



The Aix Group's previous publications include the "Economic Road Map" (2004), as well as "Israel and Palestine: Between Disengagement and the Economic Road Map" (2005).

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inside

Jerusalem

Refugees

Cooperation in Infrastructure

Fast Track

The Aix Group was formed in 2002 under the auspices of the Université Paul Cézanne-Aix-Marseille III in France, and in coordination with the Peres Center for Peace in Israel and DATA Center for Studies and Research in Palestine.

In 2005 the Aix Group, headed by its five Steering Committee members, began its third stage of research after identifying the following four issues of major economic importance with respect to final status negotiations: (1) Economic cooperation in Jerusalem under different scenarios; (2) The economic aspects of resolving the question of the Palestinian refugees; (3) Cooperation on infrastructure issues; and (4) "Fast Track" issues (examination of topics of contemporary importance) including Palestinian labor in Israel, transitional trade arrangements and the development of the Jordan Valley.

The Aix Group held dozens of meetings, three conferences, and ongoing consultations which included the participation of Israeli, Palestinian and international experts, academics, members of economic organizations, and officials from international institutions. The Aix Group is publishing its extensive analysis with the hope of providing key decision-makers within the region and internationally with a solid basis from which to make future decisions regarding final status issues. The chapters presented in this book take into account Palestinian, Israeli, and international perspectives, ensuring that the research and analysis are as impartial as possible.

> **Palestinian-Israeli Trade Relations** > **Palestinian Labor**  
> **The Jordan Valley**

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Aix Group:

Economic Dimensions of a Two-State Agreement Between Israel and Palestine

# Economic

Dimensions of a Two-State Agreement Between

# Israel and Palestine



Editors:  
Arie Arnon  
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November 2007



Economic Dimensions  
of a Two-State  
Agreement Between  
Israel and Palestine

Aix Group

Arie Arnon and Saeb Bamyá (Eds.)

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# Foreword

## The Aix Group

The Aix Group is a unique working group that researches, produces and disseminates position papers which seek to identify economic scenarios and suggest economic recommendations in order to promote win-win outcomes for Palestinians and Israelis. The group includes Palestinian, Israeli and international economists, academics, experts, and policy-makers, as well as officials who are participating as observers.

Formed five years ago under the auspices of the Université Paul Cézanne-Aix- Marseille III in France, and in coordination with the Peres Center for Peace in Israel and DATA Center for Studies and Research in Palestine, the Aix Group has been chaired by Prof. Gilbert Benhayoun from Université Paul Cézanne. The Group is headed on the Israeli side by Prof. Arie Arnon of Ben-Gurion University of the Negev, and on the Palestinian side by Mr. Saeb Bamyra, an economic adviser to the Palestinian Federation of Industries, and former Deputy Minister of National Economy.

## First Stage of Research: *The Economic Road Map (2004)*

In the belief that a sound economic context is essential to building sustainable peace between Palestinians and Israelis, the Aix Group published its first joint Palestinian-Israeli-International position paper in January 2004, entitled the “Economic Road Map”. The joint research paper examines optional models for long-term Palestinian-Israeli economic relations, and is written with Stage III (permanent status arrangements) of the Quartet’s political Road Map in mind. The research assesses future policy options in the trade, labor, fiscal, monetary and investment policy areas.

## Second Stage of Research: *Israel and Palestine: Between Disengagement and the Economic Road Map (2005)*

In May 2005, the Aix Group published its second joint position paper, entitled, “Israel and Palestine: Between Disengagement and the Economic Road Map”. In this research paper, the Aix Group analyzes the risks and benefits of the unilateral Disengagement Plan from Gaza and the northern West Bank implemented by Israel in summer 2005. The potential outcomes resulting from the disengagement are examined, as is the potential effect of the disengagement on the revival of the Palestinian economy. Additionally, there is an assessment of the conditions that must exist in order to link the Disengagement Plan with the optimal solution for long term economic relations between the two countries, as presented in the “Economic Road Map”.

## Third Stage of Research: *Economic Dimensions of a Two State Agreement between Israel and Palestine (2006-2007)*

In November 2005, the Aix Group began its third stage of research. Building on its experience and findings, the Group identified the four issues of major economic importance that are included in this book: (1) Economic cooperation in Jerusalem under different scenarios; (2) The economic aspects of resolving the question of the Palestinian refugees; (3) Cooperation in infrastructure issues; and (4) “Fast Track” issues (examination of topics of contemporary importance) including Palestinian labor in Israel, transitional trade arrangements and the development of the Jordan Valley.

The findings of the Aix Group’s research emphasizes the importance of considering economic issues in this conflict and in its solution, and further serves to provide key decision-makers within the region and internationally with a solid basis from which to make decisions regarding final status issues. Importantly, the information presented in this book takes into account Palestinian, Israeli, and international perspectives, ensuring that the research and analysis is as impartial as possible.

For more information on the Aix Group and to download previous publications, please visit the Aix Group’s website: [www.aixgroup.org](http://www.aixgroup.org).

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<sup>1</sup> Disclaimer: This book has been produced with the assistance of the European Union. The contents of the book are the sole responsibility of the Aix Group and can in no way be taken to reflect the views of the European Union.

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During two years of research, the Aix Group has held three conferences as well as dozens of meetings, to which individuals from different economic organizations, ministries and academic institutions were invited to listen and to comment on the work of the Aix Group. The following people, among others, have participated as guests and listened to the Aix Group's ideas and findings: (in an alphabetical order)

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## List of Abbreviations

AHLC	Ad-Hoc Liaison Committee
AMA	Agreement on Movement and Access
DCO	Israeli District Coordination Office
EC	European Community
EFTA	European Free Trade Association
ERM	Economic Road Map
FTA	Free Trade Area
GEU	Gaza Electric Utility
GNP	Gross National Product
IAPR	International Agency for the Palestinian Refugees
ICBS	Israel Central Bureau of Statistics
ICT	Information Communication Technology
IEC	Israeli Electric Corporation
JDEC	Jerusalem District Electric Company
JEA	Jerusalem Economic Arbitrator
JEC	Jerusalem Electric Company
JENT	Jerusalem Economic Negotiation Teams
MEFTA	Middle East Free Trade Area
MOPIC	Ministry of Planning and International Cooperation
NEU	North Electric Utility
NII	National Insurance Institute
PCBS	Palestinian Central Bureau of Statistics
PEC	Palestinian Electric Company
PMA	Palestinian Monetary Authority
PNA	Palestinian National Authority
PP	Paris Protocol
PT	Palestinian Territory
RWG	Refugee Working Group
SELCO	South Electric Company
SPS	Sanitary and Phyto-Sanitary Agreement / Certification
TBT	Technical Barriers to Trade
UN OCHA	United Nations Office for the Coordination of Humanitarian Affairs
UNCCP	UN Conciliation Commission for Palestine
UNRWA	United Nations Relief and Works Agency
WBGS	West Bank and Gaza Strip
WTO	World Trade Organization



# Introduction: The Rationale and Assumptions Behind the Aix Group Economic Analysis

Steering Committee of the Aix Group

Arie Arnon, Saeb Bamyá, Gilbert Benhayoun,  
Samir Hazboun, Ron Pundak



The Aix Group is a unique economic forum comprised of Israeli, Palestinian and international economists, policy-makers, members of economic organizations, and individuals from the academic and business spheres. Members of the Aix Group have been meeting since 2002, accompanied by official observers from both sides who have shared their thoughts with the Group and incorporated some of the Group's ideas into their policies. Within the deteriorating political circumstances in the region, the Aix Group has served as one of the only economic forums where members of the two sides continued to meet and continued rational discussions related to common concerns.

In 2003, the Group agreed on a basic concept which defines its character to this day. We came to the conclusion that one of the errors committed and followed by the two sides since 1993 was that of basing the peace process on "gradualism", whereas the right way forward was to adopt what we have called a "reverse engineering" approach (see the *Economic Road Map* (ERM 2004)). In "reverse engineering", the sides first agree on where they want to go, i.e. on the contours of a permanent agreement, and then decide how to reach that end. Gradualism, on the other hand, takes the form of an incremental approach, moving one step at a time with no agreement on (or even discussion of) the end result. This is an inappropriate approach, particularly in the context of the power imbalance between the two sides, which eventually contributed to failure. The failure to agree to and implement the "two states" formula successfully was partly due to the fact that the sides avoided serious discussions of the permanent stage; and then, at Camp David in 2000, they failed to reach an agreement. **But, whereas many concluded after the failure at Camp David that it is altogether impossible to reach an agreement, we concluded that it is impossible not to reach one.** Thus we thought, and still think, that in spite of the painful failure in 2000, and the painful consequences of that failure, the two sides should resume meaningful negotiations that will lead to a permanent settlement of the conflict.

In the ERM in 2004, the Group outlined the basic economic elements of a possible agreement based on "two states", wherein two sovereign powers will have control over economic decisions, including control over their borders. The economic regime the ERM recommended was that of a Free

Trade Area (FTA) and regulated labor flows between the sides; such trade and labor relations will best serve the interests of the two sides. In the ERM, the Aix Group also discussed the financial and monetary aspects of an agreement.

The passage of time makes the resumption of meaningful negotiations even more difficult, since two serious problems challenge an agreement: one is that of a strong opposition and terror campaign against a political two-state agreement, based on the negation of the existence and rights of Israel and the Jewish collective; the second is that of “pre-emption”, i.e. a process of creating facts on the ground through sustained settlement expansion. These processes, combined with the physical transformation of land in the occupied Palestinian territories, create conditions which undermine and supersede an agreement based on meaningful sovereignty for the two sides.

A feasible agreement on two states will have to address the difficult trio of Borders, Jerusalem and Refugees. It will also have to deal with the question of “pre-emption” and the long-term impact of creating “facts on the ground”. A positive conclusion that addresses the minimum and necessary requirements of the two sides will most probably look like the following:

- The borders between the two states will be drawn so that the two states will have continuity; the land will be divided 78% to 22% based on the 1967 borders, allowing for agreed and limited swaps of land along the “Green Line”; arrangements satisfying contiguity between Gaza and the West Bank will guarantee the free flow of people and goods within both Israel and Palestine so that travel between Gaza and the West Bank will not entail crossing a border.
- Jerusalem will be the capital of both Israel and Palestine. Two options for Jerusalem's borders can be thought of:
  - a. An “open” Jerusalem, necessitating the creation of borders around Jerusalem, or the part of the city that remains “open”.
  - b. A border that will bisect Jerusalem.
- An agreed, just and fair solution to the 1948 Palestinian refugees problem will address both the individual claims and the collective considerations

of the two sides and provide a way to reconcile the two. On the one hand, the Palestinian refugees will be able to choose a permanent place of residency; on the other hand, the implementation of these decisions will be agreed to by, and subject to the sovereignty of, all the countries that will be affected, including Palestine and Israel.

Programs for the refugees will address Resettlement/Repatriation, or what we sometimes describe as Relocation, as well as Rehabilitation. A substantial compensation scheme for the refugees will be agreed upon. The process will end the status of refugehood and turn all refugees into citizens, with the agreement and cooperation of the refugees themselves.

If the two peoples want self-determination, normalcy and prosperity, they should head towards a historical compromise. By supporting such a “package” as the outline of an agreement, the international community can also contribute to the beginning of a new path in our troubled region.

We suggest that the economic part of the new agreement should include clear key principles. First, it is imperative to agree that the sovereign authority of each party, within internationally recognized borders, includes the right to conduct internal and external economic affairs, including the operation and administration of that party’s economic borders, autonomously but in cooperation with one another. Hence, the parties must reciprocally recognize each other as independent customs territories and make this recognition the foundation for their economic and trade relations. Second, economic relations shall be guided by the concepts of cooperation in both trade and labor, as well as in infrastructure, R&D, etc. Thus the parties can establish the rules and arrangements which will regulate the trade in goods and services, and the flows of labor and investment.

The third phase of the Aix Group’s work, presented in this book, is structured around four topics, three concerned with the final status agreement and one with how to move from the present to the final status. The first three topics cover key issues in the permanent agreement: how the two sovereign states will cooperate; how to satisfactorily define arrangements in Jerusalem, consistent with the Group’s ERM; and how to deal with the 60 year-old issue of the status of the refugees.

The cooperation chapter relates to two issues which clarify the importance as well as the feasibility of cooperation in the fields of energy and

transportation. In both areas the advantages of cooperation are enormous and the consequences of non-cooperation are disastrous.

The Jerusalem chapter details the various options open to policy makers in the sensitive issue of providing working economic arrangements in a city that will become the capital of two states. The crucial questions of an open city and borders and their implications for economic performance are clearly explained.

The chapter on refugees proposes the establishment of an international body that will supervise the various arrangements, mechanisms and programs suggested. This international body will address four critical topics:

- :: Relocation programs
- :: Rehabilitation programs
- :: Claims concerning properties
- :: Compensation for refugehood

The Fast Track team provided ideas on to how to start climbing out of the “mud” and onto a new track that will lead to the ERM. The chapter on trade deals with the collapse of the current trade regime and proposes methods for creating new trade conditions. The chapter on labor emphasizes the importance of reestablishing working labor flows. The importance of developing the Jordan valley is the subject of the third Fast Track chapter.

The Aix Group efforts were not academic in the abstract meaning of the word. They did not abstract from the current situation and do not reflect a visionary’s detached exercise. We present very realistic and practical alternatives that rely on our ability to understand that there is more than one point of view. Today, the area between the River and the Sea contains two peoples who deserve better: they deserve independence, security and prosperity. The economic dimension may be secondary to the political one, but economic performance is not secondary. If the economic agreements fail to provide the necessary conditions for real development, the political agreement will also fail.

We believe that so far, an historical compromise along the lines described in this document has offered a realistic solution to the Palestinian-Israeli

conflict; but this vision is not carved in stone and will eventually have to yield to changes in the reality of conditions on the ground.

The current widespread pessimism seems to choke any initiative that dares to think about a permanent arrangement and to present an alternative to the continuation of the violent conflict. We should not surrender to the pessimists and should not accept their verdict of 40 more years of death and suffering. However, the Aix Group is aware of the fact that continued rejectionists' efforts on the one hand and pre-emption on the other hand will eventually undermine the two-state solution on which our efforts are based. Any reasonable solution therefore would require a reasonable timeline in which preemptive changes on the ground will be declared null and void, by a binding mutual agreement.

Time is running out for a two-state arrangement. If this idea is not accepted and implemented relatively soon, the two sides will have to consider an alternative political economy. The one-state alternative, while proposed and defended until recently by a minority among both sides, is today gaining ground due to the very conditions that undermine the possibility of territorial compromise. The Aix Group is convinced that if bold steps are not taken in the direction of rapid implementation of a territorial solution, then an alternative vision of one state for both people, on the basis of common citizenship and equality before the law, will increasingly be placed on the agenda. Such an agenda will require detailed new thinking about many of the elements of this document; but if the vision of "two states" crumbles, it will become the only alternative to the current conditions of continued occupation.

The Aix Group believes that the economic analysis in the ERM and in the chapters presented in this book lays the groundwork for optimistic future developments for both Israel and Palestine. The related concepts of open borders, cooperation between two sovereign states, and interdependencies, combined with conditions of stability and wide political support for the new arrangements on both sides, could lead us out of this dark period and into a better future.

## A Preliminary Note

Over the course of more than two years, the Aix Group exchanged ideas on various aspects of possible permanent resolution within an overall two-state agreement. As in the previous works of the Aix Group, we had to imagine a political solution which seemed to some observers, and sometimes also to some in the Group, as a very remote possibility. Still, we assumed throughout the work, with all the reservations we had, that an agreement acceptable to the two peoples will be reached. Only in that context the Group's detailed discussions make sense. Thus, we would like the readers to assess the arguments below while imagining that an agreement on all dimensions has been reached.

This book summarizes the major points of our discussions. However, not every sentence necessarily reflects the views of all the participants. As much as possible, the emphasis in the book is on a professional, forward-looking economic perspective, and less on the legal, historical and philosophical dimensions that are very important to our subject.



# An Outline of the Economic Issues of a Final Status Agreement in Jerusalem

Aix Group, Jerusalem Team

Joseph Zeira, Samir Hazboun, Sharon Hadad,  
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# Executive Summary

## 1. General

The main goal of this document is to offer ideas for economic agreements and arrangements that should accompany a future final status agreement between Israel and Palestine on Jerusalem. Due to the uncertainty about many aspects of the final agreement, especially on Jerusalem, we address a range of possible solutions and offer economic solutions for each possible scenario.

## 2. Main Assumptions on the Final Status Agreement

We assume that an agreement will divide Jerusalem politically between West Jerusalem / Yerushalayim, the capital of Israel, and East Jerusalem / Al Quds, the capital of Palestine. The exact location of the border between the two cities will be specified in the agreement. The two main uncertainties are the possible regime in the city and the location of the border.

There are three main possible regimes. The first is a *Divided City*, where the political border between the two cities will also be a physical border. The second is an *Open City*, with free movement of people and goods between the two cities. The third possible regime is a *Semi-Open City*, with a smaller open area, such as the Old City in the city.

As for the location of the border, we identify three main possibilities. The first is a political border along the pre-1967 border, with all Jerusalem Settlements / Neighborhoods evacuated, except for the Jewish Quarter in the Old City. The second is a border that reflects the geographical divide between Jews and Arabs. The third is a border between these two possibilities that leaves some Jerusalem Settlements / Neighborhoods within Israeli sovereignty, while others are evacuated.

### 3. Institutions for Economic Negotiations

We recommend a special two-part negotiation mechanism to reach agreement on the economic arrangements in Jerusalem. One part is the “Jerusalem Economic Negotiation Teams” (JENT), made up of an Israeli team and a Palestinian team. The second part is the “Jerusalem Economic Arbitrator” (JEA), who will decide on economic matters on which the negotiating teams are unable to reach an agreement before the time of implementation of the agreement.

### 4. International Trade

The general trade arrangement recommended by the Aix Group is that of a Free Trade Area. This arrangement can be applied to Jerusalem, but not in the case of an Open City. In that case, tariffs and taxes in Jerusalem on goods from third countries must be uniform, with lower (or equal) rates than the minimum in the two countries. An Open City model also means that transportation from the city to the rest of the two states must be subject to restrictions at the city’s outside borders. In the Semi-Open City option, application of this special trade zone can be easier.

Such a trade arrangement can be quite expensive due to smuggling and loss of state revenues. For Israel such losses are estimated at 1% of GDP, or 2.5% of total tax revenues. For Palestine these costs might be higher. These potential costs cast doubt on the desirability of the Open City option.

### 5. Labor Arrangements

To the general recommendation of the Aix Group that labor should be able to move freely between the two states, subject to regulation, we add one main recommendation on Jerusalem. Palestinians from East Jerusalem who have been working in Israel prior to the agreement will be able to keep their jobs for at least ten years, or until retirement.

### 6. Infrastructure

Infrastructure projects have significant network externalities, and hence should not be divided. But sharing infrastructure between two cities and two states might lead to inequality in services for political reasons, as each

project is run mainly by one side. We therefore recommend division of infrastructures between the two cities, but only after a transition period, as such a division requires large investments. Of course, the two sides will be able to continue to share an infrastructure beyond the transitional period, if they both agree to do so.

## 7. Costs of Setting a Border

The future of the Jerusalem Settlements / Neighborhoods in East Jerusalem is one of the main issues in the agreement. An agreement might require evacuation of all, some, or none of these areas; also, less evacuation would require more infrastructure adjustment (tunnels and bridges) to increase contiguity to both sides. The economic agreements on these issues will be reached by the JENT and the JEA (if the JENT fail to agree).

We recommend that each required infrastructure project should be planned and built by the party who uses it, but must also be agreed to by the other party, hence negotiated. The financing of such projects should be borne by Israel.

With respect to an evacuation of a Jerusalem Settlement / Neighborhood, we strongly recommend that these neighborhoods not be destroyed. We also suggest that a special Palestinian administrative body handle the distribution and transfer of these assets to Palestine. The two sides will negotiate whether and how many funds will be tendered for all assets, mobile and immobile, left by Israel in the area.

## 8. Social Security and Health

We recommend that all Palestinians in East Jerusalem who are entitled to social security benefits from the National Insurance Institute (NII) due to past contributions will continue to receive the benefits that are due to them until death. Their new contributions, however, will be paid to the Palestinian Social Security Institution.

To smooth transition of health insurance from Israeli to Palestinian providers, we suggest a special transition period during which Palestinians from East Jerusalem will continue to pay health tax to Israel and receive health services from Israeli providers.

## 9. The Current Situation and the Final Status Agreement

Two current main obstacles to a final status agreement are the separation wall / barrier in Jerusalem, and expansion of settlements in and around Jerusalem. We focus here on their economic implications only. Both the separation wall / barrier and the expansion of settlements contribute to separating the north of the West Bank from its south. Splitting the West Bank in two seriously derails economic development in Palestine, due to loss of returns to scale.

We strongly believe that economic development in Palestine is crucial to a peace agreement. A successful economy provides incentives to keep agreements and preserve peaceful relations, while economic hardship is a recipe for potential hostility and conflict. Hence, such obstacles to development are detrimental to reaching an agreement.

## 10. Summary

This document is partly optimistic and partly pessimistic. We show that it is possible to outline economic arrangements of a final status agreement, and this is optimistic; but we also show how current developments in Jerusalem put obstacles on the road to peace. Our analysis therefore highlights the urgency of beginning negotiations on the final status agreement. Time is not in favor of reaching such an agreement.

## I. Introduction

This document discusses the economic aspects of a future final status agreement between Israel and Palestine on the issue of Jerusalem. Its main goal is to offer ideas for the economic agreements and arrangements that should accompany a future final status agreement on Jerusalem. In addition, the paper discusses current economic issues that might affect the path to a final status agreement, and the economic requirements for reaching and sustaining such an agreement.

We bear in mind that an economic agreement will be part of a broader Israeli-Palestinian final status agreement, which, as we all know, will be very difficult to reach. Since we are so far away from an agreement, it is hard to imagine how it will look. Where will the border pass? What arrangements will be made for the transitional period, and how will implementation of the agreement be safeguarded? The difficulties in forecasting an agreement are even more complicated in Jerusalem, where the current positions of the two sides are much farther apart than on most other issues of the conflict, and so the shape of a future agreement is even more uncertain. Thus it is clear that our ideas and recommendations for economic arrangements should not address a single possible solution, but rather a range of possible solutions. Hence, our analysis will first examine the range of possible final status scenarios, followed by suggested economic solutions for each possible scenario.

In addition to an analysis of the final status agreement, our paper includes an analysis of some economic aspects of the road to such an agreement. We focus mainly on the current possibility for economic development in Palestine in general, and in East Jerusalem specifically. Although the prospects for future economic development for Palestine are not likely to be part of a final status agreement as such, they will have a significant impact both on the process of negotiation and on how the agreement will be implemented. A successful economy provides incentives to keep



agreements and develop peaceful relations. Conversely, economic hardship is a recipe for continued hostility and potential conflict. We therefore believe that future economic prosperity for Palestine and the means of achieving such prosperity, starting at the present time, are vital to the success of any final status process.

In order to lay down the factual basis of our analysis, we begin with some background and with a description of the current economic situation of East Jerusalem. We then describe possible scenarios for an agreement on Jerusalem, and suggest economic arrangements in the areas of trade, labor, infrastructure, social security and more. Finally, we look at some current developments in Jerusalem and examine their adverse effects on the economic development of Palestine and, as a result, on the ability to reach a final status agreement in the future.

## 2. Background

Jerusalem is a complex city due to its ethnic, religious and cultural heterogeneity. It is also special due to its importance to the three monotheistic religions and its national-historical significance to both Israelis and Palestinians. It was the capital of the country under the British Mandate and in many previous historical periods.

The enclosed map<sup>1</sup> illustrates the shifts in Jerusalem's boundaries since the end of the British Mandate. In the years 1948 – 1967, the city was divided between Israel and the Kingdom of Jordan, which ruled the West Bank and East Jerusalem in the aftermath of the 1948 war. The division line, shown on the map to the right, which was a cease fire line, is now called the pre-1967 border, or the Green Line. Before 1967 Arab East Jerusalem encompassed only 6.5 sq km. Immediately after the 1967 War and occupation, the Israeli Government decided to annex East Jerusalem, plus an additional 70 sq km which included 28 surrounding West Bank villages. Israel added this area to West Jerusalem and the annexed territory became part of the greater municipal Jerusalem, which has also expanded westward. The Palestinians in the annexed areas became residents of Israel, but not citizens. This unilateral annexation has never been recognized by any state other than Israel.

After the annexation in 1967, Israel began massive construction in the area of East Jerusalem. This construction included residential areas for Israelis, as

Jerusalem Municipal Boundaries  
1947-2000



<sup>1</sup> The Palestinian Academic Society for the Study of International Affairs (PASSIA) Website. [http://www.passia.org/palestine\\_facts/MAPS/images/jer\\_maps/Jlem1947-2000.html](http://www.passia.org/palestine_facts/MAPS/images/jer_maps/Jlem1947-2000.html)

well as infrastructure. As a result, the pre -1967 border lost much of its role as a dividing line between the two populations. This massive construction, which is still going on today, has changed the landscape of the city and has affected its demography, economy and many other aspects of life. It also makes reaching an agreement on Jerusalem much more difficult.

In 1982, the Israeli Government passed special legislation that further formalized the annexation of East Jerusalem by defining Jerusalem as a unified city within the municipal borders set by Israel. These municipal borders created a formal seam line between East Jerusalem and the West Bank and thus began to separate the Palestinians in the two areas. Palestinian residents of East Jerusalem were issued blue “Israeli” ID cards and residents of the West Bank were issued orange ID cards. The differences did not end with color, but extended to other aspects of life. Palestinians in East Jerusalem were eligible to participate in most Social Security programs in Israel through the National Insurance Institute (NII). They were also able to enter Israel and work, unlike Palestinians from the West Bank, who were subject to increasingly severe permit restrictions from the early 1990s on.

The separating line between East Jerusalem and the West Bank became more pronounced over the years, as physical barriers began to be erected in the 1990s. These barriers began as checkpoints at the main entrances to Jerusalem, and gradually became more permanent. Access restrictions on West Bank ID-holders intensified following the start of the Al-Aqsa Intifada in 2000. Recently the separation became an almost hermetic seal with the building of the separation barrier / wall, which began in 2002 and which is almost complete in the Jerusalem area. The physical separation of East Jerusalem from the West Bank, and with it the reduced territorial contiguity and mobility between the north and south of the West Bank, significantly affects the economic conditions in Palestine.

Further intensifying the separation of north and south in the West Bank is the ongoing expansion of Ma'aleh Adumim, a settlement east of Jerusalem founded in 1975, and its satellite settlements. If Ma'aleh Adumim is linked to East Jerusalem by the planned "E-1" corridor, this will effectively close the eastern gate of Jerusalem, and completely sever the West Bank in two. Such a development will have severe consequences for the economy of East Jerusalem, as it will remain without area for future growth and development. It will also have dire consequences for the development of Palestine in general. Mobility through Jerusalem will become impossible and territorial contiguity and movement between the two parts of the West Bank will be very seriously impaired.

Before we begin a detailed analysis, we need to clarify some terms used in this chapter, since terminology is a loaded issue for both sides. The first term we use is "Jerusalem". This is a factual term that describes the current municipal area of Jerusalem, without any implied recognition of these municipal borders. Second, we call the cease fire line that prevailed before June 4, 1967 (the "Green Line"), the pre-1967 border. Next, we call the part of this area that is west of this line "West Jerusalem" and the part of this area that is east of it "East Jerusalem"<sup>2</sup>. The residential areas built by Israel in East Jerusalem are viewed as Jerusalem neighborhoods by Israel and as illegal settlements by the Palestinians and the international community. In this paper we will call these neighborhoods "Jerusalem Settlements / Neighborhoods," again without any implied recognition of the legal implications of the term.

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2 To avoid too many definitions, in the rest of the paper we continue to call the future parts of Jerusalem after a final status agreement West and East Jerusalem, but the reader can think of the two capitals as Yerushalayim and Al Quds. The future border between the two cities might not be the pre-67 border; however, another border that will be agreed upon by the two sides.

### 3. The Economic Situation of the Palestinians in East Jerusalem

This chapter contains a brief description of the economic situation of the Palestinian community in East Jerusalem. This description serves as a background to our analysis of policy recommendations in this document. It does not include some specific issues like social security and infrastructure, which are discussed in separate chapters.

#### 3.1. Population

In 2005 the total population of Palestinians in East Jerusalem was estimated to be 251,000. This was 6.5% of the total Palestinian population in the occupied territories and 33% of the population of Jerusalem. Of this Palestinian population, 42% were under the age of 15 and 3.3% over the age of 65. The average household size was 5.3 members. Therefore it can be estimated that there were approximately 47,358 Palestinian households in East Jerusalem in 2005.

#### 3.2. Living Conditions

In 2004, the average monthly consumption per Palestinian household in East Jerusalem was 6,043 NIS. This was over 3 times higher than the equivalent number in the rest of the occupied territories. The Palestinian definition sets the poverty line at US\$2 a day per person, which means that the percentage of Palestinians living in poverty in East Jerusalem was just 3.6% in 2003. According to the Israeli definition, which uses a relative measure of half the median income per capita adjusted for size of family, the poverty rate among Palestinians in East Jerusalem was much higher and reached about 42% in 1999. Since then the Palestinian economic situation has further deteriorated.

### 3.3. East Jerusalem and the Municipality

Another indicator of the poverty in East Jerusalem is the low level of property tax (*arnona*) paid to the municipality. The data shows that East Jerusalem Palestinians contribute about 11% to the municipal revenues. More specifically, they contribute 10% to the residential *arnona* and 12% to the commercial *arnona*. In East Jerusalem, there is a considerable default rate on *arnona* payments; approximately 35% of charges are corrected for exemptions. In West Jerusalem the default rate is about 11%.

Palestinians in East Jerusalem are also heavily discriminated against in the budget they receive from the municipality. In an analysis of municipal expenditures in East Jerusalem in 2003 by Meir Margalit (a former council member), he finds that East Jerusalem receives only 12% of the municipal expenditures.<sup>3</sup> This number is staggering for a number of reasons: Palestinians in East Jerusalem account for 33% of city residents; their poverty rate is more than double that of the Jewish population; and they have a higher percentage of children in their overall population (42%) than the residents of West Jerusalem (32%). In spite of these facts, Palestinians receive just about 12% of the city's welfare budget and only around 15% of the education budget. Furthermore, East Jerusalem receives only 8% of the engineering services, and a mere 1.2% of the culture and art budgets. Taking into consideration the differences in population alone, these figures mean that there is a significant disparity in favor of the city's Israelis by a factor of 3.6.

The bias against East Jerusalem and the Palestinian population is evident not only in past expenditures but also in future projects and in plans to maintain favorable Jewish demographic balance. The new light rail almost completely bypasses Palestinian neighborhoods. The plan for the city's future, *Jerusalem 2000*, was strongly criticized in a special report by the architectural organization "Bimkom" as heavily biased against Palestinians in East Jerusalem.<sup>4</sup>

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3 Ir Amim Website. [http://www.ir-amim.org.il/\\_Uploads/dbsAttachedFiles/BudgetMeirMargalit\(1\).doc](http://www.ir-amim.org.il/_Uploads/dbsAttachedFiles/BudgetMeirMargalit(1).doc)

4 Bimkom Website <http://www.bimkom.org/dynContent/articles/Jerusalem%20Master%20Plan%202000.pdf>

### 3.4. Other Social Indicators<sup>5</sup>

Despite their low economic indicators, East Jerusalem Palestinians enjoy access to good health services and thus score well with respect to basic indicators such as life expectancy at birth, which is equal to 76 years. This figure is higher than in the occupied territories, where life expectancy is equal to 71 years, but it is lower than in Israel, where life expectancy is nearly 78 years. Infant mortality in East Jerusalem is low at 7.2 deaths per 1,000 live births in 2001. This is much lower than in the occupied territories, where the rate is 17 deaths per 1,000 live births. However, it is higher than for Jerusalem as a whole, with a rate of 4.2 deaths per 1,000 live births.

Most of the Palestinian population in East Jerusalem has access to the Israeli social welfare system, which covers basic health costs and provides social security benefits, though access to these services may be difficult at times.

### 3.5. The Labor Market

In 2005, the labor force in Arab East Jerusalem consisted of 53,000 people, indicating a very low labor participation rate of 37.2% (66% of men and just 8.2% of women). By comparison, the Israeli labor participation rate (which is in itself low by international standards) is approximately 55%. The unemployment rate in Arab East Jerusalem is 20% of the active labor force. Therefore, only 45,000 residents are working on a regular basis.

Of these 45,000 workers, 50% work in West Jerusalem and in the rest of Israel. The distribution of the East Jerusalem Palestinian labor force by sectors exhibits a clear orientation to the service economy. This is because there is neither a real agricultural nor an industrial base in East Jerusalem, which leaves housing and services, especially tourism, as the main sectors in the East Jerusalem economy. Note that the service sector is also the leading sector in West Jerusalem.

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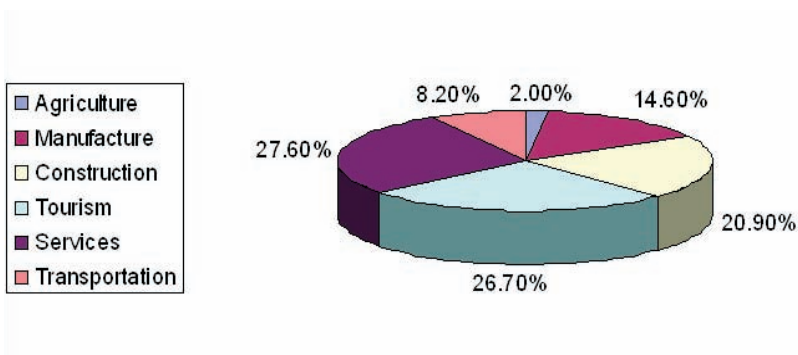
<sup>5</sup> Multi Sector Review (MSR) Project Website. <http://www.multi-sector.org/>

### 3.6. East Jerusalem's Economic Sub-sectors

The main economic sectors in Arab East Jerusalem are: housing and construction; tourism and transportation; small to medium size manufacturing; and retail and commerce. Finance and agriculture play only a minor part. Finance is currently limited to one development bank and several money changers, while total agricultural income per year amounts to only US\$2 million.

The total number of Palestinian economic establishments in East Jerusalem in 2005 was 5921 (compared with 5135 establishments in 2001). The sector breakdown for 2005 is as follows:

1. 706 are industrial establishments that employ 3486 workers.<sup>6</sup> The total production of these enterprises was US\$236 million and the value added from this production was US\$118 million.
2. The number of establishments engaged in internal trade and commerce activities was 3350. They employed 7579 workers and their total output was US\$99.1 million.
3. The number of establishments engaged in transportation was 110. This sector employs 784 workers and produced an output of US\$16.8 million in 2004.
4. The number of establishments engaged in the service sector was 1155. Those establishments employed 3643 workers in 2004. The product of this sector was US\$62.4 million and the value added was US\$45.8 million.



<sup>6</sup> Chart and statistics from the Palestinian Central Bureau of Statistics (PCBS) Website. <http://www.pcbs.gov.ps/>



### 3.7. Tourism

Tourism is considered to be the main service sub-sector of Palestinian East Jerusalem's economy, and is the major source of foreign currency. Tourism generated more than 3,500 direct jobs in 2000, but this number dropped to less than 1,800 in 2005. During the Al-Aqsa Intifada and after the September 11 attacks, tourism to Israel, and especially to East Jerusalem, dropped dramatically. Although both sides of the city are usually affected when it comes to tourism and political factors, to some extent the impact is different. In West Jerusalem, the number of bed nights in hotels dropped by 52% (from 2.85 million in 2000 to 1.36 million in 2001); in East Jerusalem, this figure dropped by 82% (from 600,000 in 2000 to 104,500 in 2001).

### 3.8. The Private Sector

The Palestinian economy in East Jerusalem is dominated by the private sector, which has had a substantial role in the development process, especially during the last two decades. The wages from the private sector are the main source of Palestinian household income in East Jerusalem. In addition to manufacturing, trade and services, many public service activities in the areas of health, education and social services are run by the private sector.

The number of Palestinian private sector enterprises in East Jerusalem declined in the 1990s: from close to 3,000 establishments in 1994, the number dropped to 2,245 in 2000. These numbers reflect the fact that much Palestinian economic activity has moved from East Jerusalem to other areas of the West Bank. Prior to the second Intifada, this process had been mainly driven by economic forces, including a less stringent regulatory environment, lower taxes, lower land and rent costs, and relative improvement in economic conditions in the West Bank between 1994 and 2001.

After 2001, Israeli security measures, namely the separation barrier / wall and the frequent closures of the West Bank, set severe obstacles in the way of normal Palestinian economic activity in East Jerusalem. This caused a further shift of capital and private enterprises to the West Bank.

