

The “West Bank First” Strategy: A Political-Economy Critical Assessment

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Introduction

June 2007 marked a turning point in the Gaza Strip's long, troubled history. Five days of a new round of internecine fighting during the second week of that month between Hamas-affiliated armed militants and the Fatah-allied security forces of the Palestinian Authority (PA) left 135 Palestinians dead and 487 injured.¹ The short factional face-off finally ended, on June 14, with the Islamist movement swiftly assuming complete control over the entire Gaza Strip.

Equally dramatic were the developments on the domestic political scene that soon followed. The PA president, Mahmoud Abbas, declared a state of emergency in the Palestinian areas; dissolved the fragile, three-month-old Hamas-led national unity government; appointed an interim emergency government, headed by former PA Finance Minister Salam Fayyad; and promised new elections. For its part, Hamas, having scored a stunning victory 18 months earlier in the January 2006 legislative elections, vehemently rejected Abbas's move, deeming the new, West Bank-based PA cabinet unconstitutional and continuing to regard the Hamas-led government as the legitimate, democratically elected representative of the Palestinian people.

As the guns in the streets of Gaza fell silent and the bloody showdown was over, a new reality suddenly emerged on the ground: An already geographically disconnected Palestinian territory has de facto become politically divided into two separately governed rival entities: one, in the virtually isolated Gaza Strip, ruled by Hamas; the other, in the territorially fragmented and occupied West Bank, run by Fatah.

More significant, perhaps, for the immediate political and economic future of the Palestinian areas were the related regional and international developments that followed. In a show of support for the PA president and his new government, Israel and other key figures in the donor community, mainly the United States and the European Union, undertook a number of policy measures that were intended to asymmetrically influence economic conditions in the newly politically-split Palestinian areas in a bid to influence the political orientation of their respective populations.

On the international front, immediately following Hamas's violent seizure of power in Gaza, the Middle East Quartet (the United States, the European Union, the United Nations, and Russia) issued a statement recognizing the new Ramallah-based PA government²—a position that was reiterated a month later when the Quartet met in Lisbon, Portugal.³ At the same time, the United States and the European Union, who both suspended all direct financial and economic aid to the PA after the formation of Hamas-led government in March 2006, announced their decision to lift their 15-month-long financial and diplomatic ban on the PA and to resume direct assistance to the new Fatah-led cabinet in the West Bank.⁴ Their decision excluded Hamas-controlled Gaza, to which emergency humanitarian aid would continue to be delivered through various United Nations agencies, NGOs, and the year-old

1. United Nations Office for the Coordination of Humanitarian Affairs in the Occupied Palestinian Territory (*hereinafter* OCHA), *Gaza Humanitarian Situation Report* (June 20, 2007), p. 3.

2. Statement of the Quartet, June 16, 2007.

3. Statement of the Quartet, Lisbon, July 19, 2007.

4. "U.S. Lifts Embargo to Help Abbas," *Washington Post*, June 19, 2007.

Temporary International Mechanism (TIM)⁵—bypassing Hamas, as was the case before the takeover.

The Israeli government, in line with the Western policy stand vis-à-vis the post-mid-June Palestinian realities, took a number of steps that would later have a measurable impact on economic and humanitarian conditions in the Palestinian areas, especially in Gaza. Three of these measures in particular stand out for their largely uneven impact on the Palestinian population: (1) the gradual release (to the West Bank-based PA government)⁶ of an estimated \$650 million in Palestinian tax money—the so-called clearance revenues—that Israel collected on behalf of the PA but had withheld since the establishment of the first Hamas-led government in March 2006;⁷ (2) the official closure of Gaza’s three main border crossings, which link the Strip with Israel (the Erez and Karni terminals) and Egypt (the Rafah terminal); and (3) the suspension by the Israeli Customs Authority of the “Gaza customs code,” which is used to identify imported goods en route to Gaza through Israeli ports.

Unlike the West Bank, however, where some of these politically motivated Western and Israeli policies were designed to yield some positive economic results, other measures were quick (as will be illustrated in the third section of this paper) to have their crushing impact felt in Gaza, leaving the largely destitute population of the coastal Strip more isolated than ever before, and increasingly dependent on foreign handouts. More devastating, perhaps, were the trade-related Israeli measures that have rapidly suffocated Gaza’s fragile economy to the point of complete—and possibly irreversible—collapse.⁸

These Israeli/Western policy steps, commonly referred to as the “West Bank First” strategy (hereinafter WBF model), along with their various potential consequences, are likely to dominate the economic and political landscape of the Palestinian areas for some time to come. Their basic underlying assumption, which will be further elucidated in the following section, is that a resumption of direct transfer of financial resources (both foreign aid and clearance revenues) to the new PA government in the West Bank, coupled with a non-humanitarian economic and political blockade of Hamas-controlled Gaza, would enable the former to prosper and cause the latter to stagnate—thereby turning Gaza’s population against the Islamist Hamas and in favor of joining their fellow Palestinians of the West Bank in order to share in their engineered economic fortune.

Whether or not such a novel approach to the post-takeover Palestinian political realities—and to the wider Israeli-Palestinian question—could in reality work has lately been the subject

5. TIM is the Quartet-endorsed channel that was created in July 2006 as a means of delivering EU financial assistance directly to the Palestinian people while bypassing the Hamas-led PA. On September 23, 2007, the Quartet extended the operation of TIM until the end of the year. See *Statement by the Middle East Quartet* (New York, September 23, 2007). For more information on TIM activities, see European Commission Technical Assistance Office for the West Bank and Gaza Strip, *Temporary International Mechanism—TIM, Key Facts* (September 7, 2007).

6. Thirty days after the appointment of the PA emergency government on June 14, 2007, the Palestinian Legislative Council failed to convene a session for a vote of confidence on a new West Bank-based PA cabinet. As a result, the emergency government continued to function, but as a caretaker cabinet.

7. The \$650 million is a net figure, and does not include other monthly deductions made at source to pay for the utilities bought by the PA from Israel. See IMF, *Macroeconomic and Fiscal Developments in the West Bank and Gaza* (September 24, 2007), p. 6

8. See “World Bank: Gaza Strip May Face ‘Irreversible’ Economic Collapse,” *Haaretz*, July 12, 2007.

of analyses that have spawned an interesting assortment of views across the board.⁹ This paper is an attempt to contribute to this still ongoing discussion by focusing exclusively on the political economy aspect of the issue—an area that has been largely missing from the debate.

To achieve this task, most of the analysis presented in this study, after a short review of the new model and the impact it has had so far on Gaza, will address the question whether the West Bank—given what has become of its economy since the start of the second Intifada in September 2000—could in reality make a quick, significant, and sustained U-turn toward recovery and growth as hypothesized by the WBF strategy. This question, in turn, raises three additional, related questions—which will also be addressed in this study—about: (1) the conditions that are necessary in order for the model to succeed; (2) the prospect that these conditions could be adequately fulfilled under the present convoluted socioeconomic, political, territorial, and security environment in the West Bank; and (3) the various impediments and complications that could potentially engender the failure of the model.

Based on what has emerged from our analysis of these issues, there is a good reason to believe (as will be shown in the fourth section of this paper) that “success” of the WBF model may not be easily achievable, and that the new model may quickly prove to be too optimistic, if not overly simplistic, for smooth implementation on the ground. If this indeed turns out to be the case, then it is not totally inconceivable that the advocates of the WBF model could end up, in the not-so-distant future, with a very messy picture on the ground; much messier, perhaps, than the one the new strategy was ostensibly designed to deal with. One should not hasten to dismiss such a view as needlessly pessimistic. After all, the recent history of the region provides many examples of how ill-thought-out and poorly implemented plans can produce disastrous outcomes. The one-sided Gaza disengagement plan is a perfect example; others are not difficult to find.¹⁰

The analysis presented in this paper, therefore, suggests a twofold goal for it. The first is to caution against the potentially grave consequences of the new strategy. The second is to strongly make the case for the need to shift gears, change course, and embark on a very different strategy—one that would take full advantage of the sudden renewed interest (in the wake of Hamas’s takeover of Gaza) in the Israeli-Palestinian conflict in a way that would refocus the entire process on issues of long-term interest for all sides.

