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# The Palestinian Economy and the Prospects for its Recovery

Economic Monitoring Report to the Ad Hoc Liaison Committee  
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# Foreword – The Context for this Report

## The Rationale for Periodic Assessments

- The World Bank presented to the December 8, 2004 meeting of the Ad Hoc Liaison Committee (AHLC) a report (*Stagnation or Revival? Israeli Disengagement and Palestinian Economic Prospects*) which argued that rapid Palestinian economic revival is essential to sustaining the momentum of a renewed peace process, but that it will only come about if there is
  - A drastic improvement in the security environment;
  - A dismantling of the various post-September 28, 2000 restrictions on the movement of Palestinian people and goods; and
  - Dynamic progress on Palestinian governance reform and institution-building.
- *If* these preconditions for economic revival emerge, it was argued, a major increase in donor assistance levels could have a transformational effect. In furtherance of this premise the Bank identified an agenda of key measures “which, if implemented, will lay the basis for the economic revival of the West Bank and Gaza” (see **Annex 3**). These measures are consistent with the obligations of the Government of Israel and the Palestinian Authority specified under Phase I of the Roadmap. As a corollary to this virtuous sequence, the Bank noted that a quantum increase in donor financing would be hard to justify if meaningful progress in security, closure and reform policy was *not* made—both because the impact of these resources would be seriously muted, and because the private sector response needed to sustain the impact of the additional spending would not emerge.
- The Bank’s report was endorsed by the December 2004 AHLC Meeting. In its Summary, the AHLC Chair requested the Bank to work with the parties and donors to translate the report’s recommendations into a set of actionable measures, and to monitor progress towards their implementation; this would then help donors form a judgment on the extent to which the preconditions for economic revival are being put in place. At the London Meeting on March 1, 2005 donors and the PA agreed that the first Bank Economic Monitoring Report should be prepared as an input to the next AHLC Meeting.
- Integral to this report is a matrix of *Indicators of Economic Revival* (**Annex 2**). These indicators were developed by the Bank with assistance from the European Commission and the United States. They should *not* be considered a checklist or scorecard, and are not of themselves determinant: they merely help anchor a qualitative analysis of the extent to which the preconditions for robust economic growth are being re-established.



# 1 – Summary Assessment and Recommendations

## I – The Need for Rapid Economic Growth

1. Sustained economic growth in the West Bank and Gaza is a vital part of the process of political normalization. As the World Bank wrote in December 2004, “While prosperity is no guarantee of tranquility, history teaches that the opposite is true: that destitution, political instability and violence are constant companions<sup>1</sup>”. Jim Wolfensohn, the Quartet Special Envoy for Disengagement, has continually emphasized the need to create Palestinian economic momentum, and its connection with Israel’s security. In his letter of October 30, 2005 to Prime Minister Sharon and President Abbas, he writes “I believe that we have an opportunity....to see a peaceful period where Palestinians can develop a better life based on tangible and visible prospects and where Israel can be more secure precisely because Palestinians....have greater freedom and hope”<sup>2</sup>.

2. Employment, and particularly youth employment, must be the essence of any Palestinian economic revitalization strategy. The Bank in December 2004 calculated that it would take an increase in the real Gross Domestic Product (GDP) of 10 percent per annum over the 2005-8 period to reduce unemployment to pre-*intifada* levels of around 12 percent—essentially a doubling of the 2003-4 rate of growth. Achieving this, it was argued, required a combination of four factors: a dramatic reduction in violence against Israelis, the restoration of Palestinian movement and access, Palestinian governance renewal and, on top of these policy preconditions, an increase in donor disbursements of about 50 percent per annum. The Quartet Special Envoy has underlined this same message on several occasions: “successful reconstruction requires four fundamentals—an absence of violence, a rolling back of the restrictions on Palestinian movement, vigorous Palestinian governance reform and increased foreign aid”.

## II – Growth in 2005 – Encouraging but Inconclusive

3. Real GDP is expected to grow by 8-9 percent in 2005<sup>3</sup>. It should be remembered that this is growth from a low base—at the end of 2005, real GDP per capita was still some 29 percent less than in 1999. Nonetheless, unemployment is expected to decline by 4 percentage points this year, from c. 27 to c. 22.5 percent, while nominal personal incomes are expected to rise by about 12 percent<sup>4</sup>.

4. This year’s performance reflects four key factors: an expansionary Palestinian Authority (PA) fiscal policy, which has raised public consumption by almost a quarter; solid economic growth in Israel and the demand this has created for Palestinian merchandise exports and Palestinian labor, along with a relaxation of border closures sufficient to permit Palestinians to take advantage of this; a 30 percent increase in credit to the private sector fuelling strong growth in the transport and construction sectors; and a 20 percent increase in donor disbursements. PA fiscal expansion, though, is unsustainable; unless checked, it will lead to functional bankruptcy (i.e. the PA’s inability to meet its monthly salary bill and deliver the most basic services). The drivers of growth also underscore the tight interconnections with the Israeli economy, and thereby the degree of dependence on Israeli closure management.

5. The Bank’s economic projections (**Annex 1**) show that such growth will not persist without good Palestinian governance, sound economic management and a continued relaxation of closure by GOI—including the maintenance of current labor

flows. The scenarios compare the relative impact of a) an improving policy environment without additional funding (the *Recovery, No Additional Aid* scenario), and b) stagnant policy with c. US\$500 million per annum of extra donor funds (*Status Quo, Additional Aid*). Neither of these scenarios delivers: good policies alone do result in positive GDP growth of about 5 percent per annum, but unemployment declines by only 2 percent over three years. Money alone is less beneficial: real GDP growth disappears by 2008, and unemployment increases by 3 percent in the coming three years<sup>5</sup>.

6. The only satisfactory way forward is to combine good policies by both sides with more money. The *Recovery, Additional Aid* scenario embodies continued easing of closures and stable labor access with strong Palestinian governance and the re-establishment of fiscal control, accompanied by generous donor assistance. This combination brings rapid growth and a marked decline in unemployment. By 2008, propelled by rising exports<sup>6</sup>, personal incomes increase by 20 percent<sup>7</sup> and unemployment falls by almost a half, to 13 percent of the workforce<sup>8</sup>.

### **III – Creating the Preconditions for Economic Recovery: A Progress Report**

7. The Bank was asked by the Ad Hoc Liaison Committee (AHLC) to assess the emergence of the preconditions for sustained economic recovery, including through a set of *Indicators of Economic Revival (Annex 2)*. This exercise shows that progress has been slower than hoped for. While a number of encouraging developments have taken place, it would be premature to say that either party has done enough to establish a solid platform for economic revival<sup>9</sup>.

#### **Security**

8. Security has improved, if measured by the frequency of security incidents or the numbers of those killed or injured in the conflict<sup>10</sup>. What is more difficult to assess is whether this abatement reflects a trend that will gather force, or represents a temporary hiatus—though it is important to note that Palestinian public support for violence has declined substantially<sup>11</sup>. Some groups refuse to be bound by the ceasefire negotiated by the PA in early 2005, and violence has not ceased. As a result, economic activity continues to evolve under the shadow of conflict.

#### **Closure**

9. The system of closures detailed in the Bank's December 2004 report is still largely in place, and remains the key risk to rapid, sustained Palestinian economic recovery. From an economic perspective, the three most important manifestations of closure are the restrictions on Palestinian labor access to Israel, the handling of Palestinian exports at the borders with Israel, and the controls on the movement of goods and people inside the West Bank.

10. Palestinian labor access has improved in 2005, with the daily average number of workers in Israel and the settlements (ISI) increasing from 50,000 in 2004 to 64,000 for the first nine months of 2005<sup>12</sup>. This positive trend stagnated after disengagement, however—the number of Palestinians with permits working in ISI declined by about a quarter between Q2 and Q3<sup>13</sup>. Exports of goods increased by 8.4 percent in real terms in the January--September 2005 period compared with 2004, but also appear to have slowed after disengagement<sup>14</sup>. Internal movement was restored in Gaza in September 2005 as

Israel withdrew; it remains constrained throughout much of the West Bank, however, and continues to exert a strongly negative impact on growth prospects<sup>15</sup>.

11. The Government of Israel (GOI) has made it clear on many occasions that Palestinian economic revival is in Israel's strategic interest<sup>16</sup>—but it also argues that the key to the rapid deconstruction of closure remains vigorous Palestinian action to combat terrorism, which it does not see as forthcoming. On the other hand, continued economic stagnation itself imperils Israeli security. Resolving this tension between the demand for “immediate security” and the need for “sustainable security” has preoccupied all three parties—Israelis, Palestinians and donors—throughout 2005.

12. The *Agreement on Movement and Access* of November 15 (**Annex 4**) offers a meaningful way forward, and represents a major Israeli commitment to Palestinian economic growth. Tackling the central issue of the movement of Palestinian people and goods across borders, notable features include the following:

- *Border passages will operate continuously*—GOI will not close a passage unless that passage is threatened, and will thereupon divert cargo to an alternative passage. This will re-introduce the crucial element of reliability in trade.
- *Market demand will determine capacity, not vice-versa*—both parties will agree ‘service standards’ for each passage that reflect this; thus at Karni, where daily export truckloads averaged 43 in the disengagement period, GOI has committed itself to process at least 150 per day by December 31, 2005<sup>17</sup>.
- *The abolition of today's inefficient back-to-back cargo system*—modern x-ray technology will be used to scan intact cargoes, in containers and/or on trailers.
- *The introduction of escorted convoys between Gaza and the West Bank*—GOI has agreed to introduce passenger convoys by December 15, 2005 and truck convoys by January 15, 2006.
- *Palestinian control over the land border with Egypt*—for the first time, a Palestinian land border will be controlled by the PA, assisted by the European Union (EU) in an oversight and monitoring role.
- *The seaport at Gaza*—GOI has given the go-ahead to build and operate the port, which will offer direct access to the world, and competition for Israeli ports.

13. Full implementation of the *Agreement* will be very challenging, as developments in the past three weeks have demonstrated<sup>18</sup>. If implemented in substance and in spirit by both parties, however, it will have appreciable impact on Palestinian trade.

14. The *Agreement* is only a first step. A process of reducing internal movement restrictions in the West Bank is proposed in the *Agreement*, but current GOI policy protects settlements and settler access by restricting Palestinian traffic on key highways, and this conflicts with the need to restore movement between towns, villages and the borders. GOI's policy on Palestinian labor should also be reconsidered. The number permitted to work in ISI in 2005 was less than half of the 1999 daily average. GOI intends to phase out all Palestinian labor access by the end of 2007, but a longer transition is needed if further serious disruption to the Palestinian economy is to be avoided. As an initial step, GOI is urged to materialize the 35,000 work permits which it committed to in principle in 2004<sup>19</sup>.

## **Palestinian Governance**

15. President Abbas' January 2005 election gave rise to hopes that the PA would press forward with governance reform, and on March 1, 2005 the PA presented the London Meeting with a *Declaration of Institutional Renewal*. Despite some important gains, overall implementation has been disappointing, with many decisions now postponed until after the January 2006 Parliamentary elections.

16. The PA's most commendable achievement this year has been its strong commitment to a democratic process at a time when real competition has emerged. Other positive steps include the inception of a solid medium-term planning process, passage of an important *Judicial Authority Law*<sup>20</sup>, the strengthening of internal auditing and public procurement and the development of the Gush Katif greenhouses as a showcase post-disengagement project.

17. The impact of these positive gains is tempered, however, by a number of negative developments. Of greatest concern is the serious deterioration in internal law and order. In his October 30, 2005 letter to the Quartet Principals, the Quartet Special Envoy referred to "disturbing signs of internal fragmentation. The current combination of violence and turmoil is undermining the stability needed to induce private investors to bring their capital to the Palestinian economy, and will vitiate efforts to create an orderly platform for development". Under pressure from public employees, the PA has also acceded to salary and pension demands which it cannot finance on a sustained basis. The PA has also taken insufficient action to combat corruption, and has not yet clarified how the vacated settlement areas will be managed and developed.

18. It is too late for this government to redress many of these shortcomings, and the new post-electoral PA will have to tackle them with commitment and speed. A new reform agenda is needed—one which has the full commitment of the President, the Prime Minister and the Cabinet. Donors are looking to the PA's emergent *Medium-Term Development Plan* to preview such an agenda and to create a framework under which donors can provide coordinated support<sup>21</sup>. The most urgent priorities will be the restoration of internal law and order and wide-ranging security reform, implementation of a strong fiscal stabilization program and the inception of a vigorous anti-corruption campaign.

## **The Role of the International Community**

19. The international community is an essential player in efforts to resolve the Israeli/Palestinian conflict. As in 2004, the Quartet has had limited success in persuading either party to abide by its Roadmap commitments, but has in other ways played a definitive role. The Quartet Special Envoy, assisted by the United States (US), the EU and the World Bank, helped the parties conduct their first technical negotiations in five year and to bring the first stage of this process to a positive conclusion. Donor disbursements this year are expected to reach US\$1.1 billion, an increase of some 20 percent over 2004 and consistent with expectations at the December 2004 AHLC meeting. The G8, at its July 2005 Gleneagles summit, gave the Quartet Special Envoy a commitment in principle to help raise up to US\$3 billion per annum in public and private finance over the coming three years if the actions of the parties merit it—a pledge which exceeds the scale of additional financing optimistically advocated by the Bank in *Stagnation or Revival*<sup>22</sup>.

20. Donor coordination in 2005 has lacked dynamism, however. More could have been done to coalesce around the delivery of the *Day After Program* initiated by the Quartet Special Envoy's Office, while systematic follow-up on the reform support tasks ascribed to donors at the March 1 London Meeting has been lacking. The inception of a new donor structure which increases the ownership of the PA in the development process, while more clearly charging certain donors with thematic responsibilities, should help correct these shortcomings in 2006<sup>23</sup>.

#### IV – Next Steps

21. The Quartet Special Envoy, the Bank, the G8 and the PA have all called for a quantum increase in donor financing to complement a strong, visible effort by both parties to create an environment in which the Palestinian economy can flourish. Despite some bright spots, the parties' performance on the ground is still lacking—though the conclusion of the *Agreement on Movement and Access* and the prospect of democratic renewal held out by the PLC election give reason to hope for substantive improvements.

22. The Bank's projections have consistently shown that donor money in the absence of committed policy adjustment by both parties will not rescue the economy. In a worst case scenario, donors could find themselves on a policy-free treadmill, disbursing three times what they did before the *intifada* without any assurance of sustainable impact.

23. Donors now face a decision about whether to move ahead with full speed to commit additional funds, or to hold off and await further developments. The Bank's view is that it is important to respect both the momentum of current events and also the economic facts of life. This means capitalizing on the enthusiasm generated by disengagement, Jim Wolfensohn's efforts, the G8's Gleneagles pledge, the *Agreement* and the PLC election; but it also means learning from past mistakes, and insisting on performance.

24. Donors should continue to plan to increase their assistance levels. The G8 members and others should follow the lead of the European Commission, which has positioned itself to double its commitments from €250 million to €500 million per annum—provided that the preconditions for growth emerge, and that other donors respond in like manner. There is a particular need for the Arab League states to step up their contributions: disbursements from Arab countries in 2005 are expected to amount to only US\$197 million, or 18 percent of the total—down from US\$388 million and 42 percent of the total in 2001<sup>24</sup>.

25. Donors need to see considerable additional progress before they disburse these additional funds, however. Accordingly, they will be paying particular attention to the implementation of the *Agreement on Movement and Access*, and to efforts to extend the dialogue into areas not yet dealt with. They will be looking to the new Palestinian government for an early demonstration of its commitment to tackling the critical governance and economic management issues identified in this report.

26. In order to help donors review and refine their judgment on how to proceed, the Bank will, at the request of the donors, continue to monitor and assess developments. A second *Bank Economic Monitoring Report to the AHLC* is planned for early 2006.

## 2 – The State of the Palestinian Economy: January through September, 2005

### I – Overview

27. The Bank estimates that real GDP growth in the West Bank and Gaza may reach 8-9 percent in 2005, continuing the modest recovery that began two years ago.

28. Reflecting on the past five years, two distinct periods are discernable: a) October 2000 through 2002, the period of severe crisis, in which GDP per capita declined by about 36 percent, and b) 2003 through 2005, a period of stabilization and gradual recovery, in which GDP growth has averaged about 7 percent per annum (**Table 1**) The early period was characterized by two severe economic shocks: first, the outbreak of violence, the initial imposition of closures and the suspension of Israeli revenue transfers in late 2000; and second, the incursions into the West Bank under operations Defensive Shield and Determined Path in the spring and summer of 2002. Israeli revenue transfers resumed in November 2002<sup>25</sup>, and while subsequent conflict (particularly in Gaza in the spring of 2004) dampened the recovery process, the impact was not comparable to the earlier shocks.

29. Nevertheless, today's Palestinian economy still operates at well below its potential, with real GDP per capita almost 30 percent lower than in 1999; at the pace of economic growth witnessed since 2003, pre-*intifada* per capita income levels would only be restored by 2010-12. The inability of the Palestinian economy to fully use its productive potential is first and foremost the result of restrictions on the movement of people and goods.

30. Unemployment levels remain unacceptably high. The third quarter (Q3) data for 2005 show unemployment at 23 percent (20 percent in the West Bank and 29 percent in Gaza), i.e. more than double pre-*intifada* levels. Predictably, youth unemployment is even more acute, with Q3 unemployment among 20-24 year-olds some 35 percent overall, 44 percent in Gaza and over 60 percent in most refugee camps and in southern Gaza (Rafah and Khan Younis). Some 43 percent of the Palestinian population still falls below the poverty line, with perhaps 15 percent classified as living in deep poverty<sup>26</sup>.

31. Over the past five years, under the pressure of closure, the structure of the Palestinian economy has adjusted significantly. The number of laborers working in ISI has declined by 56 percent, from a daily average of almost 150,000 in mid-2000 to some 66,000 by September 2005<sup>27</sup>. The consequent loss of jobs and remittance income has not been replaced by an offsetting increase in the exports of Palestinian goods and services, which have only now recovered to pre-*intifada* nominal levels. Nor have historically high levels of foreign assistance sufficed to preserve Palestinian incomes<sup>28</sup>.