Table 1: Number of Registered Private Sector Establishments and Employment in East Jerusalem by Sector, in the Year 2000

<b>Firms</b>	<b>Firms: &lt;5</b>	<b>Firms: &gt;5&lt;10</b>	<b>Firms: 10+workers</b>	<b>Total firms</b>	<b>Total Employment</b>
Industry	153	24	16	193	1,424
Repair	74	14	8	96	314
Trade	1,155	46	14	1,215	2,332
Restaurants	127	11	31	169	1,214
Transport	19	17	35	71	862
Business services	161	20	12	193	626
Social services	220	32	56	308	3,968
<b>Total</b>	<b>1,909</b>	<b>164</b>	<b>172</b>	<b>2,245</b>	<b>10,740</b>

Source: PCBS Website. <http://www.pcbs.gov.ps/>

## 4. Potential Outlines of the Final Status Agreement

Any attempt to draw possible guidelines for the economic arrangements of the final status agreement must make some assumptions about the possible political characteristics of the final status agreement itself. In this section, we describe our working assumptions and classify the main possible scenarios for a final status agreement. We then fit each scenario with the economic arrangements that suit it best.

What is true for a final status agreement in general is especially true for any agreement on Jerusalem: it will be hard to achieve and could be quite complicated. Hence, trying to outline the main characteristics of such an agreement is a very important but also very difficult task. There are some elements of such an agreement that can be predicted with certainty, while other elements are uncertain. For those uncertain elements, we describe a number of options. The uncertainties include both the type of the future regime in the city, and the location of the border. What is certain, however, is that the regime and the location of the border are strongly related.

Before we examine these two uncertainties in more detail, we present what we view as the certainties of any future agreement on Jerusalem. Namely, we list a number of working assumptions which we believe will apply to any possible future solution. These assumptions reflect the basic requirements of any future final status agreement. In our view, if any of these elements is missing, a final status agreement cannot be reached, or will not be viable or stable. These working assumptions are:

1. There will be two states, Israel and Palestine, living side by side, with an agreed-upon border between them.

2. Jerusalem will be divided into two cities. East Jerusalem / Al Quds, will be the capital of the state of Palestine under Palestinian sovereignty, and West Jerusalem / Yerushalayim, will be the capital of the State of Israel under Israeli sovereignty.<sup>7</sup>
3. The precise location of the border between the two cities will be specified in the agreement. In general, the working assumption of the Aix Group is that the overall border between the state of Israel and the state of Palestine will be based on the June 4th, 1967 Green Line with minor, reciprocal and equitable modifications agreed to by the two parties. Since many of these modifications might be in Jerusalem, they could be more substantial, relative to the size of the city, than in other border areas. Hence, this document considers below a number of options for the location of border.
4. Whether or not the two cities will be divided physically, they will have separate municipalities: a Palestinian one east of the border and an Israeli one west of the border. This is important for ending the conflicts over construction, settlement and quality of services once an agreement is reached. The two municipalities will cooperate on various issues that require cooperation.
5. Complete, free and unhindered access to the holy places in both cities will be granted to all.
6. The implementation of the agreement after it is signed will take some time, the length of which will be specified in the agreement. Our estimate is that the implementation can be as short as one year for some issues, but not longer than 5 years for any possible issue.

Note that these assumptions do not include any internationalization of the city of Jerusalem. It is our assumption that since at least one side will not agree to internationalization of its own capital, the agreement will not include internationalization of Jerusalem, as in the original UN partition decision of 1947. There might be some international local arrangements, mainly for the holy places in Jerusalem, but they will be partial, isolated, and will not affect the main regime options for the two cities.

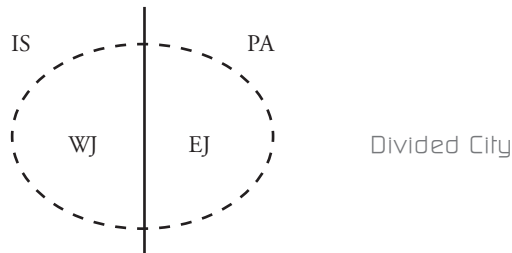
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<sup>7</sup> See footnote 2.

## 4.1. The Possible Regimes in Jerusalem

The many possible regimes in Jerusalem can be classified into three main types. We are aware, of course, that innovative negotiators can always come up with additional ideas, but we nonetheless believe that these three types are the main candidates for an agreement as envisaged today.

### 4.1.A. Divided City



One possible regime is a divided city, wherein the political border between the two cities is also a physical border that can be crossed only by use of passports or some other type of permit. Operationally this means a physical border separating the Palestinian sovereign areas from Israeli sovereign areas, with gates that enable limited passage of people and goods.<sup>8</sup> Special arrangements might be considered for tourists. Note that the divided city regime does not necessarily imply a hermetically closed border, as there can be free movement of some type (like trains or buses) between the two sides of the border. The divided city regime is described in the diagram pictured above, where a solid line stands for a physical border, while a dashed line stands for a non-physical border, either between states or a municipal border.

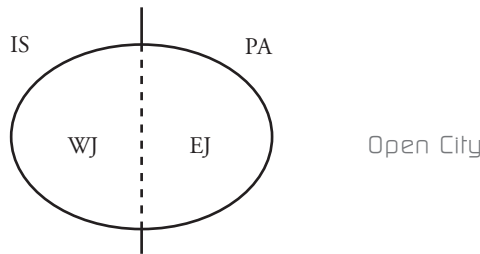
### 4.1.B. Open City

The second possibility is an open city, in which there is free movement of people and goods between the two cities, despite the political border between them. In this case Jerusalem would become an enclave, separated

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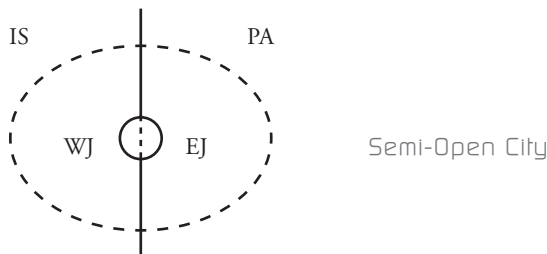
<sup>8</sup> Note that a physical border need not be a fence or a wall, but can be monitored by some electronic devices that are now available through modern technology.

physically both from the rest of Israel and from the rest of Palestine, with gates in each separation line. This solution is desirable primarily with regard to the future development of tourism in the city.<sup>9</sup> Operationally, the Open City regime means that there will be free and unimpeded movement of goods and people between the two cities, any limits to mobility will be between Jerusalem and the rest of the two states, not between the two cities. These limits will be required both for goods, through customs, and for people, through passport and security controls.<sup>10</sup> Such a regime is described in the following diagram:



#### 4.1.C. Semi-Open City

The third type envisages a smaller open area within the city (for example, all or part of the Old City) while the rest of the two cities are divided physically. This regime implies that there would be limitations on movement between the open area and the rest of the two cities.



<sup>9</sup> Having an open city will require cooperation between the two municipalities, mainly in the area of law and order; but that is not the main focus of this document.

<sup>10</sup> Our study focuses only on the need for custom controls.

## 4.2. Possible Locations of the Border

The decision about the type of regime depends heavily on another decision: the exact location of the political border within Jerusalem. There are three main possibilities for the location of the border:

1. The first is a political border that runs along the pre-1967 border, with evacuation of all Jerusalem Settlements / Neighborhoods except for the Jewish Quarter in the Old City. In this case, the Open City scenario becomes quite impossible. Such a massive evacuation will create tensions and hostility between the two populations in the city, making life in an open city very dangerous and possibly even jeopardizing the implementation of the agreement. Hence, in this case the Divided City model seems to be the only realistic option.
2. The second possibility is that the border will not go along the pre-1967 border, but will reflect the current geographical divide between Jews and Arabs.<sup>11</sup> This case raises serious questions of continuity both within the Palestinian city, and between the city and the rest of Palestine. If this is the agreed-upon border, then any of the Open and Divided City models are possible. Clearly, though, the Open City option becomes more plausible and even desirable, as it can significantly enhance mobility between the various Palestinian parts of the city.
3. The third possibility is a compromise between the strict pre-1967 border of the first case and the line between the Jewish and Arab areas in the second case. Namely, the border will leave some Jerusalem Settlements / Neighborhoods within Israeli sovereignty, but will lead to the evacuation of others, mostly to enable greater “contiguity” within the Palestinian city. Examples of settlements that could be evacuated are Atarot, Har Homa, Neve Ya’acov, or Pisgat Ze’ev. In this case we can use reasoning similar to that above and conclude that if the evacuated areas are rather small, then an open city can still be considered; but if the evacuation is extensive,

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11 A similar idea was in the Clinton Proposals. It is important to note that this solution should not apply to isolated settlement houses, like Kidmat Zion and Shimon HaTzadik.

the Open City option becomes quite impossible, leading again to a Divided City model.<sup>12</sup>

We should add here that we have considered a fourth option: withdrawal to the pre-67 border that leaves the Jerusalem Settlements / Neighborhoods in place and enables the Israelis who live there to become residents in Palestine. Despite the clear benefits of such a proposal it suffers from severe drawbacks that make it non applicable. First, such an arrangement might lead to repeated claims over the land of these neighborhoods by Palestinian land owners. Some of these claims might even lead to violence. Second, the Israelis left in East Jerusalem will suffer a significant decline in the public services they receive. They will therefore refuse to stay there and demand alternative housing in West Jerusalem. For these reasons we have decided to rule out this option.

From the above discussion, we can conclude that any future decision with regard to the regime in Jerusalem will be significantly affected by the location of the future political border within the city. Specifically, the location of the border will, to a large extent, determine the nature and degree of openness of the city. The closer the border is to the pre - 1967 border, the more likely the Divided City option becomes. If, on the contrary, the border is close to the current geographical divide between Jews and Arabs, then both the Divided City and Open City options are possible.

#### 4.3. Other Considerations

There are other considerations to take into account when discussing the question of regimes in Jerusalem. We focus next on one economic consideration. The current large gap in income and earnings between the two parts of the city might make the open city regime less favorable to Palestinians. It might lead, for example, to specialization by East Jerusalem in low-skill services, while West Jerusalem specializes in high-skill services. This could significantly hamper economic development in East Jerusalem. Such considerations should affect the agreement on the future regime in the city.

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<sup>12</sup> All three options relate mainly to the extent of territory transferred to Israel beyond the pre-1967 border. This is because this is the relevant issue for our specific discussion. It should be mentioned though that these various options can also include a transfer of some territory from Israel to Palestine within Jerusalem, such as the Wallaje area.



## 5. Institutions for Economic Negotiations

Issues relating to Jerusalem require special arrangements in many areas, both political and economic. For example, special economic arrangements are required in areas such as trade, infrastructure, and Jerusalem Settlements/ Neighborhoods. As a result, we recommend the creation of a special negotiation mechanism that is dedicated to the economic arrangements in Jerusalem, and that will work in conjunction with the political negotiators. Our suggestions are as follows:

### 5.1. Jerusalem Economic Negotiation Team

We suggest the creation of two special negotiating teams, one Israeli and one Palestinian, focused specifically on the economic aspects of an agreement on Jerusalem. These “Jerusalem Economic Negotiation Teams” (JENT) would operate in conjunction with the political negotiating teams to reach detailed agreements on trade arrangements, labor permits, financial aspects of evacuations of Jerusalem Settlements / Neighborhoods, and issues of infrastructure. Negotiations between the JENT will begin after the signing of the political agreement, or even earlier if possible, and end before the full implementation of the agreement. The teams will work together to decide the precise details of the implementation of the agreement in Jerusalem.

In principle, the JENT can be part of the Israeli and Palestinian economic negotiating teams, and the JENT should definitely be coordinated by these teams. However, due to the large amount of economic agreements required in Jerusalem and their specific characteristics, which require a significant amount of specialization, there is a strong case for creating separate negotiating teams for the issues relating to Jerusalem.

## 5.2. Jerusalem Economic Arbitration

In the event that the two economic negotiating teams are unable to reach an agreement that leaves enough time before the implementation time, the matter will be brought to a mutually acceptable “Jerusalem Economic Arbitrator” (JEA). Since all issues dealt with by the JENT must be settled before the final implementation of the agreement, there is a clear need for such an arbitration mechanism. Note that the arbitrator will not decide on major issues like the location of borders, but rather on financial and economic issues related to the agreement.

## 6. Trade Arrangements

### 6.1. Trade Regimes

The general trade arrangement recommended by the Aix Group for Israel and Palestine is a Free Trade Area (FTA): a bilateral free trade agreement between Israel and Palestine with respect to goods produced in each country, while goods from third countries will be traded with tax and tariff adjustments. This is a regime that enables each state to have an independent trade policy. In this section we examine whether Jerusalem should have the same trade regime. As we demonstrate below, the main parameter that should determine the specific trade regime in Jerusalem is whether the city is open or divided.

1. If the city is divided, the economic regime in the city can and should be the same FTA arrangement that is recommended for Israel and Palestine.
2. If the city is open, a uniform system of tariffs and taxes is necessary in the two parts of the city for goods from the two states as well as from third countries. This follows from the simple fact that an open city means free transport of goods between its two parts.
3. For each specific good, therefore, the rate of tariff and tax should be equal in both parts of Jerusalem, and it should be set at any rate between zero and the minimum rate in the two states. For example, if Israelis outside of Jerusalem pay a tax and tariff of 15% on DVD players while Palestinians outside of Jerusalem pay 20%, the rate in both parts of Jerusalem should be equal, and should be set anywhere between 0-15%. A rate higher than 15% would send Israeli shoppers from Jerusalem to a mall in Mevaseret Zion. As a result, if there is an open city in Jerusalem, it must be a special trade zone for goods from third countries relative to the rest of the two states, with lower rates for many goods.

4. In order to restrict the special trade area to Jerusalem, some restrictions must be placed on transportation at the external borders between the two cities and the rest of the two states (the solid lines in the two diagrams). We suggest that these restrictions should apply only to commercial transactions (trucks or trains) and not to households (private vehicles). One example of such an arrangement is the limitation on Eilat within Israel as a VAT-free city.
5. It is important to note that in the Semi-Open City option, the open area is relatively small. If trade in this area is restricted to certain classes of goods, like food, textile and tourism, special trade arrangements in this area will be less costly and less problematic than in the whole city.
6. One possibility of a special trade zone in the case of an open city is a full FTA with no tariffs and taxes on goods, including those from third countries, either as a permanent or as a temporary arrangement. Such an arrangement could give a significant economic boost to both parts of Jerusalem, but it also has some negative aspects, such as the potential to create resentment by favoring East Jerusalem over the rest of Palestine.

## 6.2. Economic Implications

A special trade arrangement for Jerusalem is a necessary by-product of the Open City option. Although the economic consequences of a special trade zone cannot be fully evaluated at the present time, the potential costs of such an arrangement should be taken into consideration when discussing the future model of the city. Current tariffs and excise tax rates on goods from third countries are quite similar in Israel and in the Palestinian Authority. Israel has relatively low tariffs: only 11% of Israeli imports pay tariffs (exceptions are cars, gasoline and some electric appliances). Purchase taxes are also low in Israel; only cars, cigarettes and alcohol are taxed at a high rate. If these rates continue to be coordinated and harmonized between the two states, the special trade zone in Jerusalem will not be costly. But once independent, Palestine might decide to impose higher or lower tariffs and taxes on various goods, reflecting either a need to finance its expenses, or its intentions to protect infant local industries.

Future potential discrepancies in tariffs and tax rates between Israel and Palestine might lead to massive smuggling through Jerusalem, which could be costly for both sides.

The following tax and tariff figures give some estimates of the potential smuggling costs to Israel from a free trade zone in an open city. In 2005 the income from purchase tax on cars and car parts in Israel was 6,849 million NIS, or 1.1% of GDP. The income from purchase tax on cigarettes was 3,342 million NIS in 2005, or 0.6% of GDP. Revenues from purchase tax on gasoline were 393 million NIS. The rest of the revenues from purchase taxes were 1,493 million NIS. If we omit cars from the total because they are hard to smuggle due to the need to register them, the rest of the goods created an income of 5,233 million NIS, or 0.9% of GDP. The income from tariffs to Israel reached 1,764 million NIS in 2005. Most of these tariffs were on goods that cannot be moved easily, like cars or inputs to industry. The value of tariffs on leather, textile and clothing, which are easier to move across the border, was 470 million NIS, which is less than 0.1% of GDP.

Hence, the potential income losses to the Israeli government from smuggling do not exceed 1% of GDP. This figure is not very high, but neither is it negligible: it is approximately 2.5% of the total government tax revenue. It is hard to draw conclusions from these figures with respect to losses of income to the Palestinian government, but we can say that in general, these losses can be expected to be even higher, since income from purchase tax and tariffs might be larger relative to income in Palestine.

These potential costs make the Open City option much more complicated and costly than it initially appears. Hence these potential costs cast doubt on the desirability of the Open City option. Although it might benefit tourism, it could be costly for public revenues. Furthermore, there are additional, non-pecuniary social and moral costs to making Jerusalem a main channel for smuggling between the two states. A full consideration of these costs makes the Open City option much less attractive. We could even say that the above analysis puts a dilemma before the negotiators on Jerusalem: if they prefer an open city, it almost inevitably requires a policy of tax and tariff harmonization between the two states. If Palestine insists on tax and tariff independence, it means that the option of an open city in Jerusalem has to be given up.

## 7. Labor Arrangements

The general recommendation of the Aix Group for labor arrangements between Israel and Palestine is that labor will flow freely between the two states, but will be subject to regulation through taxes and/or permits. As detailed below, we also adopt this recommendation for Jerusalem, though with one additional adjustment.

First note that unlike trade arrangements, labor arrangements do not depend much on the possible regime in the city. The main reason is that unlike trade in goods, which is to a large extent small-scale and anonymous, labor contracts are usually long-term, and drawn between well-known parties. Thus in the case of a divided city, it is possible to allow labor to flow across the border through designated passages; at the same time, it is also possible to regulate labor flows even if the city is open.

The labor arrangements in Jerusalem could therefore be similar to the overall labor arrangements between the two states, but with one important difference. We must acknowledge the fact that Palestinians from East Jerusalem have been working for Israeli employers for many years. We therefore suggest that in addition to the general labor agreement between the two states, there should be a provision for Jerusalem specifying that those Palestinians from East Jerusalem who have been working in West Jerusalem prior to the agreement will be able to keep their jobs for a minimum of ten years, or until retirement.

The team discussed the possibility of giving all Palestinians from East Jerusalem, not just those who already work in Israel, preferential treatment with regard to labor. The views on the issue were mixed. Such preferential treatment would help workers in East Jerusalem, but it might also create excess Palestinian immigration to East Jerusalem and hamper its economic development as a Palestinian capital. It might also create social tensions within the Palestinian society. We therefore decided not to include it as a recommendation by the team.

## 8. Infrastructure

The division of infrastructure between the two cities poses a serious economic question. Many infrastructure projects, such as water, sewage, trains, electricity, and wired telecommunications, have by their nature significant network externalities, and thus large returns to scale. Hence, from a pure economic point of view, in an ideal world such infrastructure networks should not be divided between the two cities. But in the real world, where politics play a significant role, sharing the same infrastructure between two cities that belong to two different states involves serious difficulties. Mainly, such an infrastructure is usually run by one side, and it therefore has a tendency to neglect and under-serve the other side. Hence, our basic recommendation is to divide the infrastructures between the two cities, but to do it gradually. The gradual transition is required by the large investment involved in building infrastructure networks. We begin this chapter with a brief survey of infrastructure in the two sides of Jerusalem, and then offer detailed recommendations.

### 8.1. Description

There is a wide gap in infrastructure and provision of basic services between East and West Jerusalem. Table 2 provides evidence for this gap with respect to roads and streets, sewage systems, garbage collection holders and public playgrounds.

Table 2: Basic Services in East and West Jerusalem<sup>13</sup>

Section	East Jerusalem	West Jerusalem, including Jerusalem Settlements/ Neighborhoods
Roads and streets	87km	680km
Street side walks	73km	700km
Sewage system	76km	650km
Street garbage collection holders	149	1849
Public playgrounds	29	1079

### 8.1.A. Electricity

Electricity in East Jerusalem is supplied by the Jerusalem Electric Company (JEC), which was established in 1914 through a special concession from the Ottoman government. The concession was revised by the British government in 1928, providing the JEC with unique, exclusive market rights in a 50km radius around the Church of the Holy Sepulcher for a period of 44 years. In 1948 the company had to give up its concession over West Jerusalem to the Israeli Electric Corporation (IEC). Since 1948, the two companies, one Israeli (IEC) and the other Palestinian (JEC), have provided electricity to Jerusalem.

Presently, the JEC is still the main electricity provider for East Jerusalem and for 25% of the West Bank. More than 90% of its electric power is bought from the Israeli Electric Company, and the Israeli government sets the prices and the connection fees. The total number of the JEC's power customers is around 130,000, of which 64,000 are in Jerusalem, 40,000 in Ramallah, 22,000 in Bethlehem and 4,000 in Jericho. The company is the largest employer of Palestinians in East Jerusalem, with 538 workers and staff. In 2004, the number of subscribers to the JEC's electric service in Jerusalem was 72,459 and they consumed 337.6 million K.W.H.<sup>14</sup>

<sup>13</sup> MSR Project based on *Haaretz*, 25 March 1999.

<sup>14</sup> See Palestinian Central Bureau of Statistics Website. <http://www.pcbs.gov.ps/>



### 8.1.B. Atarot-Qalandia Airport

This domestic-only airport is located along the road to Ramallah, in the most northern area of Jerusalem. Its official name is Jerusalem International Airport; it is called 'Qalandia' by Palestinians and 'Atarot' by Israelis. Until 1967 it was an international civilian airport run by Jordanian authorities and used by Palestinians. The airport has not been operational since the start of the Al-Aqsa Intifada in 2000.

### 8.1.C. Light Rail

The municipality of Jerusalem is currently building the first line of an above-ground light rail. The line will connect Pisgat-Ze'ev and other Jerusalem Settlements / Neighborhoods to West Jerusalem. The Palestinians strongly oppose this plan, for both legal and political reasons. The economic implications of the light rail and its relation to Israeli-Palestinian negotiations are discussed in more detail in section 11 of this chapter. In this section, we focus on the light rail as part of the city's infrastructure. It seems that any partition of the city, whether into a divided city or an open one, will require some partition of the rail lines that cross Palestinian territory. It would be helpful to consider this issue in advance, in order to economize on future costs.

## 8.2. Recommendations

Our main recommendations with respect to infrastructure are as follows:

1. The infrastructure networks should remain intact when the city is divided into two separate cities and municipalities. Citizens of each city will continue to use the other city and state's network services for a transitional period of 5, 10 or 15 years, as agreed to by both sides.
2. During the transitional period, citizens will pay their own state's providers for the infrastructure services, and the provider will settle accounts with the other side's provider. Thus, residents of an Israeli neighborhood that gets electricity from the Jerusalem Electric Company will pay the Israel Electric company, which will settle accounts with

the Jerusalem Electric Company. The rates will be negotiated and agreed upon by the Jerusalem Economic Negotiating Teams (JENT) and will be part of the economic agreement on Jerusalem.

3. During the transitional period, each municipality and each state will complete the building of its own infrastructure, so that by the end of this period the networks can be separated. It is reasonable to assume that much of the infrastructure network that will be built in East Jerusalem will be part of the general infrastructure build-up in Palestine. This investment is critical for the economic development of Palestine and it should start today. In Section 11 we discuss the current obstacles to such development. It is important to remember that development of Palestinian infrastructure is especially crucial in Jerusalem, where the two infrastructures are tangent and even intertwined.
4. It is also possible for the two sides to continue to share infrastructure beyond the transitional period, if both sides wish. This should be discussed by the two sides during the transitional period.

## 9. Costs of Setting a Border

### 9.1. Background

In the 40 years since 1967, the physical, demographic and ethnic landscape of Jerusalem has changed significantly. The change that is a principal concern for a future agreement between Israel and Palestine is the construction of the Jerusalem Settlements / Neighborhoods in East Jerusalem. Approximately 180,000 Israelis currently live in the following twelve Jerusalem Settlements / Neighborhoods: East Talpiot, Gilo, Givah Tsarfatit (French Hill), Giv'at Ha-Matos, Har Homa, the Jewish Quarter of the Old City, Ma'alot Dafna (East), Neve Ya'acov, Pisgat Ze'ev, Ramot Allon, Ramat Shlomo and Ramat Eshkol. To this we should add Atarot, which is mainly an industrial and commercial center. The basic positions of the two sides with respect to the future of the Jerusalem Settlements / Neighborhoods are quite opposed. While Israel views them as legitimate neighborhoods that should remain in Israel, the Palestinians view them as illegal settlements that should be evacuated. Still, it seems that any future agreement on Jerusalem might leave some Jerusalem Settlements / Neighborhoods under Israeli sovereignty, within the framework of a land swap, and would evacuate some in order to enable better contiguity and future development space for East Jerusalem. Hence, our working assumption is that a future agreement on Jerusalem will determine which Jerusalem Settlements / Neighborhoods will be evacuated and which will become part of Israel, and that the agreement will deal with all relevant legal and citizenship issues.

This section deals with the economic issues that such an agreement raises. While we cannot fully predict the exact location of the future border, we can foresee two types of economic-geographical issues that such a border will create: one is how to conduct an evacuation of a Jerusalem Settlement / Neighborhood once it is decided that it will be in Palestinian territory; the second is how to

adjust the infrastructure (such as tunnels and bridges) for contiguity, and how such investments in infrastructure should be built and financed.

It is important to note that for many payments from one side to the other, one of the ultimate sources of financing will probably be the international community or donor countries, paying through an international fund, which will contribute their share to facilitate the agreements. We acknowledge this possibility but discuss the various payments as bi-lateral in order to clarify responsibilities and mechanisms. Another important note is that the results of the various mechanisms, also involving various other payments, should be added together and the actual payments should be the net ones only. Hence, in reality many of the payments described below might be written off.

## 9.2. Evacuation of a Jerusalem Settlement / Neighborhood

Of the many economic issues involved in an evacuation of a settlement / neighborhood, we focus here on one narrow issue: how to transfer it to the jurisdiction of Palestine.<sup>15</sup> The specific economic agreement over each evacuated Jerusalem Settlement / Neighborhood will be conducted by the JENT and will follow these guidelines:

1. The structures in the Jerusalem Settlements / Neighborhoods are apartment buildings and are therefore suitable as residences for Jerusalem Palestinians.<sup>16</sup> Hence, it is strongly recommended that such a settlement / neighborhood will not be destroyed, as was the case in previous Israeli evacuations, but rather be transferred as is. Destroying the structures and then building others similar to them would be economically extremely inefficient and wasteful.
2. An administrative body would be created by the Palestinian state that would be mandated to handle the transfer of Jerusalem Settlements / Neighborhoods from Israel to Palestine, their management, and the allocation and distribution of their assets, with a priority of returning lands to their original owners. This administrative body will cooperate with the JENT.

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<sup>15</sup> We ignore here the important issue of how Israel should compensate the evacuated households and what incentive should be implemented to facilitate quick evacuation.

<sup>16</sup> This is not necessarily the case with many West Bank Settlements.

3. The JENT will negotiate whether funds will be tendered, and if so how much, for all tangible assets, mobile and immobile, which are left by Israel in an evacuated Jerusalem Settlement / Neighborhood. In case an agreement is not reached in due time, the matter will be brought to the JEA for a decision.

In addition to the specific agreements on the evacuated Jerusalem Settlements, the JENT will negotiate an agreement on some form of compensation for the past use of land of all Jerusalem Settlements from 1967 to the time of the agreement. Such an agreement will also include settlements that will remain under Israeli control, since these settlements will become legally Israeli only after the agreement is signed.

The details of all these agreements will be negotiated by the JENT. In the case that an agreement cannot be reached by the JENT, the issue will be taken to the Jerusalem Economic Arbitrator (JEA).

We firmly believe that the principles described above should be part of the main final status agreement, as they are political as well as economic.

### 9.3. Infrastructure Adjustments

After an agreement is reached, infrastructure projects will need to be undertaken in both cities in order to enable free and easy mobility between Jerusalem neighborhoods, or above or below neighborhoods of the other city through bridges or tunnels. Our recommendations address the construction and financing of such infrastructure.

1. The construction should be negotiated and agreed to by both sides, through the JENT. Although the party whose needs will be served by the construction should be both the planner and the builder of the infrastructure, the other party has to agree to the plans as well, in order to minimize potential harm from the project at both the construction and the operational stages.
2. The financing of such projects should be borne by Israel, since the construction of the Jerusalem Settlements / Neighborhoods created the need for such investments. Hence, an additional reason to negotiate all infrastructure projects through the JENT is to avoid a problem of agency, wherein a construction project is decided upon by Palestine and paid for by Israel. In the case of disagreements the final decision will be delegated to the JEA.

## 10. Social Security

### 10.1. The Current Situation

All Palestinians who currently have Israeli residency status are compulsorily insured by the National Insurance Institute (NII). Israel has a Beveridge-style<sup>17</sup> social security system that provides comprehensive social coverage, including old-age pensions, survivors' benefits, child allowances, maternity benefits, disability benefits, unemployment insurance, and minimum income support. The share of the National Insurance allowances in GDP is approximately 9%. According to the 1999 income survey of the Israel Central Bureau of Statistics (ICBS), East Jerusalem Palestinians received substantial amounts of their net income from the NII. This survey estimated the gross monthly household income of Palestinians in East Jerusalem to be 5,629 NIS, compared to 12,511 NIS for residents of West Jerusalem. The net monthly household income was estimated at 4,970 NIS and 9,469 NIS respectively.<sup>18</sup> Households in East Jerusalem received NII benefits amounting to 983 NIS, which was not much higher in absolute values than in West Jerusalem, but was much higher relative to net income – 19.7% compared to 9% in West Jerusalem. The reasons for the discrepancy are that residents of East Jerusalem have lower income, higher unemployment, and more children per household.

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17 Named after William Henry Beveridge, the initiator of the modern social security system in Britain.

18 In a recent survey (2004) the gross and net incomes of West Jerusalemites were 11,470 NIS and 9,167 NIS respectively.

Table 3: Income and NII Benefits of Jerusalem Households (1999)

	East Jerusalem	West Jerusalem
<b>Gross monthly income</b>	5,629	12,511
Taxes paid	660	3,042
Income tax	262	2,191
national insurance payments	156	409
health insurance	242	442
<b>Net monthly income</b>	<b>4,970</b>	<b>9,469</b>
Net monthly income tax	896	2,262
Gross monthly income from work	4,553	10,514
Other income	1,102	1,929
Capital income	34	240
Pension	23	407
<b>NII benefit payments</b>	<b>983</b>	<b>854</b>
Transfers	58	152
% NII benefit from net income	19.78%	9.02%

Source: MSR Project, Israel Central Bureau of Statistics Income survey, 1999.

Another important social security issue is the health insurance of Palestinians in East Jerusalem. Currently, the State of Israel provides health insurance through a Health Tax that is also collected by the NII. This tax entitles East Jerusalem residents to receive health services from Israeli HMOs and from Israeli hospitals.

## 10.2. Recommendations

We have four basic recommendations in this area:

1. All Palestinians in East Jerusalem who are entitled to social security benefits from the NII due to past contributions will continue to receive the benefits that are due to them until death.
2. The Jerusalem Economic Arbitrator (JEA) will set up a body to monitor these benefit payments and to ensure that the rights of the recipients are respected.
3. After the agreement is enacted, the social security contributions of Palestinians in East Jerusalem will be paid to the Palestinian Social Security Institution. They will accumulate separate benefits from then on.
4. In order to smooth the transition of health insurance and services from Israeli providers to Palestinian providers, we suggest a special temporary (e.g. 5 year) arrangement. During this transition period, Palestinians from East Jerusalem will be able to continue to pay health tax to Israel and to receive health services from Israeli providers. The tax payment could be made through the Palestinian state or through an international body set up by the JEA.



## 11. The Current Situation and the Final Status Agreement

Any future agreement will have to deal with the facts that have been created “on the ground” in the recent decades of occupation and conflict. For example, a settlement can affect an agreement whether it is annexed to Israel or evacuated. If annexed, the settlement will affect borders, space and mobility in the Palestinian territory; if evacuated, the high costs of relocation will have to be dealt with. As a result of issues such as these, it is often said that the settlements have a negative effect on the chances to reach an agreement. However, settlements and other “facts on the ground” have another, less obvious but critical economic effect which has a significant impact on the ability to reach a final status agreement: they adversely affect economic development in East Jerusalem and in Palestine as a whole. In this section, we discuss the three developments that are primarily responsible for this negative effect: the separation wall / barrier; the continued expansion of settlements; and the Jerusalem light rail project.<sup>19</sup> These developments have both political and economic consequences for the possibility of reaching a final status agreement.

We strongly believe that economic development in Palestine is crucial to reaching and sustaining an agreement. People who live in a growing economy and who work hard to improve their physical and social standards of living are less willing to indulge in fighting, hatred and hostility. This is true for Israelis and it is even truer for the Palestinians, who bear many grudges after years of occupation and suffering. Hence, this section focuses on the prospects of economic development and the obstacles to such development.

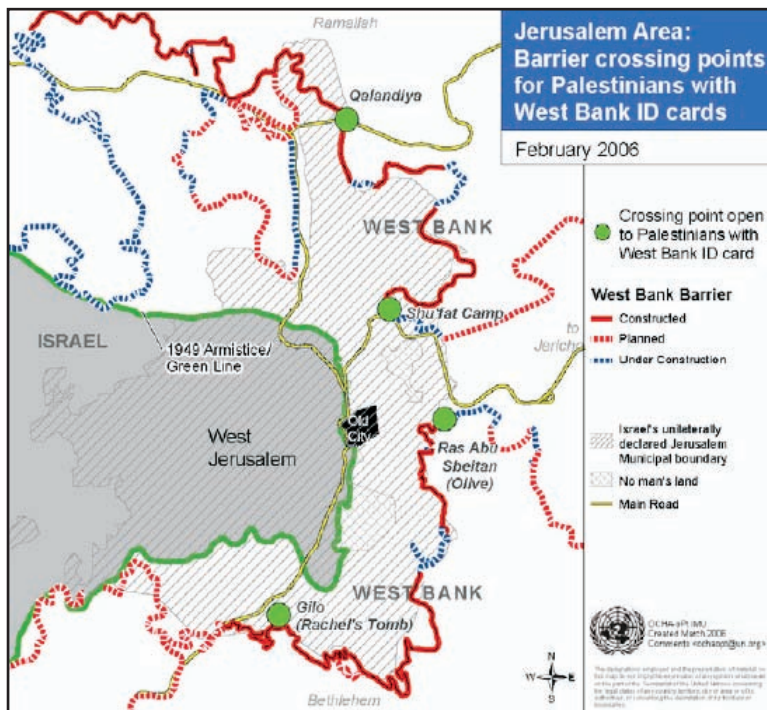
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<sup>19</sup> There are additional measures that exacerbate these three main developments, like excavations in and around the Old City of Jerusalem, the Ministry of Interior's policies of not granting ID's for Palestinians from East Jerusalem, various local policies of the Jerusalem municipality, etc. This document focuses only on the main developments.

### 1.1.1. The Separation Wall / Barrier

The most serious current obstacle to economic development is the ongoing construction of the separation wall / barrier in and around East Jerusalem. The wall cuts off all of East Jerusalem from the rest of the Palestinian territory in the West Bank. Palestinian access to the rest of the West Bank from East Jerusalem is limited to four crossing points for civilian traffic and six “back-to-back” stations for commercial and agricultural goods. This significantly reduces Palestinian mobility between Jerusalem and the West Bank, and almost completely severs the route between the northern and southern parts of the West Bank through Jerusalem. This is clearly illustrated in the map below.

Figure 1: Barrier Crossing Points for Palestinians with West Bank ID Cards, February 2006 <sup>20</sup>



<sup>20</sup> United Nations Office for the Coordination of Humanitarian Affairs (UN-OCHA).

This separation wall / barrier will lead to further deterioration of economic contacts between East Jerusalem and other parts of the West Bank and will significantly reduce the position of East Jerusalem as the center of Palestinian political and economic activity. Should this situation continue for an extended period of time, it will become extremely difficult to restore the economic role of East Jerusalem as the Palestinian capital. Hence, current developments should be considered in light of their effect on the present situation, but also with regard to their impact on a future final status agreement.

Even if the separation wall / barrier itself is removed once a final status agreement is reached, it will be very difficult to rebuild East Jerusalem as the economic hub of Palestine. But the segment that severs East Jerusalem from the other Palestinian areas has a much more profound economic effect on all of Palestine. East Jerusalem is not only the economic capital of the West Bank; it is also the main link between its northern and southern parts. If these two parts become even more disconnected than they are today, they will develop separately and not as one coherent unit.

This has serious negative implications for the economic development of Palestine, due to the loss of many returns to scale. It especially harms the Palestinians' ability to build large infrastructure projects such as roads, railways, electricity, water and sewage, where increasing returns to scale are significant. It also severely restricts the ability to economize on large-scale public systems like science and education. Unencumbered mobility between all parts of Palestine is also crucial for the development of markets, distribution networks and similar private sector activities that require large-scale operation. Thus the physical separation of Jerusalem from the rest of the West Bank will severely hamper not only the economic development of East Jerusalem, but the economic development of the entire West Bank and of Palestine as a whole.

## 11.2. Settlement Activity in Jerusalem and East of Jerusalem

The separation of East Jerusalem from the West Bank by the separation wall / barrier is further exacerbated by settlement activity both within and east of Jerusalem. This primarily includes the expansion of Ma'aleh Adumim and the plans to build in the E-1 area, which is designed to



for East Jerusalem, but for the West Bank and for Palestine as a whole. This settlement activity further blocks the territorial contiguity and physical mobility between the north and the south of the West Bank, hurting not only the current economic status of Palestinians, but also blocking to a large extent their ability to begin large scale development projects and to begin experiencing economic growth.

