מדינת ישראל

משרדי הממשלה

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(הטיוטה השניה אל)

דו"ח הבנק העולמי על כלכלת השטחים.

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Document of
The World Bank

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Report No. 11958
(6 Volumes)

DEVELOPING THE OCCUPIED TERRITORIES

AN INVESTMENT IN PEACE

VOLUME I: OVERVIEW

AUGUST 17, 1993

Middle East Department
Middle East and North Africa Region
World Bank

CURRENCY EQUIVALENTS
(As of January 1, 1993)

Currency Units in use = New Israeli Sheqalim (NIS) and Jordanian Dinar (JD)

NIS 1.00	=	US$0.361
US$1.00	=	NIS 2.764
JD 1.00	=	US$1.453
US$1.00	=	JD 0.688

FISCAL YEAR
(January 1 to December 31)

ABBREVIATIONS

CA	=	Civil Administration
EC	=	The European Community
GDP	=	Gross Domestic Product
GFCF	=	Gross Fixed Capital Formation
GNP	=	Gross National Product
JD	=	Jordanian Dinar
NGO	=	Non-Governmental Organization
NIS	=	New Israeli Sheqalim
OECD	=	Organization for Economic Cooperation and Development
OT	=	Occupied Territories (West Bank and Gaza Strip)
UNRWA	=	United Nations Relief and Works Agency
VAT	=	Value Added Tax
WHO	=	World Health Organization

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Preface

1. At the request of the sponsors and organizers of the Middle East Peace Talks, the World Bank has been supporting the work of the Multilateral Working Group on Economic Development by providing analyses of the key economic issues and developmental challenges facing the Middle East region. At its second meeting in Paris in October 1992, the Working Group requested the Bank to expand its contribution to include, *inter alia*, an assessment of the development needs and prospects of the economies of the West Bank and the Gaza Strip (commonly referred to as the Occupied Territories). In response to this request, a Bank mission visited the Occupied Territories during the period January 21-February 24, 1993. The mission comprised five teams focusing on the following areas: Agriculture, Human Resources, Infrastructure, Macroeconomics and Private Sector Development. Each team was in the field for about two weeks. The mission was led by Prem Garg who, together with Samir El-Khouri, stayed in the field throughout to provide continuity and guidance to the five teams. The staffing of the five teams was as follows:

Agriculture:	Gert van Santen (Team Leader) Ulrich Kuffner (Water Resource Engineer) Merle Jensen[1] (Horticulture Specialist)
Human Resources:	Fredrick Golladay (Team Leader) Maureen Field[1] (Education Specialist) Radwan Ali Shaban[1] (Human Resource Economist)
Infrastructure:	Alastair McKechnie (Team Leader) Ulrich Kuffner (Water Resource Engineer) Lawrence Hannah (Urban Specialist) Nail Cengiz Yucel (Transport Sector Specialist) Ted Moore[1] (Power Engineer)
Macroeconomics:	Michael Walton (Team Leader) Samir El-Khouri (Fiscal Analyst) Ishac Diwan (Macroeconomist)
Private Sector Development:	Albert Martinez (Team Leader) Robert Mertz (Financial Sector Specialist) Joseph Saba (Legal Specialist) Dileep Hurry[1] (Regulatory Environment and Tourism Specialist)

2. Mission members travelled extensively in the West Bank and Gaza, visiting municipalities, farms, businesses, industries, academic institutions, refugee camps and NGO-run facilities. Mission members also travelled in Israel, as needed, and paid several visits to Amman. The representatives of the key bilateral and multilateral donors in Jerusalem, Tel Aviv and Amman responsible for the Occupied Territories were kept briefed about the work of the mission. Close contact was also maintained with the field staff of UN agencies.

1/ Bank consultant.

3. The Bank mission was received warmly by all sides, who took keen interest in the work of the mission and provided superb logistical and counterpart support for the field work. The main counterparts on the Israeli side were the Bank of Israel and the Civil Administration in charge of the Occupied Territories. On the Palestinian side, the main counterparts were the Technical Committees of the Palestinian Team to the Peace Conference, consisting mainly of Palestinians who are members of the bilateral or multilateral peace teams. The Ministry of Planning was the main contact on the Jordanian side. The Bank would like to thank all concerned parties, especially the Israeli, Jordanian and Palestinian hosts, for the excellent support and cooperation that the Bank mission received for this field work.

4. This report is based on the findings of the above mission. Besides the mission members, the following also contributed significantly to the preparation of the report: Ahmed El-Hamri (Macroeconomic Database), Rita Hilton (Local Government and Solid Waste), Suhail J.S. Jme'An (Infrastructure), Srish Kumar (Agriculture), Anat Levy (Labor Markets), Raed Safadi (Trade), Maurice Schiff (Trade Policy) and Marc Stephens (Macroeconomic Analysis). Jo Bischoff helped with the editing of the report, and the secretarial assistance was provided by N. Perez, F. Willie, B. Williams, D. Judkins, T. North, I. Sevilla, C. Parsons, N. Cherbaka and B. Lundquist.

5. At various stages of its work, the mission benefitted greatly from comments and advice from many Bank staff, including Shawki Barghouti, Sue Berryman, Vinay Bhargava, Yousef Choucair, Gershon Feder, David Ferreira, Mike Garn, John Hayward, Magdi Iskander, Sarshan Khan, Odin Knudsen, Pierre Landel-Mills, Ira Lieberman, Slobodan Mitric, Herbert Morais, Ngozi Okonjo-Iweala, Toni Pellegrini, Klaus Schmidt-Hebbel, K. Sheorey, Vinod Thomas, William Tyler, and Arvil van Adams and Chris Ward. The mission would also like to thank Caio Koch-Weser, Ram Chopra, Harinder Kohli, Anil Sood, Lyn Squire and Abdallah Bouhabib for their guidance, advice and encouragement.

6. An earlier draft of this report was discussed with the Israeli, Jordanian and Palestinian authorities by a Bank mission to the region during July 12-26, 1993. Where appropriate, the report has been revised to incorporate the comments received by the mission during the July discussions.

7. Funding for this work was provided as grants by the European Community, Sweden and the US; their financial support is gratefully acknowledged.

I. INTRODUCTION

The Context

1.1 The economy of the Occupied Territories (OT) is currently in turmoil. Income levels have stagnated over the past decade; unemployment and underemployment are rising rapidly; public infrastructure and social services are grossly overstretched; and the fragile natural resource base is threatened with irreversible damage. Above all, the economy remains highly vulnerable to external developments, as shown vividly by the economic hardship being experienced in the aftermath of the recent border closure with Israel. The resulting sense of despair and dependency, juxtaposed against high expectations derived from exposure to Israeli living standards within the OT and in Israel, is clearly a major impediment to achieving peace and stability in the region. While Israelis and Palestinians disagree, and disagree often passionately, on many issues concerning the future of the OT, they agree on one issue: the urgent need for stimulating economic development in the OT. Building upon this shared objective, this study aims to assess prospects for sustainable development in the OT, as well as outline a priority agenda of policy reforms, institutional development and investments needed to promote such growth.

