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Looking Beyond the Numbers: The Palestinian Socioeconomic Crisis of 2006

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It is especially frightening to see the impact of prolonged crises on every aspect of the Palestinian body politic: the deterioration of law and order; the unraveling of community cohesion; the rise in crime and internal violence; and the increasing radicalization of youth in an environment of economic and political hopelessness.[1]

Karen Koning AbuZayd,
Commissioner-General of UNRWA

Introduction

Since the beginning of 2006, a confluence of factors has contributed to drive the West Bank and Gaza Strip closer to an all-out economic, social and institutional, breakdown. A crippling fiscal crisis caused by a sharp reduction in vital financial resources; intensified restrictions on the free movement of people, labor, and trade; incessant fragmentation of the Palestinian territorial landscape in the West Bank; escalation of tension and violence with Israel; the isolation of the Gaza Strip; and bitter internal political divisions coupled with intermittent factional infighting were among the principal factors that produced the current conditions of considerable economic distress, human hardships, and social fatigue. In 2006, a large segment of the Palestinian population in the West Bank and Gaza continued to increasingly lack the necessary means to secure acceptable living standards, with dwindling levels of basic services and a virtual absence of personal security. Expecting worse days ahead, the UN issued on December 7, 2006, an emergency appeal for funds to help meet the Palestinians' humanitarian needs in 2007—"the largest appeal for emergency humanitarian assistance ever launched in the occupied Palestinian territory, and the third biggest in the world."[2]

As the situation intensified and its dire effects became more pronounced by the day, help was needed, especially on the humanitarian front, to alleviate the various adverse impacts of the crisis and to prevent any further deterioration. Given the scale of the current predicament, however, there is good reason to believe that short-term ad hoc relief measures, by their very nature and important as they may be for easing the severity of conditions and stabilizing the situation, may not be sufficient this time around to arrest further deterioration in conditions or to prevent a more pernicious recurrence of the crisis, unless such measures are part of a more comprehensive policy package designed to address the root causes of the crisis. This has not happened yet, and there are no signs of such an undertaking materializing any time soon.

To emphasize this point further, a careful reflection on the 2006 socioeconomic crisis, viewed in the context of other developments in the West Bank and Gaza over the past dozen years, would reveal that so much damage has been done to the basic economic, social, institutional, and territorial structure of the Palestinian areas that only a serious, forward-looking, and comprehensive approach, designed, adopted, and implemented by all sides, can be expected to have a tangible outcome and a sustained positive impact.

The objective of this Brief is to provide an account of the socioeconomic crisis that has engulfed the West Bank and Gaza since the beginning of 2006, and to derive some useful lessons along the way. The goal here is not so much to dwell on the statistics of the still ongoing predicament, but to go beyond the available numbers and present an analysis of the current situation in order to identify core problems, detect patterns, and draw relevant conclusions.

The point of departure in this Brief is a short overview of the Palestinian socioeconomic picture as it existed on the eve of the legislative elections of January 25, 2006. The Brief will then examine the factors that precipitated the post-election crisis; address some of its social, economic, and institutional impacts; and consider how the Palestinians coped with it. An analysis of the crisis in light of the available evidence regarding the damage caused to the Palestinian economic structure over the past decade will follow, along with some of its implications. A final thought will conclude the study.

<u>*The Context*</u>

The sharp deterioration of conditions in 2006 came at a time when the Palestinian economy was already suffering from a five-year-long crisis. By the end of 2005, and despite signs of a fragile recovery, the Palestinian economy was still in a state of distress as a result of the socioeconomic crisis that began in September 2000, following the eruption of the second Intifada. The statistics on the eve of the Palestinian legislative elections of January 2006 tell the story: Gross domestic product (GDP) was 10% lower than its 1999 level; real per capita GDP was one-third below what it was in 2000; unemployment and poverty, at 24% and 44% respectively, were more than twice their pre-Intifada levels; and the Palestinian Authority (PA) ended the year 2005 in an untenable fiscal position, with a budget deficit of $800 million, or 17% of GDP (see Figures 1, 2, and 3).[3]

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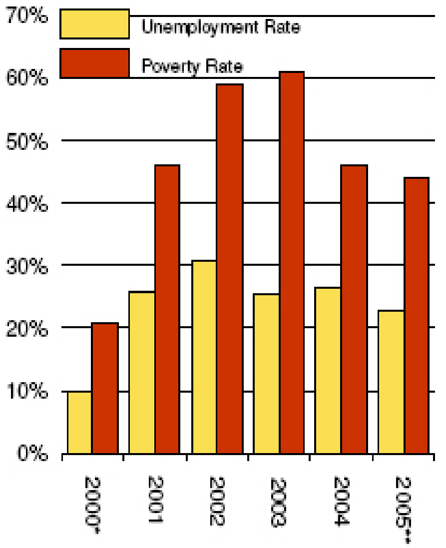
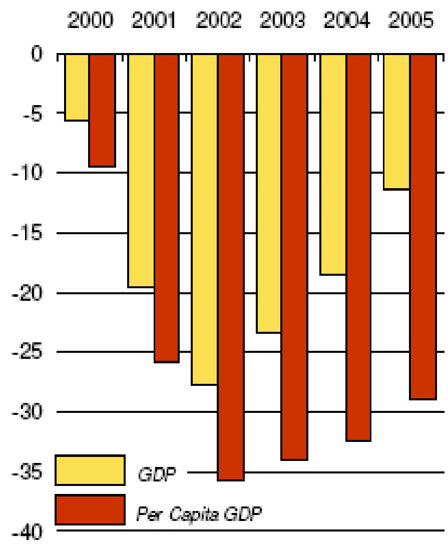
Figure 1
Poverty and Unemployment Rates in the West Bank and Gaza, 2000–2005



