of the *intifada*.

[91] *The Socio-Economic Stabilization Plan (SESP) 2004-5*.

[92] The Bank's "Status Quo" Scenario assumes disbursements of US$900 million in 2005-6 and US$800 million in 2007-8.

[93] The Bank's "Economic Recovery" Scenario assumes donor disbursements of US$1.3 billion in 2005, US$1.5 billion in 2006, US$1.4 billion in 2007 and US$1.1 billion in 2008.

[94] Attaining the budget support targets will require the Arab League states to reverse the decline in their budget support contributions. The Arab countries provided US$388 million in 2001, but this has fallen to a US$109 million this year (of which US$92 million would be from Saudi Arabia alone). Arab countries' commitment at the Cairo Summit in early 2001 was for US$45 million per month, and this was disbursed without any shortfall and on time. However, Arab countries in the GCC (which contributed 75 percent of these budget support funds) believed that other Arab countries should assume a greater share of the burden. Consequently, in March 2002, at the Beirut Summit, the Arab League made a new commitment to monthly payments of US$55 million, to be made directly by the donor countries. The total amount to be disbursed was distributed among the Arab League member countries in proportion to their shares in the Arab League budget. This, in effect, lowered the proportion payable by the Gulf countries from 75 percent to 43 percent under the new formula. Other relatively poorer members of the Arab League were expected to contribute significantly. In the event many of these did not, and all countries with the exception of Saudi Arabia have failed to meet the new targets. As a result, actual payments fell to an average of US$24 million per month between April and December 2002, declining further in 2003 to US$24 million per month, and to only US$9 million per month in 2004.

[95] *Disengagement, the Palestinian Economy and the Settlements*, op. cit., paras. 40-47.

[96] See "*Fiscal and Macroeconomic Developments, Outlook and Reform in the West Bank and Gaza*", Paper prepared by the International Monetary Fund for the Ad Hoc Liaison Committee meeting in Oslo December 8, 2004.

[97] *Palestinian Reform June - September 2004*, An Update on Recent Developments. Local Task Force on Palestinian Reform, Secretariat.

[98] Since then the reform support group on civil society was replaced by a legislation reform support group.

[99] There is as yet no law placing the security services and the police under full civilian control; likewise there is no law regulating military courts and thereby ensuring that civil cases are handled only by the civil courts. The rule of law must not only be applied by, but also be fully applied to, the police and security services; this requires that instances of abuse of authority are properly investigated and, where necessary, prosecuted.

[100] The Office of the Diwan al Fatwa was created by decree in 1995 and is part of the Ministry of Justice. Its primary responsibilities are to coordinate the drafting of legislation by the executive branch of the PA, and to publish adopted legislation in the Official Gazette. The Diwan's role in formulating legislation needs to be further clarified so that the separation of powers established in the Basic Law is fully respected and there is no conflict with the role of the PLC.

[101] The Committee's development program concentrates on a reform of PLC administration (including the development of terms of reference for PLC staff) and of its organizational structure – and points to the need to establish a code of ethics for the PLC.

[102] A recent statement by the acting President that he will sign all laws in accordance with the Basic Law is a welcome step.

[103] The Capital Markets Authority Law, the Companies Law and the Competition Law have not yet been adopted by the PLC, although they are included in the One-Year Reform Action Plan. By-laws and regulations for the implementation of the Labor Law are only gradually being adopted, more than three years after the law's passage.

[104] For example, the Social Security Law, which has been passed but not yet implemented, establishes a pensions system for private sector employees. Unfortunately, adequate analysis was not carried out in advance, and the law as written is financially unsustainable (due to a mismatch between contribution and benefit rates, and

due to its early retirement provisions and pension guarantees). It also lacks adequate implementation and governance mechanisms. Because the PA is the guarantor of the social security system under the current law, the PA would be obliged to accept a large and unfunded liability which it could not honor unless its fiscal fortunes were transformed. The PA is taking steps to study and amend the law to ensure that social protection can be provided to old-aged Palestinians on a sustainable basis.

[105] The legal framework in both the West Bank and Gaza is based on Ottoman and British Mandate laws, Israeli military orders and PA legislation. However, there are some substantial differences in the legal frameworks. The West Bank inherited some Jordanian legislation, while Gaza still has regulations from the Egyptian Mandate. Thus businesses currently need to observe different regulations in the West Bank and Gaza -- for example those governing permits and licenses.

