

PAYING FOR PEACE:

The Oslo Process and the
Limits of American Foreign Aid

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INTRODUCTION:

As the Israeli-Palestinian upheaval continues to shake the Mideast and complicate America's war on terrorism, many Americans want to know what is gained from the \$5 billion + we provide every year to Israel and its neighbors. Foreign aid, while critical to American attempts to resolve the Arab-Israeli conflict since the 1970's, is a limited tool. Under present circumstances, even positive inducements like foreign aid are not well-suited to reduce violence, resume negotiations, or change Palestinian leadership.

When Israelis and Palestinians were at the negotiating table (1993-2001), foreign aid and other inducements provided energy to the peace process, paid for practicalities, and helped soften a number of Israeli-Palestinian crises. But ultimately, even unprecedented promises of aid could not seal an Israeli-Palestinian final status accord. Since the utility of aid is limited even in the best of times, under present circumstances aid can play little more than a stabilizing role, averting humanitarian crises and sustaining agreements between Israel, Egypt and Jordan.

For its part, the Bush Administration has resisted calls to pressure Israel and has not used the aid stick. But the White House has issued a threat to stop Palestinian aid if reform does not take place.¹ Unfortunately, the Bush Administration has chosen a bad approach. Not only is the current aid threat the wrong tool for pursuing the twin objectives of reform and peacemaking, but since the U.S. provides just a small part of outside support, unilateral threats are not credible.

This paper will evaluate the use and effectiveness of American foreign aid in managing the Arab-Israeli conflict – specifically, the paper examines the role aid has played in Israeli-

¹ Two days after his June 24, 2002 speech calling for Palestinian reform and leadership change, Bush said "I can assure you, we won't be putting money into a society which is not transparent and (is) corrupt, and I suspect other countries won't either." President George W. Bush, June 26, 2002, cited from *Associated Press*.

Palestinian relations since Oslo. The focus is on foreign aid for political purposes, as distinct from development or humanitarian aid.² (see appendix)

There is a great deal of confusion in the public policy arena about the use and effectiveness of foreign aid. Also, unlike deterrence, the use of force or economic sanctions, comparatively little research has been done on foreign aid for political purposes. Moreover, in the rich and varied literature on the Arab-Israeli conflict, aid receives scant attention.³ Having already provided nearly \$200 billion in U.S. aid to the Middle East since 1970, and with almost 40 percent of today's foreign aid budget going to the region, the record needs to be set straight about what foreign aid can and cannot accomplish. Understanding the role of aid and inducements is not only important for future American involvement in the Arab-Israeli conflict, but for future U.S. efforts to manage other regional conflicts.

The following arguments are made in this paper:

First, foreign aid was a necessary, but not sufficient factor in sustaining the Oslo process from 1993-2001. Aid was only effective when the parties demonstrated the basic political will necessary to reach a negotiated settlement. Economic inducements did not bring either side to the table, but they were necessary to consummate and implement agreements and to maintain momentum in negotiations. The Oslo accords would not have endured for as long as they did if aid was not used. But aid, including President Clinton's \$35 billion offer at Camp David, could not save the process from imploding.

² The terms "foreign aid," and "positive economic inducements" encompass a wide range of policy measures, including; bilateral and multilateral foreign aid, military assistance, loans and preferential trading arrangements. A positive economic inducement entails state A ("the provider") extending or committing resources to state B ("the recipient") in exchange for a policy adjustment by B. Foreign aid for political purposes involves a concessionary transfer of resources, or the extension of other value-added benefits, from the provider to the recipient during an influence encounter. The objective is to produce a voluntary behavior change by the recipient. See Knorr, *Power and Wealth: The Political Economy of International Power* (London: MacMillan, 1973), p. 165; see also Dieter Ruloff ed., *The Politics of Positive Incentives in Arms Control* (Columbia, SC: University of South Carolina Press, 1999).

³ See Clawson and Gedal, "Dollars and Diplomacy," Washington Institute for Near East Policy, 1999; and relevant excerpts on aid in Quandt, *Peace Process*, 2000; Spiegel *The Other Arab- Israeli Conflict*, 1985; Telhami *Power and Leadership in International Bargaining*, 1990; Walt *The Origins of Alliances*, 1987; and Ball, Friedman and Rossiter on Palestinian aid in Cortright *The Price of Peace* 1997, p. 243-266.

Second, foreign aid is most effective as part of long-term strategies of engagement that combine political, economic and security assurances. It takes more than “checkbook diplomacy” to shape and sustain peace settlements. But the U.S. (and other mediators) did not provide Palestinians with enough political and security inducements to augment the role of aid.

Third, foreign aid also has “expressive value.” During the Oslo years, aid provided political cover for recipient policymakers who faced domestic discontent over peace deals. This was true for both Israeli and Palestinian leaders.

Fourth, as with other step-by-step peace settlements, Oslo aid was also meant to build public constituencies to support negotiations. However, rather than serve as an engine for economic growth and good governance, aid quickly became a band-aid for a deteriorating Palestinian economy that was weighed down by corruption, damaged by violence, and stifled by Israeli closures. Aid was not able to serve its original purpose.

Fifth, because the U.S. has relied on a multilateral aid effort (unlike earlier aid to Israel and Egypt) Washington has had less control on how aid is tied to the political process – a problem that has become most salient in recent months, with the U.S., Europe and key Arab donors in deep disagreement on how to reform Palestinian politics and put the peace process back on track.

The first section of this paper traces the role of aid in the Middle East peace process, with emphasis on Israeli-Palestinian negotiations since Oslo. The next section focuses on “lessons learned.” In the conclusion, findings are summarized and policy prescriptions are suggested.

THE ROLE OF AID BEFORE OSLO:

The origins of aid and the Middle East peace process

Beginning in the early 1970’s, the U.S. held out the promise of foreign aid to advance the peace process. Nixon and Kissinger (and later Ford) were the first to use large-scale incentives. Positive economic inducements were essential to progress, particularly with Israel. During

negotiations over the Israeli-Egyptian Interim Agreement (Sinai II), “American compensation...led Rabin to modify his position,” argues Ben-Zvi. “(Israel) was induced to sign an agreement in which the mediator rather than the opponent offered the necessary compensation for Israel’s territorial concessions to Egypt.”⁴ In other words, it was a security exchange. Israel accepted U.S. security goods in place of Egyptian ones. However, the Nixon-Kissinger strategy did not always work. In the same period, large-scale promises of U.S. aid to Syria and Jordan were not sufficient to achieve peace settlements.⁵

During the Camp David period, Jimmy Carter reluctantly turned to aid to cement Israeli-Egyptian peace. “Any aid-loan program if agreed must be predicated on Israeli compliance with Camp David agreements,” Carter told top aides in late 1978, during a contentious period in the treaty talks.⁶ When the Israel-Egypt peace treaty was signed in March 1979, the U.S. promised Israel \$3 billion to facilitate its withdrawal from Sinai, and Egypt was to receive \$1.5 billion over three years.⁷ When the dust settled and the ink dried, the totals were even higher. By the mid-1980s, Israel and Egypt had quickly become America’s largest aid recipients, with annual outlays of approximately \$3 billion and \$2.1 billion respectively. There is no doubt that aid has been a prominent part of America’s success brokering and sustaining Israeli-Egyptian peace.

Foreign aid after the Gulf War

At the end of the 1991 Gulf War, the U.S. turned its attention to Arab-Israeli peacemaking, believing there was a window of opportunity to use the political capital generated by the victory over Iraq. But unlike earlier American efforts, the Bush Administration did not believe new aid commitments would be needed. However, economic inducements did enter the process because Israel injected them. Prime Minister Shamir's request for \$10 billion in U.S. loan guarantees quickly added a new dimension to U.S. diplomacy and sparked a political showdown between his government and the Bush administration.

⁴Abraham Ben-Zvi, “Paradigm Lost? The Limits of the American-Israeli Special Relationship,” *Israel Affairs* 4 (Winter 1997): 5.

⁵ See forthcoming article by author, “Paying for Peace: How Nixon and Kissinger transformed America’s role in the Middle East.”

⁶ William Quandt, *Camp David: Peacemaking and Politics* (Washington: Brookings Institution Press, 1986), 280.

⁷ *Ibid.*, 313-314.