### II – Economic Output

32. A number of factors have fueled growth in 2005; notably lax fiscal policy, a rapid expansion of commercial bank credit, robust growth in Israel, improved worker remittances from Israel, continued demand in the construction sector and increased donor assistance. Inflation is expected to remain low at around 3 percent, reflecting underused capacity as well as Israeli inflation levels.

- Public consumption is projected to increase by about 21 percent in nominal terms in 2005, reflecting higher salaries and a significant increase in public transfers.
- Credit to the private sector from the banking sector has increased by about 30 percent during the past year, injecting significant additional liquidity into the economy.
- Growth in Israel tends to benefit the Palestinian economy, especially through an increased demand for Palestinian exports. In the first half of 2005, Israel's GDP grew 4.9 percent<sup>29</sup>; in Q1, Palestinian exports of goods and services to Israel increased by 11 percent compared to average levels in 2004.
- The value of remittances increased by almost 25 percent in the first nine months of 2005 compared with the same period in 2004, in line with increasing numbers of Palestinians working in Israel.
- Employment in construction—a good indicator of investment—grew by 25 percent, to reach 13 percent of total employment.
- Donor disbursements are expected to increase by about 20 percent this year compared with 2004.

33. With real GDP growth of 8-9 percent, unemployment is set to decline by about 4 percentage points to c. 22 percent overall, while poverty would fall from 46 to 43 percent of the population (and 38 percent of households)<sup>30</sup>.

**Table 1: Selected Macro Economic Indicators**

	2000	2001	2002	2003	2004	2005 (p)
Real GDP growth	-5.6%	-14.8%	-10.1%	6.1%	6.2%	8.7%
Cumulated growth since 1999	-5.6%	-19.6%	-27.7%	-23.3%	-18.5%	-11.4%
Cumulated growth since 1999, per capita	-9.5%	-25.9%	-35.7%	-34.1%	-32.4%	-29.0%
Population (million)	2.93	3.05	3.16	3.27	3.39	3.51
Exchange rate (NIS:US\$)	4.08	4.21	4.74	4.55	4.48	4.35
GNI per capita, US\$	1,626	1,217	1,001	1,088	1,181	1,318
Consumer price inflation	2.7%	1.2%	5.7%	4.4%	3.0%	3.0%
Unemployment rate	14.0%	26.0%	31.0%	25.6%	26.6%	22.4%
Poverty rate	31%	46%	59%	61%	46%	43%

Source: World Bank Staff calculations and PCBS. Notes: Figures exclude East-Jerusalem. (p): projection.

34. Severe movement restrictions continue to fetter economic activity, though the situation on the ground has become increasingly predictable, permitting some degree of adaptation<sup>31</sup>. The corollary to this, of course, is that closure has become increasingly institutionalized, in particular inside the West Bank (see paragraph 51).

### III – Fiscal and Financial Developments

35. The fiscal situation has become structurally unsustainable as a result of uncontained government consumption, in particular a rapidly increasing public sector wage bill, expanding social transfer schemes and rising “net lending”<sup>32</sup>. Unless addressed promptly and forcefully, this will compromise the prospects of rapid recovery by destabilizing the operations of the PA and by reducing the public and private resources otherwise available for productive investment.

36. During 2005 the PA has been running a monthly deficit of US\$57.1 million (**Table 2**), accumulating a total deficit of US\$514 million through September. Once the

full impact of the 2005 salary increases is reflected in the budget data, the monthly deficit will increase by some US\$15-20 million, and—if left unchecked—will likely exceed US\$900 million in 2006. This is clearly unfinancable: over the past three years, external budget support has averaged US\$320 million and commercial bank borrowing is already at very high levels<sup>33</sup>.

37. The severity of the fiscal situation is underscored by the PA's strong revenue performance: monthly average gross revenues are averaging US\$95 million this year, almost US\$10 million higher than projected in the Budget. Despite this, once payments for the utility bills due to Israeli providers have been deducted, the revenue that remains is not even sufficient to cover the wage bill (let alone finance any operating costs or social transfers)<sup>34</sup>. With the PA continuing to pursue a strategy of paying salaries in full as its cardinal priority, all other PA operations will depend either on donor support, which remains unpredictable, or on the liquidity created by various other coping stratagems—such as borrowing against the assets of the Palestine Investment Fund, or delaying the payment of suppliers' invoices.

**Table 2: The PA's Fiscal Operations, 2005**

US\$ million; monthly averages	2005 Budget	Actual, through Sept.
<b>Revenue</b>	<b>85.0</b>	<b>94.9</b>
Gross domestic	31.2	35.6
Gross monthly clearance	53.7	59.3
<b>Expenditure</b>	<b>124.7</b>	<b>125.8</b>
Gross wages	73.8	78.3
Civilian	44.6	48.1
Security	29.2	30.2
Non-wage expenditure	49.1	43.6
Operating	20.7	17.6
Transfers	28.4	26.0
PA financed capital spending	1.8	3.9
Net lending	10.2	24.3
VAT refunds	1.6	1.9
<b>Balance</b>	<b>-51.5</b>	<b>-57.1</b>
Financing	51.5	57.1
External Financing	51.5	31.7
Net domestic bank financing	0.0	21.3
Previously withheld clearance revenue GOI	0.0	5.6
Palestine Investment Fund advances	0.0	17.5
Net change in arrears	0.0	-19.0

Source: Ministry of Finance.

38. The financial sector in the West Bank and Gaza remains fundamentally healthy. According to the PMA and the IMF, the share of non-performing loans continue to decline and reached 8.3 percent at end-June, down from 10.4 percent at the beginning of the year. Despite a 30 percent growth in credit to the private sector during the past year, lending from commercial banks in the West Bank and Gaza continues to be low by international standards: credit to the private sector amounts to approximately 28 percent of GDP, significantly lower than the regional average, and less than half the level of Jordan. At 74 percent of GDP, private sector deposits also remain high (in Jordan, the deposit/GDP ratio is around 47 percent). Financial sector trends underscore the growth in the Palestinian economy in 2005; the average value of cleared checks, for example,

increased by 27 percent during the first 10 months of 2005 compared to the monthly average in 2004.

#### IV – Labor Market Trends

39. The past year saw a total of 44,400 new labor market entrants, while 64,000 new jobs were created<sup>35</sup>. As a result, the number of unemployed dropped by 20,000, and the economic dependency ratio declined from 6.6 to 5.8<sup>36</sup> (**Table 3**). Almost all new jobs are categorized as full-time paid employment (as opposed to part-time employment or employment as an “unpaid family workers”, which have featured prominently in some earlier periods of the 2003-5 stabilization and recovery process)<sup>37</sup>. In contrast to 2004, significant job creation took place in Gaza, where jobs increased by 21,000 (14 percent) during the first nine months of 2005 compared to the same period last year<sup>38</sup>. 29,000 jobs were created in the West Bank (up 8 percent compared to a year earlier); in addition, West Bank workers benefited from an increase of 14,000 in the number of jobs in ISI. By contrast, the already minuscule number of Gazans working in Israel declined to c. 1,000 (against 2,000 in 2004).

**Table 3: Labor Market Developments**

In thousand	2000	2001	2002	2003	2004	2005
Working-aged population	1,676	1,744	1,811	1,881	1,955	2,021
Labor Force Participation Rate	41.5%	38.6%	38.1%	40.4%	40.5%	40.9%
Labor force	695	675	690	758	790	826
Employment	596	505	474	565	578	633
West Bank	334	310	296	343	370	392
Gaza	145	125	128	166	157	177
Israel and settlements	116	70	49	54	50	64
Unemployment	100	170	216	194	212	193
Unemployment rate	14.3%	25.2%	31.3%	25.6%	26.9%	23.4%
Dependency ratio	5.4	6.5	7.2	6.2	6.6	5.9

Source: World Bank staff calculations based on PCBS. Note: All employment figures were revised recently based on a new sampling methodology adopted by PCBS. All data are year-averages; 2005 is the average of first three quarters.

40. The construction and transport sectors exhibited the highest growth rates among all sectors (25 percent and 18 percent, respectively), and contributed about one-third of the jobs created. This would seem to reflect a steady growth in residential and commercial investment, as well as an expansion in both internal and external trade. For 2005 as a whole, the Bank projects a 9 percent growth in domestic employment and an 8 percent growth in labor flows to Israel.

## 3 – Economic Recovery: Preconditions and Prospects

41. One year after the AHLC endorsed the program of actions laid out in *Stagnation or Revival?* (**Annex 3**), the picture is mixed. There has been progress in some key areas, but stasis or slippage in others, and it would be premature to suggest that enough of the elements needed for rapid recovery are in place. Nonetheless, the worst fears of some observers have not been realized, and a healthy recovery *is* still feasible. For this to happen, though, both GOI and the PA will need to do more over the coming year to support the development process than they did in 2005.

### I – Movement and Access

#### Diplomatic Initiatives

42. As the Bank argued in December 2004, closure needs to be seen as a package: “Recovery depends above all on a comprehensive Israeli approach to lifting closure. If GOI addresses only some components of the closure system, the impact of such initiatives will be muted by other remaining constraints. Economic life cannot recover if people and goods cannot move between cities and towns within the West Bank. If a truck carrying export goods from Hebron to Ashdod Port is delayed for an unpredictable periods of time en route to Tarkumiya, and is then subject to back-to-back unloading procedures, improved terminal layout and screening equipment will not make an appreciable difference. If goods produced in Ramallah cannot be transported through Israel to Gaza without long delays and multiple inspections, the feasibility of an otherwise attractive Gaza container port will be in doubt”<sup>39</sup>.

43. Jim Wolfensohn was appointed Quartet Special Envoy for Disengagement in May 2005, and on June 20, 2005 he articulated his “6 + 3” agenda in a letter to Prime Minister Sharon and President Abbas. The first four topics of this agenda deal with the restoration of Palestinian movement (border crossings and trade corridors, connecting Gaza with the West Bank, movement in the West Bank, Rafah and the Gaza air and sea ports). This led to protracted trilateral negotiations<sup>40</sup>. Formal trilaterals began on August 4, 2005 and continued up to the time of Secretary of State Rice’s visit of November 14--15, 2005, at which point the *Agreement on Borders and Access* was concluded.

44. The *Agreement* was forged under pressure and will not implement itself; the deadlines are demanding and will require a high degree of cooperation between the parties in a political environment in which elections are imminent on both sides of the Green Line. Already Israeli officials have pointed out that failure to implement a satisfactory screening process at Rafah could result in the unilateral Israeli cancellation of the customs envelope arrangements in Gaza, which form part of the *Agreement*<sup>41</sup>—while the suicide attack in Netanya on December 5, 2005 has been followed by threats to close the Gaza crossings and/or abrogate the customs envelope for Gaza<sup>42</sup>, as well as by a delay in the negotiations on convoys that may result in missing the deadline of December 15 for the inception of bus convoys. The importance and profile given to closure, however, has intensified over the past year, and a number of international bodies are now monitoring its various aspects—the Bank will continue to assess the overall economic impact of the closure regime, OCHA is monitoring internal movement restrictions in the West Bank and the Quartet Special Envoy’s Office is tracking the implementation of the

*Agreement* (**Annex 4**). The US, by taking ownership of the *Agreement*, is now involving itself on a day-to-day basis in ensuring that the parties live up to their obligations.

### **Border Passages between Israel and the West Bank & Gaza**

45. **Developments in 2005.** All Palestinian trade flows to or through Israel: for the small trade-dependent Palestinian economy, therefore, the smooth operation of the bilateral passages between Gaza, the West Bank and Israel is essential. Trade data comparing the first quarter of 2004 with the first quarter of 2005 shows a significant increase in Palestinian exports to Israel of 20 percent. Imports, by contrast, have remained flat during the same period.

46. As noted in paragraphs 29-31, though, the Palestinian economy continues to operate at well below its potential, and also well below current levels of (depressed) demand for the passages. The Bank estimates that current productive capacity in the Gaza economy will support c. 150 truckloads of exports per day (the *Agreement* commits the parties to processing 150 export trucks per day by December 31, 2005, plus any agricultural produce over and above this figure)<sup>43</sup>. Karni, the only current export terminal, processed an average of 43 trucks per day in the six months preceding disengagement, 18 per day in September and October, and 44 per day since the signing of the *Agreement*<sup>44</sup>.

47. **The Negotiations and the *Agreement*.** The section of the *Agreement* dealing with the Israeli/Palestinian passages captures in abbreviated form a year and a half of detailed negotiations<sup>45</sup>. The *Agreement* has the potential to transform border management—from a unilateral, security-based model to one which is cooperatively managed and seeks a sustainable balance between security and economics. The key elements of the *Agreement* are

- *The ‘continuous operation’ concept*—Israel has indicated that it will not close a passage unless there is a direct threat to that passage, and that in such instances traffic would be diverted to a designated alternative passage. It also follows that GOI would not close passages as part of a general response to incidents of violence. Adherence to this principle would re-introduce a crucial element of predictability into passage operations.
- *Capacity will adapt to demand, not vice-versa*—this is embodied in the parties’ agreement to adopt market-based service standards for each passage (initially numbers of trucks per day, shifting to ‘time-per-truck’ standards).
- *The adoption of a common cargo management system*, featuring close security cooperation, coordinated operational management and transparency in terminal operations (to include published procedures, fees and service standards and regular public reports on performance).
- *The abolition of today’s inefficient back-to-back cargo system*, using the modern x-ray technology now under procurement by USAID to scan intact cargoes (which for the most part would be transported in a palletized form on trailers or in containers).
- *The creation of an independent unified Palestinian Border Terminals and Ports Authority* as a counterpart to Israel’s Crossing Points Administration.

48. The parties should be congratulated for committing themselves to an approach which seeks to normalize commerce across borders where security threats remain a palpable reality<sup>46</sup>. Developing the basic *Agreement* into a series of sub-agreements for each

passage, and implementing the new strategy on a consistent basis will require greater openness and flexibility from each party, however, along with sustained stamina by the US and those supporting its efforts<sup>47</sup>.

### Internal Movement

#### *Gaza*

49. Israel's disengagement from Gaza was completed earlier than envisaged, with the settlements, military installations and the Philadelphi Corridor (the border with Egypt) all evacuated by September 12, 2005. Full internal movement has been restored to Gaza (**Map 1**).

#### *The West Bank*

50. **The Northern West Bank.** Israel no longer maintains a permanent military presence in the northern West Bank, and as **Map 2** shows, there are relatively few fixed obstacles in the area north of the checkpoint at Shave Shomron and west of the Jordan Valley. The key issue in this area is one of ambiguous authority. In December 2004 the Bank recommended that the vacated West Bank areas be redesignated Area A, giving the PA full security and civilian control. No new decision on the status of the area has been announced, leaving legal and administrative uncertainty which will, unless addressed, inhibit orderly development and deter investors<sup>48</sup>.

51. **Movement Throughout the West Bank.** Restrictions on the movement of people and goods within the West Bank emerged with the *intifada*<sup>49</sup> and with concomitant attacks on settlers and into Israel from the West Bank. These restrictions have evolved by stages into a complex system which acts as a drag anchor on Palestinian economic recovery: the Bank estimates that internal closures accounted for approximately half of the decline in real GDP (perhaps some 15 percent) observed between 2000 and 2002. Obstacles to Palestinian movement include fixed impediments (checkpoints, roadblocks, earth mounds/walls/trenches, gates, fences and the separation barrier itself), 'flying' checkpoints, movement and residence permits, curfews, restricted roads and back-to-back cargo platforms. These measures have increased costs<sup>50</sup>, impaired business predictability and fragmented economic space into small, inefficient enclaves; they also interfere with governance and the maintenance of law and order and disrupt access to schooling and health care. Area C is the only contiguous area in the West Bank, and Israeli movement restrictions in Area C prevent the movement of Palestinians between the urban areas of Areas A and B<sup>51</sup>.

- *Fixed impediments*—The number of fixed impediments was significantly reduced from 680 in November 2004 to 376 by August 2005<sup>52</sup>, i.e. by 45 percent. Most of the reduction is accounted for by the removal of 224 unmanned obstacles (earth structures and roadblocks). The total number of physical impediments increased slightly after disengagement: in November 2005 a total of 396 were counted by OCHA. Manned checkpoints constitute the most serious form of physical impediment to economic activity, and their number has remained relatively constant— 62 in November 2004, 52 in August 2005 and 55 in November 2005.
- *Flying checkpoints*—These are hard to monitor, and their impact is also difficult to assess. The average number of flying checkpoints per week identified by OCHA in the West Bank rose from 40 in mid-May to 57 by mid-August.

- *Permits*—Since January 2002 traders, bus and taxi companies and private travelers have been obliged to hold internal travel permits for various purposes<sup>53</sup>. The permit regime is complex and poorly understood, and the application process can be time-consuming and costly—as a result of which “the vast majority of Palestinians have reduced long-distance journeys to a minimum”<sup>54</sup>, and use communal taxis and buses (which often entails several changes of vehicle). Travel in private cars is almost all restricted to local areas<sup>55</sup>.
- *Restricted roads*—The Bank’s December 2004 report cited B’Tselem’s August 2004 research, which identified a considerable proportion of West Bank roads as subject to various degrees of restriction on Palestinians, in large part to protect settler movement inside the West Bank<sup>56</sup>. Currently OCHA estimates that about 1,200 kilometers of road are in some way restricted to Palestinians<sup>57</sup>.
- *Back-to-back platforms*—Several back-to-back cargo platforms operate inside the West Bank, including Betuniya, outside Ramallah and integrated into the separation barrier, and Awarta outside Nablus. These add significantly to transport costs and spoilage.
- *The Separation Barrier*—The Barrier is expected to be completed in 2006. At that point it is expected that some 10 percent of the land in the West Bank, including East Jerusalem, will lie between the barrier and the 1967 border. The newly planned route, mainly as a result of decisions by the Israeli Supreme Court, adheres more closely to the Green Line than previous alignments did, and reduces the amount of land located west of the Barrier in the “seam zone”. Roughly 49,400 Palestinians in 38 villages and towns would reside in the seam zone; in addition, an estimated 61,000 Palestinian East Jerusalem residents will need to cross the barrier to access the services they are entitled to. Approximately 500,000 Palestinians live within 1 km of the barrier and are to some extent impacted by it due to the footprint it creates across property and the disruptive effect it has on local economic and social integration. In December 2004, the Bank estimated that the barrier would depress overall Palestinian GNI potential by some 3-5 percent per annum.