[106] In 2004, PA revenues are expected to reach NIS4.2 billion (US$933 million, or US$78 per month), approximately equivalent to the 1999 level (in nominal terms). Total salary expenditures, by contrast, have increased by more than 80 percent, from NIS 2.1 billion (US$43 million/month) to NIS3.9 billion (US$72 million/month). Source: *Macroeconomic and Fiscal Developments, Outlook, and Reform in the West Bank and Gaza*, IMF, November 2004 and *West Bank and Gaza -- Economic Performance, Prospects, and Policies*, IMF 2001.

[107] The Wage Bill Containment Plan calls *inter alia* for a reduction in net public recruitment to 2,000 in 2005 and 1,500 in 2006 (to accommodate the increase in demand for new hires in health and education from demographic trends). It also states that there should be no discretionary salary increases, and that the wage drift from automatic advancement and promotions should be limited to 2% annually. Adherence to the Plan would result in wage bill growth of only 3.7% (in nominal terms) in 2005 and 3.3% in 2006.

[108] The PA's wage bill increased from c. US$62 million monthly in 2003 to c. US$72 million in 2004 – a 17% increase. Implementation of the Civil Service Law involved an increase in monthly wages from US$154 to US$240 at the lowest end of the scale (60%), and from US$1,320 to US$2,147 at the highest end (62.7%). Only half of the increase has actually been paid. Coupled with the abolition of implicit bonuses, the net result was a 15% increase in the average civil service salary. In parallel, security service staff were granted an increase of 8%.

[109] In 2001 the PA received US$532 million in budget support, in 2002, US$467 million and in 2003, US$261 million. For 2004, US$346 million is anticipated, but it is not clear that this level will be maintained in 2005.

[110] The Ministry of Finance's debt to domestic banks had risen from US$190 million at the end of 2003 to over US$280 million by the end of September 2004 (equivalent to 10% of GDP). In addition, MOF's arrears have risen. While the total stock of arrears is not known, arrears to the Gaza Pension and Insurance Company (GPIC) stood at US$180 million as of November 2004. Sums owed to the Israeli Electricity Company and Israeli suppliers of fuel for the Gaza electricity generating company stood at US$80 million at the end of October (subsequently reduced by half in November following the release of some of the PA revenues attached by Israeli courts). Arrears to domestic suppliers have also increased, and are estimated by the IMF to be c. US$45-60 million.

[111] These schemes cover only civil service employees. Security services personnel are not currently covered, but the reformed system would cater to them as well.

[112] By way of comparison, France's implicit pension debt is about 10% of GDP, and Israel's is around 18% of GDP.

[113] The current law provides for an equitable system that will be self-sustaining for the next 20-25 years. However, recent attempts by various groups within the public sector to obtain very high benefit levels could tip the system back into deficit much sooner.

[114] This estimate is based on the reformed parameters embodied in the current draft of the law, and refers to average payments over the next ten years. Costs will increase thereafter as more employees retire. Payments to groups not covered by the law, such as security services employees over 45, would require additional budget resources.

[115] Because of its tenuous fiscal situation, the PA has not paid pension contributions consistently for several years. It has also been forced to use employees' contributions (deducted at source) to meet current budget expenses, bringing total pension arrears to some US$180 million for the civil service alone. The financing for the reformed public pension system takes these arrears into account, but the sustainability of the new system is dependent on PA avoiding incurring arrears in the future.

[116] Both international comparative data and polling within the West Bank and Gaza indicate a strong belief that there is corruption within the Palestinian Authority. Transparency International's Corruption Perception Index for 2003 ranked West Bank and Gaza 78th out of 133 countries (only Algeria, Sudan and Libya had lower scores among the Arab countries). A poll by the Palestinian Center for Survey Research in September 2004 revealed that 88 percent of Palestinians believe that there is corruption within PA institutions. Other popular polls within the West Bank and Gaza – such as those conducted by the Palestinian Center for Policy and Survey Research – regularly show similar numbers.

