

Research Paper

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Realigning EU Policy in Palestine Towards a Viable State Economy and Restored Dignity



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Summary

- The EU's policy towards Palestinian economic development has long been subordinate to the political process between Israel and the Palestinians, which is not functioning. This paper calls for the EU to rethink its policy to find ways to decouple Palestinian economic development from the political process, to the greatest degree possible. If Palestinians achieve a sovereign state, they will need a viable economy to support it. Conversely, if this fundamental political goal is delayed for the longer term, Palestinians are still entitled to dignified lives until they realize it.
- As an official European Neighbourhood Policy (ENP) country, Palestine has received more than €6 billion in EU aid since 1994. But neither has Europe's vision of helping Palestinian economic development been realized, nor have its interests been met in ensuring the security of Israel or advancing stability in the region. After more than 20 years of an ailing peace process between Israel and the Palestinians, the majority of EU funding has been dedicated to supporting the Palestinian Authority (PA) through an unsustainable economic situation and to supporting the humanitarian needs of Palestinians instead of their development. The 'myth' of a Palestinian economy has come to prevail.
- The framework of the last two decades – which predicated Palestinian economic development on political progress in Israeli–Palestinian negotiations – has failed. The very high rates of poverty and unemployment in the Palestinian territories – with joblessness averaging almost 25 per cent for the past decade and reaching 27 per cent in 2014 – sit at odds with the ENP's principles and objectives. Political dependency and Israeli control of the Palestinian economy have reduced it to a political instrument for which the greatest lifeline is EU funding.
- For the EU, three core priorities should lie at the centre of turning a vision of a Palestinian economy into a reality: the political drive to alter the framework of near-total control of politics over economic development; revitalizing the Palestinian private-sector to create employment opportunities; and continued support for the PA in achieving economic self-reliance. Previous efforts to deal with the second and third priorities have foundered because of the failure to deal with the first, the political 'disablers' that have undermined the impact of any attempts to create 'economic enablers' and construct an environment conducive to private-sector growth and institutional self-reliance.
- The approach advocated by this paper is not the so-called 'economic peace'. Economic development is not a substitute for political rights. As an educated and entrepreneurial people, Palestinians are capable of creating a viable economy that would support a sovereign state unreliant on foreign aid.
- The EU policy shift would have to entail effective engagement of Israelis and Palestinians to address each other's security requirements in accordance with international standards. This includes addressing Israel's occupation and its 'layering' of measures under the name of security that undermine Palestinian economic development. A crippled Palestinian economy does not make Israel safer, but it meanwhile diminishes Palestinian dignity and hope for the future.
- Such a shift in policy on the part of the EU would better align Europe with its own ENP objectives, and would be a critical positive response to political factors at play in the Middle East. It would fill the void arising from the reduced US focus on Israel and Palestine. However, this policy shift would be enhanced if it were fortified with a degree of US acceptance – if not support.

Introduction

The aim of this paper is to persuade the European Union (EU) to shift its policy from supporting the current framework of Palestinian economic development, which in effect subordinates the economy to a political process that has become stalled and dysfunctional. It calls for the decoupling of economic development from the peace process, irrespective of the political roadblocks – or possible future progress – in the latter. Ultimately, such a policy shift would help create a more equitable environment that would help advance genuine progress towards a just solution between Israel and the Palestinians.

Shifting EU policy in this way would represent a significant step towards affording Palestinians the right to a viable and self-sustaining economy, independent of donor aid. It would also realign the EU's policy with its own core European Neighbourhood Policy (ENP) principles, which have guided Europe's support for Palestinian statehood and development.¹ Hitherto, de facto implementation of EU development assistance to the Palestinians has been at odds with those very principles of instilling stability, security, good governance and well-being because it has been subordinate to a failing political process and has rarely advanced beyond short-term humanitarian and government-expenditure support. Furthermore, a policy shift would have a positive impact on stability and security in the Middle East, and would also help improve the public perception of the EU in the region, which has suffered over the past decade. A positive policy shift as set out in this paper would go some way to enhance the perception of the EU as an equitable interlocutor in this and in other pressing matters in the region.

In May 2015, in a letter to the High Representative of the European Union for Foreign Affairs and Security Policy and Vice-President of the European Commission (HR/VP), Federica Mogherini, members of the European Eminent Persons Group (EEPG) urged the adoption of a new approach to resolving the Israeli–Palestinian conflict. The text highlighted, *inter alia*, the inequality in international status between Israel and the Palestinians as a serious flaw that has compromised the integrity of the peace process.² Recommendations included a resumption of negotiations – with recognition of the equality of the parties – with a mandatory deadline for the completion of an agreement establishing a two-state solution. The letter also included a recommendation on close and proactive involvement in the process of encouraging Palestinian reconciliation as a prerequisite of that solution.

Whether or not in the context of the 2015 ENP review announced by HR/VP Mogherini,³ or in the context of the European Council's work on the Middle East peace process, a policy shift on the part of the EU would be a timely and significant response to economic and political deterioration in the Occupied Palestinian Territories (OPT). Palestine has been an official partner in the ENP since its implementation in 2004, and has received more than €6 billion in EU aid since 1994.⁴ However, the

¹ European Union, *Palestinian Authority Action Plan, Political Chapeau*, http://eeas.europa.eu/enp/pdf/pdf/action_plans/pa_enp_ap_final_en.pdf; European Commission, *Evaluation of the EU Cooperation with the occupied Palestinian territory and support for the Palestinian People*, July 2014, http://ec.europa.eu/europeaid/sites/devco/files/evaluation-cooperation-ec-palestine-1327-main-report-201405_en.pdf.

² European Eminent Persons Group letter to the High Representative of the European Union for Foreign Affairs and Security Policy and Vice President of the European Commission, 11 May 2015, <http://static.guim.co.uk/ni/1431517700142/EEPG-letter.pdf>.

³ Under a consultation process which ended on 30 June 2015, the European External Action Service and the European Commission received contributions from stakeholders across the EU, including partner countries, civil society, think-tanks and academia. These submissions were intended to inform further communication, in the second half of 2015, setting out concrete proposals for the future direction of the ENP. For fuller details, see http://eeas.europa.eu/top_stories/2015/300615_enp-consultation_en.htm.

⁴ These objectives are stated, for instance, in European External Action Service, *The European Union and the Palestinians: Real partners make a real difference*, http://www.eeas.europa.eu/delegations/westbank/documents/news/2013_generalbrochure_en.pdf.

grave conditions of insecurity, unemployment and economic stagnation that have prevailed in Palestine over the long term run counter to the ENP's objectives of strengthening prosperity, stability and security.⁵ Given that the EEPG has itself described the protracted Oslo peace process as 'effectively defunct',⁶ and given the great difficulties Palestinians have come to endure, ENP principles and objectives can no longer stand up to scrutiny.

Moreover, shifting policy on this critical issue would help to make a revised ENP more credible. Indeed, the EU's ENP commissioner, Johannes Hahn, told EU heads of delegation in September 2015 that the new, revised ENP would pay more attention to the root causes of instability, including those that fall outside the traditional, narrow definition of 'security'. There would be more emphasis on economic development, recognizing that the lack of economic opportunities feeds into instability, he said, while also retaining a focus on universal human rights.⁷

Under the Oslo process, economic development for Palestine has effectively been subsidiary to, and fully dependent on, the peace process between Israel and the Palestinians, based on the international community's belief that progress in the latter would in turn bring with it economic development for Palestine. More than two decades later, however, neither is a sovereign Palestine in prospect through this process, nor has a Palestinian economy become a viable reality.

A shift in EU policy should be based on three priorities. First would be a political decision, and subsequent push, to alter the current framework, which has allowed near-total political control over economic development, and to enable, instead, a framework whereby Palestinian economic development is no longer liable to political failures. Second would be to influence Israel to allow Palestinians to leverage their own resources and revitalize the private sector in order to create employment opportunities. Third, and equally critically, would be continuing support for the Palestinian Authority (PA) in its efforts towards a self-reliant state economy.

A major obstacle remains Israel's security and occupation policies, which weigh heavily on the Palestinian economy. Israel's right to safety and security must be respected – as for any country. However, the EU must challenge Israel on the additional measures that it carries out in the name of security, particularly those that do not make Israel more secure – or that do not afford a potentially relatively prosperous Palestine the opportunity to forge dignified self-reliance. The EU must therefore challenge Israel, as an occupier, on those measures – various in nature, frequency and duration – that have clearly led to economic deterioration in the OPT and that critically impede virtually all Palestinians in their daily lives. Consistently high unemployment and increasing poverty, especially over the past 10 years, have fuelled the grievances and at times the violence that in turn frustrate efforts to promote stability and also allow for Israel's own security.

Furthermore, Israeli restrictions such as those on movement, those that impede the economic development of Area C,⁸ and those that largely prevent unimpeded commercial exchange between the West Bank and Gaza, as well as exports and imports from abroad, have greatly disabled the

⁵ European External Action Service, 'What Is The European Neighbourhood Policy?', http://eeas.europa.eu/enp/about-us/index_en.htm.

⁶ European Eminent Persons Group letter to the High Representative of the European Union for Foreign Affairs and Security Policy and Vice President of the European Commission, 11 May 2015.