52. **Future Developments and the *Agreement*.** The reduction of fixed obstacles is very welcome, and has resulted in easier movement between villages and between villages and urban centers. The overall economic impact of the reductions is limited, though, by the persistence of other aspects of the system—in particular the manner in which permits and checkpoints restrict access to and along the transport routes between the main towns and the Israeli border. Nor is it certain how much further the process of fixed obstacle reduction will proceed. An examination of **Map 2** reveals an emergent pattern of protection. As the separation barrier is completed, it can be assumed that threats to Israel will no longer constitute the core rationale for internal closure (any more than it does in fenced-off Gaza), leaving the protection of Israeli movement in the West Bank as the key factor<sup>58</sup>. Given this, and the continued expansion of settlements in the West Bank<sup>59</sup>, an early return to the September 28, 2000 *status quo* in the West Bank would seem unlikely.

53. The *Agreement* indicates that “the ongoing work between Israel and the US to establish an agreed list of obstacles to movement and develop a plan to reduce them to the maximum extent possible will be accelerated so that the work can be completed by December 31”. If “obstacles” are interpreted to include the gamut of restrictions described above, this approach could have a significant socio-economic impact. Actions likely to have the most beneficial effect on the Palestinian economy include a) the removal of key checkpoints<sup>60</sup>; b) reducing/eliminating internal vehicle permits; c)

promoting free truck movement along key commercial corridors; d) removing the internal back-to-back platforms; e) improving access to isolated rural areas<sup>61</sup>; and f) easing access to tightly restricted areas, in particular the Jordan Valley, the seam zone and East Jerusalem<sup>62</sup>. The PA's position on such an approach is ambivalent—it recognizes the social and economic value of such mitigation measures, but is concerned that a dialogue of this kind between donors and GOI could be construed as acceptance of the legality of settlements<sup>63</sup>.

### **Connecting Gaza and the West Bank**

54. **Developments in 2005.** The economic and social connections between Gaza and the West Bank have been largely severed since the beginning of the *intifada*; apart from permits given to a limited number of businessmen, very few West Bank residents are able to visit Gaza, and vice-versa<sup>64</sup>. Cargoes transiting between one part of the Territory and the other are subject to two back-to-back procedures and long delays, particularly at Karni, rendering Palestinian products non-competitive with imports from Israel<sup>65</sup>. As a result, merchandise flows are minimal<sup>66</sup>. In December 2004, the Bank pointed out that “an unfettered flow of people and goods between Gaza and the West Bank is needed to link the two territorial elements of the Palestinian economy, and to lay the basis for viable statehood. A functioning link would create a larger effective internal market, help trigger price and income convergence between Gaza and the West Bank (by directing factors of production more efficiently), and provide a pathway from the economy of the West Bank to a future seaport in Gaza”<sup>67</sup>. GOI agrees on the need for a functioning connection and has proposed a rail link—initially from Shar Efraim/Tulkarem to Erez, and latterly from Tarkumiya to Erez. The Bank has favored a road connection on grounds of operational costs and flexibility. In October 2005, GOI agreed to support a USAID-financed options study which is comparing the technical and economic merits of a sunken road, a dedicated railway and a tunnel. The study will be completed in early 2006 and will form the basis for bilateral negotiations on a ‘permanent’ link.

55. **The Agreement.** The Quartet Special Envoy has promoted the reintroduction of escorted convoys. The Bank and the Envoy's Office elaborated this concept, proposing a sequence beginning with escorted bus convoys, and moving to convoys of Palestinian trucks (and eventually to passenger vehicles)<sup>68</sup>. Under the *Agreement*, bus convoys are to be introduced by December 15, 2005 and truck convoys by January 15, 2006. Israel would provide security for the convoys. Implementation of this aspect of the *Agreement* should have immediate psychological, political and governance benefits, as well as laying the basis for a less distorted economic relationship between the two parts of the Palestinian Territory and the Israeli market.

### **Direct Access from Gaza to Third Countries**

56. For both political and economic reasons, the Palestinians need to develop direct connections with the outside world. This in turn requires Israel to relinquish control of Palestinian land, sea and air borders, a major issue for Israel in today's security environment. In 2004 the international community proposed, as an interim confidence-building measure, that a mutually-acceptable third party be invited to oversee security at the Gaza port and airport once Israel had withdrawn from Gaza. Prior to the Quartet Special Envoy's mission, though, many believed this suggestion was a ‘bridge too far’ for Israel. The Bank's December 2004 report implied this—“For Israel, third party

involvement in matters pertaining to Israeli security would break new ground and requires further consideration”.

57. **Rafah.** The Rafah Passage has in the past been limited to people and, for the most part, to suitcase goods. The *Agreement*, reflecting intensive prior negotiations carried out by Quartet Special Envoy and the US and EU representatives in his Office, provides for

- *Palestinian control*—For the first time, a Palestinian land border will be controlled on its side by the PA, with Israel agreeing to limit its own role to remote security monitoring using video and data receipts.
- *A third party presence*— Israel has agreed to the involvement of a third party, in this case the EU, in an oversight and monitoring role. The third party has the authority to ensure that the PA complies with the *Agreement*, and in cases of non-compliance can order the detention and re-examination by the PA of passenger, luggage, vehicle or goods.
- *Exports and imports*—Goods can be exported direct from Rafah to Egypt; imports will for 12 months be routed through the Israeli-managed passage at Kerem Shalom, after which the third party will assess PA customs capacity with a view to moving the import function to Rafah provided the PA is judged capable of managing it.
- *Maintenance of the quasi-Customs Union in Gaza*—The Agreement stipulates that the provisions of the Paris Protocol of April 29, 1994 will remain in force. This has been a major goal in donor diplomacy over the past year, since GOI indicated on November 14, 2004 that “if and when Israel withdraws from the Philadelphi Corridor, it will not be possible to maintain the customs union with Gaza (though it will continue to apply in the West Bank)”<sup>69</sup>

58. From an economic point of view, the Rafah agreement offers the opportunity to break Israel’s *de facto* trade-route monopoly, and to offer alternative ways of trading with third countries (better allowing the PA to benefit from existing arrangements with the EU, US, EFTA, Canada and others). Whether this alternative will be realized depends on agreeing the necessary protocols and logistical arrangements for Palestinian access to El-Arish (in Egypt) and beyond. It is recommended that the donors explore what they can do to support and facilitate such a process.

59. **The Gaza Port and Airport.** The acceptance of a third party role in Rafah also paves the way to open and operate the Gaza ports. The *Agreement* indicates that construction of the *Gaza seaport* can get underway, that GOI will not “interfere with operation of the port” and that the Rafah third party model will be applicable. The Bank has advised that the port should be developed in a modular fashion, beginning with a Ro-Ro facility, in order to accelerate its opening (possible this way within two years), and to avoid over-sizing the port before there is a better sense of likely demand. The EU is examining this option. The *Agreement* did not manage to deliver a precise agreement on the *Gaza airport* (“discussions will continue on the issues of security arrangements, construction, and operation”); this is unfortunate, since the airport could be put into operation in a few months and could be used to export agricultural products as well as facilitate the travel of investors to and out of Gaza.

**Labor Access**

60. Jobs for Palestinians in ISI rose by 27 percent in the first nine months of 2005, compared with the same period in 2004, with average daily labor flows of about 64,000<sup>70</sup>. The number of Palestinians working in ISI with and without a permit has declined significantly since 2000—the former by c. 50 percent, the latter by c. 64 percent. The number of workers with a Jerusalem ID has remained roughly constant. As a result, today's jobs in ISI represent only 44 per cent of the pre-*intifada* numbers (c. 146,000 per day in 2000).

61. Labor access has not featured in the Quartet Special Envoy's "6+3" agenda, nor was it covered under the *Agreement*. Nonetheless it remains an important transitional issue for the Palestinian economy. Those working in Israel still represent about 10 percent of employed Palestinians, and contributed 12 percent to Palestinian incomes in 2004<sup>71</sup>. Put another way, an additional 10,000 workers in ISI would add approximately US\$120 million to the Palestinian economy, or roughly 2.5 percent to GNI.

62. GOI's stated intention is to stop issuing work permits to Palestinians by the end of 2007. As noted in the Bank's December 2004 report, "Few economists would dispute the wisdom of moving away from a dependency on labor exports to Israel to a growth-path based on the export of goods and services to Israel and to other countries....Managing this structural transition, though, will be key....It will take time for the Palestinian economy to develop a genuine competitive edge. During this period priority must be given to preserving employment. Phasing out permits would result in a loss of 9,000 of today's jobs—but in addition, most of the approximately 20,000 illegal workers crossing the Green Line each day would lose their jobs [once] the Separation Barrier is completed....This amounts to a net loss of nearly 30,000 jobs by the end of [2007]".

63. In discussion with the Bank in late 2004, GOI indicated that in the near-term Israel would issue 15,000 permits to Gazans and 20,000 to West Bankers. This understanding was reconfirmed to the Bank in February 2005. With Palestinian economic stability a shared objective, GOI is urged to materialize this commitment as well as to prolong Palestinian labor access beyond the end of 2007, a period too short for the desired structural transformation of the Palestinian economy. In so doing, Israel would cushion the shock that completion of the Separation Barrier will otherwise cause to the Palestinian labor market, while replacing illegal labor with an equivalent quantity of permitted—hence safer—laborers. It is worth noting that the new terminal at Erez has been dimensioned to handle 15,000 persons per day, and could be expanded to accommodate double this number. This offers hope for a change in GOI's current position (the average number of laborers transiting Erez each day has been only about 1,000 in 2005).

**II – Palestinian Governance****Overview**

64. Governance reform has been a central plank of PA policy since the establishment in mid-2002 of a Ministerial Committee for Reform and the publication of its *100 Days Reform Plan*<sup>72</sup>. The new President came to power underlining his commitment to good governance, and at the London Meeting on Supporting the Palestinian Authority on March 1, the PA published a *Declaration of Institutional Renewal*<sup>73</sup>. This analysis of

Palestinian governance reviews the implementation of the *Declaration* alongside progress in the key reform areas identified in the Bank's December 2004 report and *Indicators Matrix* (**Annex 2**)<sup>74</sup>.

65. An appraisal of the elements of the *Declaration* shows that the PA has implemented a number of its commitments, and is acting on a number of others; the highlights include progress on democratization, the passage of an important *Judicial Authority Law*, the strengthening of internal auditing and public procurement reforms, strong revenue performance, the passage of a *Law on Illicit Earnings* and the successful takeover of the Gush Katif greenhouses. For all this, however, actions in other areas have been delayed and certain earlier problematic trends have been intensified: efforts to reform the security services have been accompanied by a deterioration in internal law and order; undisciplined PA spending policies have precipitated a fiscal crisis that can no longer be contained without painful corrective action; a proactive anti-corruption campaign has yet to be launched; and the future approach to developing the vacated settlement lands remains unclear.

66. In 2003, the Bank wrote that “internal pressure was a decisive element in the inception of reform in 2002....the Palestinian public has for a long time voiced its criticism of the PA's performance; concerns have focused in particular on financial corruption in the PA, but have also encompassed nepotistic practices, a restrictive environment for the private sector and inefficiency in the provision of basic services”<sup>75</sup>. After the election it will fall to a new government to carry forward the vital business of institutional renewal with conviction. Given the political risks that already confront investors in this economy, a sense of PA dynamism and commitment to good governance is essential to attract the private capital needed to generate sustainable growth.

67. Although PA performance has in many ways been disappointing, there are mitigating circumstances. First, the process of disengagement inevitably preoccupied the leadership. Second, the fact of occupation means that the PA is unable to exercise a normal span of control over activities for which it is nonetheless held accountable. Third, donors have not been as focused as they should have been (see paragraph 87), and have tended to reinforce piece-meal approaches to issues. And fourth, the PA has faced a serious internal challenge from armed groups that hold considerable local power, and often abuse it.

### **Democratization**

68. The January 2005 Presidential elections were judged by international observers as free and fair, although difficulties related to the use of the civil register were noted, and concern was expressed about external interference in Central Election Commission actions and decisions on election day<sup>76</sup>. Despite some slippages, local elections are being rolled out progressively throughout the West Bank and Gaza and are once again being seen as valid, notwithstanding certain local disputes<sup>77</sup>. A Presidential decree calls for Palestinian Legislative Council elections on January 25, 2006<sup>78</sup>, and the *Basic Law* and the *Electoral Law* have been amended to allow for the expansion of the Palestinian Legislative Council (PLC) from 88 to 132 members. The democratic process is on track; this is a major achievement.

## Law and Order

69. It is beyond the scope of this paper to analyze the bilateral security situation, but there is a clear interconnection between Palestinian security performance and the maintenance of internal law and order. In early 2005, the US appointed General William Ward as US Security Coordinator to assist in the long-overdue Palestinian security reform process. The PA confirmed at the London Meeting its commitment to “restoring internal law and order and preventing violence” by addressing deficiencies in the legal framework governing the security services, and by continuing the process of consolidating and unifying the security services into three main branches under the Ministry of the Interior.

70. The unification of the security services has in a literal sense been carried out. This, however, has not addressed the roots problems. The Palestinian security services remain divided and largely ineffective, while civilian authority over the various branches is weak. The sector is overstaffed for its mandate, poorly trained and badly equipped, and now faces the challenge of integrating former members from militant groups into its infrastructure. The security component of the wage bill has grown excessively, by 80 percent between 1999 and 2004 and by another 35 percent as a result of this year’s salary increases. A comprehensive program of restructuring, downsizing and reform is needed, and will need serious donor technical and financial support.

71. Under pressure from armed groups, and hampered in the West Bank by mobility restrictions and Israel’s ongoing prohibition on bearing arms, the security services are widely perceived as ineffective, with recent polls showing that citizens have become increasingly concerned about their personal safety<sup>79</sup>. The year has featured a number of anarchic episodes<sup>80</sup>, prompting a PLC investigative committee headed by the Deputy Speaker to report in October that the PA had not managed to impose order on armed Palestinian militias or gangs<sup>81</sup>. Cognizant of this situation, the PA has initiated a number of actions in recent weeks to improve internal security in the West Bank.

72. The new government will face difficult choices: the pressure to continue hiring and for further increase salaries is unlikely to abate, but technical and fiscal logic will require moves in the direction of downsizing and wage containment. A *Basic Law on Security* should be ready for presentation to the new PLC shortly after the election as a legal basis for the reform process; meanwhile, work on a *White Paper on Security Policy* began in November 2005. The Paper should be completed by mid-2006 and is expected to delineate the roles, missions and functions of the security services, as well as identify the reform strategy’s financial requirements.

## Legal and Judicial Reform

73. On March 14, 2005 a Steering Committee for the Development of the Judiciary was formed. The Committee subsequently drafted the long-anticipated *Judicial Authority Law*. In October, the President ratified the law, which clarifies the mandates of the Ministry of Justice, the Supreme Judicial Council, and the Office of the Attorney General, as well as providing criteria for the appointment and promotion of judges and reorganizing the Supreme Judicial Council. The law was immediately ruled unconstitutional by a committee of five judges from the Palestinian Supreme Court; the Steering Committee and the Minister of Justice are currently working on a solution to this set-back—which may require drafting amendments to the law to address the issues raised.

74. Assuming that the issues surrounding the *Judicial Authority Law* can be resolved soon, the process of judicial capacity-building must be intensified. This involves comprehensive programs to upgrade the professional capabilities of the Supreme Judicial Council, the judiciary and the Ministry of Justice, as well as to establish the Constitutional, Administrative and Labor Courts, develop the Judicial Training Institute, and create a professional cadre of public prosecutors. With public and business confidence in the judicial system at low levels, these are key tasks that will demand well-coordinated and sustained donor support for a number of years.

### Financial and Fiscal Management

75. **Financial Control.** Significant progress was made in establishing a modern system of financial controls in the 2002-4 period<sup>82</sup>. The PA's *Declaration* points to the need to continue this process with the establishment of sound internal and external audit systems. Progress on internal auditing has been satisfactory, and the expenditure management and control systems in the line ministries are being strengthened with the help of Ministry of Finance staff. On July 31, 2005, the Financial and Administrative Audit Bureau was established by President Abbas, replacing the General Control Institute. However, the recruitment of the management of new audit institution has still not been completed. A strong, independent external audit function is an essential and missing piece of the PA's financial architecture. Until it is firmly established, the PA's financial accounts are being audited by a private audit firm, as one of the benchmarks of the Bank-administered Public Financial Management Reform Trust Fund (the Reform Fund).

76. **Procurement Reform.** Progress has been made in this area. Since 2004, when the Department of Supplies and Tenders in the Ministry of Finance assumed full jurisdiction over all purchases made by PA ministries and agencies, detailed reports on all public procurements have been posted periodically on the Ministry of Finance website. In November 2005 the PA finalized the draft of a solid *Public Procurement Law*, together with its associated regulations. The draft law will now be reviewed by non-PA stakeholders and it is expected to be submitted to the PLC by mid-2006.

77. **Revenue Management and Spending Control.** The PA's revenue performance continues to be strong, with the revenue-to-GDP ratio expected to exceed 25 percent in 2005<sup>83</sup>. Expenditure management, however, has lapsed badly this year. The *Declaration* commits the PA to "tight control over the civil service wage in the 2005 budget". Wages, however, have risen sharply in recent months (see paragraph 36). Combined with the unexpected increase in unpaid municipal electricity bills to the Israeli supplier<sup>84</sup> and other forms of municipal transfer, this is likely to increase 2005 expenditures by an estimated US\$250 million over what was originally budgeted. It has also led to a breach of the Wage Bill Containment Plan, a core plank of the Reform Fund. This and other important benchmark shortcomings (for instance, the failure to adopt a medium-term Fiscal Stabilization Plan, the delay in appointing the management of the new external audit institution and the inadequate pensions laws, see paragraphs 79) have led the Bank to consider delaying the release of the November 1 tranche until serious corrective action is taken<sup>85</sup>.