In the midst of the U.S. initiative to convene an international conference, Israel said it would soon ask the United States for a five-year \$10 billion loan guarantee to help absorb immigrants from the U.S.S.R, Eastern Europe and Ethiopia.⁸ Israel expected the loan guarantees would be approved. "It was a humanitarian issue, one that the United States had supported for many years," says Shamir.⁹

In light of Shamir's pro-settlement policy, Palestinians and many Arab governments viewed the loan guarantees as a test of America's credibility as mediator. In addition to Arab opposition, the Bush administration had its own problems with the request. There was residual ill-will following Israel's refusal to verify whether a \$400 million loan guarantee granted the previous October was used for settlement expansion. "Getting people into settlements was not a humanitarian issue," said a former Bush advisor.¹⁰

Shamir and the Israel lobby mounted a public campaign, but Bush wouldn't budge. The White House won Congressional backing to delay the aid request until after the peace conference. Israel and its Arab neighbors attended the October Madrid conference. By February 1992, the aid issue was again front and center. Testifying before Congress, Secretary Baker laid out a number of conditions, including a demand that Israel freeze settlement expansion in the West Bank and Gaza as a precondition to receiving the loans.¹¹

As Israelis went to the polls in June 1992, the loan request was still in limbo. In Israel, Shamir faced a growing wave of public criticism over the loan dispute and the ensuing chill in relations with the United States. Many argued that Israel did not even need these loan guarantees. Shamir and his Likud-led government lost decisively to Yitzhak Rabin and the Labor party. Arens

⁸ . "Loan guarantees" meant that the U.S. would in effect co-sign on commercial loans sought by the Israeli government. In such situations, Congress mandates that a certain percentage of the loan amount be set aside to support the guarantees in case of default. These "set-asides" represent the only direct cost to the U.S.. Israel desperately wanted the guarantees because it could then secure commercial loans at a much lower interest rate.

⁹ Yitzhak Shamir, former Israeli prime minister, interview by author, June 16, 1999, Tel Aviv.

¹⁰ Former NSC official under George H.W. Bush, interview by author, November 11, 1999, Washington; see also William Quandt, *Peace Process* (Washington: Brookings Institution Press, 1993), p. 400

¹¹ Melman and Raviv, p. 441; See also Baker ch. 29.

argues that the Bush administration conspired to bring about Shamir's defeat. He places most of the blame for the Likud's loss on the loan guarantees "fiasco."¹²

Once Rabin entered office, it was not long before the loan dispute was resolved. During the election, Rabin pledged to end Shamir's settlement policy and reformulate national priorities. Bush and Rabin met in Maine on August 10-11, 1992, and reached agreement on the loans. On 5 October, Congress approved the \$10 billion loan package, with Israel covering the "reserve costs" of \$400 million.¹³

Following the Madrid conference, the parties broke into separate bilateral and multilateral negotiations. More than ten rounds of bilateral talks took place in Washington between Israel and three sets of interlocutors: Syria, Lebanon, and a joint Palestinian-Jordanian delegation. None of the negotiations made any serious progress. Parallel to the Washington talks, five multilateral working groups brought together Israel, its Arab neighbors (minus Syria), and a number of other Middle East and European countries plus the United States and Japan. These talks focused on water, refugees, economic development, arms control and the environment. Grandiose proposals were presented and the talks generated intense media interest but no substantive progress was achieved. Multilateral talks on economic development represented the clearest attempt to inject economic inducements into the larger process of regional normalization, but few concrete measures were implemented.

The Israeli elections in 1992 effectively froze the talks and the subsequent change of government provided another delay. Real progress would not be reached until Israelis and Palestinians opened a secret channel in Norway in 1993 where they stitched together a framework peace agreement without U.S. involvement. While aid had little to do with the origins of the Oslo track,

¹² Arens, p. 281, 298. While Shamir does not comment in his memoirs on whether the guarantees affected the 1992 Israeli elections, and he refused to discuss the issue in an interview with the author, he is eager to make the case that Bush's handling of the issue influenced the 1992 U.S. elections by severely damaging Bush's prospects for reelection. See Shamir interview.

¹³ Quandt, p. 407-408; Melman and Raviv, p. 441. In the end, Bush and Baker did not obtain a full Israeli settlement freeze. Rabin wanted construction projects that were already well underway to be completed. The U.S. and Israel devised a formula whereby Washington would deduct the amount Israel spent in the territories each year from the total amount of the loans. This arrangement was strictly implemented over the course of the loans. For example, \$437 million was deducted in 1994.

both sides expected inducements would be a critical tool to implement their secretly negotiated peace accord.

OSLO AND THE DONOR EFFORT

The early Oslo talks hardly focused on economic issues, much less the issue of foreign aid.¹⁴ Nevertheless, economic issues were not forgotten. Both sides acknowledged early on that large-scale international aid would be required to implement any agreement. Israel and the Palestinians expected the United States and other wealthy countries would contribute to an aid effort to provide peace dividends and much needed economic development to Palestinians. U.S. aid to Israel and Egypt in the late 1970s and 1980s was seen as a precedent.¹⁵ According to Foreign Minister Peres, “the aid itself didn't radically change how the Palestinians negotiated, but we both knew it would be crucial to the implementation of the agreement.”¹⁶

Israel believed that gaining popular Palestinian support for the peace process depended on Palestinian economic development. In addition, Israeli-Palestinian economic cooperation would be critical to building common interests and conciliation.¹⁷ The Palestinians knew a viable Palestinian economy would be crucial for the success of any agreement but tended to ignore economic issues during the negotiations. Throughout the final months of the secret Oslo talks, both sides understood that “someone will have to pay” for making an agreement work but were content to leave the details for later.¹⁸ In August, once it seemed certain a framework accord would be reached, Peres began to sound out European leaders on contributing aid to the Palestinians. On August 28, Peres traveled to California to brief Secretary of State Warren Christopher on the progress reached in Oslo and to discuss the need to gather economic support.¹⁹

¹⁴ See Uri Savir, *The Process* (New York: Random House, 1988); Mahmoud Abbas, *Through Secret Channels* (Reading, UK: Garnet Publishing, 1995); David Makovsky, *Making Peace with the PLO* (Boulder: Westview, 1996).

¹⁵ Shimon Peres, former Israeli prime minister, former and current foreign minister, interview by author, June 27, 1999, Tel Aviv. Uri Savir, former Director General of Israeli foreign ministry, interview by author, October 18, 1998, Tel Aviv. Shlomo Gur, former senior Israeli foreign ministry official (1992-96), interviews by author, September 28, 1998 and July 9, 1999, Jerusalem.

¹⁶ Peres interview.

¹⁷ See Shimon Peres, *The New Middle East* (New York: H. Holt, 1993) and Savir, p. 56.

¹⁸ Gur interview

¹⁹ Christopher, p. 80; Savir interview.

On September 13, 1993, on the White House lawn, Israel and the PLO signed the Declaration of Principles on Interim Self-Government Arrangements (DOP). The agreement, which focused first and foremost on political and security arrangements, also contained substantial provisions on economic matters. Annex III covers bilateral economic cooperation and calls for joint efforts in the fields of water, energy, finance, transport, communications, trade and industry--though only in general and ambiguous terms. The annex also calls for promoting international investment and forming a Palestinian Development Bank.²⁰ Annex IV discusses regional cooperation and implicitly calls for major international aid efforts to help the Palestinians, Jordan, Israel and the entire region. The parties asked the G-7 to initiate "A Development Program for the region, including the West Bank and the Gaza Strip."²¹

Before the signing ceremony, Clinton met with Arafat and the Palestinian delegation and "spoke in very clear terms about America's commitment to provide economic support."²² After the signing ceremony, Peres told Palestinian officials that he had already secured commitments from European countries to give them aid. The goal, Peres explained, is to "strengthen you economically."²³ That same day, Christopher told Palestinian officials the United States would contribute to the aid effort to "make the [Palestinian] people feel the benefit of the accord."²⁴ "The Palestinians expected several dividends of peace," says senior negotiator Nabil Shaat, "including freedom, security and economic prosperity... [the aid component] was critical to this process."²⁵

²⁰ "Declaration of Principles on Interim Self-Government Arrangements," signed by Israel and the PLO, September 13 1993, Washington. Found in Walter Laqueur and Barry Rubin (eds.), *The Israel-Arab Reader*, (New York: Penguin, 1995), p. 607-08.

²¹ *Ibid*, p. 608-609. The annex called for the establishment of a regional development bank, an effort that limped forward for five years before finally being abandoned in 1998. Aside from the aid to the Palestinians, which quickly materialized, most other economic provisions of the DOP remain dreams rather than reality.

²² Abbas, p. 213.

²³ Savir, p. 80, Abbas, p. 213. Peres had already begun to sound out governments in Scandinavia and western Europe in August after the draft Oslo agreement was signed in secret. Peres approached European governments before the U.S., knowing it would be easier for them to support the PLO. A day after initialing the Oslo draft, Peres met with the five Scandinavian foreign ministers in Stockholm. See also Peres and Savir interviews.

²⁴ Abbas, p. 8, 214.

²⁵ Nabil Shaat, senior Palestinian negotiator and Minister for Planning and International Cooperation, Palestinian National Authority, interview by author, January 31, 1999, Davos, Switzerland.