### 11.3. The Light Rail

The separation wall / barrier and the settlement activity in and around Jerusalem are physical blocks to Palestinian territorial contiguity and mobility between the northern and southern West Bank, and between Jerusalem and the West Bank. These physical restrictions are further reinforced by the Israeli Municipality in Jerusalem in the construction of the light rail in Jerusalem. Although most of the first line of the rail runs within West Jerusalem (from Mt. Herzl to Jaffa Street), the line is scheduled to directly connect Jerusalem Settlements (French Hill and Pisgat Ze'ev) to West Jerusalem. This will create greater mobility to the Jerusalem Settlements in northern Jerusalem and will increase their population. It could also lead to the expansion of these areas eastward, even beyond the current municipal borders, a process that has already begun. This would result in further encroachment on Palestinian neighborhoods, and even greater restrictions on Palestinian mobility in and out of the city and between the northern and southern West Bank. Furthermore, Pisgat Ze'ev is an important point on the route between Jerusalem and the settlements to the east and north of the city (though not to Ma'aleh Adumim). Hence, the building of the light rail will make these settlements - especially those that are very close to the city - more attractive to move to, strengthening Israeli settlements linkages with Israel proper and the light rail will make it harder to divide Jerusalem as part of a negotiated final status solution for the city. The crippling effect of such a situation on Palestinian economic development has been described above.

## 12. Summary

This chapter has two elements. The first, more optimistic element is the attempt to outline economic arrangements that might accompany a final status agreement. The other element is more pessimistic, and illustrates how current developments in and around Jerusalem are creating obstacles on the road to a peace agreement between Israel and Palestine - obstacles that are not only political but economic as well.

On the optimistic side, this document attempts to show that economic arrangements for a final status agreement on Jerusalem are attainable. Despite the difficulty of reaching such an agreement, we are able to outline various economic arrangements for almost all scenarios of an agreement. We suggest possible trade arrangements, labor arrangements, and arrangements for issues of infrastructure, social security and more. We believe that what we describe is feasible, simple and realistic, once an agreement is reached.

One issue, which we can especially imagine creating problems in the future is the economic cost of setting the border. Drawing a border line is not only a difficult political act, but it entails significant economic costs as well. In this case the economic cost is a result of the vast Israeli construction activity in East Jerusalem and in the settlements around it. This construction could lead to significant expenses when the time comes to set a border, whether the expenses are those of evacuating Settlements / Neighborhoods or of building new infrastructure in the event that some Settlements / Neighborhoods are annexed by Israel as part of a future land-swap. These costs are substantial and are growing with time as a result of ongoing settlement activity. This document does not deal directly with the political price of reaching an agreement under such conditions, but it is clear that this price is made even greater by the economic costs, and might even prevent an agreement altogether. One possible conclusion of this analysis is that imposing a settlement freeze in the West Bank

in general and in East Jerusalem in particular is both a political and an economic necessity.

Another effect of this construction activity is the obstacles it creates for Palestinian economic development. The obstacles are primarily physical, blocking Palestinian mobility to and from Jerusalem and between the northern and southern parts of the West Bank. This curtailed mobility diminishes chances for Palestinian economic re-integration, derails developments of networks, reduces returns to scale, and prevents construction of large-scale development projects. This effect is further exacerbated by the physical closure of East Jerusalem to the West Bank, since Jerusalem has been the social, economic and political center of Palestinian society for many years. Placing further obstacles on the road to economic development is not only causing human suffering, it is also hindering the possibility of reaching and sustaining a permanent peace agreement. Poverty never helped peace.

Thus our summary is somewhat mixed. We believe that we have identified ways to solve some of the main economic problems facing a future agreement, once it is reached. But we are afraid that current developments place enormous obstacles in the way of reaching such an agreement to begin with. These obstacles are both political and economic, though our document focuses mainly on the economic aspects. Interestingly, these obstacles to reaching an agreement are concentrated in the Jerusalem area, since the city is an essential link between the two parts of the West Bank and is thus a key to Palestinian economic development. Our analysis therefore highlights the urgency of beginning negotiations on the final status agreement.

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# Palestinian Refugees

Aix Group, Palestinian Refugees Team

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## Executive Summary

The Aix Group Refugees Team emphasizes in its work the issues that will have to be resolved in any practical implementation of a two-state agreement, focusing attention on the economic aspects related to the refugees.

On the practical level, abstracting from the legal, philosophical, historical and ethical levels, the Clinton parameters imply that unspecified numbers of refugees will move from where they currently live to new places of residence, others will be rehabilitated in their present locations, and some form of compensation will be given, whether in kind or in money, to individuals or collectively.

Our analysis assumes that the future agreements and the achievement of a practical solution will be based on choices made by the refugees themselves: the refugees will assess what is best for them and will choose between alternative locations for residency, as explained in the Clinton parameters. The exercise of choice among alternative options will be done individually, in a well-organized process supervised by the International Agency for the Palestinian Refugees (IAPR), an international administration created for this purpose. We propose that the individuals will choose more than one alternative and rank their priorities. A timeframe for this process will be agreed upon.

The IAPR will be responsible for implementing an agreed-upon mechanism to ensure that the final decisions satisfy the wishes of the refugees as much as possible and are in line with the overall agreements to be signed between the representatives of the two sides, and possibly also with the relevant host countries and other countries.

The IAPR will also supervise the various arrangements, mechanisms and programs that will address the following four critical topics:

- :: Resettlement/Repatriation, or what we describe sometimes as Relocation Programs

- :: Rehabilitation Programs
- :: Claims concerning properties
- :: Compensation for refugehood

The Aix Refugees Working Team estimated the costs of relocation and the costs of rehabilitation (i.e. expenses covering those programs intended for refugees who choose not to change residency) separately.

- In order to implement **comprehensive resettlement programs**, the IAPR will need funds in the order of **US\$8 billion to US\$19 billion** over a period of ten years, depending on the number of refugees who choose to relocate.
- In order to implement **rehabilitation programs**, the IAPR will need funds in the order of **US\$10 billion to US\$14 billion**, depending on the number of refugees who decide not to relocate and whether those who so decide currently reside in or outside camps.

The question of settling claims concerning lost properties, and the financial dimension of such a question, is very complicated. Under international law, and similar to other reparation programs pursued to respond to other situations, reparations can take many forms. The Aix Group has discussed the options of restitution and compensation. These, among others, are appropriate forms of reparations for Palestinian refugees. The Group introduce a concept of “full and fair compensation” to be determined objectively by a board of experts associated with the IAPR that will administer the lost properties claims process. Restitution will be considered only in those cases where “full and fair compensation” has not been offered and where the properties exist in a form that can make restitution practical and equitable.

- The funds necessary to answer expected **property claims that are “fair and full”** were estimated to be between **US\$15 billion and US\$30 billion**. The wide range reflects conceptual gaps as well as gaps in data.

We recommend the establishment of a fourth fund that will finance compensation for refugehood not related to property claims or to the above programs.

- All registered refugees will receive uniform sums. Each refugee who registers with the IAPR will receive an agreed upon sum; an additional sum will be distributed to the public authority where the refugee chooses to reside. This fund will require approximately **US\$22 billion**.

A long-term resolution of the Palestinian refugee issue should be based on all relevant UN resolutions, including GA Res. 194, while recognizing that a literal application of this Resolution is no longer possible given the substantial changes on the ground. As in the Clinton parameters, the parties would agree that the measures recommended in the paper implement resolution 194. The Aix Group considers that the right of return to their homeland, even in a modified and limited sense, together with the other measures discussed in this paper, should be an essential component of closure to this issue.

The magnitude of the financial dimensions of an agreed-upon resolution for the refugees is very significant; we estimate it as between **US\$55 billion and US\$85 billion** over the period of implementation of about ten years. The financial estimates are explained in the text; one has to remember that resettling/relocating/rehabilitating around four and half million people and settling 60 year-old claims on many lost properties is an enormous task.



## I. Introduction

A satisfactory and agreed-upon solution for the Palestinian refugees stands at the center of current debates. It became almost an issue of “make or break” in the attitude to peace. Those who argue, especially since 2000, that it is impossible to achieve a final and permanent political agreement between the two peoples base their argument, to a large extent, on an “impossibility theorem”: it is impossible to have an agreement, even a theoretical one, which will satisfy the two sides on this issue. However, official discussions from 2000-1, and documents revealed since then, as well as many later discussions in less official circles, cast serious doubt on the validity of this theorem.

The Aix Group is not in the position to propose or negotiate a formula that the two leaderships will eventually endorse. Instead, the Group emphasizes in its work the issues that will have to be resolved in any practical implementation of any such formula, focusing its attention on economic aspects. It is clear that any agreement concerning the refugees will have many dimensions; it will have major implications concerning the legal status, place of residence and financial position of a significant number of refugees. Hence, it will have important financial and economic consequences not only for the refugees but also for their current and future countries of residence. Thus it is clear that any agreement, when implemented, will bring unprecedented and dramatic changes to both the refugees and the region.

The current study by the Aix Refugees Working Team seeks to clarify and assess how these expected changes will be reflected in the economic circumstances affecting the refugees and the various economies involved. The study seeks to shed light on the economic challenges that such an agreement poses and how to shape policies and mechanisms of implementation that can guarantee, as much as possible, that the results of the agreement will be positive and constructive to the wellbeing of the refugees as well as to peace and stability in the region.

The frameworks discussed in official circles in the past few years serve as a reference, or benchmark, for our work. We adopted the Clinton parameters in particular, since they seem to provide the most comprehensive and creative formula<sup>1</sup> also used by other initiatives since 2000. Although the parameters are quite detailed, they are still far from a draft agreement. Their practical consequences are not quantitative but rather qualitative. On the practical level, abstracting from the legal, philosophical, historical and ethical levels, the Clinton parameters imply that unspecified numbers of refugees will move from where they currently live to new places of residence, others will be rehabilitated in their present locations, and some form of compensation will be given, whether in kind or in money, to individuals or collectively.

The context of our analysis is a two-state agreement, wherein two sovereign political entities will coexist. As a result of such an agreement, a clear understanding will be established as to who “belongs” to each entity as far as citizenship, residency and property rights are concerned. It will also become clear what, if any restrictions, will exist on movements of persons, goods and services, and/or capital between the two states, and whether there will be any restrictions on property ownership. However, as stated in the introductory “rationale and assumptions” statement, developments in recent years make the issue of “pre-emption” (i.e. the establishment of “facts on the grounds”) in terms of settlement expansion and major changes in topographical contours in the West Bank and in the greater Jerusalem region, a major obstacle to the two-state option. These new realities may compel us to think at some point of an alternative arrangement to the two-state option, and to the refugee issue in particular. Thus, if and when the two-state option collapses, it will call for rethinking the refugee issue in terms of residency options for both Palestinians and Israelis within the country as a whole, on the basis of common citizenship or bi-national citizenship. We did not address such an option here.

The analysis of the Aix Refugees Working Team relies on the implementation of the agreements and the achievement of a practical solution that will be based on choices made by the refugees themselves: the refugees will assess

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<sup>1</sup> See the relevant section of the text in Appendix A. See also the 2001 Moratinos “Non-Paper” in Appendix B.

what is best for them and will choose between alternative locations for residency, as explained in the Clinton parameters. The exercise of choice among alternative options will be done individually, in a well-organized process supervised by the International Agency for the Palestinian Refugees (IAPR), an international administration created for this purpose. A timeframe for this process will be agreed upon. As we explain below, we propose that the individuals will choose more than one alternative and rank their priorities. The IAPR will be responsible for implementing an agreed-upon mechanism to ensure that the final decisions satisfy the wishes of the refugees as much as possible and are in line with the agreements to be signed between the representatives of the two sides, and possibly also with the relevant host countries and other countries.

The IAPR will also supervise the various arrangements, mechanisms and programs that will address the following four critical topics:

- :: Resettlement/Repatriation, or what we sometimes describe as Relocation programs
- :: Rehabilitation programs
- :: Claims concerning properties
- :: Compensation for refugeehood

The Aix Refugees Working Group estimated the costs of relocation and the costs of rehabilitation (i.e. expenses covering those programs intended for refugees who choose not to change residency) separately.

- In order to implement **comprehensive resettlement programs**, the IAPR will need funds in the order of **US\$8 billion to US\$19 billion** over a period of ten years, depending on the number of refugees who choose to relocate.
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The question of settling claims concerning lost properties, and the financial dimension of such a question, is very complicated. Under international law, and similar to other reparation programs pursued to respond to

other situations, reparations can take many forms. The Aix Group has discussed the options of restitution and compensation. These, among others, are appropriate forms of reparations for Palestinian refugees. The Group introduced a concept of “full and fair compensation” to be determined objectively by a board of experts associated with the IAPR that will administer the lost properties claims process. Restitution will be considered only in those cases where “full and fair compensation” has not been offered and where the properties exist in a form that can make restitution practical and equitable.

- The funds necessary to answer expected **property claims that are “fair and full”** were estimated to be between **US\$15 billion and US\$30 billion**. The wide range reflects conceptual gaps as well as gaps in data.

We recommend the establishment of a fourth fund that will finance compensation for refugehood not related to property claims or to the above programs.

- All registered refugees will receive uniform sums. Each refugee who registers with the IAPR will receive an agreed upon sum; an additional sum will be distributed to the public authority where the refugee chooses to reside. This fund will require approximately **US\$22 billion**.

Thus, the magnitude of the financial dimensions of an agreed-upon resolution for the refugees is very significant; we estimate it as between **US\$55 billion and US\$85 billion** over the period of implementation. The financial estimates are explained in the text; one has to remember that resettling/relocating/rehabilitating around four and half million people and settling 60 year-old claims on many lost properties is an enormous task.

**Section 2** provides a brief review of some of the major aspects characterizing the Palestinian refugees: who is a refugee, where the refugees live, their current socio-economic conditions, what is known about their preferences, etc.

**Section 3** discusses the choices to be made by individual refugees and qualitatively presents some possible aggregates resulting from the individual’s decisions concerning residency. Thus, a “relocation matrix” emerges and several scenarios concerning possible movements of refugees from one place to another are described. These scenarios serve to assess the macro

economic implications of resettlement and enable us to address questions concerning the magnitude of the financial resources necessary to guarantee success. Using a different methodology, a more micro approach, we then assess the costs of rehabilitation both for refugees who choose to stay in camps and those who choose to stay outside the camps in different locations.

**Section 4** addresses the issue of compensation for lost properties. We present a brief survey of available data, current approaches and some estimates, and present broad assessments as to the overall financial dimension of this issue. We discuss some of the open issues concerning 60 years of lost properties claims; methods to assess property values; and rough measures of resources as well as analyses of individual and collective claims.

**Section 5** addresses possible payments associated not with lost properties or collective resettlement and rehabilitation efforts, but with reparations covering compensation for refugeehood. These reparations relate to all refugees and not only to the estimated 30% who have property claims. In this section, we also discuss the implications of each type of financial arrangement from the point of view of a successful implementation of the agreements.

**Section 6** summarizes and discusses additional work on the subject that will be necessary in the future.

**Appendices A-D** present the Clinton parameters and Moratinos' relevant texts, as well as a brief summary of the macroeconomic framework used for absorption assessment and a summary of some World Bank studies.

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We believe that a final agreement and closure on claims in the Israeli-Palestinian conflict is impossible without a solution for the refugees. We conclude that, complex as it is, resolving the conflict and satisfying the Palestinian refugees' 60 year-old problem is economically feasible. Whether the Clinton parameters, which provided the framework for the analysis, will be accepted as a framework for a political agreement by the people and their negotiating leaderships is beyond the scope of the present discussion.

## Preface

Almost 60 years after the Palestinian refugee problem was created, it is important that the sides find ways to bridge the gaps concerning this issue and start serious discussions concerning possible solutions. Over the last few years, first in the context of the efforts to establish comprehensive peace in the Middle East and then in less formal and more academic circles, important discussions intensified, and some modest achievements were reached. However, these efforts have not yet led the parties to any significant breakthroughs.<sup>2</sup> The official and unofficial discussions led to a better understanding of the alternatives and to a broader agreement on the facts. The work of the Aix Group RWG built on these efforts and sought to contribute to efforts to outline a framework for addressing the issues.

The work in this part of the paper will try to avoid, as much as possible, the important legal and political complexities, and concentrate instead on the economic implications of different feasible solutions. Feasible solutions are defined as those to which the parties might agree under unspecified political circumstances. The priority of politics over economics in the context of the Palestinian refugee issue was recognized long ago, and writing on the topic from an economic perspective should not imply that the RWG advocates reversing this order. Already in 1953 the Interim Report of the American Special Near East Refugee Survey Commission stated:

“...The general attitude and position of the Arabs and Israelis...has seriously impeded any effective work on the part of the Palestine Conciliation Commission in bringing the parties together to resolve the outstanding questions between them.

...Economic development in the area, without doubt, will make the possibilities of peace more capable of realization. However, it is not in itself a complete answer to the problem. The Commission sees **no permanent solution to the refugee problem until there is a more favorable political atmosphere leading to a workable peace established between the Arab States and Israel.**”<sup>3</sup>

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2 See Tamari (1996), Moratinos (2003), Ottawa process papers (1997, 2003), Fischbach (2003, 2006), Dumper (ed.) (2006) and Brynen and Roula (eds.) (2007) among others.

3 Scholz, N. (ed.), (1994). *U.S. Official Statements: The Palestinian Refugees*. Washington, D.C.: Institute for Palestinian Studies, page 126. Emphasis added.

Nowadays, the last sentence would have most probably mentioned the Palestinian people in addition to the Arab States. This important modification captures the changes in the political atmosphere after all these years and opens the way, hopefully, to a workable peace. However, Fischbach, in a chapter entitled, “Why has there been Neither Compensation Nor Restitution?” sounds a warning:

“Examination of the diplomatic history of compensation and restitution efforts, along with their failures and modest successes, can therefore be instructive for those concerned with redressing Palestinian grievances and forging lasting Arab-Israeli peace today. The study of past failings also offers a stark challenge to advocates of an Oslo-style ‘piecemeal peace’ that seeks to address problems in isolation from one another.”<sup>4</sup>

The range of feasible solutions where the “repeal of the official refugee-status of Palestinian refugees ... could be attained”<sup>5</sup> may vary, depending on the subjective assessments of different observers. For the sake of the present study we will expand, rather than restrict, the range of alternatives considered, even though some of the alternatives might seem improbable to some observers.

We will focus first on the difficulties to be encountered in any serious effort to achieve a solution for the refugees, resulting from the far-reaching consequences of movements of people from one location to another; from the large-scale rehabilitation programs; and from the very significant compensation schemes. The issue of large-scale movements of people calls for major efforts necessary in order to support both employment and housing demands, as well as the additional required investment in infrastructures. These processes naturally have both positive and negative effects on the economies involved.

Although the discussion will emphasize conceptual and qualitative considerations, we will aim, wherever possible, at quantitative rough evaluations of the most probable scenarios, as measured by the overall impact on the refugees and the economies involved. Clearly, these

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4 Fischbach, R.M. (2003). *Records of Dispossession: Palestinian Refugee Property Claims and the Arab-Israeli Conflict*. Columbia University Press: New York, pp. 67-8.

5 Ibid.

evaluations will depend crucially on assumptions about the specifics of the agreements, the reactions of the refugees to the agreements, and the conditions expected to prevail in the various economies. The actual magnitude of additional resources which will be available to implement the agreements, and whether these may come from within the region or via international efforts from outside, will of course be of immense importance and will receive proper attention. The current study will seek to present “means and ways” that will increase the probability that the complicated process we describe will result in a positive outcome for both the refugees and the economies involved.



## 2. The Palestinian Refugees

This section presents a brief background to the Palestinian refugees' socio-economic situation based on data from the United Nations Relief and Works Agency (UNRWA), the Palestinian Central Bureau of Statistics (PCBS), and studies by Norwegian research center FAFO (2002-3). Refugees are located mainly in Jordan, Gaza and the West Bank, Lebanon, Syria, and to a lesser degree elsewhere. In 2006, nearly one third of the registered refugees – about 1.3 million people – lived in 59 recognized UNRWA refugee camps in Jordan, Lebanon, Syria, the West Bank and Gaza; a significant number also live in informal settlements near camps.

A comparison between Palestinian refugees and non-refugees in terms of growth rates, living conditions, education and labor force participation is presented below. Since the refugee status by itself can no longer be considered a distinguishing characteristic, much of the data refer to a comparison between camp and non-camp refugees. The growth rate of the Palestinian refugee population is lower than that of their non-refugee counterparts. Fertility is lower among refugees than among non-refugees in every location, with the proportion married generally lower and age at marriage higher among the refugees. Infant mortality is relatively high in the Lebanese field, but the levels are lower among the refugees than the non-refugees everywhere else.

We need to distinguish between camp and non-camp refugees. The refugee camps are characterized by high living densities, creating very crowded and environmentally poor living conditions. The camp versus non-camp divide in terms of housing conditions, however, is mixed: in some settings and for some indicators (such as sanitation and drinking water access) camps may actually have better access than other areas. This is due primarily to the infrastructure projects carried out with the support of UNRWA and others in the camps. However, in some settings conditions are worse in camp locations, due mainly to poor stability of supply of necessities such

as drinking water and electricity, rather than lack of access per se.

Education outcomes across the different fields show significant variation in achievement among refugees depending on refugee status and availability of the data among all groups, but depending more on the country of residence. Overall the highest educational achievement is among the non-camp refugee population in Jordan and the camp population in the West Bank and Gaza (higher overall among refugees and higher than others in each location). Both camp and non-camp refugees in Lebanon stand out as having the lowest levels of educational achievement both relative to refugees elsewhere and to others in Lebanon.

Camp and non-camp refugees compared to non-refugees show very similar levels and tendencies in most socio-economic measures. In the labor market there is a slight tendency for refugees (camp refugees in particular) to have a lower participation rate than others. Other distinctions in labor force participation, notably the very low rates among women compared to men, are far more noticeable. With regard to unemployment rates, camp refugees in all fields have higher rates than others, in the range of 3-4%. Restrictions on refugees' employment exist formally in Lebanon and as a matter of practice in Jordan.

The examination of income among Palestinian refugees in Jordan, Lebanon and the Palestinian Territories indicates that the refugee camps are low-income areas compared to non-camp areas in all of the three fields reviewed. The absolute income levels of the camps (and gatherings) vary according to national level, with the Lebanese camp and gathering population lagging drastically behind Lebanese national levels. Introducing adjustments for price levels, the purchasing power of the camp and gathering populations in all the fields tend to converge (except WBGS where such estimates are not available), most notably contributing to bringing the Syrian refugees upwards.

Table 1 presents 2006 figures of the Palestinian refugees published by UNRWA, which were used in our estimates. We quote UNRWA's figures, which are the most updated available, although they are considered by some as an underestimate of the real numbers and by others as an exaggeration

of the number of refugees in certain locations.<sup>6</sup> The main reasons for the various estimates are lack of coverage of unregistered refugees and missing data on refugees outside the camps and outside UNRWA's coverage, as well as missing information about people who moved. However, for our purposes the data presented in Table 1 is a good approximation of the demographic scope of the refugee problem.

Table 1: Palestinian Refugees<sup>7</sup> - Figures as of September 2006<sup>8</sup>

UNRWA Fields of Operations	Registered Refugees	By Location %	Official Camps	Registered Refugees in Camps		
				Families	Individuals	In Country %
Jordan	1,835,704	42%	10	61,063	316,549	17%
Lebanon	405,425	9%	12	49,836	214,093	53%
Syria	434,896	10%	10	25,740	116,253	27%
West Bank	705,207	16%	19	38,954	185,121	26%
Gaza Strip	993,818	23%	8	92,322	474,130	48%
<b>Total</b>	<b>4,375,050</b>	<b>100%</b>	<b>59</b>	<b>267,915</b>	<b>1,306,191</b>	<b>30%</b>

6 In a recent paper "Statistical data on Palestinian refugees: What we know and what we don't", Abu-Libdeh (2007), a former head of the PCBS, explains that there are three reliable sources of data: UNRWA, PCBS and FAFO. Each has some weaknesses and strengths. See definitions there.

7 We used UNRWA data based on their definitions: "Under UNRWA's operational definition, Palestine refugees are persons whose normal place of residence was Palestine between June 1946 and May 1948, who lost both their homes and means of livelihood as a result of the 1948 Arab-Israeli conflict. UNRWA's services are available to all those living in its area of operations who meet this definition, who are registered with the Agency and who need assistance. UNRWA's definition of a refugee also covers the descendants of persons who became refugees in 1948. See <http://www.un.org/unrwa/english.html>.

8 <http://www.un.org/unrwa/publications/index.html>

One should recall the fact that refugees constitute about one half of all Palestinians, as illustrated below in Table 1a:

Table 1a: **Palestinian Population 2004**<sup>9</sup>

	Total Palestinians	Registered Refugees	No. of Camps	Registered Refugees in Camps	Special Hardship Cases
West Bank	2,102,360	607,770	19	163,139	30,702
Gaza	1,196,591	852,626	8	460,031	73,316
Jordan	2,637,076	1,639,718	10 (+3 unofficial)	287,951	42,364
Lebanon	391,240	382,973	12	214,728	42,448
Syria	411,119	391,651	10 (+3 unofficial)	109,466	28,513
Saudi Arabia	291,811				
Egypt	58,363				
Kuwait	37,140				
Other Gulf Countries	117,099				
Other Arab countries	6,149				
USA	227,179				
Rest of World	289,289				
Israel	1,004,600*				
<b>Total</b>	<b>8,878,926</b>	<b>3,874,738</b>	<b>59 (+6 unofficial)</b>	<b>1,235,315</b>	<b>217,388</b>
<b>Total in Diaspora**</b>	<b>4,575,375</b>	<b>2,414,342</b>	<b>32 (+6 unofficial)</b>	<b>612,145</b>	<b>113,325</b>

\*There are no refugees by UNRWA definition in Israel. The issues covered in this paper do not address Palestinians in Israel.

\*\* Outside of historic Palestine, i.e. the total number excluding those living in the West Bank, Gaza and Israel.

9 See Arnon, A. and N. Kanafani. (2004). "Absorbing Returnees in a Viable Palestinian State: A Forward Looking Macroeconomic Perspective", Ch. 10 in Cobham, D. and N. Kanafani (eds). *The Economics of Palestine: Economic Policy and Institutional Reform for a Viable Palestinian State*, London: Routledge.

### 3. Individual Choices and Possible Relocation Matrix

The Aix Group has undertaken to examine the economic dimensions of possible solutions for the refugees. This is a very difficult task, as the economic aspects cannot reasonably or accurately be assessed aside from the principles of a solution, which constitute the framework of the agreement. Pursuant to the framework, the parties will also have to decide on the parameters for implementing the principles. The principles and their implementation parameters will determine the economic consequences of the solution.

In the context of the Aix Group Refugee Working Group, the participants have sought to define the framework and the options for implementation, in order to give the economic dimension more clarity and practical meaning, as well as to give the Group a realistic basis upon which to conduct their discussions. At this stage, it is clear to us that any solution to the refugee problem will contain certain components described in the sections below. The question which remains to be answered is to what extent any or all of the components will be adopted in an agreement. Similarly, many optional components have the same economic effects as a matter of principle, but the actual cost might differ from one place to another.

Since what is unclear at this point is to what degree any or all optional components will be used, and not the optional components themselves, it may be possible to identify the economic components of the agreement based on the options we have now, without first defining an agreement or its precise course of implementation. The economic components generally stem from two different processes that will follow any agreement on refugees:

1. Resettlement / repatriation (sometimes referred to below as relocation) and rehabilitation;

## 2. Financial arrangements concerning reparations for losses and suffering and for covering costs in item 1.

It is assumed that these two processes will be pursued parallel to one another through a comprehensive mechanism designed especially for implementing a permanent status agreement on refugees. The process will be supervised and managed, as we proposed above, by an international body, the International Agency for the Palestinian Refugees (IAPR).

### 3.1. Relocation and Rehabilitation

There are over 4.5 million Palestinian refugees<sup>10</sup>, the majority of whom reside outside historic Palestine. To ensure that the decision of a permanent domicile is made voluntarily and to meet political and practical exigencies, the refugees should be given real options. The Palestinian refugees will be presented with options for electing a place of permanent domicile through which, or in parallel to which, they can normalize their status, gain citizenship and begin the process of rebuilding stable, prosperous lives.<sup>11</sup>

These options include:

- Israel
- The Palestinian state (borders on the basis of pre-1967 borders)
- An agreed-upon and limited land swap, added to the above territory
- The present host countries
- Other third countries

The IAPR will prepare a comprehensive list of all refugees. It will collect from all the refugees written statements concerning their past and present conditions and their preferences regarding future residency. As previously discussed, the process of implementing the agreements and achieving a

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10 See discussion in Abu Libdeh (2007). In this study we use UNRWA figures for September 2006. The figures can be debated, of course, both those concerning specific locations and the totals. They serve us as a point of reference; revision of the figures will change the results.

11 This study does not relate to displaced persons after the 1967 war. It is assumed that those displaced in 1967 who were not refugees of 1948 will have the right to return to their homes following the establishment of a Palestinian state.

practical solution will be based on choices made by the refugees: The refugees will exercise choice between alternative locations for residency, as explained in the Clinton parameters, assessing what is best for them. The exercise of choice among alternative options will be done individually, in a well-organized process, supervised by the IAPR. A timeframe for this process will be agreed upon. We propose that the individuals will rank their priorities and choose more than one alternative. The international body will be responsible for implementing an agreed-upon mechanism so that the final decisions will satisfy the refugees as much as possible and will be in line with the agreements to be signed between the representatives of the two sides, and possibly also with the relevant host countries and other countries.

These decisions will have to take into account not only the final destinations, but also the timetable for relocation and rehabilitation. Obviously not all refugees will be treated at once and priorities will have to be made taking into account their wishes, the urgency of their situation (based on their present conditions), the funds available at each stage and the time needed for preparing the new locations for such absorption.

The refugees who have claims concerning lost properties will file their preliminary statements at this stage.

The relocation and rehabilitation processes will be a major logistical undertaking, involving significant institutional resources. For instance, institutional arrangements will have to be established to disseminate information to refugees on their options and to register their choices. The IAPR will be responsible for the process, along with domestic ministries and organizations that will have to support and facilitate the movement and/or integration of the refugees.

### 3.1.A. Targeted Projects

Targeted projects will have to be put in place to help refugees transition to their new lives. These programs, in the West Bank, Gaza, Swap WB, Swap Gaza, etc. (see Table 2), should include housing, employment and infrastructure programs, as well as educational and health services. Regional geographical administrations will be created by the IAPR to deal with the various aspects of implementation of relocation/rehabilitation:

### Housing and Infrastructure

Improved and/or new housing will have to be provided to refugees to replace their temporary, inadequate shelters and/or to house relocating refugees.

### Education and Health Services

Education and health services for the new as well as the existing population will be an important part of managing the projects.

### Direct Rehabilitation Assistance

In addition to the generalized measures listed above, directed assistance may be provided through stipends to refugee families for the early period of re-settlement until they adjust to their new lives (a practice that Israel uses with new Jewish immigrants). Other forms of direct rehabilitation assistance may be identified, depending on particular return/resettlement needs.

These components carry costs that should be factored into an assessment of the economic dimension of a solution. While it is obvious that the components might vary from one state to another according to need, this difference would be mainly in the cost and to what degree a certain component is needed. On a general assessment, the components as a matter of principle will be the same.

In addition, the provision of services and rehabilitation assistance should be integrated with the overall macro-economy and management policies of the receiving state. The integration and rehabilitation of refugees should be part of the overall development goals of the state, particularly in the case of the future Palestinian state. The economic component of refugee resettlement should be integrated with the national Palestinian development goals in general.

Third countries will share responsibility for these costs by either absorbing refugees directly or providing financial assistance to receiving states, including the Arab host states. The financial aspects will be managed by the IAPR.

The macroeconomic implications will depend crucially on the nature of the agreements, as well as on the reaction of the population that is affected by the agreements. Thus, the socio-economic characteristics of the refugees, their current place of residency, their level of integration in the various countries, and of course the size of the populations, should



be discussed. The number of persons who would become eligible under the various scenarios was disputed for many years, but it seems that we are now approaching a consensus on the figures.

Thus, the agreement and the refugees' decisions will result in changes in places of residency. In table 2 we present a matrix of possible changes in location as proportions of the respective absolute figures presented in table 1. Below we present four scenarios, some more acceptable to one side, some more acceptable to the other, and some unacceptable to both. We will use these scenarios in order to clarify the challenges that the implementation of a possible agreement presents and to argue that the scenarios are feasible.

Table 2: **Relocation Matrix: Subsuming the Refugees' Choices and the Agreements** (in ratios of the initial figures in Table 1, cumulative over the implementation period)

<b>From: To:</b>	<b>Jordan</b>	<b>West Bank</b>	<b>Gaza Area</b>	<b>Syria</b>	<b>Lebanon</b>
Jordan	a	---	---	---	---
West Bank	b	c	d	e	f
Gaza Area	---	---	g	---	---
Syria	---	---	---	h	---
Lebanon	---	---	---	---	i
Israel	j	j	j	j	j
Swap WB	k	l	m	n	o
Swap G	---	---	p	---	---
Rest of World	q	q	q	q	q

Note: Some of the ratios are naturally zero or negligible and are marked ---.

## Notes:

- a, c, g, h, and i refer to relocation within the area, meaning “rehabilitation” within the region.
- Some restrictions apply, of course, like columns sums are 1.
- We will assume that 5% (q) will relocate to the Rest of World (RoW).
- “Swap land”, mentioned above, are territories that are now part of Israel that will become Palestine and linked to either the West Bank (WB) or Gaza (G).

## Scenario I

- Assuming that 60% of Jordanian refugees will choose rehabilitation, i.e. will not move from one place to another; 50% of Gazans; 20% of Syrians; 0% of Lebanese.
- 1% will move from where they live to Israel.
- 5% will move from where they live to the RoW.
- 20% will move from Gaza to swap land close to Gaza.
- 20% will move from the West Bank to swap land close to the West Bank.
- 5% will move from the other places to swap land close to the West Bank.

## Scenario II

- Assuming that 60% of Jordanian refugees will choose rehabilitation, i.e. will not move from one place to another; 50% of Gazans; 20% of Syrians; 0% of Lebanese.
- 5% will move from where they live to Israel.
- 5% will move from where they live to the RoW.
- 20% will move from Gaza to swap land close to Gaza.
- 20% will move from the West Bank to swap land close to the West Bank.
- 5% will move from the other places to swap land close to the West Bank.

## Scenario III

- Assuming that 80% of Jordanian refugees will choose rehabilitation, i.e. will not move from one place to another; 60% of Gazans; 40% of Syrians; 20% of Lebanese.
- 5% will move from where they live to Israel.
- 5% will move from where they live to the RoW.

- 20% will move from Gaza to swap land close to Gaza.
- 20% will move from the West Bank to swap land close to the West Bank.
- 5% will move from the other places to swap land close to the West Bank.

#### Scenario IV

- Assuming that 80% of Jordanian refugees will choose rehabilitation, i.e. will not move from one place to another; 60% of Gazans; 40% of Syrians; 20% of Lebanese.
- 8% will move from where they live to Israel.
- 5% will move from where they live to the RoW.
- 20% will move from Gaza to a swap land close to Gaza.
- 20% will move from the West Bank to swap land close to the West Bank.
- 5% will move from the other places to swap land close to the West Bank.

The results of the four scenarios, presented in terms of the total numbers of refugees in each location, are presented in Table 3.

Table 3: *Accumulative Refugees at Each Location under the Four Scenarios* (in thousands, rounded figures)

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
<b>In:</b>				
Jordan	1101	1101	1469	1101
West Bank	1904	1729	1094	1330
Gaza	497	497	596	596
Syria	87	87	174	174
Lebanon	0	0	81	81
Swap WB	325	325	325	325
Swap G	199	199	199	199
Israel	44	219	219	350
R o W	219	219	219	219

The scenarios reflect a summation of the many decisions of the refugees and represent “net” outcomes; thus, for example, in Scenario 1 the refugee population in the West Bank (1,904,000) includes those who decided to stay and rehabilitate and those who opted to come to the West Bank from other locations, minus those who left to other places. Among the options for the refugees we include what we called “Swap West Bank” and “Swap Gaza”, two areas where new specific development plans are planned. Thus, the number of refugees in the West Bank does not include those who opted to settle in the new construction projects in the “Swap WB” areas.

We can calculate the changes in the numbers of refugees in each location under each scenario. We present these figures in Table 4.

Table 4: Changes (inflow and outflow) of Refugees at Each Location under the Four Scenarios (in thousands, rounded figures)

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
<b>In:</b>				
Jordan	-734	-734	-367	-734
West Bank	1199	1024	389	625
Gaza	-497	-497	-398	-398
Syria	-348	-348	-261	-261
Lebanon	-405	-405	-324	-324
Swap WB	325	325	325	325
Swap G	199	199	199	199
Israel	44	219	219	350
R o W	219	219	219	219

As is clear from Tables 2 – 4, although the impact of any feasible agreement will be felt throughout the region, the major effect from movement of

people will most likely be felt in the West Bank, but also in what we call Swap West Bank and Swap Gaza. Thus, the IAPR, in its efforts to ensure successful implementation, will manage specific projects for the various areas with appropriate resources.<sup>12</sup>

### 3.2. Relocation

We have estimated separately the costs of financing the relocation programs, covering those refugees who decide to change place of residency, and the costs of rehabilitation programs, covering those who decide not to change place of residency. In Table 5 we present macro estimates of the funds necessary to guarantee successful absorption, i.e., the costs for financing relocation. In Table 6 we present results concerning rehabilitation.

