The Palestinian economy under occupation: economicide

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The main purpose of the article is to analyze the nature, structure, and dynamics of the relation between the Israeli and Palestinian economies as they have evolved during the occupation period. The aim is to reveal various asymmetries and anomalies in the relation, the way they have affected the course of the Palestinian economy, the costs that have been incurred by Palestinians, and the benefits that have accrued to Israelis from their continuation. The removal of these anomalies and asymmetries are a prerequisite for any serious and genuine peace that would permit the economic infrastructure to promote and support a stable and durable peace.

Both theoretical analysis and empirical studies suggest that the dynamic between a large, advanced, and rich economy and a small, underdeveloped, and poor economy always generates two opposing forces whose net effect disproportionately affects the smaller economy and adversely shapes its development.

The article is divided into four sections. The first provides the theoretical framework within which the relationship between the two economies is analyzed. It focuses on the connections between a large, advanced, and well-connected economy and a small, poor, and disarticulated economy, as formulated by Myrdal, Thirlwall, Krugman, and others. It identifies both positive and negative consequences of the links between the two economies. Positive consequences, which are presumed to help the small economy expand, develop, and grow, are called the spread effects. Negative repercussions, that tend to work in the opposite direction and thus retard the evolution of the small economy and reinforce its underdevelopment, are called the backwash effects.

In the second section, specific practices and the policies of successive Israeli governments — restrictions over the use of natural resources, inhibition of business activities by an imposed regulatory regime, fiscal compression and diversion, severance of the Palestinian economy from its natural environment and markets, tying the fortunes of Palestinian labor to the Israeli economy, fragmentation of the Palestinian market, and raising transaction costs — are all identified as responsible for incapacitating the normal operation of market forces in the Palestinian economy. The emasculation of natural market forces is blocking the spread effects and bolstering the backwash effects as the dominant and exclusive forces in the existing relation between the Israeli and the Palestinian economies.

The third section summarizes the cumulative effects of the specific restrictive practices discussed in the prior section, and section four presents some conclusions relating to the present situation of the Palestinian economy and prospects for future development.

Israeli economic interactions with the occupied Palestinian economy: structure and dynamics

In 1967, Israel occupied the West Bank and Gaza Strip (WBGS) and integrated their markets into its own. The size of the Israeli economy at that time was around ten times that of the Palestinian economy, its sectoral diversification was much greater, and the manufacturing sector's share in GDP was more than four times larger. These differences in size and structure made the relation between the two economies as one between a large, advanced, and rich economy and a small, underdeveloped, and poor economy. Both theoretical analysis and empirical studies suggest that the dynamics of such a relation always generate two opposing forces that disproportionately affect the smaller economy and shape its development. Favorable repercussions may include an increased demand for the products of the small economy, possible diffusion of technology and knowledge, as well as other spread effects, that could result from the geographical proximity of the small economy to a large market. These effects typically lead to subcontracting, joint ventures, and coordination in tourism and other services. Unfavorable repercussions arise from the disappearance of many industries in the small economy, its confinement to producing labor intensive and low-skilled goods, and the emigration of a sizable segment of its labor force to the neighboring economy, as well as to other countries. These effects are known in the literature as backwash or polarization effects. They arise from the capability of efficient, large-scale industries in the advanced economy to out-compete inefficient, small-scale industries in the less advanced economy, and to attract both their labor and capital.[1]