1.2 It is worth highlighting two limitations of this study right at the outset. First, a number of key issues bearing upon the future development of the OT (e.g., the allocation of land and water resources, the disposition of Israeli settlements in the OT, the future status of expatriate Palestinians, the territorial issues surrounding Jerusalem and, most importantly, the nature of the proposed "self-governing" arrangements for the OT) are the subject of ongoing bilateral negotiations between the Israelis and the Palestinians. The resolution of these issues is likely to be based primarily on political and security considerations. As the Bank mission to the OT was a *technical mission*, with neither the mandate nor the expertise to deal with political or security aspects, this study does not take any position on issues that are on the agenda for bilateral negotiations. The focus instead is on policies, institutions and investments--where optimal choices are largely invariant to the eventual political arrangements that may emerge from the bilateral negotiations. Thus, for example, while analysing, where appropriate, the economic links between East Jerusalem on the one hand and the West Bank and Gaza on the other, the report avoids making any judgements regarding the future status of East Jerusalem.

1.3 Second, the study has had to cope with very serious *data gaps and inconsistencies*. Much of the data on the OT are, directly or indirectly, from official Israeli sources. There are, however, serious gaps in the OT data base. A population census has not been carried out in the OT for more than 25 years. As a result, most of the demographic and labor force data are based on extrapolations and on sample surveys, the reliability of which are undermined by problems of nonresponse, especially since the onset of the *Intifada* (popular uprising) in 1987. Data on East Jerusalem and on Israeli settlements in the OT, both of which are treated as part of Israel by the official Israeli sources, are mostly unavailable. Data available on trade between the OT and Israel and on the profitability and competitiveness of the agricultural, industrial and service enterprises are also very limited. Data on the OT from Palestinian and Israeli nonofficial sources are sparse and selective. Also, Palestinian data, when they exist, are often based on *ad hoc* surveys that do not lend themselves easily to cross-sectional or longitudinal comparisons. In many instances, data differ between sources, and, even when the same source is used, there are gaps and apparent inconsistencies. Given these data problems, the report uses estimates that appear most plausible in light of the mission's field observations. In cases where the data differences among various sources are particularly sharp (e.g., population, unemployment and social indicators), the report attempts, where possible, to examine the reasons for these differences and to indicate the implications of alternative estimates for the results of the analysis.

Box 1.1: Occupied Territories–A Brief Profile

The Occupied Territories (OT) consist of the West Bank and the Gaza Strip.[1/] Together with what are now Israel and Jordan, the OT were among the areas ruled by the Ottoman Empire prior to 1917. Towards the end of World War I, Britain gained control of Palestine, and in 1922, the areas were entrusted to Britain by a mandate of the League of Nations.

Escalating strife and unsuccessful British attempts to mediate between Jewish and Palestinian nationalisms caused Britain to return its mandate to the UN in 1947. The UN suggested Palestinian and Jewish independence on a partition basis. The Palestinians and Arabs rejected the suggestion, and the State of Israel was proclaimed in 1948. In the aftermath of the ensuing military conflict, the Gaza Strip came under Egyptian control and the West Bank, under Jordanian control. During the 1967 Arab-Israeli war, the West Bank and Gaza were occupied by Israel. Since then, Israel has administered the areas as the occupying power, except that Eastern Jerusalem has been formally annexed by Israel and is considered part of Israel by the Israeli authorities. Israel's annexation of East Jerusalem has not been recognized by the United Nations.

The West Bank and Gaza have a combined area of about 6,000 sq kms; a 1991 population of about 1.7 million; a GNP of about US$2.9 billion; and a GNP per capita of US$1,715. The population of East Jerusalem is about 300,000, including about 150,000 Jews, mostly settled there since 1967. In addition, there are about 135,000 Israeli settlers residing in some 150 settlements that have been built in the OT over the past 25 years.

It is estimated that currently about 3.5 million Palestinians live outside of the OT. Some have maintained residency rights in the OT and are, in principle, free to return, while the return of others will be subject to negotiation between Israel and the Palestinians. How many Palestinians might actually return would also depend upon their perceptions of future economic opportunities in the OT.

The economy of the OT is mainly service-oriented with agriculture accounting for about 30 percent of GDP in 1991, industry about 8 percent, construction about 12 percent and services the remaining 50 percent. Private sector activity dominates the economy of the OT, accounting for about 85 percent of GDP. A striking feature of the OT economy is its heavy dependence on the Israeli economy. Until the recent border closure with Israel, about one third of the OT labor force worked in Israel (mostly on a daily commute basis), and earnings from these workers accounted for more than one quarter of the GNP of the OT. Over 90 percent of the OT trade is also with Israel. Remittances from Palestinians working in the Gulf countries have been another important component of the disposable OT income.

All powers of government concerning the OT are currently vested in the two Area Commanders (one each for the West Bank and Gaza) appointed by the Israeli authorities. The Civil Administration (CA), working on behalf of the Area Commanders, is responsible for administering all economic matters including, *inter alia*, granting licenses and permits, regulating trade, collecting taxes, organizing public infrastructure and services and supervising the operations of local governments. Currently, the CA has about 22,000 employees, of which approximately 95 percent are Palestinians. Most policy-making and senior administrative positions in the CA are, however, staffed by the Israelis.

Local-level governments in the OT consist of 29 municipalities and 96 village councils. In addition, there are 27 refugee camps run by the United Nations Relief and Works Agency (UNRWA). Generally, local governments are responsible for operating power, water, solid waste and local road services within their jurisdictions; the CA, on the other hand, has direct responsibility for delivering education, health and inter-city road services. The provision of services in the refugee camps is mostly the responsibility of UNRWA.

Except in the case of three municipalities (Bethlehem, Tulkarm and Rafah) where mayors elected in 1976 are still in place, all local government bodies are run by Israeli-appointed officials.

1/ In addition, a small parcel of land (Al-Himma) near the Sea of Galilee is part of the OT.

Box 1.2: Population Data on the Occupied Territories

The only comprehensive data set on the population of the OT is from the Israeli Central Bureau of Statistics (CBS). According to the CBS, the population of the West Bank (excluding East Jerusalem) totalled 1.0 million at the end of 1991 and that of Gaza, 0.68 million, for a combined total of 1.68 million. The estimates are based on a census conducted in September 1967 and updated annually by adding reported births, subtracting estimated deaths and adjusting for the number of net migrants.