⁷ EU Neighbourhood Information News Centre, 'Commissioner Hahn reveals 'sneak preview' of new European Neighbourhood Policy', 4 September 2015, <http://www.enpi-info.eu/eastportal/news/latest/41926/Commissioner-Hahn-reveals-%E2%80%98sneak-preview%E2%80%99-of-new-European-Neighbourhood-Policy>.

⁸ More than 60 per cent of the West Bank is classed as Area C, where Israel retains almost exclusive control including over law enforcement, planning and construction. See UN Office for the Coordination of Humanitarian Affairs (OCHA) occupied Palestine territory, 'Area C of the West Bank: Key Humanitarian Concerns', Fact Sheet Update August 2014, https://www.ochaopt.org/documents/ocha_opt_area_c_factsheet_august_2014_english.pdf.

Palestinian economy. The PA has become dependent on foreign aid to sustain itself, rather than being able to develop a viable economy, and the EU has become the perpetual financier – providing aid and budget support that enables the PA to keep the economy barely afloat. In the absence of an effective political challenge from the EU, and since EU finance continues to support the PA to avoid its collapse, Israel has had little incentive to alter its security and occupation policies. Israel, for its part, is fully aware of the burdens and liabilities arising from the lack of Palestinian development, and is satisfied with the EU continuing to shore up the PA financially.

The PA has become dependent on foreign aid to sustain itself, rather than being able to develop a viable economy, and the EU has become the perpetual financier – providing aid and budget support that enables the PA to keep the economy barely afloat.

There are additional real and perceived obstacles that discourage EU governments from devoting further political capital to the Palestinian crisis, obscuring the urgency with which this should be addressed. These obstacles include broader regional developments – such as the escalating conflicts in Syria, Libya and Yemen, and the Syrian refugee crisis – which now take a higher priority on the policy agenda. Within Europe, furthermore, some experts feel that EU will not be sufficiently trusted by Israel to take a larger role either in the peace process or in any of the fundamental aspects such as Palestinian economic development. Others in Europe are reluctant to challenge Israel's position, predicting that it would reject alternatives. A widespread view among European policy-makers is that for the EU to deviate from US policy on Israel and Palestine would harm Europe's treasured transatlantic alliance with Washington, but this is not necessarily the case. All this undermines the EU's credibility in the Middle East, saps trust and stores up far greater difficulties for the future. The issue of Palestine will not disappear. Rather, losses will become greater, the costs of maintaining an unchanged policy will increase, and, inevitably, any eventual resolution will come at even greater cost. Moreover, the perpetuation of the conflict between Israel and the Palestinians has a negative impact on the perception of the international community – including the EU – in the eyes of the people of the Middle East. The current approach to the conflict may be likened to repeatedly pressing the snooze button on an alarm clock.

Harsh living conditions and high levels of poverty have caused many unemployed Palestinians to take their children out of school, forcing them on to the streets in search of any means to earn a basic living. In a society where this was previously rare, anecdotal evidence suggests that for some Palestinian households children are now becoming the main breadwinner.⁹ For those who have descended into joblessness and poverty in recent years, the notion of development assistance – and of the donor funding that supports it – is regarded as both irrelevant and insignificant. Moreover, the general view among Palestinians is that donors are perpetuating the current state of affairs in order to avoid challenging Israeli policy. This is not what the EU originally intended.

Multilateral and bilateral aid organizations working in Palestine – including bilateral organizations from EU member states – could do far more to draw attention to the urgency of fostering a viable Palestinian economy. These organizations have witnessed the failure of a framework that, rather than being an enabler of genuine development and growth, has essentially come to be used by Israel

⁹ To date, no official statistics have been compiled that document the number of children who have become their family's main breadwinner. However, evidence on the ground, particularly in the Gaza Strip, testifies to this new phenomenon.

as a political lever that frustrates Palestinian development initiatives – which often end in failure or with their effectiveness on the ground severely compromised.

Regardless of whether the political process between Israel and the Palestinians eventually progresses or remains stalled, the PA, the Israeli government and donor countries must all consider the compromise to the livelihood of Palestinians that the conflict continues to inflict. At present, and in the effective absence of the peace process, the EU's policy of supporting economic development has come to prop up failure rather than helping to build peace, and economic and infrastructural development has taken a back seat to humanitarian aid. A change of approach is necessary.

The current framework – and its failings

This paper discusses the relationship between Palestinian economic development and the negotiations between Palestinians and Israelis under the Oslo peace process. Within this framework, it was envisaged that Palestinians would be assisted to develop a viable economy that would be ready and able to support a sovereign state arising from the successful conclusion of negotiations for a two-state solution.

The necessity that the US, the EU and some Arab states would help support Palestinian economic development came hand in hand with the signing of the Oslo Accords in 1993¹⁰ between the Palestine Liberation Organization (PLO) and Israel. Under the terms of the Oslo Accords, the PA was established as an interim administration intended to establish institutions, build an economy in the OPT and run Palestinian affairs for a transitional period, not exceeding five years, leading to a permanent settlement based on UN Security Council Resolutions 242 and 338. Palestinians envisioned this permanent settlement as culminating in a two-state solution, whereby Palestine would become a sovereign state with a viable and active economy in place to support it.

The framework was flawed from the outset, not least because the prospect of Palestinian economic development was established as an adjunct to, and contingent upon, the peace process rather than as a discrete effort that would itself catalyse a positive political accommodation between the Palestinians and Israel. Israel's total control of the crossing points leading to and from the OPT, and of all import-export and transport routes, meant that it was able to pressure the Palestinians by restricting their economy's ability to develop. Furthermore, efforts towards a viable and self-sustaining Palestinian economy became consistently subordinate to cyclical political crises, with Israel often employing development as a political instrument by which to exert pressure on the Palestinians – for example withholding tax and customs levies owed to the PA, for periods exceeding what was agreed based on the 1994 Protocol on Economic Relations (or Paris Protocol), for political reasons. The most recent such instance occurred in January–March 2015,¹¹ in response to the Palestinian application for admission to the International Criminal Court (ICC).¹² In other words, Israel employed what was otherwise a protocol on economic relations to exert political pressure on the PA. Israel eventually released withheld revenues to the PA, but by the active exercise of the imbalance of control under the

¹⁰ Central to the Oslo Accords was the Declaration of Principles on Interim Self-Government Arrangements, signed in Washington, DC, in 1993, whereby Israel and the PLO declared that 'it is time to put an end to decades of confrontation and conflict, recognise their mutual legitimate and political rights, and strive to live in peaceful coexistence and mutual dignity and security and achieve a just, lasting and comprehensive peace settlement and historic reconciliation through the agreed political process.' A full text of the Declaration of Principles is available via, *inter alia*, http://news.bbc.co.uk/2/hi/in_depth/middle_east/israel_and_the_palestinians/key_documents/1682727.stm.

¹¹ 'Israel likely to withhold additional \$100m in Palestinian tax funds', The Media Line, 2 February 2015. <http://www.ynetnews.com/articles/0,7340,L-4623165,00.html>.

¹² By joining the ICC, Palestinians could request the court to indict Israeli officials for war crimes and/or other breaches.

status quo, it has frequently placed the PA under considerable, and at times critical, financial strain. Tax and customs revenues typically amount to 70 per cent of the PA's revenues, and when these have been withheld by Israel, the PA has been unable to maintain its salary payments to public officials¹³ – even when it has continued to receive direct financial support from the EU towards its salary obligations.

Consistently high rates of unemployment and severe fluctuations in economic growth and contraction in the Palestinian territories are evidence that the political–economic model instituted under the Oslo process has not worked. Moreover, simply to recommend solutions within this present framework would be highly unlikely to yield results; and while some European experts and current and retired officials interviewed for this paper have acknowledged the shortcomings of the current model, they are not certain about what could feasibly be done to fix it. Certain Israeli policies, such as restricting Palestinian activity in Area C and leveraging the Paris Protocol against the PA, are widely perceived by European officials and experts as going beyond security concerns and being politically motivated. And while the political process between Palestinians and Israel has been stalled, if not in constant regress, they do not see what Europe could do to alter the current situation. Thus, this paper makes the case for serious consideration of an approach that would decouple economic development and the political process as far as possible. While, of course, politics and economics will always be linked, this paper emphasizes a change to the approach that has dominated since Oslo, which has made economic development largely hostage to the political process – or political regress – between Israel and the Palestinians.

The inability of the PA to control the inflow of its own tax and customs revenues has, therefore, fundamentally affected its ability to manage its budget predictably and to pay salaries on time. Israel's practice of withholding these revenues at times when it wants to place political pressure on the PA was, apparently, unforeseen by the Palestinians when the Paris Protocol was negotiated. Two decades on, the international community should consider new options either to ensure that the protocol's provisions on timely transfer of revenues are met, or actively to encourage Israel and the Palestinians to find other ways to allow the PA to collect the revenues that are due to it.

¹³ See for instance, World Bank, West Bank and Gaza Overview (September 2015 update), <http://www.worldbank.org/en/country/westbankandgaza/overview>.