From the perspective of the small economy, therefore, the crucial question is the net balance between the two opposing dynamic impacts: to what extent did they help promote development, and to what extent did they reinforce underdevelopment? Among the factors that determine the relative strength of these two forces is the degree of integration between the two sides, which can be easily appreciated by considering trade. A removal of tariff and other barriers to trade between the two countries is presumed to increase the exports of the small economy to its neighbor, as trade between them takes on a pattern based on comparative advantage. This level of exports, however, will not be sustained if free trade between the two countries is accompanied by a common external tariff (as in a customs union) and where the tariff is substantial and is set, as it were, with the objective of protecting the advanced economy's industries. Such protection increases the price of intermediate and capital goods imported by the small economy, and thus raise its cost of production in a way that would compromise its comparative advantage. Further measures of integration between the two economies, such as allowing free movement of labor and capital, would significantly reduce the export of goods from the small to the large economy as the export of labor services would be substituted for the export of goods. In other words, free trade and free mobility of factors would gradually wipe out trade based on comparative advantage and confine it to trade based on absolute advantage, resulting in the small economy exporting low-skilled goods and importing high-skilled goods, thus "locking in" its poverty.[2] The small economy would be relegated to the status of a backward region in an otherwise advanced country, as is the case of the south in Italy and central Appalachia in the United States.

The advantages Israel derived from this asymmetric relation with the Palestinian economy under occupation and free trade are numerous and profound. A synopsis includes the following. First, Israel possesses the majority of the modern sectors operating under increasing returns to scale, characteristic of manufacturing activities. Second, Israel has been able to offer a wage premium to Palestinian workers in the traditional sector and has assured itself of an wage-responsive (elastic) supply of labor to its modern industries through releasing Israeli labor from traditional activities that Palestinian labor has substituted for. This wage premium was a small one given the low wages in Palestinian agriculture and given the geographical proximity of the pools of migrating workers to their work in Israel. Third, the influx of Palestinian labor into Israel at a fraction of the Israeli labor cost has reduced the wage premium in the Israeli modern sector and made it more profitable, competitive, and sustainable. Fourth, the shekels earned by Palestinian migrant workers in Israel are typically spent in the consumption of Israeli products. The Israelis not only captured an elastic supply of labor at low relative wages, but also a sufficiently large effective demand for the increased products of their modern sectors. Fifth, Israel imposed on the Palestinian economy a tariff regime that effectively wiped out any comparative advantage they have had or could have had with neighboring Arab markets. Sixth, the geographical proximity reduced transaction costs (transportation and time taken to move between the two economies), and the destruction of the traditional sector economic base through usurpation of land and water denied the Palestinian economy of any protection it may have had against the flow of Palestinian resources toward the Israeli economy at relatively cheap wages. Palestine lost even its absolute advantage in many agricultural products, the traditional sector in Palestine was devastated, and could not even act as a buffer sector for local employment.

The economic consequences of the occupation

Immediately after occupation in 1967, Israel imposed on the West Bank and Gaza Strip a customs union trade arrangement that increased tariffs approximately fourfold.[3] Naturally, this drastic increase, along with the many nontariff barriers applied by Israel, resulted in a huge trade diversion away from neighboring Arab countries and the rest of the world toward the Israeli market, raising the cost of capital and intermediary goods to Palestinian producers that effectively eliminated their competitive edge in foreign markets. Several studies have shown, for instance, that the cost of garment production in the West Bank is larger than that of Jordan by a factor of 2.17. An important component of that difference is due to the fact that Palestinian producers pay double the price for their imported Turkish textiles, compared to the superior-quality East Asian materials imported by Jordanian producers. The Palestinians cannot import the Asian textiles because of the prohibitive tariff imposed by Israel to protect its own industry. Similarly, the cost of agricultural products, pharmaceuticals, and shoes in Jordan is lower than in Palestine partly because of the differences in imported input prices.[4]

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Another reason for the high cost of Palestinian production in both agriculture and industry is the relatively high wage rate. It is estimated that wages of Palestinian workers are larger than those in Jordan by a factor of 2 to 3 in agriculture, a factor of 2 in the garment industry, and a factor of 2.3 in the shoe industry.[5] These high wages are the result of distortions in the labor market created by the hiring of Palestinian commuters to work by the day in Israel as noted above, a practice that started with the occupation and steadily increased to account for almost a third of the Palestinian labor force in the 1990s.[6] Naturally, this trade arrangement has increased the cost of Palestinian production, causing Palestinian exporters to loose their comparative advantage in traditional neighboring markets and facilitated their migration to Israel. More importantly, economies of scale realized by advanced Israeli manufacturers enabled them to undercut small Palestinian firms producing for the domestic market, disrupting and replacing Palestinian artisan and small industry production. The migration of Palestinian labor to Israel destroyed the fledgling indigenous industrial sector and eliminated any comparative advantage it may have had while bestowing simultaneously comparative and absolute advantages on Israeli manufacturing. A United Nations study of the mid-1980s showed that 50 percent of Palestinian imports from Israel had been produced domestically prior to the occupation.[7]