Several attempts to verify the population figures, mostly by Palestinian but also by some Israeli researchers, have concluded that the CBS figures underestimate the population of the West Bank and the Gaza Strip by anywhere from 10 to 15 percent. One possible reason advanced for the underestimation is that the base figure from the 1967 census might be flawed; the census, conducted only three months after the occupation, was conducted under a military curfew using Israeli enumerators. Another possible reason cited for the underestimation is that both births and infant deaths are underreported. While the CBS corrects for the underreporting of infant deaths, it does not carry out a similar correction for the underreporting of births. The CBS disputes the validity of these arguments and believes that the official data represent the best estimate of the OT population.

To the extent that the CBS figures may underestimate the size of the population, the per capita economic and social indicators for the OT derived from the CBS estimates would need to be interpreted with care. The possible error in the population size would also have a bearing on the social and physical infrastructural needs for the future. The continuing controversy on this issue underlines the urgent need for improving the statistical data base for the OT. In particular, organizing a new population census should be accorded high priority by the authorities.

1.4 In view of the limitations on the mission mandate, the data difficulties and the time and resource constraints, this study can only be considered a beginning. The analysis in the study, especially for the longer term, is necessarily incomplete; as, and when, progress is made in the bilateral negotiations, the study will need to be updated and expanded to take account of the agreements reached. Also, notwithstanding the care exercised in locating and interpreting the data from various sources, the empirical underpinnings of this study leave something to be desired, and, therefore, the conclusions of the study should be treated only as indicative of broad trends and priorities. Further, in-depth studies and project feasibility work will be required before the findings of this report could be used to make operational decisions.

A SYNOPSIS

1.5 The report is in six volumes; this synthesis volume is complemented by five other volumes detailing the analysis and recommendations of the five teams dealing, respectively, with macroeconomic issues, private sector development, agriculture, infrastructure and human resources. A brief synopsis of the six volumes follows.

- **Volume I** provides a summary *overview* of the key findings and recommendations of the study. After commenting selectively on the current socioeconomic situation in the OT and its evolution over time, it discusses prospects for sustainable development in the future and outlines the priority agenda of policies and programs needed to promote such development.

- **Volume II** explores the strategic choices at the ***macro*** level that will be faced by the OT in the future and their implications for economic relations between the OT and the rest of the region. The study looks at the current economic situation and its evolution over the past 25 years. The study then examines several policy choices for the future affecting the structure of development in the OT. Finally, it outlines some illustrative scenarios for the future, focussing on the consequences of current developments in the region.

- **Volume III** reviews the performance of the ***private sector*** (including, in particular, the industry and tourism sectors) in the OT. It assesses the environment in which the private sector operates and makes recommendations for accelerating private sector development in the future.

- **Volume IV** reviews the evolution and structure of the ***agricultural*** sector in the OT; analyzes its current characteristics; assesses OT competitiveness in the immediate and longer term; outlines the main policy options and their implications; and provides a preliminary assessment of sectoral financial and technical assistance (TA) needs.

- **Volume V** assesses the current situation in the ***infrastructure*** sectors (electricity, water supply and sanitation, transport, housing and solid waste services) in the OT; identifies the major issues confronting these sectors; and outlines priorities for TA and investment needs. As local authorities are major institutions in the delivery of public services in these sectors, the study also includes a review of their current situation and makes recommendations for improving the functioning of municipalities.

- **Volume VI** reviews the current status as regards ***human resource*** development; analyzes options for enhancing individual welfare and labor productivity in the OT; and outlines investment and TA priorities for strengthening existing programs and for laying the foundation for later reforms.

II. PAST DEVELOPMENTS AND CURRENT CONSTRAINTS

2.1 At the risk of some oversimplification, the economic performance of the OT over the past 25 years can be characterized as *rapid growth, but with serious imbalances*. Specifically, while the current per capita income levels in the OT are about thrice the level that prevailed in the early years of the occupation, this growth has been highly uneven over time and has been accompanied by the emergence of major distortions in labor markets, in sectoral production structure, in the structure of trade and in the balance between public and private consumption.

Box 2.1: Occupied Territories--Key Socioeconomic Indicators

	1970	1980	1987	1991
Population (000)	980	1,181	1,434	1,682
GNP per Capita (1991 US$)	780	1,700	1,880	1,715
GDP per capita (1991 US$)	670	1,310	1,280	1,275
Wage Income from Israel (% of GNP)	12	24	28	24
Share of Industry (% of GDP)	5	7	9	8
Exports (% of GNP)	22	23	15	9
Imports (% of GNP)	47	46	43	40
Employment (000s) in OT	160	141	169	190
Employment (000s) in Israel	21	75	109	97
Primary Enrollment (000s)	179	259	295	321
Secondary Enrollment (000s)	26	53	56	70
Tertiary Enrollment (000s)	(?)	(?)	(?)	16
Hospital Beds (per 1,000 pop.)	-	1.9	1.6	1.4
Birth Rate (per 1,000 pop.)	42	48	48	51
Daily per Capita Calorie Consumption	2,300	2,650	2,750	2,800
Life Expectancy (years)	56	61	65	66
Infant Mortality (per 1,000 live births)	95	65	50	42
Households with Electricity (%)	30	66	75	90
Households with Safe Water (%)	15	47	67	95
Households with Refrigerators (%)	11	57	71	85
Households with Washing Machines (%)	-	23	38	61
Households with Automobiles (%)	2	-	-	16

Sources: Statistical Abstracts of Israel, Central Bureau of Statistics, Various Issues.
Mission Estimates

OVERALL ECONOMIC TRENDS

2.2 The economy of the OT grew rapidly between 1968 and 1980 (average annual increase of 7% and 9 percent in real per capita GDP and GNP, respectively), triggered by a number of factors, including the rapid integration with Israel and the regional economic boom. In the early years of the occupation, there was a sharp expansion in the employment of unskilled Palestinian labor in Israel and a rise in incomes, which in turn spurred domestic economic activity, especially in the construction sector. Earnings of Palestinian workers in Israel rose from negligible levels in 1968 to almost one quarter of GNP in 1975. The increased monetization of the economy following the occupation could have also contributed to the reported growth in the early years.

2.3 The rapid growth in the economy of the OT continued even after economic growth in Israel slowed in the mid-1970s following the first oil crisis, as skilled Palestinians from the OT increasingly found employment in the Gulf. As oil prices increased, so did the remittances of Palestinian workers and transfers from oil-rich Arab countries, offsetting weaker opportunities in oil-dependent Israel. Since unskilled labor played a central role in the growth, the poor shared in this growth, and as a result, in all likelihood, there was a significant reduction in poverty in this period. Household conditions also improved substantially, with a several-fold rise in the possession of consumer durables and significant increases in access to municipal water and electricity connections. Life expectancy increased by a decade, and there was significant progress in reducing infant mortality. School enrollments also rose during this time. These advances mirrored substantial improvements in income levels and in living conditions all through the region during the 1970s.