The Reality of EU Assistance – How Palestinians Pay Heavily

The EU originally envisioned its funds being used to support long-term economic development in the Palestinian territories, but despite the disbursement of more than €6 billion in EU funds to the Palestinian people over the past two decades, Palestinians still barely have a functioning economy. With the foundering of an economic model so closely dependent on the political process, which has failed to progress, EU funds have largely been used in support of the Palestinians' short-term economic and humanitarian needs. In the period 2000–13, direct and indirect financial support to the Palestinians amounted to 43 per cent of total EU support; total support to the UN Relief and Works Agency for Palestine Refugees in the New East (UNRWA) amounted to 31 per cent; and humanitarian aid, food aid, food security and food facility constituted 11 per cent of the total for the same period.¹⁴ Direct and indirect financial support represented support to the PA to meet its recurrent expenditures on public sector salaries, pensions and social allowances to households living in extreme poverty. Further, while support to UNRWA was mainly earmarked to fund health and education, it also entailed support for relief, protection programming and addressing essential humanitarian needs of Palestinian refugees, all of which have become growing demands.¹⁵ Although through continued goodwill, rather than because it considers this to be the best strategy for the Palestinian economy, the EU's support has come to focus more on meeting this combination of urgent demands, while longer-term economic development and private-sector needs have ended up taking a back seat.

That the current state of affairs comes at far greater cost to Palestinians than to Israel and to the EU only exacerbates the Palestinians' sense of compromised dignity and erosion of trust in the goodwill of the powers involved in the peace process. Furthermore, the longer the economic decline under the impact of Israel's security and occupation policies is allowed to continue, the greater will be the cost of restoring Palestinian livelihoods. The question arises as to whether Europe wants to continue footing the bill. The reality is that conditions in one of its ENP countries run counter to the policy's central principles and objectives.

[T]he longer the economic decline under the impact of Israel's security and occupation policies is allowed to continue, the greater will be the cost of restoring Palestinian livelihoods.

A World Bank study published in 2013 estimated that if the severe restrictions that Israel imposes on Area C in the West Bank were to be lifted, the potential economic gain in Palestinian gross domestic product (GDP), in terms of direct and indirect added value, would amount to some \$3.4 billion annually.¹⁶ This far exceeds the combined annual aid to the Palestinians from the EU and other donors. In 2005, for example, net official development assistance and official aid received, in current US

¹⁴ Data provided to the author by the Office of the European Union Representative, West Bank and Gaza Strip, UNRWA.

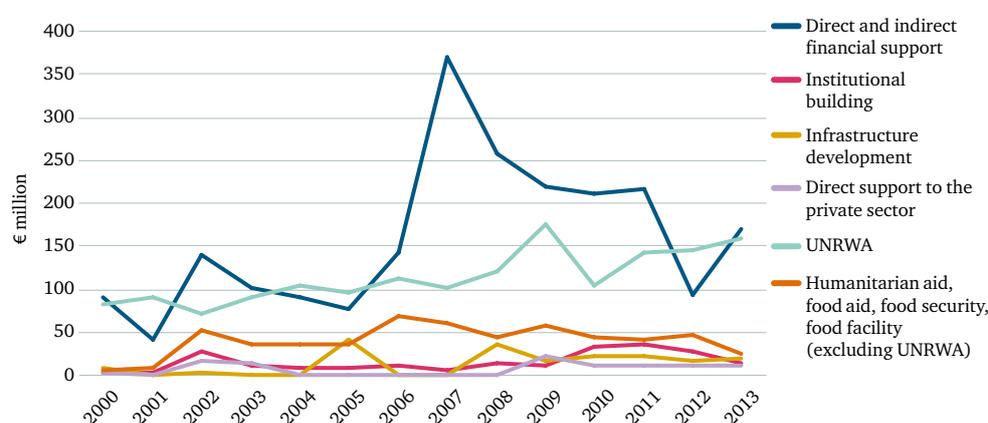
¹⁵ European External Action Service, *The European Union and the Palestinians*.

¹⁶ World Bank, *West Bank and Gaza – Area C and the Future of the Palestinian Economy*, West Bank and Gaza General, http://www.wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/01/23/000442464_20140123122135/Rendered/PDF/AUS29220REPLACOEVISION0January02014.pdf.

dollars, totalled slightly more than \$1 billion. Disbursements reached their highest point, at \$2.83 billion, in 2009, and stood at \$2.61 billion in 2013.¹⁷ In other words, Palestinians are in effect deprived of the opportunity to earn considerably more than the aggregate foreign aid they receive; donor aid is poor compensation for what Palestinians could legitimately earn if their economy was freed up. Adding potential contributions to Palestinian GDP from the remainder of the West Bank and from the Gaza Strip would arguably contribute further to this premium.

Equally important is the need to recognize that the PA has established the necessary governing institutions and mechanisms of a functioning economy, and that Palestinians possess the expertise and the motivation to develop such an economy. In a 2011 review, IMF staff assessed that ‘the PA is now able to conduct the sound economic policies expected of a future well-functioning Palestinian state’.¹⁸

Figure 1: Main EU financial commitments to the Palestinian people, 2000–13



Note: The EU provides three additional streams of funding, for East Jerusalem initiatives; civil society; and assistance under the Common Foreign and Security Policy and Rapid Reaction Mechanism. Together, these accounted for €341 million of the €5.2 billion disbursed in 2000–13, or some 6.5 per cent of the total.

Source: Office of the European Union Representative, West Bank and Gaza Strip, UNRWA.

Over the period 2000–13, the EU committed €5.22 billion to the Palestinian people. The total support to what could be considered development assistance over the same period – i.e. combined funding for institution-building, infrastructure development and direct support to the private sector amounted to 9.5 per cent of the total. As noted above, the remainder went mainly to non-developmental government expenditures and to humanitarian and refugee support. Even if it is assumed that one-third of the support for government spending, in the form of direct and indirect financial support, went on development, i.e. an additional 14 per cent of total EU support, the total proportion of aid used for development would be no more than 25 per cent.

The PA has been the symbol of the ongoing peace process – albeit a process that has in effect been set aside with its aims unachieved – and an example of successful institution-building that must be preserved. The issue now is that the Palestinian institutions need an economy to sustain them – and that will be able to provide employment for the hundreds of thousands of Palestinians deprived of economic opportunity under current conditions. With aid subordinated to political conditions,

¹⁷ World Bank, Net official development assistance and official aid received (current US dollars), West Bank and Gaza, <http://data.worldbank.org/indicator/DI.ODA.ALLD.CD/countries>.

¹⁸ International Monetary Fund, *Macroeconomic and Fiscal Framework for the West Bank and Gaza: Seventh Review of Progress*, 13 Apr 2011, <http://www.imf.org/external/country/wbg/rr/2011/041311.pdf>.

the prospect of Palestinian economic advancement has been practically nullified by deterioration on the ground, despite relatively high per capita aid spending. As principal financier, the EU has been put in a position of having to spend more on aid for humanitarian, subsistence and service provision, such as for water and sanitation, rather than on supporting infrastructure development and economic advancement. In parallel, opportunities for political engagement have taken a back seat to preventing the economic collapse of the PA.

In summarizing its partnership with the Palestinians between 2008 and 2012,¹⁹ the EU described the Palestinian institution-building process as an international success story. But the nominally exemplary PA institutions have largely lacked a viable economy to support them and have been dependent, to varying degrees, on the EU's direct financial support.

The impact of Israeli restrictions

A major factor limiting the efficacy of EU aid is the restrictions that Israel places on Palestinian economic activity and individual livelihoods through a combination of security and occupation policies that to Palestinians go beyond international standards. The layers of measures implemented by Israel under the name of security do much to undermine the ability of Palestinians to realize their aspirations; and such apparently arbitrary measures lend credibility to the Palestinian perception of Israeli restrictions as ones that make their lives difficult and diminish their hopes for a dignified future and yet fail to advance Israel's security. For example, the lengthy delays at checkpoints in the West Bank are often not the result of great crowds of people wanting to cross, but are rather due to an Israeli commander's decision to not let people through. Of course, the effects of Israel's policy are greater than these delays. Not only does the unpredictability of when, how and where such measures are imposed make it very difficult for ordinary people to go about their daily lives, but it also makes it very difficult for the PA reliably to plan and implement economic development measures.

Through its security and occupation policies, Israel could thus be said to have created the conditions whereby Palestinians have been effectively disallowed from utilizing much of the financial assistance that they have received, and whereby the pipeline of EU aid keeps them afloat – and only that. Faced with so many obstacles in the form of Israeli restrictions, but also conscious that the flow of aid will be maintained as a sign of good faith in the political process, the PA has not consistently sought ways of utilizing assistance to foster economic growth as much as it has become concerned about sustaining itself through Israel's restrictions.

The lack of Palestinian economic and infrastructure development presents great risks. Economic deterioration, and what this entails both in terms of financial loss and diminished aspiration for the Palestinians, will inevitably harm Israel's security and fuel further enmity.

Hundreds of military checkpoints and security barriers around the West Bank, the inaccessibility of Area C and the blockade of the Gaza Strip (described in fuller detail below) provide stark examples of economic disablement. Notably, Israel has allowed Palestinians to plan development only in about 1 per cent of Area C.²⁰

¹⁹ European External Action Service, *The European Union and the Palestinians*.

²⁰ OCHA, 'Area C of The West Bank: Key Humanitarian Concerns', Fact Sheet Update August 2014; OCHA notes that: 'The lack of an appropriate planning and zoning system in Area C means that most Palestinians cannot obtain permits for construction or rehabilitation of homes, animal shelters, or essential infrastructure.'

