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Israelis and Palestinians: the Need for Economic Cooperation

Recent events have forced many Israelis to reassess the cliché, which they firmly believed, especially after Oslo, that economic cooperation would be a major tool for improving economic conditions while cementing peace. Cooperation certainly has accomplished the former: The data indicate that in the period after Oslo, despite the ups and downs of the peace process as expressed in border closures, the percentage of Palestinian wage earners within the total number of workers employed in Israel steadily grew (see Table 1). This means that in the absence of conflict, economic cooperation contributes to the rise in Palestinian income either directly, through wages, or indirectly, through the value-added tax (VAT) and other taxes paid by Palestinian workers in Israel and later reimbursed to the Palestinian Authority.

My purpose here is to suggest some avenues for sustaining economic cooperation without assuming that such efforts automatically lead to peace; they can only enhance the peace process in the presence of political will on both sides. As events during the last six months dramatically show, equating economic with political normalization is foolhardy. I hope to avoid such delusions.

Interdependence, Prosperity and Peace

Some view the structure of economic relations to which I will allude as symptoms of dependence, not signs of interdependence. For example, the taxes transferred to the Palestinian Authority (PA) provide sixty percent of the PA's budget. But, if we view the process in the long term, this figure simply indicates the earnings potential of Palestinian workers once political preconditions are in place. Again, between 1994 and the first nine months of 2000, before eruption of the Intifada El-Aqsa, Israel absorbed about forty five percent of new Palestinian entrants into the work force (see Table 1). This means that Israel has provided a »natural« source of income for Palestinians for years; it also means that the two entities, at least at present, are intimately linked in several economic sectors.

This brings us back to the political framework; the peace process that economic cooperation was thought to cement. Recent events have revised our conceptions of this cement. In its present form, it is inadequate; it easily crumbles in the absence of the appropriate political preconditions.

Prior to the signing of the Oslo Agreements, gross domestic product (GDP) per capita in the West Bank and the Gaza Strip was estimated at about 2,500 US-dollars; as of 1993, in response to the sporadic border closures, GDP per capita fell to about 1,700 US-dollars, while unemployment rose to more than thirty percent. This trend was dramatically reversed in response to positive economic trends, related to the altered political environment. Hence, foreign investments, especially in 1999 and the first half of 2000, began to flow into the region. The rate of unemployment in the PA fell to eleven percent, and GDP rose by seven percent, accompanied by growth in exports to Israel and other markets, as well as increased foreign investment. The negative impacts that replaced these positive trends began with the outbreak of violence.

- *Internal impacts:* According to the latest announcement released by the Office of the UN Special Coordinator, direct losses in GDP during the first four months of restrictions are estimated as seventy five percent of annual wages earned by Palestinian workers in Israel, or twenty percent of projected GDP for the year 2000 assuming no border closures. In addition, unemployment has risen to about thirty eight percent, or 250,000 persons, mainly because employment of Palestinian workers in Israel effectively ceased with the border closures.

Table 1:
Palestinian Wage Earners (in thousands)

	1994	1995	1996	1997	1998	1999	Jan.-Sept. 2000
In Israel	70	60	58	74	107	116	124
In the Palestinian Authority	325	343	342	364	387	415	444
Palestinian Wage Earners in Israel							
As percentage of total wage earners employed in Israel	3,5%	2,8%	2,6%	3,3%	4,7%	4,9%	5,0%
As percentage of total Palestinian wage earners	17,7%	14,9%	14,6%	17,0%	21,6%	21,8%	21,8%

- *Balance of PA-Israeli trade:* Following the trade interruptions, losses in income from PA exports to Israel have averaged about two million dollars per day; the losses incurred in Israel by the lack of exports to the PA is estimated as threefold.
- *Miscellaneous effects:* The value of the damages to property and infrastructure in the Palestinian Authority has been too great to be quickly assessed. More importantly, the poverty rate has risen from twenty one to thirty two percent in the same four-month period. Due to the high dependency ratio in the PA, more than 900,000 people are bearing the costs of unemployment. Similar outcomes are beginning to be felt in Israel as well, especially in the area of unemployment and its social consequences.

Put briefly, the PA's economy has more or less stalled due to interruptions in both local and to cross-border economic activity. The Palestinian leadership should understand that it will have to answer eventually to its people for the severe economic price they are paying for their political agenda.