Box 2.2: Income Levels in the Occupied Territories--A Comparative Perspective

On the basis of the official statistics, the OT had a GNP per capita of US$1,715 in 1991. This GNP is similar to that of Tunisia (US$1,500) and Turkey (US$1,780) and substantially ahead of Jordan (US$1,050), Morocco (US$1,030) and Egypt (US$610). However, this probably overstates the relative position of the OT, possibly by a substantial margin, for two reasons. First, some adjustment would be necessary to the extent that official estimates of the population may be underestimated. More important in quantitative terms, comparisons at official exchange rates often fail to reflect relative incomes in terms of real purchasing power because of differences in the prices of goods and services across countries. In general, the poorer the country, the cheaper the average price level is since non-tradeable factors of production are paid less (e.g., wages and land rents are lower) and, consequently, the non-traded goods are cheaper. The International Comparisons Project attempts to adjust for this by directly comparing the prices of goods in different countries. In terms of "international" purchasing power (using prices in the United States as a base), the GNP per capita for Morocco is estimated at US$3,300; for Tunisia it is US$4,700; for Turkey, US$4,800; and for Egypt, US$3,600. There is no direct data for Jordan, though on the basis of adjustments made in other countries, its GNP per capita would also be expected to be increased by three to four times. The OT, for which there is also no direct information, will be affected by the high degree of openness to Israeli prices: the ICP estimate for Israel's GNP per capita in "international" purchasing power terms is only 10 percent more than the figure at official exchange rates. The adjustment for the OT will be higher than this since wages and land rents are lower than in Israel, but it is probable that it will be substantially less than that for the other lower-middle income economies in the region. Accordingly, the OT income levels could well be below those in Jordan, Morocco and Tunisia and not above them, as the estimates at official exchange rates indicate. In the absence of firm statistical underpinning, this conclusion remains, of course, highly conjectural.

2.4 Growth started slowing down with the end of the regional boom in the early 1980s, and decline set in after 1987. Between 1980/81 and 1986/87, real GNP per capita increased by 12 percent, and the real GDP per capita increased by only 5 percent. Export growth also stagnated during that period. The situation was exacerbated after 1987 with the *Intifada* and the Gulf war, which caused disruptions in economic relations with Israel. Periodic border closures and strikes adversely affected employment and trading activity. Exports fell sharply after 1987 and never fully recovered. In 1991, merchandise exports were estimated at US$248 million, compared with US$395 million in 1987. The border was effectively closed for several weeks in 1991 during the Gulf war, causing large income losses. There was also a large decline in the number of hours worked; in 1991, the number of hours worked in Israel was about 75 percent of the 1987 level. In the aftermath of the Gulf war, many Palestinians also lost employment in the Gulf countries, leading to a significant decline in remittances from abroad; in turn, the reduced purchasing power adversely affected domestic economic activities. The impact of adverse external shocks was further amplified by a tightening up of the regulatory regime bearing on private sector activities, including restrictions on the movement of goods and people, prolonged delays in the granting of business licenses and permits and stringent tax administration measures. A subordination of OT economic interests to those of Israel may have also played a role in this respect. As a result, the per capita income levels hardly increased during the 1980s[2]–a major turnaround from the exceptionally rapid growth of the 1970s. While there was a substantial rebound of economic activity in 1992, fueled partly by expectations of peace, a sharp downturn is expected in 1993 mainly as a result of the (partial) closure of Israel to the OT economy in March.

2.5 With income levels stagnating or declining in many parts of the world, the 1980s were indeed a difficult period for the world economy as a whole. Clearly, some of the economic difficulties experienced in the OT during the 1980s were simply a manifestation of the general malaise that affected the world economy and the economy of the Middle East region in particular. They also reflect, however, serious structural problems in the OT economy, which have emerged over time and which, if left unattended, will seriously handicap the future economic prospects of the OT.

STRUCTURAL IMBALANCES AND DISTORTIONS

2.6 The structural imbalances of the OT economy are manifested in several areas: (i) heavy dependence on outside sources of employment for the OT labor force; (ii) an unusually low degree of industrialization; (iii) a trade structure heavily dominated by trading links with Israel and with a large trade deficit; and (iv) inadequacies in the provision of public infrastructure and services.

Labor Markets

2.7 In the aftermath of the 1967 war, some 300,000 Palestinians migrated out, mostly to Jordan. Significant emigration also continued afterwards (at an average rate of 1 percent per annum). Nevertheless, the Palestinian labor force in the OT more than doubled over the past quarter century. In contrast, the domestic employment opportunities grew by less than 25 percent. Instead, Palestinian

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2/ Even this was only possible due to an unusually high growth reported in the OT agriculture sector following the *Intifada*, apparently stimulated by Palestinian resistance to consuming imported produce. Per capita non-agriculture GDP declined by 12 percent between 1987 and 1991.

employment grew mostly in two areas: unskilled work in Israel and higher-skill services throughout the world, but particularly in the Gulf countries. Prior to the 1967 war, the West Bank and Gaza had no economic relations with Israel. That changed rapidly after the occupation, and the number of Palestinians working in Israel rose to 75,000 in 1980 and to 109,000 by 1987; these workers accounted for 35 percent of the employed population in the West Bank and 45 percent in Gaza. This source of growth accounted for essentially the entire growth in the labor force until the *Intifada*. Employment was overwhelmingly in unskilled and semi-skilled work; construction employed the most workers; and wages were around the Israeli minimum wage. Only 2 percent of the Palestinians working in Israel were engaged in professional, technical and clerical occupations.

2.8 The pattern of employment of Palestinians in the Gulf states was quite different. The highest demand in the Gulf states was for skilled Palestinian labor; and the wages earned there were substantially higher than those in the West Bank and Gaza. It is estimated that about 40,000 Palestinians from the OT went to work in the Gulf states during the 1973-1982 period. With the decline in oil prices and the regional recession, demand dropped considerably after 1982, and there was probably very little net outflow of labor to the Gulf during the rest of the decade. This is reflected in the relative price of skilled labor in the OT over time: the premium to a university education appears to have vanished by the end of the 1980s.

2.9 Direct contribution to GNP from wage income from abroad, mainly in Israel, rose from negligible levels at the start of the occupation to about US$350 million in 1980 and to about US$675 million in 1987, before stabilizing around that level in nominal terms. Although reliable data are lacking, remittances from long-term Palestinian workers in Gulf countries, and elsewhere, have also constituted an important source of disposable income. Adding the indirect economic stimulus provided by this large resource infusion, it is clear that external labor markets have played an important role in the economic growth of the OT over the past 25 years.