In its Palestinian Reform and Development Plan for 2008–10, the PA highlighted the risks that Israel’s occupation measures represent to its efforts towards economic development that would create jobs.²¹ Although not explicitly set out in any of its development plans – rather, by default as a consequence of Israeli policies – the PA became the principal employer in the Palestinian territories. The PA thus came to play an involuntary role in the economic difficulties with which it had to contend, as the proliferation of government jobs left the administration with an inflated payroll burden. In a working document published by the European Commission in March 2015, the office of the HR/VP, noting that the Palestinian economy had been slowing since 2013 and had entered recession in 2014, stated: ‘The restrictions imposed by the Israeli occupation, particularly in Area C, remained the biggest obstacle to Palestinian socio-economic development.’²²

Meanwhile, the Palestinian private sector in the Gaza Strip became virtually inactive,²³ with the Israeli blockade – in particular the severe restrictions on the movement of goods and people in and out of the territory – acting as a major disincentive to private-sector investment in projects there. The private sector in the West Bank functioned rather better, but could arguably have achieved far more had it not had to contend with restrictions on movement via Israeli checkpoints²⁴ – and if it were allowed to tap the potential of Area C. Such underperformance, from a private sector that could otherwise drive a well-functioning economy,²⁵ has also meant a major opportunity cost for the PA, in terms of foregoing the tax revenues that could otherwise have accrued in both the West Bank and Gaza. To give just one example, Gaza’s subdued agricultural sector offers multiple examples of loss of opportunity and of potential revenue generation.²⁶

The EU has dedicated assistance to the Palestinian private sector, but, as illustrated above, this allocation has been relatively modest as a share of overall funding. In the case of Gaza, the conjunction of the de facto Hamas administration and the Israeli blockade apparently made it very difficult for the EU to support private-sector activity.

Following the 2006 Palestinian legislative elections, at which the Islamist Hamas won a decisive victory and displaced the rival Fatah of PA President Mahmoud Abbas, the position of the EU²⁷ (as part of the Quartet with the UN, the United States and Russia) was to continue supporting President Mahmoud Abbas and the Palestinian people. However, it stated that it could not

²¹ Palestinian National Authority, *Palestinian Reform and Development Plan 2008–2010*, section titled ‘Implementation issues and risks’, <http://www.mopad.pna.ps/en/attachments/article/2/National%20Plan%202008-2010.pdf>.

²² European Commission, High Representative of The European Union for Foreign Affairs and Security Policy, *Implementation of the European Neighbourhood Policy in Palestine Progress in 2014 and recommendations for actions*, 25 March 2015, Page 3, http://eeas.europa.eu/enp/pdf/2015/palestine-enp-report-2015_en.pdf. The paper further noted that the PA had none the less achieved results such as: developing local employment and training councils; endorsing a new water law; approving implementing regulations for the Public Procurement Law; progress in reforming the energy sector; and presenting a number of sectoral strategies in the fields of export promotion, social protection, environment, water and health.

²³ A 2012 study by the Portland Trust found that by 2010, after three years of the blockade, only one-third of the businesses that had been operating in Gaza in 2010 were still operational, and most of those were operating at around a third of their capacity. The Portland Trust, *Bulletin Special Feature: The Private Sector in the Gaza Strip*, February 2012. http://www.portlandtrust.org/sites/default/files/peb/feature_gaza_feb_2012.pdf.

²⁴ See for instance, Nabila Assaf, *West Bank and Gaza Investment Climate Assessment (ICA): fragmentation and uncertainty*, World Bank, January 2014. <http://documents.worldbank.org/curated/en/2014/01/20189765/west-bank-gaza-investment-climate-assessment-fragmentation-uncertainty>. This concludes, inter alia, that ‘political instability, the result of the unresolved conflict and the restrictions on movement and access to resources and markets, remains the key obstacle to economic growth’ in the West Bank and Gaza, and notes that while restrictions had eased within the West Bank since the last ICA in 2006, restrictions on external trade remained significant.

²⁵ Positives cited in the World Bank ICA include labour productivity and bureaucratic functioning on a par with competitor countries, while the US Department of State’s ‘2011 Investment Climate Statement – West Bank and Gaza’ notes that ‘Palestinian businesses have a reputation for a high level of professionalism and product quality ... The labor force is well-educated and familiar with technologies and practices in overseas markets.’ <http://www.state.gov/e/eb/rls/othr/ics/2011/157385.htm>.

²⁶ See for example, Donald Macintyre, ‘Israel’s economic blockade stops Gaza’s strawberry-farmers selling their crop’, *Independent*, 16 November 2007, <http://www.independent.co.uk/news/world/middle-east/israels-economic-blockade-stops-gazas-strawberry-farmers-selling-their-crop-400562.html>.

²⁷ Speech by Javier Solana, EU High Representative for the Common Foreign and Security Policy, Middle East Peace Process, 5 April 2006, <http://unispal.un.org/UNISPAL.NSF/0/438E206EDCACBF6F8525714700510B6B>.

continue direct support to the PA under the government of Hamas, unless Hamas unequivocally respected the international community's principles in line with the Quartet statement of 30 March 2006.²⁸ In this statement, the Quartet called on the new Palestinian government to commit to principles of nonviolence, recognize Israel, and to accept previous agreements and obligations.²⁹ The Hamas government did not and was boycotted. The effects of this boycott were compounded by Israeli sanctions and the blockade of Gaza; an adviser to Israel's prime minister stated: 'The idea is to put the Palestinians on a diet, but not to make them die of hunger.'³⁰ In the context of mounting pressures on the Palestinian territories, the 'unity government' brokered between Hamas and Fatah in early 2007 swiftly failed, culminating in Hamas's takeover as the de facto government of Gaza in June of that year. This schism, and the political reality of the Gaza Strip under Hamas administration, further impeded the EU's scope to extend meaningful economic assistance. Israel's designation of the Gaza Strip as a 'hostile entity' some three months later³¹ brought Gaza's economy closer to collapse,³² with severe restrictions including controls over the Palestinian banking system and the flow of paper money into Gaza imposing unprecedented financial burdens on the PA, incapacitating Hamas's de facto government, and further fuelling joblessness and poverty there. It thus became virtually impossible for the PA to rely on the Gaza Strip for any economic growth – not least as there was scant coordination between the (internationally recognized) PA cabinet in the West Bank, which focused its governance there, and the de facto Hamas administration in Gaza.

Many Palestinians perceive donor funding as inadequate and irrelevant, and the PA is not regarded as having worked for the benefit of its own public to the degree that was expected.

But even in the context of the pressure resulting from Israel's policies in the West Bank and Gaza, the extent to which the PA has been able to demonstrate economic growth and productivity from donor funding requires assessment. Notwithstanding the IMF's 2011 assessment of the capacity of the PA (as noted above), government services have not reached deep enough levels of Palestinian society. While government institutions were being built in the West Bank, jobless people in Gaza received little government assistance to help them withstand the impact on their lives of the Israeli blockade. It remains for the PA to address openly with the Palestinians and with the donor community alike whether there were obstacles beyond its control that impeded its ability to fulfil its responsibilities in terms of governance and service provision, or whether it should have reprioritized spending in order to address the immediate needs of its people. Many Palestinians perceive donor funding as inadequate and irrelevant, and often the PA is not regarded as having worked for the benefit of its own public to the degree that was expected.

²⁸ As at October 2015, Hamas remained classified by the EU as a terrorist organization under the terms of Common Position 2001/931/CFSP, adopted by the Council of the European Union in December 2001; see <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32015D1334&qid=1440691334018&from=EN>.

²⁹ Statement of the Middle East Quartet – United Nations, United States, Russian Federation, European Union, 30 March 2006, available at <http://2001-2009.state.gov/p/nea/rls/63910.htm>.

³⁰ Conal Urquhart, 'Gaza on brink of implosion as aid cut-off starts to bite', *Guardian*, 16 April 2006, <http://www.theguardian.com/world/2006/apr/16/israel>.

³¹ 'Israelis declare Gaza "hostile"', BBC News, 19 September 2007, <http://news.bbc.co.uk/1/hi/7002576.stm>.

³² 'Cashless In Gaza?', Wikileaks cable, Leaked Cables on Israel, Israel Kept Gaza Economy Functioning at Lowest Level, 3 November 2008, https://wikileaks.org/plusd/cables/08TELAIV2447_a.htmlhttps://www.jewishvirtuallibrary.org/jsources/US-Israel/wikiIsrael10.html.

Meanwhile, a number of prominent voices in Israel, including some from within the military establishment,³³ have acknowledged the need to change the situation for Palestinians, especially in Gaza, and enable economic development, on the basis that a population that is economically better off would be less motivated to engage in violence and would thus represent a lesser security risk to Israel. Furthermore, Israel has made efforts to ease the situation for Palestinians in the West Bank and Gaza in areas including water and electricity supply and provisions for medical transfers. (These are seen by Palestinians as positive, even though they believe that such matters remain among Israel's obligations as an occupying power.) The Israeli military has also at times increased the number of exit permits issued for travel from Gaza to the West Bank and to Israel, and similarly from the West Bank to Gaza and to Israel, albeit with still limited overall numbers in the case of exits from Gaza. Since the third Gaza war, in 2014, the office of the Coordinator of Government Activities in the Territories (COGAT) within the Israeli ministry of defence has been willing to assist by admitting supplies into Gaza for post-conflict reconstruction, as part of the Gaza Reconstruction Mechanism brokered by the Office of the UN Special Coordinator for the Middle East Peace Process (UNSCO),³⁴ however, this is still regarded as insufficient to meet reconstruction needs.