The discussion in this paper is organized as follows. After this Introduction, which serves as the first section of the study, the second section presents a detailed description of the nature of the WBF model and its basic assumptions. The third section provides a brief account of the post-Hamas takeover economic and humanitarian developments, especially in Gaza, that have transpired as a result of the implementation of the new strategy. The fourth section, which represents the main part of the study, is an analysis of

9. See, for example, the following op-ed pieces: Robert Malley and Aaron David Miller, “West Bank First: It Won’t Work,” *Washington Post*, June 19, 2007; Jonathan Freedland, “The Scene of Fatahland Flowering as Hamastan Wilts Is Sheer Fantasy,” *Guardian*, June 20, 2007; Daniel Levy, “What Next on Palestine: Time to Get Real,” *ProspectsforPeace.com*, June 15, 2007; Martin Indyk, “A ‘Two-State Solution,’ Palestinian-Style,” *Washington Post*, June 15, 2007; and Yossi Beilin, “The Great Illusion,” *Bitterlemons.org* (September 24, 2007).

10. Consider for example the assumption—which turned out to be grossly unrealistic—that oil revenues in post-Saddam/post-U.S.-led-invasion Iraq could finance the country’s reconstruction.

the essential conditions and potential impediments that might lead, respectively, to the success or failure of the WBF model. The fifth section concludes the paper with some final thoughts.

The “West Bank First” Model: Objectives and Basic Assumptions

The West Bank First strategy—or “Focus on the West Bank and leave Gaza behind for now” type of thinking—made its debut as Gaza was falling into the hands of Hamas militants during the second week of June 2007.¹¹

The strategy was largely born out of the desire, mainly on the part of the Israeli government and the United States, and with the tacit approval of the new PA government this time, to either isolate Hamas, weaken it, force it to moderate, or defeat it altogether, when all past attempts to do so—including a 15-month-long financial and diplomatic siege—had conspicuously failed to produce any of these outcomes. The fall of Gaza, and the ensuing violent schism in the Palestinian political terrain, therefore presented the U.S. and Israel with a “window of opportunity” to pursue a new approach to the “Hamas question” where WBF model takes center stage.

The new model is predicated on pursuing two vastly contrasting policies vis-à-vis the two, politically divided Palestinian areas: one for the Fatah-run West Bank and another for the Hamas-controlled Gaza Strip. The aim of the strategy, according to its architects, is to create two drastically different realities in the two Palestinian territories, whereby the West Bank prospers and Gaza despairs. The clear choice that the model intends to present to the Palestinian people (if the model’s predictions materialize) will be between moderation that pays, and extremism that costs dearly. The rational choice, so the theory goes, will favor prosperity over deprivation, leading Palestinians in Gaza to rise up against Hamas and force it to either moderate or lose. The resulting defeat of Islamic fundamentalists in Gaza will create conditions that will ultimately make possible a negotiated political settlement to the Palestinian-Israeli conflict.

Here is how WBF model is supposed to work in real life.

Under the new strategy, the West Bank and its Palestinian leadership will be the focus of sustained attention by the international community, whose aid and active diplomacy will work in tandem to transform the place into *an oasis of prosperity and stability*. The resumption of the heretofore banned direct external financial assistance, both in grants and in soft loans, along with the release and continued transfer by Israel of Palestinian tax and customs money, will lead to a surge in both public and private investment, creating more jobs for the unemployed and raising the standard of living of the poor. The relaxation of Israeli restrictions on Palestinian movement in the West Bank will help restore mobility and provide much-needed relief for businesses as well as for the Palestinian masses, generating greater confidence with respect to the future. All along, international diplomacy will work closely with international money to make sure that the process of transformation in the Fatah-run West Bank proceeds as planned.

11. Traces of such thinking can be found in some earlier writings, however; see, for example, Shlomo Brom, “Making the West Bank a Model,” *Bitterlemons.org* (May 21, 2007).

In contrast to the West Bank, Hamas-controlled Gaza will be further isolated under the WBF plan, both financially and politically. In accordance with the plan's strict conditions, and in order to undermine Hamas, Gaza will be placed under total economic and physical siege, its borders remaining tightly sealed to all but basic humanitarian assistance sufficient only to keep Gaza's population alive. Normal trade or business relations with Gaza will not be allowed, and its population will be locked-up within the Strip's boundaries, not permitted to exit or enter as they wish. None of the international public or private investment capital flowing into the West Bank in the context of the new strategy will find its way to Gaza, so its depressed economy will continue to wither, its crumbling public infrastructure will be further debilitated, and its public services will continue to deteriorate. The Islamists, in short, will not be given the opportunity to successfully govern Gaza.

The basic underlying assumption behind the WBF carrots-for-the-West-Bank/sticks-for-Gaza model is that, as the Strip experiences the full impact of virtual abandonment and the burden of economic strangulation under Islamist rule while the West Bank begins its journey toward stability, greater mobility, and economic well-being under the Fatah-led PA government, the latter will start to compare favorably against the impoverished and besieged Gaza; and this is where, according to the model, things start to happen. Support for Hamas in Gaza will be deemed counterproductive and gradually wane, replaced by pressure on the Islamists to change course, moderate their stance, and join the West Bank, Fatah-led government in pursuit of a different future. Failure on the part of the Hamas leadership to heed the public's demands and attend to its interests will ultimately lead to the mobilization of public opinion against them. This, in turn, will bring about the desired change—or, if that does not work, lead to internal revolt, achieving change by force if necessary. Either way, goes the plan, moderates win, moderation prevails, and the model's underlying premises are vindicated.

Support for the WBF approach, and the way that support increased sharply after the unexpected shift in Palestinian politics, was impressive. A month after the takeover, on July 16, U.S. President George W. Bush in a speech on the Middle East announced “a series of steps to strengthen the forces of moderation and peace among the Palestinian people. . . [and] lay the foundation for a successful Palestinian state in the West Bank and Gaza.”¹² These included the lifting of the U.S. financial blockade on the PA; a package of direct financial aid to the new PA government; and the convening later in the year, in November, of a U.S.-led international meeting to “review the progress that has been made toward building Palestinian institutions. . . support further reform. . . [and] provide diplomatic support for the [Palestinian and Israeli] parties in their bilateral discussions and negotiations. . . .”¹³

The planned meeting in November—to be held in Annapolis, Maryland—has been preceded by a gathering in New York on September 24 of key donor countries, led by Norway, to garner international financial support for the PA government; with a second “pledging” meeting scheduled at the end of the year for the same purpose. The appointment on June 27 of the former British prime minister Tony Blair as the new Middle East Quartet representative, with a mandate to “[m]obilize international assistance to the Palestinians,” “[h]elp to identify [and

12. The full text of the president's speech can be found at <http://www.whitehouse.gov>.

13. Ibid. The U.S. financial package includes \$190 million in aid and \$80 million in security assistance. None of this “new” aid on the part of the U.S., however, represents entirely new funding; rather, it is “old” money that was previously committed but never disbursed owing to political or administrative complications. See Nathan Guttman, “New Aid for Palestinians Called a Mirage,” *Forward*, July 18, 2007.

address] the institutional governance needs of the [future] Palestinian state,” and “[d]evelop plans to promote Palestinian economic development” was another move to provide support for the PA.¹⁴ So, too, was the establishment of a joint U.S.-Palestinian investment fund to provide \$228 million in loans to Palestinian small- and medium-sized businesses.¹⁵

Policy Measures and Early Impact

In the wake of the Hamas takeover project, both economic and humanitarian conditions in the Palestinian areas, and especially in the Gaza Strip, have been largely dictated by the subsequent and immediate implementation of the WBF strategy, and the policy measures taken by the sponsoring countries in an attempt to see the strategy through. This section briefly reviews these measures and provides a brief account of the related developments that followed in both parts of the Palestinian territories. The discussion here is intended as a prelude to the overall assessment of the WBF model which will be introduced in the next section.

Early impact on the West Bank

In the West Bank, the resumption of direct foreign aid to the new PA government; the release by Israel—albeit in installments and over a six-month period—of Palestinian tax money; and the prospects for the easing of some Israeli restrictions on Palestinian movement are all expected to have a positive economic impact.