2.10 The future prospects for these labor markets, however, do not look promising; most Gulf demand for Palestinian labor has dried up in the wake of the Gulf war. The deteriorating security situation, and the increasing restrictions on the movement of people since the onset of the *Intifada* in 1987, are threatening the continuing access to the Israeli labor market. The Israeli labor demand would have fallen sharply in any case after the current construction boom fades in Israel. Prospects in nontraditional labor markets in Europe and other Arab countries also do not appear good. Meanwhile, given the rapid population growth of the past, and the unusually low current labor force participation rate (especially for women), the labor force is set to double before 2010, even without considering the return of any Palestinian expatriates to the OT in the wake of a peace agreement.

Production Structure

2.11 Related to the heavy dependence on outside employment is the lack of dynamism in domestic economic activities in the OT, particularly in the industrial and service sectors. At less than 8 percent of the GDP, the share of industrial production in the OT is much below that in other economies with similar income levels. Mauritius, for example, like the OT, is a small, open economy with a significant agriculture sector and about the same income level; the share of industry in GNP in Mauritius is, however, three times as high as in the OT. The tourism sector, potentially a flagship industry in the OT, has also remained stunted with stagnation, or even actual decline, in supporting infrastructure such as hotels, travel agencies and tourist guides.

Box 2,3: Differences Between the West Bank and Gaza

As many of the structural problems and strategic choices affecting the West Bank and Gaza are quite similar, to avoid repetition and unnecessary detail, much of the discussion in this report treats the two territories together. There are, however, notable differences that must be kept in mind:

- The population density in Gaza (1,870 persons per sq km) is almost 10 times that of the West Bank.
- GNP per capita in Gaza amounted to US$1,230 in 1991, compared to US$2,000 in the West Bank.
- Investment per capita in Gaza is less than half of that in the West Bank, and the physical infrastructure is much worse in Gaza than in the West Bank.
- The water demand/supply balance is much more precarious in Gaza than in the West Bank.
- Refugees make up over two thirds of the population of Gaza, compared to about 40 percent for the West Bank.
- Dependence on the Israeli market for employment is significantly higher for Gaza than for the West Bank; about 39 percent of the Gaza labor force in 1991 was employed in Israel, compared with 31 percent for the West Bank.

The report attempts to address, as much as possible, the problems arising from the differences between the West Bank and Gaza, especially in relation to investment needs.

2.12 Small, underdeveloped enterprises dominate the production and service sectors. While individual and firm-level entrepreneurial initiative and innovation are abundantly evident in the OT, this has not resulted in strong sectoral performance. Instead, the economy remains predominantly based on small cottage industries and sole proprietorships. In the industrial sector, only 5 percent of enterprises employ more than 20 persons, with almost two thirds employing fewer than 4 staff. The normal consolidation and rationalization of the industrial sector has not occurred, impeding the realization of economies of scale. The combination of the small size of the enterprises, the undeveloped state of marketing services and the lack of infrastructure and distribution systems constrains producers to sell directly to customers within a small geographical area (often a single town or village). This decreases competition, severely impedes the efficiency of factor utilization and militates against integrated markets. The lack of clear zoning regulations and public land use policy have acted to distort urban/industrial land prices, becoming a barrier to industrial expansion. Finally, business support services and institutions, both public and private, have yet to develop to a stage where they can cater to the needs of a dynamic private sector. These include, *inter alia*, information services to promote the diffusion of technology and the more efficient functioning of markets; training facilities for skill upgrading; and accounting and auditing services to meet the needs of larger business operations.

2.13 Investment by the private sector in productive assets has remained extremely low. While total gross fixed capital formation (GFCF) averaged a robust 27 percent of GDP during the period 1968 to 1991, construction (mainly in housing) accounted for more than 80 percent of GFCF. Investment in industry has often not even kept pace with the depreciation of capital stock. The low investment level reflects a combination of factors, including political uncertainty, tenuous property rights, entry barriers,

a restrictive regulatory and taxation environment and the lack of a supportive financial system. Formal financial intermediation remains at an exceptionally low level. There is no institutional capacity for mobilizing and allocating medium- to long-term funds. Private sector investments are, therefore, limited to individual savings and internal cash generation. A perceived lack of effective recourse against arbitrary actions by the OT administration has also discouraged entrepreneurial activity. Following the relaxation of some of the regulatory and administrative impediments over the past couple of years, there have been some signs of increased investment activity in recent months. However, lacking a fundamental change in perceptions about the business environment which appears possible only in the context of a peace agreement, the private sector response to these reform measures is likely to remain half-hearted and fragile.

2.14 The growth potential of the agricultural sector, rather modest in any case, has remained constrained by a stagnating or shrinking land and water resource base and by asymmetric trade relations with Israel which limits OT agricultural exports to Israel, where they are generally quite competitive. Annually renewable groundwater resources in the West Bank and Gaza amount to about 750 million cubic meters. Although this aquifer, shared between Israel and the OT, is now fully exploited, annual use by the Palestinians has remained capped at about 200 million cubic meters--the pre-1967 level. Current restrictions on access to water, including administrative limitations on surface water harvesting and the high costs of water caused by difficulties in renewing inefficient and worn-out wells, have meant the stagnation of the irrigated area under Palestinian cultivation. In selected areas, notably in parts of Gaza, increasing salinity levels caused by excessive extraction have virtually halted agricultural production. Loss of access to traditional grazing lands in the West Bank, due to security considerations and the increase in nature reserves, has affected animal husbandry operations, forcing pastoralists to keep their flocks in confined areas. Security-related restrictions affecting the fishing areas in which Gaza fishermen can operate have limited fish production to a fraction of the pre-1967 levels.

Trade

2.15 The two most striking developments in OT trade during the past 25 years are: a major redirection of trade towards Israel and the emergence of a large trade deficit. From no trading relations before the occupation, Israel has become practically the sole trading partner of the OT. The share of Jordan in total OT trade declined drastically over this period: exports to Jordan as a share of total OT exports declined from 45 percent in 1968 to 15 percent in 1991. Exports to Jordan are constrained by regulatory and security restrictions imposed by Israel, as well as by requirements regarding proof of origin and seasonal quotas on agricultural products imposed by Jordan, especially since the mid-1980s. However, Jordan does not impose any customs duties on goods imported from the OT. Furthermore, as a result of the security restrictions imposed by Israel, the OT can import virtually nothing from Jordan, even though in a number of cases (agricultural inputs, construction materials and households durables) Jordanian products could be highly competitive in the OT.