Though the United States was left out of the original Oslo track, the parties moved quickly to bring Washington into the heart of the process. Unlike previous agreements, Israel did not seek economic assistance for itself, instead choosing to help raise funds for the Palestinians. Israel did ask for U.S. permission to divert some of its annual aid toward West Bank and Gaza military redeployment costs, but these were small amounts. For its part, Israel expected to seek major new aid packages only in the context of a final status peace agreement, when border, settlement and security arrangements would require significant implementation costs for Israel.²⁶

Two weeks after the signing, the United States organized a donors conference for the Palestinians. According to Christopher, the meeting was to mobilize "the resources needed to make the agreement work."²⁷ More than \$2 billion was pledged over five years, mainly by the United States, the European Union, Japan, Norway and Saudi Arabia. (At later meetings, pledges rose to about \$3.6 billion.)²⁸ Although the United States was the single largest donor, pledging \$500 million, Europe as a whole represented the largest portion of the total aid effort.²⁹ (see appendix – aid charts) "International assistance," according to one U.S. official, was intended to "build a peace constituency (among the Palestinians)."³⁰

In the subsequent talks that produced the Gaza-Jericho Agreement (May 1994), the early empowerment agreement (August 1994), the Interim Agreement (September 1995), and the Hebron Accord (January 1997), economic aid was not an important part of negotiating "moments" or decision points.³¹ Still, the donor process was an ever-present element and the

²⁶ Gur interview; Savir interview. Israel's eventual requests did come. Beginning in late 1999 and up to the Camp David summit in July 2000, Israel asked the U.S. for a huge financial and military package – which translated into Clinton's \$35 billion promise during the summit.

²⁷ Warren Christopher, *In the Stream of History* (Stanford: Stanford University Press, 1998), p. 84.

²⁸ See Palestinian Authority, Ministry of Planning and International Cooperation (MOPIC), "MOPIC's 2000 First Quarterly Monitoring Report," May 2000, Ramallah.

²⁹ In addition to the Oslo related aid, the U.S. also contributes about \$75 million annually to Palestinian refugees through UNRWA.

³⁰ Interview with Clinton peace team official. Of the initial \$500 million U.S. pledge, \$375 million was disbursed between 1994-98.

³¹ Savir interview. During talks on the Interim agreement (also known as "Oslo II" - signed in September 1995), the U.S. tried to bring closure by pointing to the Congressional budget calendar. The White House encouraged both sides to conclude an agreement before October 1, when the new fiscal year began, saying it could improve the prospects for Congressional approval of aid to the Palestinians. There was one other incident where aid entered the negotiating process. In the final stages of negotiations over the Hebron accord (January 1997), the U.S. offered to finance a number of infrastructure improvements in the city. The overall amount of aid was small (several million dollars), and the impact on the negotiations was marginal. The aid did provide some political cover for the

Palestinians were constantly striving for faster and less-conditional disbursements. Aid was used to set up the PA, the body that would govern Palestinians during the interim period. Early on, aid was not expected to be the only instrument for Palestinian economic revival. The Palestinians, Israel, and the donor community expected private sector investment would pour into the territories.³² Initially, a good deal of interest was expressed, particularly in the tourism field. But it was not long before the investment climate turned sour.

In addition to direct aid and investment, the United States and other donors developed a regional economic program, as called for in the DOP. In October 1994, a major regional business conference was held in Casablanca, Morocco, the first of four annual meetings. Also, the multilateral peace talks were renewed and the Regional Economic Development Working Group (REDWG) was revived. The United States was involved in a number of other economic initiatives, including efforts to create a Middle East Development Bank and a regional tourism board.³³ While heavy with hype, most of these regional initiatives did not go beyond the planning stages. The regional track came to a complete halt when Arab states refused to participate as a protest against Prime Minister Netanyahu's policies.

As for the multilateral aid to the Palestinians, the effort was slow to begin functioning. Aid disbursement was seriously hampered by "intra-PLO politics, the Palestinian leadership's resistance to donors' standards of accountability, and inexperienced [Palestinian] middle management," according to one U.S. official.³⁴ In addition, the multilateral nature of the donor effort slowed the process. Also, Clinton faced domestic political hurdles in fulfilling his Palestinian aid pledges.³⁵ After the Palestinians assumed control in Gaza and Jericho in May

Palestinians, and was meant to improve living conditions in the strife-torn city. These two instances were exceptions that prove the rule.

³² Joan Spero, former Undersecretary of State for Economic, Business and Agricultural Affairs, interview by author, November 5, 1999, New York.

³³ See Patrick Clawson and Zoe Godal, *Dollars and Diplomacy* (Washington: Washington Institute for Near East Studies, 1999), p. 75-98. The regional development bank came closest to becoming a reality, but the effort was completely abandoned in late 1998, see *New York Times*, November 30, 1998.

³⁴ Joan Spero, U.S. Undersecretary of State for Economic Affairs, speech at Columbia University, April 3, 1995.

³⁵ See Blumenthal in *New Yorker* and Lasensky in *MERIA*, esp. references to the Middle East Peace Facilitation Act (MEPFA). Obstructionists (mainly anti-Oslo American Jews and Israeli, together with their supporters in Congress) sought to curtail US aid to the Palestinians through a variety of reporting and other legislative measures. While these forces had limited success influencing the timing and programmatic focus of U.S. aid (i.e. none went directly to the PA), Clinton was always able to get the overall level of funding he requested.

1994, Arafat and his aides were quick to complain that the donor effort was too slow. In response, donors created the World Bank-administered "Holst Fund" to pay recurrent and start-up costs.

By the end of 1994, disbursement began to pick up, with 66 percent of donor pledges (\$523 million of \$789 million) going to projects. Implementation slowly improved from 1995-1997, with disbursement levels reaching 70-75 percent of commitments.³⁶ Despite delays, corruption and organizational problems, the aid effort was massive, going well beyond many other post-conflict U.S. aid efforts. In 1997 alone, per capita aid to the Palestinians was \$203, roughly 15 percent of the PA's GNP, an extraordinary figure.³⁷ Palestinians soon became the highest per-capita recipients of development aid.

Though concerned about quick disbursement and the potential political impact of aid, the United States and other donors were equally concerned about transparency and accountability. The donor community generally insisted on strict accounting and disclosure standards in an effort to get the PA to follow internationally accepted norms of transparency and oversight. From the start, Arafat resisted such donor demands. He expected to receive the aid promptly, directly, and without strings attached. Arafat wanted "walking-around money," says one U.S. official, to use PA and PLO political programs.³⁸

"Arafat...had great difficulty acceding to the donors' demands for transparency and accountability, concepts that were alien to him," says Savir. "He treated the foreign aid as compensation that was naturally due to his people for suffering so valiantly throughout their history, particularly under Israeli occupation."³⁹ Palestinian demands for quicker disbursement were also fueled by a deteriorating economic situation in the territories. Beginning in 1994, Israel responded to a wave of Palestinian suicide bombings by sporadically closing the territories and preventing Palestinian laborers from entering Israel. The closures also created severe obstacles for outside investment. With the security situation in a downward spiral, the PA's own growing

³⁶ Rex Brynen, Hisham Awartani and Clare Woodcraft, *Donor Assistance in Palestine* (Draft, Montreal: April, 1998), p. 49; MOPIC 2000 report.

³⁷ See Clawson and Gedal, p.23.

³⁸ Spero interview.

pains, little foreign investment, a cumbersome, multilateral aid process, and the long Israeli closures, it was not long before the Palestinian economy took a nose-dive. Palestinian per capita GNP fell every year from 1993 to 1997, and the number of Palestinians working in Israel (a major source of income) fell by 60 to 80 percent.⁴⁰

ROAD TO WYE

The Wye River Memorandum (October 23, 1998) marked a clear transformation of America's role in the peace process. Historically, the United States served as facilitator and mediator using political support, security guarantees and economic aid (both positive and negative) to help implement peace agreements and create an atmosphere conducive to further progress. However, with the Wye accords the United States assumed the role of referee and arbitrator. It was a move from co-sponsor to co-participant. With the new U.S. political role came a greater reliance on foreign aid. For the first time since Madrid, the U.S. used aid to sign, seal and implement a peace accord.

Early in Netanyahu's tenure, there were signs of strains in the U.S.-Israel relationship. Netanyahu did not rush to carry out the planned Israeli redeployment in the West Bank city of Hebron. The Clinton Administration began intensive mediation following the October 1996 "tunnel" riots when it seemed the entire fabric of Oslo could fall apart. An agreement was reached in January 1997, partly due to an eleventh hour U.S. aid commitment for municipal improvements in Hebron. However, in March 1997, Israeli-Palestinian talks were suspended after Israel announced it would begin housing construction at Har Homa, near Jerusalem. Tension continued to grow between the Administration and the Netanyahu government, with President Clinton publicly criticizing Israeli settlement activity on more than one occasion.⁴¹ But despite the tension, Clinton never used aid as a weapon to block settlements, though such a strategy may have had a major impact on Israeli political discourse (but at a high political price for Clinton).

³⁹ Savir, p. 146.

⁴⁰ Brynen, p. 21, 67. The Palestinian economy did pick up in 1999, but nose-dived again following the outbreak of the second Intifada.

⁴¹ See Scott Lasensky, "Israel Must Heal its Strained U.S. Ties" *Boston Sunday Globe*, March 20, 1997. In December 1996, Clinton called Israeli settlement expansion an "obstacle to peace," and in March 1997, said Israeli plans to build Jewish housing in east Jerusalem created "mistrust."

By early 1998, U.S.-Israel relations had reached one of their lowest points since the 1991-92 loan guarantees dispute.