Although the economic impacts suffered by Israel's economy have been less severe than those experienced in the PA, they are nonetheless widespread, and will have long-term repercussions for its economy. Israel's Central Bureau of Statistics (CBS) estimates that the country's annual rate of economic growth in 2000, ignoring the latest events in the West Bank and Gaza, would have been more than double that of 1998 and 1999. The CBS has published a revised estimate showing that in the last quarter of 2000, subsequent to the outbreak of the Intifada El-Aqsa, growth fell by almost ten percent. This figure is particularly dramatic if we remember that the structural sources of Israel's economic growth have changed in the last decade. In the early 1990s, growth was stimulated by rising demand based on waves of immigration from the former Soviet Union; today, growth rests on hi-tech exports, which are relatively immune to changes in Israel's relations with the Palestinian Authority. The hi-tech sector responds to other factors, such as the state of local infrastructure, communications, the general level of market stability (which has not significantly changed), and global trends, including events in the US stock market. The latest figures show, however, that the hi-tech sector cannot completely compensate for the damage to other areas of Israel's economy caused by political events.

For instance, the long-term border closures have slowed construction, which recently began to absorb Palestinian workers once more, as well as agricultural production. Tourism has virtually halted. The pessimism and low morale brought on by security problems has reduced household demand for non-basic goods like internal tourism, entertainment, and even clothing. Local as well as foreign investment also declined as uncertainty grew. And, as stated, the deteriorated relations with the PA have begun to influence Israel's economic ties with its trading partners, at least at the margins.

Three Scenarios of Palestinian-Israeli Relations

Any recommendations for reversing these impacts should be viewed against the background of three scenarios, each of which is motivated by the political agendas of both sides. Our brief review will emphasize the economic aspects of these scenarios.

Total Separation

This option, involving hermetic borders between Israel and the Palestinian Authority, has been proposed by several political figures in Israel in response to the Intifada El-Aqsa. It rests on a number of assumptions that may be politically attractive but are actually economically unreasonable. Specifically, separation involves the imposition of strict control over the movement of labor and goods. Should this scenario be implemented, we can expect Palestinian income per capita to decline by tens of percentage points as unemployment grows and income from taxation declines. Israel, for its part, will be forced to import greater numbers of wage earners from foreign countries, a move that would reverse Palestinian reintegration into Israel's labor market (see Table 2 and Figure 1). As Israel's export surplus to the West Bank and Gaza, amounting to 5.9 Billion US-dollars in 1999, plummets, additional decline in GDP will be felt in both entities.

Total separation between Israel and the PA is not, then, an operable solution, because of its economic toll and because of the difficulties involved in executing the policy, especially given Israel's need for labor. Any abatement of the security threat would also undermine both parties' willingness to continue such a policy. In addition, the cost of constructing a hermetic border, estimated at two billion US-dollars, is too high to be seriously considered, especially in a short- or medium-term time frame.

Unstable Relations

This scenario reflects the status quo as well as current perceptions of a possibly long, drawn-out period until the tension subsides and an interim peace agreement (at the least) is signed. Sporadic interruptions in the movement of goods and labor would continue. Some procedural changes in the areas of tax reimbursements or trade in agricultural goods would also be introduced. Economic relations between the two entities would respond immediately to political instability anticipated prior to reaching a political solution. In the absence of a long-term solution, this appears to be the option most likely to be adopted at this point in time. It is also the most appropriate for minimizing the severe economic damages attendant upon total separation of the two economies.

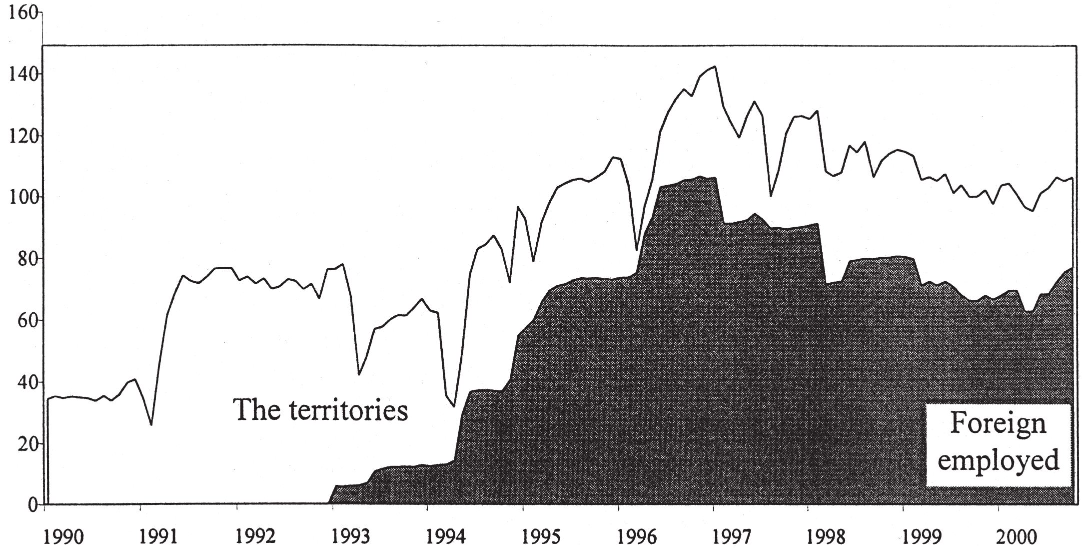
Table 2:

Structure of Wage Earners Employed in Construction (thousands)

	1995	1996	1997	1998	1999	Jan.-Sept. 2000
Total employed	**227.6**	**245.7**	**248.8**	**235.3**	**223.8**	**221.5**
Israelis	144.1	150.5	146.7	131.4	120.3	113.1
Palestinians officially reported	18.3	14.7	18.4	19.9	17.9	20.2
Palestinians not officially reported	19.7	18.4	24.0	40.5	46.7	50.5
Wage earners from foreign countries	45.5	62.1	59.7	43.5	38.9	37.7
Percentage of Israelis	63.3%	61.3%	59.0%	55.8%	53.8%	51.1%

Figure 1:

Wage Earners from Foreign Countries and Palestinians from the Palestinian Authority Employed in Israel



And it appears to be the most responsive to political exigencies.

Regional Cooperation

This scenario may be the closest economic equivalent to what has been dubbed the »New Middle East.« It is therefore intimately linked with long-term political arrangements and a shared political agenda extending beyond the PA and Israel to the neighbouring countries. It involves the establishment of international administrative structures that would promote economic cooperation in policy and practice. It provides the preferred framework for the practical steps proposed in this paper.

Throughout Europe today, regional cross-border commuting has replaced long-term migrant labor as a major input for project planning and implementation. The history of institutionalized cross-border markets, established after centuries of conflict, provides important precedents that the Middle East might learn from. In addition, these bottom-up initiatives illustrate how small commercial projects can provide a basis for establishing cooperation at higher levels. That is, because the projects are micro-level, or »people-to-people« and »business-to-business«, they offer options for solving a range of economic problems and easing the state of unemployment relatively quickly. In policy terms, this means that some forms of cooperative economic activity, dependent on administrative mechanisms (including arrangements for capital mobility), can be established between neighboring countries independently of higher-level political solutions. Stated differently, political conditions need not automatically interfere with mutually beneficial economic relations.

Indications of the approach's feasibility are already available. We need only cite joint ventures, such as those begun at the Erez Border Crossing, as well as labor statistics. The latter especially indicate that Israelis and Palestinians have found ways to side step both bureaucratic and political obstacles for years. For example, the number of Palestinians employed in the construction sector who were not officially reported has always been greater than the number officially reported, and these numbers have consistently grown (see Table 3). During the first nine months of 2000, only about one-third of the 70,000 Palestinians working in construction were registered. This trend has held despite the border closures (see

Table 3:
Structure of Wage Earners Employed in Agriculture (thousands)

	1995	1996	1997	1998	1999	Jan.-Sept. 2000
Total employed in branch	**77.9**	**78.5**	**78.5**	**82.7**	**83.6**	**81.0**
Israelis	56.8	50.4	48.2	47.5	49.6	47.1
Wage earners from foreign countries	15.1	22.0	22.5	24.1	24.0	23.4
Palestinians working with permits	5.7	4.1	5.3	6.4	6.5	6.3
Palestinians working without permits	0.3	2.0	2.5	4.7	3.5	4.2
Percentage of Palestinians among total employed	7.7%	7.8%	9.9%	13.4%	12.0%	13.0%

Table 4). The data indicate that small-scale, private ventures can solve some labor market problems existing in both the PA and in Israel. They also indicate that under conditions of normalization, the flow of black market labor would more or less cease. All Palestinian workers could then begin to enjoy the legislated social and economic benefits as well as the legal protection that are unavailable to them under present conditions.

Before turning to our suggestions for putting cooperation into practice, we should comment on the respective time span. Previous expectations regarding the realization of many economic projects were unrealistic. That is, many of the economic outcomes of Oslo anticipated by Israelis could not materialize in the absence of lower-level cooperative mechanisms. Thus, the suggestions we offer are keyed to what we consider to be the appropriate temporal dimension in order to avoid delusions related to their applicability.

By 1996 the PA began experiencing real growth in income per capita; the current violence has abruptly halted this trend. The growth resulted from attempts to translate the atmosphere of the Oslo Agreements into economic behavior. Specifically, Oslo stimulated attempts to develop the Palestinian economy independently of Israel. This meant that foreign capital was invited and began to flow to the PA, but not at a level that could have been reached if Israeli investors had been included. Major projects initiated were long-term in character and required investment and planning resources beyond those available to the PA. Reaping the fruits of these projects was therefore delayed.