While these adverse backwash effects were at work, positive spread effects were also introduced by the occupation. These included the emergence of a limited number of new opportunities for employment in and trade with Israel and for some minor transfer of technology. The income earned by Palestinians working in Israel contributed to rapidly rising money income and, in turn, to increased demand and domestic economic activities. Palestinian agriculture benefitted from a transfer of technology from the more advanced Israeli agricultural sector and this contributed to increased exports of some agriculture products to Israel. The cumulative impact of this expansion in economic activities helped increase income, saving, and investment, especially investment in residential construction.

The role of Israeli measures in creating an adverse path dependence

The higher cost of living in Israel and the external diseconomies produced by congestion in Israel suggest that backwash effects have ultimately outweighed the benefits of greater efficiency and economies of scale in Israel. This differential in costs should have given rise (according to neoclassical economics) to increased investments in the Palestinian economy. Increased economic activities in the Palestinian territories would then have gradually corrected the distortion in the labor market by reducing the number of Palestinians seeking daily work in Israel. The spread effects would have asserted themselves and generated a process whereby Palestinian income was created endogenously in the internal productive sectors, rather than from outside. This did not happen as the continuous influx of labor from Palestine allowed the Israeli economy to thrive at the expense of the Palestinian economy. Instead, the relation between the two economies has followed quite a different path. As shown in Table 1, the Palestinian economy benefitted significantly from its relation with Israel in just the first decade, whereafter the relation became harmful. In the first decade, Palestinian GDP per capita grew from 11 percent of that of Israel to 16 percent, but then the ratio declined continuously and at the start of limited Palestinian self-rule was about the level of a quarter of century before. Thus, in the first decade of occupation the relation between the two economies went through a process of convergence; the poor economy grew at a rate faster than the rich economy. Afterwards, the process was reversed and became one of divergence; the rich economy growing at a faster rate. The reason for this reversal is that the economic relations between the two economies were not confined to the working of the polarization and spread effects operating through the market. The policies practiced by Israel since the start of occupation, which increased in intensity and aggressiveness in the mid-1970s, have circumvented the forces in the market, bolstering the effects of polarization and diminishing the spread effects. These policies include restrictions on the use of Palestinian natural resources, emasculation of agriculture, undermining industry and other productive sectors, massive resource transfers from the poor Palestinian economy to the rich Israeli economy, and the weakening of the Palestinian public sector.

These policies, measures, and practices took many forms but particularly the following.

Restriction on the use of natural resources

Since the start of the occupation, the Palestinians in the West Bank and Gaza Strip have increasingly lost control over their land and their supply of water. Israeli authorities used many different and complex measures and policies, all of which were designed to place under Israeli control the largest possible area of fertile land and the maximum amount of water. It is widely believed that by the time of establishing Palestinian limited self-rule Israel had confiscated 68 percent of the total land of the West Bank, and 40 percent of that of Gaza Strip.[8] In contrast, estimates indicate that Palestinians in the West Bank use only about 15 to 20 percent of the annually available water originating in the area. The rest is used by Israeli settlers and within Israel.[9] New Jewish settlements were built on part of the land taken from Palestinian use and control. The rest of the confiscated land was turned into closed military areas. By the end of 1991, the number of these settlements had reached at least 156 in the West Bank and 18 in Gaza Strip, with a population of 250,000.[10] These Israeli policies toward land, water, and settlements had a profoundly negative impact on all economic activities but particularly on agriculture. Most importantly they facilitated the migration of labor whose ranks swelled from the proletarization of farmers who lost their land and water. The adverse effect in agriculture manifested themselves in a sharp decline in the area of irrigated land, and sharp increases in the prices of land and water.[11] This distortion of prices, combined with the refusal of Israeli authorities to allow for the normal expansion of municipal boundaries has also resulted in high building costs for new industrial plants and thus acted as a strong barrier to industrial expansion.