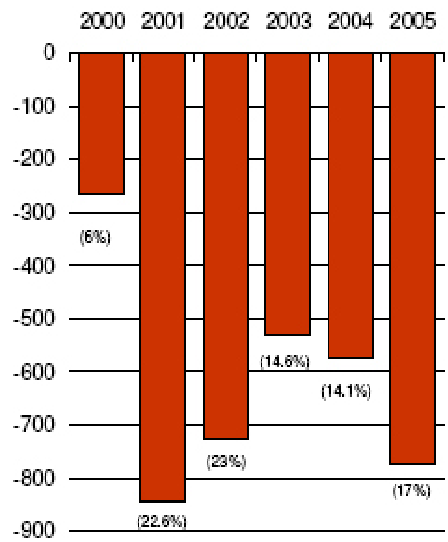
* Figures are for September 2000 on the eve of the 2nd Intifada.
** The inclusion of "discouraged" workers in calculating unemployment rate in 2005 would bring the "relaxed" definition of jobless rate to 28%.
Source: World Bank, The Palestinian Economy and the Prospects for Its Recovery (December 2005), Table 1, p. 7.

Figure 2
Cumulated Growth in GDP and in Per Capita GDP since 2000
(percentage change)



Source: World Bank, The Palestinian Economy and the Prospects for its Recovery (December 2005), Table 1, p. 7.

Figure 3
PA Fiscal Balance, 2000–2005
(In million of U.S. dollars);
(Columns labels refer to deficit in percentage of GDP)



Source: IMF, Macroeconomic Developments and Outlook in the West Bank and Gaza (December 2005), Table 3, p. 17. Figures for the year 2000 were calculated from A. Bennett, et. al., West Bank and Gaza: Economic Performance and Reform under Conflict Conditions (IMF, September 15, 2003), Tables 2.2 and 4.2.

Such a dismal economic record was achieved even as the international community doubled its financial support to the PA, from an average of $500 million a year in the 1990s to about $1 billion annually after the year 2000, with disbursement in 2005 alone amounting to $1.3 billion (or 22% of the gross domestic income, or GDI).[4] Turmoil and armed confrontation, political instability, and stringent Israeli restrictions on Palestinian movement, both within the West Bank and Gaza and across border lines, were largely identified as the main precipitators of the (2000–2005) crisis.

The policy prescriptions for reversing the Palestinian economic decline and achieving a rapid recovery were straightforward, or so at least they seemed at that time: an end to violence; the dismantling of the decade-long Israeli restrictions; continued serious reforms of the Palestinian governing system; and then—and only then—an increase of 50% in the annual level of donor financial support, in order to expedite the desired outcome. According to this recipe for recovery, advanced principally by the World Bank in 2004 and 2005, the Palestinian economy was projected, in the course of a three-year period, to realize a respectable 10% annual growth rate in real GDP, and eventually to regain its pre-2000 levels.[5]

That recipe for a way out from the post-2000 crisis, which was endorsed by all parties—the Palestinian Authority, Israel, and donors—was never implemented, however; and the Palestinian economy was in for a very rough ride on a totally different trajectory, marked by an intensification of violence, a tightening of Israeli restrictions, a halt to (or even a regression in) reforms, and the drying up of Western donors' direct assistance to the PA government. In 2006, Murphy's Law seemed to have gone into full gear: Everything that could possibly go wrong *did* go wrong.

Different interpretations have been introduced to explain what exactly caused this sudden downturn of fortune. Rarely, however, was an attempt made to state what should have been obvious: Five years of prolonged economic crisis under intense conflict conditions have taken a heavy toll on the Palestinian population, to an extent that made what was seemingly a sound set of recovery policies immensely difficult, if not impossible, to implement. With high and dangerous rates of poverty and unemployment, mounting social distress, an unprecedented rise in internal lawlessness and chaos, a bloated and grossly inefficient bureaucracy, and an increasingly weakened central governing body, the Palestinian domestic stage was already set for a very dramatic and difficult course.