78. Looking ahead, the PA faces an unfinancable fiscal deficit in 2006. One of the first priorities for the new government will be tackling the budget crisis. In preparation for this, the IMF and the Bank have helped the PA to draft a *Medium-Term Fiscal Stabilization Plan* (FSP) that freezes wages and employment and sharply reduces net

lending<sup>86</sup>. Adoption of the FSP would place the PA on an orderly fiscal footing, particularly if associated with significant retrenchment from the public service. For the FSP to succeed, however, the PA's implementation of its Reform Fund commitments will need to improve, while donors will have to provide the additional financing required to implement the adjustment program.

79. **Pension Reform.** Reform of the public sector pension systems has been a PA priority for several years, on account of the large fiscal liabilities associated with existing arrangements. PA pension fund obligations have in recent years been left unpaid in favor of monthly salary payments, and the PA is currently over US\$200 million in arrears to the Gaza Pension Corporation. In January 2005 a new *Security Services Pension Law* was approved, providing pension coverage to all security personnel 45 years and above. While the law provides a mechanism for enforcing security service retirement, its provisions are over-generous<sup>87</sup> and financially unsustainable<sup>88</sup>. A *Unified Pension Law*, covering all civil servants and those security services employees under 45, came into force in May 2005. This law also sets financial parameters (benefit and contribution levels) that are unrealistic<sup>89</sup>, while the governance of the new Palestinian Pensions Agency does not guarantee full protection of public pension assets. Several legislative amendments will be needed before the PA can claim to have a sustainable public pensions system in place.

### **Corruption**

80. In its *Declaration of Institutional Renewal*, the PA recognized the need to improve transparency and combat corruption; steps are also needed to address other forms, such as nepotism and conflicts of interest. Polls suggest that the majority of citizens feel the PA is corrupt to some degree; however the question is phrased, over four-fifths of respondents consistently express this opinion<sup>90</sup>. The PA has taken some actions to combat corruption but these do not yet counter the damaging public perception. An important step was taken with the passage of a new *Law on Illicit Earnings* in February 2005. The law charges a Commissioner with collecting information on the assets of public servants and investigating complaints of corruption against them. The first Commissioner has been appointed, but adequate resources have yet to be provided to him to begin serious work. At the same time, a number of investigations of prominent PA officials have been initiated recently.

81. In discussions with the Bank, some senior PA officials have taken the position that the public lacks adequate information on the PA's achievements to date, pointing to the poor general understanding of the achievements made in fiscal transparency, and citing the Bank's 2004 *Country Financial Accountability Assessment* as external corroboration of this.

### **Public Administration and Civil Service Reform**

82. Some steps have been taken to improve the internal organization of PA ministries by developing new structures and ministerial development plans, although the legal foundations of these changes are weak (the existing *Civil Service Law* requires modification). Much remains to be done to strengthen Cabinet processes, introduce merit-based recruitment and promotion policies, and upgrade human resource information systems.

## The Takeover, Management and Development of the Evacuated Assets

83. **Takeover.** The PA's performance in handling the vacated settlements and residual assets will likely be seen by Palestinians and the international community as a barometer of the PA's intentions and abilities. In February 2005 the PA established a Ministerial Committee on Withdrawals, supported by a Technical Committee of more than 30 PA entities. In August, President Abbas signed a decree to put in place temporary protective measures and establish PA authority over these areas; the PLC has still not passed legislation to determine how the evacuated areas will be used. On the eve of the IDF's withdrawal, the PA decided not to restrict access to the sites, acknowledging the inability of the security services to control the anticipated crowds. In the event, the withdrawal itself was completed quickly, efficiently and without violence—a credit to the good sense and on-the-spot military coordination of both sides on the day itself<sup>91</sup>. The takeover process was somewhat chaotic, however. Although PA security forces entered most settlements before the general public, looting and scavenging followed once the public gained access, including some looting of the greenhouses purchased for the Palestinians with the Quartet Special Envoy and others<sup>92</sup>. The Technical Committee's takeover plans thereby proved largely redundant; PA preparations for/implementation of the takeover were also hindered by GOI delays in handing over details of what would remain behind.

84. **Management.** UNDP, financed by GOI, is expected to begin removing the Gaza settlement rubble in February 2006, and to complete this work in about eight months; crushing the rubble to be recycled in Gaza would take another year<sup>93</sup>. Work in the Gush Katif greenhouses is going well, under the management of the special-purpose Palestine Economic Development Company. About 2,200 dunums of vegetables have been planted, and this season's harvest is expected to yield gross revenues of about US\$25 million—a windfall to the Palestinian economy, provided that the produce is properly evacuated through Karni as stipulated in the *Agreement on Movement and Access*. PA entities have also been rehabilitating some public infrastructure in the evacuated areas in Gaza, including water and electricity facilities and lines, and supply arrangements have been made with the Israel Electric Company and Mekorot (water).

85. **Use of the Evacuated Areas.** There are two major concerns relating to the evacuated areas, and neither has yet been dealt with properly. First, there are a number of reports of illegal occupation and use of the areas. The PA needs to rectify cases in which public land in Gaza has been seized illegally before and after disengagement; until now, this has only been done sporadically. Such acts can be expected to continue, though, until a clear and transparent process for disposing of the land has been put in place. Second, there is no policy in place for the development of the evacuated areas. Several ministries have come up with proposals, but these have not been brought together under a consistent planning framework.

### III – Growth Prospects and the Role of the Donors

We are doing well [on increasing foreign aid], with donors signaling a clear commitment to bring significant new sums of money. However, the other....areas give me serious cause for concern. If we do not succeed in containing violence, restoring access and movement and stabilizing Palestinian society, the money will simply not flow. Both donors and private investors will give up, and take their money elsewhere.....Until the movement issues are resolved....and the PA is able to provide stable governance and to reassert civil control, we will be hard-pressed to convince governments or investors that anything much has changed, and that this is a bankable part of the world again. *James D. Wolfensohn, Letters of October 30, 2005 to Prime Minister Sharon and President Abbas, and to the Quartet Principals.*

86. **Donor Disbursements and Performance in 2005.** Donor disbursements are likely to total c. US\$1.1 billion, the highest annual level to date<sup>94</sup>; this reflects donors' wish to support the positive opportunity engendered by Israel's disengagement and the launching of Palestinian democratization.

87. Disbursements this year could have been higher, even given the difficult working environment<sup>95</sup>, had donors been better organized. In previous periods of crisis or opportunity, local donors have come together more effectively than they did in 2005. Two factors influenced this outcome. First, the decision at the London Meeting of March 1 to reform local aid coordination was followed by an unnecessarily long period of deliberation before agreement was reached on the proposed structure, creating a vacuum in aid management. Second, the Quartet Special Envoy's timely initiative in compiling a *Day After Program* of quick impact projects should have been complemented by a process that ensured coordination at the operational level. Now that the new aid management structures have been agreed, it is important that donors focus on supporting the new leadership role accorded to the PA, and ensure that coordinated implementation is given high priority in 2006.

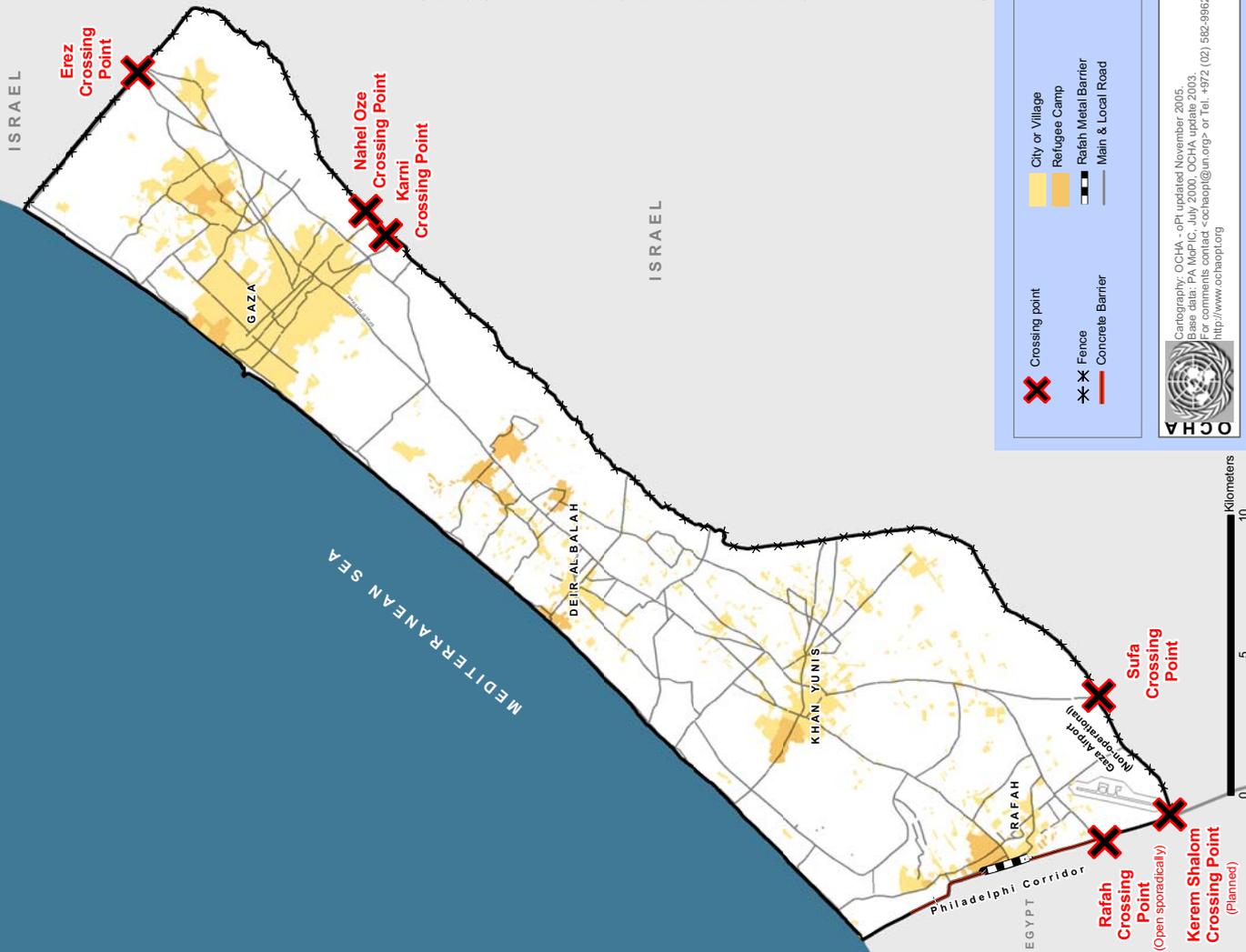
88. **Economic Strategy and Donor Disbursements in 2006-8.** High unemployment, particularly high youth unemployment, represents a major threat to political and social stability; it erodes self-esteem and breeds frustration, bitterness and anger, and should be the prime target of Palestinian economic policy. Tackling unemployment convincingly requires a combination of factors that will together spur Palestinian exports and move the economy away from excessive dependence on the Israeli economy. The most critical issue is the creation of a positive policy environment. In the Quartet Special Envoy's words, the 'right policies' are "an absence of violence, a rolling back of the restrictions on Palestinian movement [and] vigorous Palestinian governance reform". These are the essential prerequisites for any sustainable growth path. Of themselves, though, they are not enough. Bank projections (**Annex 1** and **Table 4**) show that a radical easing of closures and committed governance reform accompanied by aid levels similar to those of the past four years (the *Recovery, No Additional Assistance* scenario) will deliver sustained real GDP growth of about 5-6 percent per annum, enough to prevent unemployment from rising but—given annual labor force growth of over 4.5 percent—not enough to effect a rapid reduction.

89. If good policies are accompanied by an *additional* US\$0.5 billion in donor funds each year, however (the *Recovery, Additional Aid* scenario), this is likely to trigger high inflows of private investment from abroad and double-digit GDP growth. This in turn will bring unemployment down to about 13 percent of the workforce within three years.

The Bank's projections indicate that high levels of donor assistance in the *absence* of an improved policy environment (the *Status Quo, Additional Aid* scenario) would boost growth in 2006, but would not draw in major private capital and would not prevent unemployment from increasing. What is needed, therefore, is *a combination of all four factors*—a stable bilateral security environment, a significant easing of closure, the restoration of internal law and order plus a determined effort to bring the PA fiscal situation under control, and expanded aid flows.

# Gaza Post-Disengagement

September 2005



The United Nations employed and the presentation of material on this map do not imply the expression of any opinion whatsoever on the part of the Secretariat of the United Nations concerning the legal status of any country, territory, city or area or of its authorities, or concerning the delimitation of its frontiers or boundaries.

**Legend:**

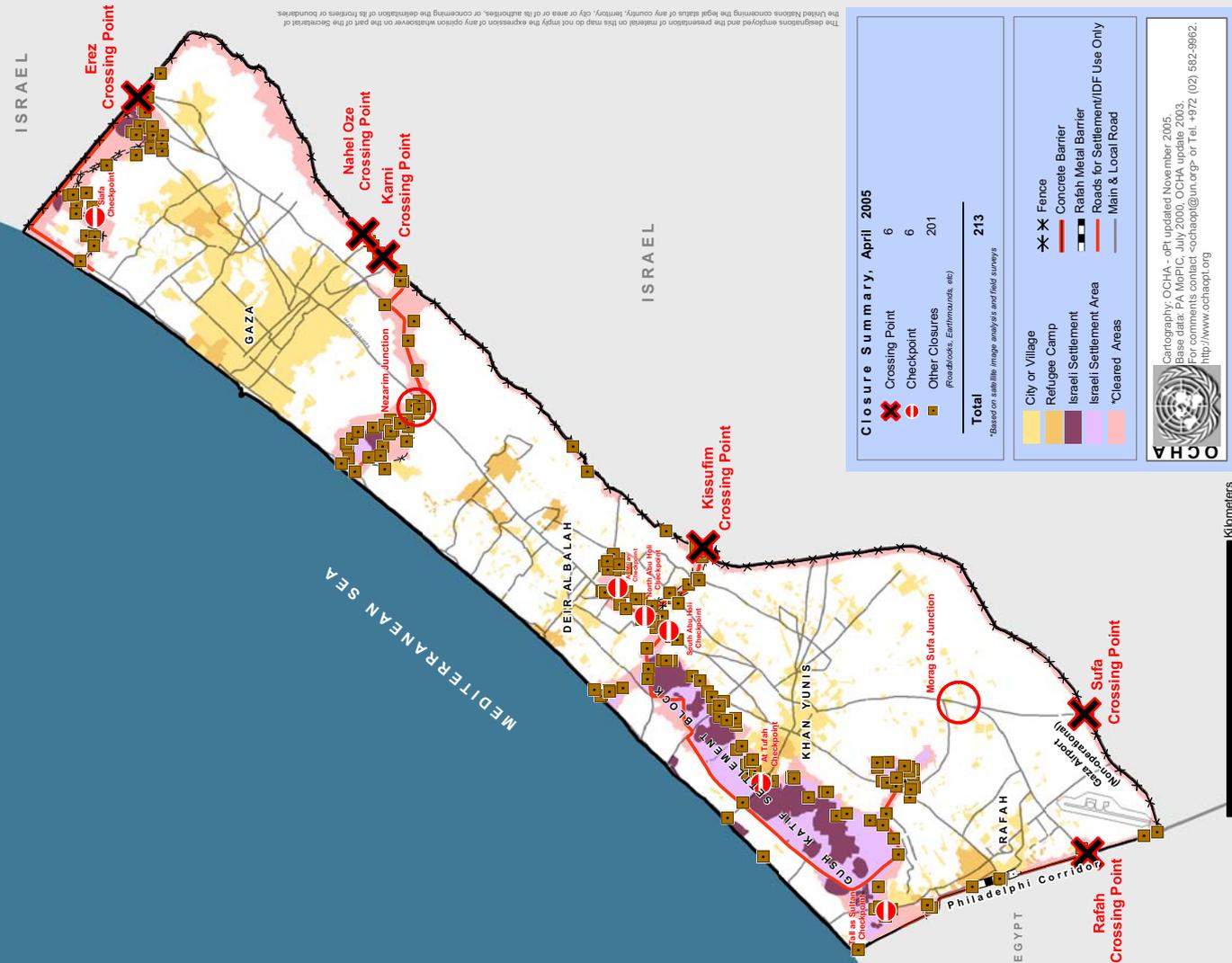
- Red X: Crossing point
- Black X: Fence
- Red line: Concrete Barrier
- Yellow square: City or Village
- Orange square: Refugee Camp
- Black dashed line: Rafah Metal Barrier
- Black solid line: Main & Local Road

**Scale:** 0, 5, 10 Kilometers

**Cartography:** OCHA - oPT updated November 2005.  
 Base data: PA MoPIC, July 2000, OCHA update 2003.  
 For comments contact <ochaopt@un.org> or Tel. +972 (02) 562-9962.  
<http://www.ochaopt.org>

# Gaza Pre-Disengagement

August 2005



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**Legend:**

- Red X: Crossing point
- Black X: Fence
- Red line: Concrete Barrier
- Black dashed line: Rafah Metal Barrier
- Black solid line: Roads for Settlement/IDF Use Only
- Yellow square: City or Village
- Orange square: Refugee Camp
- Purple square: Israeli Settlement
- Pink square: Israeli Settlement Area
- Light blue square: Cleared Areas
- Black solid line: Main & Local Road

**Scale:** 0, 5, 10 Kilometers

**Cartography:** OCHA - oPT updated November 2005.  
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# UN Office for the Coordination of Humanitarian Affairs West Bank Closures

August 2005

### CLOSURES

#### Checkpoints

- Permanent Checkpoint
- Partial Checkpoint

#### Other Closures

- Observation Tower
- Road Gate
- Roadblock
- Earth Mound
- Earth Wall
- Trench

#### Oslo Agreement

- AREA (A)<sup>1</sup>
- AREA (B)<sup>2</sup>
- AREA (C)<sup>3</sup>
- Nature Reserve
- Special Case (H2)<sup>4</sup>

1 Full Palestinian civil and military control  
2 Full Palestinian civil control and limited Israeli military control  
3 Full Israeli civil and military control  
4 Israel Agreement

### Barrier

- Completed
- Under construction
- Planned Barrier
- Road protection
- Special security arrangement area
- Route subject to completion of further inter-ministerial examination

**Planned Barrier** - path based on Israeli Government (Ministry of Defence - Seam Zone Authority) map, published 20 Feb. 2005 and IDF and security orders.  
**Barrier** - path extracted from satellite imagery and verified with field surveys as of July 2005.