2.16 The Arab boycott of Israel as it relates to the OT, as well as various impediments to trade with the rest of the world, have also acted to distort the overall pattern of trade. A preliminary analysis of trading patterns based on the size of the economies, the geographical proximity and cultural similarities suggests that, in the absence of the above restrictions, Israel's share in OT trade would have been much lower; and Egypt, Jordan and the Gulf and OECD countries would have been significant trading partners. The disproportionate dependence on Israel for trading relations is in part linked to relatively better treatment received by the OT industry when subcontracting for Israeli firms, rather than directly exporting to non-Israeli markets. On the import side, the heavy dependence on Israel sometimes leads to inefficient sourcing of inputs for the OT enterprises, undermining their overall competitiveness.

2.17 The above trade patterns were accompanied by a sizeable OT trade deficit, which reached US$675 million in 1987, or 28 percent of GNP. The trade deficit was mainly with Israel while the OT enjoyed a trade surplus with Jordan. Although the trade deficit has been largely offset by incomes of Palestinian laborers in Israel, the resulting dependence on a single market makes the OT economy highly vulnerable to shocks, especially because labor flows are subject to political developments in the region. A collapse in labor income from Israel, as happened recently, would lead to a sharp decline in imports and have a depressive effect on domestic economic activity.

Public Infrastructure and Services

2.18 In contrast to impressive gains in private incomes and consumption, the provision of public services and physical infrastructure in the OT is highly inadequate. Although the coverage of services, particularly in the major urban areas, is fairly high, the quality of services often leaves much to be desired. The average urban water supply, for example, is only about 60 liters per capita per day (compared to 115 for Tunisia, 137 for Jordan and 230 for Egypt); a consequence of limited access to water resources and inadequate investment. Water actually consumed is much less due to deficient distribution systems with high losses (40-60 percent) in most municipalities. The inadequate supplies force many water departments to rotate water supplies to parts of their networks. The intermittent supply leads to the contamination of water from the intrusion of polluted water into the networks.

2.19 Due to supply constraints and network deficiencies, current electricity consumption of about 680 kwh/capita/year is also low compared to Egypt (815) and Jordan (1,055). Some 138 Palestinian villages have no electricity supply or only a part-time supply from isolated diesels. Suppressed peak demand is estimated at 30-50 percent. Load shedding and power interruptions are a frequent occurrence. Regulatory constraints on network expansion and on supplies from the Israeli system have forced many industrial users to resort to expensive captive supplies. Distribution losses are high at 20 percent, reflecting the need for major rehabilitation and upgrading. Because of these problems, and due to inadequate consumer tariffs and overdue accounts, all electric utilities in the OT are in poor financial condition.

2.20 Solid waste collection and disposal is grossly inadequate, raising serious health and environmental concerns. There are no modern sanitary landfills in the OT. Refuse, if and when collected, is simply dumped outside municipal boundaries and often burned to reduce volume, leading to air pollution. None of the municipalities has a satisfactory wastewater collection or treatment system. Generally, wastewater is discharged into seasonal streams or *wadis*. Where wastewater treatment plants exist, they appear to be poorly designed and operated. The poor management of wastewater is contributing to the contamination of groundwater, particularly in Gaza.

2.21 While the length of road networks per capita is typical of a country with similar per capita GDP, the physical condition of the roads serving the Palestinian population has deteriorated to the point where, without immediate rehabilitation, past investments may be completely lost. Most of the network needs to be improved through pavement strengthening. Many sections of the system need to be upgraded through improved vertical and horizontal alignments. The condition of the urban networks is also very poor. Roads in all municipalities lack adequate markings, lighting and the capacity to serve the needs of the population. The inadequate road network, especially rural roads, has served to increase the cost of transporting goods to markets dramatically, particularly for perishable agricultural products.

Box 2.4: Occupied Territories–Selected Comparative Data (1991)

	Occupied Territories	Middle East & North Africa 1/	Jordan
GNP per Capita (US$)	1,715	1,940	1,050
GDP per Capita (US$)	1,275	..	1,130
Gross Enrollment Ratios			
Primary (% school age pop.)	102	97	94
Secondary (% school age pop.)	80	60	65
Pupil-Teacher Ratio (primary schools)	30	26	17
Repeater Rate:Primary (% of total enrollment)	7 2/	11	5
Illiteracy (% of pop. age 15+)	40	45	20
Persons per Physician	847	1,668	767
Persons per Hospital Bed	658	635	519
Age Dependency Ratio 3/	1.08	0.87	0.92
Total Fertility Rate (births per woman)	7.3	5.3	5.3
Infant Mortality (per 1,000 live births)	42	60	29
Life Expectancy (years)	66	64	69
Households with Safe Water (%)	95	83	96
Urban Water Supply (liters per capita)	60	..	137
Households with Electricity (%)	90	..	98
Electricity Consumption (kwh/capita)	680	..	1,130
Telephone Subscribers (per '000 pop.)	22	..	67

1/ Includes 18 countries extending from Algeria to Iran.
2/ Data for UNRWA Schools only.
3/ Defined as the ratio of dependent pop. (under 15 and over 64) to the working age pop. (15-64).

2.22 The ratio of telephone subscribers to total population in the West Bank and Gaza is about 1:46, as compared to 1:15 in Jordan and 1:34 in Egypt. There is a large suppressed demand with the backlog for new connections in the West Bank alone exceeding 12,500, or about one third the number of lines currently in use. Of 400 villages in the West Bank, only 80 had telephone service as of end-1991. Of these, most had usually only one connection, and it was frequently out of service. The lack of adequate telecommunications capabilities has had a particularly deleterious impact on the service industry, a sector heavily dependent on good telecommunications.

2.23 Educational facilities are also in poor condition. Many school buildings require major repairs. Libraries and laboratories are generally inadequate, as are supplies of textbooks and materials. The curricula require modernization, and the qualifications of educational personnel in almost all positions need to be upgraded through pre-service and in-service training. Vocational schools are seriously underfunded and have inadequate facilities and obsolete equipment. Universities are too small to be able to provide the facilities required for advanced study, particularly in the physical sciences. The fragmentation of the educational system--the Egyptian system is used in Gaza and the Jordanian system in the West Bank--is an added handicap. The frequent school closings since the beginning of the *Intifada* have reportedly led to an increase in dropout rates, a breakdown in discipline and a deterioration in student achievement. Widespread violence has also produced an alarming growth in the population that is physically or mentally disabled.

2.24 The health infrastructure is less in need of repair. However, the OT devote a relatively large share of their output (7 percent of GNP) to the health sector and do not obtain the health impact that should be expected from this expenditure. Several reasons for the poor performance are apparent. First, most health care resources are being used to provide costly, high technology, hospital-based care for the benefit of the relatively well to do. Second, very small, inefficient hospitals have been allowed to proliferate (over two thirds of all hospitals have fewer than 100 beds). Third, highly specialized procedures are being carried out by units that are too small either to exploit economies of scale or to provide physicians and staff with enough practice to maintain skills. Finally, too little attention is being given to reaching out to underserved groups, especially women.