Table 1: Comparison of GDP per capita in Israel and the Palestinian territories (US$ at 1986 prices)

Year	*Israel (1)*	*WBGS (2)*	*Ratio of (2)/(1)*
1968	4,373	484	0.11
1975	6,220	799	0.13
1980	6,430	1,033	0.16
1985	6,793	1,002	0.14
1990	7,424	887	0.12
1995*	15,611	1,690	0.10
1997*	16,579	1,512	0.09

*GDP per capita for 1995 and 1997 are in current prices. *Sources*: Calculated from Statistical Abstract of Israel (1993); World Bank (1993). *Developing the Occupied Territories*. Vol. 2, Table 1, p. 135; Arron, *et al*. (1997, Table 2.7, p. 41); Palestinian Central Bureau of Statistics (1998). Palestinian GDP per capita for 1997 is based on estimates by the IMF and the Palestinian Ministry of Finance. Memo (October 1998).

The special case of agriculture

The agricultural sector is a very important constituent component of the Palestinian economy that employed around one quarter of the labor force and contributed approximately one third of GDP and exports.[12] In contrast, Israeli agriculture is a very advanced, capital-intensive sector, but contributes no more than 2 percent to GDP and even less (1.7 percent) to exports. The loss of large stretches of agricultural land, after 1967, due to land confiscation and closures, and limitations on water supply and product markets, has led to a substantial decline in the production and importance of this sector.

In 1967, Palestinian agricultural production was almost identical to Israel's: tomatoes, cucumbers, and melons were roughly half of Israel's crop; plums and grape production were equal to Israel's; and Palestinian production of olives, dates, and almonds was higher. At that time, the West Bank exported 80 percent of the entire vegetable crop it produced, and 45 percent of total fruit production.[13]

The agricultural sector was hit hard after Israel occupied the West Bank and Gaza Strip. Thereafter the sector's contribution to GDP in the Palestinian Occupied Territories declined. Between 1968/1970 and 1983/1985 the percentage of agricultural contribution to the overall GDP in the West Bank fell from 37.4 to 53.5 percent to 18.5 to 25.4 percent. The labor force employed in this sector also declined. Between 1969 and 1985, the agricultural labor force, as a percentage of the total labor force, fell from 46 to 27.4 percent.[14]

There has been a continuous decline in the Palestinian cultivated areas in the West Bank since 1967. In 1965, before the Israeli occupation, the actual cultivated area was estimated at 2,435 km^2. The total area fell to 1,951 km^2 in 1980. In 1985, the cultivated area reached 1,735 km^2, and in 1989, it was 1,706 km^2. The average of actual cultivated land in the West Bank, between 1980 and 1994, was 1,707 km^2, a reduction by 30 percent of the area cultivated in 1965.[15]

Marketing of farm products and their distribution to local and external markets is one of the major obstacles facing Palestinian farmers. Throughout the occupation years, selling Palestinian agricultural products within Israel required special permits to be issued by the Israeli authorities. Transporting products from north to south in the West Bank has become difficult as well, especially after Israel enforced a closure on East Jerusalem, the main road connecting northern with southern parts of the West Bank. Movement of agricultural products between the West Bank and Gaza Strip is also subject to Israeli control.

The Gulf War in 1991 also severely affected Palestinian agriculture, since the bulk of exports were previously sent to Arab Gulf countries. Palestinian exports to the Gulf States had previously accounted for approximately $25.4 million per year. As a result of the war, Palestinian exports fell by 14 percent.