### Barrier Gates

- Currently inaccessible for Palestinians
- Restricted access to Palestinians

63 Barrier gates have been observed by the UN, of these 25 are currently open to Palestinians with appropriate permits as of March 2005.

### Road Networks

- Prohibited Roads
- Restricted Roads
- Unrestricted roads (Main or Regional)
- Unrestricted Roads (Other roads)

### Prohibited Roads

Roads on which Israel prohibits Palestinian vehicle use.

### Restricted Roads

Roads with restrictions for Palestinian vehicle use.

### Unrestricted Roads

Free access for Palestinian travel.

### Residential Areas

- Palestinian Built-Up Area
- Israeli Settlement
- Israeli Built-Up Area

### Passages

- Planned Underpass / Bridge
- Existing Underpass / Bridge

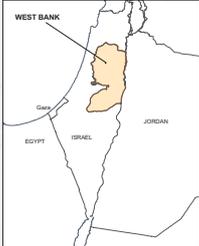
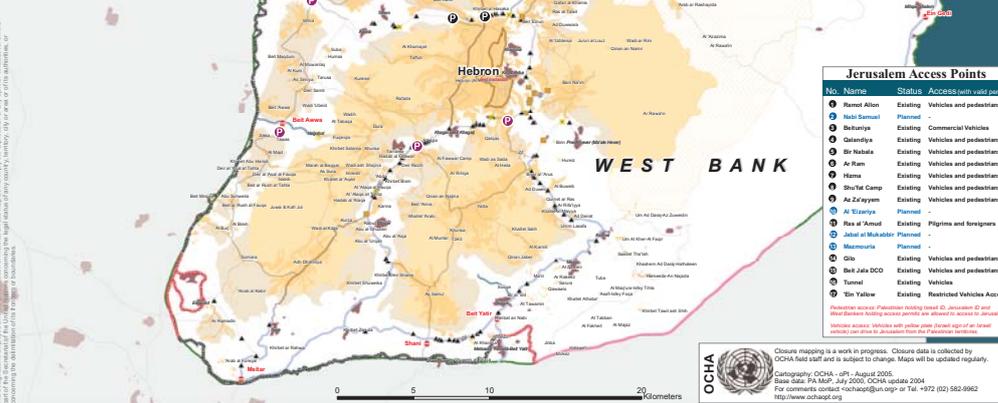


Governorate	Checkpoint	Partial Checkpoint	Roadblock	Road Gate	Earth Mound	Earth Wall	Trench	Total
Jenin	4	0	1	2	0	0	3	10
Tulkarm	2	0	0	0	10	0	0	12
Nabulus	8	1	3	4	36	0	5	57
Tubas	2	0	0	1	1	1	1	6
Salfit	3	0	2	2	3	1	1	12
Qalqilya	2	1	2	1	2	0	0	8
Jerusalem	8	0	6	1	19	0	0	34
Jericho	3	2	3	1	5	0	1	15
Ramallah	5	3	19	12	19	1	1	60
Bethlehem	9	0	2	4	15	0	0	30
Hebron	6	0	11	20	90	5	0	132
<b>Total</b>	<b>52</b>	<b>7</b>	<b>49</b>	<b>48</b>	<b>200</b>	<b>8</b>	<b>12</b>	<b>376</b>

\*The total number of observation towers is 45.  
\*\* Excluding closures in H2 area.

### Closures in Hebron - H2

Checkpoints	17
Inner city gates	7
Road blocks	9
Iron fences	29
Concrete road blocks	14
Iron gates	12
Barrels	13
Earthmounds	12
<b>Total of closures:</b>	<b>101</b>



### The West Bank Barrier:

A complex series of concrete walls, electronic fences, observation towers, trenches, patrol roads and razor wire, used to control Palestinian pedestrian and vehicular movement.



### Barrier Gate:

Allows restricted movement through the West Bank Barrier to Palestinian lands and to Israel. Permits are required for Palestinians to pass through a gate.

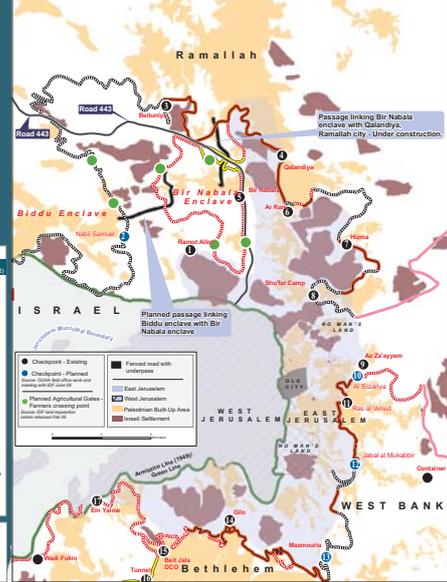


### Partial Checkpoint:

An established checkpoint operating periodically.



### Barrier and Checkpoints in and around East Jerusalem



### Jerusalem Access Points

No.	Name	Status	ACCESS (with valid permit)
1	Ramad Aton	Existing	Vehicles and pedestrians
2	Nash Sanaul	Planned	Vehicles and pedestrians
3	Beitanyia	Existing	Commercial Vehicles
4	Qalqilya	Existing	Vehicles and pedestrians
5	Shu'fat	Existing	Vehicles and pedestrians
6	Al-Sayyid	Existing	Vehicles and pedestrians
7	Al-Ram	Existing	Vehicles and pedestrians
8	Hama	Existing	Vehicles and pedestrians
9	Shu'fat Camp	Existing	Vehicles and pedestrians
10	Al-Sayyid	Existing	Vehicles and pedestrians
11	Al-Sayyid	Planned	Vehicles and pedestrians
12	Rax al-'Amud	Existing	Pilgrims and foreigners
13	Jabal al-Mukabbir	Planned	Vehicles and pedestrians
14	Magdala	Existing	Vehicles and pedestrians
15	Gilo	Existing	Vehicles and pedestrians
16	Beit Jala DCO	Existing	Vehicles and pedestrians
17	Tamul	Existing	Vehicles
18	Sh Yaffa	Existing	Restricted Vehicles Access

This map is based on OCHA's mapping of the West Bank and East Jerusalem. It is not intended to be a legal document. The UN does not take any position on the status of the West Bank and East Jerusalem. The UN does not take any position on the status of the West Bank and East Jerusalem. The UN does not take any position on the status of the West Bank and East Jerusalem.

## Annex 1 – Economic Scenarios

1. The Bank has developed four medium-term economic scenarios. To isolate the impact arising from a radical easing of closures and Palestinian reform from that of higher foreign developmental assistance, the Bank varied the scenarios for 2006-8 in the manner described in **Box 1**. These scenarios, it should be noted, are not *forecasts*, but aim to illustrate plausible outcomes under specific sets of assumptions.

<b>Box 1: Economic Scenarios</b> <b>Assumptions on Policy Reforms and Donor Assistance</b>	
<p><b>Status Quo.</b> The lifting of internal closures in Gaza and the northern West Bank, coupled with improved border management following the <i>Agreement on Movement and Access</i>, are assumed to lead to a moderate reduction in transaction costs. It is assumed that the Separation Barrier will be completed by mid-2006, which would largely eliminate clandestine Palestinian labor flows to Israel, and that labor permits to Israel would be cancelled by end-2007 (leaving only East Jerusalem ID holders and foreign nationals resident in the West Bank). It is further assumed that the PA is unable to make a serious dent in its fiscal deficit: a slight improvement in tax collection is envisaged, but the PA's inability to contain public sector wages and net lending to municipalities and to create a sustainable pension scheme would result in a persistently high deficit-to-GDP ratio. A certain degree of continuing internal instability is also assumed.</p>	<p><b>Recovery.</b> The lifting of internal closures in Gaza and a radical easing in the whole of the West Bank, coupled with a major improvement in border management, the establishment of a functioning convoy system between Gaza and the West Bank and the development of direct trade access to third countries would reduce transaction costs considerably. The decline in clandestine Palestinian labor flows to Israel following the completion of the Separation Barrier in 2006 would be compensated for by a higher number of labor permits, which would be sustained through 2008. On the fiscal front, further improvements in tax collection would be accompanied by the rigorous implementation of a Fiscal Stabilization Plan and a significant reduction in the public sector deficit. Bilateral security, internal law and order and the domestic business environment would all improve considerably.</p>
<p><b>No Additional Aid.</b> The donor community would progressively reduce its financial assistance from c. US\$1 billion in 2006 to US\$800 million in 2008 (against an estimated US\$1.05-1.1 billion in 2005). Budget support would decline, be it as a result of lower PA financing needs (<i>Recovery</i>) or donor unwillingness to finance a growing fiscal deficit (<i>Status Quo</i>). Donors would adjust the quantity of humanitarian assistance in line with the evolution of poverty.</p>	<p><b>With Additional Aid.</b> Donors would increase yearly disbursements to US\$1.45 billion on average over the period 2006-8. Budget support would decline, be it as a result of lower PA financing needs (<i>Recovery</i>) or donor unwillingness to finance a growing fiscal deficit (<i>Status Quo</i>). Donors would adjust the quantity of humanitarian assistance in line with the evolution of poverty.</p>

2. The scenarios highlight the vital role played by appropriate policies in achieving sustained growth and a rapid reduction in unemployment. The scenarios suggest that under the *Status Quo*, *No Additional Aid* scenario, the Palestinian economy would stagnate in the medium-term, with continued movement constraints and declining labor flows to Israel curbing economic activity and growth. Significant amounts of additional assistance under such circumstances (*Status Quo*, *Additional Aid*) would exert little economic leverage, since much of the increment would finance additional consumption, which would in turn result in higher imports and added inflationary pressures. As a result,

economic recovery would be short-lived; the initial real GDP growth of c.10 percent would fade rapidly since it would not be sustained by any major boost in private investment.

3. A radical easing of closures underpinned by the development of trade infrastructure and vigorous PA governance reforms would lay the foundation for an economic recovery. Achieving this, however, would require a major additional infusion of donor funds. With savings drained to finance consumption, local Palestinian public and private investment capacity is no longer able to capitalize on a new, improved investment environment. Under *Recovery, No Additional Aid*, real GDP growth would likely hover around 5-6 percent. The *Recovery, Additional Aid* scenario suggests that an additional c. US\$500 million per annum in aid (when compared with the annual average for 2001-5) could boost real GDP growth to about 10 percent per annum in 2006-8<sup>96</sup>. This would be sufficient to bring unemployment down to pre-*intifada* levels by 2008 or 2009.

**Table 4: Economic Scenarios**

	2005	A – Status Quo, No Additional Aid			B – Status Quo, With Additional Aid			C – Recovery, No Additional Aid			D – Recovery, With Additional Aid		
		2006	2007	2008	2006	2007	2008	2006	2007	2008	2006	2007	2008
Real GDP growth (%)	8.7	3.3	1.6	0.0	10.3	2.9	0.1	4.6	5.3	6.1	13.1	8.2	8.8
Real GDP p.c. change since 1999	-29%	-29%	-30%	-33%	-24%	-25%	-27%	-28%	-27%	-25%	-22%	-19%	-15%
Population (million)	3.5	3.6	3.8	3.9	3.6	3.8	3.9	3.6	3.8	3.9	3.6	3.8	3.9
GNI per capita, US\$	1,327	1,274	1,253	1,189	1,354	1,291	1,200	1,290	1,285	1,287	1,447	1,509	1,583
Consumer price inflation (%)	3.0	3.5	2.0	2.0	5.0	5.0	4.0	3.5	3.0	2.5	4.0	4.0	4.0
Unemployment rate (%)	22.4	24.2	26.7	30.4	21.0	22.2	25.3	22.8	21.9	20.3	17.1	15.2	12.9
Poverty rate (%)	42.9	43.0	44.2	46.8	37.8	38.3	40.9	42.3	40.7	38.6	35.9	32.5	29.3
Palestinian workers in ISI	46,000	28,656	23,536	12,394	28,656	23,536	12,394	46,000	46,000	46,000	46,000	46,000	46,000
Foreign public assistance (US\$m)	1,100	989	935	818	1,446	1,489	1,402	989	935	818	1,446	1,489	1,402

Source: World Bank staff calculations. Figures exclude East Jerusalem. Figures are expressed in US\$ million unless otherwise specified.

## Annex 2 – Indicators of Economic Revival

Ref	Action Area	Progress Report as of November 2005
<b>Closure</b>		
<b>Internal Movement Restrictions</b>		
C 1.1	Removal of checkpoints and barriers in Gaza and the West Bank; opening of existing internal access routes between West Bank cities and regions and to the borders; easing movement into and out of East Jerusalem	Full internal movement was restored in Gaza on September 12, 2005 when the Israeli withdrawal was completed. Since the IDF withdrew from the four settlements in the northern West Bank, GOI does not have a military presence there. However, the evacuated areas are still Area C and thus under full Israeli military and civilian control. The number of fixed impediments in the West Bank decreased from 680 in November 2004 to 376 by August 2005, but increased to 396 by November. The number of manned checkpoints remained fairly constant, with 55 in November 2005, but flying checkpoints increased from 40 in mid-May to 57 by mid-August. The permit regime continues to be enforced at certain checkpoints, for vehicles and for residents of the seam zone. The latest OCHA estimate suggests that 1,200 km of road are variously restricted to Palestinians. The <i>Agreement on Movement and Access</i> describes ongoing work to establish an agreed list of ‘obstacles’ and develop a plan to reduce them to the maximum extent possible by December 31, 2005. OCHA has identified five sets of checkpoints whose removal would have a significant impact on mobility; other priorities would include reducing/eliminating internal vehicle permits, promoting free truck movement along key commercial corridors, improving access to isolated rural areas, and easing access to tightly restricted areas---in particular the Jordan Valley, the seam zone and East Jerusalem.
C 1.2	Separation Barrier	A revised trajectory approved was approved in February 2005 totaling about 690 kilometers. The Barrier is expected to be completed in 2006, after which c. 10 percent of the land in the West Bank would be in the seam zone. Close to 50,000 Palestinians will be living in the seam zone; in addition to 61,000 East Jerusalem residents who will need to cross the barrier to access services. The Bank has estimated that the Barrier may reduce potential GNI by 3-5%.
<b>Border and Trade Logistics</b>		
C 2.1	Adoption of a bilaterally-managed system of border passages and facilities	The <i>Agreement</i> calls for the adoption by both parties of a common passages management system for the Palestinian/Israeli passages on the borders of Gaza and the West Bank; much of this has been negotiated already, and would include the continuous operation of passages (specifically mentioned in the <i>Agreement</i> ---meaning no closure of a passage unless that passage is threatened, and the use of back-up passages in the event of a closure), the adoption and publication of common operating procedures at each passage, agreement on throughput service standards and their transparent monitoring at each passage, a mechanism to resolve disputes and the introduction and appropriate use of new x-ray technologies in order to dispense with today’s inefficient back-to-back cargo handling system (specifically mentioned in the <i>Agreement</i> ---the modern x-ray technology now under procurement by USAID would be used to scan intact cargoes, which for the most part would be transported in a palletized form on trailers or in containers). The capacity of the passages would also be adjusted to meet market demand to the extent feasible: thus in the case of Karni, the <i>Agreement</i> provides for a daily export truck total of 150 by December 31, 2005

Ref	Action Area	Progress Report as of November 2005
		(Karni has processed an average of 44 export per day since the signing of the <i>Agreement</i> ); this is estimated to be the current productive capacity of the Gaza economy. USAID is working on procuring the scanner that will enable this target to be met. No closures have been reported at Karni since the signing of the <i>Agreement</i> . On November 25, 2005 the Rafah crossing opened for Palestinian ID holders under PA management with third party monitoring by the EU.
C 2.2	Development of a Trade Logistics Project	A number of initiatives are underway. USAID is procuring modern x-ray technology to scan intact cargoes, and is financing related infrastructure at the crossings in Gaza. The PA Cabinet approved the establishment of a Palestinian Authority for Borders and Crossings (PABC) on November 29, 2005. Canada is prepared to provide border services experts along with financing to establish and train the PABC. The EU is considering the provision of equipment, infrastructure and technical support for the crossings, while the Bank will offer continued analytical and advisory support to GOI and the PA. The EU is providing Third Party assistance at Rafah, and USAID has provided security equipment.
<b>Connecting Gaza and the West Bank</b>		
C 3.1	Short-term—improve Gaza-West Bank road access	GOI agrees on the need for a functioning connection. Per the <i>Agreement</i> , the operation of bus convoys for people is expected to take effect on December 15, and of truck convoys on January 15, 2006. However, GOI suspended talks on bus convoys after the suicide bombing in Netanya on December 5 and the deadline is in question.
C 3.2	Longer-term—development of ‘second generation’ Gaza-West Bank transport links	GOI agrees on the need for a functioning connection and has proposed a rail link. USAID, with Bank involvement, is financing a feasibility study of road, rail and tunnel options for a permanent link between Gaza and the West Bank. The analysis is expected to be completed in early 2006.
<b>Direct Access to Third Countries</b>		
C 4.1	Develop the Gaza seaport	In the <i>Agreement</i> the parties have agreed that a Gaza seaport will be built. The EU is examining the option of beginning with a Roll-On, Roll-Off facility. Construction can commence at once, and GOI has committed to not interfering with the operation of the port.
C 4.2	Develop Gaza air links	The <i>Agreement</i> stipulates that discussions will begin between the two parties on reestablishing the Gaza airport, but no dates have been agreed yet.
<b>Facilitating Work of Donor and Aid Agencies</b>		
C 5	Ensure access to and throughout the West Bank and Gaza for donor employees and humanitarian/project supplies	There is little visible change in GOI facilitation. Access conditions at Erez remain problematic and clearance requirements for entry have been tightened. The donor community has made repeated requests for any new security measures to take into consideration movement requirements in delivering humanitarian aid. In part due to internal disorder and instances of kidnap, in August 2005 UNRWA declared a Security Phase IV for Gaza, leading to the evacuation of all non-essential personnel
<b>Investor Access</b>		
C 6	Permit Israeli and foreign investors to enter industrial zones, provide adequate	Israeli citizens/investors are still prohibited from visiting areas under PA security control, including the Erez Industrial Estate post-disengagement. Israeli owners removed assets from the Erez Industrial Estate before the IDF withdrawal; it is now partially derelict, but new foreign investors from Turkey and/or the US are anticipated. No

