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From Dreams to Reality — Economic Facts about the Palestinian Economy

When the World Bank first began talking about “developing the Occupied Territories” and investing “in peace” during the summer of 1993, it represented an unprecedented moment for the Palestinian people, a moment the offered Palestinians the opportunity to participate in devising their own development strategy. Following lengthy negotiations between the PLO, Israel, and the World Bank, a neo-liberal model of economic regeneration emerged. The model advocated an overall strategy of economic liberalization, coupled with minimum state intervention for the purpose of promoting private sector growth.

The years 1994/1995 witnessed a steady flow of Palestinian businesspersons from the Diaspora, intent on investing in the Palestinian Authority (PNA) in response to the optimistic atmosphere that prevailed after the signing of the Oslo Agreement. During that period, the opportunities for establishing Palestinian-Israeli joint ventures also seemed good. Nonetheless, after initial discussions, many Palestinian investors became disappointed for they felt that the Israelis were looking for quick profits and bridges to other Arab markets. It appears that these impressions significantly limited the scope of potential investment.

In light of the prevailing political and economic realities that have developed since that period of euphoria, the difficulties of applying any model to a non-sovereign economy have become increasingly clear.

The continuing Israeli closures of the West Bank and the Gaza Strip, and the increasingly strict control of trade crossings, have curtailed economic activity and stalled donor-funded programs. These events have further highlighted the challenges inherent in development under limited autonomy.

The realization by the international donor community that project implementation was not going according to plan has provoked an interesting response. Absent serious structural changes in the Palestinian economy, public sector investment programs are being abruptly decelerated in order to address private sector distress and alarmingly high levels of unemployment — that rate was 28.6% during the first half of 1996.

Thus, last year, despite it being one of the hardest yet faced by the Palestinian economy — the available data for 1996 indicate that GNP per capita was about $1,715, while GDP per capita was about $1,400. Despite these trends, the Nablus Stock Exchange was established and opened its doors to trading in February 1997. Another milestone was the publication of the first official statement on investment— *Commercial Law and Investment in Palestine* — an adaptation of the *Encouragement of Investment Law in Israel.*

It obvious that the PNA was able, in a relatively short time, to establish the institutions necessary for the conduct of normal, daily life, and to ensure development and progress. This was clearly reflect in the PNA's first *Proposed Budget for 1997*, presented to the donor countries. The size of that budget was estimated at $866 million. Expected income from taxes and revenues was estimated at $814 million, which leaves a deficit of $52 million. These figures indicate that the PNA is actively engaged in developing Palestinian society and creating economic and political stability.

Another interesting fact is the financial status of the different banks operating in the PNA. Since the signing of the Oslo Agreement, 14 banks, having 58 branches, have been established throughout the West Bank and Gaza Strip. Total bank assets at the beginning of 1997 were about $2 billion, an increase of about 45% from the previous year. Deposits have increased by 40% (valued at $634 million) in comparison to early 1996.

It is clear that the PNA's small economy is essentially underdeveloped. In 1992, the last year for which relatively reliable data is available, GNP per capita reached nearly $2,500 in the West Bank (of which 21% came from income earned in Israel) and $1,600 in Gaza (of which 29% came from income earned in Israel). Agriculture, primarily low-technology and family-based, contributed about 30% of GDP, while manufacturing contributed less than 10%.

After a 7.3% real increase in GDP in 1994 — a productive year in the olive harvesting cycle and the start of a "building boom" in Gaza and Ramallah — GDP was estimated by the IMF to have grown by 3.5%, in real terms, in 1995, reaching $3,355 million. More telling, perhaps, is GNP for that year, a figure that incorporates the value of income earned abroad. The PNA's GNP is believed to have decreased, in 1995 drastically in real terms, as a result of a 52% reduction in worker remittances. With population growth of about 5% per annum, income per capita, and therefore living standards, appear to have dropped by about 10% in 1995.

Regarding trade, more than 80% of the PNA's direct foreign trade is with Israel. IMF estimates suggest that the 1993 level of $230 million, itself disappointing, was again reached in 1995, after the prolonged 1994 border closure that seriously affected exports. However, imports increased slightly during 1995, to a level more than five times that of exports, and resulted in a deficit exceeding $1,000 million on the balance of trade. As the “compensatory” value of income earned by Palestinian workers in Israel declined, current account deficits (excluding grants) increased from $282 million in 1993 to $402 million in 1994 and $641 million in 1995.

Data made available by the Israeli Central Bureau of Statistics further illustrate that imports of goods from Israel, after reaching record levels in 1992 and 1993, dropped by 20% in 1994, to $815 million; exports to Israel declined from $249 million in 1992 to $178 million in 1993 and $130 million in 1994.

What is to be done in the future? The first measures to be taken, at least for the medium term, must be based on the assumption that Israel will continue to regard the movement of goods as a security problem. Such movement is now permitted, but it is subject to slow, often humiliating scrutiny by unmotivated military personnel. The installation of fast, autonomic screening equipment would provide Israel the needed security and, at the same time, eliminate the current huge delay in transporting goods out of the Wet Bank and Gaza. Such a step would also eliminate the rationale behind Israel’s continued closure to goods and would Palestinian efforts to develop trade with alternative, optimal partners, those who could provide the PNA with the cheapest and most appropriate goods.

Another critical step is the creation of employment opportunities as substitutes for those rapidly disappearing in Israel.

The development problems in the PNA can be resolved if an honest and timely restructuring of priorities is implement. This would entail the following measures:

- Creation of incentives to external companies to locate, develop, and manage production in the PNA. Output would be targeted, at first, to those firms’ external markets; eventually the capacity could be sold, in the form of viable companies, to local interests.
- Provision of massive support to local producers.
- Support of financing for the creation of physical infrastructure and marketing of the tourist industry.
- Provision of PNA and donor support for agriculture, including the development of new crops.
- Stimulation of trade between the West Bank and Gaza Strip through the adoption of instruments such as safe passage measures.
- Encouragement of reciprocity in trade between the Palestinian Authority and Israel.

Some of these steps may appear modish and neo-liberal. However, they do represent the need for a more interventionist policy that can overcome past failures while preparing the groundwork for future success.