None the less, such economic concessions or facilitation on the ground have generally been in the context of already severe degradation in the OPT, and are not nearly enough.³⁵ Any improvement over great scarcity may be seen as a substantive change, but in reality this is not the case. Moreover, it cannot be expected that the political aspirations of Palestinians can be muted with economic prosperity alone, let alone by measures that merely ease current hardships.

The EU should therefore engage with those members of the Israeli security establishment who understand that suppressing the prospect of Palestinian economic self-reliance will not bring genuine security to Israel. Eliminating the barriers that stand in the way of Palestinian economic development and Israeli security should not be seen as competing aims.

The West Bank is not much better off than the Gaza Strip

Political conditions, international accessibility and EU support differ between the West Bank and the Gaza Strip. With respective populations estimated at 2.86 million and 1.82 million as at mid-2015,³⁶ Palestinians in both territories³⁷ are subject to conditions that frustrate their ability to develop a viable economy. Israeli military checkpoints and settlement-building fragment the West Bank and chip away at Palestinian land there,³⁸ while Israel's blockade of Gaza in effect cuts the territory off from the rest of the world. While acknowledging Israeli settlements as 'realities on the ground' that represent real

³³ See for instance, Amos Harel, 'Israel's Defense Establishment Recommends Easing Gaza Restrictions', *Haaretz*, 31 August 2014, <http://www.haaretz.com/news/diplomacy-defense/.premium-1.613239>.

³⁴ See <http://www.unsco.org/Gaza%20Reconstruction%20Mechanism%20Fact%20Sheet%209%20October%202014.pdf>.

³⁵ UNRWA estimates that almost 140,000 homes were damaged or destroyed in the 2014 conflict. See United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), 'A year after the Gaza war started, the causes of conflict remain unaddressed', 8 July 2015, <http://unispal.un.org/UNISPAL.nsf/47D4E277B48D9D3685256DDC00612265/207038BA17270EF885257E7C0048A1F9#sthash.Hq5Rl0rd.dpuf>.

³⁶ Source: Palestinian Central Bureau of Statistics, http://pcbs.gov.ps/Portals/_Rainbow/Documents/gover_e.htm.

³⁷ After Israel physically withdrew its army and emptied its settlements in Gaza in 2005, the issue of whether the Gaza Strip is occupied by Israel has been debated. Palestinians regard it as occupied while Israelis do not. In the publication referenced here, the European Commission refers to Gaza as an occupied territory. See European Commission Humanitarian Aid and Civil Protection, *Gaza Crisis*, ECHO Factsheet, August 2014, http://ec.europa.eu/echo/files/aid/countries/factsheets/gaza_en.pdf. Furthermore, the UN Human Rights Council considers the Gaza Strip occupied. See for example, Human Rights Council resolution S-21/1, adopted 23 July 2014, http://www.ohchr.org/Documents/HRBodies/HRCouncil/SpecialSession/Session21/A-HRC-RES-S-21-1_en.doc.

³⁸ Ishan Tharoor, 'Map: The spread of Israeli settlements in the West Bank', *Washington Post*, 22 December 2014, <https://www.washingtonpost.com/news/worldviews/wp/2014/12/22/map-the-spread-of-israeli-settlements-in-the-west-bank/>.

obstacles to realizing a two-state solution,³⁹ and stating that they would like to alleviate the situation of ordinary people in Gaza affected by the blockade, the international community continues to witness the unfolding consequences of Israeli policy with regard to the OPT without influencing any curb on it.

By 2015, after more than two decades of the peace process – and the financial and development support to the Palestinians that has accompanied this process, with combined EU and other assistance averaging more than €1 billion annually – the overall unemployment rate in Palestine exceeded 25 per cent (having averaged some 24 per cent over the period 2005–14).⁴⁰ Such persistently high rates of joblessness run counter to the vision of the EU and other donors that their financial backing would help propel Palestinian development. Moreover, a darker political and economic future is in prospect for Palestine, with a series of severe and avoidable crises along the way, in the absence of a change in EU political and economic policy; and it is highly unlikely that Palestinian reliance on financial aid will lead to prosperity while the main obstacles of Israel's security and occupation policies remain unchallenged.

In the years prior to Israel's blockade of the Gaza Strip, Gaza was subject to a strict closure policy that was instituted by the Israeli authorities after Hamas affiliates carried out a series of suicide bombings within Israel in 2000–05. Although from 2005 there were no such attacks by Hamas inside Israel, movement in and out of Gaza remained highly restricted. Israel attributed the cessation of Hamas suicide bombings inside its territory to the maintenance of security measures over Gaza and to the separation wall that it constructed between the West Bank and Israel. However, this stoppage also reflected what is understood to have been Hamas's (unpublicized) decision not to use such tactics.

Israel unilaterally dismantled its settlements and withdrew its military from the Gaza Strip in late 2005. However, it retained total control of the territory's perimeter including all crossing points, its airspace and sea access, thereby perpetuating restrictions on Palestinian movement. A formal blockade was imposed after Hamas won the Palestinian legislative elections in 2006, thereby highly circumscribing all aspects of life in Gaza and resulting in greater deprivation for the people of Gaza – the majority of whom are civilian non-combatants. Israel cited the firing of locally made rockets from Gaza towards targets in southern Israel as justification for the blockade; however, the heightened restrictions spurred some armed Palestinian groups, including Hamas, to fire more rockets towards southern Israel, and neither Israel nor the Palestinians have since yielded on the issue of which party pushes which to act against the other. Since then, there have been no moves by Palestinian factions to renounce rocket fire. There have been some extended periods of calm during which Palestinian factions did not fire any rockets towards Israel. However, rather than becoming the basis for reciprocal confidence-building measures, these did not lead to any easing of the blockade, and indeed were sometimes met by its tightening. For Palestinians, the lack of a positive response to these periods of calm added to their existing perception that Israel's blockade of Gaza was more of a political issue than one that is related to military concerns or security (while for Israel, these periods of calm were not sufficient to change their overall policy towards Hamas).

In the West Bank, which remained under the administration of the PA after the Hamas takeover of Gaza in 2007, the PA has conducted very close intelligence and security coordination with its Israeli counterparts. The hundreds of military checkpoints maintained by Israel between Palestinian cities and villages in the West Bank, although less stringent than those around Gaza's perimeter, have

³⁹ Daniel Bernstein and AFP, 'UN, EU denounce approval of fresh settlement homes', *Times of Israel*, 29 July 2015, <http://www.timesofisrael.com/un-eu-denounce-approval-of-fresh-settlement-houses/>.

⁴⁰ According to the World Bank. Data available from: <http://data.worldbank.org/indicator/SL.UEM.TOTL.ZS/countries>, West Bank and Gaza, and <http://www.worldbank.org/en/country/westbankandgaza/overview>.

continued to impede freedom of movement and general commercial activity, and while the movement of people and goods is clearly easier in and out of the West Bank if compared with access to and from the Gaza Strip, both remain highly restricted compared with activity in a free economy. Thus, in the relatively less problematic environment of the West Bank, it appears that Israel's policy is, as in Gaza, based more on domestic political agendas than on security.

Under uncertain and highly circumscribed conditions, the flight of professional capacity and redirection of investment funds affects the economic potential of the West Bank and the Gaza Strip in similar ways. Almost no capital investment can be expected to yield any return; and uncontrollable obstacles – and sometimes total closures – frequently stand in the way of producers and suppliers with contractual obligations to fulfil promised demand. Several international express mail couriers that used to deliver to the Palestinian territories no longer do so, particularly to Gaza. This is just one example of services that are widely considered routine elsewhere but are no longer available to Palestinians.

A policy shift by the EU is overdue. The framework of hinging real economic development for Palestinians on the assumption that Israel would allow it has so far failed. The EU's vision has not been realized, and real developments on the ground in the West Bank and Gaza have eluded the principles and objectives of the ENP. The EU therefore needs to readdress the political and economic realities that have prevented Palestinians from being able to utilize its funding effectively to build a viable and self-sustaining economy.

The ‘Myth’ of a Palestinian Economy

The Palestinian economy is more of a ‘ghost’ economy than a functioning economy in its own right, with the government of Israel often playing a more pivotal role than do the PA and the Palestinian people themselves. Israeli pressure, in the form of security and political interventions as well as economic and financial restrictions, means that the Palestinian economy may be kept at constant risk of near-collapse, or may be afforded just enough space to sustain (barely) its institutions and public services.

In private conversations with the author, several current and former senior members of the donor community stated their awareness of the problems of the current framework and the pressures that it imposes on the Palestinian economy. However, these same figures have also stated that they are not prepared openly to acknowledge such failures, and feel that they have run out of options to change the status quo.

It is difficult for government institutions to become viable in the absence of infrastructure and resources to enable them, and nationally generated revenue to finance them. Arguably, the opportunity to have a real Palestinian economy was put on hold with the advent of the PA in 1994, because it was at that point that Palestinian development was leveraged as a political instrument. In reality, what has been commonly termed an economy has not amounted to much more than highly cyclical commercial activity. Whereas under normal conditions an economy chiefly relies on market supply and demand, the model prevailing in Palestine largely fails.