More specifically, and to the extent that (1) direct foreign aid is restored to a level adequate to meet the PA financial resource needs, especially to finance the burgeoning budget deficit expected in 2007 to reach over \$1.5 billion¹⁶; (2) clearance revenues, old and new, continue to be regularly released so as to enable the new PA government to meet its growing financial obligations, both in the West Bank and in Gaza; and (3) stringent restrictions on movement are meaningfully relaxed, so as to allow businesses and ordinary citizens to conduct their economic and social activities in a relatively free and unfettered environment; all this should represent a considerable relief for the cash-strapped PA, which was devastated by the Western-led financial siege that followed Hamas’s electoral rise to power and by the continued application of a multitude of Israeli physical and administrative impediments that affected every aspect of Palestinian life in the West Bank.¹⁷

How fast, and to what degree, these measures can significantly mitigate the grave economic and social conditions in the West Bank and lay the groundwork for future economic recovery and subsequent growth, and whether they can survive unforeseen political and security

14. Statement by Middle East Quartet (June 27, 2007).

15. See a press release by the U.S. Overseas Private Investment Corporation (OPIC), “OPIC to Support Small Business Lending Program for Palestinians” (Washington, D.C., July 25, 2007).

16. See IMF report cited in the next footnote, table 3, p. 14.

17. For a discussion of the post-January 2006 Palestinian financial and economic crisis, see the following three reports: World Bank, *Two Years after London: Restarting Palestinian Economic Recovery*, Economic Monitoring Report to the Ad Hoc Liaison Committee, September 24, 2007; IMF, “Macroeconomic and Fiscal Developments in the West Bank and Gaza,” Ad Hoc Liaison Committee Meeting, New York, September 24, 2007; and UNCTAD, *Report on UNCTAD Assistance to the Palestinian People*, report no. TD/B/54/3 (Geneva, July 11, 2007), particularly sections I and II, pp. 3–10. See also OCHA, *Palestinian Finance under Siege: Economic Decline and Institutional Degradation* (April 2007).

developments that may run counter to the assumptions underlying the WBF model, are questions that will be tackled in the next section.

So far, however, and apart from the resumption of monthly payments of the *full* salary of the PA's civil and security workers for the first time since March 2006, the impact of the new strategy is yet to be tangibly felt by the Palestinians of the West Bank.¹⁸

The crushing impact on the Gaza Strip

As for the Gaza Strip, the impact of the application of the WBF strategy was immediate, profound, and almost destructive in nature.

Before discussing in some detail the economic, humanitarian, and institutional impact of the new strategy on Gaza, a brief note, first, on what makes this 365-square-kilometer coastal enclave particularly vulnerable to any adverse security or political developments with Israel.

Despite the departure of the Israeli settlers and army from Gaza in the context of disengagement in September 2005, Israel continues to maintain exclusive and total control over all exit and entry points, for both people and trade, from and to the Strip. Nothing can enter or leave Gaza without Israel's approval. With no functional seaport or airport providing an independent direct link to the outside world, all exports and imports into and out of the Gaza Strip have to go through Israeli ports. Furthermore, Israel is Gaza's dominant trading partner: Over 90 percent of trade transactions are conducted with the Israeli economy, and almost all consumer, intermediate and capital goods come either from or through Israel. Gaza's dependence on Israel runs even deeper: All of Gaza's gas supplies, 60 percent of its electricity, and 40 percent of its water needs come from Israel.¹⁹ Under these most exceptional of conditions, the resource-poor and largely underdeveloped Gaza economy is extremely vulnerable to any adverse development that could disturb its four-decade-old dependency on Israel that began in June 1967, when Gaza fell under Israeli occupation.

Worse still, frequent Israeli air and land military operations inside, and directed at, Gaza, and the continued firing from the Strip by Palestinian militants of homemade rockets at Israeli targets across borderlines—and at times even at border crossings—have further added to the volatility of conditions.²⁰

18. Not all PA employees were paid their salaries. An estimated 31,000 civil and police workers hired after the January 1, 2006 were not paid, and their status with the PA is still under review by the PA Ministry of Finance. OCHA, *Gaza Humanitarian Situation Report, June 28–July 5, 2007*; and World Bank, *Two Years after London*, op. cit., p. 25.

19. Note here that even the electricity that is generated domestically from the only power plant in Gaza is totally dependent on the fuel imported from Israel and paid for by an EU special fund.

20. On September 19, 2007, following the firing of homemade rockets a week earlier by Palestinian militants from Gaza at an Israeli military base inside Israel that wounded 69 soldiers, the Israeli security cabinet declared the Gaza Strip a "hostile entity" and approved plans to disrupt future supplies of electric power and fuel to Gaza. See "Security Ministers Declare Gaza 'Hostile Entity,' Vote to Disrupt Power, Fuel," *Haaretz*, September 19, 2007. This was followed a week later by Bank Hapoalim – Israel's largest commercial bank – decision to terminate all financial links with the Palestinian banks in Gaza. See "Bank Hapoalim To Sever Ties With Palestinian Banks In Gaza," *Haaretz*, September 25, 2007. Two weeks later, on October 10, the Israeli Discount Bank took a similar action and severed its ties with the banks in Gaza. See "In Line With Government Policy, Discount Bank Cuts Ties With Gaza Banks," *Haaretz*, October 10, 2007.

The physical blockade of Gaza is particularly detrimental. Citing security risks and the absence of any Palestinian party with whom to coordinate security measures, Israel has officially closed, since the second week of June 2007, all three key border crossings that link the Gaza Strip with Israel and the outside world: (1) the Karni cargo terminal, which constitutes the principal lifeline for the Gaza economy and the only exit and entry point for commercial trade with Israel, the West Bank, and other countries; (2) the Rafah passenger crossing—the only transit point that provides the population of Gaza with access, through Egypt, to the rest of the world;²¹ and (3) the Erez border crossing, which is mainly used as an entry/exit point by senior Gaza businessmen and by international staff working for the UN and for other foreign agencies operating in Gaza.²²

The prolonged closure of the Gaza borders has had disastrous consequences. According to the new Israeli policy vis-à-vis Hamas-ruled Gaza, only items identified as necessary to avert a humanitarian crisis (basic foodstuffs, medical supplies, and the like) are allowed to enter the Strip through other, much smaller (in both size and capacity) border crossings: the Sufa Crossing, on the southeastern Gaza-Israel border, and the Kerem Shalom Crossing, located at the Gaza-Israel-Egypt border.²³ And the operation of even these alternative crossings is conducted under subnormal conditions that compromise both the flow of items into Gaza and their quality.²⁴

Most damaging of all to the already stagnant Gaza economy, however, is that no exports of any kind have been allowed out of Gaza since Hamas took control in mid-June, and no imported nonhumanitarian commercial commodities—from Israel, the West Bank, or other countries—have been allowed in.^{25,26}

The extended closure of Gaza’s border crossings and the deletion of its customs code from the computer system in Israeli ports²⁷ have proven to be very costly in particular to Gaza’s

21. Since November 15, 2005, Rafah Crossing has been operated by the Palestinians in the presence of a monitoring European mission (the European Union Border Assistance Mission) in accordance with the U.S.-sponsored Agreement of Movement and Access.

22. Palestinian workers from Gaza who in the past used this designated border crossing to enter Israel in search of jobs have been totally barred from entry since March 2006.

23. It is worth noting in this regard that there seems to be no clear agreement on the Israeli side with respect to the definition of “humanitarian items.” According to a spokesman for the Israeli army, “Some people feel we should be allowing in water, electricity and that’s it.” See “With Pressure Put on Hamas, Gaza Is Cut Off,” *New York Times*, July 10, 2007. Continued disagreement over what exactly constitutes humanitarian aid resulted, for example, in delays in delivering five truckloads of paper needed by UNRWA to print books for some 200,000 schoolchildren at the start of the new school year in Gaza on September 1. See OCHA, *Gaza Humanitarian Situation Report, August 15–23, 2007*.

24. On how Sufa Crossing operates in the absence of contact between the Palestinian and Israeli sides to coordinate incoming transactions to Gaza, see the report by the *Times*, “Blockade Drains Life from Gaza,” July 17, 2007, *Times Online*.