[117] That corruption – whether perceived or actual – hurts investments is widely documented, see e.g. *World Development Report – A Better Investment Climate for Everyone*, the World Bank 2005.
[118] *Country Financial Accountability Assessment*, the World Bank, June 2004.
[119] The new Palestinian Pension Agency to be established under the Unified Pension Law provides a good example of a governance structure where transparency, accountability and the avoidance of conflict of interest are paramount.
[120] Also welcome is the statements in the PIF's Annual Report for 2003 that (i) "the fund shall no compete with the private sector in Palestine in any and all economic investment sectors where the private sector has traditionally taken an active participating role", and (ii) that the fund would gradually withdraw from existing projects consistent also with a concept of privatization, and according to a timely business plan.
[121] *Compensation in the Context of the Gaza Disengagement,* PLO Negotiation Affairs Department (Final Draft).
[122] Data from Sept. 00, 2001, 2002, 2003, through Sept. 2004: a) no. of Israelis killed: 47, 297, 453, 214, 97; b) no. of Israelis injured: 265, 1579, 2309, 1004, 441; c) no. of suicide attacks: 4, 35, 60, 26, 13; d) no. of shooting attacks: 2230, 5274, 2917, 2111, 1198. Source: *Four Years of Conflict: Israel's War Against Terrorism*, 3rd October 2004, Israeli Security Agency, available on www.mfa.gov.il.
[123] Article IX, *Interim Agreement*, op. cit.
[124] *Disengagement, the Palestinian Economy and the Settlements*, op. cit.
[125] See, for example, *Twenty-Seven Months – Intifada, Closures and Palestinian Economic Crisis*, World Bank, op. cit., paragraph 20: "World Bank analysis shows the limited power of donor assistance under the conditions pertaining in 2002. Since the beginning of the intifada, donors have provided about US$315 per person per year, an unprecedented level of international financial commitment. Despite the importance of these contributions in staving off fiscal disintegration and the disappearance of the PA as a viable service provider, the economy has contracted by almost a half. A doubling of donor disbursements to US$2 billion in 2003 and 2004 -- something which there is no reason to believe can happen – would only reduce the poverty rate by seven percentage points by the end of 2004. On the other hand, if internal closures were removed and exports facilitated, GDP could surge by about 21 percentage points by the end of 2003, and poverty could fall by 15 percentage points by the end of 2004."
[126] This would amount to per capita aid transfers of US$225 per person over the period – less than the historically high levels of the past 3 years (over US$300 per person per year) on account of the explosive increase in the Palestinian population, which would reach some 4.3 million in the West Bank and Gaza by 2008.
[127] *Fiscal and Macroeconomic Developments, Outlook and Reform in the West Bank and Gaza*, IMF, November 2004.
[128] Arab League budget support was critical in 2001-2, in which US$388 million and US$316 million respectively were disbursed. In 2003 this fell to US$132 million, and in 2004 is expected to amount to US$109 million, with all but US$17 million of this coming from Saudi Arabia. A conservative estimate of commitments owed the PA but not disbursed indicates that the Gulf countries (excluding Saudi) alone owe approximately US$400 million.
[129] Donors are also encouraged to support the implementation of a new reformed public sector pension system (see paragraph 83). This would most easily be done through the Reform Fund, which has specific ongoing benchmarks dealing with pension reform.
[130] On the basis of the December 2003 National Poverty Survey (NPS) conducted by PCBS, 40.3% of Palestinians fell below the official poverty line of NIS 1800 (approximately US$410) per month for family of two adults and four children that month. Accounting for seasonal factors and methodological differences between the NPS and the more extensive Palestinian Expenditures and Consumption Surveys, an average poverty rate for 2003 is estimated at 47%. Subsistence poverty is a measure of deep poverty. Based on the cost of satisfying the minimum caloric intake as established by FAO/WHO, plus a basic allowance for non-food items, such as clothing and shelter, the subsistence poverty line was set at NIS 205 per person per month (approximately US$280 per month for a family of six). Using this definition, 16% of the Palestinian population, or approximately 607,000 persons, cannot afford the basics for survival. See *Deep Palestinian Poverty in the Midst of Economic Crisis*, World Bank, October 2004.
[131] Initial MOP estimates suggest a total of about US$245 million.