That course began with the stunning outcome of the January 2006 parliamentary elections, which brought the Islamic Resistance Movement, Hamas, to power—and continued throughout the year with a series of tragic events that left their devastating marks on every aspect of Palestinian life.

Factors Triggering the Crisis

The crisis of 2006 was triggered by a number of adverse measures taken by Western donors (led by the Middle East Quartet: the United States, the EU, the UN, and Russia) and the Israeli government early in the year, and maintained until the time of writing of this Brief, in response to Hamas's refusal to adhere to principles considered by the donors and the Jewish state as preconditions for establishing a working relationship with the new PA government: (1) recognition of Israel, (2) renunciation of violence, and (3) acceptance of all past PA commitments.[6] Subsequently, the situation was made even worse by the continued inability of a bitterly divided Palestinian side to reach a unified stand regarding a way out of the crisis, and by the unwillingness of the Western donor community and Israel to change their policy approach vis-à-vis the new political realities in the Palestinian areas.

Three measures were particularly devastating: (1) the suspension by Israel of the monthly transfer of the value-added tax (VAT) and customs receipts, the so-called clearance revenues, that Israel collects on behalf of the PA in accordance with the economic protocol signed between the two sides in 1994; (2) the tightening of the existing restrictions on the movement of Palestinian people, labor, and goods, which Israel imposed on security grounds; and (3) the suspension by the donor community of all direct budgetary support to the newly constituted PA government, along with a significant reduction in the level of developmental aid.

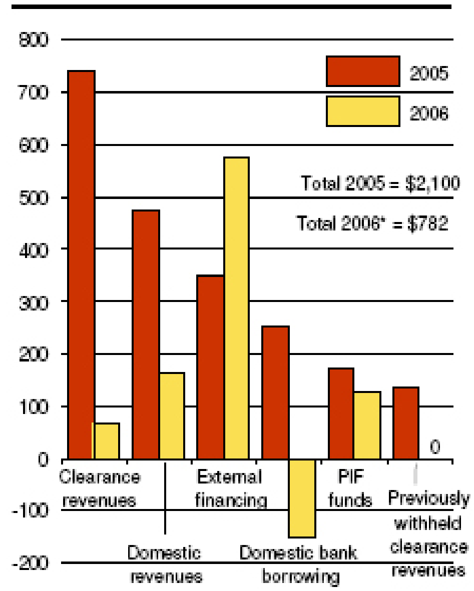
For a small economy like the Palestinian economy, which is highly dependent on trade and foreign aid for survival, and with the additional peculiarity of having virtually no control over its access routes to external and internal markets and no policy tools at its disposal to cushion against sudden external shocks, these measures by Israel and the Western donors, taken at a time when the Palestinian economy was still struggling to recover from its five-year-long plunge, resulted in a crushing fiscal and access crisis that was the defining mark of the Palestinian areas in 2006.

The crisis has virtually crippled the Hamas-led government's ability to function, devastated the Palestinian private sector, and, at times, hampered international relief efforts. An Israeli military operation inside Gaza during the second half of the year, following the abduction of an Israeli soldier by Palestinian militants on June 25, brought the crisis situation in the Palestinian territories to a boiling point, resulted in a tragic loss of human life and caused extensive damage to Gaza's basic infrastructure.[7]

The PA Fiscal Crisis

The fiscal crisis of 2006 was triggered by a sudden shortfall in PA revenues, with most of the previously available sources of funds either dwindling, no longer existent, or inaccessible.

Figure 4
PA Financial Resources, 2005–2006*
(In millions of US dollars)



* Figures for 2006 are only for the first three quarters (Jan.–Sept.).
** External financing in 2006 includes three channels: support to PA President's office ($262 m.); PA gov't. ($197 m.); and TIM ($114 m.).
Source: IMF, West Bank and Gaza (October 2006), op. cit.; World Bank, West Bank and Gaza Update (April 2006; Sept. 2006). See footnote 14 for a definition and an elaborated description of TIM.

The decision by Israel in mid-February 2006 to withhold the transfer of Palestinian indirect tax money to Palestinian Authority coffers (an average of about $60 million a month), along with the suspension by Western donors of their direct financial support of the PA budget (an average of $30 million a month), almost overnight resulted in a hefty 50% drop in the total funds available to finance PA monthly expenditures.[8] Furthermore, and as economic activities in the West Bank and Gaza were negatively affected by the crisis conditions, domestic revenues declined, dropping from their monthly average of $40 million in 2005 to just $20 million per month in 2006, reflecting an erosion of the domestic tax base. Meanwhile, the Palestinian banking sector, fearing possible litigation under U.S. anti-terror law,[9] refused to do business with the new PA government or to provide previously available lending facilities to help partially make up for the shortage of funds from other sources.[10] The Palestinian Investment Fund (PIF), which is controlled by the PA president, did step in and made some of its resources available, but at a lower level than the previous year, and at the cost of liquidating some of its increasingly depleted assets. As a result of all this, by the end of September 2006 the Palestinian government had only 37.2% of the total financial inflows it had in 2005. Figure 4 shows the PA fiscal position in 2005–2006.