25. Commenting on this policy, a spokesman for the Israeli government remarked, “As long as Hamas doesn’t rethink its position, things will stay the way they are. The Palestinians in Gaza can survive without the opening of the crossings. True, there are difficulties and the situation isn’t good, but they are not collapsing tomorrow morning. There will be no starvation in Gaza.” (“Gaza’s Economy Barely Alive,” *Los Angeles Times*, July 20, 2007.);

26. OCHA reported that on August 27, 130 tons of potatoes were exported from Gaza to Jordan through Kerem Shalom Crossing. No further exports were recorded after that date owing to Hamas’s refusal, according to the report, to use Kerem Shalom as an alternative to Karni Crossing. See OCHA, *Gaza Humanitarian Situation Report, September 13, 2007*.

27. Since the cancellation of Gaza’s customs code (on June 21, 2007) by the Israeli Customs Authority, an estimated 1,600 commercial containers destined for Gaza have been stranded in Israeli ports. See OCHA, *Gaza Humanitarian*

business sector, in which over 90 percent of industries are dependent on raw materials imported from Israel.²⁸

During the first month alone of the closure, an estimated 80 percent of Gaza's industrial factories have temporarily been forced to close, leaving about 30,000 of an estimated 120,000 private sector employees out of work. The remaining operating businesses have continued to function, but at less than 60 percent of production capacity. Another 30,000 workers in Gaza's construction sector are also reported to have lost their jobs owing to the lack of imported building materials, which has ground the sector's activities to a halt. Shortages of building supplies have also forced UNRWA (the United Nations Relief and Work Agency), UNDP (the United Nations Development Program), and the World Bank to suspend more than \$200 million worth of construction projects, including homes, schools, medical facilities, water networks, and sewage treatment plants.²⁹

Furthermore, the lack of imported seedlings, fertilizers, and chemical products has also threatened Gaza's agricultural exports, and with it an estimated 65,000 farming jobs.³⁰ And the garment and furniture sectors in Gaza, which are heavily dependent on Israel for raw materials and the marketing of their finished products, have mostly shut down.

This rapid meltdown of Gaza's economic base in such a record time led the World Bank, less than a month into the border blockade, to issue the following warning: "The pillars of Gaza's economy have weakened over the years. Now, with a sustained closure on this current scale, they would be at risk of virtually irreversible collapse."³¹

Humanitarian conditions in Gaza have continued to deteriorate despite the entry of most humanitarian and other basic commercial items necessary to meet the population's needs. The statistics in this regard are quite telling. Over 1.1 million people, or close to 80 percent of Gaza's population, are unable to feed themselves without external assistance. Of these, an estimated 850,000 refugees are dependent on emergency food rations distributed by UNRWA, and another 275,000 non-refugee residents are receiving basic foodstuffs from the World Food Program. The latter figure jumped by over 100,000 in the two weeks following the Hamas takeover, "and it is increasing daily because of the situation."³²

Finally, Gaza's public institutions, which have been sapped as a result of the 15-month-long financial boycott, continue to decay, owing, in part, to the ongoing financial squeeze of Hamas-controlled Gaza.³³ The recent Palestinian political split has further added to Gaza's

Situation Report, July 31– August 7, 2007. (That figure also includes imported shipments that were cleared by Israeli customs prior to the enforcement of the ban, but were not permitted to enter Gaza owing to border closure.)

28. On the early impact of post-takeover border closures on the economy of the Gaza Strip, see the following two Palestinian and Israeli documents: Palestine Trade Center (Pal Trade), *Border Closures: Effects on Private Sector in Gaza*, a publication prepared for the Palestinian Private Sector Coordination Council (Gaza, July 12, 2007), and Center for the Legal Protection of Freedom of Movement (Gisha), *Commercial Closure: Deleting Gaza's Economy from the Map* (Tel Aviv, July 2007).

29. OCHA, *Gaza Humanitarian Situation Report, September 13, 2007*, p. 3.

30. OCHA, *The Humanitarian Monitor, Number 16, August 2007*.

31. "World Bank: Gaza Strip May Face 'Irreversible' Economic Collapse."

32. World Food Program spokeswoman Christiane Berthiaume was so quoted in an interview. See "UN: More Gazans Relying on Handouts," *Jerusalem Post*, June 26, 2007.

33. For more on the institutional decay of the PA, see Nathan J. Brown, "The Peace Process Has No Clothes: The Decay of the Palestinian Authority and the International Response" (Washington, D.C.: Carnegie Endowment for International Peace, June 15, 2007).

institutional troubles, as it caught public workers, both civil servants and official security forces, in the middle of the political crossfire between Hamas and the West Bank–based PA government. In Hamas-ruled Gaza today, for example, some PA workers, who continue to be paid by the West Bank–based government, are not sure if they have to show up for work or not, whom to report to if they *do* show up, or even on what day, or days, of the working week they should rest.³⁴

To summarize: In four months following Hamas’s military takeover of the Gaza Strip and the subsequent strict application of the WBF strategy, Gaza, already isolated and burdened with high rates of poverty and unemployment, has been effectively sealed off from the rest of the world; its anemic economy lies in tatters; and the vast majority of its population has been reduced to welfare cases, almost fully dependent for their basic survival on foreign handouts.

How long Gaza can wait until the WBF model succeeds in transforming the West Bank into an area of economic prosperity and political stability that would—as the WBF model postulates—trigger a popular unrest in Gaza against its Islamist rulers largely depends on two factors: (1) the model’s ability to overcome a number of challenges that could complicate, if not totally frustrate, its successful implementation on the ground, and (2) whether the model itself can survive potential future attempts by Hamas to foil it.

Given the nature of the new strategy, the complex context in which it was conceived and carried out, and the very convoluted political, territorial, socioeconomic, and security environment that exists in today’s West Bank, the challenges facing successful implementation of the WBF strategy could indeed be serious. The next section explains why this may well be the case.

Potential Constraints and Limitations

There are at least five crucial conditions that need to be fully met in order for the WBF model to succeed, over time, in lifting the West Bank from its current socioeconomic decline, reversing the general downward economic trend that has been in place since September 2000 and ushering in a process that might potentially lead to sustained economic recovery.³⁵ These conditions are: (1) a favorable political environment; (2) substantial dismantling of Israeli restrictions on Palestinian movement; (3) effective use of foreign aid to rebuild the Palestinian economy’s productive capacity; (4) a resurgence of confidence on the part of the domestic private sector; and (5) non-renewal of violence—both intra-Palestinian violence and Palestinian-Israeli violence.

Under the intricate conditions currently existing in the Palestinian areas, however, there is good reason to believe, as will be discussed in some detail below, that the attainment of the above “requirements for success” may not be easy, if not impossible altogether. As such, the new model is expected to face substantial impediments that could very well bring an early

34. For more detailed examples of how the recent Palestinian political rift has created a multitude of institutional difficulties for Gaza Palestinians in the health, education, and other public service sectors, see “Two Governments at Odds,” *Al-Ahram Weekly*, August 2–8, 2007.

35. It should be noted here that the short-lived economic recovery of 2003-2005 was primarily achieved through an *unsustainable* expansionary fiscal policy that led to higher budget deficit as a percentage of GDP, from 14.6 percent in 2003 to 17 percent in 2005. see IMF, *Macroeconomic and Fiscal Developments in the West Bank and Gaza* (September 24, 2007), table 1, p. 12.

end to it—leaving behind, in all likelihood, a legacy of yet another failed experiment at a time when neither the potentially explosive present situation in the Palestinian areas nor the prevailing volatile environment in the region can afford such an outcome.

The remaining part of this section is devoted to elaborate on the nature of these impediments that constitute “binding constraints” on the ability of the WBF model to achieve sustained positive outcome in the West Bank.

a) A nonconductive political climate

For the WBF model to have a realistic shot at success in improving, or at least mitigating, the current dire socioeconomic conditions in the West Bank, both conflict conditions and political instability—the root source of all economic ills in the Palestinian territories—must be addressed first. Only a viable political process with a clear chance of success can help create the environment needed to start to undo the structural damage caused to the Palestinian economy by years of occupation, confrontation, and restrictions on access and movement; enable the domestic private sector to play an effective role in economic recovery; and help make available adequate amounts of the foreign financial resources necessary to rebuild the physical and institutional infrastructure necessary for future growth.