The Palestinians, convinced Netanyahu would not negotiate unless pressured by the U.S., increasingly sought a more active American role. The U.S. put forward a bridging proposal that called for a 13 percent Israeli pullback in the West Bank. Netanyahu, still hoping to avoid saying “yes,” seized on the possibility of additional U.S. aid to gain political cover at home should he accept the 13 percent figure. In May, he asked for \$1.2 billion in additional aid to cover the costs of a further redeployment.⁴² Toward the end of the summer, Netanyahu signaled he would agree to the 13 percent figure and was hoping to use the \$1.2 billion to placate right wing members of his government. One U.S. official in Israel called the request “dead in the water.”⁴³ However, once the United States brought both sides to the Wye Plantation in October, the aid request suddenly sprung back to life.

To gain final Israeli acceptance of the 13 percent formula, and Palestinian agreement to additional Israeli security and political demands, the United States relied on a number of positive political and economic assurances. The political assurances centered on a commitment to monitor and verify each side's compliance with the accords, including Palestinian security measures against terrorism.⁴⁴ Clinton also said he would visit the region to oversee implementation of the Wye accord. The visit, in December 1998, included a historic stop in Gaza and an address to the Palestinian Legislative Council.

At Wye, Netanyahu's \$1 billion May request was “resurrected.”⁴⁵ Netanyahu reportedly saw a chance to gain further benefits and tried to increase the figure to \$2.3 billion and obtain a new U.S.-Israel Memorandum of Understanding (MOU) on security matters. In the end, he settled for a promise of \$1.2 billion in additional military aid that was conditioned on implementation of the

⁴² *Washington Post*, May 23, 1998.

⁴³ Crowley interview.

⁴⁴ See text of Wye River Memorandum. The CIA was charged with implementing the verification commitments.

⁴⁵ Interview with Clinton peace team official.

accord.⁴⁶ Netanyahu wanted the money to pacify a growing number of elements in his coalition who opposed a deal.

For Palestinians, Clinton promised to increase economic aid and quickly reconvene the donor countries to formulate the second five-year aid program. (Planning for a second major donors conference had been on hold for months awaiting progress on the political track.) Arafat sought to justify the Wye deal by pointing to the new aid and improving ties with the United States.⁴⁷ A month after Wye, Clinton convened the donor group and over \$2 billion was pledged to the PA for 1999-2003. The U.S. commitment rose 80 percent to \$900 million over five years.⁴⁸ There were even financial rewards for Jordan, in recognition of King Hussein's last minute mediation at Wye.

The new U.S. aid commitments were conditioned on Israeli and Palestinian compliance with the provisions of Wye. Disbursement would be delayed to maintain leverage and ensure compliance. It would also be parceled out over several years as another form of conditionality. In addition, Clinton told Netanyahu at Wye that the money could not be used in the territories.⁴⁹ The ink was hardly dry before Israel began to push for quick disbursement of its share of the new aid. But the United States refused, saying Israel must first implement the Wye agreement. During his December visit to Israel, Clinton's meetings with Netanyahu revealed continuing strains in U.S.-Israel relations. In contrast, Clinton's visit to the West Bank and Gaza was a major symbolic victory for Arafat and the PA.

By January, after Netanyahu said he was freezing implementation of Wye, the Administration told Congress Israel's special aid package should be withheld. However, the White House said Palestinian aid should be expedited since the PA was fulfilling its obligations.⁵⁰ But politics would again intrude. The process was put on hold as Israel went into an election cycle. By

⁴⁶ *Ha'aretz*, March 5, 1999; interview with Clinton peace team official.

⁴⁷ *Ha'aretz*, December 4, 1998.

⁴⁸ See The White House, "Remarks by the President at Conference to Support Middle East Peace and Development," November 30, 1998.

⁴⁹ *Ha'aretz*, January 4, 1999.

⁵⁰ *Ha'aretz*, January 4, 1999; November 22, 1998.

summer 1999, Netanyahu was out of office. His successor, Ehud Barak, was committed to pursue a negotiated settlement.

By fall, the Administration began to lobby hard for the \$1.9 billion Wye supplemental appropriation. After a brief confrontation over the FY2000 foreign aid bill--which led to a temporary hold on the Wye request--Congress approved the new aid package in its entirety in mid-November.⁵¹ Some members of Congress were irked by what they saw as "Clinton's commitment, rather than an American commitment." But in the end, despite Republican grumblings, the new aid was approved.⁵²

CAMP DAVID AND BEYOND

After putting the Israeli-Palestinian process back on track with the Sharm el Sheikh agreement (September 1999) the U.S. – encouraged by Barak – turned its attention to the Israeli-Syrian track. In late 1999 and early 2000, Clinton focused intensively on brokering a deal, first at the Shepherdstown summit and later in bilateral meetings with Barak and Syrian President Assad. The story of these failed negotiations is better told elsewhere, but important for this analysis are the U.S.-Israeli discussions at the time about a package of political, security and economic inducements for Israel should a peace treaty be concluded.

Barak reportedly asked Clinton for a mutual defense treaty, U.S. peacekeepers on the Golan Heights, and billions of dollars in economic and military aid.⁵³ Barak's strategy resembled the earlier approach of Rabin and Begin in which Israel would accept certain inducements and guarantees from the U.S. in lieu of those it could not obtain from its adversary. For Barak, it was

⁵¹ *Jerusalem Post*, December 3, 1999. The package consisted of \$1.2 billion in foreign military financing (FMF) for Israel, \$400 million in economic support funds (ESF) for the Palestinians, and \$300 million in FMF and ESF for Jordan. See Martin Indyk, Assistant Secretary of State for Near East Affairs, Congressional testimony on the Middle East peace process, March 25, 1999. www.state.gov.

⁵² Quote from AIPAC interview. The AIPAC official said several legislators used the referenced description of the aid package (i.e. "Clinton's commitment").

⁵³ See *The New York Times*, "Clinton Breaks Impasse at the Israel-Syria Talks," 5 January 2000. During the course of the January talks, there was intense speculation about the size of a future U.S. aid package. Estimates ranged from \$17 billion to as high as \$70 billion. See Ze'ev Schiff, "Full asking price for peace aid: \$65 billion," *Ha'aretz*, 7 January 2000.

a security exchange. The U.S. also reportedly promised aid to Syria, though Clinton expected any such aid to come primarily from international donors. Reports about promises of aid and peacekeepers raised eyebrows inside the Beltway, but the Washington debate ended abruptly when the talks collapsed in the spring.

Barak (and Clinton) quickly shifted attention to the Palestinian track. Following secret Israeli-Palestinian talks in Stockholm in May, the U.S. – again, encouraged by Barak -- began to plan for a summit. In mid-July, Clinton brought Barak and Arafat to Camp David with the aim of reaching a final status agreement. For the first time, Israel and the Palestinians held serious, far-reaching discussions about all final status issues, including Jerusalem and refugees. Clinton, eager to close a deal, promised a large U.S. and international aid package to cement an agreement.

Although scattered details of the aid package have filtered out through various media reports, the most accurate account comes from Bruce Riedel, Clinton's long-time national security assistant for the Middle East. According to Riedel, Israel's requests from the failed Syrian track, including a mutual defense treaty, were resurrected. "Equally important to the proposed ... U.S.-Israeli defense partnership," says Riedel, "Barak also asked for an enormous new U.S. financial package to help buttress the chances an Israeli-Palestinian peace agreement would endure."⁵⁴

The U.S. agreed to a \$35 billion package, some of which would come from other donors. About \$10 billion would go to compensate Palestinian refugees, another \$10 billion toward Israeli-Palestinian-Jordanian water desalination projects, and an additional \$15 billion would go to Israel – for upgrading the IDF, deploying out of the territories, and moving settlers.⁵⁵ "It is fair to say there was also a fair degree of sticker shock at the size of the package," says Riedel, "some aides wondered whether the Congress would balk at a request of this magnitude."⁵⁶ "Chairman Arafat made only one request from the President," says Riedel, "(that) American military

⁵⁴ Bruce Riedel, "Camp David—The U.S.-Israeli Bargain." *Bitterlemons.org*. 15 July, 2002.

⁵⁵ *Ibid.* Riedel said the U.S. team knew the refugee aid figure was low, but considered it an opening bid.

⁵⁶ *Ibid.*

personnel would form the core of a peacekeeping force to be deployed in the Jordan Valley to replace the IDF deployment there.”⁵⁷

But at the end of the day there was no agreement to be had. An Israeli-Palestinian permanent status accord could not be “bought.” While significant progress was reached at the summit (and during months of frantic diplomacy afterward), an Israeli-Palestinian agreement did not materialize. Clinton’s unprecedented offers of American aid were important for Barak, but were insufficient to convince Arafat and the Palestinian leadership to accept a peace deal, even a framework one.⁵⁸

AFTERWORD – GEORGE W. BUSH

George W. Bush entered office with the second intifada raging and the last threads of the Oslo process unraveling. Initially, the Administration was reluctant to engage deeply in Israeli-Palestinian matters. U.S. aid to the Palestinians, averaging \$75-\$100 million annually, continued to flow – despite increasing opposition from Congress. With the intifada decimating the Palestinian economy, and Israel freezing Palestinian tax revenue, European and Arab donors stepped in to cover most of the PA’s monthly operating expenses.