This unprecedented fiscal crisis, which choked the Palestinian economy in 2006, has had many severe consequences, of which two stand out as probably the most significant, both for their decimating impact on Palestinian living conditions and for their damaging impact on the integrity of the entire Palestinian financial system.

The impact of the PA fiscal crisis on Palestinian living conditions has been nothing short of utter devastation. The estimated 165,000 PA workers have not been paid in full since March 2006, with only partial payments made when funds became available. Over a million people who are directly supported by the wages earned from the public sector were left without the means to secure their basic needs. Transfer payments to 47,000 Palestinian families classified as hardship cases have also gone unpaid. Hospitals and public health centers ran out of essential medical supplies and were no longer able to provide more than emergency treatments. Teachers, having gone without full salaries for months, went on strike at the beginning of the school year on September 2, 2006, largely paralyzing the PA-run education sector and leaving tens of thousands of students, mainly in the West Bank and to some extent in Gaza, without classroom education.[11] Public institutions' capacity to provide basic services to the Palestinian population was severely compromised, with many institutions essentially not functioning since September owing to a lack of operating funds and to striking PA workers.[12] PA security forces frequently went out into the streets, setting fires, blocking roads, hindering traffic, and occupying public buildings—all in protest against continued nonpayment of their full salaries.[13]

The fiscal crisis of 2006 has also resulted in a serious fragmentation of the Palestinian financial system and caused considerable damage to the fiscal reforms that were achieved in 2002–2003. At present, one can identify at least three different institutions that are handling PA finances, depending on the source of funds: the office of the PA president (funds coming mainly from Arab countries), the PA Ministry of Finance (funds coming either from domestic taxes or from cash brought in suitcases from abroad across the Gaza border with Egypt), and the Quartet-created Temporary International Mechanism, or TIM (financed by European Commission money).[14] The Single Treasury Account, one of the major fiscal reforms intended to assure that all PA finances were handled in a transparent manner, is no longer functioning after the Arab Bank refused to continue hosting the account under Hamas-led government. With such fragmentation of the PA financial landscape, the transparency and efficiency by which PA fiscal operations are conducted have been greatly undermined.

The Access Crisis

In the Palestinian context, the access issue refers to the extent to which Palestinian people, labor, and goods can move freely inside the Palestinian areas, between the West Bank and Gaza, and across border lines with Israel and third countries. For more than a decade, such free movement has been seriously compromised by various forms of restrictions imposed by the Israeli government on security grounds. These restrictions, known collectively as the "closure and permit system," were quite common in the 1990s, but they were considerably intensified, both in extent and in complexity, after the outbreak of the second Intifada in late 2000. They physically hindered the flow of economic transactions, raised the cost of doing business, and disrupted the conduct of normal economic activities in the West Bank and Gaza. Their frequency, unpredictability, and duration caused considerable damage to the Palestinian economy, and they are largely considered, both by the international community and by independent analysts, to be the main reason behind the poor Palestinian economic performance.[15]

In 2006, with the overall deterioration in conditions, the access problem became much more serious, as existing Israeli restrictions on Palestinian movement, both inside the Palestinian areas and across border lines, were tightened. Increased territorial fragmentation of the West Bank; continued construction of the separation barrier on Palestinian land; the virtual isolation of the Gaza Strip, especially in the second half of the year; and the continued commercial and human separation between the West Bank and Gaza, and between these two areas and East Jerusalem—All become more pronounced in 2006, adding to the severity of the crisis and resulting in further worsening of socioeconomic conditions in the Palestinian territories.

An assessment of the U.S.-brokered *Agreement on Movement and Access* (AMA) one year after it was signed between Israel and the PA on November 15, 2005 should help us understand the severity of the access question.[16] Almost everything the Agreement called for went unimplemented in 2006. The Rafah border crossing, Gaza's main gateway to the world, was closed 86% of the time after June 25;[17] Karni/Al-Montar crossing, Gaza's only commercial outlet, had an average of 12 truckloads of exports per day, a negligible fraction of the 400-truckload target set by the AMA for December 31, 2006;[18] agricultural produce from Gaza's former settlement greenhouses, to which the AMA assigned a top priority in terms of exports, was either given away or destroyed, as only 4% of the total harvest was exported; deadlines for establishing passenger and commercial convoys between Gaza and the West Bank were not met; discussions on the construction of Gaza seaport and operation of the Gaza airport never commenced; and the number of obstacles restricting movement inside the West Bank, which the AMA stipulated be reviewed vis-à-vis Israeli security concerns, has actually increased by 44% over the year.[19] In 2006, the Palestinian ability to move freely remained extremely limited, and the flow of commercial trade was negligible.[20]

For a small, "open" economy like the Palestinian economy, with total trade representing about 85% of GDP and trade with Israel accounting for over 90% of trade transactions, the impact of tightening restrictions on the flow of goods in and out of the Palestinian territories was crushing. Recent statistics on Palestinian trade indicate a decline in imports and exports since mid-2005 of 22% and 16%, respectively,[21] with a comparable decrease in clearance revenues estimated at about 20% between the end of 2005 and September 2006.[22] Unable to reach external markets with ease and on a competitive basis, both for the export of their products and the purchase of raw materials, the Palestinian private sector reacted by turning inward, producing lower value-added goods for the local market and using domestic input in their production[23]—a devastating blow to an economy whose future largely depends on an outward-oriented growth strategy.