We defined “success” in absorption as the ability to maintain a rising path in the standards of living in the Palestinian economy while absorbing refugees. To estimate the costs we made the following assumptions:

- The economy’s structure is that of the Palestinian economy before the 2000 crisis.
- The economy was assumed to recover after achieving a permanent peace agreement, in line with the assumptions of the Aix Group in the Economic Road Map (ERM 2004).
- To simplify, we assumed four scenarios concerning the number of refugees who change their residency:
  - :: 900,000
  - :: 1,200,000

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12 Several studies focus on presenting quantitative estimates of such outcomes for the Palestinian economy in the West Bank. World Bank, see Kraft and Elwan. (2003). “Housing and Infrastructure Scenarios for Refugees and Displaced Persons”, presented in *Stocktaking Conference on Palestinian Refugee Research* in Ottawa, Canada, June 17-20, 2003. See: [http://www.arts.mcgill.ca/mepp/new\\_prm/activities/index.htm](http://www.arts.mcgill.ca/mepp/new_prm/activities/index.htm) and Arnon & Kanafani (2004). See also review of studies for the EU in Dumper. (2003). “An EU Study on the Return and Re-integration of Palestinian Refugees and Displaced Persons: A summary”, presented at the *Stocktaking Conference on Palestinian Refugee Research* in Ottawa, Canada, June 17-20, 2003. [http://network.idrc.ca/uploads/user-S/10576730890Session\\_6-\\_Mick\\_Dumper-\\_Paper.doc](http://network.idrc.ca/uploads/user-S/10576730890Session_6-_Mick_Dumper-_Paper.doc)

:: 1,500,000

:: 1,800,000<sup>13</sup>

The economic framework is presented briefly in Appendix C. We assumed implementation over 10 years and assessed four possibilities: high government spending and low government spending, financed by high taxes or low taxes<sup>14</sup>. The necessary additional resources which guarantee a successful absorption process are calculated so as to keep the economy on its positive development path assuming no refugee resettlement; thus, we assessed the necessary “costs” of maintaining the growth rates of a positive benchmark scenario, after the conflict will end and absorptions start. The two main channels to support the economy’s growth in the face of population inflow are an increase in capital beyond that of the pre-absorption conditions, and higher public spending financed from outside sources. Thus, the calculations provide rough estimates of what is necessary financially as additional resources in order for the various scenarios to “work” in the sense of being in line with the ERM basic approach: rising standards of living in the face of the huge task of facilitating the refugees.

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13 These figures are the rounded numbers from the four scenarios in Table 4 aggregating returning/resettling/relocating refugees to the Palestinian economy. We do not relate here to rehabilitation costs.

14 The scenarios are based on per worker growth calculations. The high government spending assumes additional government spending of \$5000 per capita for each additional person; the low government spending assumes only \$2500. The additional costs are calibrated for the average worker in the economy. High taxes are assumed as 25% and low taxes are 20%.

Table 5: Estimating Absorption: Necessary Additional Private and Public Costs for Success (million dollars, 2007 prices)

		Scenario 1	Scenario 2	Scenario 3	Scenario 4
Number of Refugees Resettling		900,000	1,200,000	1,500,000	1,800,000
<b>High Public Sector</b>					
Additional Private Investments	High Taxes	2,402	3,083	4,003	4,804
	Low Taxes	2,987	3,720	4,693	5,547
Additional Government Expenditures	High Taxes	4,828	5,851	8,180	9,888
	Low Taxes	7,568	8,764	11,265	13,146
<b>Total</b>	High Taxes	7,230	8,934	12,184	14,693
	Low Taxes	10,555	12,484	15,958	18,692
<b>Low Public Sector</b>					
Additional Private Investments	High Taxes	1,952	2,543	3,253	3,904
	Low Taxes	2,537	3,180	3,943	4,647
Additional Government Expenditures	High Taxes	2,414	2,926	4,090	4,944
	Low Taxes	5,154	5,838	7,175	8,201
<b>Total</b>	High Taxes	4,366	5,468	7,343	8,848
	Low Taxes	7,691	9,018	11,118	12,848

The results should be interpreted with caution. They do not reflect all the tradeoffs that exist in an economy facing such an enormous challenge. The government can choose between high and low expenditure as well as between greater or lesser reliance on local taxes only because we assumed no impact on the fundamentals, since the economy has an available supply of financial support from the outside. Thus, a decision to have lower taxes will necessarily make the outside support more crucial as well as bigger in size. As can be seen in the table, “low taxes” increase the additional costs to be financed from outside sources by 30% to more than 70%, depending on whether we assume “high” or “low” public sector expenditures. The level of necessary outside support is higher, of course, for the “high” public sector relative to that of the “low” one; but the change in that support when taxes are lower is more dramatic. In other words, the sensitivity of “necessary additional costs” is relatively higher for the “low” public sector scenarios. The changes are in the range of 30% to 75%.

However, it is important to emphasize that with enough resources all the scenarios addressed are feasible. The question of who carries the burden has more implications than the calculations can capture.

### 3.3. Rehabilitation

A different methodology used in other studies estimates the direct costs of absorption and rehabilitation of a certain number of refugees. The studies<sup>15</sup> describe various possibilities and different locations and cover housing, public infrastructures and social infrastructures costs. Based on these studies the conclusion is that the costs per 1000 refugees range between US\$9 million and US\$14 million, depending on the location and the degree of rehabilitation necessary.

In Table 6 we present four complementary scenarios estimating the costs of financing rehabilitation for those refugees who will not relocate. We assumed that the average cost for rehabilitation differs between refugees living in camps and those outside the camps. Based on the various studies,

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15 See the survey in Kraft, N. and Elwan, A. (2007). “Infrastructure scenarios for refugees and displaced persons”, in Brynen, R. and Roula, E. (eds) *The Palestinian Refugees: Challenges of Repatriation and Development*, London: Tauris. <http://www.idrc.ca/openebooks/231-0>



we assumed the average cost for rehabilitation in camps to be US\$12,000 per capita, and that for rehabilitation outside the camps to be US\$3,000 per capita. Furthermore, we assumed that refugees in camps will have a higher tendency to resettle/relocate than refugees outside the camps. Thus, for example, based on these assumptions, the total estimated expenditure for rehabilitating refugees' residential areas in camps and outside camps are presented in Table 6.

The refugees who decide not to change their place of residency will be part of the various rehabilitation programs. We estimated the costs of rehabilitation under different assumptions, distinguishing between rehabilitation programs for refugees living in camps and those living outside the camps. We assumed that the probability of refugees residing in camps to decide to relocate will be higher than that of non-camp refugees.<sup>16</sup>

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16 In Jordan, West Bank and Gaza the probability of camp refugees to relocate was assumed as twice that of non-camp refugees. In Syria it was 25% higher; in Lebanon we assumed that all camp refugees will relocate in all the scenarios and that if refugees in Lebanon decide to stay, they will be non-camp refugees (only scenarios 3 & 4).

Table 6: Estimating Rehabilitation Costs Expenditures in Camps and Outside Camps (million dollars, 2007 prices; number of refugees in parentheses)

	Scenario A	Scenario B	Scenario C	Scenario D
Number of Refugees				
Rehabilitating*	2,210,000	2,179,000	2,814,000	2,435,000
Rehabilitation of Camps	4,438 (370,000)	4,297 (358,000)	6,690 (558,000)	5,289 (441,000)
Rehabilitation Outside Camps	5,512 (1,840,000)	5,463 (1,821,000)	6,768 (2,256,000)	5,953 (1,984,000)
Total Costs	9,950	9,760	13,458	11,242
<b>Jordan</b>				
Camps	1,207 (101,000)	1,207 (101,000)	2,503 (209,000)	1,207 (101,000)
Outside Camps	3,003 (1,001,000)	3,003 (1,001,000)	3,780 (1,260,000)	3,003 (1,001,000)
<b>West Bank</b>				
Camps	1,306 (109,000)	1,166 (97,000)	1,166 (97,000)	1,060 (88,000)
Outside Camps	1,239 (413,000)	1,190 (397,000)	1,190 (397,000)	1,152 (384,000)
<b>Gaza</b>				
Camps	1,838 (153,000)	1,838 (153,000)	2,608 (217,000)	2,608 (217,000)
Outside Camps	1,031 (344,000)	1,031 (344,000)	1,137 (379,000)	1,137 (379,000)
<b>Syria</b>				
Camps	87 (7,000)	87 (7,000)	414 (35,000)	414 (35,000)
Outside Camps	239 (80,000)	239 (80,000)	418 (139,000)	418 (139,000)
<b>Lebanon</b>				
Camps	0 (0)	0 (0)	0 (0)	0 (0)
Outside Camps	0 (0)	0 (0)	243 (81,000)	243 (81,000)

\* The numbers correspond to the resettlement scenarios.

The four scenarios we present here, in line with the assumptions outlined above, take into account the numbers of refugees in camps and outside the camps, since these will determine the rehabilitation costs. For example, in Jordan, out of the 316,000 refugees living in camps (2006, UNRWA figures), between 100,000 to 200,000 will leave the camps depending on the refugees' choices to resettle/relocate explained above. Accordingly, outside the camps, 1,000,000 to 1,250,000 will choose to stay. In the West Bank, out of 185,000 camp refugees, 82,000 to 109,000 will decide to stay; and out of 520,000 non-camp refugees, around 400,000 will stay. We calculated the costs for rehabilitation in camps and outside the camps in each scenario. The total expenditures according to these scenarios will reach between US\$9.76 billion and US\$13.5 billion

## 4. Refugees' Lost Properties Claims

Settling sixty year-old claims on lost properties is a very complicated issue. Under international law, and similar to other reparation programs pursued to respond to other situations, reparations can take many forms. The Aix Group has discussed the options of restitution and compensation. These, among others, are appropriate forms of reparations for Palestinian refugees. The Group introduced a concept of “full and fair compensation” to be determined objectively by a board of experts associated with the IAPR who will administer the implementation of the lost properties claims process. Restitution will be considered only in those cases where “full and fair compensation” has not been offered and where the properties exist in a form that can make restitution practical and equitable.

### 4.1. Reparations

Separate from the issue of place of domicile and rehabilitation is the issue of reparations, or remedies, for losses and suffering. The provision of remedies will be an essential factor in achieving closure of the refugee question from both the Israeli and the Palestinian point-of-view. The various estimated magnitude of claims in terms of housing units, cultivated areas and values are discussed below.

#### 4.1.A. Funding for Reparations Process

Funds will have to be committed to a “claims commission” empowered to adjudicate claims and dispense reparations under the IAPR administration. A schedule according to which the funds will be transferred to the commission and a methodology for assessing the global losses of Palestinian refugees will have to be set. Israel has controlled and benefited from the disputed properties since 1948. Many of the properties do not exist today as they were in 1948: many changed form, many are used or held by new owners,

and it is not clear how many can be identified beyond doubt. Therefore, restitution may be impossible in principle in many cases. Moreover, Israel has traditionally rejected the possibility of restitution. Thus, if Israel rejects restitution as it has over the years, it is first and foremost an Israeli responsibility to guarantee that the necessary funds for “fair and full” compensation will be available.

#### 4.2. Estimating the Overall Financial Dimension

There are several approaches to the issue of compensation for claimed lost properties of the Palestinian refugees:

- a. A backward-looking approach whereby current estimated values of properties are determined on the basis of their past values. Thus, the present values of the properties and the proposed “full and fair” compensation are calculated on the basis of the historical values of the properties, which are brought to their present value via usual present value formulas.
- b. A second approach seeks to determine the overall value of the properties based on macro considerations. This approach is only good for planning purposes and is not relevant for individual cases. However, it can be helpful in determining collective forms of compensation.
- c. A third approach seeks to assess the value of properties under similar economic conditions; it is an indirect approach. This method can be used in order to assess the overall value of properties but cannot be used for individual claims.

#### 4.3. Factual Background Concerning Lost Properties

Surveying the results of different studies will help to reach rough estimates on the order of magnitude of the aggregate financial compensation for lost properties.

Since 1948, several studies have attempted to document, evaluate and measure the size and the values of the lost properties. In the brief survey below, we rely on comprehensive studies of Fischbach (2003, 2006). The most important data set was that prepared in 1964 by the UN Conciliation

Commission for Palestine (UNCCP - Technical Program) which covers about 450,000 recorded claims on properties inside Israel. The data set is now computerized and in the possession of several authorities.

According to Fischbach<sup>17</sup>, estimates of the potential sum of compensation vary widely among the parties which have estimated the property (the UN estimates, Israeli estimates and Arab estimates). The divergence between the estimates results from: 1) Different conceptual definition of land (should the definition include only privately owned property which is registered, or also land held collectively without being registered?); and 2) Different assigned values (should the value be based on market factors or taxation assessment, and when did Israel become liable for compensation - immediately after the refugees left or only after the Israeli authority took control?).

#### 4.3.A. UN Estimates

1. The United Nation Relief for Palestinian Refugees in the Near East (UNRWA), distributed questionnaires in the 1950s to 84,000 persons who were heads of refugee households, which represented approximately 340,000 refugees. The study revealed that 34% of refugees' families in Jordan and the West Bank lost houses, while 66% sustained losses in land.
2. In 1951, the UNCCP evaluated the assessments according to the following definition of abandoned land (a much broader definition than that used by Israel): it included all the land which was formally held by Arabs and which had passed to the Israeli authority. The assessment determined land values on the day of the beginning of the fighting, by capitalizing British land taxation figures. There was also a division between immovable and movable assets. The immovable assets included also uncultivated land, but no value was assigned to it. The movable assets were estimated under three different approaches which yielded similar estimates:
  - a. assuming a fixed ratio between immovable and movable assets,

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<sup>17</sup> Fischbach (2006). *The Peace Process and the Palestinian Refugee Claims: Addressing Claims for Property Compensation and Restitution*, Washington, D.C.: United States Institute of Peace Press.

- based on the actual proportions of assets for refugees in other parts of the world.
- b. assuming the value of movable assets to be a fixed proportion (40%) of the national income of the Arab sector of Palestine during the final years of British rule.
  - c. directly estimating the value of various types of assets left behind by the refugees.
3. The UNCCP Technical Program, the UN study of the refugee property that was undertaken during 1952-1964, is the most thorough evaluation of the property to date. The study covered all Arab-owned land in Israel as of 1948 according to the British records, and did not differentiate between refugees and Palestinian who stayed, or between Palestinian Arabs and foreign Arabs who owned land in Palestine at that time. Although the UNCCP did not manage to produce documentation for every parcel of land, it remains the most detailed source of records to date. The Technical Office's methodology was to make recourse of official land and land taxation records from the British administration in Palestine and determine the value of the property. The value of refugees' land abandoned in Israel, according to UNCCP Technical Program, 1964, was less than one-half of the UNCCP's 1951 Global Estimate, since it did not include the Beersheba district as Arab-owned property confiscated by Israel. The micro-level details on individuals' property were kept secret (it used the same three procedures as the previous study of the UNCCP), and only the macro level statistics were publicly available.

#### 4.3.B. Israeli Estimates

1. The first Israeli study was carried out by a government committee in 1948, which published a report under the name "Report of Settlement for the Arab Refugees." The report restricted the definition of land to privately owned land only, not land that was collectively controlled by villages as a whole, uncultivated arid land outside villages, or movable property.

2. Three additional agencies within the Israeli government developed other estimates a few years after 1948: 1) The Custodian of Absentee Property; their figures were based on annual reports regarding the amount of land under its control; 2) The Ministry of Agriculture, who used a much broader definition of “abandoned” property; and 3) The Ministry of Foreign Affairs, that provided its estimates to the U.S. government in 1953. Finally, the Ministry of Justice’s Land Assessment Division issued an internal estimate in 1962 in response to the UN study of the matter.

#### 4.3.C. Arab Estimates

1. The first figures of abandoned refugee property were estimated by two Palestinian refugee property owners, Tannous (1951) and Baydas (1951). The first evaluated immovable assets which were separated for buildings and land. The latter estimated the value of land, including uncultivable land, and buildings based on projected rental value. Since he included the uncultivable land which was excluded from most Israeli studies, the scope of the lost land was double that of the highest Israeli estimates.
2. The Arab Higher Committee and the League of Arab States produced counter-estimates to that of the UNCCP in the mid-1950s. These assessments included several additional elements: not only land and buildings, but also abandoned movable property and financial assets.
3. Two other evaluations, much more disaggregated and better documented, have been made by Sayigh (1967) and Hadawi and Kubursi (1988 and 2001). They included two new components in their assessment of the losses: various types of real estate, whether privately or publicly owned, and a wider range of movable assets.



Table 7: Comparative UN, Israeli, and Arab Estimates on the Scope and Values of Abandoned Land

Study	Year	Scope (in dunums)	Value <sup>18</sup> (US\$)
<b>UN estimates:</b>			
1. UNRWA survey	1951	3,508,540	None
Buildings	1951	51,981	None
2. UNNCP	1964	19,083,921	404,546,448
3. The Technical Program		6,057,032	824,780,808
<b>Israeli Estimates:</b>			
1. Report of Settlement for the Arab Refugee	1948	2,008,114	328,445,000
2. Ministry of Agriculture	1949	16,593,000	None
3. Custodian of Absentee Property	1950	3,299,447	36,681,935
4. Ministry of Foreign Affairs	1953	3,600,000	None
5. Custodian of Absentee Property	1954	4,450,000	None
6. Ministry of Justice	1962	None	Over 564,200,000
<b>Arab Estimates:</b>			
1. Sa'ib Baydas	1951	9,150,000	129,342,850 (1948\$) 89,866,000 (1951\$)
2. Arab Higher Committee	1955	None	6,553,183,000
3. Arab League	1956	None	7,789,990,999 (1948\$) 5,412,400,000 (1956\$)
4. Yusif Sayigh	1966	6,611,250	1,625,702,000
Buildings		173,000	954,304,000
Total			2,580,006,000
5. Hadawi-Kubursi	1988	19,031,012	2,131,467,000

Source: Fischbach (2006) table 21.

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<sup>18</sup> US\$ for the date chosen for valuation which in most cases was 1947-1948.

#### 4.4. Summary

The wide range of estimates concerning the number of residential units, size of land and their monetary values is clear. However, if one has to assess the magnitude of possible claims, the 1964 UNCCP Technical Program seems the better source; the estimated scope of the land in northern and central Israel, thus excluding the disputed south (Negev), is calculated to be around 4,170,000 dunums or 4,170 sq.km.<sup>19</sup>

Transforming past values to their present equivalent is always open to dispute. If we look at the 1964 Technical Program as a mid-point estimate, the scope of the issue becomes clear. According to that estimate, the claims refer to **more than 6 million dunams or 6,000 sq.km.** (including the south), and the value in 1948 prices is more than US\$800 million. A conservative estimate of the present value will put it at US\$14 billion. Thus, without addressing the enormous changes over the last 60 years that created a prosperous Israeli economy and vibrant housing market, it is clear that we have to understand that we are talking about tens of billions of dollars.

##### 4.4.A. Micro Measures for the Value of Properties

Over the last decade, several attempts to assess the value of lost properties via a micro process have been carried out. Not much had been published, and the researchers, even when discussing the results, refer more to methods than actual estimates.<sup>20</sup> The source of the data for those studies was apparently the lists prepared by the Technical Program; efforts successfully identified the specific plots and housing units and estimated their value using real estate experts. We understand that such efforts were made by Palestinian and Israeli teams. However, the estimates diverge: the Israeli estimates put the value of lost properties at around US\$10 billion, while

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19 Calculated from Fischbach (2006) p. 41.

20 But see Nathanson, R. (2003). "Survey of Palestinian Refugee Real Estate Holdings in Israel: Legal Mechanisms after 1948 which Enable Accurate Identification of Real Estate Owned by Palestinian Refugees and a Proposed Compensation Model Accordingly", presented at the *Stocktaking Conference on Palestinian Refugee Research* in Ottawa, Canada, June 17-20, 2003. [http://network.idrc.ca/uploads/user-S/10576734600Session\\_7\\_-\\_Roby\\_Nathanson\\_-\\_Paper.DOC](http://network.idrc.ca/uploads/user-S/10576734600Session_7_-_Roby_Nathanson_-_Paper.DOC). The Refugees Working Group also met with Dr. Nathanson on January 2007.

recent Palestinian studies reach estimates of between US\$44 billion and US\$60 billion and more, depending to a large extent on the present value formula.<sup>21</sup> The major differences apparently result from the methods used to calculate present values over such a long period, but also from other methodological issues. Therefore, as we argue below, an agreed-upon professional mechanism will have to be set up to reach agreed-upon assessments.

#### 4.4.B. Macro Measures for the Value of Properties

In order to reach a rough estimate of the value of lost properties, one can look at the total value of housing and agriculture land values. There are not many sources for such data and the estimates vary according to the state of the economy, its structure, etc. Thus, a different attempt to reach a rough estimate of the value of lost properties will involve more general macro considerations. From data on several developed economies where the value of dwellings and land is recorded, we can assess the value of land and dwellings relative to GDP. In Canada, France and Holland, the value of dwellings is close to that of GDP; land values, which vary more, are between 15% and 50% of GDP.<sup>22</sup> The range of these measures is wide, and clearly in LDC's the ratios may be completely different. Moreover, even if the ratios are in a similar range, one will have to decide what the denominator is in our case: that of the Israeli economy or that of the Palestinian and neighboring economies. However, as a rough rule of thumb, it can be helpful to know that such ratios exist for other economies.

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21 The Palestinians presented but did not yet publish their results.

22 The data from the OECD: Canada, dwellings 79% of GDP in 1995, 80% in 2004; land 43% in 1995 54% in 2004. France, dwellings 121% in 1995 and 139% in 2005 whereas land 48% in 1995 and 170% in 2005. Holland, dwellings 95% in 1995 112% in 2004; land 14% in 1995 and 16% in 2004.

## 5. Refugehood

A different type of financial arrangement should address refugehood, meaning the claims made for lost livelihood, pain and suffering of the Palestinian refugees. There are disagreements regarding this type of compensation; but we think that since the IAPR will administer processes of choice concerning residency and claims on lost properties as described above, it should also be responsible for distributing payments to individual refugees, even if they do not have property claims. Thus, we think that the IAPR should provide per capita, uniform sums to all refugees.

According to the data on ownership, the majority of refugees will not have property claims. We think that the IAPR should fix a sum per capita as a uniform payment to all refugees. In addition we recommend that a sum of dollars be paid to the authority where the refugee will opt to live.

## 6. Conclusion

The Aix Refugees Working Group, after discussing the major dimensions of an agreed-upon solution for the refugees, concluded that a solution for the Palestinian refugees along the main lines described above, although an enormous task, is feasible. Under reasonable assumptions, the process of choice, the agreements between the two sides, and the resulting scenarios of relocation/rehabilitation that we described can become a positive experience that is also feasible from an economic point of view.

A long-term resolution of the Palestinian refugee issue should be based on all relevant UN resolutions, including GA Resolution 194, while recognizing that a literal application of this Resolution is no longer possible given the substantial changes on the ground. As in the Clinton parameters, the parties would agree that the measures implement resolution 194. The Aix Group considers that the right of return to their homeland, even in a modified and limited sense, together with the other measures discussed in this paper, should be an essential component of closure to this issue. In actual implementation both the Israeli and Palestinian sides should take into consideration realities on the ground, as we did in this paper. The passage of time has not eliminated the relevance of this resolution, but requires that we examine its practical application, necessitating a combination of measures as described above.

The experience will become less painful as the uncertainties related to the process decrease; the more stable the political environment and secure the financial resources, the better the probabilities of success. Clearly, the decisions made by the refugees, the parties to the agreements and the international community will be crucial. The agreements should address the concerns of all those who might be affected, first and foremost the refugees, and create incentives that will guarantee success.

From an economic point of view, it will prove very important to determine the number of probable relocations as early as possible, and to arrange the time of their resettlement with the refugees themselves. Though it is impossible to fully plan such an effort, some broad plans should be recommended, and several agencies should be created that will be capable of efficiently implementing those programs under the uncertain circumstances. The programs for relocation and rehabilitation will need the coordinated efforts of many strong, capable and flexible agencies. The settling of lost properties claims should be done in an equitable and efficient manner by objective professionals.

We strongly recommend the creation of the International Agency for The Palestinian Refugees to manage and coordinate the political and economic efforts; this agency is critical to the success of these efforts. Through such an institution the agreements will be multinational and not restricted to the direct parties involved. Such an institution may have an important contribution in raising the necessary funds.

The Aix Refugees Working Group, after surveying various published estimates prepared over the years by Palestinian, Israeli and international experts, and based on its own work, tried to assess the financial magnitudes necessary to implement a comprehensive solution. Such assessments are naturally open to criticism since they are based on assumptions and “guesstimates”. However, it is better in our view to have some numbers than none. The most diverging estimates relate to property losses since the basic principles on which to base the assessment are debatable. One can argue that there is no “pure” financial aspect to that part since, in theory, if claims are proven, restitution has no financial dimension. As we explained, we adopted a concept of a “fair and full” offer to be determined by the IAPR.

**Thus:**

- In order to implement **comprehensive resettlement programs**, the IAPR will need funds in the order of between **US\$8 billion and US\$19 billion** over a ten year period, depending on the number of refugees who will choose to resettle/relocate.
- In order to implement **rehabilitation programs**, the IAPR will need funds in the order of between **US\$10 billion and US\$14 billion**, depending

on the numbers of refugees who will decide not to resettle/relocate, and depending on how many of those who so decide currently live in camps or outside the camps.

- The funds necessary to answer expected **property claims that are “fair and full”** were estimated to be between **US\$15 billion and \$US30 billion**.
- All registered refugees will receive uniform sums; refugees who registers with the IAPR will receive an agreed upon sum; an additional sum will be distributed to the public authority where the refugee chooses to reside. This fund will require about **US\$22 billion**.

Thus, the magnitude of the financial dimensions of an agreed-upon resolution for the refugees is very significant. We estimate it as between **US\$55 billion and US\$85 billion** over the period of implementation. The financial estimates are explained in the text; one has to remember that resettling/relocating/rehabilitating around four and half million people and settling 60 year-old claims on many lost properties is an enormous task.

The process should bring to an end the refugees’ sufferings and special status since 1948 and make all refugees citizens with full rights.

## Appendix A: Refugees: from the Clinton Parameters

(as read to the sides on 23.12.2000)<sup>23</sup>

I sense that the differences are more relating to formulations and less to what will happen on a practical level.

I believe that Israel is prepared to acknowledge the moral and material suffering caused to the Palestinian people as a result of the 1948 war and the need to assist the international community in addressing the problem.

An international commission should be established to implement all the aspects that flow from your agreement: compensation, resettlement, rehabilitation, etc. The US is prepared to lead an international effort to help the refugees.

The fundamental gap is on how to handle the concept of the right of return. I know the history of the issue and how hard it will be for the Palestinian leadership to appear to be abandoning this principle.

The Israeli side could not accept any reference to a right of return that would imply a right to immigrate to Israel in defiance of Israel's sovereign policies and admission or that would threaten the Jewish character of the state.

Any solution must address both needs. The solution will have to be consistent with the two-state approach that both sides have accepted as a way to end the Palestinian-Israeli conflict: the state of Palestine as the homeland of the Palestinian people and the state of Israel as the homeland of the Jewish people.

Under the two-state solution, the guiding principle should be that the Palestinian state would be the focal point for Palestinians who choose to return to the area without ruling out that Israel will accept some of these refugees.

I believe that we need to adopt a formulation on the right of return that will make clear that there is no specific right of return to Israel itself but that does not negate the aspiration of the Palestinian people to return to the area.

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23 Clinton Parameters, December, 23, 2000. See: [http://www.fmep.org/documents/clinton\\_parameters12-23-00.html](http://www.fmep.org/documents/clinton_parameters12-23-00.html)



In light of the above, I propose two alternatives:

1. Both sides recognize the right of Palestinian refugees to return to historic Palestine, or,
2. Both sides recognize the right of Palestinian refugees to return to their homeland.

The agreement will define the implementation of this general right in a way that is consistent with the two-state solution. It would list the five possible homes for the refugees:

1. The state of Palestine.
2. Areas in Israel being transferred to Palestine in the land swap.
3. Rehabilitation in host country.
4. Resettlement in third country.
5. Admission to Israel.

In listing these options, the agreement will make clear that the return to the West Bank, Gaza Strip, and areas acquired in the land swap would be the right of all Palestinian refugees, while rehabilitation in host countries, resettlement in third countries and absorption into Israel will depend upon the policies of those countries.

Israel could indicate in the agreement that it intends to establish a policy so that some of the refugees would be absorbed into Israel consistent with Israel's sovereign decision.

I believe that priority should be given to the refugee population in Lebanon.

The parties would agree that this implements resolution 194.

## Appendix B: Refugees: from Moratinos Non-Paper<sup>24</sup>

### 3. Refugees

Non-papers were exchanged, which were regarded as a good basis for the talks. Both sides stated that the issue of the Palestinian refugees is central to the Israeli-Palestinian relations and that a comprehensive and just solution is essential to creating a lasting and morally scrupulous peace. Both sides agreed to adopt the principles and references which could facilitate the adoption of an agreement.

Both sides suggested, as a basis, that the parties should agree that a just settlement of the refugee problem in accordance with the UN Security Council Resolution 242 must lead to the implementation of UN General Assembly Resolution 194.

#### 3.1 Narrative

The Israeli side put forward a suggested joint narrative for the tragedy of the Palestinian refugees. The Palestinian side discussed the proposed narrative and there was much progress, although no agreement was reached in an attempt to develop an historical narrative in the general text.

#### 3.2 Return, Repatriation and Relocation and Rehabilitation

Both sides engaged in a discussion of the practicalities of resolving the refugee issue. The Palestinian side reiterated that the Palestinian refugees should have the right of return to their homes in accordance with the interpretation of UNGAR 194. The Israeli side expressed its understanding that the wish to return as per wording of UNGAR 194 shall be implemented within the framework of one of the following programs:

#### A. Return and Repatriation

1. to Israel
2. to Israel swapped territory
3. to the Palestine state.

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<sup>24</sup> Moratinos, (2002). *EU "Non Paper"*. see Palestinian Refugee Research Net: [http://www.arts.mcgill.ca/mepp/new\\_prm/research/papers/moratinos.htm](http://www.arts.mcgill.ca/mepp/new_prm/research/papers/moratinos.htm) (accessed 25.9.2006)

## B. Rehabilitation and Relocation

1. Rehabilitation in host country.
2. Relocation to a third country.

Preference in all these programs shall be accorded to the Palestinian refugee population in Lebanon. The Palestinian side stressed that the above shall be subject to the individual free choice of the refugees, and shall not prejudice their right to their homes in accordance with its interpretation of UNGAR 194.

The Israeli side, informally, suggested a three-track 15-year absorption program, which was discussed but not agreed upon. The first track referred to the absorption to Israel. No numbers were agreed upon, but with a non-paper referring to 25,000 in the first three years of this program (40,000 in the first five years of this program did not appear in the non-paper but was raised verbally). The second track referred to the absorption of Palestinian refugees into the Israeli territory, that shall be transferred to Palestinian sovereignty, and the third track referring to the absorption of refugees in the context of family reunification scheme.

The Palestinian side did not present a number, but stated that the negotiations could not start without an Israeli opening position. It maintained that Israel's acceptance of the return of refugees should not prejudice existing programs within Israel such as family reunification.

### 3.3 Compensation

Both sides agreed to the establishment of an International Commission and an International Fund as a mechanism for dealing with compensation in all its aspects. Both sides agreed that "small-sum" compensation shall be paid to the refugees in the "fast-track" procedure, claims of compensation for property losses below certain amount shall be subject to "fast-track" procedures.

There was also progress on Israeli compensation for material losses, land and assets expropriated, including agreement on a payment from an Israeli lump sum or proper amount to be agreed upon that would feed into the International Fund. According to the Israeli side the calculation of this payment would be based on a macro-economic survey to evaluate

the assets in order to reach a fair value. The Palestinian side, however, said that this sum would be calculated on the records of the UNCCP, the Custodian for Absentee Property and other relevant data with a multiplier to reach a fair value.

### 3.4 UNRWA

Both sides agreed that UNRWA should be phased out in accordance with an agreed timetable of five years, as a targeted period. The Palestinian side added a possible adjustment of that period to make sure that this will be subject to the implementation of the other aspects of the agreement dealing with refugees, and with termination of Palestinian refugee status in the various locations.

### 3.5 Former Jewish Refugees

The Israeli side requested that the issue of compensation to former Jewish refugees from Arab countries be recognized, while accepting that it was not a Palestinian responsibility or a bilateral issue. The Palestinian side maintained that this is not a subject for a bilateral Palestinian-Israeli agreement.

### 3.6 Restitution

The Palestinian side raised the issue of restitution of refugee property. The Israeli side rejected this.

### 3.7 End of Claims

The issue of the end of claims was discussed, and it was suggested that the implementation of the agreement shall constitute a complete and final implementation of UNGAR 194 and therefore ends all claims.

## Appendix C: A Macro Approach to Resettlement

The dynamic resettlement macro developments (as summarized in Table 5) were estimated using a standard growth model. The model captures the economy's developments in terms of its GDP per capita over time and the path of capital accumulation, the private sector and the public sector.

The economy's bench mark performance was estimated first, based on its past performance, before 2000, assuming that there are no exogenous changes in population but only natural growth. We assumed that the economy was yet outside its steady state, growing faster as a result of the new environment. Then the economy's initial conditions had been changed due to the increase in population caused by the absorption of refugees. Thus, from natural growth of population of 4 percent ( $n=4\%$ ) assumed under no-returning refugees, the various scenarios assumed higher population growth due to the return of refugees: 600,000; 900,000; 1,200,000; and 1,800,000.

The specific assumptions the model used:

- $y$  – GDP per worker
- $k$  – Capital per worker
- $n$  - Population growth (4%)
- $d$  - Depreciation rate (5%)
- $g$  - Government expenditure per capita
- $s$  – Saving rate (20%)

And the following equations:

$$sk^\alpha = (n + \delta)k + (1 - s)nb + sg + (sr^i - n)b_f$$

$$y = 2.5k^{0.63}$$

$$S_p + S_g = I$$

$$s(y_t + rb_t - t_t) + (1 - \delta)k_t - (g_t + rb_t - t) = (1 + n)k_{t+1}$$

$$d_t = g_t + rb_t - t \quad d = \text{deficit}$$

$$s(y_t + rb_t - t_t) - d_t + (1 - \delta)k = (1 + n)k_{t+1}$$

$$sAk^\alpha + s(d_t - g_t) - d_t + (1 - \delta)k = (1 + n)k_{t+1}$$

$$sAk^\alpha - sg_t - (1 - s)d_t + (1 - \delta)k_t = (1 + n)k_{t+1}$$

We ran four alternative scenarios for each of the four population changes: one where the government expenditure, measured as additional expenditure per refugee, was high, at US\$5000 per capita, and one where it was low, at US\$2500. We also allowed more internal financing through taxes (25%) and less (20%). The scenarios calculated the missing capital and missing financial resources for the government that are necessary in order to keep the economy on its bench mark track.

## Appendix D: A Micro Approach to the Costs of Rehabilitating the Refugees

From a forward-looking approach, the estimation of the refugees' rehabilitation costs is much more difficult to assess, since the costs are based on the total number of refugees each country will admit, which in turn depends, among other factors, on the refugees' preferences. Assuming that the economic factor is a dominant factor which will determine the refugees' preferences regarding whether they would like to stay or move to another country (and to which country), the amount of payments each country will receive will have a dominant impact on the number of refugees who would like to be admitted into that country. Thus, the difficulty in assessing the consequences of any feasible agreement results from unavoidable uncertainties built into the process: not only are the particulars of the agreements unknown, but the reactions of the refugees to the agreements will remain uncertain and can only, at best, be guessed. Furthermore, the reactions may depend to a large extent on the economic developments in the various economies of the region, which will not be known to the refugees themselves at the start of the process of implementing the agreements.

The forward-looking approach will first address the estimated cost of the refugees' rehabilitation per one thousand people in the main refugees' locations (the West Bank and Gaza, Jordan, Lebanon, and Syria), in terms of public and social infrastructures, initial absorption payments and housing. Land value is estimated separately only for publicly owned land in specific sites in the West Bank and Gaza.

### The Costs of Rehabilitation of the Palestinian Refugees

This section presents a framework for analyzing various forms of upgrading or new development, and estimating their costs.

The economic aspects of rehabilitating the people who will stay at their current place of residency (mainly in the Palestinian State, Jordan, Syria and Lebanon) involves the costs of upgrading some refugee camps to proper municipal standards, developing new extensions to existing villages, towns and cities, and creating new towns.

The analysis is based on several studies of the World Bank: (1) West

Bank and Gaza: Infrastructures and Housing (2000). (2) Housing and Infrastructure Scenarios for Refugees and Displaced Persons<sup>25</sup> (2003). The World Bank's studies are drawn from its experience in upgrading camps and informal housing areas and developing new residential areas. The present analysis also relies on the Israeli experience of the absorption costs of new immigrants according to the Israeli Ministry of Immigrant Absorption budget from the year 2001.