In this context, both theory and worldwide evidence suggest that normal economic activities cannot be efficiently conducted and economies cannot achieve adequate and sustainable growth rates under the continued prevalence of conditions of conflict and political instability. This is even more so, as recent past experience has vividly shown, in the case of the Palestinian areas.³⁶

That being said, however, it is yet to be seen whether the sudden surge of U.S.-led diplomatic activities following the Hamas takeover of Gaza, including a plan to convene an international meeting later in the year in Annapolis, or the renewed and continuous contacts between the PA and Israel at the level of top political leadership on both sides, can succeed in meaningfully bringing back to life the seven-year-dormant Israeli-Palestinian peace process, and in so doing help provide the crucial political ingredient needed for the WBF to succeed.³⁷

On this question there is plenty of serious political analysis around, enough to make one skeptical.³⁸ This analysis has raised a number of tough questions on a variety of issues which, when all add up, render the possibility that the planned U.S.-led meeting in Annapolis, Maryland, if and when it is held, to arrive at a satisfactory resolution highly unlikely. Some of the factors identified as likely impediments to success include: the quality of both Palestinian and Israeli leadership, and their present political standing among their own constituencies;

36. For a short literature review of the relationship between conflict and economics and their relevance to the Palestinian case, see the World Bank study, *Long-Term Policy Options for the Palestinian Economy* (July 2002), Chapter 1, pp. 9-12.

37. Following Hamas’s takeover of Gaza, PA president Mahmoud Abbas and Israeli Prime Minister Ehud Olmert met six times between June 25 and October 3, 2007: first in the Egyptian Red Sea resort of Sharm El Sheikh on June 25, 2007, in the presence of the Egyptian and Jordanian heads of state; then in West Jerusalem (on July 16, August 28, September 10, and October 3) and in the West Bank city of Jericho (on August 6).

38. See, for instance, the articles cited in footnote no. 9 by Robert Malley and Aaron David Miller, Jonathan Freedland, and Daniel Levy. See also Meron Benvenisti, “Beware of Oslo’s Destructive Route,” *Haaretz*, July 19, 2007; Aluf Benn, “PlayStation Palestine,” *Haaretz*, August 2, 2007; and Yossi Alpher, “The Consequences of Failure,” *Bitterlemons.org* (August 20, 2007).

current unfavorable domestic political realities in both Palestine and Israel; prevailing regional political and security complications; and last but not least, the virtual impossibility of achieving success in the absence of a minimal consensus among Palestinians on the contours of a future political settlement, or on what needs to be done to get there.³⁹

Furthermore, the narrow mandate of the new Quartet representative, which limits his role to nonpolitical issues;⁴⁰ some official statements on what to expect or not to expect from the planned meeting in Annapolis—whether it would constitute a major political breakthrough, lead to an announcement of a binding agreement on principles to govern future bilateral negotiations, or just be an occasion to declare a joint nonbinding statement of intentions;⁴¹ and the continuing ambiguity with regard to meeting preparations, agenda, and potential participants—all give rise to further doubts and increased skepticism.⁴²

Such grim prospects for a political breakthrough, and the likelihood for an escalation of tensions and renewed violence if current expectations are not met, could further worsen security conditions in the West Bank and lead, as has always happened in the past, to an intensification of Israeli restrictions on the movement of Palestinian people and trade, potentially thwarting all efforts to achieve economic recovery. This possibility of continued political instability and renewed confrontation constitutes a real constraint on the ability of the WBF model to deliver on its promise for a quick economic recovery in the West Bank. All other potential problems with the model follow from that.

b) Territorial fragmentation and restrictions on movement

The prospects for sustained economic revival in the West Bank critically depend on a substantial relaxation of Israeli restrictions on Palestinian people and trade in a manner that allows for free and unimpeded access and movement, both within the area and across its borderlines. This is a core requirement if the WBF strategy currently under implementation is to succeed in getting the West Bank economy out of its seven-year-long recession and back on the road to recovery. Given the highly fragmented territorial *and economic* space of the West Bank, no recovery is possible in the absence of this basic requirement.⁴³

39. A recent public opinion poll in the West Bank and Gaza, for example, conducted between August 16 and August 20, 2007, found that 81.9 percent of Palestinians are against the annexation of the major Jewish settlement blocks in the West Bank by Israel; 61 percent oppose a possible land swap; 67.2 percent oppose declaring only parts of East Jerusalem to be the capital of a future Palestinian state; 93.5 percent are against Israeli jurisdiction over the Al-Aqsa Mosque; and 68.5 percent are in favor of the return of all Palestinian refugees to their homes in Israel. For full access to the poll results, see Jerusalem Media and Communication Center, Poll no. 62 (Jerusalem).

40. In a recent newspaper interview, James Wolfensohn, the former Middle East Quartet special envoy for disengagement, identified the restriction of his assignment to only nonpolitical issues as a major factor that contributed to his not having achieved success in his job. See the full text of the interview in “All the Dreams We Had Are Now Gone,” *Haaretz*, July 21, 2007.

41. In a meeting with his Kadima Party on September 16, the Israeli prime minister reportedly dismissed the possibility of reaching any binding political agreement on principles with the Palestinian side in the context of their preparation for the planned Washington meeting, provoking a threat by Palestinian officials to boycott the conference. See “Israel Lowers Hopes for Middle East Talks,” *Washington Post*, September 16, 2007.

42. See “U.S. Faces a Middle East Hungry for Peace Specifics,” *Washington Post*, September 18, 2007. See also *Financial Times*, “Deep Scepticism Faces Bush’s Peace Mission,” September 12, 2007.

43. For a concise analysis of the nature of the Israeli restrictions on movement and access in the West Bank and their economic impact, see World Bank, *Movement and Access Restrictions in the West Bank: Uncertainty and Inefficiency in the Palestinian Economy* (May 9, 2007).

The issue of restrictions on Palestinian movement and access is very serious and very well documented, with constantly updated maps and figures, by both international and Israeli sources.⁴⁴ As of August 2007, according to OCHA, there are 149 Jewish settlements inside the West Bank (including East Jerusalem), 102 Jewish outposts, 48 Israeli military bases and closed military zones that cover about 20 percent of West Bank land, and a 1661-kilometer network of Jewish-only roads designed to connect the settlements, outposts, and military areas with one another and with Israel.⁴⁵

As a result of this extensive Israeli presence inside the West Bank, normal movement, both commercial and civilian, between most Palestinian urban and rural communities has been severely curtailed by numerous Israeli military administrative orders and hundreds of physical restrictions. The latter include fixed checkpoints, flying (temporary) checkpoints, concert roadblocks, dirt mounds, iron gates, and trenches. Over the past two years, the number of these physical obstacles has increased by 41.5 percent, from 376 in August 2005 to 532 in August 2007.⁴⁶

These physical and administrative restrictions—commonly referred to as the “closure and permit regime,” which Israel has imposed since 1993 on security grounds—have effectively divided the West Bank into six major Palestinian enclaves: three separate areas running from north to south; the Jordan valley to the east; the area west of the still-under-construction 780-kilometer-long separation barrier⁴⁷ (a water-rich area of fertile land, constituting about 10.2 percent of the West Bank⁴⁸); and East Jerusalem. Furthermore, Palestinian access to the Jordan valley, to the area west of the barrier, and to East Jerusalem is severely restricted; and when other restricted areas in the West Bank are added to the picture, the estimated size of the area off-limits to Palestinians amounts to about 38.6 percent of the West Bank.⁴⁹

Whether this convoluted territorial situation in the West Bank can be substantially changed in the context of the WBF model is not clear. For instance, recent announcements by the Israeli government about its intention to relax restrictions on Palestinian internal movement raise a series of important questions regarding how soon the restrictions will be removed; which such restrictions, how many, and where they apply; and whether their removal, if and when it happens and given the advanced and intricate state of the “closure regime,” can

44. OCHA and B'Tselem (The Israeli Information Center for Human Rights in the Occupied Territories) are among the most notable sources of information and continued reporting on the subject. See especially these two recent reports: OCHA, *The Humanitarian Impact on Palestinians of Israeli Settlements and other Infrastructure in the West Bank* (July 2007), and B'Tselem, *Ground to a Halt: Denial of Palestinians' Freedom of Movement in the West Bank* (August 2007). The OCHA report, in particular, represents one of the most comprehensive and well-documented studies to date on the subject.