Israel has restricted Palestinian water usage and exploited Palestinian water resources after occupation. Presently, more than 85 percent of the Palestinian water from the West Bank aquifers is taken by Israel, accounting for 25.3 percent of Israel's water needs. Palestinians are also denied their right to utilize water resources from the Jordan and Yarmouk rivers, to which both Israel and Palestine are riparians. West Bank farmers historically used the waters of the Jordan river to irrigate their fields, but this source has become quite polluted as Israel is diverting saline water flows from around Lake Tiberias into the lower Jordan. Moreover, Israeli diversions from Lake Tiberias into the National Water Carrier have reduced the flow considerably, leaving Palestinians downstream with little water, and of low quality.

In Gaza, the coastal aquifer serves as its main water resource. Other Gazan water sources, such as runoff from the Hebron hills, have been diverted for Israeli purposes. The Gaza Strip, which housed only 50,000 people before 1948 is now one of the most densely populated regions in the world. This is the result of the high levels of forced immigration following the 1948 and 1967 conflicts, and the high rate of natural population increase. Gaza's coastal aquifer is now suffering from severe saltwater intrusion.

With regard to total water consumption, an Israeli uses 1959 cubic meters per year (CM/year), compared to an average Palestinian use of 238 CM/year.

Israeli restrictions have drastically limited the irrigation of Palestinian land so that today only 6 percent of the West Bank land cultivated by Palestinians is under irrigation, the same proportion as in 1967. By contrast, about 70 percent of the area cultivated by Jewish settlers is irrigated.

Restrictions on the economic activities of other productive sectors

In addition to the removal of land and water from Palestinian control, Israeli authorities have followed a general practice aimed at changing the structure and performance of the Palestinian economy. All economic activities were placed under the scrutiny of the Israeli military administration in the territories. Every economic undertaking required its approval. Plans by Palestinian businessmen to start a new venture, or to expand an old one, were often frustrated by delays in granting the appropriate permit, or in outright denial. Permits were required for all activities related to the acquisition of land, the construction of buildings, the transformation of goods, and export and import activities.

The taxation of Palestinian business activity was equally detrimental. Palestinian firms have had to pay value- added tax (VAT) on all their imports of raw materials through Israel. The long delay in receiving the refunds of this tax caused these firms severe problems of cash flow and shortage of capital. This has resulted in an annual loss estimated to be 8 to 12 percent of the value of their finished products.[16]

While these measures distorted incentives, and increased the risk to business activities, investment was further discouraged by the underdevelopment of effective financial intermediation in the Palestinian economy. This reflected the fact that all Arab banks were closed at the beginning of the occupation and only reopened on a very small scale in the mid-1980s.

Another important restriction is related to technological change and modernization. Israeli authorities did not permit Palestinian firms to import machines and tools incorporating the latest technology. Instead, they were compelled to buy second-hand machines from Israel.

It should also be noted that the customs union arrangements Israel imposed on the territories, was, in effect, an asymmetric trade scheme which allowed Israel's own heavily subsidized products free entry into Palestinian markets but prevented the entry of Palestinian products into the Israeli market, except on a selective and limited bases. This asymmetric trade relation, combined with complex administrative procedures aimed at discouraging Palestinian exports to the rest of the world, has made Palestinian trade completely dependent on Israel. That 90 percent of all Palestinian imports comes from Israel presents one side of this forced dependency. The other side is shown in that Palestinians pay for these imports partly by exporting labor services to Israel, and partly by exporting goods manufactured under subcontracting arrangement with Israeli firms.