Various forms of upgrading or new development, referred to as “options”, have been assessed, although it should be understood that any or all of them could occur:

- **Option 1: Camp Upgrading.** The options for upgrading camps range from minimal upgrading, which involves the provision of missing utilities to the existing setting of the camp (type 1), to full upgrading and/or redevelopment, which involves demolishing parts of the camp and rebuilding them to municipal standards (type 7).
- **Option 2: Upgrading in Informal Areas outside Camps.**
- **Option 3: Urban Expansion Areas for Resettlement/Returnees.** Two modules were designed to be adjacent to an existing village or an existing larger town. They were both based on a 30-hectare development scheme. Module A focuses on individual plots (accommodating 12,500 people with a density of 400 p/ha), and Module B on apartments (accommodating 20,500 people with a density of 630 p/ha).
- **Option 4: New Communities.** Under this option, resettlement is assumed to take place away from existing habitation, requiring more extensive infrastructure including municipal capacity, municipal buildings, and connector roads to other towns, etc. The creation of a new town is based on accommodating 50,000 people in a minimum site of 240 hectares; the creation of a new city is based on accommodating 250,000 people in at least 1200 hectares.

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25 This study summaries the first paper with two other studies of the World Bank from 2002, which involved analyses by consultants, coordinated by the Ministry of Planning and International Cooperation (MOPIIC): 1) “The Absorption of Refugees in the West Bank and Gaza: Potential for Housing Accommodation on Public Land in Selected Study Areas”; 2) “Housing Finance for Returnees: Issues and Policy Options.”



The costs are divided into five categories<sup>26</sup>: on-site public infrastructure, social infrastructure, housing, initial absorption payments and off-site infrastructure investment costs. They are expressed in US dollars per 1000 refugees.

- **On-site public infrastructure.** The estimated infrastructure cost refers to the construction of roads and footpaths, water and sewerage, drainage, power, and telephone lines; for upgrading works; and for work on road widths and housing density. Construction costs vary significantly, depending on topography and soil type, and contracting market conditions. The costs are estimated according to observed construction costs in Jordan.
- **Social infrastructure.** The infrastructure includes the construction of schools, health centers and community buildings in new urban expansion areas. The cost estimates are also largely based on costs observed in Jordan.
- **Housing.** Housing costs were estimated on the basis of certain assumptions regarding the average household size, building standards and construction costs in the region (in line with “typical” housing in the region). New housing construction costs have been estimated on the basis of 120 square meters of built accommodation per household, providing accommodation for a 6 to 7- person household. In the camps, much of the existing housing is sub-standard and needs to be expanded, modified, or rebuilt to municipal standards.
- **Initial absorption payments.** The payments are based on the Israeli experience of the absorption costs of new immigrants<sup>27</sup>. According to the Ministry of Immigrant Absorption, these costs refer to employment assistance, under an initial assumption of 40% unemployment rate.
- **Off-site infrastructure investment costs.** These costs were estimated based on off-site water, wastewater and transportation requirements in several types of selected study locations in the West Bank and

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26 Land values vary greatly in the study region, thus the costs of land will be estimated separately only for publicly owned land in specific sites in the West Bank and Gaza.

27 The costs are based on the Israeli Ministry of Immigrant Absorption budget from the year 2001. These payments are given to new immigrants in the first year of their stay.

Gaza<sup>28</sup>. The assumption regarding water and sewage costs was that the service levels, which are currently far below generally accepted norms, would increase gradually for the existing population as well as for the returnees. The average road construction cost was limited to the assumed access roadway linking the potential residential development areas in each study site to the existing roadway network, and the associated intersections.

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28 The study areas were several urban centers with possible expansion areas which refer to the option of urban expansion: Jenin, Jericho, Nablus, Tarqumia and Tubas, and three potential "new town" sites in the areas of the Jordan Valley, Latrun and Rafah.

Table 8: The Rehabilitation Costs in the West Bank and Gaza, Jordan, Lebanon and Syria (2002 US\$ thousand, per one thousand people)\*

	Camp upgrading							Infimal upgrading	Urban expansion		New communities	
	type 1	type 2	type 3	Type 4	type 5	type 6	type 7		Module A	Module B	New Town	New City
<b>Initial absorption payments</b>												
Jordan	315.4											
West Bank	473.1											
Gaza	425.8											
Syria & Lebanon	268											
<b>On-Site Public infrastructure</b>												
Jordan	157	230	238	193	171	310	172	175	169	77	422	422
West Bank	235	346	358	290	257	465	258	262	253	116	633	633
Gaza	212	311	322	261	231	418	232	236	228	104	570	570
Syria & Lebanon	133	196	203	164	145	263	146	149	143	66	359	359
<b>Social infrastructure</b>												
Jordan	157	283	378	288	297	310	172	279	420	317	736	798
West Bank	235	424	568	431	445	465	258	418	631	475	1,103	1,197
Gaza	212	382	511	389	401	418	232	376	567	428	993	1,077
Syria & Lebanon	133	240	322	244	252	263	146	237	357	269	625	678
<b>Housing</b>												
Jordan	2,520	2,800	3,266	3,444	3,864	3,111	3,864		3,864	3,864	3,864	3,864
West Bank	3,780	4,200	4,899	5,166	5,796	4,666	5,796		5,796	5,796	5,796	5,796
Gaza	3,402	3,780	4,409	4,649	5,216	4,199	5,216		5,216	5,216	5,216	5,216
Syria & Lebanon	2,142	2,380	2,776	2,927	3,284	2,644	3,284		3,284	3,284	3,284	3,284
<b>Off-site Infrastructure Investment Costs</b>												
Jordan	843-1338											
West Bank	1264-2007											
Gaza	716-1137											
Syria & Lebanon	1138-1806.3											

\* The indices for the West Bank, Gaza and Syria and Lebanon are taken from the World Bank paper, and are estimated at 1.5, 1.35 and 0.85 of the estimated costs in Jordan. The index for Israel is calculated according to the 2002 PPP, and is estimated at 1.9 of the estimated costs in Jordan.

## Land Availability and Costs in the West Bank and Gaza

Land values vary greatly in the study regions, thus costs are estimated only for publicly owned land in specific sites in the West Bank and Gaza. This section relies on the second paper of the World Bank which summarizes three studies coordinated by the Ministry of Planning and International Cooperation (MOPIC):

Nijem, Khalil, “*Absorption Capacity in the West Bank and Gaza Governorates: Public and Waqf Land*,” September, 2001.

Asa'd, AbdelKarim, and Anan Jayyousi, “*Water and Wastewater Sector Investment for Refugees*,” June, 2001; and

Zeidan, Khaled, “*Estimating the Roadway Costs Associated with Absorbing Palestinian Returnees to the West Bank and Gaza*,” September, 2001.

Analysis was limited to public land in the study areas<sup>29</sup>. Several areas were found to be options for relocating returnees in the West Bank and Gaza since they have enough “vacant” public lands sufficient to absorb a significant number of new residents (approximately 300,000 immigrants on a minimum public land area of 2000 square meters). The study areas were five existing towns/villages: Jenin, Nablus, Tubas, Jericho and Tarqumia; and three potential “new town” sites: one in the northern part of the Jordan Valley; one west of Jerusalem/Ramallah in the Latrun area; and one in the southeastern part of Gaza, near Rafah airport.

The land areas were analyzed for their ability to accommodate new residents, taking into account guidelines related to population growth, land utilization density, and urban expansion areas, and the zoning and building requirements in each location. Three scenarios were constructed using different assumptions for land utilization (horizontal expansion) and type and height of buildings (vertical expansion):

- Scenario 1: Available public land is used to its maximum; i.e. depending

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29 This limitation reflects the direct public investment perspective of this particular study, and the assumption that serviced land (with or without housing) may need to be made available quickly, for example, to assist families who have no option to remain in current host countries. Waqf land was not taken into account because it was largely found to be either already utilized or of small size.

on zoning requirements, maximum allowable construction percentages and number of floors is assumed.

- Scenario 2: Only 50% of available public land is used; however, maximum zoning requirements for each plot is assumed.
- Scenario 3: All the available public land is used, but housing types are mixed – a combination of single houses and multi-story buildings is assumed.

Depending on the residential density assumed and on whether sites inside and/or outside municipal boundaries were included, it was found that these five existing towns/villages could absorb from around 51,000 to around 211,000 new residents on publicly-owned land. The three new town sites were estimated to be able to accommodate some 130,000 to 165,000 people on public land.<sup>30</sup>

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30 The absorption capacity of the new town sites included in the study is potentially much larger (more than 300,000 at low density levels) if all the available public land in the Gaza site east of Rafah is taken into consideration, rather than the limiting number of 50,000 used for that site.

Table 9: Potential for Accommodating New Residents on Public Land in or near Existing Towns and in New Towns

Study Area	Scenario	Potential numbers of new residents		
		Within municipality boundaries	Outside municipality boundaries	Inside and outside municipal boundaries
Jenin	1	13,225	45,287	58,512
	3	5,881	20,139	26,020
Jericho	1	6,028	55,351	61,379
	3	3,299	30,295	33,594
Nablus	1	54,895	3,416	58,311
	3	31,753	11,013	32,765
Tarqumiya	1	7,903	10,806	18,708
	3	4,016	3,844	7,861
Tubas	1	14,248	0	14,248
	3	5,924	0	5,924
Total	1	96,299	114,860	211,158
<b>New Towns</b>	<b>Selected Areas/density</b>	<b>Potential numbers of new residents</b>		
North West Bank: Al-Malih	High Density	36,364		
	Low Density	21,557		
Latrun	High Density	77,778		
	Low Density	57,082		
East of Rafah	High or Low Density	50,000		

Table 10: Illustrative Cost Estimates of Infrastructure and Housing for New Residents in Study Areas (From Kraft and Elwan (2007))

<b>Town</b>	<b>Estimated cost of infrastructure</b> (US\$m per 1,000 persons, col (6), Table 7.10)(a)	<b>Housing construction cost(b)</b> (US\$m per 1,000 persons)	<b>Infrastructure and housing construction cost(c)</b> (US\$m per 1,000 persons)
Jenin	3.52	6.84	10.36
Jericho	3.01	6.16	9.17
Nablus	5.98	8.21	14.19
Tarqumia	4.00	6.84	10.84
Tubas	5.88	6.84	12.72
New town, North Jordan Valley	2.97	8.23	11.20
New town, Latrun	2.64	10.64	13.28
New town, E. of Rafah	2.44	7.34	9.78

(a) Includes costs of upgrading existing water/wastewater infrastructure for existing residents, (from Table 7.10. in Kraft & Elwan, 2007)

(b) Housing cost estimates are from Appendix III in the Phase II consultant's report (Nijem 2001).

(c) Since the figures for existing towns include the costs of upgrading water and wastewater services for existing residents and the estimated costs for new towns do not take into account any considerations related to building viable new communities, the figures for existing towns are not comparable with the estimates for new towns in the same column.

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# Cooperation between Two Economies: The Cases of Transportation and Electricity

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## Executive Summary

This chapter examines various fields in which the two economies could cooperate and mutually utilize the existing and planned infrastructure. In general, infrastructure projects at the national level are expensive and therefore enjoy the advantage of scale. When considering the future infrastructure requirements of Palestine, one cannot ignore the benefits of utilization of the existing, modern Israeli infrastructure. On the other hand, control and self-supply of the basic infrastructure reduces the dependency on Israel and increases sovereignty. Palestine and Israel should find the balance between the two while bearing in mind the current infrastructure capacity and expansion plans.

We chose to focus on two fields of cooperation between the two economies; transportation and electricity. The chapter opens with a series of assumptions regarding Palestine's future borders, population size, metropolitan centers and required infrastructural linkages. For each field, we characterize the existing infrastructure and then suggest a strategy for its development to meet future needs, as well as account for the mutual benefits of cooperation to both economies.

The section on transportation mainly addresses the required road infrastructure in Palestine and the fields where cooperation with Israel could take place. This section also mentions some other types of transportation infrastructure, such as sea-ports and airports in Palestine. The existing road infrastructure is in a state of disrepair. We recommend the construction of a three level hierarchy road system: (1) A longitudinal national link that will serve as the backbone of the network as a whole, which will also connect Gaza and the West Bank; (2) A secondary East–West link, located mostly in the West Bank and connecting Palestine to neighboring countries and among the medium size cities; and (3) A local and regional road network, connecting small towns and villages to the second level link.

We argue that the alternative of a train system would be more expensive to implement and less flexible to use.

Within this scope, we discuss two levels of cooperation. The first relates to the infrastructure at the network level (the infrastructure itself); we discuss the link between Gaza and the West Bank and its usage for delivering a whole set of infrastructures such as cables, electricity lines, and a gas line. Furthermore, we discuss the extension of Route 1 from Tel Aviv to Amman through Palestinian territory, and the fundamental need to construct dozens of border terminals along the connection points of the road networks of Israel and Palestine. Such terminals are needed in order to enable, on the one hand, a controllable border, and on the other hand, an efficient and humane border crossing regime. The second level relates to traffic. We discuss various aspects of integration between the two road networks such as marking language, car license, trade in used vehicles, import policies, etc. We recommend forming a bi-national committee that will address these aspects of the traffic integration.

The section on electricity opens with a detailed description of the causes of the poor quality of electrical supply in Palestine. We discuss the existing electricity supply and estimate the future demand for electricity. Our analysis finds that demands for electricity in Palestine already outstrip supply. Furthermore, our projections for electricity demand growth suggest that additional investment in electricity supply capacity is needed. We estimate the required supply capacity to reach at least 2300MW by the year 2020. This suggests the urgent need for expanding the Gaza power plant, and even then, we do not expect Palestine to be able to reduce its dependency on electricity imports from Israel in the near future. However, we recommend that Palestinians aim at gradually reducing their dependency on electricity imports from Israel from over 90% today to about 50% by the year 2020. Since Palestinian dependency on electricity imports from Israel will continue to exist for quite some time, we recommend discussions of a long-term electricity trade agreement between Palestine and Israel.

In addition, the section discusses a development strategy that would help lower the high losses in transmission and distribution of electricity. The strategy includes establishing a dissemination system that does not exist today. We recommend constructing a national electricity carrier that will

have the capacity to meet future electricity demand, as well as provide a series of recommendations concerning the form of bureaucratic organizations and technological solutions that would help reduce the losses and improve the quality of the electricity supply.

We close by suggesting different forms of cooperation in electricity infrastructure between Palestine and Israel. These types of cooperation include the long-term electricity trade agreement mentioned above, environmentally-friendly electricity production, and joint electricity production using Palestinian natural gas reserves.

## 1. Introduction

Israel and Palestine are highly diverse – culturally, socially, economically and politically. There are large development gaps within and among the two countries, and enormous differences in income levels and living standards. At a practical level, an appropriate model for further economic cooperation between Israel and Palestine must consider and respond to these vast differences, while helping them to narrow the development gaps, individually and collectively, and narrow the imbalance of power between them.

Due to long neglect of basic infrastructural development, Palestinians are heavily reliant on Israeli infrastructure. Even rapid development plans cannot lead Palestine to self-sufficiency in the coming decades. Reducing Palestinian dependency on Israel as a major supplier may set a too heavy a burden on the Palestinian economy. Therefore, we considered steps that will lead to an improvement in Palestinian terms of trade by improving the existing infrastructure and providing a long-term solution that will ensure sovereignty and the benefits of cooperation with Israel.

The most pragmatic scenario would be a multi-track, multi-speed approach that allows Palestine and Israel to embrace regional cooperation according to their particular needs, levels of development and sovereignty considerations. For instance, it may be more efficient for the Palestinians to postpone the self-production of electricity and rely on electricity imports from Israel, Jordan and Egypt, thus strengthening their bargaining position in the market.

Policies that will bring Palestine closer to meeting its infrastructure needs do not contradict cooperation with Israel; on the contrary, they may contribute to Israeli-Palestinian economic relations. This paper primarily suggests that Palestine, as a sovereign nation, can and should provide its

residents with their basic infrastructural needs. This does not suggest constructing infrastructure projects that ignore the benefits of utilizing existing infrastructure in Israel. The Israeli infrastructure could, in some cases, provide service to both Israel and Palestine. At the same time, Israel may benefit from the development of certain infrastructures in the Palestinian state. The integration of Egypt and Jordan to systems like electricity may benefit the region as a whole. The approach presented here is based on the assumption that, in addition to free market considerations, cooperation must be based on reciprocity, improved bargaining positions of all actors and consideration of national security in supplying crucial basic needs.

Currently, Israel controls Palestine's primary infrastructures, leaving Palestinians vulnerable to boycotts that halt economic activity and the supply of basic needs. A key principle presented in this document is a suggested development strategy to change the distorted power relations and encourage more balanced cooperation for the mutual interest of both sides.

This chapter focuses on roads and electricity to demonstrate cooperation possibilities in other infrastructure projects. For example, by applying the suggested methodology to the case of road infrastructure, Palestinians will have two alternatives for travel between Gaza and the West Bank. The first alternative, essential to the performance of Palestine as a unified economic space, should be a road directly controlled by Palestine. This does not exclude the possibility of enabling a second option that crosses Israeli-controlled territories. Therefore, uninterrupted movement between all regions of Palestine will not be subject to Israeli "good will". The same is true in the case of the construction of a seaport in Gaza; we expect Palestinian foreign trade to be shipped via both Gaza and the Israeli seaports as much as we expect Israeli traders to use the services of the Gaza seaport. However, in case Israel imposes restrictions on Palestinian use of Israeli seaports, the Palestinians will be able to continue trading via the Gaza seaport.

Any attempt to develop modern infrastructures in Palestine needs to start from the following assumptions:

- Palestine will include all the territories conquered by Israel in 1967 with some minor exchanges of territories. Between 5-6 million Palestinians will inhabit the state in 2020, depending on levels of decline in fertility

rates and the number of refugees that will be absorbed in the state. The Palestinian state will experience rapid economic growth once peace frees the existing constraints set by Israeli martial law and once an import of international capital, including compensations for the refugees, is invested in economic development.

- Palestine's national space will be developed around two main centers: greater Al Quds and Gaza. Greater Al Quds' metropolitan area will include Ramallah and Bethlehem. They will be the political capital of the state, the center of businesses, economic management and social and cultural life. Gaza will develop around the international sea and air ports, energy distribution and production centers, a large water desalination project, etc. Around these infrastructures, industrial areas and control centers are expected to develop (mostly export-oriented products to the European market).
- Except for the two metropolitan centers of Al Quds and Gaza, the other cities should be developed as compact cities. A small number of compact cities makes public transport system more competitive; in a state as crowded as Palestine, this may leave some open spaces between urban areas. Open spaces are essential to the quality of life in the new state. Urban sprawl and suburbanization should be limited to the use of the settlements' infrastructures. Otherwise, condensed neighborhoods and work centers should be built on the fringes of existing cities.
- The main frontier of the state, in which refugees may be settled, will develop along the eastern slopes of the West Bank and Jordan Valley. Lands owned by the government contain reservoirs of unused water. These, along with the warm climate, are ideal conditions for farming and producing export to the Arabian Gulf countries and Europe.
- An efficient and free access between the West Bank and Gaza Strip are fundamental for the success of Palestine as a united state. On the one hand, territorially divided states have not been successful in the past. On the other hand, the small amount of Israeli territory between the two areas can be crossed within 20 minutes if political and infrastructural facilities permit. We believe that if a Palestinian citizen and entrepreneur will be able to cross from one area of Palestine

to the other without a border crossing, and the economy will be free from the threat of boycotts, territorial considerations will not put any burden on the livability and unity of the Palestinian state.

- The rest of the territories located in the peripheral regions must be connected to the larger cities as the centers of economic development. Therefore, the first priority should be given to the construction of modern roads connecting the peripheral regions to the main centers, rather than the development of these regions as industrial centers. Due to the state's small size, all the peripheral areas are within commuting distance from the core areas in a way that will make it possible for them to join the modern labor market in the cities.

This chapter forecasts the need to develop transportation and electricity for the next two decades, focusing on the opportunities for international cooperation between Palestine and Israel. The first step to achieving this goal is to characterize the existing infrastructure and suggest a general strategy for its development to meet future needs. Following this, projects for cooperation are extracted.

Some general principles applicable for both sectors are:

- Priority given to existing infrastructure through their repair and rehabilitation.
- Investment programs based on economic viability of projects.
- Cooperation must be based on mutual interests.

## 2. Transportation

### 2.1. General

The existing transportation facilities in Palestine are incapable of providing a cost-effective service to the region and realizing its full development potential. The development of a comprehensive roads network is one of the bases for building an integrated and economically developed Middle East. Exploiting the existing infrastructure in both Palestine and Israel, and jointly planning to develop the integrated network will **mutually benefit** both sides. A flawless transportation network will create opportunities for new enterprises at the regional level by taking advantage of lowered production and distribution costs for local and imported goods.

In the case of cooperation in road infrastructure, our guiding principle is that the two states' permanent status agreement will create a peaceful environment in which it will be possible to drive vehicles between Palestine and all its neighboring countries, including Israel, via border crossings, and back again.

#### 2.1.A. Development Strategy

The physical condition of the current network serving the Palestinian population is in a state of disrepair. Inadequate services follow long years of occupation, lack of maintenance and underinvestment. Around 50% of the roads in the Gaza Strip are unpaved, while 40% of the West Bank's road network is below acceptable service levels.<sup>1</sup> Large sections of the network pass through densely populated areas. The Israeli network, on the other hand, is in far better condition.

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<sup>1</sup> United Nations Conference on Trade and Development: <http://www.unctad.org/gds/app/2003/1>.  
*Transit Trade and Maritime Transport Facilitation for the Rehabilitation and Development of the Palestinian Economy*, Page 4.



The total length of the road network in the West Bank and Gaza Strip are 2,206km and 294km, respectively. After the Declaration of Principles in 1993, intensive construction of **bypass roads** was initiated by the Israelis. These roads were constructed on land confiscated from Palestinians. Their construction adversely affected the Palestinian society by transforming the communities into disintegrated geographic entities; affecting land use and socio-economic development of the West Bank and Gaza Strip. A total of 818km of bypass roads was built with 768km in the West Bank and the rest in Gaza Strip.<sup>2</sup>

It is worth noting that the Palestinian network standards inspire to be similar to the Israeli network. However, these standards were poorly implemented due to the lack of resources. In the development of a transport network, several elements must be taken into consideration:

- Trade offs among different transportation means.
- Trade offs between the cost of developing the infrastructure and the cost of using the infrastructure.
- Topographical and other physical characteristics of the environment.

The first dilemma relates to the trade off between railroads or car roads. The constant investment in rail is higher than in car roads. In the mountainous topography of Palestine the differences can be close to double. Trains have a higher capacity to transfer heavy and large cargoes for longer distances at lower prices. However, cars are more flexible and can transport goods directly to their targets, losing less time in terminals. Since most transport across Palestine is predicted to consist of passengers and products of light industries, and because distances are generally short (not more than several dozen kilometers), road transport has a significant advantage over railroads.

Based on train prices from Tel Aviv to Jerusalem, which crosses a mountainous topography, one mile of rail infrastructure is expected to cost \$21 million, or \$315 billion for the entire route (about 150 miles). Furthermore, even the *RAND Report*,<sup>3</sup> which recommends constructing a railway system, admits that

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2 Palestinian Central Bureau of Statistics, 2006.

3 Suisman, D. (2005). "The Arc: A formal structure for a Palestinian State", *RAND Report*.

it must be complemented by a car road system. A road system will cost, based on the prices of Route 6 in Israel, about \$13.4 million per mile or about \$2 billion in total. Assuming that a wider road system will cost about 50% more, and taking into consideration the need to build two terminals in each of the larger cities – one for trains and one for busses – at an expense of about \$30 million each, makes the railroad system too expensive. A rough estimation leads to the conclusion that the railroad and car road system will cost around \$5.5 billion, while the road system will cost around \$2.5 billion.

Any transportation network has to be based on the optimal balance between the costs of supplying the infrastructures and the user costs of these infrastructures. Road constructors are concerned in connecting all destinations via the shortest route while consumers' interest rely on the shortest route between any two destinations, which means constructing the longest total road system. This dilemma leads to a clear solution in Palestine along the contrasting interests. A main route along the crest of the West Bank mountains creates shorter connectivity between urban destinations, connects about 75% of Palestinian urban populations, and serves the roads' supply and demand.

The resulting road system will be based, therefore, on the following principles:

1. The system will be based on a three level hierarchy of links: (i) A longitudinal national link that will serve as the backbone of the network as a whole; (ii) A secondary East-West link, located mostly in the West Bank, connecting Palestine to neighboring countries, and between medium size cities; and (iii) A local and regional road network, connecting small towns and villages to the second level link.
2. The system should encourage the development of the existing cities in a compact form.
3. The system should encourage the development of the eastern frontier with second and third level roads.
4. The system should encourage connecting the network to the neighboring countries.

The transport network infrastructure will be built around a national North-South Route between Jenin and the Gaza Strip and along the rest of the

West Bank through Nablus, Ramallah, Al Quds, Bethlehem, El-Khalil, Gaza, Khan Unis, Dir El Balah, Rafah Airport and Rafah. The route will cross Israeli territories along a channel and enable free crossing with no check points or international terminals.

The main route will follow the infrastructures of Route 60 along the West Bank, and Route 4 along the Gaza Strip. However, to avoid congestion, the route should bypass the larger cities on their east sides, as close as possible to the city centers. Large cities will have two to three exits while the smaller cities will have only one exit. A public transport terminal will be built adjacent to the central station in each city. This means that 11 terminals and 20 to 25 exits will be built along the route. Smaller towns will have to connect to the backbone route (60) through these exits only. This will discourage the process of urban sprawl and suburbanization, and will advantage compact urban development.

There are two questions concerning the national route: First, should it be based on a railroad system or car road system? Second, what should the location of the route be? Concerning the first question, we suggest developing a highway with 3–4 lanes in each direction, enabling the transfer of trucks, busses and private cars efficiently and at high speed (140km/h). The entire complex, which will be about 120m wide, will also include the national electrical, telecommunication and fuel lines. The small number of exits will enable smooth traffic flows along the route.

The alternate train system will be more expensive to implement and less flexible to use, despite the major investment required. Bus stations will be located closer to city centers. Busses will leave stations more frequently requiring less waiting time from consumers and easy access by private cars will be available. We estimate that passengers from the metropolitan core of Al Quds will be able to reach the international airport in Rafah or Gaza city center in the reasonable time of less than one hour.

Concerning the location of the route, three alternatives may be considered:

1. The existing Route 60 in the West Bank and Route 4 in the Gaza Strip. This alternative is the cheapest to construct. However, it has the significant disadvantage of increasing traffic congestion to impossible levels.

2. The second alternative is to use the relatively unpopulated areas along the eastern slopes of the mountains in the West Bank. This can be implemented as a lever for building new modern towns 10-15 km east to each of the larger cities in Palestine, and connecting the new cities to the old ones by a wide road. Planners of the *RAND Report* believe that such a large, national project will improve living standards, and supply national identity, pride and the ethos of progress. We believe that this ambitious and expensive alternative will be more of an economic, social and cultural burden than a lever for progress. It is based on a blind belief in the modernist idea of progress and the power of comprehensive rational planning to lead to progress. We prefer to reserve additional capital for creating long lasting profit oriented jobs. The use of comprehensive rational planning methods proved itself destructive to urban culture, traditions and the crystallization of socio-cultural identity. City builders build houses and infrastructure but not urban lifestyles and cultures which grow organically. We estimate that this alternative will lead to the deterioration of the old cities with their local cultural characteristics of bazaars, markets and livability. This will have a tremendous impact on socio-economic gaps, etc. The new cities may produce alienation and loss of identity similar to renewal projects in western cities and the attempts to build new capitals in cities like Brazilia.
3. The third alternative is to utilize, as much as possible, Routes 60 and 4, but to build bypass sections to the cities and/or channels underneath the central cities. The most problematic part will be in Al Quds, a section that will need special care and planning considering functional and political aspects of the plan.

The second level of roads will focus on East-West routes that will connect medium-size cities to the national route and Palestine to neighboring states. The Israeli roads, built for the settlers will supply the foundation for this second level network. These roads are already bypassing the large cities. Nevertheless exits to these cities will have to be built anew. They will enable rapid connection from the main access to cities like Tul-Karem, Qalquilia and Jericho, as well as shorter routes to smaller cities like Salfit and Tubas.

Figure 1: Planned Road Network



The main roads connecting Palestine to Jordan will be the Al Quds–Jericho Route and the Nablus–Jiftlick Route. Connections to Israel are already being built along the Hotze Shomron and the highway to Jerusalem (Route 1). These roads can be upgraded to international roads that cross Israel and Palestine, from west to east, into Jordan. Furthermore, the second level of the network will also include three longitudinal routes in the West Bank and additional one along the coast line in the Gaza Strip. In the West Bank the Jordan Valley Route 90 and the Alon Road (458) will become the backbones of the frontier development region, and the Western Route 446 will complement the network improving connectivity within the eastern and western zones.

The third level in the hierarchy will constitute the Palestinian road system. Most of these roads will be connected to the second level network, creating the intra-regional road network. Most of these roads need intensive reconstruction following neglect during the Israeli occupation, damage by the Israeli military, and lack of developmental priority by the PA.

### 2.1.B. Forms of Cooperation

Within this scope, with the road network, joint cooperation will exist on two levels: (1) The network level (the infrastructure itself); and, (2) The traffic level.

Currently the Israeli and the Palestinian networks are separated and, due to security concerns, the few existing linkage points are controlled by Israel. Furthermore, the Jewish settlements are served by bypass roads that are closed to Palestinians. In the short-term, the Palestinians urgently need freedom of movement among cities and towns and a territorial link between the West Bank and Gaza Strip. With a peace agreement all road blocks inside Palestine should be eliminated, all bypass roads opened for Palestinian use and the link between Gaza and the West Bank operated.

An envisioned peace agreement in the region will allow cooperation opportunities in many fields, mostly technical. Such cooperation, supported by agreements and treaties, will facilitate the seamless integration of both networks.

The first set of recommendations relates to infrastructures:

- The most salient project is the link that will enable free movement between Gaza and the West Bank by cars. In addition, the link has to enable the construction of a whole set of infrastructures like cables, electricity lines, a gas line etc. The route must be fully controlled by the Palestinians, but the land above the link will remain Israeli territory. Such an arrangement must be anchored in a formal agreement between the states, and will secure Palestinian free movement and access to maintenance.
- Route 1 from Tel Aviv to Allenby Bridge, and the suggested route from Cross Samaria to Damia Bridge will be upgraded to enable easy access from Tel Aviv to Amman through the Palestinian territory. In addition, the Palestinians will develop modern cross-border terminals in Damia and Allenby that will serve both the Israeli and Palestinian transportation. The project will be financed by border taxes.
- We believe that open borders is not realistic in the foreseen future, for three reasons: First, economic gaps and different economic policies may encourage mass attempts to smuggle merchandizes through the open borders (see the chapter on Jerusalem). Second, Israel may be threatened by the mass entrance of unregistered migrant workers from throughout the Arab countries. Third, both countries will be interested in maintaining security, threatened by fundamental groups from both sides. Under these circumstances cooperation between the two states must be based on border management that enables a controlled border crossing on the one hand, but a flexible system of crossing on the other hand.

To meet these needs a large, modern terminal will need to be built. The terminal must be able to process large numbers of people, within half an hour in peak times, and not more than fifteen minutes on average, including all the security checks. Estimates indicate a need for about 40 such terminals, of two kinds: one for commuters and one for cargo. Eight cargo terminals will be needed – two in Gaza, one in the northern border of the West Bank (Jenin), one in the southern border of the West Bank, two in Jerusalem (towards Ramallah and Bethlehem) and two towards central Israel. The exact number can be reconsidered according to the

development of economic relations between the two countries. The rest of the terminals will be devoted to passengers. A special focus must be given to the Al Quds-Jerusalem border where higher levels of integration and free crossings are needed for commuters and tourists. Commuters and truck drivers will cross the border with their original cars, and security checks, if needed, will take only a few minutes and will be based on new technologies such as x-rays for trucks and personal properties. Visas will be given at the terminal. People and cars that frequently cross the borders will be able to acquire long-term visas. The terminals will serve Israelis and Palestinians under equal terms, like international terminals operating throughout the world. In the long-term we recommend abolishing visas.

- Two terminals will be located along the West Bank-Gaza canal enabling exits to Route 6 and Route 25, which connect also to Route 4 and 20 along the Israeli coastline plain.
- The terminals will be used also for the payment of taxes. This applies mainly for the cargo terminals, where Palestinians will be able to collect customs and clearances independently of Israel.
- Concerning the network management we suggest the following:

#### 2.1.B.a. **The Marking System:**

The current marking system is inherited from the Israelis and follows international standards. Therefore, cooperation on this level and unifying both systems requires minimal effort.

- **Marking language:** The Arabic language is used within the Israeli marking system as it is considered an official language; this promotes easier integration on the regional level where Arabic is widely used. In Palestine, Arabic and English will be used for marking.
- As both networks will be integrated, new traffic patterns will emerge; this might require the establishment of a bi-national committee that will recommend adaptations of the Israeli and the Palestinian transportation networks to the new developments initiated by the integration of the systems.
- Car license registrations must be unified for both Israel and Palestine to enable border crossing between Israel and Palestine with cars. If



Palestine allows the importation of cheap cars (produced especially for third world countries), we recommend supplying Palestinians with two types of registration numbers – one with permission to drive only in Palestine and other countries that allow these cars, and a registration number that is also recognized by Israel. The two registration numbers will be distinguished by different colors. This recommendation considers the growing market for simple cars for third world countries, cars that Israel will, most likely, not allow, but may interest Palestinians.

- Taxis adequately licensed will be allowed to cross the border to serve cross-border passengers.
- Bus companies from Israel and Palestine will be allowed to apply for rights to operate cross-border lines. Such applications will be submitted to the bi-national committee suggested above. One can foresee the attractiveness of several such lines. A bus from Tel Aviv through Jerusalem and Al Quds, to Jericho and Amman may be a demonstration for the new opportunities opened to transportation companies.

The bi-national committee will also deal with coordinating the following issues:

- Sharing cars, car owners and drivers databases. This is essential when drivers from both countries will use each others networks (in cases of accident, theft, etc).
- Mechanisms for selling and buying cars between both sides.
- Import policies (totally dependent).
- To introduce locked-freight transportation systems, food and beverage, industrial and agricultural, and to agreed standards of the transportation of these goods.
- The Palestinians are independent on the issue of permanent entrance of vehicles and to re-evaluate the agreements with Egypt and Jordan.
- Introduce cooperation on meteorological issues related to traffic on land, sea and air.
- Share data of traffic and traffic patterns within the network.
- Environmental impact of any network development.

We have devoted a special concern for the development of sea and air

ports and to cooperation policies in managing them.

## 2.2. Airport

An examination of future transportation needs clearly indicates the necessity for air transport services to handle the projected passenger and cargo, internally and between Palestine and other parts of the world. This requires the reopening of the Gaza International Airport. The airport is located at about 40 minutes driving distance from Al Quds, the capital of the Palestinian state. An international port in Gaza does not pose special difficulties in coordinating air traffic with Israel and Egypt beyond common air transport regulations. Unlike the Gaza airport, an airport in Al Quds poses complex coordination issues with Israel. Therefore, we recommend that only a small and secondary airport for small airplanes be considered there. It will serve local flights to Gaza Strip and neighboring countries, mainly Amman. In the future, it may be used to supplement the Gaza International Airport. However we do not believe that there is any justification to channel significant investment to the development of a second airport in Palestine. The right of Palestinian flights above Israel between Al Quds and Gaza should be secured in bilateral agreements.

## 2.3. Seaport

With the absence of a Palestinian port, the whole region is currently being served by the modern Israeli ports along the Mediterranean. Palestinians are in favor of developing a seaport in Gaza Strip. Such a port must remain flexible and able to handle different types of cargoes, rather than specialize in one particular cargo. This may increase competition with Israeli ports and improve the bargaining position of Palestinian exporters and importers. If the Gaza seaport is a cheaper option Israeli businessmen may choose to utilize it.

One important aspect of the road link between Gaza and the West Bank will be its connection to the Gaza seaport. We expect a considerable portion of the Palestinian foreign trade to pass through the Israeli seaports. However, if Palestinian utilization of Israeli seaports will be too costly, the option to deliver Palestinian foreign trade through Gaza would ensure the viability of the

Palestinian economy. This will strengthen the bargaining power of Palestinian and some Israeli users of the Ashdod port. In order to increase competition between the two ports we recommend developing the railroad between Gaza and Ashdod. The line can later be expanded to Tel Aviv through Gaza and Rafah and extended to Egypt; linking Asia with Africa. This would be a recreation of the same route created by the British during their mandate in the region.

## Strategic Scenarios

Within this study three possible scenarios are benchmarked within the current situation.

**The current situation:** There are two transportation networks; Israelis control the Palestinian intercity linkages and no linkages exist between the Gaza Strip and West Bank. There is a developed Israeli network. The Palestinian network is underdeveloped; Palestinians have no port, a damaged airport and no free access to the developed transportation services on the Israeli side.

In all the following three scenarios, the **two-states** solution is envisioned, the impact of the **separation wall / barrier** is minimized, and the **territorial link** between the Gaza Strip and West Bank exists.