45. OCHA, *The Humanitarian Impact on Palestinians of Israeli Settlements*. This study contains very detailed maps documenting the exact number and location of all kinds of Israeli military and civilian presence and its associated infrastructure inside the West Bank.

46. See OCHA, *Implementation of Agreement on Movement and Access (July 25– August 7, 2007)*, report no. 45 (August 13, 2007).

47. By September 2007, about 53 percent of the barrier has been completed. See OCHA, *The Humanitarian Monitor*, Number 16 (September 2007), p. 9.

48. According to UNCTAD's estimates, the continued construction of the separation barrier has resulted in a 15 percent loss of all West Bank agricultural land, and a loss of control over 49 water wells. See UNCTAD, *Report on UNCTAD's Assistance to the Palestinian People* (TD/B/53/2, Geneva, July 19, 2006), p. 7.

49. OCHA, *The Humanitarian Impact on Palestinians of Israeli Settlements*, op. cit., p. 71.

significantly allow for free movement within and across the West Bank in a way that can make a real difference in both living and economic conditions in the West Bank.⁵⁰

Moreover, the experience of the recent past has shown that pledges to ease restrictions on Palestinians were either never carried out (e.g., the U.S.-sponsored Agreement on Movement and Access, reached on November 15, 2005)⁵¹, or even reversed.⁵² Whether recent announcements in the context of the new WBF strategy will end up meeting the same fate is yet to be seen. Early indications on the subject, however, are not encouraging and show *an increase*, not a decline, in the number of physical restrictions inside the West Bank during September 2007, despite promises to the contrary.⁵³

Bottom line: The continued imposition of the Israeli “closure and permit regime” in the West Bank represents one of the most serious challenges facing the new WBF model, potentially vitiating whatever positive economic impact might result from either the resumption of direct international financial assistance to the new PA government, or the foreign private capital that is being made available on favorable terms to the domestic private sector. The May 2007 World Bank report on the subject summed this up as follows:

In economic terms, the restrictions arising from closure not only increase transaction costs, but create such a high level of uncertainty and inefficiency that the normal conduct of business becomes exceedingly difficult and stymies the growth and investment which is necessary to fuel economic revival. . . . without efficient and predictable movement of people and goods, there is very little prospect for a sustainable Palestinian economic recovery.⁵⁴

c) A limited developmental role for foreign aid

The WBF model assigns a role to foreign aid similar to the one it played in the Palestinian areas during the 1990s. According to the new strategy, the resumption of international financial assistance to the new PA government will help reconstruct the ruptured economy of the West Bank, put it back on the road to recovery, and make the area a model for all Palestinians.

50. In this regard, the World Bank report of September 24, 2007, noted that “incremental steps are unlikely to lead to sustainable improvements as they have historically lacked permanence, and have been withdrawn or replaced by other restrictions. Moreover, economic recovery will remain elusive if large areas of the West Bank are inaccessible for economic exploitation and restricted movement remains the norm for the most Palestinians, their products, and their investment funds.” See World Bank, *Two Years after London*, op. cit., pp. 19–20.

51. See Jim Wolfensohn interview with *Ha'aretz*, op. cit. For the full text of the agreement, see Annex 5 of the World Bank report, *Two Years after London*, op. cit.

52. B'Tselem's communications director, Sarit Michaeli, commented with respect to the repeated Israeli announcements: “Israel systematically spreads false promises to ease the movement restrictions on Palestinians in the West Bank, but the situation on the ground moves in the direction of the tightening of control, as the restriction regime in its entirety is becoming more institutionalized” (“Restrictions on Palestinians Decried,” *Washington Post*, August 8, 2007). On the same subject, OCHA observed that “[t]he closure regime that originated as a temporary security measure during the peak of terrorist attacks now appears institutionalized” (OCHA, *The Humanitarian Impact on Palestinians of Israeli Settlements*, p. 68).

53. According to OCHA, the number of roadblocks in the West Bank has increased from 532 to 563 between August and September 2007, bringing the total increase since August 2005 to 49.7 percent. See OCHA, *Humanitarian Situation and Humanitarian Access*, Background paper for the Ad-Hoc Liaison Committee, September 24, 2007, p. 3. Also see “UN Finds 40 New W. Bank Roadblocks in Two Months,” *Haaretz*, September 21, 2007.

54. World Bank, *Movement and Access Restrictions in the West Bank*, p. 1.

Times, however, have changed; and the past cannot just be rewind and replayed again. An unprecedented socioeconomic and fiscal crisis facing the PA in 2007 is expected to divert almost all of incoming foreign aid to budgetary and humanitarian uses, leaving little in the way of external funds to finance development projects that can have a measurable impact on the productive capacity of the West Bank economy. In 2007—and barring any exceptional generosity by the donor community above and beyond what could be reasonably expected—the presumed developmental role for foreign aid, even in a more supportive political and territorial setting, is simply not possible; not in the immediate future. To understand why this will most likely be the case, a brief historical note is necessary.

In the context of the “Oslo paradigm” that followed the signing of the Declaration of Principles by Israel and the PLO in September 1993, donor support was predicated on the assumption that providing enough financial resources to the newly created PA would help the Authority set up its public institutions, rehabilitate and upgrade its physical infrastructure, and, in the process, attract private capital, both domestic and foreign, to take advantage of emerging business opportunities in the West Bank and Gaza—so that by the end of a stipulated five-year transitional period in 1999, the ingredients of success would all be in place and the Palestinian economy would be able to take off on the road to prosperity. That, at least, was the prevailing theory at the time.

By the end of the decade, however, and after the disbursement of close to \$3 billion of donors’ money, not only has the outcome been disappointing, but, worse, whatever success was achieved in the area of public institutions and basic infrastructure was severely compromised by the political turmoil and armed confrontation that dominated the scene in the seven years following the outbreak of the second Intifada in September 2000.⁵⁵

The lesson: Under conditions of continuing conflict and in the absence of political stability in the areas to which foreign aid is disbursed, its ability to help the recipient communities achieve sustained economic success is severely limited. In the context of the WBF model, wherein the prospects for positive political developments remain highly uncertain, and where, consequently, restrictions on movement are likely to continue to fracture the territorial landscape of the West Bank, the limited developmental impact of foreign aid to the new PA government is almost certain.

Moreover, in today’s West Bank, neither the dire socioeconomic conditions of the majority of Palestinians nor the spiraling and largely unsustainable fiscal deficit of the PA would allow foreign aid to play much of a role in the development sphere in any case. Under present conditions, the bulk of incoming donor funding, as has increasingly been the case over the past few years, is expected to be allocated to bridge the PA fiscal gap and to meet the humanitarian needs of a growing and increasingly impoverished population. Once again, a brief reflection on how things have reached their present state is necessary in order to put in perspectives what should realistically be expected from foreign aid.

55. For a concise assessment of economic performance in the Palestinian areas during the 1994–2000 time period, see Stanley Fischer et al., “Economic Development in the West Bank and Gaza since Oslo,” *Economic Journal* 111 (June 2001): 254–75. A more thorough and detailed assessment can be found in *Development under Adversity: The Palestinian Economy in Transition*, ed. Ishac Diwan and Radwan A. Shaban (Washington, D.C.: World Bank, 1999). On the effectiveness of foreign aid to PA, see the World Bank report *Two Years after London*, op. cit; section 3.3, pp. 29–33. Also see Nadia Hijab’s review of the book *Aid, Diplomacy and Facts on the Ground: The Case of Palestine* in *Middle East Policy* 14, no. 2 (Summer 2007): 159–62.