Box 2.5: Israeli Settlements in the West Bank and Gaza

Israeli settlement of the West Bank and Gaza, while beginning immediately after the 1967 war, intensified during the 1980s. According to unofficial Israeli sources, in 1992 there were about 136 settlements in the West Bank with 130,000 inhabitants and 17 settlements in Gaza with a population of 4,000 to 5,000.

Israelis argue that land for settlements has been acquired through legal means; Ottoman, British mandate, Jordanian and Israeli legislation have been used to obtain former state land, land left by Palestinian refugees and land where Palestinian occupants have been unable to prove their title. Palestinians have the right to appeal acquisition of land by the Israeli authorities through the Israeli legal system, but few cases have been successful. Palestinians point out that such settlements are prohibited under international law and are, therefore, illegal. The UN has taken the position that Israeli settlements in the OT have no legal validity and should be dismantled.

In order to attract settlers, the Israeli Government offers a number of incentives including: direct housing subsidies; land at discounted prices; mortgages at reduced rates; free hookups to utilities and municipal services; and higher schooling subsidies than in Israel. Israeli budgetary allocations for building settlements are not clear, but several sources report that they have been very large–perhaps as much as US$20 billion over the past 25 years.

Infrastructure for the settlements is fully integrated into the Israeli national systems. Water, telecommunications and electricity grids function as integral parts of the Israeli systems and are operated by the national Israeli agencies. Transport systems built during the past 25 years have also been designed primarily to meet the needs of settlements, linking them to metropolitan areas in Israel.

A striking feature of the infrastructure in the OT is its bifurcated nature. For all infrastructure systems, there is an obvious difference in quality between facilities for Israelis and Palestinians. In contrast to the generally inadequate and poorly maintained infrastructure for the Palestinian population, there is well-designed and well-maintained infrastructure catering to the needs of the Israeli settlements. For example, the electric service to Israeli settlements, supplied by dedicated supply lines, is markedly superior, with annual per capita consumption more than double that of the Palestinian population. Similarly, most residences and businesses in Israeli settlements enjoy individual telephone connections, and the waiting period for new connections is one of weeks rather than of months or years, as in the case of Palestinians. Integrating the two separate systems into a rational, single system should offer significant cost savings and overall improvements in service standards.

2.25 The inadequacies in the provision of public services have to be seen in light of OT public finances. Expenditures by the Civil Administration (CA) and the municipalities (including the public utilities) have been confined to the revenues collected by them: i.e., taxes, fees and utility tariffs. Public sector capital expenditures amounted to about 3.5 percent of GDP over the 1970-90 period, which is significantly below the average for developing countries. In Jordan, for example, the central government capital expenditure/GDP ratio has averaged about 9 percent in recent years. Three reasons seem to account for the "underinvestment" in infrastructure in the OT. First, the CA and the local bodies have inadequate resources because the tax effort is relatively low and because not all the taxes paid by the residents of the OT accrue to the budgets of the CA or the municipalities. The foregone revenues mainly relate to tariffs on trade with and through Israel. The shortfall between the revenues collected by the CA and the amount of taxes that are actually paid by the Palestinians leads to an element of "fiscal compression" and an underfinancing of public sector investment needs. Other agencies, both official and private, have tried to fill the gap left by inadequate availability of resources to the CA. Foremost amongst these is UNRWA which provides basic services to almost half the OT population at an annual cost of about US$100 million. Jordan has been the other major contributor until the 1988 "disengagement", providing some US$750 million of assistance during 1967-1988, mostly as salaries and renumeration for the West Bank civil servants. OECD donors, UNDP and NGOs have also provided significant resources. Nevertheless, the overall availability remains much below the need.

2.26 Second, neither the CA nor the utilities borrow to finance investment expenditure, while such financing is a common feature in many of the developing countries. Public utilities have been forced to finance most investments from current revenues after part of the revenue has been siphoned off to cover non-fee-earning municipal services.

2.27 Lastly, the poor state of physical infrastructure and the inadequacies of the services provided reflect the lack of coherence in sectoral policies and programs. This incoherence is due to the lack of mechanisms and institutions for policy and program development responsive to the preferences and priorities of the population to be served. The fragmentation of institutional responsibilities for program implementation and operation contributes to diffused accountabilities, indifferent service standards and, sometimes, duplication of effort. The programs of the CA, for example, are poorly coordinated with those of UNRWA or with those of the numerous NGOs operating in the OT.

2.28 To **sum up**, the economy of the OT grew very rapidly in the 1970s. Growth slowed down considerably in the 1980s but was still not out of line with performance in the rest of the region. This relatively respectable growth has been accompanied, however, by a skewed pattern of development and a serious underprovision of public services. High dependence on sources of employment that are now drying up combined with limited internal opportunities is perhaps the most serious structural problem facing the OT. Providing productive employment to the new entrants, as well as to those who may no longer be able to find employment outside the OT, will be among the most important challenges facing the OT in coming years. Stimulating growth in the productive sectors and services, particularly the latter, will be essential for coping with this challenge. As the OT economy tries to reduce its future dependence on labor flows to Israel, it also needs to improve its trade position by promoting exports, developing efficient import substitution and diversifying its trading relations. Significant improvements in public infrastructure and services are needed not only to improve living conditions directly, but also to support private business activities and to avoid environmental degradation. Past distortions and a series of adverse shocks, especially in areas critical to past sources of growth, are leading to economic stagnation, putting at risk the past gains in living standards. This, in turn, threatens the prospects for lasting peace in the region. Addressing these weaknesses is, therefore, essential for the future peace and prosperity in the region.

III. PROSPECTS AND A STRATEGY FOR THE FUTURE

Future Prospects

3.1 Although the OT suffer from serious structural problems and imbalances and have a very limited natural resource base, they also have substantial assets:

- First, the OT are blessed with a high quality human resource base. The Palestinians have the largest proportion of their population completing higher education of any Arab group (18 college graduates per thousand population). Despite significant outmigration, there is no shortage of either entrepreneurial talent or professional skills. The private sector in the OT is highly resourceful with a demonstrated ability to operate under rather challenging conditions. The removal of regulatory constraints and the establishment of supporting institutions and infrastructure should, therefore, help generate a significant supply response.