This Study will also evaluate the transportation sector from the following expected scenarios:

### Scenario I: Full Integration

Two independent states comprising of a common transportation network, allowing free access to everyone, everywhere. There will be no need for a designated territorial link between the West Bank and Gaza Strip - similar to the European Union.

### Scenario II: Separation

Two independent states with separate networks. Palestinians remain in Palestine and Israelis aren't permitted to enter Palestine. The Gaza-West Bank linkage should exist.

### Scenario III: Partial Integration

Two independent states with shared partial usage of main links, such as

the North-South Route and some specific highways, without restrictions. Citizens from both countries can drive in either state but require special permission (visa).

## 2.4. Roads

The current road network is not ideal. There are many roads that are not maintained and are damaged and blocked. Additionally, links between the Palestinian cities are unreliable.

Assumptions:

1. Palestinian networks need extensive rehabilitation to reach internationally accepted standards. It is the assumption that the donor community will participate in developing the road network.
2. When sharing the roads, a joint office will arrange for road tax allocation upon a specific agreement.

Table 1: Transportation Scenario, Road

	Current	Full Integration	Separation	Partial Integration
Cost (-)	High	Low	High	Medium
Independence (+)	Low	Low	High	High
Transfer of Technology (T.o.T)(+)	Low	High	Low	Medium
Mutual benefit (+)	Low	High	Low	Medium
Network efficiency (+)	Low	High	Medium	High

The best strategy for this sector is to implement **partial integration** for the first 7–10 years; then gradually implement **full integration** as the optimal solution for the region.

## 2.5. Rail

There are no rail services currently operating in Palestine, though a rail system exists in Israel.

Assumptions:

1. No rail network will be implemented within Palestine in the near future.
2. Under **Scenario I** and **III** Palestinians will have access to the Israeli rail network at the same cost as the Israelis.

Table 2: *Transportation Scenario, Rail*

	Current	Full Integration	Separation	Partial Integration
Cost (-)	N/A	Medium	High	N/A
Independence (+)	N/A	Low	Low	Low
T.o.T (+)	N/A	N/A	N/A	N/A
Mutual benefit (+)	Low	Low	Low	Low
Network efficiency (+)	Low	Low	Low	Low

It is recommended that **partial integration** within the rail sector be implemented for 7–10 years, allowing Palestinians the use of the Israeli rail network. Following this period, a traffic evaluation must be conducted to **reevaluate** the **full integration** option, and to consider extending the Israeli network within Palestine, by a Palestinian rail company.

## 2.6. Air

An assessment of future transportation needs clearly indicates the necessity for air transport services to handle the passenger and cargo to other parts of the world. This requires the reopening of Gaza International Airport, and the construction of another secondary airport in the West Bank.

Assumptions:

1. International airport in Gaza.
2. National airport in the West Bank.
3. In Scenario III, transit flights are acceptable.
4. In Scenarios I and III, Israelis can fly out of Gaza and Palestinians fly out of Ben Gurion Airport.

Table 3: *Transportation Scenario, Air*

	<b>Current</b>	<b>Full Integration</b>	<b>Separation</b>	<b>Partial Integration</b>
Cost (-)	High	Low	High	Medium
Independence (+)	Low	High	High	High
T.o.T (+)	Low	High	Low	High
Mutual benefit (+)	Low	High	Low	High
Network efficiency (+)	Low	High	Medium	High

The **partial integration** scenario is the best for both parties, where both will cooperate within specific and certain issues that both agree benefits them.

## 2.7. *Sea*

Though it is not the most economically efficient solution, Palestinians view the sea port as a symbol of economic sovereignty.

Assumptions:

1. Roll on roll off.
2. % usage of Israeli port.

Table 4: **Transportation Scenario, Sea**

	<b>Current</b>	<b>Full Integration</b>	<b>Separation</b>	<b>Partial Integration</b>
Cost	High	Low	Low	Medium
Independence	N/A	High	High	High
T.o.T	N/A	Medium	Medium	High
Mutual benefit	Low	Medium	High	High
Network efficiency	Low	High	High	High

Again, **Partial Integration** is the best option, where the Palestinians will have their own port but can continue to utilize the Israeli ports. Both Israelis and Palestinian should be able to choose their desired shipping port based on economic incentives.

## 3. Electricity

### 3.1. General

Supply of electricity to the Palestinian state requires an analysis of production and available fuels, dissemination and distribution. In addition, it requires understanding the role of the main actors - Palestine, Israel, Egypt, and Jordan - in the supply of electricity to Palestine and as partners for cooperation with them. As in the discussion on transportation, we briefly characterize the current system, predict future needs and the different means for meeting these growing demands, and recommend projects for cooperation and regional electrical systems integration. Stable, uninterrupted and relatively cheap electricity supply is a necessary condition for sustained economic growth. We therefore view the development of economic cooperation based on reciprocal relations as a power to consolidate the peace process between Palestine and Israel.

Currently, Palestine is heavily dependant on electricity imports from Israel. The domestic electricity production cannot meet demands and the status of the network is despairing.

Table 5: Existing Palestinian Supply Capacity

West Bank	Gaza
500MW – IEC	110MW – IEC
20MW – Jordan to Jericho	140MW – Gaza Power Plant
	17MW – Egypt to Raffah
520MW – Total existing capacity	267MW – Total existing capacity

Source: World Bank, West Bank and Gaza Energy Sector Review, May 2007.



The only power station in Gaza works on diesel engine, producing relatively expensive electricity. The production can be distributed only in Gaza. This means that the dependency ratio on electricity imports from Israel is close to 80%, creating complete dependency on Israel. Imports from Egypt and Jordan are marginal and are restricted to Rafah and Jericho.

Transmission systems are almost non-existent. The Palestinian territories are subdivided into four regions, each of them supplied by end lines of the Israeli network. They have transmission capacities that range between 6.6KV–33KV. Electrical networks in the West Bank are considered distribution networks. The Israeli Electrical Company (IEC) supplies electricity to Palestinian villages adjacent to its overhead lines. There are three main lines in the West Bank and nine main lines in Gaza Strip. These lines were designated to supply Israeli settlements and military camps. During the last four decades, electrical installations were financed by the local population. For this reason, some rural villages located far from Jenin or Hebron have no electricity.

The Palestinian Electric Company (PEC) was established in 1999, with 33% of its assets for public shareholders, and 67% for private shareholders. Municipalities in the West Bank perform the role of electricity distribution companies; in some cases there is a limited production capacity. Maintenance standards of the lines are low resulting in higher rates of losses. Misusage causes the wires and transformers to heat, thus creating losses and supply interruptions in the electricity system. Moreover, it creates lower tension in the electricity lines, especially near the ends. This results in a poor, practically unusable quality of electricity. Industry and other essential consumers are economically injured as they are prevented from maintaining a normal production pace and are unable to upgrade and extend production to modern standards. Consequently, these consumers are forced to establish their own production units close to the factory. Needless to say, this temporary solution complicates production and makes it more expensive. In total, estimation losses reach the impossible rate of

30-35%,<sup>4</sup> partly due to the network's low standards and mainly to low rates of payment to the electricity companies.

The economic consequence of such losses is estimated at \$4.29 million per year. This, in turn, increases the price for KWh (between \$0.1-0.5 per KWh).<sup>5</sup> In addition, the Palestinian Authority highly subsidizes the prices by paying part of the customs accumulated for them by Israel to the IEC. For example, on December 3, 2001, the IEC asked the Israeli government to cut \$20 million from the transfer payments (taxes collected from Palestinian workers in Israel) it makes to the PNA as a result of the accumulated electricity debt for the municipality of Gaza. The IEC threatened to cut power because of the "critical" nature of the political situation. In the case of a military closure, however, the amount of money transferred to the PNA is minimal.

The percentage of households connected to the public electricity network increased from 96.8% in January 1999 to 99.5% in July 2000. However, this figure is misleading. In fact, only 93.1% of households receive uninterrupted electricity services (twenty-four hours a day, seven days a week), while the transmission losses were very high, indicating a poor quality of supply. The implications of the defective electricity system for the industrial sector are considerable. The industrial sector suffers from a supply shortage, while the proportion of the cost of electricity is very high (nearly 35% of the operation cost). In 2000 the average price of electricity reached nearly US\$0.30 per KWh. This was 3 times higher than the average price in Israel or Jordan; twice as high as that in Lebanon and 5 times higher than the average price in the USA.<sup>6</sup>

Electricity supply depends on import, especially in the West Bank. The Palestinian Energy Authority is expected to regulate this in the PT, in zones under its control, while the Jerusalem District Electric Company (JDEC) distributes electricity to East Jerusalem and some Palestinian suburbs around Jerusalem. After the Oslo Agreement, three distribution

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4 Abu Alkhair, A. (2006). *The Current Status of the Energy Sector in Palestine, with a Special Focus on the Electricity Sector*, Geneva: University of Geneva.

5 Palestinian Energy Research Center (PEC). (1994b). *Status of Electricity Services in the Occupied Territories, Rural Electrification, Characteristics of Technical Attempts for Electrical Networks*.

6 Abu Alkhair, 2006.

companies were considered: Gaza Electric Utility (GEU), South Electric Company (SELCO), and North Electric Utility (NEU). Municipalities act as distribution utilities and collect payment for electricity from the consumers. However, some 65 localities in the West Bank are not connected to a public electricity network, including 38 in the Hebron district. Of the 531 West Bank and Gaza Strip localities with connections, 165 received their electricity from the JDEC, 215 from the IEC, 22 from private generators, 68 from community councils and 61 from other sources.<sup>7</sup>

In addition to the desperate situation of the network and the mismanagement of distribution the IEC does not respond to Palestinian needs:

- The municipalities and village councils purchase a limited amount of electrical energy from the IEC. In order for the municipalities to increase their electric supply, they have to pay large amounts of extra money in the form of fees to the IEC.
- The IEC does not respond positively to this increase in the demand, unless it has an overflow on its transmission lines. In all other cases, those requesting increases in electricity must finance it themselves.
- Priority of service is given to the Israeli customer. Concurrently, a low voltage exists at the end of the feeder lines.
- The low voltage at the end of the transmission lines is attributed to the radial system used for these main feeders. This causes the electricity to be easily cut off in cases such as grid maintenance making it difficult for businesses to develop.

### 3.2. Estimating Future Demand <sup>8</sup>

Energy consumption in the West Bank and Gaza Strip is small in total, and low by regional standards per capita.<sup>9</sup> Despite the troubles of recent years, energy demand has continued to grow quite rapidly. Total electricity

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<sup>7</sup> Abu Alkhair, A. 2006.

<sup>8</sup> MEDA program. (2002). *Applications of Solar Thermal Energy in the Mediterranean Basin, Palestine*.

<sup>9</sup> Some critique has been raised about the accuracy of PCBS population figures. Therefore, per capita calculations may suffer a downward bias. (See, Bennett Zimmerman. (2006) *The Million Person Gap: The Arab Population in the West Bank and Gaza*, The Begin-Sadat Center for Strategic Studies, Bar-Ilan University).

consumption, as indicated by electricity purchases of GEDCO and JDECO, grew by an average of 10% annually in 1999-2005. The World Bank estimates indicate that even under a low consumption scenario, demand will outstrip supply capacity by 2008. According to a published report from the MEDA program,<sup>10</sup> electricity problems, high prices and low reliability play a significant role in preventing industrialization. In addition to political instability, electricity supply shortages limit growth prospects.

In order to estimate the required investment in electricity generation capacity, we compared current Palestinian electricity consumption with that of Israel in the late 1950s. Palestinian electricity consumption in 1995 was similar to that of Israel in 1957, and in 2001-2002 Palestinian electricity consumption was equivalent to Israel in 1961.<sup>11</sup> Israeli electricity consumption per capita in 1970 was used as reference to determine Palestinian electricity consumption per capita for the year 2020.<sup>12</sup> Israeli electricity consumption per capita for this period was 1900 kWh. Moreover, the following characteristics, unique to the Palestinian economy, were taken into consideration:

1. The general population is expected to grow due to natural growth and the return of refugees. The current average number of persons per household is 6.4. The average household size is expected to decline over time.
2. The marginal effect of the household size over the basic electricity consumption i.e. lighting, refrigerating etc. is low, but will grow parallel to Israeli development during the compared years.
3. The Palestinian industry will not be as energy intensive as Israel's. The rate of growth in electricity consumption by the Palestinian

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10 MEDA Program. (2002). *Applications of Solar Thermal Energy in the Mediterranean Basin, Palestine*.

11 Palestinian and Israeli peak electricity demand:  
 294MW in 1995 (equivalent to Israel, 1957)  
 405MW in 1999 (equivalent to Israel, 1960)  
 454MW in 2001 (equivalent to Israel, 1961)  
 456MW in 2002 (equivalent to Israel, 1961)  
 Source: IEC Statistic's yearbooks.

12 The figure is 3.25 times greater than Palestinian consumption in the year 2000. As mentioned, this is similar to Israeli electricity consumption in 1961.

industrial sector will not exceed that of the residential electricity consumption.

4. Electricity intensive projects such as the construction of the national water canal in Israel during the selected period, and construction of a water desalination facility in Gaza are accounted for separately.

According to the characteristics described above, in order to predict Palestinian electricity consumption by comparison to Israeli figures, it is necessary to deduct approximately 25%<sup>13</sup> of the equivalent Israeli consumption per capita. Therefore the average electricity consumption per capita in Palestine is predicted to reach 1400 kWh by the year 2020, similar to the average consumption per capita in Israel in 1966-1967.<sup>14</sup>

Based on the assumption that the annual electricity consumption per capita will amount to 1400 kWh by the year 2020, and assuming the general population size will reach 6 million,<sup>15</sup> electricity consumption in

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<sup>13</sup> Israeli electricity consumption in that period includes electricity intensive industry and water pumping. The adjustment is needed in order to correct the possible upward bias.

<sup>14</sup> Notes and comments regarding forecasts based on average consumption per capita:

(1) This method of prediction was chosen due to insufficient data.

(2) Predictions are usually based on consumption and demand analysis of the different homogenous consumption groups. Typical dichotomy of these consumption groups is: residential, commercial, industrial, agricultural, water pumping and street lighting. The electricity demand of these consumption groups differ by the time of use at various seasons, weeks, days and daily hours. A consumption and demand forecast is usually obtained by collecting and analyzing data relevant to each consumption group.

(3) The basic electricity consumption, for lighting, refrigerating, etc. is fixed only to lower levels of income. Therefore, we assume the modernization and improvement of living standards will cause growth in the residential consumption relative to the industrial consumption.

(4) Reduction of the high rate of electricity transition losses may reduce electricity prices. The changing demand for electricity is relatively high. Therefore, the rate of growth in residential electricity consumption and demand will be affected by the degree of utilization of energy such as air conditioning. The rate of growth in industrial consumption is expected to be slower due to the need to establish the industrial infrastructure and to the yet unclear nature of future industry.

(5) During current (2004) economic conditions there was no clear difference in electricity consumption throughout the year. However, as more electric appliances will be used for heating/cooling clear differences are expected to be observed due to the seasonal highs and lows.

The above comments affect the predictions of the peak electricity demands. The peak demand serves as a base for planning electricity production, transmission and tariff determinations.

<sup>15</sup> The Palestinian Central Bureau of Statistics estimates 5,091,314 residents by the year 2015. The marginal production capacity needed for 1 million people is 383 MW (approximated cost \$500 million for a coal power station or \$270 million for a gas power station).

the Gaza Strip and West Bank will amount to roughly 8.4 billion KWh per year. Assuming 18% system losses, the estimated production required to meet the expected demand will be 10.2 billion KWh per year.

Assuming the load factor<sup>16</sup> to be 68%,<sup>17</sup> the production capability required would be 1700MW. However, due to occasional malfunctions, periodic repairs and production units' maintenance, an additional 25% operational reserve is required.<sup>18</sup> Hence, it is expected that the required installed production capacity to provide Palestine with reliable electricity supply to be 2300MW. This additional reserve is also required in order to cover the possible downward bias in comparison to Israel<sup>19</sup> due to the differences in the expected rate of increasing demand for electricity.

Note: Due to the lack of sufficient information, risks and uncertainty, the given estimations ought to be refreshed prior to practical application. Data and estimations should be adjusted according to updated circumstances and conditions.

Based on the analysis described above, it is more probable that risks to this projection lie on the up side. The future consumption can exceed our projection due to the necessity of constructing a water desalination facility in Gaza. Downward bias to this estimate could also occur when barriers to economic growth are lifted or if return of Palestinian refugees exceeds population growth assumptions. Even a more simplistic extrapolation of 10% growth per year, based on current electricity supply figures, suggests electricity supply requirements would exceed 2700MW.<sup>20</sup>

Even if we accept the more modest prediction, we have to assume a dramatic increase in consumption due to rapid population growth and economic

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16 Load factor: the relation between the average annual production and the annual maximal demand.

17 Where consumption is basic, the correlation between the different elements responsible for creating the maximal demand is stronger.

18 This additional reserve is also required since the high probability that the rate of growth of future electricity consumption and demand in Palestine will exceed the average pace of growth in other electricity markets.

19 The subtraction of 25% from Israeli electricity consumption figures in 1970 adds an additional element of uncertainty.

20 Since current, suppressed demand already outstrips the 770MW supply, stretching current supply by a growth factor of 10% a year; implies supply requirements of 2716MW by the year 2020.

development. This will set tremendous challenges to the development of electricity sources. The problem is even more disturbing due to the potential for imports from neighboring countries. Israel, which is the main supplier of electricity to Palestine, is facing a shortage in production that will last at least up to the target year of 2020. Therefore, one can expect that Israel will be reluctant to increase export to Palestine. The IEC has even considered initiating stops in electricity supply to selective regions in peak times to reduce the risk of the collapse of the entire production system. Under these circumstances Palestinian regions may be especially vulnerable to electricity stops. Jordan and Egypt do not have the facilities to increase electricity export to Palestine. Some private Egyptian investors proposed to build a gas power station in Sinai that will export electricity to Palestine. However, the Egyptian government refused to approve the project. A Jordanian initiative is even more complex, since it depends on the construction of a gas pipe from Egypt to Jordan, which may be quite expensive. This leads to the conclusion that the Palestinians will have to increase self production, and increase efforts to secure supply by official, long-term agreements with all neighboring countries.

### 3.3. Development Strategy

The main conclusion from the analysis is that the electricity infrastructure requires emergency treatment in building the dissemination network, the distribution system and the access to supply sources. Without it, any economic development will be blocked. The most emergent projects are as follows:

- Establishing a dissemination system that does not exist today. We recommend building a national electricity carrier starting from Gaza and ending in Jenin. This will also enable connections to the Israeli, Egyptian and Jordanian networks. Such a carrier must have a capacity of 161 kWh, to meet demands till 2020. The carrier will become the backbone of the Palestinian network bringing most of the population closer to the high voltage lines. These lines will integrate the system, enabling compensation for shortcuts in any area of Palestine. It will also enable the production of most Palestinian electricity in Gaza, which is close to the sources of gas and gasoline imports and to cooling facilities

based on sea water. We believe that such an option will be cheaper than piping gas from Gaza to the West Bank in order to produce electricity in the West Bank based on air cooling systems.

- Upgrading local and regional networks and connecting them to the national carrier. Upgrading the existing networks, shortening the length of supply lines, reducing the number of consumers connected to each transformer, adjusting the cable's section to the expected demand in the line, and all other technicalities are required to provide normal and reliable electricity supplies. These steps may reduce about one third of losses in the electrical network.
- Reducing the major part of the losses requires a reorganization of the bureaucratic organizations that control and collect payments from users. The Palestinian Authority established four regional companies that failed to impose payment collection. Customers adjust the meters, by by-passing the meter or by connecting directly to the network without notifying the supplier (usually, the municipal authority, since the IEC sells electricity to the municipalities at bulks and then the municipality sells the electricity to the end users), to minimize the measured electricity counted. The problem can be solved through a combination of means.

First, a new metering technology, based on a prepaid system, should be implemented in order to increase the difficulty to bypass the control system. The whole process will be computerized and involve codes programmed to the meter,<sup>21</sup> ensuring no electricity income prevention. The suggested technological solution enables the electricity supplier to collect information regarding the regular electricity consumption readings and will trigger an alarm whenever irregularities, caused from income prevention, occur. These types of meters have been successful with handling electricity income prevention in other parts of the world.

Second, the authority must find ways to exercise its authority on consumers and supply the companies with effective mechanisms for imposing payments. The Palestinian Authority should impose one

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<sup>21</sup> Another technology involves payments via a chargeable magnetic card.



price on electricity throughout the entire country in order to supply all regions with equal opportunities for development. We recommend planning electricity as a closed market, in which profits will be used for further investments, and in developing the network and production capacities.

It may be that such challenges will be better met by a single united national company that will both produce and distribute electricity. The corollary of this development is that revenues from electricity sales will be retained in the sector, and applied to urgent and substantial rehabilitation and development needs, and the full payment for purchases of bulk power supply. The PNA will benefit from this change through a sharp and lasting increase in receipts of clearance revenue (upon restoration of payments), once the utilities improve bill collections from consumers – enabling them to pay their bills to IEC. Electricity consumers will receive better service over time as the utilities suppliers use revenues to upgrade their facilities.

- The Palestinians will have to produce part of their electricity independently. The power station in Gaza has land reserves for units that can produce about 560MW. However, for costs and environmental purposes, the station should be transformed from gasoline to gas (the current oil and gas prices being discussed by British Gas and the Israeli Government). The savings from using natural gas could reach \$83 million per year.<sup>22</sup> Such a power station will not produce more than one quarter of the total demands in Palestine. Coal stations may be cheaper than gasoline but they require space consuming infrastructures that will be difficult to install in Gaza. They also have negative environmental impacts. Furthermore, coal stations are more efficient when large stations are built (800MW+).
- It is difficult to foresee how Palestinians will be able to make further investments in electrical production till the year 2020. Nevertheless, they will remain highly vulnerable to decisions made in Israel, Egypt and Jordan, countries already stressed to meet their own needs. Furthermore, alternative fuels like wind and sun cannot be used as

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22 World Bank, *West Bank and Gaza Energy Sector Review*, May 2007.

major sources. Wind stations are predicted to be active only one-third of the year, due to the wind regime; and solar stations are too expensive for the Palestinian electricity system.

- Population growth vis-à-vis the scarcity of fresh water will eventually require establishing a desalination facility of the shores of the Gaza Strip. A desalination facility is electricity intensive. Assuming the capacity of the desalination facility built would be 100 million cubic meters, with an electric capacity of 100MW and the annual operation time to be 8000 hours; the facility's annual electricity consumption will amount to 800 million kWh. The desalination facility would, no doubt, be the major and most significant electricity consumer in the state. The production of desalinated water may be limited to the hours of low demand for electricity, reducing the burden on the electricity system and lowering the cost of water.
- The 65 remote rural municipalities, mainly in the El-Halil region, that are not connected to the electrical network should be supplied by electricity. In these areas the use of wind and solar sources should be considered.

### 3.4. Forms of Cooperation

- The Palestinian Authority should strive to reach a long-term agreement with Israel for the supply of electricity. Due to the shortages in Israel it will be difficult for the Palestinians to significantly increase the current supply, despite the expected rapid growth in demands. It is also in Palestine's interest to reduce their dependency on Israeli electricity to about 50% of their total demands, in order to increase the security of resources.
- The next best option is to import electricity from Egypt. This requires the approval from the Egyptian government to private investors to build a gas power station in Sinai. We recommend that the Palestinian Authority enter negotiations with the Egyptian government concerning such an agreement.
- The Palestinian electricity network can be planned as a central element

in a regional electrical network. Connection to the regional network would benefit Israel, since the completion from these regional producers would limit the monopoly of Israel's privatized production. Such a network will enable Palestine, Israel, Egypt, and Jordan, and through them additional countries, to benefit from trading electricity, mostly during times of repair, peak hours, etc.

- Cooperation in the use of gas. Palestinian gas reserves and demands are low to the degree that it is not economical to develop them for solely internal demands. Therefore, an agreement with the Israeli gas company may benefit both countries. Connecting to the Egyptian-Israeli gas pipe may enable even more flexible use of the gas for the benefit of all parties.
- Since Israel is subsidizing environmentally friendly electricity production, both sides may consider the production of solar energy in Palestine, mainly for Israeli consumption, in return for increased export of cheap Israeli electricity. A power station of about 200-250 MW could be built in the Jordan valley, close to the main line that connects Jordan, Palestine and Israel. It must be noted that such a project may be feasible only if the high investment will be donated by third countries, and if Israel commits to a long-term contract to buy the solar energy.

### Strategic Scenarios

Benefits that arise through cooperation in the energy sector are already being reaped in other regions of the world. However, to achieve the desired level of cooperation it is imperative to have a sustained and high-level of political support, and a regional coordinating body. Confidence building measures among countries in the region is necessary. In order to investigate future cooperation in the electricity sector, five key drivers have been selected. These are:

- Environment
- Cost
- Independency
- Technology Transfer
- Mutual Benefits

The research team agreed to discuss **four strategic cooperative alternatives**. These alternatives are briefly presented as follows:

### Scenario I - Maintaining the status quo

In this scenario, Israel will remain the dominant provider of electricity to Palestinians. Some areas will be connected to the Jordanian and Egyptian networks (connecting Rafah with the Egyptian network, and Jericho with the Jordanian network).

In this scenario, Israel will have to account for the entire growth in Palestinian and Israeli electricity consumption. Since the IEC already operates near full capacity, with no long-term trade agreement, Palestine will face shortages. The IEC may also use its monopoly to charge the PA higher electricity prices.

### Scenario II - Reducing Palestine Electricity Dependency Ratio to 50% and Constructing a Regional Electricity Network

This scenario assumes that Palestinians will build their own plant and strive to supply as much as 50% of the projected Palestinian electricity consumption in 2020. Israel will supply the marginal Palestinian demand for electricity.

In this scenario, pressure on electricity production capacity in Israel is reduced. Palestine benefits from the self-production and control of a basic infrastructural resource, while reducing the excess burden of financing an extremely large investment. Israel gains as Arab entrepreneurs utilize the regional network to supply electricity to Israel.

### Scenario III - Israel Cuts Electricity Supply to Palestine. Palestinians Fully Import their Electricity from Jordan and Egypt

In this scenario, Israel forces a cut from its electricity supply. Palestine will be unable to raise the necessary funds for self production. Therefore, Palestinians buy their electricity needs from the regional Arab countries.

This scenario will be devastating to the Palestinian economy. Israel would lose a major electricity export destination.

### Scenario IV - Palestinians Export Electricity to Israel

This scenario assumes that Palestinians will have the excess capacity to export electricity to Israel. Palestinians will use gas in Gaza and Egypt to produce the electricity.

This scenario requires massive investments that will cause Palestinian national debt to increase dramatically. Construction of such magnitude will make it impossible to finance any other capital intensive project.

### Evaluating the Strategic Scenarios

Scenario II contains the most benefits for both Palestine and Israel. This scenario could, in the future, evolve to scenario IV. However, given the current, poor starting point, we recommend reducing Palestine's electricity dependency ratio to 50% and constructing a regional electricity network.

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Fast Track: Rethinking the Transitional  
Economic Arrangements  
between Israel and the  
Palestinian Authority: An  
Alternative to the Paris Protocol

Palestinian Labor

The Jordan Valley

Aix Group, Fast Track Team

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## Prologue

In an attempt to comprehensively cover the economic issues addressed by the Aix Group, starting from the current state of conflict to the end result of a permanent status agreement on economic relations between the two parties, the Group has devised what is known as “Fast Track.” The Fast Track Working Group covers current economic topics which have an impact on the implementation of the permanent status vision of the Group as presented in the Economic Road Map (ERM 2004).

Under this concept, the Aix Group produced the following three documents; The first addresses the creation of a transitional economic regime to replace the Paris Protocol on relations between the Palestinian and Israeli economies in the interim period, until the achievement of Permanent Status. The second chapter explores possible solutions to labor issues caused by the prevention of entry of Palestinian workers into the Israeli labor market. The third one deals with the future development of the Jordan Valley.

These three documents were prepared prior to the unfortunate events which were perpetrated by the armed wing of Hamas in the Gaza Strip. It is important to note that the Aix Group sees this as an internal Palestinian issue, which should be treated accordingly. We also believe that these events should not change the Group’s vision concerning the necessity of establishing a two-state solution, whereby Palestinian territories (West Bank and Gaza Strip) are a single economic and political entity.



# Rethinking the Transitional Economic Arrangements between Israel and the Palestinian Authority: An Alternative to the Paris Protocol

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## Executive Summary

The outdated and poorly implemented Paris Protocol (PP) has left the Palestinian economy without a functional and clear trade regime in the past years. The PP was part of the provisional interim agreement and was expected to lead in due course to the Palestinian National Authority's (PNA) control over its internal markets and external borders. However, these changes never happened.

Despite the tremendous importance of maintaining healthy Israeli-Palestinian trade relations, as well as internal Palestinian movement of goods, current movement restrictions have rendered the PP dysfunctional. In addition, the highly changeable security and political situation has preempted improvement of trade relations.

Both sides generally see a "two-state" solution as the most feasible political compromise. Within this context, a new transitional agreement is needed, one that advances the two-state solution. The agreement should avoid the pitfalls of the PP by establishing a free-trade agreement with other sectoral agreements which would move slightly more towards integration of the two economies.

This new agreement must project the commitment of both parties to an open market economy. The short-term goal is to create a transitional regime that is more time and situation consistent and that would better serve the interests of both economies. The new agreement would greatly benefit the Palestinian side by allowing it more freedom for internal and external trade. The Israeli side would benefit from the free trade arrangements and the formation of two customs territories, which would best serve the latest separation policies promoted by the Israeli government.

The process of moving towards the new transitional regime will require

both parties to re-initiate negotiations in order to reach agreement within the parameters of the suggested new regime. There will be numerous difficulties before reaching such an agreement. However, by identifying these obstacles and presenting them as such, it will be possible to pave the way towards defining measures to deal with them.

The implementation of such a regime will start with the execution of the Agreement on Movement and Access (AMA) and the signing of the Customs Protocols. At a later stage both sides must agree on rules of origin.

Palestinian institutions will need to build their capacities in areas such as customs, border controls, border operations and anti-smuggling, standards and specifications, sanitary and phytosanitary measures, and certification of origin.

It is recommended that the two sides conduct independent studies concerning the costs and benefits of the new regime. These studies will serve as tools in reaching more informed decisions and in clarifying the issues ahead.

## I. Introduction

The current status quo and de facto trade regime is inconsistent with the Paris Protocol (PP) in several areas. This is most relevant in the absence of relative free movement of people and goods between the Palestinian Territory and Israel. This paper explores the benefits of revising the PP or negotiating a new agreement that takes into account changes on the ground. Such a revision must specifically address the economic separation, and how to leverage this separation into greater economic and trade freedom for the Palestinian Territory in relation to third countries. The aim is to create arrangements which will benefit the Palestinian economy in the short run while avoiding additional shocks which may lead to further deterioration. The proposed arrangements will also take into account Israeli economic concerns and interests. The recommendations are in line with the implementation of a Free Trade Area (FTA) under final status negotiations, as proposed in the Economic Road Map (ERM, 2004).

While a new trade agreement could create a new paradigm for economic relations, it cannot, nor is it intended to, address the key final status issues of borders, Jerusalem, and refugees, either on a broad political level or even in terms of these issues' economic implications. These issues must be resolved in a negotiated final status agreement. Therefore, while this proposed new trade agreement presumes economic borders, the location of these borders would reflect only status quo and not assume any agreed border delineation.

We believe that the adoption of a set of new principles for a permanent agreement (e.g. an FTA, regulated labor flows, financial independence, etc.), to replace those assumed in the PP, has the additional advantage of clarifying the principles of future economic relations.

### 1.1. Purpose of the Paris Protocol

The PP was adopted by the Government of Israel and the Palestine Liberation Organization as Protocol IV of the Oslo Agreement. The PP was established as an expression of the regulating regime which would govern the Palestinian–Israeli economic relationship during the interim period, until a final status agreement based on the Declaration of Principles was reached.

The PP was intended to be a transitional instrument which would ensure that a change in the economic and regulatory relationship would not harm the existing economic relationship between the two sides. Hence, the PP was aimed at avoiding shocks to both the Palestinian and Israeli markets by continuing and potentially expanding the cooperative relationship between the two sides, ensuring that businesses were eased through the separation into two markets. The PP also gave the Palestinians some sovereignty in managing their internal market. It also allowed for the potential diversification of trading partners, recognizing the historical ties between the Palestinian market and Arab and Islamic markets that were severed earlier due to occupation. Most importantly, the PP was intended to ensure the free movement of goods between the two sides by establishing the premise of a union between the two markets, with no economic borders. The PP also dealt with the movement of labor as a result of the Palestinian economy's dependence on the Israeli labor market.

The PP included measures intended to serve the fiscal needs of the Palestinians in terms of revenue collection. To ensure operations of the Palestinian National Authority (PNA), the process of clearance by the Israeli customs and revenue transfer would continue until Palestinian customs could handle customs clearance independently. This section of the PP is integral to the Customs Union during the transitional period, until Palestinian institutions that could handle this responsibility as stipulated in the PP were built.

The Customs Union is fundamental to the agreement, and was seen at the time as the best economic arrangement for the transitional period. It also served the purpose of avoiding final status negotiations on borders. The decision to implement a Customs Union also led to the adoption of



trade arrangements which were consistent with Israeli interests but not necessarily with those of the Palestinian economy.

## 1.2. Inapplicability of the Paris Protocol in the Current Situation

The PP's applicability has been minimized to the level of being almost obsolete, due to the lack of implementation of key elements of the PP; the severe infringement on both the spirit and letter of the agreement; changes which have taken place within the last six years; and the temporary and gradual nature of the agreement.

Closures were already in effect in 1993-94, and according to the Israeli interpretation, the PP accommodated some forms of closures. The issue therefore is not the existence or degree of any closure; rather it is a qualitative shift in the manner in which business is conducted within the PT and between the PT and Israel. This shift has caused the issue of PP non-implementation to change from a situation in which there are some violations and non-applied sections, to one of nearly total obsolescence. It is almost beyond debate that the PP has become a dead letter during the last few years, as its vision was not implemented.

This qualitative shift is a result of several issues. These include the ongoing political turmoil and the Israeli policy of separation and disengagement, including the building of the separation wall / barrier; continued settlement expansion; associated restrictions and closure regime; and the establishment of border crossings between the Gaza Strip and Israel, and between the West Bank and Israel. There have been a number of policies implemented on a local basis that have collectively rendered the PP inoperable:

- The Israeli settlements in the West Bank and the roads leading to them have essentially resulted in the dissection of the West Bank into various "cantons". These limit movement within the West Bank as well as create greater barriers between the West Bank and Israeli markets.
- The restriction of the Jordan Valley from most Palestinian access has limited Palestinian investment in and economic benefit from this critical agricultural region.
- The continued low-level of operation and intermittent closures of

the Karni / Al Montar Border Crossing and the near-closure of the Rafah border crossing have choked off economic activity in the Gaza Strip.

- The continued separation of East Jerusalem from the West Bank by the complex system of areas and sub-areas created by the separation wall / barrier, Israeli- defined municipal boundaries, and checkpoints have deprived the West Bank of an important source of trade and commerce.

These transformations have eliminated any potential for the free movement of goods between the sides as envisaged in the PP, and created de facto border crossings. Consequently the PP's basic concept of free movement of goods and people is not being implemented. Though continued hostilities play a major role in the measures taken and serve as a basis for their justification, their categorical implementation and intensity have had a detrimental effect on the entire Palestinian economy and population. The nature and severity of closures have increased and created a new economic regime preventing both sides from economic integration. The unilateral creation of de facto and non-agreed economic borders (the separation wall / barrier) has brought the sides closer to an "imposed separation." Imposed separation is no doubt the worst option, since it will lead to enormous economic losses. This is especially relevant for the weaker economy – the Palestinian economy, which has suffered from continuing crises, especially in 1994 to 1996 when the closures were severe, and again since 2000 when an additional system of internal closures emerged.

The tremendous importance of continued trade relations between the sides, as well as the importance of the diversification of the Palestinian economy's external trade, can be seen in the share of trade between the sides. In 2004, 73.7% of total Palestinian imports of goods were from Israel. In the same year, 89.8% of total Palestinian exports of goods were to Israel. The share of Israeli imports of goods from the PNA in 2005 was relatively low (close to 1%) while the share of Israeli exports of goods (excluding diamonds) to the PNA was 6.3% of Israel's overall exports.<sup>1</sup>

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<sup>1</sup> Paltrade and The Peres Center For Peace. (December 2006). *The Untapped Potential*, Tel-Aviv: Peres Center for Peace and PalTrade.

These statistics indicate the obvious: further separation and limitation on trade between Israel and the PNA will have severe negative effects on the Palestinian economy and its recovery potential. The Israeli side will face fewer difficulties on the macro level, but nonetheless, some sectors will be harmed.<sup>2</sup>

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2 Taking into account that these numbers represent the Palestinian economy in a deep recession, the potential of economic trade and therefore losses for both economies is much greater:

## 2. Need for a New Transitional Regime on the Road to Recovery and Realizing the Economic Road Map

Before moving into a discussion of the type of transitional economic regime needed, it is essential to first briefly consider the reasons behind the non-implementation of the PP. As discussed above, the root of the issue is the emergence of a new Israeli policy of unilateral separation and disengagement; continued hostilities; and the continued commitment to the settlement enterprise in the West Bank. These are incompatible with the spirit of the PP (and indeed even of the Oslo agreement). In addition, the PP was an incomplete contract that was time-inconsistent. However, for our current purposes, it will suffice to say that the Protocol was not implemented because the conflict and unbalanced bargaining between the two sides continued.