Ref	Action Area	Progress Report as of November 2005
	protection	agreement has yet been reached on moving goods into and out of the Erez Industrial Estate, however. The special lane at Karni for handling goods from the Gaza Industrial Estate remains non-operational and access difficulties continue to hamper the development of the facility.
<b>Reform</b>		
<b>Democratization</b>		
R 1	Hold free and fair PLC elections in 2005; complete program of rolling local elections throughout the West Bank and Gaza in 2005	Mr. Mahmoud Abbas won a Presidential election on January 9, 2005 that was considered free and fair. A transitional cabinet was approved in February 2005. PLC elections will be held on January 25, 2006 (they were originally planned for July 2005). Municipal elections are being carried out throughout the West Bank and Gaza. The Basic Law and the Electoral Law have been amended to allow for the expansion of the PLC from 88 to 132 members.
<b>Legal and Judicial Reform</b>		
R 2.1	Define and develop legal and judicial functions	On March 14, 2005, a Steering Committee for the Development of the Judiciary was established. A new <i>Judicial Authority Law</i> was drafted by the PLC and signed into law by the President in October 2005. The Law provides clarity on a number of critical issues. However, the Supreme Court issued a decision in December 2005 calling into question the constitutionality of some of the provisions of the new Law, which might now require legislative amendments.
R 2.2	Professionalize public legal and judicial services	The Supreme Judicial Council and the Ministry of Justice committed to preparing action plans for professionalizing legal and judicial services prior to 2005. These actions plans were to define the structures, priorities and resources and staffing needs. To date, neither entity has finalized its plan, which would also be needed to guide donor assistance.
R 2.3	Establish civilian jurisdiction over the security services	In early 2005, the US appointed General William Ward as Security Coordinator, to assist in the long-overdue Palestinian security reform process. The unification of the security services into three branches under the Ministry of the Interior was mandated by Presidential Decree in July 2005, but functional civilian control remains inconsistent. A <i>Basic Law on Security</i> should be ready for presentation to the new PLC shortly after the election as a legal basis for much-needed security reform. Work on a <i>White Paper on Security Policy</i> began in November 2005. The Paper should be completed by mid-2006 and is expected to delineate the roles, missions and functions of the security services, as well as identifying the reform strategy's financial requirements.
R 2.4	Develop a coordinated donor sector support program	Several new legal and judicial support activities have been announced by a range of donors, addressing areas such as improvement of prisons, construction of courthouse, monitoring of legal institutions, judicial training and commercial law reform, and support to the public prosecution. However, greater ownership, participation and coordination by the PA is necessary, as is greater functional coordination among donors.

Ref	Action Area	Progress Report as of November 2005
<b>Fiscal Management</b>		
R 3.1	Contain public recurrent expenditure in 2005	The <i>2005 Budget Law</i> was approved in March 2005. As of July, salary increases have been implemented for public employees. During the first three quarters of 2005, net lending was more than double the budgeted amount. The fiscal situation has become untenable. No action has so far been taken by the PA to redress the imbalance in the wage bill, despite a proposal from the Ministry of Finance to retrench up to 13,000 personnel before year's end.
R 3.2	Meet agreed Reform Fund benchmarks (PA), finance 2005 external budget gap (donors)	The last tranche of the Reform Fund was released in August 2005 upon fulfillment by the PA of the mid-2004 benchmarks. Several end-2005 benchmarks have not yet been met, including most importantly the containment of the PA's wage bill; other shortfalls include the adoption of a medium-term Fiscal Stabilization Plan, and the appointment of the management of the new external audit institution. This puts in doubt the rapid disbursement of the current tranche. The Reform Fund has disbursed around US\$130 million in 2005 so far, with the release of another US\$60 million still pending. Overall, external budget support for 2005 is projected at around US\$360 million, which is far short of the unexpectedly high fiscal deficit of US\$760 million.
R 3.3	Enact a sustainable package of pension, social security and social safety net reforms	The <i>Security Services Pension Law</i> of January 2005 provides very generous and financially unsustainable payments to security services personnel 45 and over. The <i>Unified Pension Law</i> passed in May 2005 will cover all employees of the PA including civil servants and security services under 45 years. However, the law as written is financially unsustainable and provides insufficient protection of financial assets. Legislative amendments will be needed before a sustainable and well-governed public pensions system is in place.
R.3.4	Develop Fiscal Stabilization Plan	The IMF and the Bank have helped the PA draft a <i>Fiscal Stabilization Plan</i> . The current draft foresees a degree of public sector service retrenchment, a net hiring freeze on civil servants, no further wage increases over the medium-term and a sharp reduction in net lending. The adoption and rigorous implementation of the Plan would place the PA on an orderly fiscal footing in the medium-term but would require additional donor financial support.
<b>Transparency and Accountability</b>		
R 4.1	Publicize financial control measures taken since 2002	Progress on internal auditing has been satisfactory: the expenditure management and control systems in the line ministries are being strengthened with the help of Ministry of Finance staff, an Internal Audit Committee is being established, and the new Financial Regulations have been published. However, the PA has not publicized such improvements in a strategic manner.
R 4.2	Develop proactive anti-corruption strategy	A new <i>Law on Illicit Earnings</i> has been ratified, and the PA has expressed interest in the development of a comprehensive anti-corruption strategy. A number of investigations of prominent PA officials have been initiated recently. However, more concerted active steps are needed to combat corruption, and to counter damaging public perceptions.
R 4.3	Develop public audit capacity	On July 31, 2005, the Financial and Administrative Audit Bureau was established by President Abbas, replacing the General Control Institute. The recruitment of the management of the new institution has still not been completed. Until the institution is firmly established, the PA's financial accounts will be audited by a private audit firm; this is one of the benchmarks under the Reform Fund. The PA's 2004 financial statements have not yet been submitted to the PLC, and completion of the audit of the 2003 financial statements is not expected before the end of 2005.

Ref	Action Area	Progress Report as of November 2005
R 4.4	Review and enhance transparency of public procurement	Since 2004, when the Department of Supplies and Tenders in the Ministry of Finance assumed full jurisdiction over all purchases made by PA ministries and agencies, detailed reports on all public procurements are posted periodically on the Ministry of Finance website. Furthermore, the PA finalized a draft <i>Public Procurement Law</i> in November 2005, together with the associated regulations. The draft should now be reviewed by non-PA stakeholders and should be submitted to the PLC by mid-2006.
<b>Disengagement and Beyond</b>		
<b>Disengagement</b>		
D 1.1	Ensure an orderly transfer, management and disposal (TMD) of settlement assets	The PA established several committees but the PLC has not yet approved a law pertaining to the development of the evacuated areas; President Abbas signed a decree in August to put in place temporary protective measures. The withdrawal itself was completed quickly, efficiently and without violence but the takeover process was somewhat chaotic. The PA's takeover plans proved largely redundant; PA work was also hindered by GOI delays in handing over details of what would remain behind. Clearing of the rubble in Gaza by UNDP (financed by GOI) is expected to commence in early 2006, and work on the greenhouses is going well. Two major concerns have not yet been dealt with in a satisfactory way---first, the establishment of a clear and transparent process for the disposal of public land; and second, the development and enactment of a policy for the rational and comprehensive development of the evacuated areas.
D 1.2	Clarify the legal status of areas in the northern West Bank from which Israel disengages	GOI has not agreed to transfer the status of evacuated settlements in the northern West Bank to Area A or B. They remain Area C and thus under full Israeli military and civilian control. This complicates PA management and development of the assets considerably.
<b>Palestinian Labor Access</b>		
D 2	Improve, regularize access by Palestinian labor to Israel	Jobs for Palestinians in Israel and the Israeli settlements rose by 27 percent in the first nine months of 2005, compared with the same period in 2004, with average daily labor flows of about 64,000. This still represents only 44 per cent of the pre- <i>intifada</i> numbers. After disengagement, the number of workers in ISI dropped by around 20,000. GOI's stated intention is still to stop issuing work permits to Palestinians by the end of 2007. However, the new terminal at Erez has been dimensioned to handle 15,000 persons per day, and could be expanded to accommodate double this number (in 2005, only c. 1,000 per day have been crossing Erez for work). This offers hope of a change in GOI's position on labor flows to Israel.

Ref	Action Area	Progress Report as of November 2005
<b>The Quasi Customs Union and Paris Protocol</b>		
D 3.1	Upgrade PA customs capabilities, integrate PA/Israeli customs data, reintroduce PA customs function at international terminals	The Cabinet approved the Palestinian Authority for Borders and Crossings on November 29, 2005. The Authority will be responsible for security, financial, managerial and trade aspects of border services at access and crossing points, the seaport and the airport. It will be headed by a person of ministerial rank and report to the Prime Minister. Its early establishment is critical to the development of a strong Palestinian capacity to protect and manage the border crossings. The EU and UNCTAD are also working with the PA on rolling out the ASYCUDA system.
D 3.2	Improve implementation of Paris Protocol with emphasis on capturing lost revenues and full implementation of third country trade agreements	The EU established a trilateral ad hoc working group with the PA and GOI to help resolve outstanding issues related to the implementation of the quasi-Customs Union, and the Palestinian free trade agreements with Europe. At the group's second meeting in November, GOI and the PA confirmed the maintenance of the customs envelop. Israel and the PA also agreed to examine new mechanisms to enhance cooperation on customs, standards and investment promotion and to discuss the issue of tax leakage in this forum. Israel remains committed to the principle of final destination as laid down in the Paris Protocol. GOI and the PA indicated agreement to the reactivation of the Joint Economic Committee as established by the Paris Protocol. The parties will work towards a ministerial declaration to lay down the agreements reached so far. However, GOI has recently indicated that the quasi-Customs Union could be abrogated if it feels the PA does not control the movement of people through Rafah.
D 3.3	Establish arbitration commission envisaged under Paris Protocol	Within the framework of the trilateral ad hoc working group, the Palestinians indicated that the predictability and reliability of economic relations between the PA and any other trading partner would be safeguarded by an efficient and credible dispute settlement mechanism. GOI has indicated that there was no need for a dispute settlement mechanism to be added to the Joint Economic Committee. The EC has agreed to share its experiences with the parties on different modalities of dispute settlement, including arbitration, conciliation and mediation.

## Annex 3 – “Turning the Corner”

From Chapter 6 of the Overview of *Stagnation or Revival* (World Bank, December 2004)

### I. Additional Measures Will Make the Difference

101. **As the “Disengagement Plus” Scenario shows, the basis for vibrant economic recovery does not yet exist.**

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

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

104. **To accelerate the dismantling of internal closures in the West Bank, the PA will need to demonstrate strong and sustained commitment to security reform.** If a vigorous PA effort to enforce law and order further reduces the frequency of attacks on Israelis<sup>97</sup>, the case for maintaining today’s complex and invasive set of restrictions will no longer resonate.

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

106. **The following paragraphs summarize key measures which, if implemented, will lay the basis for the economic revival of the West Bank and Gaza.** The Bank hopes that these measures, which derive from an intensive process of donor analysis and interaction with both the parties, will be of assistance to them in individual and joint deliberations over the coming months.

➤ **The Government of Israel***Borders and Trade Logistics*

- ❑ **In light of PA and donor objections to their location inside the West Bank, it is recommended that all West Bank border terminals be located on the 1949 Armistice (Green) Line.**
- ❑ **The back-to-back system should be rapidly abolished.** A new approach should be tested, as a matter of urgency, in two locations (Karni and Jalame). These pilot projects should feature terminal infrastructure upgrades, the introduction of security technology, the adoption of terminal service standards, the introduction of risk-management systems and the development of a commercial recourse mechanism. The pilots should be jointly designed by GOI and the PA, with strong involvement by Palestinian and Israeli businessmen. Needed investments by both parties (infrastructure, equipment and technical services) could be financed by the donor community. Assessment of the progress of the pilot can be contracted out to experts acceptable to both parties. If successful, the program could be generalized out to all border terminals. It is important that these pilots be launched immediately; they can reach full development as and when new infrastructure and equipment become available.
- ❑ **Israel should permit the construction of a RoRo terminal in Gaza as the first stage of a full-service harbor; in addition, air services should be restored.** Israel's legitimate security concerns must be catered to if these projects are to proceed, and GOI and the PA are both urged to consider the use of third-party security oversight under the sponsorship of a country or an institution in which they both have confidence.
- ❑ **A secure, efficient and reliable Gaza – West Bank transport link should be re-established.** The parties hold strongly divergent views on this issue. From an economic perspective, without prejudice to legal and political arguments, a quick, reliable and cheap flow of people and goods between the two parts of the Territories is needed to promote economic efficiency and good government – and technical solutions that can ensure this without undue risk are available (see paragraph 53 and **Technical Paper I**). This is an issue which the two parties need deal with face-to-face. They should take as their point of departure the logic of the Interim Agreement – “The two sides view the West Bank and Gaza as a single territorial unit, the integrity and status of which will be preserved during the interim period”<sup>98</sup>.

*Internal Movement in the West Bank*

- ❑ **The system of over 700 checkpoints and barriers in the West Bank should be re-evaluated, and progressively dismantled.**
- ❑ **Those areas of the West Bank from which Israel withdraws should be redesignated as Area A.** This would constitute GOI recognition of the nature of the jurisdiction that the PA will then exercise.

*Labor*

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

*The quasi-Customs Union*

- **Current trade, tariff and customs procedures should be maintained in both Gaza and the West Bank until re-negotiated by the two sides.** The current arrangements should not be abrogated unilaterally. Nor should GOI treat Gaza and the West Bank differently in terms of the qCU. Doing so would cause serious damage to the Palestinian economy, compromising both revenues and trade. The Bank believes that Israel's customs interests can be protected with a combination of international management expertise, Palestinian customs capacity building and IMF monitoring.
- **The emphasis in the coming period should instead be on improving the implementation of the Paris Protocol,** with a particular emphasis on capturing the revenues lost to the PA due to untaxed indirect imports.

*Other Issues*

- **GOI should provide to the PA detailed information on the assets it intends to leave behind in the settlements,** to enable the PA's planning process to go forward, and as a first step in initiating technical contact between the two sides on this issue.
- **GOI needs to pay more serious attention to facilitating the work of the donor and aid agencies.** The conditions facing the aid community on the ground, and in particular humanitarian agencies and their contractors have continued to deteriorate in 2004, as the Task Force on Project Implementation (TFPI)'s submission to the AHLC describes. This is at odds with the commitment in the Disengagement Plan that Israel will "coordinate with the international organizations the arrangements that will make [their] activity easier." As things stand, donors have no functional point of coordination with GOI, and for the past two months have been virtually denied access to Gaza. The TFPI has suspended its regular meetings with COGAT due to this channel's ineffectiveness. This impasse makes no sense at a time when Israel is seeking international support for the Disengagement Plan.
- **GOI needs to play its part in facilitating Palestinian reform.** Above all in the coming months, this will involve enabling Palestinians to move freely within the West Bank to register and to vote in the presidential, parliamentary and local elections planned during 2005. In addition, GOI should continue to provide long-term permits to reformers, but should aim to accelerate what has proven to be a slow and uncertain process.

➤ **The Palestinian Authority***Security and the Rule of Law*

- ❑ **Security reform needs to be accorded top priority.** As the Bank’s June 23 report points out, “Easing internal closures throughout the West Bank must be accompanied by a credible Palestinian security effort; as long as Palestinian violence persist, the case for dismantling closures will be contestable”<sup>99</sup>.
- ❑ **A court system that delivers impartial justice within reasonable timeframes has to be developed without further delay.** The stand-off between the Supreme Judicial Council and the Ministry of Law and Justice should be resolved by amendments to the Judicial Authority Law. This would then open the way to a program of accelerated court development, such as the Judicial Training Institute project planned by the EC, and maximize the benefits of past projects funded by USAID and the World Bank.

### *Fiscal Management*

- ❑ **The PA needs to maintain control over recurrent spending.** The economic crisis of the past four years has brought chronic revenue starvation. Despite commendable domestic revenue performance, recurrent spending has increased excessively, leading to month-to-month crises which force the Minister of Finance to devote much of his energy to securing PA salary payments. The PA needs to freeze public sector wages and adhere rigorously to the Wage Bill Containment Plan.
- ❑ **The PA should make every effort to ensure that a sustainable Unified Pensions Law is quickly enacted.** Not only is this important in order to avoid an impending pensions crisis, but it will also enable the PA to carry out an appropriate downsizing of the public sector once the economy recovers and unemployment falls to more manageable levels.

### *Transparency and Accountability*

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

### *The Settlement Assets*

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

## **Annex 4 – Agreement on Movement and Access**

To promote peaceful economic development and improve the humanitarian situation on the ground, the following agreement has been reached. It represents the commitments of the Government of Israel (GoI) and the Palestinian Authority (PA). Its implementation and further elaboration will be assisted by the Quartet Special Envoy for Disengagement and his staff and/or the United States Security Coordinator (USSC) and his staff.

### **1. Rafah**

The parties have agreed to the attached statement of principles. Rafah will be opened as soon as it is ready to operate at an international standard in accordance with the specifications of this agreement and as soon as the 3<sup>rd</sup> party is on site, with a target date of November 25.