For several years now – and particularly in the Gaza Strip, where unemployment reached 41 per cent and poverty hit 39 per cent in 2014⁴¹ – consumption has depended mainly on whatever levels of basic goods and supplies the government of Israel has allowed to enter the territory. Imports of raw materials for construction, manufacturing and light industry have been severely restricted, as the Israeli defence ministry’s list of proscribed ‘dual use’ items⁴² includes goods such as cement and concrete.

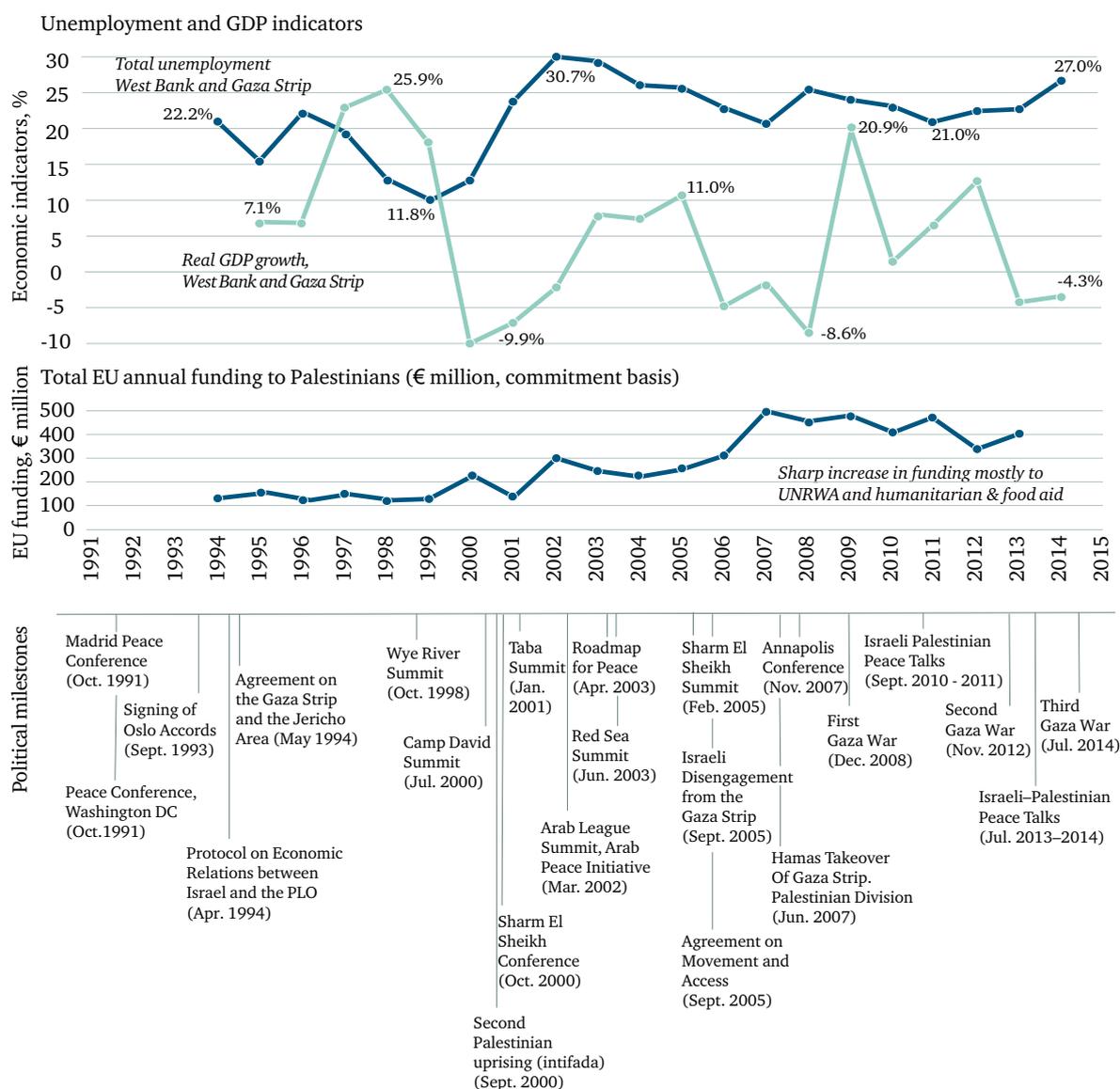
However, Palestinian importers have often been free to order unlimited quantities of allowed goods. In this case, their limitations have instead been on the demand side, as consumers whose resources have been drained by years of unemployment and conflict, as in Gaza, have no longer been able to afford much beyond what is basic. Gaza’s activity in particular has been squeezed and thereby much reduced to a state of simple commerce, within which limited space it has supposedly been free to operate. Still the international community – not just policy-makers, but also aid and development organizations – have called this an economy. Furthermore, many in international media, diplomatic and policy-making circles have apparently accepted irregular factors as indicators of Gaza’s economic activity. In conversations they cite data such as the number of Palestinians allowed through Israel’s army checkpoint in the northern Gaza Strip, or the number of trucks carrying restricted supplies allowed in; these are indicators of Israeli political will rather than Palestinian economic demand.

⁴¹ World Bank, *Gaza: Fact Sheet August 1, 2014*, <http://www.worldbank.org/content/dam/Worldbank/gaza-fact-sheet-final140801-ECR.pdf>.

⁴² Co-ordination and Liaison Administration to Gaza, Co-ordinator of Government Activities in the Territories, Ministry of Defence, State of Israel, *Restricted Import List: Gaza 2013*; OCHA, ‘List of items restricted as ‘dual’ civilian- military use expanded’, OCHA OPT, September 2015. <http://gaza.ochaopt.org/2015/09/import-restrictions-impede-delivery-of-services-and-humanitarian-assistance/>.

In the West Bank, where the annual unemployment rate averaged 18.9 per cent over the period 2004–2015,⁴³ approximately half that in the Gaza Strip, the economy has not been subject to as much pressure. None the less, what remains a high unemployment rate is symptomatic of severe economic instability, if not a crisis.

Figure 2: The ‘myth’ of a Palestinian economy



To offer some perspective, of the 23 per cent of the total area of historic Palestine that is today’s Palestine (i.e. the Gaza Strip and the West Bank including East Jerusalem), the West Bank constitutes 94 per cent, but the PA is completely without administrative and security jurisdiction over more than 60 per cent of the area of the West Bank. This is the mostly contiguous Area C, the topography and natural characteristics of which render it ideal for economic and infrastructure development. Israeli

⁴³ Source: Palestinian Central Bureau of Statistics, http://www.pcbs.gov.ps/Portals/_Rainbow/StatInd/TSDDataWestBank.htm.

restrictions bar any such development by Palestinians in Area C, compounding the impact of the blockade of what was once Palestine's other economic powerhouse, the Gaza Strip. As a result, the PA has been left with the impossible task of providing employment opportunities and building proper infrastructure for its people, without being able to access land and resources that are fundamental to any such development.

The PA has been left with the impossible task of providing employment opportunities and building proper infrastructure for its people, without being able to access land and resources that are fundamental to any such development.

The situation in the Gaza Strip has of course had a negative impact on the overall Palestinian economy. Since the boycott of Hamas from 2006 and its takeover of Gaza from its rival Fatah in 2007, the economy has been subject to varying degrees of political pressure from Israel, and the constantly worsening situation in the Gaza Strip has compounded the economic strain. As Gaza's contribution to Palestinian GDP fell sharply, its need for budgetary allocations from the PA increased – although it did not necessarily consistently receive the substantial funds that it required – in order to deal with its worsening circumstances and with the great compromise in the provision of public services.

Between 2004 and 2014, Palestine's GDP, at current prices, increased from \$4.32 billion to \$12.74 billion.⁴⁴ While percentages may vary from year to year, experts interviewed during the course of this research estimated that foreign aid to the PA, a significant amount of which comes from the EU, funds some 40 per cent of government spending, while the rest of its spending capacity comes from other sources such as tax and customs transfers from Israel to the PA⁴⁵ and from local tax revenue. Given that in 2004–13 Palestinian GDP, at current prices, averaged \$7.67 billion per year, and given that the total net official development assistance and official aid from foreign donors for the same period averaged \$2.02 billion annually, foreign aid equalled some 26 per cent of Palestine's GDP. Even with this high dependence on foreign aid for government expenditures, the PA is barely able to stay afloat.

To examine this a little further, donor funding underwrites a significant amount of PA government spending, including public sector salaries and direct financial assistance to the poor, along with several other services and undertakings. It is with these salaries and direct assistance payments that many Palestinians buy their goods, thereby remitting taxes that are factored into the prices of their purchases – along with taxes paid by retailers – back to the government.

GDP is a measure of the total value of final goods and services in a nation's economy over a given period, including government spending. In the case of Palestinian GDP, 30–40 per cent⁴⁶ comes direct from government spending (and, as indicated above, government spending triggers a significant part of the economic cycle as goods and services are bought and sold down the line using money that originated in the form of government expenditures, such as a government employee's salary). For the PA, however, government spending is largely dependent on annual financial support that is contingent on foreign aid disbursements and on revenues that are dependent on Israel's willingness to transfer tax revenues. The latter, as a key area of Israeli leverage over the PA, have been repeatedly withheld for political reasons.