The economy has become another form of pressure and a victim of the transitory and partial nature of the negotiating process. Unfortunately, this process of negotiating on the ground under a highly changeable political environment continues today, giving scant reason to believe that the PP can be revived from its dead de jure status to real de facto implementation on the ground.

The architects of the PP (and the Oslo process) avoided in 1993-4 the difficult issues of sovereignty (a state, borders, withdrawal, removing settlements, etc.) by creating a vague concept of Palestinian sovereignty. They constructed a framework for an interim agreement where the two societies will first coexist under Israeli-controlled external borders, without internal borders and without a link between the West Bank and Gaza Strip. It was envisaged that the process would slowly continue towards the creation of a Palestinian state, through Palestinian control of external

borders, the creation of the safe passages, and then entry into permanent status negotiations, whereby the borders will be demarcated and the permanent territorial link will be discussed. This transitional framework promised the Palestinians high living standards as well as time to build their internal capacity, in order to operate the institutions and semblance of a state. In 1998 (or 1999 or later in 2000, depending on the terms of the different documents) this framework was supposed to terminate and the two sides were to reach a permanent agreement. This never happened.

The Aix Group, subscribing to the two-state solution, has presented the ERM, which is based on the Group's vision of future economic relations between the State of Palestine and the State of Israel. This vision is based on the creation of a FTA, which would facilitate the growth of both economies by meeting the requirements of both sides while leaving room for high levels of cooperation and integration based on mutual interests.

As mentioned in the Aix Group's ERM, the long-term option of an FTA assumes delineation of trade borders where trade policy and a policy of regulated labor movements can be applied. Thus, it will call for economic borders, where trade and labor would flow through well constructed passages that the Palestinian and Israeli sides will shape and control.

On both sides it is generally agreed that the most feasible political compromise is a two-state solution. We have assumed that a viable two-state solution will embody the following factors:

- The Palestinian state will have the power to define its economic objectives and strategies and to implement them freely within the parameters of a bilateral permanent agreement.
- Economic cooperation will be conducted in good faith and mutuality, free of any intention to dominate.
- There will be a clear, unambiguous agreement on borders, including the final resolution of the issues of Jerusalem and the settlements.<sup>3</sup>
- The Palestinian state will have full economic jurisdiction over its external borders with Jordan, Egypt and Israel, meaning that the

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3 The separation wall / barrier currently under construction, should it prove to be a permanent structure, will have severe negative effects on Palestinian economic viability. Its permanency is, in our view, incompatible with the economic vision reflected in this document.

Palestinian state and Israel will implement trade, labor and other regulatory policies in a manner congruent with normal relations between sovereign states.

- The Palestinian state will feature contiguity within the West Bank and efficient connections with the Gaza Strip.

A two-state solution, therefore, means agreed-upon political borders. Over the last few years, economic analysts have come to the conclusion that economic borders, if constructed in agreement and efficiently, would contribute to rather than harm the prosperity of both economies.<sup>4</sup> Thus, assuming the final status agreement is a two-state solution, and that the most viable economic agreement between the sides is the implementation of a free trade agreement, the short-term goal is to create a transitional regime that is more time and situation consistent and that would better serve the interests of both economies, while easing them into the vision of the ERM.

The new agreement would greatly benefit the Palestinian side by allowing it to clearly form a separate customs territory from Israel, thereby guaranteeing that market diversification would take place. This, in turn, will minimize Palestinian dependence on the Israeli market as the only market for its products, while giving the Palestinian state the opportunity to import production inputs and consumer goods at lower prices than those imported from Israel, which is an expensive market for some of these resources. On the Israeli side, the decision which Israel has taken to separate from the Palestinian market may be best served by the formulation of two separate customs territories and economies.

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<sup>4</sup> See Astrup, C. and S. Dessus. (April 2002). "Exporting Labor or Goods? Long-term Implications for the Palestinian Economy," April 2002. *MENA Working Papers*, Series 29, Washington, D.C.

### 3. Principles of a New Transitional Trade Regime

Based on the above analysis we recommend an initiative, led and supported by international key players: the Quartet, donor countries, the World Bank, etc. Their role will be to discuss and then negotiate a new economic agreement between Israel and the PNA, to fill the vacuum created by the de facto disappearance of the PP.

#### 3.1. General Features and Basis of the New Transitional Trade Regime

Given the current political and economic context, a new transitional trade agreement is needed to serve the transitioning Israeli-Palestinian economic relations towards an FTA under a two-state solution. This agreement would be a combination of a free trade agreement and other sectoral agreements, which would move slightly more towards integration of the two economies, and would contain the following features:

- Continued and revived free Palestinian-Israeli trade.
- Mutually managed flows of Palestinian labor into Israel.
- Palestinian control of its own tax and customs revenues through collection by Palestinian customs.
- Palestinian control of its internal markets in the West Bank and Gaza Strip.
- Palestinian control over its economic relations with third parties.
- Palestinian control of its economic border crossings with Israel and third parties.

The agreement must project the commitment of both parties to several issues. These include an open market economy and freeing trade from all restrictions that do not serve specific public policies. Additionally, both

sides need to show commitment to encouraging and supporting trade in goods and services, the protection of investments, competition, and regulated access to labor markets, with a view to fostering the sustainable development of both economies and the welfare of their populations. This would entail abolishing restrictions on trade in goods and services within an agreed upon period in accordance with the provisions of the World Trade Organization (WTO). The agreement would maintain the zero tariff treatment on the import and export of agricultural and industrial goods originating in the territory of either side, and would commit to not raising these tariffs throughout the lifetime of the agreement.

The agreement would also include the gradual elimination of barriers to trade in services in harmony with the Euromed Process of Liberalization of Trade in Services. It will also eliminate any type of quantitative restriction on imports and exports of goods or services from either side to the other. Any remaining restriction on trade should be fully rooted in an overriding public interest and in accordance with the general principle of proportionality. Measures which are more restrictive than necessary to achieve the public interest goal should not be taken. The concept of national and most favored nation treatment of goods and services, based on the WTO National Treatment concept, would govern the market entry and access processes on both sides.

### 3.2. Principles of the Transitional Agreement

The following are some points which need to be addressed in any agreement between the sides. They encompass the spirit of the concept indicated above, while ensuring movement towards the creation of two separate economies with normalized ties under a free trade agreement.

#### 3.2.A. Rules of Origin – Asymmetric

The Parties shall adopt rules of origin that are in accordance with internationally recognised standards.<sup>5</sup> They shall operate inspections of such products on the basis of certificates of origin at borders or by means of customs clearing houses.

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<sup>5</sup> In order to comply with cumulation and the Palermo Protocol, Israel and Palestine will need to harmonize their rules of origin with those of the European Union.



As a result of the disparity in the level of development between Israeli and Palestinian industries, and in order to avoid economic shock, the parties would agree to extend a grace period in which the rules of origin applicable in bilateral trade would be asymmetric. This means that origin criteria for Palestinian exports to Israel would be less demanding for a certain period of time until production processes can be adjusted to meet required criteria. If necessary, an international body could help supervise the inspections for a limited period, thus giving them more credibility and lowering mistrust.

### 3.2.B. Standards and SPS

The Parties will agree to base their relations on technical, health, safety and environmental requirements based on the relevant WTO Agreements. They will also agree to operate under a principle of mutual recognition of the results of trade-related conformity assessment procedures, and seek to harmonise such requirements and procedures and cooperate in their implementation.

During this transition period, Palestine will probably not yet be acceded to the WTO. However, the easiest and the most effective way to regulate Technical Barriers to Trade (TBT) and Sanitary and Phyto-Sanitary Agreement / Certification (SPS) issues between Palestine and Israel would be to base such regulations on the relevant provisions of the WTO, TBT and SPS Agreements. For Israel, this arrangement would clearly be the easiest to implement, and for Palestine it would represent appropriate and necessary preparation for its planned accession to the WTO. Furthermore, this will provide Israel with the guarantee that the rules being applied by Palestine are based on international best practices and, therefore, would be transparent, predictable and reliable. This would include decisions and recommendations of the WTO, TBT and SPS committees on the proper understanding and implementation of the WTO Agreements. This would be most important in the pertinent recommendations and decisions of the Dispute Settlement Body, which are legally-binding interpretations of the Agreements. A specific provision on notifications will be necessary, since Palestine, which is not a member of WTO, would not be part of the notification process.

There is also room for provisions on mutual recognition of test results and certificates. Similarly, there is a need for provisions on harmonisation of regulations and standards, without affecting the ability of Palestine or Israel to harmonise at least some of their regulations and standards with international, European, or Arab standards. The same is true for the need for administrative review due to the importance of an adequate appeals procedure on TBT and SPS issues. The recognition of each other's standards will be based on agreements between the standards institutes of both sides.

### 3.2.C. General Exceptions and Security Exceptions

Without delving into too much detail, this area would cover safeguards, countervailing duties and other measures, as well as security exceptions. Furthermore, it would be bound by both the WTO agreements and the necessity and proportionality principles. This area would also include a provision on the resolution of disputes and an agreed-upon list of actions for specified security issues. This will ensure that the necessary security measures are undertaken, without inflicting unnecessary trade obstructing measures.

### 3.2.D. Border Crossings

**Removal of obstacles to trade within the West Bank and Gaza Strip and full use of existing infrastructure.** It is obvious that a normalized Palestinian economy will, first and foremost, have to rely on normalized internal economic conditions. Palestinian internal trade – movement of goods, service providers, business people and workers – will have to be free of physical or administrative encumbrances. This includes full and free access to, and use of, all roads and other infrastructure, as well as natural resources within the Palestinian Territory. It also includes the free passage of economic traffic (goods, people) through the West Bank separation wall / barrier to the areas east of the Green Line (the pre-1967 armistice lines). The presence of settlements and the issue of final demarcation of borders will be serious impediments to the implementation of a suggested transitional regime with the above requirements. However, realistically, there are certain issues such as the aforementioned and others, which need to be dealt with in the final status negotiations.

**Territorial Link between the West Bank and Gaza Strip.** The physical territorial link between the West Bank and Gaza Strip should be established as soon as possible to create full, unhindered territorial continuity for the Palestinian economy. It must be understood that the physical link will at all times in the future co-exist and work in tandem with a fully normalized transit system between the West Bank and Gaza Strip via normal Israeli road and rail infrastructure (safe passage).

**Modern, integrated customs and security management and infrastructure.** All Palestinian borders – with Israel, Jordan and Egypt, as well as the seaport and airport – will have to rely on modern and integrated customs and security management (procedures, standards) and infrastructure (technology, physical infrastructure). This requires both individual upgrade work by the respective parties on their respective sides of borders and close cooperation between them.

**Terminal infrastructure at Gaza seaport, airport and Rafah, as well as Allenby and Damia.** The physical infrastructure for processing goods traffic at the level of market needs will be put in place at the three first direct entry/exit points between Palestine and the outside world, namely Rafah, the Gaza seaport and the airport. Donor support is sought for related investments that should bring these Palestinian border crossings up to the latest standards to ensure the best possible service to all users. The same applies to crossing points between the West Bank and Jordan, starting with the Allenby and Damia bridges.

### 3.2.E. Transit Agreement

The agreement should include an efficient regime for safe transit traffic of persons and goods between the West Bank and Gaza Strip as well as from Israeli ports (air and sea) to these areas. This regime should be placed under international supervision, as indicated in the Agreement on Movement and Access (AMA). In the longer term, this matter should be placed on the agenda again and under new conditions and criteria which go beyond those of the PP / Interim Agreement.

1. Utilization of Israeli ports – Israel would allow the Palestinian side to utilize Israeli ports and airports in order to import products from third parties; rules of transit would apply on these.

2. Clearance of goods – The clearance of goods imported to the Palestinian side from third parties through Israeli ports and airports may be cleared in accordance with Palestinian customs law in one of two ways:
- Presence of Palestinian customs officials in Israeli ports, which would clear the products and ensure their transport through Israeli territory under the transit agreement.
  - Clearance by Palestinian customs either at in-land clearing houses or at border crossings, after passing through Israeli territory under the provisions of the transit agreement.

### 3.2.F. Monetary

Relations between the Bank of Israel and the Palestinian Monetary Authority will ensure coordination on the exchange rate and the utilization of the Israeli Shekel by the PMA. They will also ensure clearance between banks and financial institutions. In the longer term, and once the Palestinian side decides to mint a Palestinian currency, the monetary part of the agreement would be re-negotiated.

### 3.2.G. Labor Relations

In the absence of a return to a status quo ante in labour relations with Israel, access should be secured for a given number of Palestinian workers.<sup>6</sup>

### 3.2.H. Palestinian Relations with Third Parties

This includes flanking policies and trade initiatives with third countries, expansion of labour relations and trade facilitation with neighbouring countries, within the scope of the new trade regime being put in place. In this regard, it is necessary to explore how far the current scope of the PNA's external policies should be widened beyond the PP.

#### 3.2.1.a. Trade Arrangements

Utilization and examination of existing trade agreements (EU and others), including the extent to which existing agreements with the EU and European Free Trade Association (EFTA) can be used to support the

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<sup>6</sup> For a further discussion on recommendations for labor relations between Israel and the PA in the short run see the Aix Group paper on labor issues presented in this book.

expansion of external relations, with a view to decreasing dependence on the Israeli market for main export and import commodities.

With respect to **future trade relations**, several regional integration initiatives and activities have either taken place or are under way which will affect the future relations of, and between, both Israel and Palestine. Perhaps the most important one is the Barcelona, or Euro-Med, Process, which aims to establish a Free Trade Area including goods, services and investment in the Euro-Mediterranean space. Both Palestine and Israel are parties to this process, which aims to impact not only on their respective relationships with the EU but also on their bilateral relations in matters as diverse as rules of origin (Palermo Protocol), and trade in services and investment. A further aspect of this process is the prospect of Palestine joining the Agadir Group (Jordan, Egypt, Morocco and Tunisia).

Another important development is the emergence of the (Greater) Arab Free Trade Area, a process that is likely to have a significant impact on the Palestinian economy's integration with Arab economies. Depending on political factors in particular, this process could indirectly affect Israeli regional economic perspectives as well. Another regional integration initiative is the US-initiative to develop a "Middle East Free Trade Area" (MEFTA), meaning a Middle East–USA free trade area.

These factors – and many more – need to be accounted for when considering the future shape of the regional economy, and hence the blueprint for Palestinian-Israeli trade and economic relations. The same is true for the international trade regulations imposed by the WTO. These provide a partial rather than stringent framework for the respective external trade relations of both Palestine and Israel. While only Israel is a WTO member at this point, Palestine's accession should be firmly anticipated when looking at its future trade relations, including those with Israel.

### 3.2.1.b. **Border Crossings and External Trade**

**Securing air- and sea-port access for the import of goods under international supervision and security arrangements.** The extent to which the law of the sea conventions, customary international law and humanitarian law can be used to support such guarantees with a view to securing operations should be explored.

- **Rafah, Allenby, Damiah.** The intensive negotiations over the future Palestinian-Egyptian border crossing at Rafah have been a showcase of, as well as a test case for, Palestinian-Israeli negotiations and relations now and in the future. The straightforward solution would have been to have Palestinians and Egyptians administer the border as a crossing for people and goods alike. In order to allay Israeli concerns, the sides can reach a multitude of monitoring and control mechanisms, from the presence of Israeli officers, or the presence of (public or private) third party monitoring, to technological surveillance solutions. The Palestinian Authority would control its own borders.
- **Seaport.** The World Bank's Report<sup>7</sup> proposes the establishment of a seaport in the Gaza Strip, starting with a RoRo terminal. Israel has agreed to the start of construction, and the process should begin immediately. Establishing a seaport and controlling its access to the high seas are the normal prerogatives of a coastal state. If Palestinian statehood were the accepted target, as it is, the opening of the sea port would be highly warranted.
- **Airport.** The same rationale applies to the Gaza airport, which may utilize international monitors for security purposes for a certain period of time.

### 3.2.J. Dispute Settlement

Efforts to bring about effective third party dispute settlement in the areas addressed by this agreement require examination as to how and who could assist in securing international implementation of third party dispute resolution and monitoring. This matter should be developed primarily with the European Community (EC) and US and could perhaps lead to some undertaking by the UN.

### 3.3. Areas of Cooperation

The proposed new trade regime would take both parties in the definitive direction of separation in economic and trade issues. However, in order

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<sup>7</sup> See The World Bank, (December 2004), *Stagnation or Revival? Israeli Disengagement and Palestinian Economic Revival*.

for such an agreement to succeed, it should be predicated on mutual cooperation and active coordination in key areas such as bilateral trade, operation of borders, investment and fiscal policy. This cooperation must be at a level that not only addresses operational and policy issues, but it must also function under unpredictable and difficult circumstances.

### 3.3.1. Reviving Palestinian-Israeli Bilateral Trade and Palestinian Domestic Trade

As previously mentioned, internal closures and measures which reduce mobility and movement as well as access of goods from one side to the other must be rationalized. This includes the implementation of the movement and access agreement and the 12 points within the Ad-Hoc Liaison Committee (AHLIC) report of December, 2005. This would serve as an important step towards removing trade and movement obstacles which have caused the reduction of Palestinian-Israeli and Palestinian domestic trade within the past 7 years.

### 3.3.2. Border operations

Within the new regime, the management of movement of goods through border crossings will prove to be the most taxing issue if economic relations are to be maintained and enhanced. In order to guarantee that trade facilitative measures are taken, ensuring the smooth movement of goods through border crossings between the two sides, agreement must be reached on the management systems to be followed at the border crossings, including modes of cooperation and information sharing, scheduling and movement of cargo through the terminals, operational procedures and hours, etc.<sup>8</sup>

In general, the economic dimensions of the borders should be managed by the two sides in a symmetrical fashion with each side exercising identical sovereignty.

### 3.3.3. Investment

Joint projects and joint industrial zones should be encouraged through tax legislation and grants. Provisions on promotion and protection of investment

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<sup>8</sup> See "Through Traffic" for a phased approach to coordinated border terminal management. Peres Center for Peace and PalTrade, 2006.

are increasingly linked to trade liberalization in the field of services and also regulation of intellectual property. There is a strong Palestinian interest in attracting foreign direct investment from Israel in order to create jobs in its territory. Similarly, Palestinian enterprises should be supported in creating outlets and subsidiaries in Israel. Provisions on investment protection would thus clearly indicate a willingness to pursue economic cooperation. Given the tight connections between the economies of Palestine and Israel, this step should be contemplated in the framework of any economic agreement. The provisions on investment protection need careful coordination, particularly with regard to provisions relating to services.

Investment protection must not impair the functions of government, nor its freedom to regulate the economy and preserve essential interests, particularly in the fields of culture, education, utilities and energy. It is important to achieve a balance between these interests and requirements, on the one hand, and promotion and attraction of foreign direct investment on the other hand. Such a balance is of particular importance in relation to the State of Israel as compared to other states and unions with whom Palestinian relations have not been subject to the same strains and difficulties.

In the effort to strike a balance between attracting investments and preserving national interests, the concept of national treatment must be carefully contemplated. The proposed agreement should essentially grant the Parties' investors and investments no less favorable treatment than that accorded to national investors and investments under the terms of national legislation on investment protection, while enumerating exemptions.

The agreement should also include a provision on most favored nation (MFN) treatment of investors, whereby the Parties would be obliged to extend to the other any rights and privileges granted to third Parties.

The agreement should also contain procedural provisions for swift and rapid government authorization procedures which are key to creating a favorable climate for foreign investment. Accordingly, the creation of a one-stop-shop system for processing investment plans and projects is suggested, in line with the functions of a joint investment board, which would deal with border areas and joint industrial zones contemplated by both sides in the future.

The agreement on protection of investment should contain within it



provisions for the elimination of double taxation and the facilitation of movement of business people.

#### 3.3.4. Fiscal Policies

Due to the long borders and the wide difference in the standards of living in Israel and the PNA, there will be a large incentive for smuggling. Coordination of the following is recommended in order to decrease the incentives and the potential fiscal losses:

- Coordination on purchase taxes on durable goods, tobacco, gasoline, etc.
- Mechanisms for coordination before either side changes tax rates.
- Coordination on VAT rates. A narrow margin of up to 3% is possible.
- Customs rates will be determined by each side according to its policy, though coordination is possible. The sides will keep their own policy regarding taxation on vehicles.

#### 3.4. Facilitating Provisions

The experience of the PP has provided some lessons in terms of establishing a Palestinian-Israeli trade agreement. Primary among these lessons is that an agreement between unequal parties is likely to fail if the agreement is simply put in place and managed on the assumption of equal bargaining and trading power. In order to avoid a similar fate for the proposed new transitional trade agreement, it is proposed that a number of measures for ensuring implementation be put in place that compensate for the disparity between the two parties:

- The creation of an Economic Coordination Committee with a new framework for engagement that does not fall into the trap of the Joint Economic Committee, which simply represented a microcosm of the power disparity that exists on the macro level.
- Dispute settlement mechanisms that include clearly agreed means for dispute settlement, including identification of agreed arbiters and legal options.
- The inclusion of a third party at critical points in the agreement, such as in border crossing coordination and dispute settlement. The third party must have "teeth" to ensure implementation.

## 4. Application

### 4.1. Returning to the Negotiating Table

The process of moving towards the new transitional regime will require that both parties re-initiate negotiations in order to reach agreement within the parameters of the suggested new regime. The obstacles for implementing the principles are clear since they assume “free and full access to, and use of, all roads and other infrastructure and natural resources within the Palestinian Territory.” Thus, identifying the concrete obstacles to free movement and presenting them as such, will pave the way to defining measures to deal with them.

- The discussions will list and thus reveal to the two sides the causes behind the impediments to access. The sides will then be able to establish means to correct them. The obstacles should not be allowed to continually dictate the current outcome of no access.
- The difficult issue of *de facto* separate economic regions, both within the West Bank and between it and the Gaza Strip, will require special attention and solution. Thus, again, the current arrangements should be replaced by new ones where movement between the regions will be free, from an economic point of view.
- The 14-year-old agreement in principle on a territorial link should also be reaffirmed.
- The *de facto* passages that are not on the old Green Line represent a major difficulty. They should be relocated.

### 4.2. Time Table

These discussions will need to be accompanied by specific steps, which are to be implemented in the immediate and short term in order to facilitate

the application of the suggested regime. These steps may be outlined in a two-phase process as follows:

■ **Phase I:**

The AMA should be implemented, as a start down the road to returning to the pre-September 2000 internal movement situation.

This phase would also include the immediate signing of the customs protocol, allowing for the full operation of Rafah as a commercial terminal. This phase would also demand that commercial control be handed over to the Palestinian side. Third party assistance may be utilized to allay Israeli worries about the operation.

Issues regarding the implementation of the Customs Union should gradually be illuminated in order to allow for the opening up of Palestinian trade to third parties. This would include ensuring that trade facilitation is balanced with security needs. The first step in this process is the immediate implementation of the convoys for goods and people between the West Bank and Gaza Strip, en route to reaching an agreement on the Safe Passage in the short term, and the eventual establishment of the permanent Territorial Link between the West Bank and Gaza Strip.

Other immediate steps should be the signing of transit agreements with Israel, Jordan and Egypt, which would allow for unfettered movement of goods destined either as exports from or imports to Palestine.

■ **Phase II:**

In the second phase, an agreement should be reached on rules of origin, which would be of asymmetric nature, giving the PNA an advantage for a certain period of time in trade with Israel. A customs cooperation agreement, which would allow for the movement of goods between the two economies with minimal interference or delays, should also be agreed upon.

It is also important to ensure that all the systems of cooperation required for operating a free trade agreement are put in place and sequenced in such a way as to guarantee smooth transition.

### 4.3. Internal Capacity for Application

In order for the Palestinian authorities to be ready for the changes that will take place and be able to successfully deal with the responsibilities which will be entrusted to them, the capabilities of Palestinian institutions must be developed. The areas which need urgent addressing are customs and border controls, border operations and anti-smuggling, standards and specifications, sanitary and phyto-sanitary measures and certification of origin. Significant work has already been conducted on most of these, but a full check list should be developed and diligently worked on.

### 4.4. Cost Benefit Analysis

It is well known that the regime we are proposing will have both negative and positive impacts on the Palestinian and Israeli economies. These need to be identified and listed, with an in-depth analysis of each. We recommend that the two sides carry out independent studies concerning the costs and benefits of the new regime. These studies will serve as tools in reaching better informed decisions and clarifying the issues ahead.

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# Labor in Palestine

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## Executive Summary

In the past decade, and especially since the end of 2000, the Palestinian labor market has suffered from very high unemployment rates. This has led to severe social difficulties and a high level of dependence on foreign assistance.

The fast growth of the labor supply was not matched by local demand for labor. Furthermore, the Palestinian economy did not grow autonomously and create enough new jobs, as was hoped for following the signing of the Paris Protocol. The number of Palestinians working in Israel, which in the past served as a central employer for Palestinians, declined sharply and became subject to regulatory constraints and Israeli permit and closure policies. At the same time, the Israeli labor market shifted toward foreign workers. Consequently, the Palestinian public sector became an alternative for employment and grew rapidly, adding pressure to the Palestinian National Authority's (PNA) budgetary constraints.

Improvement in the economic situation in the West Bank and Gaza Strip, and thus in Palestinian livelihood, should be based on the recovery of the domestic Palestinian labor market. The most important factor impacting employment rates in both the West Bank and Gaza Strip is movement and access. The immediate implementation of the Agreement on Movement and Access (AMA) should serve as a first step for stimulating internal and external trade. In turn, this will increase the potential market size for the Palestinian private sector, thereby increasing productivity and employment. Additional short-term employment opportunities should come from the development of large scale projects within the West Bank and Gaza Strip with the help of the donor community. Such projects will also benefit the Palestinian economy by improving infrastructure – a necessity for any developing country. In the short- to medium-term, the development of industrial estates has much potential. Such developments will attract investments and provide employment both in the construction phase as well as in the actual operation.



A return to the high share of Palestinians working in Israel, as was the case up to the beginning of the 1990s, is not realistic in the near future. On the other hand, the Israeli labor market will remain an important employer for low-skilled Palestinian labor. Thus, Palestinian labor in Israel should remain at least at its current level. The flow of these workers into Israel should be predictable, and security restrictions must be limited to the minimum necessary.

Possible employment in the Gulf countries should also be explored. The target should be the private sector in the Arabian Gulf. Since a large share of Palestinians hold higher educational qualifications, they can compete for positions with other nationalities if given the chance.

## I . Introduction

For over a decade, Palestinian society has been suffering from high levels of unemployment. In the past six years, since the outbreak of the Al-Aqsa Intifada, unemployment has risen to unprecedented levels, leading to high poverty rates and severe social difficulties.

Until the beginning of the 1990s nearly a third of Palestinian employment was in Israel. This supported low levels of unemployment in the West Bank and Gaza Strip. However, it also limited potential Palestinian economic growth by focusing on employment in low-skilled industries. The signing of the Paris Protocol (PP) was intended to support the transition into a self-sufficient Palestinian economy, thus decreasing the Palestinian labor market's dependence on the Israeli labor market, while maintaining a certain level of Palestinian laborers working in Israel. This did not occur.

Recent developments, including the suspension of tax revenues from Israel and donor assistance, put an additional burden on the Palestinian labor market and economy, which contracted by 10% in 2006. Poverty rates, which reached 22.3% in the West Bank and 43.7% in the Gaza Strip in 2005, kept climbing in 2006.<sup>1</sup>

Achieving improvement in the Palestinian labor market is essential for regaining economic and social stability, lessening frustration and creating hope for a better future. However, the continued hostilities, political turmoil and internal closure regime levied by Israel remain central impediments for any positive change. Moreover, possible developments such as a further decrease in the number of Palestinian workers in Israel, as suggested in the disengagement plan, will lead to further difficulties in the Palestinian labor market and may not necessarily reflect Israel's economic interests.

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<sup>1</sup> Palestinian Central Bureau of Statistics, 2006. *Poverty in the Palestinian Territory, 2005. Main Findings Report.*

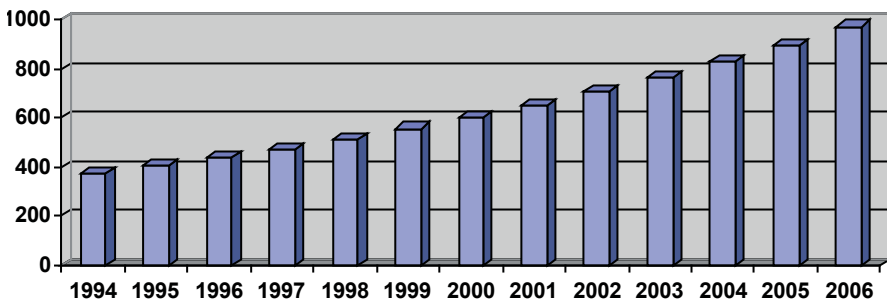
This paper will discuss some of the difficulties hindering the development of the Palestinian labor market and will suggest basic measures which, if implemented, will serve as a first step for economic recovery. The first section of the paper presents basic statistics of the Palestinian labor market. The second section explores the domestic labor market and requirements for its development. The third section discusses Palestinian employment in Israel. The fourth section examines possible Palestinian employment in the Arabian Gulf, and the fifth concludes with concrete recommendations.

## 2. The Palestinian Labor Market

### 2.1. Labor Supply & Demand

The Palestinian labor force supply has been growing rapidly, exceeding the labor demand in the past decade. The labor force increased from 373,000 in 1994 to 973,000 in 2006, of which 70% are in the West Bank and 30% in the Gaza Strip.

Chart 1: Palestinian Labor Force, 1994-2006

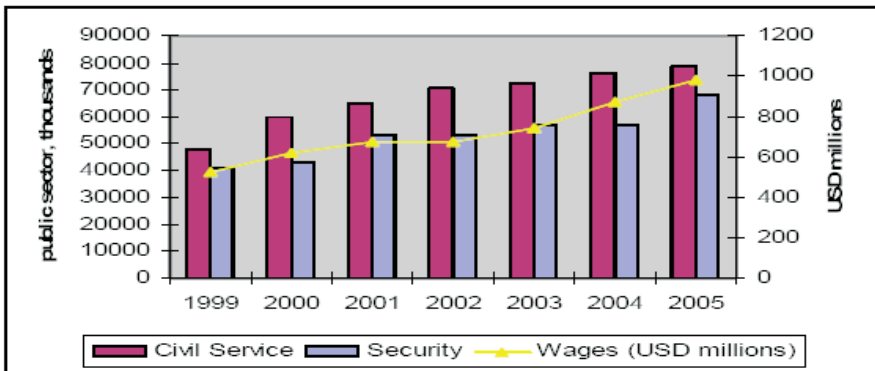


Source: PCBS

With unemployment soaring to unprecedented levels, civil service was the main option for absorbing labor released from the Israeli market and from a contracting private sector. Employment in services, which consists of the public sector (especially education, health and security services), commerce, hotels, transportation and communication, reached almost 60% in 2006.

Overall, public sector employment has grown 70% in the six years since the second Intifada. Increases in both civil service and security employment have continued steadily under the pressures of a private sector that is contracting under movement and access restrictions, increasingly limited employment in Israel, and a deteriorating security situation. The public sector currently represents over 20% of the total employment.

Chart 2: Public Sector Employment and Total Wages, 1999-2005

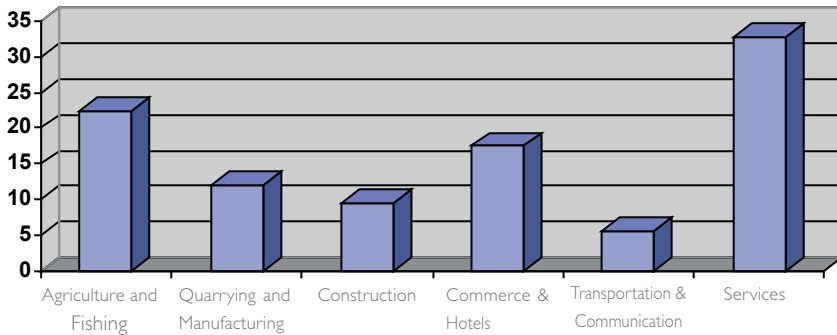


Source: Public Expenditure Review, World Bank, 2007.

The private sector absorbs the majority of all employment. The agricultural sector remains the employer of last resort in the private sector, accounting for 13-15% of employment (and about 20% of overall employment during the olive picking season).<sup>2</sup> The industrial sector remains limited in its ability to absorb labor due to its inability to attract investments and reach markets under the current conditions.

<sup>2</sup> A large share of workers in agriculture are unpaid family members.

Chart 3: Palestinian Labor Distribution by Economic Activity, Fourth Quarter 2006



Source: PCBS

A central and important characteristic of the Palestinian labor force is the relatively high share of college and university graduates. During the last 20 years, more than 215,000 Palestinian students graduated (finished an academic degree), of which 47.5% hold a bachelor's degree and above, and 30.8% hold an associate diploma.

## 2.2. Unemployment

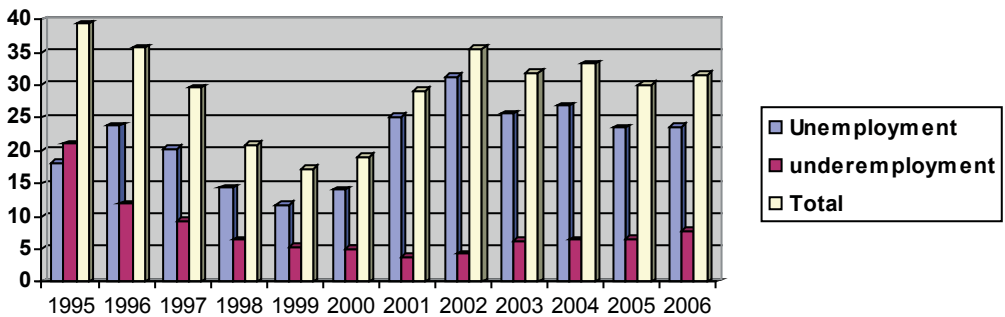
Unemployment, with its severe economic and social outcomes, is still one of the most pressing problems facing the Palestinian National Authority since the beginning of the peace process in 1993. This was not always the case. Before the first Intifada in 1987, unemployment rates had never exceeded 5-6% of the labor force. With the advent of the peace process, Palestinians were promised a better life, but found themselves trapped in economic stagnation and Israeli control over employment opportunities. In the past few years, and especially since the end of 2000, unemployment has reached and remained at extremely high levels.

The unemployment rate in the fourth quarter of 2006 was 22%<sup>3</sup> (24.2% in the third quarter)<sup>4</sup> compared to 10% in the third quarter of 2000 – before the beginning of the Al-Aqsa Intifada. In the West Bank unemployment in the fourth quarter of 2006 was 16.2% while in the Gaza Strip it was as high as 34.8%.

Though high, the unemployment rates do not reveal the full picture. 8.2% of those working are underemployed. This means they work less than usual due to lack of employment, or work under poor conditions or for insufficient wages relative to their skills.

Unemployment, though highest among unskilled workers, is also very high among the skilled. In the fourth quarter of 2006, 17.9% of participants in the labor force with 13 or more years of schooling were unemployed. Unemployment is exceptionally high among the younger age groups. 34.8% of participants between the ages 20-24 years were unemployed in the same period.

Chart 4: Unemployment and Underemployment Trends in the PNA, 1995-2006



Source: PCBS

3 See PCBS (Palestinian Central Bureau of Statistics), Labor Force Survey, different years. Other figures in this part are from the same sources.

4 Most labor market indicators for the fourth quarter of 2006 seem significantly better than the third quarter (unemployment, participation rate etc.). The improvement, however, is the result of seasonal changes due to the olive picking season which supplied only temporary work. The share of employed in agriculture, out of total employed, climbed from 13.7% in the third quarter of 2006 to 21.5% in the fourth quarter.

### 2.3. Participation in the Labor Force

In the fourth quarter of 2006, participation rate in the labor force stood at 43%<sup>5</sup> (41.3% in the third quarter) compared to 43.5% in the third quarter of 2000, prior to the Al-Aqsa Intifada. The current situation in the West Bank, though severe, is relatively better than in the Gaza Strip. Participation rate in the West Bank in the fourth quarter of 2006 was 45.7% while in the Gaza Strip it was 38.0%.

A central reason for the relatively low participation rates is the very low participation rate among women. In the fourth quarter of 2006, 17.5% of Palestinian women participated in the labor force. In the West Bank the participation rate was 21.2% while in the Gaza Strip it was only 10.8%. The participation rate among men was 68%.

### 2.4. Dependency on Employed Persons

The low participation rate coupled with the high unemployment and the fast population growth<sup>6</sup> has led to a 14.6% increase in the number of people dependent on each employed person. In the fourth quarter of 2006, 5.5 people were dependent on each employed person in the West Bank compared with 4.8 in the third quarter of 2000. The situation in the Gaza Strip has deteriorated exceptionally – the dependency ratio grew during the same period from 5.9 to 7.9.