Resource transfer to Israel, and the neglect of the public sector

The forced integration of the Palestinian economy into that of Israel was associated with a transfer of resources from the former to the latter. Three channels were involved. First, Palestinians paid VAT and custom duties on products imported from Israel. It is estimated that half of the taxes paid by Palestinians in the Occupied Territories accrued to the Israeli treasury in this way.[17] The second source is the income tax and social security contributions paid by Palestinians working in Israel. The third was the seigniorage revenue Israel received because its currency was been made legal tender in the Occupied Territories. The total of these resource transfers is large, and according to some estimates has reached, in any given year, from fifteen percent to a quarter of the Palestinian GNP.[18] Dubbed the "occupation tax" by an Israeli observer,[19] it would be more appropriate to call it the "Zionist exaction." Given that Israel was not prepared to undertake public expenditure in the Occupied Territories beyond the tax revenues actually raised there (as opposed to those paid by Palestinian consumers and workers but collected in Israel), all public infrastructure in the West Bank and Gaza Strip is in a very poor state, and the level and quality of public services and utilities are far below those of neighboring countries.[20] The poor condition of the basic infrastructure and public services causes market fragmentation, and this inhibits specialization and the realization of economies of scale which are essential for a small economy to be competitive.

Cumulate effects

The cumulative impact of the restrictions placed on resource use, business activities, and domestic and international trade, has substantially weakened the traditional productive sectors of the Palestinian economy. This has caused a general reallocation of factors of production combined with the reorientation of trade flows to the benefit of Israel. As a consequence a major structural transformation of the Palestinian economy has taken place. It has become an economy characterized by two growing gaps: a resource gap and labor market imbalance, and a great and unhealthy dependence on external sources of income. It also features a sectoral disarticulation and an infrastructure gap.

The resource gap

The Palestinian economy suffers from a chronic incapacity to generate more than two-thirds of its national income. Usually, the yearly total domestic absorption (domestic consumption and investment and government expenditures) is more than one and a half times the economy's total production, GDP. Imports fill this gap, and assume a very important role in the economy. In the years preceding the establishment of limited self-rule, the import surplus (imports minus exports) measured as a percentage of GDP, had reached 59 percent and had never been less than 43 percent (see Table 2). The financing of these huge imports was generated mainly from the income of Palestinians working in Israel, and the remittances of those working in the Gulf states. These factor incomes account for the wide disparity between GNP and GDP, and are shown in the same table.

Table 2: The resource gap (in %)

	*Import surplus**	*Investment surplus***	*GDP/ GNP*
1968	34	43	107
1975	59	24	78
1980	45	16	80
1985	56	15	77
1990	39	5	75
1995	37	28	93
1998	42	28	86

Note: * defined as (imports-exports) / GDP; ** defined as (investment-saving) / GNP. *Sources*: Calculated from Table 1 in *Developing the Occupied Territories*, Vol. 2 (1993) and a memo issued by the Palestinian National Authority, Ministry of Finance, October 1998.

Another manifestation of the resource gap and the central role played by factor incomes is the investment-saving imbalance. Domestic savings in every year of the occupation were negative. Thanks to factor income, however, national saving was positive, and generated part of the funds needed for investment; the rest has been acquired from foreign savings.

The labor market imbalance

The mirror-image of the resource gap is the imbalance in the labor market between the growing supply of labor, reflecting both a high natural rate of growth and the age structure of the population, and the limited capacity for employment due to hostile economic environment of the occupation. Between 1972 and 1987 the labor force increased by around 50 percent, while domestic employment increased by 27 percent

Table 3: The labor force imbalance

	Labor force ('000)	*Number employed ('000)*	*Employed in Israel (in %)*	*Unemploy-ment rate (in %)*
1968	146.6	128.0	0.0	13.1
1975	206.6	264.7	32.4	0.9
1980	218.5	215.7	34.8	1.3
1985	251.5	242.1	36.8	2.6
1990	307.8	297.0	36.4	3.7
1995	497.2	402.9	16.1	18.2
1997	572.	444.9	16.1	22.1

Source: Farsakh (1998, Tables 2, 5).