When fighting escalated in April 2002, Israeli military strikes caused hundreds of millions of dollars in damage to Palestinian institutions. Somewhat ironically, Israel destroyed a great many of the very institutions it had lobbied international donors to underwrite. International donors have met frequently in recent months to pledge emergency aid to the Palestinians, but much has yet to be disbursed aside from the on-going budgetary support.

While initially seeking to restrain Israel, Bush has been generally supportive of Sharon’s military operations – and the White House has resisted international and domestic calls to curtail

⁵⁷ Ibid.

⁵⁸ After Camp David, Arafat and the Palestinian negotiating team were angered by Clinton’s public glorification of Barak (and blame of Arafat). Long-simmering Palestinian frustrations with the U.S. mediating role bubbled to the surface when Palestinian negotiators released a statement attacking Clinton and Dennis Ross just one day after the president left office. See Palestinian negotiating team, statement criticizing U.S. role, released by Palestine Media Center, 22 January 2001.

economic or military aid. But Bush has threatened to cut off aid to the Palestinians. On the heels of his June 24th speech, which called for a provisional Palestinian state if far-reaching reforms are undertaken, Bush said “I can assure you, we won't be putting money into a society which is not transparent and (is) corrupt, and I suspect other countries won't either.”⁵⁹

While European and Arab states have declared support for the reforms Bush outlined, they have balked at the U.S. call to oust Arafat. In fact, a number of senior European officials rushed to meet with Arafat after the president's speech – and European donors have not announced any quid pro quos vis-à-vis aid and reform. With the U.S. share of Palestinian aid still relatively modest (and no U.S. aid going directly to the PA), it's unclear where the Administration plans to apply leverage – and it remains to be seen whether Bush follows up on his threat to stop aid.

AID AND THE OSLO PROCESS: LESSONS LEARNED

Baldwin (1985), Cortright (1997), Sigal (1998), Shambaugh and Davidson (1999), Drezner (1999) and Haass and O'Sullivan (2001) argue that positive economic inducements can serve critical American national security goals like managing regional conflicts. But even proponents acknowledge the utility of aid-based and inducement-based strategies is limited, particularly when security goods are at stake. Among tough security cases, the Israeli-Palestinian conflict presents an especially rigorous test for any tool of statecraft. By definition, foreign aid for political purposes rests on voluntary compliance, it is not a tool to compel.

Aid is more suited to implementing agreements and managing long-term bargaining relationships. The Oslo years provide a good example. Aid can positively influence the cost-benefit analysis that determines target state strategies, but only if leaders are committed to a negotiated settlement.⁶⁰ Aid can provide reassurance and risk management, but only when used in conjunction with other positive inducements, like political and security guarantees. The

⁵⁹ President George W. Bush, June 26, 2002, cited from *Associated Press*.

⁶⁰ See Princen, 27.

overall record of American peacemaking efforts in the Middle East demonstrates that economic carrots work best when bunched together with other positive inducements.⁶¹

Integrated positive inducements provide reassurance and risk management to targets facing acute threats and insecurities. Inducements do not alter threat perceptions, but they can positively affect the security strategies states select. Like economic sanctions, inducements also have "expressive" value, in that they may be used to send a message as much as to influence an immediate policy concern.

Therefore, considering what we know about aid, what can we learn from the Oslo years?

"U.S. aid was instrumental in achieving accords between Israel and the PLO in 1993," argues Hook in a study of U.S. foreign aid.⁶² Such a conclusion is off the mark. During the secret negotiations in Norway, economic issues were important but secondary. In addition, the traditional provider of economic and military aid, the U.S., was not involved in the talks. Still, foreign aid was critical for consummating and implementing Israeli-Palestinian interim agreements. Aid helped underwrite the practical costs of Palestinian self-rule and provided the Palestinian leadership with the means to cultivate domestic support.

Aid was not used to compel or pressure the parties to sign the Oslo accords but was part of each side's pay-off expectations. "Agreements weren't signed because of money...but if agreements were expected to work, money was needed more than anything else," says senior Palestinian official Nabil Shaat.⁶³ The Oslo process began without an American commitment to provide economic incentives, but it could not have continued without aid. Still, in the end, all the aid in the world (or at least Clinton's promise of \$35 billion) could not save the process.

⁶¹ See Liska, p. 234, he calls for a more "coherent" use of foreign aid that is fully integrated with political and military policies. Bunching carrots together into integrated inducement packages demonstrates what Nye calls "soft power." According to Nye, soft power is used to attract states, while "hard power" (like deterrence or the use of force) is used to compel. See Joseph Nye, *Bound to Lead*, New York: Basic Books, 1990.

⁶² Stephen Hook, *Foreign Aid Toward the Millennium*. Boulder: Lynne Rienner, 1996, p. 66.

⁶³ Shaat interview.

The U.S. shares some blame for the failure at Camp David and afterward. As argued earlier, integrated strategies are critical to aid efficacy. Purely economic transactions make it easier for the recipient to defect or extort. Integrated strategies not only engage, but also entangle. The first Camp David negotiations are illustrative. Rather than “the best peace money could buy,” the Israeli-Egyptian peace treaty represented a formula for entangling both Israel and Egypt in a web of mutually beneficial security, political and economic relationships that ran through Washington. By bunching carrots together, the Carter administration sweetened the bitter pill of concessions Begin and Sadat were forced to swallow.

During the Oslo years, the Palestinians were not fully entangled with Washington. While much is made of Clinton’s visit to Gaza, Arafat’s many White House visits, and close CIA-PA security cooperation, the relationship was thin – so thin that Clinton was willing to cast it aside in the aftermath of Camp David when he blamed Arafat and the Palestinian leadership. The Palestinians, unlike Egypt, had not defected to America’s side as part of a bipolar global conflict. Also, unlike the Israeli-Egyptian process, the U.S. did not “deliver” Israel, especially when it came to settlements and territory.⁶⁴

Considering the close U.S.-Israeli coordination before Camp David, and America’s adoption of many Israeli positions, it seems Barak is the one who delivered Clinton. In theory, partiality does not preclude effective third-party mediation, assuming the mediator is prepared to use its influence. As Zartman and Touval argue, “closeness to one party implies the possibility of ‘delivering’ it, thereby stimulating the other party’s cooperation.... (therefore) mediators can allow themselves some latitude in their degree of partiality.”⁶⁵ Not only could the U.S. have benefited from a more broadly-based inducement strategy with the Palestinians, but tougher action against policies that eroded confidence (including Israeli settlement policy) would also have helped.

The domestic side of aid:

⁶⁴ Wye is the exception that proves the rule.

⁶⁵ Zartman and Touval in Crocker, Hampson eds. 1996, p. 451.

Foreign aid works at both the international and the domestic level. Aid can play a positive role within the recipient's society. It provides decision makers with domestic cover and helps to build public support for compromises and conciliation. Economic inducements help recipient policymakers build their own domestic support system for compliance decisions. Economic incentives also give certain segments of society a valuable stake in cooperative policies. In Palestinian society, the most obvious example has been the large cadre of PA and PLO functionaries, especially thousands of security service personnel. Such constituencies can reinforce the compliance decisions of policymakers. This is particularly important in long-term, step-by-step processes.

Sanctions also affect target constituencies, but in the opposite way. Sanctions typically hurt those groups in society predisposed to cooperative behavior. For example, aid helped buy the loyalty of Palestinian security personnel, who took great risks for several years (1997-1999) in confronting armed rejectionist groups.⁶⁶ On the flipside, Bush's current threat to stop aid to the Palestinians could potentially hurt the very constituencies the U.S. will need in order to control violence and return to negotiations.

In what was expected to be drawn-out, step-by-step negotiations, economic aid was intended to maintain momentum and build a peace constituency among Palestinians. Unfortunately, the process did not unfold as policymakers expected. After 1993, the Palestinian economy contracted. Popular Palestinian expectations were shattered.⁶⁷ Rather than drive economic growth and build constituencies for peace, aid "quickly became life support, not development aid."⁶⁸ The U.S. (and other donors) should be more modest about the transformative effects of aid, particularly when one side (Israel) asks third-parties to accept the burden of providing a peace dividend without relinquishing overall control. Israel's ultimate veto over action on the ground – whether merited or not – damaged prospects for aid effectiveness.

⁶⁶ Admittedly, there is much debate about the when and whether the PA "cracked down." Also, any analysis is complicated by the fact that after September 2000 PA security forces were no longer acting under Arafat's sole authority and used violence against Israelis.

⁶⁷ Waleed Siam interview; See also Adel Zagher and Manal Jamal. *Foreign Aid and Development in Palestine: Phase 1-3 Reports* (Jerusalem: The Jerusalem Media and Communication Center, 1997-98).

⁶⁸ Spero interview.

During the Oslo years, domestic support was gained through direct patronage. Arafat used donor money to provide jobs and public services. In addition, at Wye both Arafat and Netanyahu relied on aid to sell the agreement back home. The U.S. also hoped aid would build popular support for peacemaking. Looking back eight years later, aid clearly helped Arafat build the PA and stay in power. But the question for the U.S. (and other donors) is -- did Arafat ultimately help the cause of reaching a negotiated settlement? Also, in terms of aid delivery, could economic assistance have been better targeted to create greater Palestinian public support for Oslo? Or, given the huge economic challenges and competing social program of rejectionists like Hamas, was the task simply too daunting? At a minimum, we know that numerous policymakers, from Clinton and Ross to Peres and Beilin, now acknowledge that greater attention should have been given to peace-building and people-to-people efforts.