### **2. Crossing Points**

The parties have agreed that:

The passages will operate continuously. On an urgent basis, Israel will permit the export of all agricultural products from Gaza during this 2005 harvest season.

The new and additional scanner will be installed and fully operational by December 31. At that time, the number of export trucks per day to be processed through Karni will reach 150, and 400 by end-2006. A common management system will be adopted by both parties.

In addition to the number of trucks above, Israel will permit export of agricultural produce from Gaza and will facilitate its speedy exit and onward movement so that quality and freshness can be maintained. Israel will ensure the continued opportunity to export.

To enhance operation, the parties agree that:

- When a new generation of x-ray equipment able to scan trailers as well as containers becomes available it will be used. Once it arrives in the country, testing will also be carried out with the assistance of the Quartet Special Envoy.
- The USSC will ensure continuing consultation, with unresolved implementation issues to be discussed as needed with the parties.
- The PA will ensure that the passages will be protected on the Palestinian side of the border and will train and upgrade the management of all crossings to ensure efficiency and effectiveness. The PA will establish, without delay, a unified system of border management.
- The management system that has been developed for Karni should, with suitable local variations, be adapted to the passages at Erez and Kerem Shalom. Israel also undertakes to put in place similar arrangements as appropriate that will make West Bank passages fully operational as soon as possible. A bilateral committee, with participation as needed of the Quartet Special Envoy and/or the USSC, will develop operational procedures for those passages.

### **3. Link between Gaza and the West Bank**

Israel will allow the passage of convoys to facilitate the movements of goods and persons. Specifically:

- Establish bus convoys by December 15.
- Establish truck convoys by January 15.
- Work out detailed implementation arrangements in a bilateral committee of the GoI and PA with participation as needed from the Quartet team and the USSC.

It is understood that security is a prime and continuing concern for Israel and that appropriate arrangements to ensure security will be adopted.

### **4. Movement within the West Bank**

Consistent with Israel's security needs, to facilitate movement of people and goods within the West Bank and to minimize disruption to Palestinian lives, the ongoing work between Israel and the U.S. to establish an agreed list of obstacles to movement and develop a plan to reduce them to the maximum extent possible will be accelerated so that the work can be completed by December 31.

### **5. Gaza Seaport**

Construction of a seaport can commence. The GoI will undertake to assure donors that it will not interfere with operation of the port. The parties will establish a U.S.-led tripartite committee to develop security and other relevant arrangements for the port prior to its opening. The 3<sup>rd</sup> party model to be used at Rafah will provide the basis for this work.

### **6. Airport**

The parties agree on the importance of the airport. Discussions will continue on the issues of security arrangements, construction, and operation.

## Agreed Principles for Rafah Crossing

To be supplemented prior to opening by agreements on security, customs and 3<sup>rd</sup> party implementation procedures

### General

- Rafah will be operated by the Palestinian Authority on its side, and Egypt on its side, according to international standards, in accordance with Palestinian law and subject to the terms of this agreement.
- Rafah will be opened as soon as it is ready to operate at an international standard in accordance with the specifications of this agreement and as soon as the 3<sup>rd</sup> party is on site, with a target date of November 25.
- Use of the Rafah crossing will be restricted to Palestinian ID card holders and others by exception in agreed categories with prior notification to the GoI and approval of senior PA leadership.
  - The PA will notify the GoI 48 hours in advance of the crossing of a person in the excepted categories—diplomats, foreign investors, foreign representatives of recognized international organizations and humanitarian cases.
  - The GoI will respond within 24 hours with any objections and will include the reasons for the objections;
  - The PA will notify the GoI of their decision within 24 hours and will include the reasons for their decision;
  - The 3<sup>rd</sup> party will ensure the proper procedures are followed and will advise both sides of any information in its possession pertaining to the people applying to cross under these exceptions.
  - These procedures will remain in place for a period of 12 months, unless the 3<sup>rd</sup> party delivers a negative evaluation of the PA running the Rafah crossing. This evaluation will be done in close coordination with both sides and will give due consideration to the opinion of both sides.
- Rafah will also be used for export of goods to Egypt.
- Objective criteria for the inspection of cars will be established by consensus. The criteria are as follows:
  - Search equipment will be installed, including:
    - Black lights
    - Power tools and a compressor for the tools
    - Technology to be agreed, possibly including sonic imagery, gamma detection (full vehicle or hand held), and/or millimetre wave imagery
    - Mirrors and bore scope equipment to search hard to reach places
  - Personnel will be trained to search vehicles and on the use of this equipment by the 3<sup>rd</sup> party to international standards
  - Cameras will be installed to monitor the search process
- The 3<sup>rd</sup> party will evaluate the capacity of the PA to inspect cars according to these criteria and to international standards. Once the PA develops the capacity to inspect cars to the satisfaction of the 3<sup>rd</sup> party, cars will be allowed to pass through Rafah. Until that time, cars will pass through on an exceptional basis, subject to specifications agreed in the security protocol.
- Rafah will be the only crossing point between the Gaza Strip and Egypt (with the exception of Kerem Shalom for the agreed period).

- The PA will establish clear operating procedures.
- Until Rafah is operational, the PA will open Rafah crossing on an ad hoc basis for religious pilgrims, medical patients, and others, in coordination with General Gilad's office on the Israeli side.
- Israel will provide the PA with all information needed to update the Palestinian population registry, including all information on Palestinian ID card holders who are currently outside the country.
- A liaison office, led by the 3<sup>rd</sup> party, will receive real-time video and data feed of the activities at Rafah and will meet regularly to review implementation of this agreement, resolve any disputes arising from this agreement, and perform other tasks specified in this agreement.

#### Security

- The PA will act to prevent the movement of weapons and explosives at the Rafah crossing.
- The PA will establish baggage limits for each passenger as part of the procedures. Limits will be the same as currently applied by the GoI; very frequent travellers (suitcase policy) to be agreed.
  - Travellers, including returning residents, may use the crossing point to bring in personal effects as defined in Rule 1(e) to Heading 7 of the Annex to the prevailing Customs Tariff. Any other personal belongings or other goods shall be cleared at the Kerem Shalom crossing point.
- The PA will provide the 3<sup>rd</sup> party a list of names of the workers at Rafah crossing which will be shared with the Israelis. The PA will take the Israelis concerns into account.
- Security services from Israel, PA, the U.S., and Egypt will continue to coordinate on security issues and will participate in the security working group.
- On a case by case basis, the PA will consider information on persons of concern provided by the GoI. The PA will consult with the GoI and the 3<sup>rd</sup> party prior to the PA making a decision to prohibit travel or not. During this consultation, which will not take more than six hours, the person in question will not be permitted to cross.

#### Customs

- GoI and PA will continue to apply the Paris Protocol of 29 April 1994.
- Rafah will be operated according to international standards and rules and the Paris Protocol.
- GoI and PA agree on widest possible co-operation and information sharing.
- GoI and PA will co-operate on training issues.
- GoI and PA customs will hold regular meetings to which the GoE will be invited as appropriate.

#### Kerem Shalom

- PA customs officials will clear incoming cargo at Kerem Shalom under the supervision of Israeli customs agents.
- Both sides will discuss operating procedures at a later stage.
- Operations at Kerem Shalom will provide training and capacity building to PA customs staff.

- The 3<sup>rd</sup> party will review the PA's customs capacity in 12 months and make a recommendation to both sides for a joint decision regarding future arrangements. In the event of a disagreement, the U.S., in consultation with the GoI, the PA, and the 3<sup>rd</sup> party, will resolve the issue expeditiously.

Third Party

- The 3<sup>rd</sup> party will have the authority to ensure that the PA complies with all applicable rules and regulations concerning the Rafah crossing point and the terms of this agreement. In case of non-compliance the 3<sup>rd</sup> party has the authority to order the re-examination and reassessment of any passenger, luggage, vehicle or goods. While the request is being processed, the person, luggage, vehicle or cargo in question will not be allowed to leave the premises of the Rafah crossing point.
- The 3<sup>rd</sup> party will assist the PA to build capacity -- training, equipment and technical assistance -- on border management and customs.
- Details of the 3<sup>rd</sup> party's role are specified in the attached memorandum of understanding.
- The 3<sup>rd</sup> party will be the European Union.

## Endnotes

<sup>1</sup> *Stagnation or Revival? Israeli Disengagement and Palestinian Economic Prospects*, December 2004, World Bank (“The Bank’s December 2004 Report”).

<sup>2</sup> Letter to Prime Minister Sharon and President Abbas of October 30, 2005.

<sup>3</sup> Equivalent to 4.5-5.5 percent on a per capita basis.

<sup>4</sup> Measured in Gross National Income (GNI) per capita terms; GNI incorporates domestic value added and transfers from abroad, including via foreign assistance.

<sup>5</sup> The *Status Quo*, *Additional Aid* scenario assumes that border management will improve as a result of implementation of the Agreement on Movement and Access, but that the completion of the separation barrier will eliminate clandestine Palestinian labor flows to Israel and that labor permits to Israel will be cancelled by the end of 2007 in accordance with stated policy. It is also assumed that the PA is unable to make a serious dent in its fiscal deficit, and that continuing internal law and order problems dampen investor confidence. Donors nonetheless increase their annual disbursements from US\$970 million per annum (2001-5) to US\$1.45 billion per annum (2006-8), an increase of just under US\$500 million per annum. Real GDP growth would peak at 10 percent in 2006, but in the absence of a vigorous private sector response cannot be sustained, and falls back to 3 percent in 2007 before disappearing in 2008. Export growth tails off, falling from 14 percent in nominal terms in 2005 to 8 percent per annum in 2006-8; today’s nominal GNI per capita declines by 9 percent by 2008—and unemployment, after falling to 21 percent in 2006, rises to 25 percent by 2008.

<sup>6</sup> Which would grow by 28 percent per annum in nominal terms.

<sup>7</sup> Nominal GNI per capita increases from US\$1,327 to US\$1,583 per annum.

<sup>8</sup> Poverty, though, would persist at around 30 percent of the population, illustrating the long-term difficulty of dealing with the loss of assets that has taken place over the past five years.

<sup>9</sup> “Indications of good intent are not enough, and no longer resonate. Only actions will do, and of these I have not seen enough from either party.” Jim Wolfensohn, Letter to Prime Minister Sharon and President Abbas, October 30, 2005.

<sup>10</sup> The average number of fatalities per month during the fifth year of the intifada (October 2004 through September 2005) declined from 11 Israelis and 77 Palestinians per month in the fourth year to fewer than 5 Israelis and 35 Palestinians. In the second and most violent year of the intifada, an average of 36 Israelis and 88 Palestinians died each month. Source: *Intifada’s Fifth Year Saw Lowest Death Toll*, Ha’aretz, September 29, 2005, citing Israeli Defense Forces, Shin Bet, the Israeli Foreign Ministry, B’Tselem and the Palestinian Central Bureau of Statistics.

<sup>11</sup> Take, for example, *Public Poll #15*, Palestine Center for Policy and Survey Research, March 2005. According to this data, three-quarters of Palestinians see Israel’s disengagement from Gaza as a victory for the Palestinian armed struggle against Israel, but only 29 percent support the continuation of armed attacks against Israel from Gaza after full disengagement (while 68 percent oppose this). The same poll discusses findings showing 29 percent supporting the Tel Aviv night club suicide attack in February 2005—compared with 77 percent who supported the Bersheva suicide attack in September 2004 and 75 percent supporting the Maxim Restaurant suicide attack in Haifa in October 2003. 81 percent of those surveyed in March 2005 advocated reconciliation with Israel, compared to 67 percent in June 2004.

<sup>12</sup> This includes workers from East Jerusalem.

<sup>13</sup> By 4,700. For September the average daily number of permit-holders working in ISI totaled only 6,800, compared with 18,000 in Q2.

<sup>14</sup> Especially in Gaza where truckloads of exports through Karni declined by more than 50 percent in September and October compared with the six months prior to disengagement.

<sup>15</sup> The Bank has estimated that internal closure in the West Bank retards Palestinian economic growth potential by as much as 3.5 percent of GDP. Separately, the Bank has estimated that the Separation Barrier may have a depressive effect on GNI of perhaps 3-5%.

<sup>16</sup> For example, “Economic stability and growth for the Palestinians is a strategic stabilizer for Israel”—*Continuous Movement in the West Bank—An Economic Component to the Disengagement Plan*, Office of the Coordinator of Government Activity in the Territories, July 2004.

<sup>17</sup> And to handle all agricultural exports on top of this if necessary.

<sup>18</sup> On December 8 GOI, following the December 5 suicide bombing in Netanya, GOI indicated that it was suspending talks on introducing bus convoys between Gaza and the West Bank, despite its previous commitment to introduce them by December 15. GOI officials have also threatened to abrogate the common customs envelope in Gaza, maintenance of which is a key provision of the *Agreement*, in frustration with initial Palestinian management of the Rafah Crossing. On December 9 a Ministry of Defense spokesperson indicated that the Minister might redesignate Karni and Erez as

international border terminals within 48 hours unless the PA took various forms of corrective action against militants and at the Rafah passage: “this would mean boosted security and scrutiny and customs regulations, which naturally can be expected to affect the flow of Palestinian trade in and out of Gaza” Source: *Israel Vows Clampdown Unless Militants Curbed*, Reuters, December 9, 2005. The Minister of Defense also spoke of closing the Karni Crossing after the Netanya bombing. Consistent with the provisions of the *Agreement*, however, this did not happen.

<sup>19</sup> In discussion with the Bank in late 2004, GOI indicated that in the near-term Israel would issue 15,000 permits to Gazans and 20,000 to West Bankers, subject to security considerations and market demand—and reconfirmed this in February 2005. Issuing these permits would cushion the shock that completion of the Separation Barrier will otherwise cause to the Palestinian labor market, while replacing illegal labor with an equivalent quantity of permitted—hence safer—laborers.

<sup>20</sup> Unfortunately, the law was immediately ruled unconstitutional by the Palestinian Supreme Court. Solutions are now being sought, and may require the drafting of amendments.

<sup>21</sup> An encouraging recent sign was the issuance by the President on December 8 of a decree charging his Economic Adviser with reviewing the *Governance Priorities under the Medium-Term Development Plan: A Donor View* (prepared by the European Commission (EC) for the December 2005 AHLC Meeting), and reporting back to him on PA progress.

<sup>22</sup> In pursuit of this the European Commission made a conditional pledge on October 5 to double its assistance to the Palestinians from €250 million to €500 million per annum, observing that “subject to the progress made on the six points, the Quartet Envoy has proposed a doubling of resources from the international community to \$3 billion a year over the next three years. This has been endorsed by the G8. The priorities set out in this Communication are part of the response to this new context.”

<sup>23</sup> Under the new structure the EC will co-chair with the PA a governance thematic group; the other donor co-chairs will be the Bank (economic policy), USAID (infrastructure development) and the UN (social development and humanitarian assistance).

<sup>24</sup> Source: Quartet Special Envoy’s Office.

<sup>25</sup> Since then GOI has also transferred the bulk of the revenues withheld in the previous period.

<sup>26</sup> Unemployment follows the standard ILO definition, which only includes people who are out of job and who are actively seeking employment (i.e., it does not include so-called discouraged workers). The poverty line is defined as per capita consumption of US\$2.3 per day for a benchmark household of two adults and four children. The deep poverty line is US\$1.5 per day.

<sup>27</sup> Includes Palestinian workers from East Jerusalem.

<sup>28</sup> On a per capita basis, disbursements have exceeded US\$300 per person per year since 2001, the highest sustained level of foreign assistance to any developing country in post-WW II history.

<sup>29</sup> On an annual basis. Source: Israel Central Bureau of Statistics.

<sup>30</sup> In absolute terms, this translates into a slight decline in the number of poor, to about 1.5 million.

<sup>31</sup> Compared with 2001 and 2002, the difference between transport price inflation (a proxy for transaction costs) and overall consumer price inflation dropped significantly in 2003 and in 2004. In the first half of 2005, overall price inflation slightly exceeded transport price inflation for the first time since 1999.

<sup>32</sup> Net lending includes a) payments by the PA of utility bills due to Israeli providers from local governments, which are deducted by GOI from clearance revenues and are usually around US\$8-9 million per month; b) payments of fuel oil for the Gaza Electricity Generating Company, to ensure continued production and distribution of electricity in Gaza, which average US\$4 million per month; and c) exceptional advances to local governments. Net lending has averaged US\$24 million per month for the year to date.

<sup>33</sup> Donor budget disbursements amounted to US\$261 million in 2003, US\$353 million in 2004 and are projected at US\$352 million for 2005 as a whole. Current commercial bank debt is estimated at US\$583 million and further expansion will be difficult given PA repayment capacity and limited assets against which to borrow further.

<sup>34</sup> The wage bill-to-gross revenue ratio has now climbed to about 100 percent; thus after deductions for utility bills not paid by municipalities the PA’s revenues are no longer sufficient to cover the wage bill.

<sup>35</sup> Numbers represent averages over the first three quarters of 2005 compared to the same period last year.

<sup>36</sup> The dependency ratio is defined as the size of the population divided by the number of employed persons. The Q3-2005 dependency ratio in the West Bank was 5.1 while it was 7.5 in Gaza. On the eve of the *intifada* it was 4.3 and 5.9 respectively.

<sup>37</sup> For example, between 2002 and 2003, 17 % (16,000) of all new jobs created was in the form of unpaid family workers.

<sup>38</sup> All net Palestinian jobs creation in 2004 took place in the West Bank; Gaza experienced a 5 percent decline in the number of jobs.

<sup>39</sup> *Stagnation or Revival?* Op. cit.

<sup>40</sup> On the subject of border crossings and trade corridors these were chaired by the Bank on the Quartet Special Envoy's behalf, while on Rafah they were chaired by the US and EU delegates to the Special Envoy's Office.