⁴⁴ World Bank, GDP (current US dollars), West Bank and Gaza, <http://data.worldbank.org/indicator/NY.GDP.MKTP.CD/countries?page=2>.

⁴⁵ The Paris Protocol is the interim framework agreement for economic relations between Israel and the PA. As part of creating a customs union between Israel and the PA, it stipulates that Israel would collect import taxes on all goods destined to the OPT. Israel would then transfer those tax and customs monies to the PA on a monthly basis.

⁴⁶ International Monetary Fund, *West Bank and Gaza, Report to the Ad Hoc Liaison Committee*, 12 September 2014, <https://www.imf.org/external/country/WBG/RR/2014/091214.pdf>.

Palestine's GDP does not therefore represent genuine national output. None the less, the fact that a GDP – of which a significant percentage is sourced from donors – is able to be recorded has long misled the international community into believing that Palestinians possess a national economy that grows and contracts as other economies do. The reality is that Palestinian GDP would be slashed if donor funding were to stop. The false impression of there being an actual productive national economy dilutes recognition that political and economic policy is in need of serious revision. Palestine's myth of an economy has arisen as a uniquely politicized economy, and not one that is capable, under the current restrictions, of domestic growth that creates sustainable value.

A practical approach to an EU policy shift would begin with recognition that several layers of Israel's restrictions under the name of security appear politically motivated, that the West Bank is not much better off economically than Gaza, and that a potentially promising Palestinian economy has faded into myth. Most critical for the EU is to recognize and address the reality that its funding has been derailed.

Political Considerations for the EU

Set out in this section are measures that, if implemented, would improve the perception of the EU as an even-handed actor in the Middle East, and as one that has taken the initiative in the interests of advancing stability and security for all in the region.

The EU's review of the ENP, in conjunction with a shift to engage more closely with the Israeli–Palestinian peace process, is not only timely but also very much needed. Assessing five aspects directly pertaining to Europe's involvement in the Israeli–Palestinian issue would be of great relevance to the ENP review and to the EU's own interests. Allied to this, the EU will also have to confront the hindrances that are presented by Israel's political and economic policies and security measures. It is these policies and practices that have indirectly caused the EU to contravene the ENP's objectives of stability, prosperity and security for all. Furthermore, these same policies have failed to bring Israel a deep and lasting security.

The EU needs first to assess the effectiveness of the PA in utilizing aid, and whether Palestinians have, in reality, been able to control their economic destiny. Second, the EU needs to examine the part played by Israeli policy in cooperating with, or, in contrast, in putting obstacles in the way of, the PA's duty to serve the needs of its people. Third, the EU should consider the degree to which – and for how much longer – it is willing to fund a process that has morphed into a reality of expenditure with neither political advancement nor economic development as an outcome. Fourth, the EU should assess what realistic and feasible modifications it could implement to continue its support of the peace process but to realign this support with its own guiding principles and objectives. Fifth, it is necessary for the EU to evaluate how feasible and realistic it would be to act more autonomously on its renewed vision of becoming more actively involved in the peace process, especially given the position of the Quartet.

Deeper involvement in the Israeli–Palestinian issue, together with a shift in policy, would realign the EU's support for the peace process and its funding of Palestinian development with its own guiding principles of stability, security, good governance and well-being. Moreover, by acknowledging and taking steps towards genuine, freed-up economic development for the Palestinians, along with the political decisions needed to achieve this, Europe would send a clear message to the entire Middle East that the region's interests are just as valued as its own and of those of its ally Israel. This signalled equity would serve Europe's interests in the region by restoring the trust of the people of the Middle East and would further instil confidence that EU policy is not geared towards the best interests of Israel at the expense of Palestinians and others in the region.

Recent changes in the EU's political stance towards Israel on the issue of settlements, for example, are not of a degree commensurate with the mounting political, economic and geographic challenges that face Palestinians. EU policy is yet to approach a point where Palestinian interests are treated just as equitably as those of Israel.

In 2014 the EU rightly supported reconciliation between Fatah and Hamas. (The United States looked the other way, and has not opposed the EU's endorsement.) However, the EU has not hitherto carried this through in terms of encouraging political sharing in a context of the overall understanding of creating a common political programme based on a two-state solution and consensus on previous

agreements under the Middle East peace process – as would be to the advantage of both Israel and the Palestinians. Furthermore, a unified Palestinian party would rid the international community and the Palestinians of the obstacles presented by the so-called ‘Quartet principles’. In several meetings with the author in recent years, various Western officials privately, and unofficially, acknowledged these principles as unworkable.

Instead, the overall spirit of the Quartet principles could be achieved through direct dialogue with all Palestinians, including Hamas. The EU’s credibility as a fair interlocutor only stands to gain by encouraging Palestinian reconciliation under a joint Fatah–Hamas political programme, and by openly encouraging Israel and the Palestinians to negotiate an end to Israel’s occupation and to address one another’s security concerns. While the US administration may not endorse such EU engagement, neither may it block this.

The position of the United States on Israel and Palestine matters a great deal, as has its stance on reconciliation between Fatah and Hamas. However, with the final year of his term in office approaching, it is unlikely that US President Barack Obama will be able to exercise much effective influence to nudge the peace process forward – especially as he devotes his political capital to, and is faced with congressional criticism over, the Iran nuclear deal. This de facto US disengagement from the Israeli–Palestinian track creates ample space for the EU to engage more closely and creatively on it.

For the EU to take a more active role than the United States on Israel–Palestine would neither compromise the greater alliance between Europe and the United States, nor diminish the reality that the EU will remain an ally of Israel. The distinction would be that the EU would realign its policy with its own ENP principles of supporting the establishment of an independent Palestinian state with a viable economy that is capable of supporting it. An EU policy shift would also respond to active public opinion on the issue of Israel and Palestine in key member countries. While no opinion poll has been conducted on the specific policy argument of this paper, sympathies towards the Palestinians seem significant enough⁴⁷ to warrant EU consideration of public sentiment in considering a policy shift on Palestine.

Given the length of time that restrictions have been in place on Palestinian movement in and out of the West Bank and the Gaza Strip, and between the two territories, with protracted cycles of tightening and loosening of these measures, the Palestinian people today are highly strung by default. As a result, a shift in EU policy will not be sufficiently impactful or trusted if this does not far exceed previous and occasional practices of influencing Israel towards easing restrictions on Palestinians, or to improve their lives. The concept of economic peace has not taken shape in reality because it sidelined the importance of addressing the politics of the conflict, and these policies and practices that impose great difficulties for Palestinian development prospects. Likewise, it would no longer be enough for the EU to ‘engage’ in any efforts to help the private sector, to ‘strengthen’ civil society, or to ‘assist’ Palestinians with ‘capacity-building’. The time has come for a substantive reconsideration of such practices, and for a major shift in policy and in approach.

⁴⁷ See for example, YouGov UK, ‘British public more pro-Palestinian than French or Americans’, 5 August 2014, <https://yougov.co.uk/news/2014/08/05/sympathy-palestinians-more-common-britain-france-a/>. A 2011 ICM poll of 7,045 people in France, Germany, the UK, the Netherlands, Italy and Spain found that 31 per cent of respondents said that the Palestinians were the primary victims of the conflict, while 6 per cent thought the Israelis were the primary victims. In Spain, 33 per cent said the Israelis were the primary aggressors, while 14 per cent said the Palestinians played this role. ICM Unlimited, *European Public Perceptions of the Israel–Palestine Conflict*, January 2011, tables 10 and 13, http://www.icmunlimited.com/pdfs/2011_march_memo_israelpalestine_poll.pdf.

Conclusions – Practical Actions Towards a Viable Framework

Three core priorities, elaborated in this concluding section, will be central to turning the Palestinian economy into a viable reality. Acting on these priorities would have a positive impact on two of the objectives identified in the introduction to this paper. First, that Palestinians would begin to develop a self-sustaining economy that would eventually enable the PA to let go of the lifeline of EU funding on which it has had no option but to depend over the past two decades. Second, the EU would realign its funding with its ENP objectives of welfare, prosperity and security for all in the region. These benefits would promote perceptions of the EU as an equitable actor in the Middle East.

Altering the present framework

If Palestinian economic and infrastructure development is to succeed, it must be freed from the liabilities of political pressures as applied by Israel. Previous efforts aimed at creating economic enablers for the Palestinians have either failed or have had little benefit. Indeed, these were unviable in the first place, as they were undertaken within the present framework – and thus subject to the multiple disablers brought about by Israel's occupation policy and security measures. Development of a Palestinian economy under the present framework has failed, and it is likely that progress will continue to be undermined for as long as activity remains circumscribed by strict Israeli controls.

To alter the framework:

- EU member states that have recognized Palestine as a state, or are currently debating this, should amend their current stance, or expected decision on recognition, to push explicitly for the unimpeded development of a self-reliant economy able to support a Palestinian state. This would have the effect of applying positive internal pressure on the EU as a whole from a possibly growing body of member states. Furthermore, by making economic development a critical complement to a viable state, the EU would take a practical step in heightening its importance and level of priority along with the equally urgent – if not more so – necessity of political advancement and eventual just resolution.
- In line with the advice documented in the EEPG letter to the HR/VP of May 2015, the EU should formally commit to re-engage Israel and the Palestinians in renewed and more equitable peace negotiations.
- Instilling one of the objectives of ENP, the EU must push Israel and the Palestinians to equally recognize and accommodate one another's security needs, in accordance with international standards. This would address possible risks that Israel may perceive as arising from the free movement of goods and people in and out of the West Bank and the Gaza Strip. It would also address Israeli restrictions that go beyond ensuring Israel's security. Most importantly, this 'security-for-all' approach would bring about conditions that are more conducive to economic and political progress.