Palestinian workers' access to the Israeli labor market also continued to be further restricted in 2006, with a projected zero access by the end of 2007 as part of the Israeli government's stated policy of doing without Palestinian labor. Over a five-year period, the number of Palestinian workers employed daily in Israel went from an average of 146,000 on the eve of the second Intifada, with earned income of over $1 billion a year, to just 30,200 workers by the end of the first quarter of 2006 (almost all from the West Bank, and none from Gaza).[24] With the Palestinian economy currently unable to provide alternative local jobs to compensate for those lost inside Israel, unemployment rates in Gaza and the West Bank have reached dangerous levels, while the reduced income has further depressed domestic demand.

Coping with the Crisis

For most Palestinians, coping in 2006 largely meant having enough means to survive the day. A sharp drop in personal incomes; the dwindling provision of core social services; tightening restrictions on movement; depression and hopelessness in an environment marked by continuing conflict with Israel and an unprecedented rise in domestic violence—All were common currency in the West Bank and Gaza throughout most of 2006, triggering a humanitarian crisis in the process and resulting in profound hardship for the majority of the population. Coping in 2006 was a tough and at times hopeless exercise, in a situation where most had already exhausted all possible coping mechanisms owing to the continued deterioration of their living conditions since September 2000.[25]

The available statistics reveal high rates of deep poverty and open unemployment. Seventy-one percent of PA employees are estimated now to have fallen below the poverty line, while 36% of them are classified as extremely poor.[26] In Gaza, where 41% of employment is in the public sector, almost 80% of the population currently depends on food aid from UNRWA and World Food Program,[27] and unemployment is reported to have jumped from 33% in 2005 to 42% by mid-2006, with even higher rates among younger Palestinians. Eight months into the crisis, 52% of the Palestinian population no longer had the means to manage their lives (48% in the West Bank and 54% in Gaza).[28] Conditions worsened immensely in the Gaza Strip after June 28, 2006, with the destruction by Israel of Gaza's only electric power plant (which provides over 40% of Gaza's domestic electricity needs), resulting in extended hours of lack of electricity and water shortages, scarcity of fuel for generators, and problems in sewage waste treatment, causing serious threats to the entire public health system in Gaza.[29]

Throughout 2006, coping was made much more complicated by heretofore unseen levels of domestic chaos, lawlessness, factional violence, and killings on political or family grounds, especially in the Gaza Strip.[30] The increasing difficulty in the West Bank to move from one place to another—to reach a workplace or farmland, to visit relatives, or to access a hospital or school—all added to the Palestinian population's daily anguish.[31]

The Palestinian private sector was equally hit by the twin fiscal-and-access crisis of 2006. A drastic shortfall in government revenues led to a sharp reduction in Palestinian Authority operating capital and to a subsequent decline in public sector purchases of domestic goods and services. Continued nonpayment of PA full wage bill, estimated at $100 million a month, had an additional adverse impact on the private sector, leading to a sharp drop in household demand for goods and services.[32] The tightening of restrictions on movement within the West Bank, and the prolonged closure of Gaza border lines, also made it increasingly difficult for Palestinian businesses to reach their customers outside the PA territories and caused further losses in their already declining share of export markets, both in Israel and in third countries—markets that will become harder to recoup in the future even after the situation stabilizes. Domestic banks are reporting a higher ratio of bad loans to the private sector, with an alarming rise from 15.5% in the beginning of 2006 to about 20% by year's end, and with an even higher percentage expected in 2007.[33]

Coping with the crisis differed across private sector establishments. Some Palestinian businesses have closed, while others, especially big companies, relocated outside the Palestinian areas; some estimates have 100 closing and 75 relocating.[34] Some businesses which are still operating are reported to have started to refuse paying taxes in response to the PA government's inability to pay for the goods and services supplied to it.[35]

Looking Beyond the Numbers

With the twin fiscal-and-access crisis of 2006, unprecedented in its nature, scale, and consequences, it is becoming abundantly clear that more than a decade of continued attempts by the international community to reconstruct the Palestinian economy under conflict conditions have finally reached a dead end. A review of two recent reports on the present state of the Palestinian economy by the World Bank and the International Monetary Fund makes this conclusion clear—although neither of the two organizations made that declaration; at least, not yet.[36]

Two extremely alarming statements, with potentially far-reaching implications, can be found in these two reports.