Table 4: Sectoral disarticulation. Sectoral shares in GDP (%)

	Palestine	Jordan	Egypt	Israel
Agriculture	25	6	18	2
Industry	10	17	30	22
Construction	14	7	n/a	10
Services	48	37	52	65

Source: The figures for Palestine are calculated as an average of two years to smooth the olive cycle. They are taken from estimates of the UNCTAD Secretariat for the years 1992-1993. The rest of the figures are calculated for 1991 at current prices. World Bank (1994). *Peace and the Jordanian Economy* (Table 1.2, p. 10).

in the West Bank, and 18 percent in Gaza Strip. The difference was mainly absorbed by the Israeli market, in which employment of Palestinians from the West Bank increased by 80 percent, and from Gaza strip by 163 percent, in the same period. Table 3 shows the main features of the labor market.

The sectoral distortion

While the resource gap and the labor market imbalance portray weaknesses of the Palestinian economy at the macro level, the sectoral distortion pertains to the underlying causes of this weakness at a micro level. Table 4 presents the Palestinian sectoral shares in GDP, along with those of neighboring countries. The harmful structural transformation noted previously is revealed by the fact that the share of agriculture in Palestine is the highest, and its share of industry the lowest. It is striking that the Palestinian agricultural share is more than four times that of Jordan, while its share of industry is little more than half that of Jordan.

Table 5: The infrastructure gap, 1992-1994

	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Egypt	55.0	650	21.0	14.0	50	4.3	39
Jordan	3.9	1,120	25.0	19.0	100	7.0	170
WBGS	2.4	1,450	13.0	30.0	25	3.1	80
Lebanon	4.0	2,500	32.0	n/a	n/a	9.3	n/a
Syria	13.0	2,800	30.0	n/a	63	4.1	180
Israel	5.1	13,500	82.0	4.0	100	37.1	266
LMICs*	1,152.6	1,620	21.5	12.4	-	7.9	-

Notes: (1) population (million); per capita income (US$); (3) electric supply (kw per 100 people); (4) electric power system loss (percent); (5) households with sanitation (percent); (6) number of phones (per 100 people); (7) meters of paved roads (per 100 people). * Lower Middle Income countries. *Source*: Diwan and Shaban (1999).

The infrastructure gap

Fiscal compression and under-investment as well as neglect in the public sector have made the Palestinian economy seriously deficient in most infrastructures and public services. Table 5 shows that the Palestinian economy is lagging behind in all infrastructure provision as compared to its neighbors. Transportation and sanitation are in dire straits. Almost all the major roads in the West Bank and Gaza Strip were constructed before 1967, and have received minimal maintenance during the years of occupation. Sanitation is in health-threatening conditions, as only 25 percent of households in the West Bank and Gaza Strip are connected to sewerage networks. Garbage collection is deficient and poses a major health hazard. One feature of Table 5 is especially noteworthy: at the regional level, Israel is ranked first, and the Palestinian territories last in infrastructure provision.

Conclusion

The asymmetrical division of power between Israel and the Palestinians, which lies at the very root of the Palestinians' economic and political problems, has enabled Israel to deny Palestinians access to their own natural resources and to sustain the exploitive structures Israel was able to impose on the Palestinians during occupation. Zionist colonial policies over more than a quarter of a century of occupation have engendered debilitating path dependence in the Palestinian economy. Six years of limited self-rule have not been able to overcome that path and to replace it by a qualitatively new growth-augmenting style of development. The Palestinian economy today is almost as dependent on Israel as it was during the occupation years.

Notwithstanding some improvements in the economic environment brought about by the establishment of limited self-rule, the essence of the relation between the Israeli and the Palestinian economies is still as it was during the occupation. A relation between two dissimilar and unequal economies, whereby the large economy practices policies that keeps the small economy weak and dependent. The working of the labor market best epitomizes the dynamic of this relation. The dynamics of this export of labor to Israel, instead of being a vehicle to stimulate domestic economic activities, became a means of paying for imports from Israel. The Palestinian imports bill, of which 90 percent goes to Israel, amounts on average to around 60 percent of Palestinian GDP and more than 50 percent of private consumption.[21] Put it another way, the Palestinian economy became doubly dependent on the Israeli economy for income and imports. The former amounts to almost 30 percent of GNP and the later to around 40 percent.[22] The vulnerability of the economy to such one-sided dependency has been exposed in the 1990s after Israel implemented its permits and closure policies.[23] Estimates of economic losses from the resulting interruption to labor and trade flows vary, but most indicate very big losses, reaching in 1996 about 18.2 and 39.6 percent of GNP of the West Bank and Gaza Strip, respectively.[24]