Policy Priorities

The main objective of any short-term economic policy under present circumstances is to ease the severe economic distress experienced by the Palestinian population and modify (i.e., halt if not

Table 4:
Duration of Border Closures by Days per Year

Year	West Bank	Gaza
1993	17	26
1994	64	76
1995	80	102
1996	90	138
1997	57	70
1998	14	48
1999 (First half)	6	6

reverse) the negative trends appearing in Israel. As indicated, this requires, first and foremost, acceptance of the fact that the two economies will remain interdependent irrespective of political developments.

Jobs and Income

The most critical problem is unemployment. Job creation should be targeted at the PA itself. Projects should entail small-scale investments or transfers of support to established businesses in danger of folding or, alternatively, to those displaying growth potential. A quick glance at the Erez border crossing, whose warehouses are clogged with Palestinian goods awaiting shipment to Israel, indicates the potential of such commercial projects. Measures such as boycotting Israeli products should be avoided for their destructive impact on commercial normalization.

Second, border restrictions on the movement of labor should be eased. In addition to renewing access to sources of direct income to Palestinian families, this move would re-institute the flow of taxes reimbursed by Israel to the PA, funds that significantly contribute to the PA's administrative budget. These steps should be supported by Palestinian authorities in order to restore the minimum confidence required for labor market cooperation. In tandem, the number of work permits issued to Palestinians seeking employment in Israel should be greatly increased, together with the possibility of allowing more workers to remain in Israel overnight. From Israel's point of view, such a policy would reduce the nation's dependence on wage earners coming from countries beyond the Middle Eastern region.

Wage considerations should also play a part in reviving the cross-border movement of labor. Unfortunately, as the wage gap will continue for some time, the hiring of Palestinian workers continues to be a basic tool for reducing the wage costs of Israeli manufacturing. This implies that Israel is the PA's most accessible supplier of services, such as occupational and management training. Short-term training pro-jects should be devised to meet immediate as well as medium-range needs.

Foreign Investment

Obviously, the willingness of private Israeli interests to invest in projects in the PA has diminished considerably since the latest outbreak of violence. Hence, the Palestinians will have to turn to institutional bodies, major corporations, NGOs, and government agencies in Israel and abroad, with requests to develop operable programs of capital investment in the PA and channel the requisite funds.

One promising suggestion, based on available institutional resources, could be the creation of a UN-sponsored »International Emergency Forum.« Members of this forum would include, among others, the PA, Israel, the US, and the European Union. This forum would operate as a think tank and investment clearing house: It would propose programs and, at the same time, arrange the financing for them. Due to its access to information, the forum could coordinate projects more easily and ensure maximum efficiency of resource allocation. It could also lobby for projects favored by the Palestinians. With both Israelis and Palestinians participating, this forum could help introduce uniformity into the standards and tools of proper administration which, in addition to cooperation, is needed for effective governance.

Exports

Another route entails making foreign markets accessible to Palestinian exports, particularly agricultural products. Although this demands the cooperation of governments in the area of trade and tariffs, a reasonable level of coordination could be achieved in the medium term. Nevertheless, such a policy has limitations: Just how receptive European markets are to penetration by the current range of Palestinian goods, including agricultural produce, must be thoroughly investigated. In the Far East, there may be too much local competition for Palestinian manufactured goods. Export targets in the Middle East and Africa are problematic: Income per capita in these nations is lower than that in the PA, which means that these markets have little potential to absorb Palestinian goods. Therefore, they can provide few stimuli to Palestinian industrial development. This leaves Israel as the most »natural« market for Palestinian exports, a fact that emphasizes the negative effects of commercial embargoes.

Infrastructure

Obviously, long-term economic cooperation can be maintained only if the participants view themselves as fully-fledged partners. This requires upgrading the economic capacities of the »junior« partner. Therefore, in order to achieve long-term results, the development of the PA's infrastructure must be accelerated now, especially those civil engineering projects already on the drawing board. It is true that infrastructure projects supply little short-term respite from unemployment because of the long time frame in which they are realized, but they are unavoidable. Not least important is the respite from the hardships of daily life that only water, sewage, electrification, communications, and transportation projects can provide. The choice of projects should depend, in part, on how quickly they can be executed and how much manpower is needed. In the background lies the need to inject huge amounts of international development capital – a project that Israel could actively support.

The Need for a Palestinian State

My concluding remarks return us to the political issues that provide the framework for our list of practical suggestions geared toward economic cooperation. The long-term solution to economic development that I foresee is the most problematic: I firmly believe that a Palestinian state is the necessary response to many of the economic problems besetting both the PA and Israel. This is based on the view, shared by many economists as well as politicians in Israel, that there is no alternative to a political solution for either party. In order for regional cooperation and development to progress, formal institutions that can set agendas, recruit resources, and guarantee policy implementation are required. We need laws, courts, tax authorities, border control and inspection, health services, administrative as well as planning agencies. Only sovereign states can make it possible to turn economic interdependence into an equitable, shared destiny. ◀