First: According to the World Bank Study, although restrictions on the movement of Palestinian people and goods have for over a decade now represented the single most damaging factor impinging on the Palestinian economy's performance and growth prospects, "there are signs [now] indicating that the WBG's [West Bank and Gaza's] capacity to generate fast economic growth has been eroded, *even if the closure regime becomes less oppressive*"[37] (emphasis added). What most likely led the World Bank to this assessment is the continued informalization, deindustrialization, and internalization of Palestinian economic activities over the past decade.[38] The crisis of 2006 has undoubtedly exposed these structural weaknesses of the Palestinian economy, and further compounded their severity.

The second statement emerged from the IMF's continued monitoring of the Palestinian Authority's fiscal position. In the IMF's view, "*even with the receipt of clearance revenues* from the GoI [Government of Israel], the PNA [in 2006] was facing a monthly financing gap of some $70–80 million [or close to $1 billion a year]"(emphasis added).[39] This unsustainable fiscal gap presents the PA with a serious fiscal challenge that demands "strong and politically difficult measures… to put the government's finances on a sustainable path."[40] The trouble with such a somber assessment by the IMF is that conditions in the West Bank and Gaza have now reached such a point that if such measures were taken, at a time when the PA government is under increasing pressure to provide public employment in an economy grossly lacking alternative job opportunities, and when there is pressure to use government resources to meet the basic social needs of an increasingly impoverished and rapidly growing population, it will almost certainly lead to further domestic political and social instability, with potentially grave consequences.

What does all this tell us? One thing is clear: Under such circumstances, a return to the pre-January 2006 conditions cannot be considered an economically viable option; neither would be, from an economic standpoint, a Palestinian national unity government that would have to operate under those conditions if and when it is formed. Under the conditions that existed on the eve of the January 2006 elections, and based on the experience of the past decade, continued inflow of foreign aid, important as it may be for mitigating human suffering, will not be enough to make a measurable dent in the crisis; governance reforms, although vital under any circumstances, cannot not be expected to have a sustained impact; and the domestic private sector, in all likelihood, will not be able to lead the Palestinian economy out of the crisis toward recovery.

Furthermore, if one looks beyond the depressing statistics of the current crisis and focuses on how things have developed in the West Bank and Gaza over the past decade or so, a much more disturbing picture is likely to emerge; a picture of an economy that not only continues to be increasingly unable to provide minimally acceptable living conditions for its rapidly growing population, but, perhaps more critically for the future prospects of the economy itself, that the quality and quantity of whatever little has been achieved since 1994 by way of attempting to build the institutional, physical, and social foundations necessary for sustained long-term growth, has been severely compromised, if not already dissipated altogether.

Closing Thoughts

The Palestinian economy in 2006 experienced one of the most damaging shocks in decades. The year 2006 will probably go down in Palestinian history as the year that began with a sudden political earthquake of major proportions that profoundly transformed the Palestinian political terrain, possibly for good, with grave economic and social aftershocks that continued to reverberate across the West Bank and Gaza throughout the year. It has undermined the very foundations of the Palestinian economy in a way that will most likely make future recovery a very formidable task indeed.

But that need not necessarily be the fate of the Palestinian economy if we are to understand the events of the past year in their proper context, draw the relevant conclusions, and act judiciously in a completely different direction. What is now needed is a holistic approach to the crisis that sees the events of 2006 as an integral part of how things have developed in the West Bank and Gaza over the past decade, and not merely as a post-Hamas predicament.

The first step on that course, if it is destined to be taken, is the realization by all parties of the high long-term cost of returning to the "old" nonviable status quo, and the virtual impossibility of achieving a sustained economic recovery under continued conflict conditions. Once this crucial step is taken, then it becomes *possible* to design, adopt, and implement a comprehensive package that would eventually provide the Palestinian economy with what is necessary for long-term growth but has so far been grossly lacking: adequate control over physical resources, effective policy tools for economic management, and modern institutions to support the attainment of high growth rates. Only in such an environment would it become possible for the relatively small Palestinian economy to take advantage of some of its hidden, and so far grossly underutilized, strengths: its human capital, its entrepreneurial capabilities and rich Diaspora, its proximity to the more advanced Israeli economy, its close ties with the neighboring Arab countries, and a world that has always shown a readiness to be a partner in peace.

For that possibility to be translated into reality, however, the root *political* causes of the current socioeconomic crisis in the West Bank and Gaza need to be tackled first. Absent any serious positive noise on that front, we are likely to continue down the same slippery road, unable or perhaps unwilling to see the glaringly alarming signs along the way, heading, yet again, towards another dead end.