Obviously, a relation between two neighboring countries in which measures taken by one can cause the other to lose overnight the income of one-third of its labor force, and interrupt 90 percent of its imports and 80 percent of its exports, is simply untenable. This disproportionality in what might be called the costs of dissociation renders the Palestinian-Israeli relation unstable and must be both corrected and seen to be corrected if more rapid economic growth is to develop. From the Palestinian side, this requires a complete eradication of all activities that skew the relation in favor of Israel and its polarization effects. It also requires a new arrangement where there is a clear matching between responsibility and authority. For example, those who have the power to license business should also have the authority over crossing of borders and movements of goods, labor, and capital.

The total independence of the Palestinians and their full sovereignty and control over their resources are necessary conditions for a growth-augmenting path and for anchoring peace on firm and durable foundations. Re-establishing their natural links to the Arab world should be a Palestinian dominant strategy that can help them in redeveloping their natural and historical markets and for developing competitive norms and experiences under symmetrical conditions for a smooth re-entry into the world economy. Nothing else will work.

Notes

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1. For a good analysis of these effects see Krugman and Obstfeld (1994), Krugman (1998), and Thirlwall (1994).

2. The advanced economy is generally more productive in the majority of sectors. The small economy will be able to export to the large economy goods that have no absolute advantage in production provided it has smaller productivity disadvantages and its labor accepts wages lower than those prevailing in the large economy. Free mobility of labor would induce labor to move from the low-wage small economy's industries to the high-wage large economy's industries, gradually wiping out the former and expanding the latter. In the long-run, no industry will survive in the small economy unless it enjoys an absolute advantage over its counterpart in the large economy, and that means a predominance of low-skilled industries.

3. See German-Arab Chamber of Commerce (1995).

4. For analysis of the cost of agricultural products, see Awartani (1994), and for similar analysis related to garments, pharmaceuticals, and shoes see Makhool (1996).

5. Awartani (1994); Makhool (1996).

6. UNCTAD (1996).

7. UNCTAD (1984).

8. UNCTAD (1993).

9. World Bank (1993, vol. 4, p. 54).

10. World Bank (1993, vol. 4, p. 20).

11. World Bank (1993, vol. 4, p. 20).

12. The very low contribution of agriculture to GDP and exports reflects the rapid transformation of the Israeli economy towards high-tech activities, as well as a considerable reduction in government subsidies to agriculture in recent years.

13. Hazboun (1986).

14. UNCTAD (1990); Kahan (1987).

15. Al-'Aloul (1987); UNCTAD (1990).

16. World Bank (1993, vol. 3, p. 16).

17. Fischer, *et al*. (1994, p. 120).

18. Hamed and Shaban (1993); Luski and Weinblatt (1996).

19. M. Benevenisti, ex-deputy of the Mayor of Jerusalem. See Roy (1995, p. 195).

20. This Israeli behavior is quite consistent with past British and French colonial behavior in the Middle East. One of their major underlying economic principles was that "colonies should pay for themselves without recourse to special financial assistance from the metropolis." Owen and Pamuk (1999, p. 52).

21. UNCTAD (1998, Table 7, p. 108).

22. UNCTAD (1998, Table 7, p. 108).

23. Since March 1993, Israel has closed intermittently various borders — between the West Bank and Gaza Strip, between the West Bank or Gaza Strip and Israel or the rest of the world, and between various cities and communities of the West Bank — for varying lengths of time.

24. Diwan and Shaban (1999, p. 52).

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