What Bush is attempting vis-à-vis the Palestinians is to hold out the promise of inducements in order to get recipient constituencies to bring pressure to bear on their own government. The U.S. used this technique to encourage Serbians to oust Milosevic. But Serbia had democratic, pro-U.S., pro-Western groups. Similar elements exist in Palestinian society, but are drowned out by more powerful forces (like Hamas) that oppose Arafat and are hostile to the U.S.

Sharing the burden:

During the Oslo years the U.S. increasingly monopolized mediation while relying on multilateral efforts to provide the economic assistance needed to sustain the process. The arrangement was not unique to the Middle East, having also been used with Bosnia (Dayton accords) and North Korea (Agreed Framework). Also, consortium aid efforts in post-conflict settings have become a hallmark of the post-Cold War era, from El Salvador and Cambodia, to Afghanistan and East Timor. But ultimately, the U.S. strategy of relying on other potential mediators only to pay the bills and/or embark on 11th hour diplomatic rescue missions hurt American mediation.

President Clinton, following a model set by his predecessors, promised Israel an expansive set of political, economic and security inducements. But there was no patron to “deliver” the

Palestinians. Furthermore, under present conditions, Bush's insistence on reform and leadership change is hampered by Washington's inability to dictate how other donors spend aid.

The U.S. had limited influence with the Palestinians, and third-parties who did have leverage were not intimately involved in mediation. Also, unlike the Dayton accords or other cases where force was employed, the U.S. could not compel Palestinians to sign a deal. Israel premised its willingness to sign a final status agreement on a security exchange with the U.S., much like the security exchanges in the 1970's that fueled the Israeli-Egyptian peace process. In lieu of security "goods" Israel needed but could not receive from its adversary, alternatives (based on aid and other inducements) would be provided by the U.S.. Whatever Barak needed from the U.S., especially given his shaky domestic situation, he received. This inducement-based strategy is not new to the Arab-Israeli conflict. However, at Camp David and afterward, the Palestinians were not offered anything similar – either by the U.S. or another third-party.⁶⁹

Did we give enough?:

What about the role of conditionality and donors' twin goals of economic growth and good governance? Patrick Clawson and Zoe Gedal argue that the PA should have received more direct aid.⁷⁰ Others also contend donors could have been more generous in funding recurrent costs.⁷¹ However, per capita aid was already very high. It seems unlikely less conditionality and more direct aid to the PA would have turned around an already difficult political atmosphere. Also, conditionality was a response to PA mismanagement. Two years into the second intifada, with increasing evidence of widespread PA corruption, these earlier recommendations seem terribly misplaced.

⁶⁹ One caveat: this analysis is based on the assumption the Palestinian leadership (e.g. Arafat) wanted to reach an agreement along the lines of Clinton's plan – an assumption some believe to be false. Barak himself is the chief proponent of the theory Arafat was never interested in a negotiated settlement. Barak claims he succeeded in "unmasking" Arafat's true face.

⁷⁰ Clawson & Gedal, p. 32.

⁷¹ Ball et. al. in David Cortright (ed.), *The Price of Peace* (Lanham, MD: Rowman & Littlefield, 1997), p. 254-259.

Donor insistence on transparency and accountability had a positive, but limited, affect on PA administrative practices and good governance.⁷² Money is fungible. Although most donor aid was not misused (due to some of the most intrusive monitoring mechanisms ever used in a post-conflict international aid program), the PA had other financial resources at its disposal. Also, donors were (and still are) unwilling to put forward strong quid pro quo's on aid, reform and security cooperation. During the Oslo years, donors did not want to cut off aid so as not to undermine prospects for achieving the ultimate goal – e.g. reaching a final status agreement, a goal that always took precedence over day-to-day failings in security cooperation or governance. Today, donors are unwilling to cut off aid (especially budgetary support) to avert a total collapse of the PA and/or a humanitarian crisis in the territories.

CONCLUSION

Just as corporations need investment banks to go public on Wall Street, peace accords require underwriters. This has been most apparent in the Middle East, where the U.S. has long been the lead underwriter. "Markets" in the region lack the mutual trust, risk assurance and political capital peace agreements require. The U.S. role has been essential, and America's willingness to underwrite negotiated settlements continues to have a real impact on whether agreements are consummated and carried out.

While foreign aid from Washington represents the tangible manifestations of U.S. political and security guarantees, underwriting peace is not the same as buying peace. Inducement strategies are not the same as checkbook diplomacy. America's role is as much about political and security inducements as it is about economic carrots. As with investment banks on Wall Street, underwriting peace is as much about credibility and the intangible benefits of building a positive relationship as it is about the provision of development dollars and/or F-16s.

⁷² Many reports of PA corruption, mismanagement and complicity in terror have been published, including recent material released by the Israeli army (available at www.idf.il) claiming Arafat approved funds for terrorist operations. Of the many reports, two good ones are: PA Public Monitoring Department, "First Annual Report 1996," May 1997; Proceedings of the Ad-Hoc Liaison Committee, June 5, 1997; and "British Aid Used to House Arafat Elite," *London Sunday Times*, November 29, 1998.

But aid cannot drive politics. An inducement-based approach by the U.S. was not able to avert a collapse of the Israeli-Palestinian peace process. Still, such a strategy has helped sustain peace agreements between Israel, Egypt and Jordan. Given the current state of affairs, including the near collapse of the Palestinian Authority, one might say the billion dollars America has spent on the Palestinians since 1994 has been money down a rat hole. As this paper has tried to argue, during most of the Oslo years aid was essential to keeping the peace process alive. Aid appeared to be a worthwhile investment in future peace and security.

However, with the process in shambles it is not unfair to ask whether aid would have been better spent elsewhere. Although it is still too early to draw final judgments, it would not be surprising if the U.S. and other donors hold back on future aid pledges in the months and years ahead until a political path emerges. Also, given the current trajectory of violence and Palestinian institutional collapse, it is no longer wild speculation to talk about an international administrative regime in Palestine not unlike Kosovo or East Timor.

Still, if Palestinians and Israelis are able to muster the necessary political will to reach a cease-fire and agree to restart serious negotiations, then the U.S. will be in a position to use its political, security and (most important) its economic muscle to underwrite a stabilization and disengagement package. New promises of American aid could encourage further Israeli withdrawals from Palestinian areas and underwrite more effective security measures to protect Israelis. Also, once the decision is taken, aid may even help dismantle Israeli settlements and relocate some settlers.

There are also ways to use economic carrots on the Palestinian side. If the Palestinian leadership were to outline a specific plan for a permanent settlement, one that stated unequivocally that Palestinians were not seeking to force Israel to accept the return of refugees, then the U.S. could lead an international effort to help compensate and re-settle Palestinian refugees. Rather than continue a system that perpetuates the tragedy of Palestinian refugees, the U.S. could lead an international effort that provides refugees with a positive alternative. Such an initiative would begin to extract some of the poison that lies at the heart of this conflict, and could even be initiated before the two sides reach a final status agreement.

APPENDIX

- A. Terminology/Typology
- B. Aid charts (excel files)

Terminology/Typology

My independent variable is positive economic inducements, or what can be more generally referred to as “foreign aid.” This term is meant to encompass a wide range of policy measures, but mainly refers to bilateral and multilateral foreign aid, military assistance, loans and investment or export/import guarantees.

TABLE 1
**Positive Economic Inducements / Foreign Aid
 TOOLBOX**

financial/economic	military	trade
grants (ESF) loans & loan guarantees commodity transfer* direct capital investments** investment guarantees	grants (FMF) loans military equipment transfers direct capital investments**	free trade agreements most-favored-nation status import-export credits import-export licenses
commitments thereof	commitments thereof	commitments thereof

* commodity transfer – i.e. U.S. supplying heavy fuel oil and food aid to North Korea

** direct capital investments – i.e. U.S. building airbases for Israel after Camp David

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Foreign aid is designed to change behavior by making cooperation attractive. Economic inducements aim to positively influence a target’s strategy. “Incentive strategies attempt to address and shape the subjective motivations that determine policy preferences,” argues Cortright.⁷³ They seek to produce a voluntary behavior change by the recipient. According to Long, inducements are non-coercive instruments that provide a tangible material benefit.⁷⁴ Obviously, providers face certain costs when a recipient accepts an inducement attempt and elects compliance. In such cases providers face a “burden of response” and must pay up.⁷⁵

U.S. loan guarantees to Israel (1990-92) are a good example of foreign aid being used for political purposes. The U.S. offered Israel a new aid package (\$10 billion in loan guarantees to resettle new immigrants), but conditioned the funds on freezing West Bank and Gaza settlement activity. The funds were over and above Israel’s annual aid allocation. Israel eventually complied

⁷³ Cortright, *Price of Peace*, 271.