Endnotes

1 United Nations Relief and Works Agency (UNRWA), *Prolonged Crisis in the Occupied Palestinian Territories: Socio-Economic Impact on Refugees and Non-Refugees* (November 2006).*

2 See the UN press release, December 7, 2006. Only two countries, Sudan and the Democratic Republic of Congo, are projected by the UN to have a need for larger emergency funds to meet their humanitarian needs in 2007. Countr like Uganda, Chad, and Somalia come in fifth, seventh, and tenth place, respectively. See United Nations, *Occupied Palestinian territory, Consolidated Appeals Process, CAP 2007* (December 7, 2006).*

3 In Figure (4), the PA fiscal balance in 2005 (with a deficit of 17 percent of GDP) should be compared with that of 1999, when the PA was able to realize a surplus in its recurrent balance equivalent to 1 percent of GDP. See, von Allmen, Ulric E., "Recent Developments in the Palestinian Economy," in Rosa A. Valdivieso et. al., *West Bank and Gaza: Economic Performance, Prospects, and Policies* (IMF, 2001), p. 15.

4 The $1.3 billion of external assistance to the PA in 2005 was disbursed as follows: $350 million in direct budgetary support; $450 million for development activities; and $500 million for humanitarian assistance, mainly through UN agencies and NGOs operating in the West Bank and Gaza (World Bank, *West Bank and Gaza: Economic Update and Potential Outlook* [March 15, 2006]). GDI is a measure of all available resources in the economy; in the case of Palestine, that includes domestic output (GDP), foreign aid transfers, and labor remittances.*

5 See, for example the following two studies by the World Bank: *Stagnation or Revival? Israeli Disengagement and Palestinian Economic Prospects* (December 2, 2004) and *The Palestinian Economy and the Prospects for Its Recovery*, Economic Monitoring Report to the Ad Hoc Liaison Committee, No. 1 (December 2005).*

6 The position of the Western donor community was made formal in a statement made by the Middle East Quartet on January 30, 2006 in London. "It is the view of the Quartet that all members of a future Palestinian government must be committed to nonviolence, recognition of Israel, and acceptance of previous agreements and obligations, including the Roadmap." This position was reiterated in subsequent statements by the Quartet on March 30, May 9, June 17, and September 20, 2006, and more recently in a statement on February 2, 2007 in Washington, DC.*

7 On November 26, 2006, the Israeli military operation in Gaza ended after a cease-fire was declared. Although the cease-fire remains fragile, it continues to hold as of this writing, despite continued intermittent firing of homemade rockets from Gaza by Palestinian militant groups.

8 On January 19, 2007, the Israeli government released $100 million of the estimated $500 million of the withheld Palestinian tax money. The transfer was made to the office of the PA president, not to the Hamas-led government, and was earmarked for expenditure on humanitarian-related needs. *Haaretz*, "Israel transfers $100m in frozen Palestinian tax funds to Abbas" (January 20, 2007).*

9 The reference here is to the restrictions issued on April 12, 2006, by the Office of Foreign Assets Control (OFAC), U.S. Department of the Treasury, prohibiting any financial dealings with, or any engagement in any transactions with, the Hamas-led PA government.

10 In fact, the banking sector in 2006 became a "burden" on the PA government's finances, by withholding domestic tax revenues accruing to the Ministry of Finance's bank accounts. See International Monetary Fund (IMF), *West Bank and Gaza: Recent Fiscal and Financial Developments* (October 2006), p. 5.*

11 On January 13, 2007, teachers and other PA civil workers agreed to suspend their four-month strike and returned to work after an agreement with the government was reached to schedule repayment of their salaries.

12 As of October 2006, only 20% of PA hospitals and PA-run schools were operating; deaths and births were not being regularly registered; passports and drivers' licenses were not being issued or renewed; and people were increasingly relying on traditional tribal customs and Islamic laws instead of PA courts to resolve disputes, thus further weakening the legal system. See UN Office for the Coordinator of Humanitarian Affairs (OCHA), *The Humanitarian Monitor, no. 6* (October 2006).*

13 For a preliminary assessment of the impact of the PA fiscal crisis on public institutions, see World Bank, *Coping with Crisis: Palestinian Authority Institutional Performance* (November 2006).

14 The establishment of the Temporary International Mechanism was endorsed by the Quartet in a meeting held on May 9, 2006, in New York in order to facilitate the disbursement of international humanitarian aid directly to the Palestinian people, bypassing the Hamas-led government. TIM, which became operational at the end of June 2006, has three windows or channels for disbursing assistance. Window I is managed by the World Bank

and allocates resources through the existing Emergency Service Support Program (ESSP) for essential supplies and nonwage running costs in the PA core social sector; Window II is managed by the European Union (EU) through its existing Interim Emergency Relief Contribution (IERC) to allocate funds to pay for utilities, water, and fuel oil bought from Israeli suppliers; and Window III is a Cash Transfer Scheme (CTS) facility which pays allowances to PA health workers, hardship cases, PA retirees, and low-income PA civil workers. The office of the PA president acts as the sole Palestinian interlocutor with TIM. See EU, *Temporary International Mechanism— TIM: Key Facts* (29 September 2006).*

15 See, for example, World Bank, *Four Years— Intifada, Closure, and Palestinian Economic Crisis: An Assessment* (October 2004), chap. 2.*

16 The principle goal of the *Agreement on Movement and Access* was to facilitate the free movement of Palestinian people and products and relax Israeli restrictions on the Palestinian economy.*

17 Rafah crossing was closed following a cross-border raid by Palestinian militants on the nearby Kerem-Shalom military post inside Israel and the kidnapping of an Israeli soldier in the attack.