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5 Participation rate is defined as the share of persons aged 15 years and above who participate in the labor force.

6 According to PCBS estimates, annual population growth in the West Bank and Gaza is approximately 3.3%.



### 3. Palestinian Domestic Labor Market

Until the beginning of the 1990s, Palestinian labor flows were a key factor in the integration of the economy of the West Bank and Gaza Strip, and later of the PNA with the Israeli economy. Daily Palestinian commuters to Israel, predominated by male unskilled laborers, represented a third of the employed population and generated over a quarter of the West Bank and Gaza Strip Gross National Product (GNP). In the first years this led to rapid economic growth in the West Bank and Gaza Strip while supporting an increase in exports of Israeli goods to these territories. It also supplied the Israeli labor market with cheap labor in different sectors such as construction and services.

In the PP of 1994 the parties pledged to “attempt to maintain the normality of labor movement between Israel and the PNA.”<sup>7</sup> This was considered to be central to the successful growth of the Palestinian economy, especially in the early stages of its expansion. It was hoped that the peace process would stimulate a rise in domestic investment and industrial growth, bring an influx of foreign capital and a growth in trade, and thereby lead to a rise in local employment that would help reduce Palestinian reliance on the Israeli labor market. However, the Palestinian economy failed to grow autonomously or separate from Israel. Additionally, attempts to integrate it into the regional or global economy remained limited, as the Palestinian economic growth remained restricted by the political and security unrest and Israeli closure policies.

Employment generation capacities varied between the West Bank and Gaza Strip. In the Gaza Strip, most of the jobs created were in the public sector. This sector has absorbed 25-30% of the domestic employed workforce ever since 1995. In the West Bank, the public sector represented only 18%

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7 The implication of the labor clause in the Paris Protocol, as to the scope of Palestinian workers in Israel, has been in debate between the sides since its signing.

of total employment. The fiscal viability and the productivity of these jobs is questionable given that many of them were created in response to pressures resulting from lack of other employment opportunities in the private sector rather than due to actual need within the public sector.

### 3.1. Trade and Movement Restrictions

Achieving recovery in the Palestinian domestic labor market is critical and challenging. Any improvement in the economic situation in the PNA and thus in Palestinian livelihood is based on the recovery of the domestic Palestinian labor market. However, for any significant improvement to take place there must be a noticeable change in the Israeli restrictions on the Palestinian economy and specifically on the Palestinian labor force. Central limitations which constrain Palestinian economic recovery are limitations on trade between the PNA and its neighbors and on transportation and movement between the West Bank and Gaza Strip as well as within the West Bank.<sup>8</sup> Some of these restrictions, though excessive, are the result of the political and security situation, and the continued violent conflict hinders the prospects of their complete removal. On the other hand, these limitations increase Palestinian frustration, deny hope for improvement and discourage economic initiatives.

An example of the effect of the limitation of trade could be seen in Gush Katif. Following the disengagement some of the green houses were transferred to the PNA intact. This was supposed to create new workplaces and partially compensate for the loss of jobs in the evacuated settlements. The high hopes and heavy Palestinian investments in rehabilitating the greenhouses diminished due to the closing of the Karni / Al Montar border crossing and the inability to export the products.

Restrictions on movement levied by Israel make the situation worse. Possible new security restrictions and the completion of the separation

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8 Access to markets for Palestinians both within and beyond the territories is tightly controlled by the Israeli Defense Force. The number of obstacles to movement in the West Bank continues to grow, the commercial and passenger crossings between the territories and Israel are operating at a very low capacity and the cost of trading is proving prohibitive (The situation of workers of the occupied Arab territories, Appendix to the Report of the Director-General to the International Labor Conference, 96th Session, International Labour Office, Geneva, 2007).

wall / barrier will lead to further deteriorations in the labor market. The current movement restrictions<sup>9</sup> have many negative effects on the labor market. To mention a few:

1. The disconnection between the labor market in the Gaza Strip and the West Bank limits trade between the two areas, though both share the same people, government and fiscal policies.
2. The restrictions on movement between localities within the West Bank create artificial inefficiencies in the labor market and limit the possibility of working beyond the place of residence. This decreases possible matching between suitable workers and the needs of the labor market and has a negative effect on the chances of finding a job and on wages. The restrictions on movement also raise the cost of transportation and as a result hamper domestic trade.
3. Restricting access to the Jordan Valley has a direct negative impact on employment in the agricultural industry in the Jordan Valley and an indirect impact on the tourism industry. Both of these industries could supply much-needed employment opportunities in the short term.
4. The restrictions prevent access to East Jerusalem, the relative size of which makes it an important market and offers employment in commerce, services and tourism.

The Palestinian labor market also suffers from the absence of investments. Such investment could create new jobs and limit the emigration of qualified individuals who have a good alternative for employment with better terms outside the PNA. Under better circumstances these individuals may have been the backbone of local development.

### 3.2. Effects of the Separation Wall / Barrier on Labor

The construction of the separation wall / barrier not only presents a deep political disagreement between the Government of Israel and the PNA, but also creates serious restrictions on movement, adding further limitations to possible employment. The constructed sections of the separation wall

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<sup>9</sup> In March 2007 there were 547 physical obstacles. See, *OCHA*, 2007a.

/ barrier that border Palestinian localities have already had an impact by limiting access to agricultural land and nearby localities. Only 20% of the wall / barrier's revised route lies along the Green Line, with 575 sq km (or 10.2%) of West Bank land falling within the "seam zone" between the separation wall / barrier and the Green Line. This includes much of the West Bank's fertile farmland and water resources.<sup>10</sup> The economies of border towns such as Jenin, Tulkarem, and Qalqilya rely heavily on commerce from Israelis, particularly Arab Israelis, from neighboring towns on the other side of the Green Line. These towns are now cut off from their key customer base and markets. The completion of the wall / barrier around Jerusalem will complete its physical isolation from the West Bank and thereby prevent Palestinians from the West Bank from entering East Jerusalem.<sup>11</sup> This will have a direct negative impact on employment and also an indirect impact by cutting off trade between the West Bank and Jerusalem.

The completion of the separation wall / barrier north of Jerusalem will also mean the dislocation of the industrial zone in Atarot from the West Bank. Currently, there are approximately 1,500 Palestinians from the West Bank regularly employed by Israeli firms in Atarot. Following the completion of the separation wall / barrier, Palestinians will be unable to access the industrial zone. This will increase unemployment in the West Bank, much like the closing of the Erez industrial zone did in the Gaza Strip. Israeli firms operating in Atarot will have to find new employees and will be negatively impacted by significantly higher wage expenditures and by the training required by the new employees.<sup>12</sup>

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10 OCHA. (August 30, 2007). "The Humanitarian Impact on Palestinians of Israeli Settlements and Other Infrastructure in the West Bank." [http://www.ochaopt.org/?module=displaysection&section\\_id=97&static=0&format=html](http://www.ochaopt.org/?module=displaysection&section_id=97&static=0&format=html)

11 The current permits and checkpoint regime already has a similar affect of limiting entry from the West Bank to East Jerusalem. The completion of the separation wall / barrier will likely make the situation worse.

12 In the past few months there have been discussions between Israeli firms from the industrial zone in Atarot and the Israeli security authorities. It seems that, at least in the near future, Palestinian workers' entry to Atarot will continue.

### 3.3. The Public Sector – Fiscal Difficulties

The Palestinian public sector employs over 20% of the Palestinian labor force. The financing of the public sector is dependent on domestic taxation, including the transfer of taxes collected by Israel for the PNA (as agreed upon in the PP), and on donor assistance. Both the transfer of taxes by Israel and donor assistance to the public sector were suspended following the Hamas victory in the PLC elections in 2006.<sup>13</sup> As a result, the PNA was unable to pay its employees their full salaries over the past months.<sup>14</sup> While these workers are still officially classified as employed, there is now a large category of civil service workers who have little to no income, leading to an increase in poverty and contributing to economic stagnation.

Following the election of the Hamas government in January 2006, Israel changed its policy towards Palestinians residents with foreign nationalities. Until recently, these Palestinians could leave the PNA, receive a new visa and return. The new policy asserts that previously these residents, who entered the PNA on a regular visa rather than a work permit, had been working illegally. It is not clear whether this new policy is another Israeli sanction against the PNA and is a temporary measure (as some of those denied entrance work in its institutions), or if it is a permanent change. It should be emphasized that the people affected by this policy are usually highly qualified, hold important positions in the Palestinian governance and are usually supporters of dialogue with Israel. If this policy remains in place, not only will the people denied entrance and their families be directly harmed, but so will the PNA and a possible advance towards peace.

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<sup>13</sup> These suspensions were recently lifted.

<sup>14</sup> Government workers on average received payments equivalent to only about 40% of their normal incomes from April-September 2006 (see IMF, West Bank and Gaza, Recent Fiscal and Financial Developments, October 2006). The transfer of taxes and donor assistance were resumed recently.

## 4. Palestinian Labor Flow into Israel

Until the beginning of the 1990s the Israeli labor market enjoyed the wide participation of cheap Palestinian labor. A third of the Palestinian labor force was working in Israel. This meant low rates of unemployment in the West Bank and Gaza Strip and relatively high income. Palestinian employment in Israel was concentrated in low-tech industries such as construction, agriculture and services. In the long-term, however, the dependency on employment in Israel harmed potential economic growth in the Palestinian economy. This was the result of the high compensation for work in Israel compared to the Palestinian territories. It limited incentives for accumulating human capital and created a labor market which specialized in low value added activities. In addition, the relatively high domestic wages (compared to other countries in the region apart from Israel) did not attract investors or technologies which could increase local productivity.

Since 1993, several changes have occurred to Palestinian employment in Israel:

- Palestinian labor flow became irregular.
- Access to Israel has become more restricted to the West Bank labor force and virtually closed to the Gaza Strip labor force.
- Official and unofficial employment in the Israeli settlements built in the West Bank increased.

While restrictions on Palestinian employees entering Israel were gradually added, the Israeli labor market was shifting towards foreign labor. Some prosperity periods for Palestinian labor occurred during the second half of the 1990s (though most of those laborers were without permits). Any improvement, however, disappeared with the beginning of the Al-Aqsa Intifada in September 2000.

Although some Palestinians received permits to work in Israel, continued closures and restriction policies imposed by Israel meant that many of those workers found themselves holding a useless working permit.

#### 4.1. Institutional Barriers

Since 1993, Palestinian employment in Israel has become dependent on Israeli regulatory constraints, and particularly on Israel's permit and closure policies. Israel's permit policy consists of regulating the entry of workers into its area on the basis of security considerations, rather than on the basis of supply and demand in the Israeli labor market. The complex and inconsistent permit policy, which was imposed in 1991, made entry of Palestinian workers into Israel conditional on obtaining a security clearance from the Israeli military establishment, as well as on acquiring a request of employment from an Israeli employer. Moreover, these permits bound the workers to a specific firm and place of employment, thereby restricting their opportunities.<sup>15</sup>

In addition, the ever-changing security procedures and measures which Israel imposes create a high degree of uncertainty as to whether workers with labor permits will be able to reach their work places. This has a negative effect on both the Palestinian worker and the Israeli employer.

#### 4.2. The Current Situation

Currently, approximately 40,000 Palestinians receive work permits (most of these workers are from the West Bank; since the disengagement there are very few Palestinians from the Gaza Strip working in Israel). These permits are issued directly to the Palestinian workers (working for Israeli companies) and contractors<sup>16</sup> without coordination with the Palestinian side.

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<sup>15</sup> In the absence of sufficient income earning opportunities in the occupied territories, tens of thousands of desperate Palestinians are prepared to risk entering Israel illegally in search of livelihoods for themselves and their dependants.

<sup>16</sup> According to the Palestinian Central Bureau of Statistics, the total number of Palestinians working in Israel and the settlements in 2006 (on a daily or weekly basis) reached 64,000 (including all workers, irrespective of permits held). Workers are predominantly male and within the age and family status requirements specified by Israel (usually aged over 35 years, married and with children).

The recent policies of reducing the number of Palestinian workers in Israel and creating separation between the two labor markets took a step forward with the disengagement plan, which suggested that in the “long-term” (without specifying an actual date), there should be no Palestinian workers in Israel. The explanation given for this policy was that it would encourage greater Palestinian economic independence.<sup>17</sup> Such a policy, if implemented under current conditions and without a drastic change in employment opportunities for unskilled labor in the PNA, would be harmful to the Palestinian economy. Furthermore, it does not necessarily reflect the needs of the Israeli labor market.

The Israeli policy to lower the number of foreign workers,<sup>18</sup> though legitimate,<sup>19</sup> does not mean that there should be further lowering in the number of Palestinian workers allowed to enter Israel. As a result of their long periods of stay in Israel, foreign workers have higher negative externalities to the Israeli economy, compared to Palestinians. Therefore, economically and socially, Israel benefits by giving Palestinian workers preference over foreign workers.

The daily net wage in Israel for a Palestinian employee in the fourth quarter of 2006 was 65% higher than in the West Bank and 95% higher than in the Gaza Strip (130.6 NIS compared to 79.3 NIS and 67.0 NIS respectively<sup>20</sup>). These figures indicate that a Palestinian who loses his job in Israel will suffer a significant loss of income, even if he finds employment in the PNA. A complete halt to Palestinian employment in Israel will consequently spill over into other economic dimensions, decreasing private consumption, savings and tax collections and negatively affecting other indicators.

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17 See the cabinet resolution regarding the disengagement plan: <http://www.mfa.gov.il/MFA/Peace+Process/Reference+Documents/Revised+Disengagement+Plan+6-June-2004.htm>

18 According to the Israeli Central Bureau of Statistics, in 2006 there were close to 200,000 foreign workers in Israel.

19 The Israeli labor market has been facing high rates of unemployment for almost a decade. The large number of foreign workers in Israel is seen as a central component in the growth of unemployment during this period. The Israeli government, therefore, adopted a policy of lowering their number. In this aspect, foreign workers and Palestinian workers are considered as one group.

20 See PCBS, Labor Market Survey.



## 5. Palestinian Employment in the Arabian Gulf Countries

In the past, the Arabian Gulf was a major market for Palestinian employees. Before the first Gulf War (until the end of the 1980s), it absorbed a large number of Palestinian employees, including workers in high skilled professions. In those years Palestinians were given preference over workers of other nationalities.

In recent years the situation has changed. Various factors are affecting the number of Palestinians employed in the Arabian Gulf, including:

- Economic and political developments in the Gulf, particularly oil prices and the impacts of the Gulf Wars. These have strongly affected employment opportunities in the Arabian Gulf.
- Employment policies in the Gulf countries, specifically the drive in GCC countries to increase the proportion of nationals in the labor force (e.g., the “Emeritization” and “Saudification” policies).
- Political relations between the PNA and the Arabian Gulf countries; these have suffered in past years, but are lately more positive and have resulted in increasing facilitation of work permits for Palestinian labor.
- The competitiveness of Asian labor, particularly skilled labor, with the Palestinian skilled labor force.

## 6. Recommendations

The Palestinian economy is on the brink. Any new employment opportunities would be extremely beneficial. Nonetheless, a return to the high share of Palestinians working in Israel, as was the case up to the beginning of the 1990s, is unrealistic in the near future. Furthermore, as mentioned above, it is also not constructive for the future development of the Palestinian economy. Therefore, it is of utmost importance that internal and external trade is stimulated, increasing the potential market size for the Palestinian private sector and thereby increasing productivity and employment.

The single most crucial factor impacting employment rates in both the West Bank and Gaza Strip is movement and access. The full and immediate implementation of the Agreement on Movement and Access (AMA)<sup>21</sup> will have an immediate impact on increasing employment.

Advancing employment rates from this limited, though important, immediate impact towards sustainable growth, requires additional actions aimed at increasing the reliability of movement and access and thus improving the prospects of the Palestinian private sector. Such actions are discussed further under “short- to medium-term” recommendations. These actions are necessary to keep up with the expanding labor force and allow the private sector to absorb workers shed from the public sector.

The successful implementation of the following recommendations also requires the introduction of measures that would:

- Maintain the competitiveness of the labor market.
- Improve the matching between supply and demand with respect to the type and degree of labor skills required in domestic activity.

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21 The Agreement on Movement and Access (AMA) was published on November 15, 2005. It dealt with the Rafah crossing, crossing points between Gaza and Israel (especially Karni / Al Montar), convoys between the West Bank and Gaza, movement within the West Bank, the Gaza seaport and airport.

- Overcome externalities that may arise in the promotion of activities such as entrepreneurial training, international marketing, small-scale credit provision, technology acquisition and research and development.
- Encourage Palestinian workers to seek employment opportunities within their territory, at least when suitable opportunities are available there.

### 6.1. Large Scale and Local Construction Projects

Development of large scale projects within the PNA with the help of the donor community is of fundamental importance. Such projects will have dual benefits: first, an immediate reduction in unemployment; and second, the development of the PNA infrastructure, as is needed for any developing country. Since many of the infrastructure investments are of the public type, they cannot be accomplished by private sector activities. Such public projects require broad investments and support from external sources.

In this context, the following projects should be undertaken in the immediate future:

- **The reconstruction of the Gaza Strip Airport:** This will create jobs in the Gaza Strip and open the potential for its utilization as an alternative route for Palestinian trade to international markets.
- **The construction of the Gaza Strip Sea Port:** This will create a large number of jobs and establish a necessary alternative route for Palestinian trade.
- **Municipal construction projects:** Determined on a needs basis and in the context of careful urban planning such as roads, water / wastewater, schools and housing. This would provide immediate, short-term employment opportunities on the local level.

## 6.2. Industry and Trade

### 6.2.A. Immediate-Term

There is an urgent need to revitalize the private sector in the Palestinian economy, which has shrunk to an unprecedented size. Removing restrictions on the movement of individuals and products is a key factor in this process. Thus, it is recommended that Israel immediately removes restrictions on internal movement within the West Bank, in an effort to implement the AMA, with an emphasis on:

- Supporting predictable and stable exports from the PNA to other markets.
- Creating specific access mechanisms for business people, skilled labor and service providers.
- Adopting a policy which provides work permits and residency in the PNA to foreigners (including those of Palestinian origin) in order to enable them to live and work in the PNA.

We make the following industry specific recommendations:

**Agriculture and Agri-Business:** Agriculture is one of the largest sectors in the Palestinian economy. The potential for the growth of this sector is tremendous, both in terms of direct absorption of the large number of agricultural workers who no longer have access to the Israeli labor market, and in the process of increasing the potential for export and internal access of agricultural goods to markets. Hence, the following issues require immediate address in order to increase potential labor absorption:

- Improvement of movement and access to both internal and external markets through:
  - a. Opening of the Gaza Strip Airport;
  - b. Operation of the Rafah commercial crossing point to allow commercial exports and imports from Egypt through Kerem Shalom;
  - c. The re-opening of the Jordan Valley to the rest of the West Bank, to allow movement of laborers into this area;
  - d. Implementation of convoys linking the West Bank and Gaza Strip in order to expand the local market.

- The facilitation of movement of agricultural goods into the Israeli market, as well as their movement through the Israeli airport and seaports to foreign markets.
- The facilitation of movement of agricultural goods through the Damia and Allenby Bridges for trade to and through Jordan.

### 6.2.B. Short to Medium-Term

In the short- to medium-term, the focus should be on the development of industry. This can be done through the creation of industrial enhancement programs and the establishment and activation of industrial estates. These will absorb unemployed workers both in the construction phase as well as in actual operation. Industrial zones require an enabling environment which would enhance the potential for investment from external as well as internal sources.

In this regard, immediate work should proceed in the following areas:

- **Jenin Industrial Zone:** This zone will assist in the absorption of skilled and trained Palestinian labor in the high value added area of Information Communication Technology (ICT). This is especially pertinent since movement and access do not pose a serious problem for the ICT community as they do for other goods.
- **The Erez Industrial Estates:** These can absorb a large number of employees, especially considering the high level of investment by the Turkish Government and the private sector.
- **The proposed Agri-business Industrial Zone in the Jordan Valley:** Proposed by the Japanese Government, this would greatly stimulate employment and target external markets in that the backward and forward linkages of agriculture<sup>22</sup> would be exploited to increase profitability of agricultural production and the shelf life of these products.
- **Reinvigorate the Gaza Strip Industrial Estates (Al-Montar/ Karni)** in order to increase employment in these estates through the re-creation of the agreed upon trade facilitation regime.
- **Revitalize the Nablus Industrial Base:** This area has been heavily

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22 The integration of agriculture into industry and distribution channels.

damaged by the particularly harsh restrictions surrounding Nablus since 2001.

- **Create programs and opportunities** for market diversification into regional and European markets with advantageous trade agreements and arrangements.

### 6.3. Labor Flow into Israel

Palestinian labor flows to the Israeli economy are not solely determined by political and security constraints, but also by the Israeli labor market demand. In the 1980s, various segments of the Israeli economy became dependent on the supply of low cost Palestinian workers whose wages were typically 20-40% lower than the wage of an Israeli employed in the same job. West Bank and Gaza Strip workers tended to concentrate in low-skilled occupations shunned by Israelis. At the time, Palestinian workers were not found to displace Israeli workers or to negatively affect Israeli unemployment rates and their employment was found to be positively correlated to the growth of Israeli GDP.<sup>23</sup>

Labor flow into Israel today is determined almost entirely by the Israeli army, and is often stopped or reduced as a measure of military policy with little regard to the economic impact. Decisions on such issues should involve branches of government that are more professional in labor economic considerations. The guidelines for these decisions should be:

- The number of Palestinians permitted to work in Israel should be maintained at least at its current value.
- Palestinian labor should be favored over foreign labor.
- The flow of Palestinian workers into Israel should be predictable and security restrictions must be limited to the minimum necessary.
- Measures affecting the flow of workers into Israel should be discussed with Palestinian counterparts before being imposed.
- A legal office that monitors the rights of Palestinian workers in Israel should be established.

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23 Khaleefeh, M. (1996). *Demand for Palestinian labor in Israel and the Occupied Territories*, Unpublished MA thesis, University of Yarmook, Jordan.

## 6.4. Labor Flows to the Gulf Countries

Taking into account the above-mentioned factors affecting employment of Palestinians in the Arabian Gulf, there are some actions which can enhance the chances of absorbing more Palestinians into this promising market. These include:

- **The PNA developing their diplomatic relations with the Arabian Gulf countries:** With regular remittances from these countries, a large Palestinian work force in the Arabian Gulf can have a significant impact on the national Palestinian economy.
- **Targeting the private sector in the Arabian Gulf:** A significant proportion of Palestinians hold higher educational qualifications and can compete with other nationalities, if given the opportunity.

However, the export of semi-skilled labor to the Arabian Gulf is not currently the trend. These jobs are being filled with cheaper labor from East Asia and Egypt. Palestinian laborers not only have a slimmer chance of securing job opportunities in these sectors, but the wages for such positions in Israel and the West Bank are significantly higher than in the Arabian Gulf. For this reason, Israel remains an important market for unskilled workers.

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# The Jordan Valley

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## Executive Summary

The Jordan Valley is a critically important region for the economic and demographic development of the West Bank both in the short and long term. The Jordan Valley's importance in the economic development of the West Bank is most notable in the areas of agriculture and tourism. Removing the limitations on movement of agricultural products from the Jordan Valley to other parts of the West Bank, the Gaza Strip, Israel and Jordan, and removing the limitations on movement of workers and non-resident land owners will give a boost to agricultural production. To reduce water shortages which limit economic and social development, there must be development and reconstruction of water infrastructure, and removal of limitations on access to areas with water-rich wells.

The presence of major tourist attractions such as Jericho, the Dead Sea and Christian religious sites gives the tourism sector in the Jordan Valley outstanding potential for development. Unique climate conditions could make the Valley a central attraction for winter tourism if limitations on movement are reduced and a better political atmosphere spreads.

The Jordan Valley is also the most reasonable area for future demographic expansion of the West Bank. It has an abundance of unutilized land and lies between the highly congested population centers in the western and central sections of the West Bank and the Jordan River. Development of agro-based industries and other economic sectors will provide employment and support the social needs of the fast-growing Palestinian population.

## I. Introduction

The Jordan Valley is a critically important region for the economic development of the West Bank. Its economy and development are currently facing serious problems as a result of the economic, political and security impediments being implemented by Israel.

### I.1. Importance of the Jordan Valley to the Palestinian Economy

The Jordan Valley is an integral part of the West Bank. A unique environmental and climatic region, the area is an important source of agricultural production. The Jordan Valley is known among Palestinians as the “bread basket” of the West Bank due to its fertile soil and the agricultural importance it represents to Palestinian food security, as well as to potential exports to Israel and other markets.

The Jordan Valley



## 1.2. Potential for Present and Future Economic Development

The Jordan Valley is the most reasonable area for demographic expansion of the West Bank: it has an abundance of unutilized land and lies between the highly congested population centers in the western and central sections of the West Bank and the Jordan River. There are several factors that highlight the importance of the Jordan Valley as a significant part of the potential viability of the future state of Palestine:

### 1.2.A. Socio-Economic Development

The Palestinian economy is by and large agrarian; agriculture plays a significant role either as the sole source of income for some families or as supplemental income to most families. According to the Palestinian Central Bureau of Statistics (PCBS), agriculture comprises around 17% of Palestinian GDP and provides approximately 15% of overall employment.<sup>1</sup> One-third of total agricultural goods are currently produced in the Jordan Valley despite the existing Israeli restrictions on movement and access.<sup>2</sup> Thus, the Jordan Valley's significance is highlighted by the fact that it formulates a very significant portion of Palestinian agricultural land, and hence a serious part of national income. It is predicted that agricultural production in the Jordan valley can easily triple in a very short period of time if the obstacles to access in general and to water in particular are removed.<sup>3</sup>

On the societal level, agriculture has developed into a social support process. The whole family is involved in planting and picking during the produce seasons. This provides a supplemental income of 25-35% of total earnings for the family.<sup>4</sup>

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1 The share of those employed in agriculture out of the total employed increases substantially during the planting and picking seasons. For example, in the fourth quarter of 2006, which was an olive picking season, the share of those employed in agriculture, fishing and forestry was 21.5%. See PCBS, Labor Force Survey Q4 2006, February 2007.

2 PCBS, March 2007, Export Data - 2006.

3 Interview with Amid Masri, chairman of TALEM Associates, International Agricultural Development Company (July 2007).

4 Interview with Amid Masri, chairman of TALEM Associates, International Agricultural Development Company (July 2007).

### 1.2.B. Population Expansion

The current population of the Jordan valley, including Jericho, is quite small; but the fertile land and the large undeveloped areas extending from the population centers of the western West Bank towards the Jordan Valley can be an important part of the development strategy in the short, medium and long term. Palestine has a large and rapidly growing population that will strain the ability of the new state to provide basic services and housing over time, even if there were no return of refugees to the new state. As of early 2007, there were approximately 4.1 million people living in the West Bank and Gaza Strip,<sup>5</sup> about 40% of the Palestinian population worldwide. This population is growing rapidly: the fertility rates of Palestinian women in the West Bank and Gaza Strip are among the highest in the world, at 5.6 and 6.9 children per woman of child-bearing age, respectively. By 2015, the population is estimated to be over 5 million.<sup>6</sup>

The circumstances just described apply to a situation in which there has been no large-scale refugee return. If, as anticipated, a final status accord leads to an ingathering of the exiles, the existing situation and the projections based upon it will change, perhaps profoundly.

Under any circumstances, the short-term potential for population expansion as well as absorption of the unemployed can best be served by increasing the utilization of the Jordan Valley for agricultural production, as well as by developing agro-based industries. These industries would utilize the Valley's agricultural production and add value to products aimed at external markets, thereby absorbing large numbers of both skilled and unskilled workers in the short to medium term, and opening the way for further economic development in the long term. The agro-industry park planned by the Japanese government as part of the "Corridor for Peace" can be an important catalyst for further development of the Jordan Valley.

### 1.2.C. Tourism

The Jordan Valley forms an integral part of the tourism route when visiting both Palestine and the region in general. Jericho, one of the oldest

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5 PCBS, July 2007. Population Data survey

6 The Rand Corporation. (2007). *The Arc, A Formal Structure for a Palestinian State*, Santa Monica, California.

standing cities in the world; the Dead Sea, the lowest point on earth; and the religious value of the Jordan Valley to Christianity all make it an inseparable part of the tourist attractions in the region. The location also completes the pilgrimage road between Bethlehem, Nazareth and Jerusalem and connects Palestine with Jordan, conveniently attracting tourists worldwide.

The unique climatic conditions of the Jordan Valley provide for excellent winter tourism, contributing to the potential growth of tourism overall. Hence, within the scope of Palestinian economic viability, the Jordan Valley plays a major role in one of the most important economic sectors.

Furthermore, the salt and minerals found in the Dead Sea are used for cosmetics and spa therapies that are unequalled by any other natural mineral source. This enhances the Jordan Valley's potential as a tourist attraction and may support economic development in this field.



## 2. Current Israeli Practices in the Jordan Valley

In October 2005, by virtue of an Israeli military order, it became necessary to obtain a permit to pass through the four checkpoints channeling traffic into the area of the Jordan Valley; frequent, long delays are experienced at the checkpoints.<sup>7</sup> The trench between Tammoun, Tubas and the Jordan Valley has been lengthened. The IDF also imposed new ID requirements on access to the Jordan Valley. These measures were not implemented until October 2005, five years after the start of the Al-Aqsa Intifada, thereby minimizing the claim that they are security requirements.<sup>8</sup>

Thus, it seems that the planned “eastern wall” has already been implemented in reality through strategically placed checkpoints and road blocks within the Jordan Valley. This has already had a significant impact by restricting the access of Jordan Valley farmers to their land.

### 2.1. Movement Restrictions in the Jordan Valley

According to the United Nations Office for the Coordination of Humanitarian Affairs (OCHA), in April 2007 there were 21<sup>9</sup> physical obstacles in the Jordan Valley, including a series of checkpoints, earth mounds, road gates, earth trenches and road blocks restricting movement into and within the area.

Jordan Valley areas designated as being under “settlement jurisdiction” and thus inaccessible to Palestinians represent 28% of the area of the West Bank.

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7 OCHA. (October, 2005). *Humanitarian Update Focus: the Jordan Valley*.

8 At the end of April 2007 the need for a permit to enter the Jordan Valley for West Bank residents was lifted. However, the access is possible only with public transportation. Furthermore, this policy change has not been fully implemented on the ground.

9 OCHA. (April 2007). *Closure Update*.

### 2.1.A. Residency Restrictions

Since May 2005, only Palestinians with an address on their identification card from the north of the Jordan Valley are allowed to reside in the northern Jordan Valley. This has affected many people who have lived in the Jordan Valley for years, but who do not have that address on their identification card. Those most affected are women who have married into a family from the Jordan Valley and those who were born in other areas of the West Bank but now live in the northern Jordan Valley. Residents of the northern Jordan Valley who do not have the corrected address on their identification card fear traveling to other areas of the West Bank in case they are prohibited from returning to their homes.

### 2.1.B. Permits to Access Work and Land

**Non-resident landowners:** Palestinians who own land or property in the Jordan Valley but who live in the Tubas areas can no longer access their property without a permit. The permits issued to landowners are not for overnight stays, so people must travel back and forth daily. They frequently face delays at either the Tayasir or Hamra checkpoints that connect the Jordan Valley with the rest of the West Bank.

**Workers:** Workers who want to work in the Jordan Valley are required to have a permit. Permits for workers in the agricultural areas of the Jordan Valley are issued by the Israeli District Coordination Office (DCO) or by settlements on which farm hands work. The permits are only valid for a limited period of time and are subject to security restrictions.

### 2.1.C. Military Zones, Israeli-declared Conservation Areas and Israeli Settlements

Even Palestinian non-residents of the Jordan Valley who do have permits are prohibited to travel on Road 90 (the main highway running through the Jordan Valley) north of the Al 'Auja partial checkpoint. Access to water sources and grazing areas is also increasingly limited because of the presence of extensive Israeli-declared conservation areas and military zones, particularly in the northern areas of the Jordan Valley.

The example of the village of Al Jiftlik clearly illustrates these difficulties. Straddled on all sides by settlements, closed military areas and military

bases, villagers have difficulty leaving their village to graze their animals or even market their crops within the West Bank. Compounding this problem is the restriction on workers from Tammoun and Tubas from traveling to this area, preventing optimal work on the land and reducing income even further.

## 2.2. Water Supply

Water shortages are a central impediment for Palestinian economic and social development in the Jordan Valley.

These shortages mainly arise from the following:

- Less water flow in the Jordan River. In the past decades Israel, Jordan and Syria have built dams and water reservoirs along water routes which used to flow into the Jordan River. As a result the river is almost dry most of the year and cannot supply water as in the past.
- Many of the water-rich wells which used to supply water before 1967 are in military closed areas and are therefore inaccessible to the local population.
- Water development projects and maintenance are carried out based on Israeli needs while Palestinians are prohibited from digging additional wells or restructuring existing ones.<sup>10</sup> The building of new wells has also led, in some cases, to the drying out or downgrading of wells used by the Palestinian population.

The absence of water treatment facilities for sewage water has also led to the pollution of existing water resources such as in Ein Wadi el Qult and a well in Zbeidat area.<sup>11</sup>

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10 It should be noted that a concern was raised about whether the depth of some of the wells dug in the Jordan Valley poses a threat to the underground water basin and thus to the sustainability of the eco-system of the Jordan River and the Dead Sea.

11 Ma'an Development Center: *Eye on the Jordan Valley, Fact Sheet*: <http://www.maan-ctr.org/WhatsNew/30-4-07/all.pdf>

### 2.3. Access to Markets

Having lost access to Israeli markets, Jordan Valley farmers increasingly rely on local West Bank markets. These are more difficult to reach.

All trade from the Jordan Valley must be processed through the Jalameh gate, which has been designated as a back-to-back crossing point into Israel and en route to the Gaza Strip. In contrast, in the past goods and customers passed relatively unrestricted in and out of the Jenin area, as agreed upon in the Oslo Agreement and particularly in the Paris Protocol.

### 3. Impact of Israeli Measures on Local and Overall Palestinian Economic Development

The impact of the aforementioned Israeli measures on both the local and overall economy has been tremendous. According to UN OCHA, “the economy of the Jordan Valley is based on tourism, mainly focusing in and around Jericho, whereas the rest of the Valley depends primarily on agriculture.”<sup>12</sup> The closure of Jericho has therefore had a tremendous impact on the tourism sector, which has been severely restricted by constant delays and harassment of both local and international tourists at the checkpoint at the entrance to Jericho, as well as by the prevention of the entry of Israeli cars and tourists at will.

As previously mentioned, access to agricultural lands has also been restricted, especially for those who do not reside in the Jordan Valley but who work there as either agricultural workers or land owners. The inability of Israeli trucks to enter the Jordan Valley in order to carry Palestinian produce to the Israeli market is another serious impediment to agricultural trade. Until recently, agricultural produce carrying Palestinian invoices could not go through the Bissan (Bet She’an) crossing and had to go through Jalameh. Although, at the present, Palestinian produce can go through Bissan, it is only done through back-to-back, which imposes additional costs and reduces the competitive capacity of these products.

Additionally, shepherds and Bedouins who used to move freely within the Jordan Valley in search of water and fresh feed for their herds are now facing the risk of being fined by Israeli authorities when crossing through Israeli-declared national reserves.<sup>13</sup>

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<sup>12</sup> OCHA. (October, 2005). *Focus: The Jordan Valley*.

<sup>13</sup> Ibid.

### 3.1. Elimination of Potential for Natural Population Growth and Expansion

Without access to the Jordan Valley, natural population growth in the direction of the east will be restricted. This area is rich in unused lands that are suited to the construction of housing projects and are relatively far from the highly concentrated urban areas in the western West Bank. With the potential for eastward expansion thus constrained, congestion in the already existing urban areas will increase and the viability of the Palestinian state will be reduced.

## 4. Proposed Solutions

### 4.1. Immediate to Short Term

In the immediate to short term, the restrictions on the movement of goods and people within and into the Jordan Valley should be removed or at least minimized, as follows:

1. Allow movement of agricultural goods from the Jordan Valley to all parts of the West Bank, and allow access to the Gaza Strip.
2. Allow Israeli trucks to enter the Jordan Valley to pick up agricultural goods from Palestinian farms.
3. Allow Israeli trucks to enter Israel through the Bet She'an crossing after they pick up goods from Palestinian farms in the Jordan Valley.
4. Allow Palestinian trucks carrying produce from the Jordan Valley to use all border crossings into Israel.
5. Remove the checkpoint at the entrance to Jericho, and remove all checkpoints that prevent the movement of tourists into the Jordan Valley area.

### 4.2. Medium Term

In the medium term, the following further steps need to be taken to normalize access of Palestinians to the Jordan Valley and support its development:

1. Elimination of all movement and access restrictions to the Jordan Valley from all parts of the West Bank.
2. Improvement of the road infrastructure between the northern West Bank and the Jordan Valley, especially from the Badhan – Toubas area to the Jordan Valley.

3. Improvement of the road network between Nablus and Damia Bridge.
4. Open Damia Bridge for export of Jordan Valley agricultural products and agro-business in general.
5. Improve access to the Allenby Bridge in order to provide better access for tourists to the Jordan Valley.
6. Development and reconstruction of water infrastructure and removal of the limitations on access to water-rich areas.

#### 4.3. Long Term

Implement the vision of the Economic Road Map.



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