⁷⁴ William J. Long, *Economic Incentives and Bilateral Cooperation* (Ann Arbor: University of Michigan Press, 1996), 82.

⁷⁵ David Baldwin, *Economic Statecraft* (Princeton: Princeton University Press, 1985), 28. see also Knorr, *Power and Wealth*, 8.

with most of the American conditions, but only after elections brought a new left-center government to power in Jerusalem. Aid was consequential in securing the Israeli policy change. The U.S. uses foreign aid in the following four policy areas: “borders” – reducing regional or local conflicts; “bullets” - curbing weapons proliferation; “butter”- promoting trade and economic reform; and “beliefs” – supporting democratization and human rights.⁷⁶

TABLE 2

Positive Economic Inducement Strategies – Policy Categories

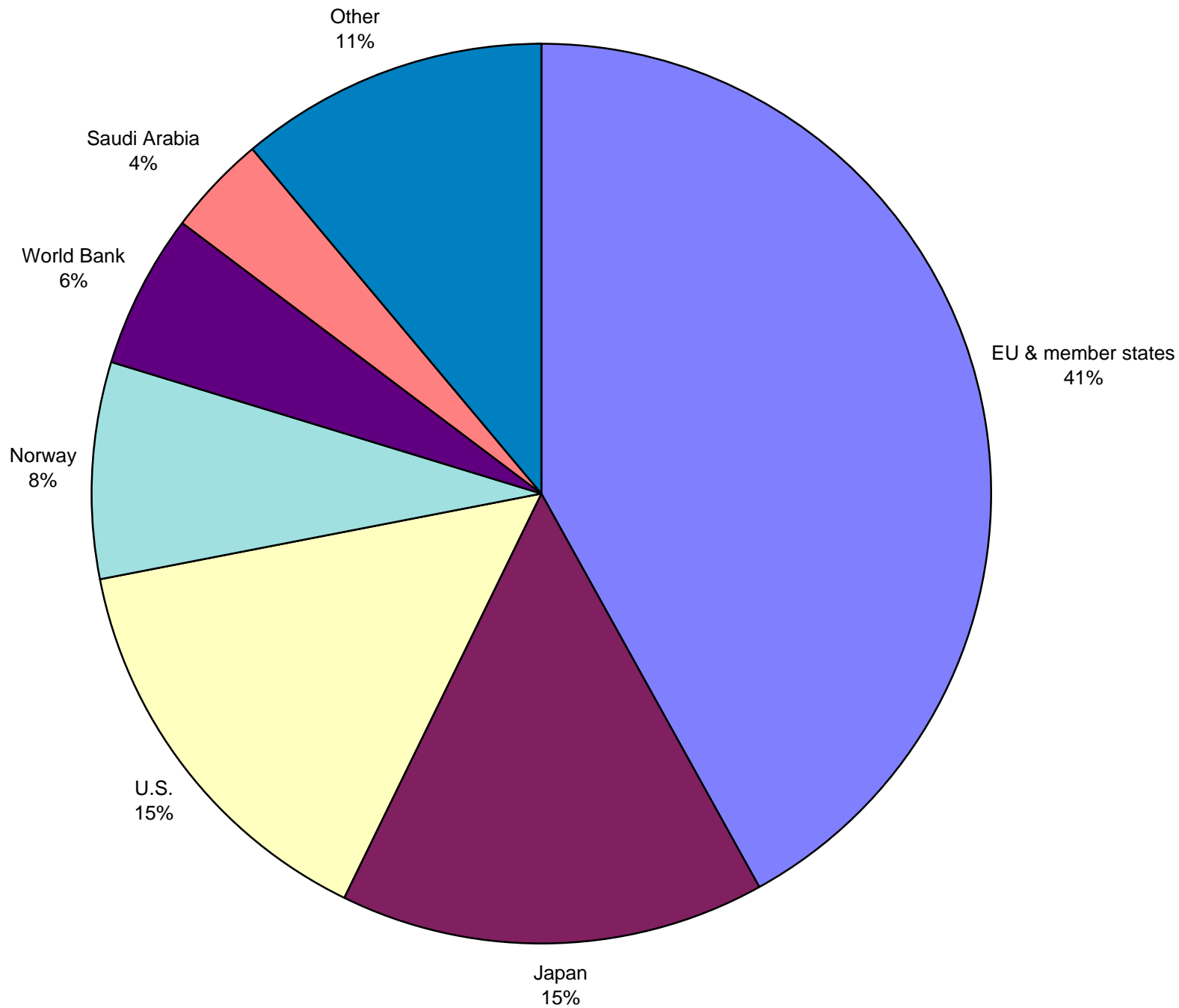
reducing regional conflicts (“borders”)	curbing weapons proliferation (“bullets”)	trade, economic and social reform (“butter”)	democracy/human rights (“beliefs”)
Arab-Israeli Balkans El Salvador Cambodia Indonesia-Timor	Ukraine Kazakhstan North Korea Pakistan FSU/Nunn-Lugar	W. Europe - Marshal Plan Russia Mexico ROK & Indonesia E. Europe enterprise funds Uganda – debt relief	China-HR Russia-DEM Haiti-DEM

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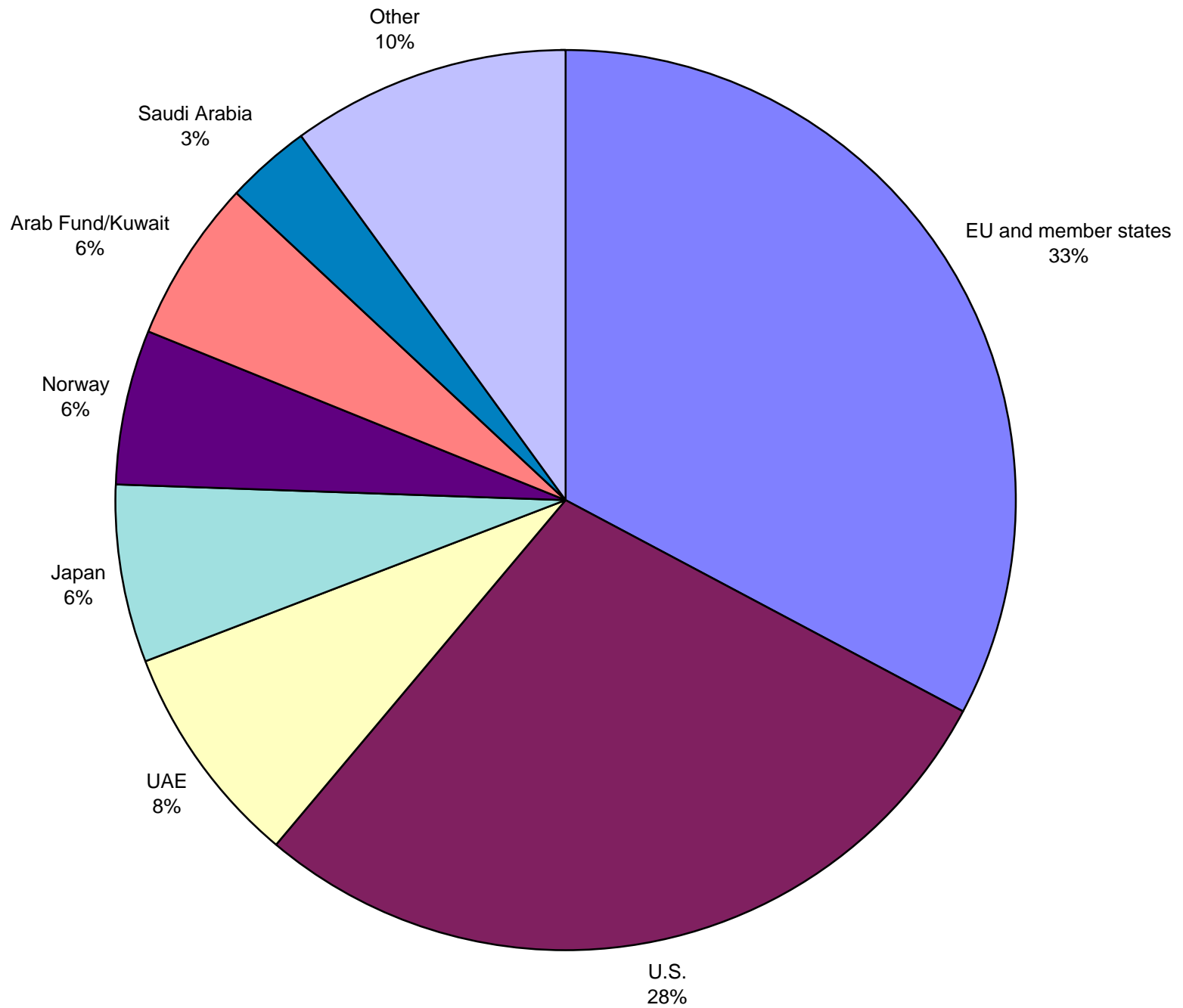
This study focuses on the first category; regional conflicts. States are less likely to comply with security-related policy demands than economic-related ones. Therefore, security cases provide a tough test for aid. Since the policy orientation of this project is focused heavily on the foreign aid debate, it is only natural that the data points would draw exclusively on a major regional conflict like the Arab-Israeli dispute. It is also the policy category (and case) that represents the largest portion of the foreign aid budget.