During the turbulent period of 2001–5, turmoil, confrontation, political instability, and intensification of the Israeli “closure regime” threw the Palestinian economy into deep depression. Private investment sharply declined; Palestinian jobs in Israel were largely lost to foreign workers; and unemployment and poverty in the West Bank and Gaza reached dangerous levels. PA revenues dwindled as a result of the continued erosion of the economy’s tax base, and increasingly fell short of rising expenditures, setting off recurrent budget deficits.⁵⁶ International aid was subsequently diverted from development projects to emergency (i.e., budgetary and humanitarian) assistance. And the shift, according to one study, was quite remarkable. “In 2000, the ratio between development and emergency assistance was approximately 7:1 in favor of development assistance. By 2002, the ratio had shifted to almost 5:1 in favor of emergency assistance.”⁵⁷

The decline in the share of development assistance continued after 2002, albeit at a lower rate. On the eve of the January 2006 elections that brought Hamas to power, for example, only \$450 million, or a little over one-third of the \$1.3 billion aid package received by the PA in 2005, was allocated to development projects, while the rest went for budgetary support (\$350 million) and humanitarian assistance (\$500 million).^{58,59} In 2006, however, the diversion of foreign aid to nondevelopmental activities was more pronounced, despite the disbursement of an estimated \$1.4 billion of foreign assistance to the West Bank and Gaza. Only 18 percent, or \$253 million, of the received financial assistance went to finance development activities; budgetary and humanitarian assistance, by contrast, consumed 52.6 percent (\$738 million) and 29.4 percent (\$412 million), respectively.⁶⁰

In 2007, the pressure for foreign aid to be allocated to nondevelopmental needs is even greater under the present, post-takeover circumstances facing the new PA government. Despite the release by the Israeli government of the previously withheld clearance revenues, and the expected continued transfer of the new collected tax money, the PA is projected by the IMF to have an unprecedented recurrent budget deficit on the order of \$1.57 billion in 2007, or an estimated 34 percent of GDP⁶¹—a deficit that is likely to

56. The rise in PA recurrent expenditures was caused mainly by continued expansion of public hiring at an average rate of 9 percent a year between 2000 and 2005, and the subsequent sharp increase in the wage bill by 11 percent annually during the same period. The PA also continued to bail out financially stressed public entities (mainly municipalities), with payments in 2005 alone of \$344 million. Other factors contributing to the rise in recurrent public expenditures include the financing of new social programs and pension funds. See World Bank, *West Bank and Gaza Update: March 2007*, p. 11.

57. World Bank, *Twenty-Seven Months – Intifada, Closures and Palestinian Economic Crisis: An Assessment* (West Bank and Gaza Office, May 2003), p. xvii.

58. It is important to note that not all of the foreign aid earmarked for development purposes has the chance to be translated into actual projects on the ground. The Palestinian Socio-Economic Stabilization Plan (SESP) for 2004–5, for example, expected no more than 10 percent of the funds allocated for infrastructure projects in 2004 to actually be spent, owing to continued restrictions on access and movement. See Palestinian Authority, Ministry of Planning, *SESP, 2004–2005* (English version), pp. 23–24.

59. See World Bank, *West Bank and Gaza: Economic Update and Potential Outlook*, March 15, 2006.

60. See World Bank, *Two Years after London*, p. 29.

61. See IMF, “Macroeconomic and Fiscal Developments in the West Bank and Gaza,” September 24, 2007, pp. 13–14, tables 3 and 4. For a more in-depth analysis of the PA’s current fiscal condition, see the two-volume study by the World Bank, *West Bank and Gaza Public Expenditure Review: From Crisis to Greater Fiscal Independence* (Washington, D.C., February 2007).

consume a hefty 94 percent of the estimated \$1.62 billion in foreign assistance that the PA needs this year just to stay afloat.⁶²

Under these conditions, would the resumption of foreign aid to the PA, even if sustained, make a difference? At the budgetary and humanitarian levels, where the need is greatest, it most certainly would. But in the area of development, where things really matter at the end of the day in order to expand the rapidly shrinking productive capacity of the Palestinian economy and lay the foundation for sustained recovery and growth in the future, chances are it wouldn't—not least because foreign aid is being openly used this time (i.e., in the context of the WBF model) as a tool to meddle in Palestinian politics and not as a response to the pressing development needs of the Palestinians.

d) A highly constrained Palestinian private sector

The WBF model comes with a package of future economic projects and business ideas, some of which are still under deliberation, in an attempt to inspire—and in the process give support to and enable—the Palestinian private sector to participate in a mission to lift the struggling West Bank economy from its deep recession, improve the living conditions of the 2.4 million Palestinians of the territory, and help pave the way for future prosperity.

Among the ideas that have been circulated to date as potential money-making opportunities for interested private investors are the creation of border industrial zones in the West Bank; new agricultural, transportation, and tourism projects; and a “peace corridor” between the West Bank and Jordan, intended to facilitate the marketing of Palestinian products abroad via a new airport to be constructed on the Jordanian side. Meetings between Israeli and Palestinian business leaders have been arranged to discuss joint ventures in the West Bank; and investment funds are being established to provide soft loans to Palestinian small- and medium-sized businesses.

Despite the positive tone of these efforts, however, and the new jobs and income that would likely be generated if and when these projects and investment ideas materialized, this approach to the Palestinian economic crisis largely misses the point of what exactly lies at the heart of the West Bank's continued economic decline, as well as the true nature of the binding constraints on doing business in today's West Bank.

To illustrate the point, here is what a recent survey study carried out by the World Bank to assess the Palestinian investment climate found out:

The ICA [Investment Climate Assessment survey] reveals that shrinking market access and the lack of free movement are the main constraints to growth for Palestinian enterprises. Relative to other countries in the region, the Palestinian investment climate is good: petty corruption is low, the bureaucracy is relatively efficient and financial markets are well developed. Despite this, Palestinian enterprises have not invested enough to maintain their international competitiveness. *Managers know they need to invest and have access to the necessary resources.*

62. World Bank, *Two Years after London*, op. cit., pp. 13-14. The IMF also estimated that by the end of 2007, the total stock of PA arrears accumulated during 2006 and 2007 will reach \$1.1 billion, or 23 percent of GDP. See IMF, *Ibid*, p. 7, footnote 9.

*However, they are unwilling to do so unless they are assured secure and predictable access to both domestic and international markets.*⁶³ (Emphasis added)

As the World Bank study reveals, financing is not a major constraint on Palestinian business. In fact, the Palestinian banking sector is awash with liquidity where only one-third of local bank deposits are loaned, compared with a regional average of about two-thirds. Domestic businesses, according to the survey, are reluctant to invest because of “the few profitable investment opportunities and not because the banks will not lend to them or the required collateral is too high.”⁶⁴ The World Bank study also reported that not only are Palestinian businesses increasingly unable to reach markets outside Palestine, but their ability to sell their products even in their own backyard is shrinking as well.

Restrictions on free movement, and the high degree of uncertainty and inefficiency they introduce in the domestic business environment, thus seem to be the principal predicament facing the Palestinian private sector. A just-released World Bank study showed that in response to these restrictions, “enterprises have closed and large amounts of financial and human capital have fled. The pace of capital flight has reached an all-time high in the last two years with almost no foreign direct investment and most local capital being kept abroad or invested in real estate or short term trading activities.”⁶⁵ In 2006 alone, according to the same report, Palestinian private investment fell by over 15 percent, and businesses were operating at less than 50 percent of their production capacity.⁶⁶ Under these conditions, as a recent UNCTAD study argued, “[i]t would be imprudent from a public policy perspective . . . to anticipate or rely on changes in private sector behaviour, given the current circumstances of occupation and closure policy.”⁶⁷

But even if the issue of restrictions is miraculously resolved, the Palestinian private sector will still have to face a more daunting challenge of reinventing itself: from largely family-based, small-sized, low-capacity, labor-intensive sector to modern businesses capable of linking up with the rest of the international economy, from which they have been detached for decades. Achieving this will require a gradual and sustained shift from low-value, high-cost product lines that were primarily developed to service the needs of the Israeli economy to high-value, quality exports capable of competing at the global level on the basis of price, quality, and timely delivery. Such a dramatic shift is not easy, and will, under the best of circumstances, take a number of years to materialize before the desired transformation translates into productive jobs, higher incomes, and better standards of living that can be sustained over a long period of time.

And the resources needed to accomplish this task will not be trivial. As the 2005 RAND study on the Palestinian economy clearly showed, it will take an estimated \$3.3 billion a year of international investment over a five-year period, and an unrestricted operating business environment, for the domestic private sector to be able to generate new jobs “at

63. World Bank, *West Bank and Gaza Investment Climate Assessment: Unlocking the Potential of the Private Sector*, March 20, 2007. The study survey was conducted based on data collected in 2005—i.e., before the further worsening of economic conditions that followed the January 2006 elections and the subsequent West’s financial and economic boycott of the Hamas-led PA.