<sup>41</sup> In response to reports that suspected Hamas activists have been infiltrating Gaza through Rafah, Prime Minister Sharon and Defense Minister Mofaz both announced that the customs arrangements could be abrogated—"If it turns out that we don't have real-time monitoring of who is coming in, Israel has one tool -- perhaps the most effective and the most painful 'that the crossings between the Gaza Strip and Israel...will become (international) border crossings', and the customs arrangement will be rescinded, Sharon said." AP, December 1, 2005, *Sharon Confident of Winning Third Term*.

<sup>42</sup> "One of the steps recommended by Defense Minister Shaul Mofaz in retaliation against the Netanya suicide bombing is that Israel impose a closure on the Gaza Strip, only allowing the passage of goods via the Karni crossing (the passage of workers via the Erez crossing would be prohibited). This step contravenes an agreement reached between Israel and the Palestinian Authority on the Gaza Strip border crossings, which allows Israel to shut down a crossing for passage only in the wake of an attack or warning directly related to that crossing. In addition, if Prime Minister Ariel Sharon accepts this suggestion he would be breaching a promise he gave U.S. Secretary of State Condoleezza Rice and special envoy James Wolfensohn that Israel would refrain from imposing a closure on the Gaza Strip in retaliation to attacks in Israel proper (this was one of the major sections in the negotiations preceding the crossings agreement)." Akiva Eldar, Ha'aretz Online, December 5, 2005.

<sup>43</sup> In 1999, prior to the intifada, daily export truck averages exceeded 200, with many leaving from Erez in convoy. Source: UNSCO, Paltrade.

<sup>44</sup> Sources: UNSCO, Paltrade; *Al-Montar/Karni Terminal Performance Brief, Biweekly Report for November 15-25*, Paltrade.

<sup>45</sup> It can be read in conjunction with the technical 'mother' document which summarizes the agreements reached by the parties and their respective positions on unresolved issues as of November 15, 2005, *The Agreement on Movement and Access: The Passages—Technical Elaboration*, World Bank, December 2, 2005. This and approximately 20 other World Bank technical notes which were used during the negotiations can be found on the Bank's website as *Papers on Movement and Access—Contributions to a Negotiated Solution* at [www.worldbank.org/ps](http://www.worldbank.org/ps).

<sup>46</sup> On January 13, 2005 a group of Palestinian militants attacked the Karni cargo facility, killing six employees of the Israeli Airports Authority.

<sup>47</sup> Under the leadership of the United States, support is expected to be provided by USAID (security equipment for GOI, security equipment and terminal infrastructure for the PA), Canada (help in developing the Palestinian Border Terminals and Ports Authority), the EU (equipment and infrastructure, technical support), and the Bank (continued analytical and advisory support to all three parties).

<sup>48</sup> "The decision of the GoI, or more specifically the lack of decision regarding the status of the area disengaged, has created a situation in which the Civil Administration remains responsible in these civilian sectors, although there won't be any permanent presence of Israeli authorities on the ground.... Disengagement actually deprives the Civil Administration of its capacity to operate on the ground on a day to day basis....The withdrawal of Israeli administration from the Northern West Bank is likely to reduce, or even eliminate any kind of enforcement on the use of water resources by private Palestinian consumers. This is mainly due to the disagreements between Israel and the PA on the right to access water from the lower aquifer, considered by the PA as a sovereign legitimate right. The second reason is the lack of sufficient water resources available for the Palestinians which is recognized by the GOI. Both elements are likely to diminish the motivation of the PA to fight against illegal drilling.... the Palestinians are not allowed to be armed and in uniform in area B and C. No decision has been made by the government of Israel on the implications of the Disengagement in this matter. As a consequence, Palestinian local authorities won't be able to guarantee law enforcement on illegal constructions, illegal drilling, pirate electric connection, destruction of infrastructure, etc" *Implications of the Disengagement from the Northern West Bank—Civilian Issues*, Economic Cooperation Foundation, October 16, 2005.

<sup>49</sup> Prior to the *intifada*, 37 checkpoints existed along the green line (source: OCHA).

<sup>50</sup> Prior to September 28, 2000 a Palestinian producer paid NIS 100-150 NIS to transport a single truckload of bulk material from Nablus to Ramallah; the same cargo today will cost NIS 600-700. OCHA estimates that 15-20 percent of the available work-time of the average Palestinian is forfeit on account of internal closures.

<sup>51</sup> Movement restrictions affecting Palestinians are not codified in a single military order, as they are for Israelis traveling in the West Bank; instead, local military commanders can restrict the use of roads for security reasons through verbal orders. This mechanism has produced an *ad hoc* system of restrictions that can be modified without notice, thereby creating considerable uncertainty for Palestinian travelers. In addition to checkpoints and roadblocks, the imposition of fines and confiscation of vehicles also act to restrict movement.

<sup>52</sup> Source: OCHA. OCHA and the IDF have worked closely this year to align their data bases, and this resulted in a near-consensus on the August 1 number of fixed obstacles, with OCHA's figure about 40 more than that of the IDF (largely due to definitional differences).

<sup>53</sup> Permits are required to cross specific internal checkpoints, to reside in or to access the 'closed area' between the Green Line and the separation barrier, by West Bank residents to access work and their land in the Jordan Valley, and for travel to East Jerusalem.

<sup>54</sup> *Restrictions on the Movement of People and Goods Within the West Bank*, OCHA, November 23, 2005, draft.

<sup>55</sup> Approximately 7 percent of licensed private cars have permits to move inside the West Bank (source: OCHA).

<sup>56</sup> *Forbidden Roads: The Discriminatory West Bank Road Regime*, B'Tselem, August 2004.

<sup>57</sup> In 2004, GOI suggested that donors could as a pragmatic solution finance a "continuous movement" package for West Bank Palestinians consisting of 52 road segments (totaling about 500 kilometers) and 16 under/overpasses. Donors declined to do so, maintaining that Palestinians should be given access to the existing road system. The donor reaction was influenced by the ICJ Advisory Opinion of July 2004, which warned against providing assistance that would help maintain the settlements (which it deemed to be illegal under international law). At a meeting of the Local Aid Coordination Committee in October 2004, the PA and the donors concurred that decisions on road construction in the West Bank should be taken on a case-by-case basis, while avoiding structures perceived to be helping create a separate transport system, or contouring the separation barrier or any settlements. To date, 28 such tunnels/overpasses have been constructed by GOI, and another 16 are planned. Source: *Humanitarian Update*, OCHA, August 2005.

<sup>58</sup> **Map 2** suggests that the remaining fixed obstacles will help a) secure Israeli access between Israel and the Jordan Valley along two main east-west axes (Ariel—Tappua/Zatara—Jordan Valley, and Mod'in—Route 443—Jordan Valley), and b) provide safe passage for settlers along a number of main roads to and between settlement areas.

<sup>59</sup> As of mid-2005, roughly 4,200 additional residential units were under construction in areas of the West Bank outside East Jerusalem, an increase of more than 200 units from the same period in 2004. Most construction is taking place in settlements located in the seam zone.

<sup>60</sup> OCHA has identified five sets of checkpoints whose removal would have an appreciable impact on commerce and social mobility. These are a) Container Checkpoint (between the south and middle areas of the West Bank); b) Atara Bridge partial checkpoint (north of Ramallah); c) the Nablus complex—movement into/out of Nablus runs through the Sara, Huwwara, Beit Iba checkpoints and the 'Awarta back-to-back commercial checkpoint; d) the east-west line of Shave Shomeron, Beit Furik and Hamra checkpoints; and e) Tappua/Za'atara checkpoint (east of Salfit).

<sup>61</sup> OCHA has identified 112 isolated villages in 25 clusters containing c. 180,000 people.

<sup>62</sup> These recommendations are consistent with (and draw on) recommendations made by OCHA in *Restrictions on the Movement of People and Goods Within the West Bank*, Op.cit.

<sup>63</sup> See, for example, *Permanent Status Issues and the Palestinian Position*, Negotiations Support Unit, on [www.nad-plo.org](http://www.nad-plo.org).

<sup>64</sup> In September and October 2005, about 6,500 permits were issued to traders in the West Bank, and another 1,000 to traders in Gaza. Less than 4,500 traders from the West Bank used these permits, while virtually no Gaza traders exited Gaza.

<sup>65</sup> This is particularly acute in the case of perishables, such as dairy products.

<sup>66</sup> Average daily truckloads of merchandise exports from Gaza were over 75 percent lower in 2005 than in 1996-9.

<sup>67</sup> Op.cit.

<sup>68</sup> *Linking Gaza and the West Bank: Convoys*, World Bank Technical Team/Quartet Special Envoy's Office, September 30. This paper is available at [www.worldbank.org/ps](http://www.worldbank.org/ps). Truck convoys would not be subject to back-to-back procedures—"since trucks can already transit between Gaza and the West Bank on this basis, a convoy system [based on back-to-back transfers] would be disadvantageous since it would merely add time and cost."

<sup>69</sup> *Economic Aspects of the Israeli Disengagement Plan, Meeting with the World Bank*, Israeli National Security Council, November 14, 2004, PowerPoint.

<sup>70</sup> These figures include Palestinians with Jerusalem ID. In Q2 of 2005, the most recent period for which the detailed breakdown is available, a total of 66,000 Palestinians worked in Israel. Of these, 28,000 had Jerusalem ID or foreign citizenship, 21,000 had a permit and 18,000 were clandestine workers without a permit.

<sup>71</sup> Measured by GNI.

<sup>72</sup> This important step was promoted forcefully by a number of external parties, including President Bush, who on June 24, 2002 said “A Palestinian state will never be created by terror—it will be built through reform. And reform must be more than cosmetic change, or veiled attempts to preserve the status quo. True reform will require entirely new political and economic institutions, based on democracy, market economics and action against terrorism.” The antecedents to this speech go back to 1999 and the “Rocard” report (*Strengthening Palestinian Public Institutions*, Council on Foreign Relations) as well as to the October 1999 version of the *Tripartite Action Plan* and the *Economic Policy Framework* developed largely by Salam Fayyad when he was IMF Representative to the West Bank and Gaza.

<sup>73</sup> See the *Conclusions of the London Meeting on Supporting the Palestinian Authority*, March 1, 2005. The *Declaration* is organized under three broad themes, under which sub-tasks are identified—1. Governance (national and local elections; strengthening the public sector and civil service, to include pension reform; judiciary, to include abolition of the state security courts and the approval and implementation of an amended Judicial Authority Law); 2. Security (passage of a National Security Law, reform of the command structures); and 3. Economic Development (divided into three areas—a) *Economic Governance*, to include action against corruption, maintaining wage bill control, further reform of the PA’s internal and external audit mechanisms, conduct of a public expenditure review, reform of intergovernmental transfer mechanisms; b) *Stimulating Private Sector Growth*, to include developing a medium-term development plan, facilitating credit expansion and enhancing public procurement; and c) *Organizing the Transfer, Management and Disposal* of the settlement assets.

<sup>74</sup> It also draws on the EC’s *Governance Priorities under the Medium-Term Plan: A Donor View*, paper submitted to the AHLC, December 2005.

<sup>75</sup> *Twenty-Seven Months—Intifada, Closures and Palestinian Economic Crisis*, World Bank, May 2003.

<sup>76</sup> For example, the National Democratic Institute/Carter Center mission to the election stated, among others, that the election was “mostly orderly and conducted by dedicated and professional officials”, *Preliminary Statement of the NDI International Election Observer Delegation to the January 9, 2005 Palestinian Presidential Election*.

<sup>77</sup> For example, the Palestinian Center for Human Rights reported that in the January 2005 local elections, armed men entered some of the polling centers, that campaigning continued outside polling stations and that there were a number of confrontations between *Hamas* and *Fateh* cadres.

<sup>78</sup> This had earlier been scheduled for July 17, 2005.

<sup>79</sup> In PRS’ *Public Opinion Poll # 17*, for example, 64 percent of those surveyed felt that their personal and family security was under threat.

<sup>80</sup> These include the October 2005 irruption by security service personnel into the PLC Chamber in Gaza in October and a rash of kidnapping incidents involving foreigners in Gaza from August onwards, in relation to which no arrests have been made. It has been estimated that the number of Palestinians killed in internal violence in 2005 is more than the number killed in clashes with the IDF, and is four times higher than in 2000. Source: *Press Release Ref 72/2005*, Palestinian Center for Human Rights, June 2005.

<sup>81</sup> The panel was established to investigate many of the aforementioned incidents, as well as the weapons explosion at a Hamas rally in Jabaliya in September. It found that in almost none of the cases was any action taken against the suspects and even when it was, suspects were generally released quickly, for “irrelevant reasons”. *Panel Has Done Nothing to Impose Order*, Arnon Regular, Ha’aretz, October 7, 2005.

<sup>82</sup> For a summary of progress, see for example, the Bank’s *Country Financial Accountability Assessment*, June 2004. Specific milestones include: the establishment of a Single Treasury Account capturing government revenues that were formerly outside the budget, the establishment of a central payroll system and payment of all public sector salaries into bank accounts, and the establishment of the Palestine Investment Fund and the valuation and audit of its assets.

<sup>83</sup> AHLC Note, IMF, November 28, 2005.

<sup>84</sup> Deducted by GOI from the monthly revenue transfer, and thereby lost to the PA treasury.

<sup>85</sup> In a letter to President Abbas of October 7, the Bank stated that “the main cause for the ballooning deficit is a PA policy of increasing public employment and raising wages. This led to an increase in the salary bill of 68 percent between 1999 and 2004 (a time in which private sector wages were stagnant, and inflation remained well below the rate of public pay increase). Although the PA has been able to

pay wages on a regular basis, doing so has meant that the remaining resources were insufficient to cover the operating costs so vital to the delivery of basic services; in other words, raising the salaries of a group of people that is already relatively privileged (by having stable jobs and excellent pension prospects) has come at the expense of the broad public. The recent salary decisions further exacerbate this.” The PA had offered to retrench up to 13,000 staff, most of them inactive salary recipients in the security services, to help redress the imbalance in the Wage Bill Containment Plan. As of the time of writing, though, no action has been taken.

<sup>86</sup> See AHLC Note, IMF, November 28, 2005. The Council of Ministers in November 2005 issued a circular to the municipalities stating that they now bear full responsibility for the payment of utility bills, even if this involves cutting off electricity supplies. With the PA’s lack of direct control over the billing process, though, execution of this circular will be difficult. Going forward, plans are underway to rationalize transfer payments to municipalities and increase their transparency through the establishment of a Municipal Fund.

<sup>87</sup> The law provides retirees a pension worth over 100 percent of final salary.

<sup>88</sup> Since there are no security pension assets, and nearly all those personnel covered by the law will be eligible for retirement upon the law’s full implementation, all expenditures for this system will need to be met from the PA’s revenues, as opposed to any built-up of assets in a fund. Annual implementation costs are assessed at c. US\$40 million per annum.

<sup>89</sup> Contribution rates are insufficient to finance benefit levels, and major unfunded liabilities accruing from past PLO service have been passed on to the Pension Agency (without any corresponding assets). Moreover, the *Unified Pension Law* promises a payment of US\$100 a month to all needy Palestinians over the age of 60.

<sup>90</sup> In March, 86.5 percent of the persons interviewed answered “yes” to the question “Do you think that there is corruption in the PA?” (Source: Poll No. 15, March 15, 2005, Palestine Center for Policy and Survey Research), and in a PRS poll in September 2005 (Public Opinion Poll No. 17), 80 percent gave the same response to a similar question. The perception of corruption has not changed materially in recent years. The percentage in a similar poll taken in September 2004 was 87.9 (Source: Poll No. 13, March 15, 2005, PCPSR). In December 2002, when asked whether there was significant corruption in the PA, 82.7 percent of respondents answered “yes” (JMCC, Poll No. 47). Palestinian popular beliefs are corroborated by Transparency International’s *Corruption Perception Index* (CPI) for 2005, which places the West Bank and Gaza in the bottom quintile in the Middle East when it comes to non-transparency and corruption.

<sup>91</sup> IDF withdrawal from Gaza and the northern West Bank was completed on September 12 and September 21, respectively. No prior coordination took place for the four West Bank settlements.

<sup>92</sup> It is estimated that about 10 percent of the greenhouses were destroyed, and another 20 percent damaged to varying degrees. Some of the departing settlers also looted equipment that had been purchased from them, and the extent of this is being verified as part of the final reconciliation process.

<sup>93</sup> The removal of the rubble in the West Bank remains to be addressed; it would appear that some amount of it was buried *in situ*.

<sup>94</sup> This excludes amounts disbursed against UNRWA’s ‘regular’ program. Due to the conventions adopted in the Oslo period, regular contributions to UNRWA are considered to represent a pre-Oslo commitment, and have been excluded from the comparative analysis of ‘peace process’ donor contributions. The distinction is now archaic, and it is recommended that they be included in future in the global total, with an appropriate retrospective revaluation of the 1994-2005 disbursement history.

<sup>95</sup> Donor project staff continued to face appreciable movement restrictions, particularly in trying to access Gaza through the Erez crossing. In addition, the UN on August 15, 2005 declared Security Phase IV for Gaza, which strictly limits employee residence in Gaza. A further inhibiting factor has been the spate of kidnappings of foreign nationals that began this summer. While none of the hostages taken thus far has been hurt, it makes it that much harder to attract international staff to work in Gaza.

<sup>96</sup> The simulations take into account the fiscal contraction envisaged under a Fiscal Stabilization Plan, which would dampen growth. The effects of this, however, would be muted by the increase in donor assistance and by the significant reduction in economic transactions costs arising from a radical easing of closure.

<sup>97</sup> Data from Sept. 00, 2001, 2002, 2003, through Sept. 2004: a) no. of Israelis killed: 47, 297, 453, 214, 97; b) no. of Israelis injured: 265, 1579, 2309, 1004, 441; c) no. of suicide attacks: 4, 35, 60, 26, 13; d) no. of shooting attacks: 2230, 5274, 2917, 2111, 1198. Source: *Four Years of Conflict: Israel’s War Against Terrorism*, 3<sup>rd</sup> October 2004, Israeli Security Agency, available on [www.mfa.gov.il](http://www.mfa.gov.il).

<sup>98</sup> Article IX, *Interim Agreement*, op. cit.

<sup>99</sup> *Disengagement, the Palestinian Economy and the Settlements*, op. cit.