⁷⁶ These goals are rarely pursued in isolation from each other, although one category usually predominates during a particular episode. For example, in Indonesia, U.S.-backed IMF aid after 1997 aimed at overhauling that country’s troubled financial system. However, by mid-September 1999, with genocidal violence gripping East Timor, the U.S. threatened to block further IMF aid --- thereby transforming an aid attempt that was originally aimed largely at economic reform into an attempt also aimed at protecting human rights and resolving a territorial dispute. See Elizabeth Becker, “U.S.-to-Jakarta Messenger: Chairman of the Joint Chiefs,” *New York Times*, 14 September 1999.

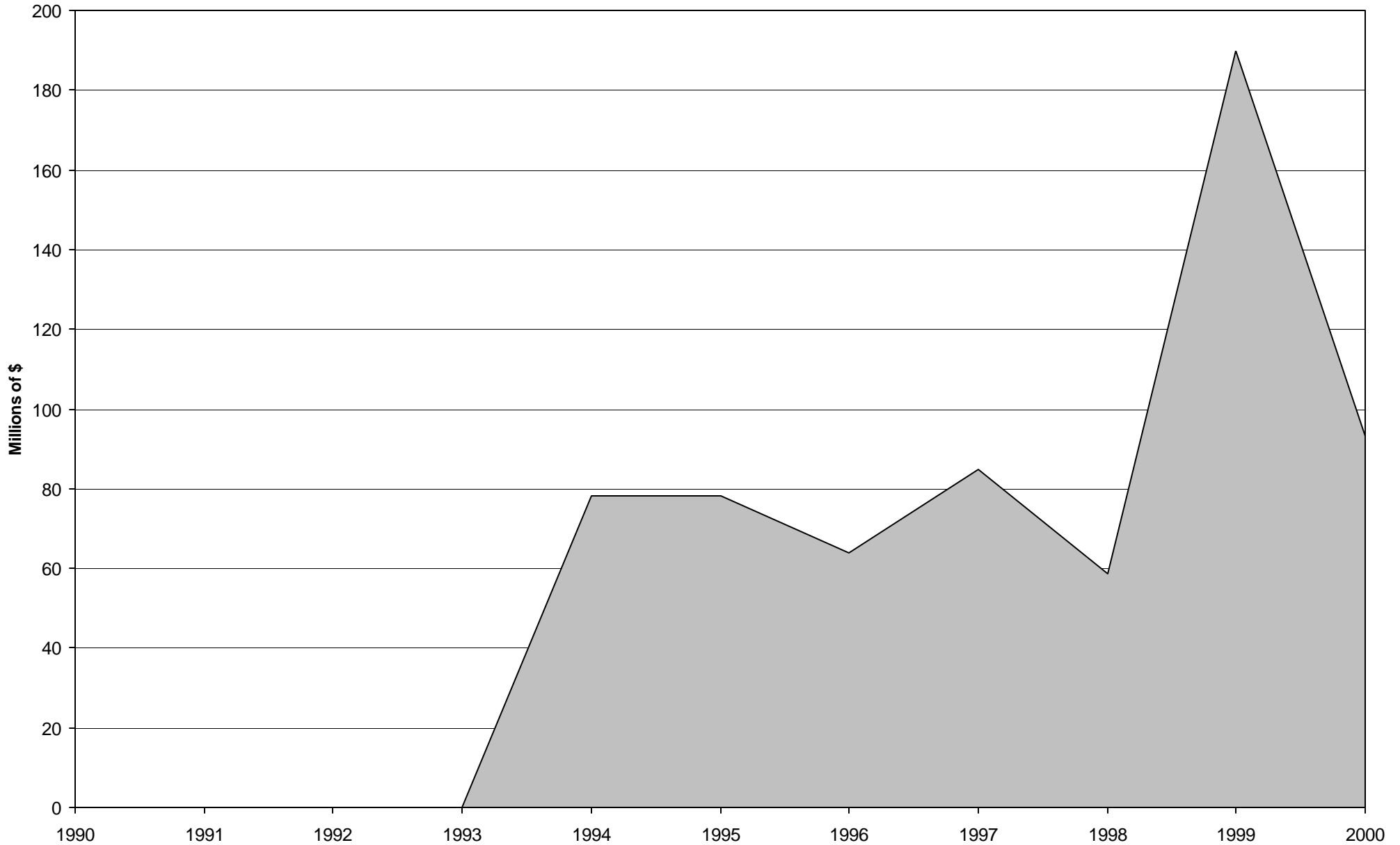
**International Donors to the Palestinians
Aid Disbursed 1994-1998**



**International Donors to the Palestinians
1999-2003 (millions of \$) (excl. budgetary support)**



U.S. Aid to the Palestinians from FY1990-FY2000



Sept 13, 1993:
DOP signed

Sept 28, 1995:
Israeli-Palestinian
Interim Agreement

TIMELINE

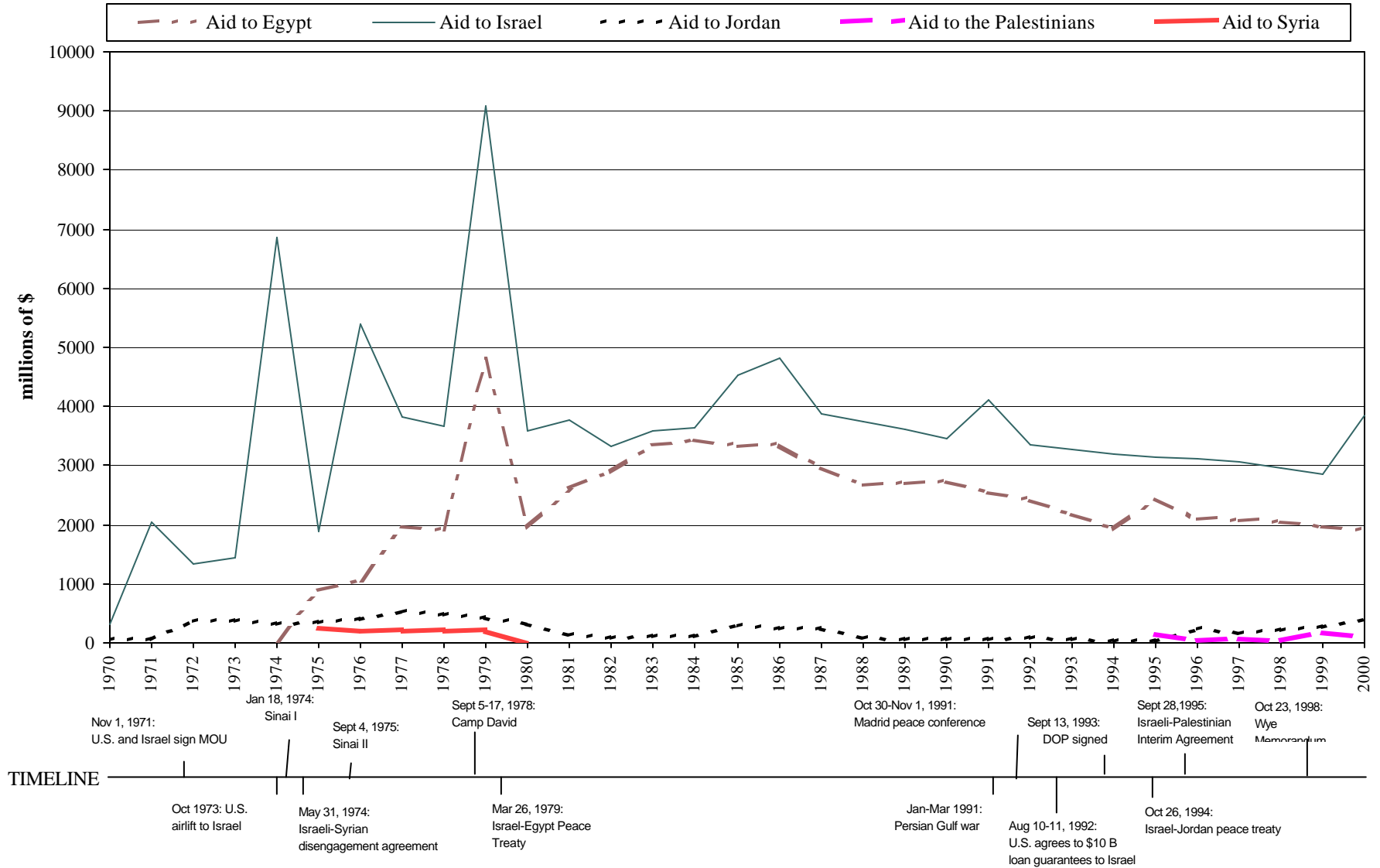
Oct 30-Nov 1, 1991:
Madrid peace
conference

May 4, 1994:
Gaza-Jericho Agreement

Oct 23, 1998:
Wye Memorandum

The Middle East Peace Process and U.S. Aid: 1970 to 2000

constant 1996 dollars; loans and grants; actual disbursements



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