64. *Ibid.*

65. World Bank, *Two Years after London*, p. 2.

66. World Bank, *Two Years after London*, op. cit., p. 11.

67. UNCTAD, *Report on UNCTAD Assistance to the Palestinian People*, pp. 7–8.

a substantial pace (perhaps at an annual average of 15 to 18 percent) . . . to reach rates of employment last seen during the summer of 2000.”⁶⁸

The gist of the above discussion is that the future of the Palestinian private sector, and that of the West Bank economy, is inextricably linked to the politics of the present, highly volatile situation. Until that is seriously and adequately addressed, economic projects and business ideas presented in the context of the WBF model may, under the best of circumstances, produce isolated cases of relative success—enough, perhaps, to reveal the hidden and largely underutilized potential of the Palestinian private sector, but far too little to engender substantial and sustained changes on the ground.

e) The likely prospect of renewed violence

Another major, and potentially serious, constraint facing the WBF model is the real possibility of renewed violence—both intra-Palestinian violence and Palestinian-Israeli violence—in a way that could greatly complicate the implementation of the strategy on the ground. Two sources of such an eventuality can be envisaged here.

First: Hamas may not willingly submit to, or allow the existence of conditions that permit, the “success” of a strategy that is openly designed to isolate it and undermine its power. As the overall living conditions in Hamas-controlled Gaza continue to rapidly worsen, with its fragile economic base wrecked to ground and the hardship of the entire population continuing to mount under the rigid terms of the WBF policy, Hamas may opt to act in an attempt to sabotage the whole strategy.

Second: Palestinians in the West Bank may not passively react if the promised benefits of the WBF strategy are late in coming—a highly likely possibility, as even under the best of conditions the model could take many years to bear tangible fruit. As a result, the West Bank population may begin to lose patience and faith in the possibility of attaining the stability and prosperity that continue to elude them.

In both cases, the WBF model could easily backfire, possibly leading to more violence both among the Palestinians themselves and against Israel and thus bringing the whole strategy to an unpleasant final chapter.

On this subject, serious political analyses have warned for some time that the deliberate isolation of Gaza and the increased pressure put on the Islamists there could lead Hamas “to use its own forces to ensure that the West Bank also is ungovernable”⁶⁹ or push Hamas to “promote disorder and use its own influence in the West Bank to frustrate Abbas’s plans”;⁷⁰ or that “Hamas will come under pressure to resume attacks on Israel if the siege of Gaza is tightened”⁷¹; or that “the West Bank could become a new battleground between

68. RAND Corporation, *Building a Successful Palestinian State* (Santa Monica, CA., 2007). The calculations of the RAND study took into account both the West Bank and Gaza.

69. “A Bet on Mr. Abbas,” *Washington Post*, June 20, 2007.

70. Aaron David Millar, “Is Peace Out of Reach?” *Los Angeles Times*, July 15, 2007.

71. International Institute for Strategic Studies, “Hamas Coup in Gaza: Fundamental Shift in Palestinian Politics,” *IISS Strategic Comments*, vol. 13, issue 5 (June 2007), p. 2.

Fatah and Hamas.”⁷² “The danger of the current [WBF] approach,” as a recent official British report has concluded, “is that it might push Hamas into a corner which encourages violence rather than negotiation . . . [thus] further jeopardising the peace process.”⁷³

All these warnings are surely not baseless. A recent public opinion poll conducted nearly three months after the takeover of Gaza revealed that despite the rejection by close to three-quarters of Palestinians of Hamas’s military action, the drop in Hamas’s popularity was not significant.⁷⁴ According to the survey, 30 percent of the Palestinians of the West Bank and Gaza still view the government of Hamas leader Ismail Haniyeh as the legitimate PA government (only 38 percent view the West Bank–based government as legitimate), and 40 percent of the Palestinian public still want the Hamas government to stay in office (as compared with 49 percent for the West Bank-based government).

Hamas, in other words, continues to maintain a popular presence in the Palestinian street, and that includes the West Bank, where Islamists have in the last two years registered impressive victories in both the municipal elections of 2005 and the parliamentary elections of January 2006.⁷⁵

Add to this the frustration that could result from the possible failure of the model to produce fast economic results for the Palestinians of the West Bank, where chaos, lawlessness, and lack of law and order are still prevalent,⁷⁶ and Hamas’s task, if it chooses to disrupt the situation there, may not be all that difficult.

Indeed, under these circumstances, the Islamic movement may find a largely conducive environment and a very receptive audience for its actions, potentially turning the West Bank into something altogether different from what the WBF strategists had in mind.⁷⁷

72. According to Ron Pondak, director of the Tel Aviv–based Peres Center for Peace and one of the architects of the Oslo process, as quoted in “With Hamas Takeover, Tough Calls for Israel,” *Washington Post*, June 30, 2007.

73. See House of Commons Foreign Affairs Committee, *Global Security: The Middle East*, Eighth Report of Session 2006–07 (August 13, 2007), p. 31.

74. See Palestinian Center for Policy and Survey Research, Public Opinion Poll No. 25 (Ramallah, West Bank, September 10, 2007).

75. In the municipal elections of 2005, Hamas registered an impressive showing—winning, e.g., 13 out of 15 seats in Nablus, 9 out of 15 seats in Ramallah’s twin city of El-Bireh, and all 15 seats in Qalqilya. The same sweeping electoral success was evident in the legislative elections of January 2006, in which Hamas won 30 seats in the West Bank to Fatah’s 12 seats (e.g.: in Ramallah, 4 seats to Hamas vs. 1 for Fatah; in Nablus, 4 seats to 2; in Hebron, 9 seats to none; and in Jerusalem, 4 seats to 2). For the complete election results, see the website of the Palestinian Central Elections Commission, <http://www.elections.ps>.

76. In the public opinion poll cited above, 33 percent of surveyed Palestinians expressed concern over lawlessness and lack of law and order in the West Bank, and 22 percent wanted political reforms and an end to corruption; only 18 percent considered returning to the peace process to be a top priority for the West Bank–based government.

77. Ahmed Youssef, a senior Hamas official in Gaza, was quoted in an interview in the *International Herald Tribune* as observing that “[w]e could turn the table on [the PA president] Abu Mazen in Ramallah if we want to . . . but we hope that in a few months we can talk together and solve our internal problems and find a solution on a new government” (“Peace Settles on Gaza, but Economy Crumbles,” September 7, 2007).

Concluding Thoughts

Since the announcement of the West Bank First strategy in the wake of Hamas's violent seizure of power in Gaza in mid-June, most of the published analyses on the subject have cast doubt on its prospects of success, warned of the grim implications of its hasty implementation, and persistently advocated a more sensible, realistic, and long-term approach to the Israeli-Palestinian question. The present work, with its emphasis on the political economy side of the subject, shares this view.

With economic success in the West Bank under the WBF strategy at best questionable, and the model's economic and humanitarian impact to date on Gaza utterly devastating, it would be extremely hard to overlook the high probability that this strategy will deliver anything but the exact opposite of its intended consequences, thus further worsening what has already been for some years a steady and dangerous downward spiral of socioeconomic conditions in the Palestinian areas.

Furthermore, and although the recent surge of interest in the West Bank economy and in Palestinian institutions and reform is a healthy development, it is the context in which such interest has been conceived and implemented that is the most worrying of all. And here lies the fundamental problem with, and the potential danger of, the WBF model. Being politically motivated, and hardheadedly focused on the single goal of isolating and defeating Hamas, the strategy has caused extensive damage to the frail economy of the Gaza Strip and needlessly brought mounting misery to its already stressed population—without any assurances of the model's success in the West Bank, or any thoughtful consideration of the grave consequences of its likely failure.

All this suggests the need to seriously reconsider the WBF strategy and its questionable underlying assumptions in favor of a different and more realistic approach that would help foster Palestinian reconciliation, bring Gaza back into the Palestinian main political and economic fabric, and stabilize the fragile conditions on the ground. Such an approach—if driven and sustained by a shared strategic vision by all sides—should provide a more auspicious environment for both negotiating a lasting political settlement and, at the same time, dealing effectively with the adverse economic consequences of continued conflict on the Palestinian side.

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