18 A recent report by Pal-Trade indicates an increase in the volume of truckload exports through Karni crossing to an average of 39 a day in December 2006. See Palestine Trade Center—PalTrade, *Al Montar/Karni Terminal Movement Monitoring, Monthly Report—December 2006* (January 11, 2007). Although this represents improvement from the daily average during the year, it is still substantially below the target set by the agreement of 400 truckloads of exports per day.*

19 Internal restrictions on movements in the West Bank were estimated to have caused a loss of economic growth potential of about 3.5% of GDP. The separation barrier also was estimated to have had a negative impact on gross national income (GNI), by about 3–5% a year. See World Bank, *The Palestinian Economy and the Prospects for Its Recovery*, p. 44.

20 United Nations Office for the Coordination of Humanitarian Affairs (OCHA), *The Agreement on Movement and Access: One Year On* (November 2006).*

21 World Bank, *West Bank and Gaza Update* (September 2006), p. 11.*

22 IMF, *West Bank and Gaza*, op. cit., p. 8.

23 For an elaborated recent discussion on the constraints facing the Palestinian private sector, see World Bank, *Growth in West Bank and Gaza: Opportunities and Constraints* (September 2006), chap. 4, pp. 56–77.*

24 World Bank, *West Bank and Gaza Update* (September 2006), p. 12, footnote 3.*

25 These coping mechanisms included nonpayment of public utility bills (mainly water and electricity); drawing on personal savings; buying on credit; reducing consumption, including consumption of food items; selling off house assets, mainly furniture and appliances; cashing in gold jewelry; a traditional from of savings in Palestinian society; and receiving handouts, both in cash and kind, from relatively well-off extended family members.

26 World Bank, *Coping with Crisis*; op. cit., p. 7.

27 By mid-2006, UNRWA added 100,000 refugees, mostly PA employees, to the 650,000 already in its food distribution program; and the World Food Program increased the number of nonrefugee people it feeds by 37%, from 160,000 to 220,000 people monthly. Source: *Statement on Gaza by United Nations Humanitarian Agencies* (August 3, 2006).*

28 Near East Consulting, *NEC's Monthly Report on Palestinian Perceptions Towards their Political, Economic, and Social Conditions*, Bulletin no. 10 (October 2006), p. 4.*

29 See the monthly reporting by OCHA, *Gaza Strip Situation Report*, various issues.

30 In 2006, the number of people killed during internal Palestinian infighting totaled 146, as compared to the 11 killed in similar circumstances in 2005. The situation in Gaza got much worse in 2007 where three days of intense armed clashes (February 1-3) between the two dominant Palestinian factions, Hamas and Fatah, resulted, among other things, in the killing of 33 people and the injury of 242; bringing the number of those killed in internal Palestinian clashes to 86 in the first five weeks of 2007 alone. See OCHA, *Gaza Strip Situation Report – 6 February 2007: Vast increase in Gaza Death toll* (February 2007).

31 OCHA, *West Bank: Closure Count and Analysis* (September 2006).*

32 According to a recent study by UNRWA, the PA fiscal crisis resulted in a reduction in public sector expenditures, both wage and nonwage, of about $500 million in the first half on 2006. This is only the immediate impact, not counting the usual multiplier effect. See UNRWA, *Prolonged Crisis in the Occupied Palestinian Territories*, p. 29.

33 Ibid., p. 10; and Portland Trust, *Palestinian Economic Bulletin*, issue 4 (January 2007).*

34 From an address by Zahi Khouri, a prominent Palestinian businessman, reflecting the views of the Palestinian International Business Forum, at a conference in Stockholm (September 1, 2006).

35 IMF, *West Bank and Gaza*, p. 3.

36 World Bank, *Growth in West Bank and Gaza*; and IMF, *West Bank and Gaza*.

37 World Bank, *Growth in West Bank and Gaza*, p. iii.

38 The term "informalization" here refers to the situation where economic activities take place outside the "formal" sector that is organized and controlled by the government laws and regulations. As such, these "informal" economic activities, which are quite common in most developing countries, usually do not pay taxes, and operate without registration.*

39 World Bank, *West Bank and Gaza Update* (April 2006); see the part prepared by the IMF entitled *West Bank and Gaza: Recent Economic and Financial Developments*, p. 31. In 2005, PA had an expenditure/GDP ratio of 49%—second in the world only to Eritrea. World Bank, *Growth in West Bank and Gaza,* p. 11.*

40 IMF, *West Bank and Gaza: Recent Fiscal and Financial Developments*, p. 9.

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