- The EU, Israel and the Palestinians have to acknowledge the likelihood of actions, including violence, specifically aimed at sabotaging a new political and economic approach. None the less, any such occurrences should not be permitted to derail a major policy shift to end the damaging economic and political stagnation in this extremely sensitive region.
- Political agreements and insurance schemes should be established to protect Palestinian and foreign capital investments, including those from EU funding, from damage or destruction. Similar arrangements should be put in place to protect perishable and date-sensitive goods from loss of value as a result of severe delays or denial of passage at Israeli checkpoints.
- Bilateral and multilateral development and aid agencies are urged to evaluate more consistently the actual impact for Palestinians of projects that they run. Based on perceptions on the ground, it seems likely that a thorough review would show that many of the current aid projects are barely viable under the present framework, and would also help to shed light on how projects that showed initial promise ended up missing their targets. This step would help to redirect EU funding away from current aid projects with limited impact, and more towards large-scale economic development.

Influencing Israel to allow Palestinians to revitalize their private sector and to leverage their resources

With annual average unemployment in the OPT exceeding 25 per cent over the past decade, future efforts to address genuine economic development would be far more credible if they emphasized employment generation and investment in infrastructure development as central priorities. This would only be possible if Palestinians were able themselves to leverage their resources and revitalize their private sector. Naturally, this would entail the EU's continued political and economic support of the PA in better enabling its government institutions and promoting infrastructure development. Equally important, if not more so, these key steps in developing a functioning economy would restore ordinary people's hopes for a better future.

To revitalize the Palestinian private sector:

- The PA and EU should directly support the private sector, with priority given to business and feasibility plans with the greatest potential for sustainable job creation in sectors such as agriculture, food-processing, light industry, hardware maintenance and machining and construction.
- The private sector should be further supported in generating employment opportunities through the establishment of a national development fund based on regular periodic contributions from employed individuals. This fund would provide seed money to help smaller-scale businesses start up and be able to recruit employees.
- The PA, together with Palestinian banks backed initially by EU support for loan insurance, should facilitate loan programmes for larger private-sector business plans where part of the return on investment would be leveraged to grow the endowment of this same national development fund. Initial funding for these loan programmes would come from resources previously allocated to PA institution-building, with growth thereafter sustained by return on investment and by mandatory contributions from all employed persons in these larger private-sector businesses with income above a certain level.

- As the Palestinian private sector grows, it must respect the tax base by ensuring payment to the PA based on revenues generated. It must also incorporate contribution schemes to the national development fund, and help develop ways to integrate the planned redeployment of government employees within the ranks of its newly employed.
- The EU should bring its influence to bear on Israel to allow consistent and uninterrupted access for Palestinians to local markets between the West Bank, the Gaza Strip and Israel, as well as to international markets. Moreover, it should influence Israel to allow a consistent and normal flow of goods and people in and out of the Gaza Strip and the West Bank. This principally requires ending the blockade of Gaza and the elimination of military checkpoints that frustrate people's activities in the West Bank.

The EU should bring its influence to bear on Israel to allow consistent and uninterrupted access for Palestinians to local markets between the West Bank, the Gaza Strip and Israel, as well as to international markets.

- The EU should help influence Israel to allow Palestinians use of Area C in the West Bank, and to access this land's resources, investment opportunities and potential for economic added value.
- A shift on the part of the EU away from humanitarian aid and towards enablement and active development aid would help upgrade the Palestinian infrastructure that will be vital if the private sector is to thrive. Such a refocus of assistance should include investments in water and electricity resources in the West Bank and Gaza, as well as help in establishing a sea port in Gaza (something that Israel might find easier to agree to in the short to medium term than it would an airport).
- Along the lines of the EU's shift to enablement aid would be also to increase funding to UNRWA specifically for employment skills training and enablement. As Figure 1 on p. 9 indicates, assistance to UNRWA is already a significant element of EU aid. A considerable part of UNRWA's budget for the OPT is earmarked for humanitarian and food aid as well assistance to poor families, mostly to the refugee population in the West Bank and Gaza. However, UNRWA's budget requirements to address the needs of a growing disadvantaged refugee population can only be expected to increase under current arrangements. Real channels of development need to be opened up to enable job creation – in vocational crafts and trades, in general services or in professional services, for example – if there is to be any prospect of reducing the scale of the budgetary requirement for humanitarian subsistence, even in the context of refugee population growth.
- The EU could also do more to support the extremely disadvantaged non-refugees who do not fall within UNRWA's mandate, prioritizing the poorest and most disadvantaged, and to better support the agencies and organizations working with them. Through this would come a gradual reinvestment in these people's capacity to relearn and to improve their skills, especially in higher-yielding economic sectors.
- The EU should also encourage and support international institutions such as the World Bank, as well as bilateral agencies, to widen the scope of planning with the Palestinian private sector and the PA, prioritizing large-scale economic projects that will create new employment opportunities for the greatest number of people in the short to medium term. Examples are

re-enabling agriculture, and the creation of light-industry zones in both the West Bank and the Gaza Strip, with active commercial and supply-chain links between both.

Continuing to support the PA, with a focus on self-reliance

A policy shift on the part of the EU to alter the current framework and revitalize the Palestinian private sector would not only help create jobs, but would also result in real added value to the Palestinian economy that would directly support the PA. The PA would earn significantly more in tax revenues from the private sector itself, and from those newly employed within the sector. In the longer term, the PA would be better able to restructure some of its overstuffed institutions, rerouting some employees to the private sector and thereby reducing the payroll burden on its budget. Over time, EU budget support for the PA would no longer be as great a priority as it has been over the past years, and the PA would be on its way to self-reliance – and eventually in a position to serve its people better.

To support the PA towards self-reliance:

- A joint review by the EU and the PA of the extent to which aid has achieved its aims seems timely. Similarly timely would be an assessment of how effective it has been for the EU to divert funds from development aid to humanitarian aid and budgetary support to the Palestinians.
- Having successfully established its institutions of state, the PA stands only to gain by redoubling its focus on generating economic productivity through EU funding. This would be through supporting the revitalization of the private sector and associated job creation, thereby reducing the pressure on its own payroll. It could also be in the form of financial and tax incentives to the private sector that would revert to the PA as tax revenue. The PA should also assess how to widen its internal revenue base through commonly accepted tax collection methods.
- Given that Israel's practice of sometimes withholding PA customs revenues, for political reasons, has repeatedly impeded the PA's ability to plan and to pay salaries on time, the EU should consider new options either to ensure that the Paris Protocol's provisions on prompt transfer of revenues are implemented, or to encourage Israelis and Palestinians to find other ways to allow the PA to collect its own customs revenues.
- The PA and the EU should jointly agree that the PA imposes a moratorium on building government institutions in the West Bank, excluding schools and medical care facilities where needed, while allowing the construction of the minimum needed in the Gaza Strip to offset the effects of armed conflicts and the three wars there since 2008.
- The EU, the PA and Palestinian civil society should agree a total moratorium on constructing buildings for professional associations or non-governmental organizations (NGOs) across the West Bank and the Gaza Strip. This would be for the greater benefit of the Palestinian people, by the rechanneling of funds to help improve the livelihoods of a sizeable proportion of the population that neither NGO activity nor PA and EU welfare assistance currently reach.

The urgency that the situation in the OPT impels, the practical and targeted nature of the measures set out above, and how these would help the EU realign its policy on Palestine – as an ENP country – all warrant serious policy reconsideration and swift action by the EU.

Acronyms

COGAT	Coordinator of Government Activities in the Territories
EEPG	European Eminent Persons Group
ENP	European Neighbourhood Policy
GDP	gross domestic product
HR/VP	High Representative of the European Union for Foreign Affairs and Security Policy and Vice-President of the European Commission
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
OPT	Occupied Palestinian Territories
PA	Palestinian Authority
UNRWA	United Nations Relief and Works Agency for Palestine Refugees in the Near East

About the Author

Sami Abdel-Shafi joined Chatham House as an Academy Asfari Senior Fellow in 2015. His current research focuses on UK and EU foreign policy on Palestine and Israel, and he has also been representing the Carter Center in the Gaza Strip. Originally with a background in technology and business analysis and consulting, he also undertook political and economic consulting during his work in Gaza, including several engagements with the private sector. He holds a degree in commerce, majoring in decision and information sciences from Santa Clara University, California, and has worked for small and medium-sized and Fortune 500 companies in Silicon Valley. He has in recent years frequently provided analysis and recommendations on Palestinian–Israeli affairs, particularly concerning the Gaza Strip, to a wide range of mostly foreign audiences, diplomatic missions and organizations. He has also published economic and political analysis and commentary in international print media.

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Cover image: A Palestinian boy carries strawberries in a strawberry field in Beit Lahia, Gaza, on 29 December 2014.

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