- Second, given the right climate, there could be significant private capital flows to the OT from the large and relatively prosperous expatriate Palestinian community in the Arab world and elsewhere. Many of the successful businessmen in the Arab world are of Palestinian origin. Surveys conducted in the early 1980s indicated that about one half of the Palestinians working in the Gulf states held what were classified as "professional and technical" jobs, the highest ranking category in terms of pay scale. Prior to the Gulf crisis, annual remittances from Palestinians working abroad (other than in Israel) exceeded US$300 million, about a third of which came from Kuwait. It is estimated that currently there are some 200,000 Palestinian workers and businessmen living in the Gulf states and the OECD countries. Given the strong community ties among the Palestinians, it is likely that, in the wake of a peace agreement, a good fraction of these businessmen and professionals would wish to strengthen their links with the OT through increased remittances, as well as direct investment in productive ventures. In addition, Palestinian financial resources abroad could be tapped to support public sector investment through, for example, subscription to a Palestinian bond scheme.

- Third, because of their unique religious and cultural heritage, the OT have the potential for developing into an important tourism centre. The tourism industry was the mainstay of the economy of the West Bank before 1967, but it has suffered serious setbacks since then because of the unsettled political and security situation. With peace and the normalization of relations in the region, tourism and related industries can become a major source of foreign exchange earnings for the OT economy, especially if cooperative arrangements can be developed with neighboring countries to promote tourism on a regional basis. The geographic location of the OT, and the fact that the Palestinians now have experience in trading with both the Israeli and Arab economies, should also make the OT important transit points for future trade within the region.

- Fourth, unlike most developing countries, the OT do not have to deal with the burden of crushing external debt. Public finances are also close to balance, and there is neither a bloated bureaucracy nor any loss-making public enterprise. Free from these legacies, public policy can, therefore, focus on structural reform. It also means that the OT economy can sustain a certain amount of external borrowing, especially for upgrading essential public infrastructure. Sound macroeconomic conditions can, however, be swiftly lost by imprudent policies, especially in the public sector.

- o Finally, given the strategic location of the area and the problems that the OT have experienced, there are good prospects for attracting international official assistance to help overcome infrastructural bottlenecks and deficiencies.

3.2 A prerequisite for transforming the above potential into sustainable development for the future is the resolution of the long-standing political, security and governance issues affecting the region. That should release for socioeconomic development major resources, both financial and human, now being spent to cope with the actual or perceived administrative obstacles, security threats and inequities. More importantly, by removing the strategic uncertainty and the perception of risk, the political settlement should unleash the financial and entrepreneurial resources of the private sector, both domestic and expatriate, for long-term investments in the OT. Lastly, access to external markets in the Arab world, likely to be normalized only with progress in the peace process, would provide additional impetus to development.

Elements of A Strategy for Economic Development

3.3 Political settlement and peace is a necessary, but not a sufficient, condition for economic development in the OT. Much will also depend upon the *quality of economic management* in the post-peace period and the strategic choices made in managing the OT economy. Choices on two issues will be particularly critical: the balance between the *roles of the public and the private sectors* in the OT; and the nature of *OT economic links to the rest of the world*, particularly neighboring countries.

3.4 Because of the existing economic imbalances and the unmet social needs, the public sector would clearly have an important role to play in economic development, particularly during the transition period. The upgrading of physical and social infrastructure, a key priority for improving living standards of the population and for stimulating private sector development, would have to be undertaken mostly by the public sector as private sector interest in financing such investments is likely to be limited, at least for some time. Even where private sector initiative may be forthcoming (e.g., in some segments of health services), a sound sectoral policy framework to safeguard the interests of both the providers and users of such services needs to be established. An even more crucial function for the public sector would be to provide a supportive business environment within which the private sector could flourish while, at the same time, protecting public interests in areas such as health, safety and the environment. There will be a need for a substantial strengthening of public action in many areas, including macroeconomic management, tax administration, the regulatory framework and the supervision of the banking system. In addition, this would mean relaxing some of the supply-side constraints (e.g., increasing the availability of land for new industries and businesses through an overhaul of the municipal zoning laws) currently affecting private sector performance. Providing an affordable social "safety net" through targeted programs would be another important function for the public sector.

3.5 While recognizing these imperatives, it is essential that the public sector role be not overstretched. In particular, any involvement by the public sector in directly productive ventures or interference in the marketplace by propping up unviable private sector activities (e.g., through price controls and by limiting competition) would retard economic development and, therefore, should be resisted. International experience indicates that differentiated patterns of protection, activist industrial policy or public channelling of money into unviable enterprises via the financial system too frequently lead to economic disaster. Economies that have prospered in the past have relied primarily on the private sector, working in undistorted markets, as the primary engine of economic growth. Relying on the private sector would be particularly prudent in the OT because, first, as noted above, the private sector in the OT is dynamic and capable; and, second, public sector resources, financial as well as administrative, are likely to be very scarce, at least for some time to come.

Box 3.1: The Issue of Jerusalem

The city of Jerusalem has occupied a central place in the history of three great religions - Judaism, Christianity and Islam. It has also played a major role in shaping the economic, social and political lives of the Middle East Region for over three thousand years. Therefore, an important aspect of the current conflict in the Region centers on the control of Jerusalem.

The 1948 war led to partition of Jerusalem with Eastern and Western parts coming under Jordanian and Israeli control respectively. At the end of the 1967 War, East Jerusalem was occupied by Israeli forces. Following the occupation, the Jerusalem city limits were expanded by Israel to include East Jerusalem, as well as some other parts of the West Bank. The expanded city was annexed by Israel on July 30, 1980. Arab residents of Jerusalem have been given the option of obtaining Israeli citizenship although very few have chosen to do so. Israel views Jerusalem as its historic capital and maintains that Jerusalem must never again be a divided city.

Actions taken by Israel were considered invalid by the United Nations, which called upon Israel to refrain from taking any action that would alter the status of Jerusalem. Although the international community has not recognized the Israeli annexation of East Jerusalem, Israel continues to exercise authority over the area and considers it an integral part of Israel and not subject to further negotiations. The Palestinians insist that East Jerusalem is part of the West Bank as per the pre-1967 borders and that Israel should withdraw from all areas occupied during the 1967 war as per the United Nations resolutions.

There are important economic links between the West Bank and Gaza Strip and Jerusalem. Decisions concerning Jerusalem would, therefore, have important implications for future economic prospects and priorities for the OT. The following are among the most important of these links:

- The tourist potential of the West Bank is critically dependent on the ancient religious sites of Jerusalem.
- Major north-south transportation links in the West Bank pass through Jerusalem.
- The only tertiary care hospital and some of the best secondary care hospitals available to the West Bank population are located in East Jerusalem.
- East Jerusalem houses much of the Palestinian financial services, marketing facilities, and social and cultural infrastructure.
- Qalandia airport, a potential outlet for linking the West Bank with regional airports, is within annexed Jerusalem.
- Parts of East Jerusalem are an integral part of the power network covering the area from Ramallah to Bethlehem.

Considering that the question of Jerusalem is essentially a political matter, this report should not be construed as taking any position on this issue. Therefore, while analyzing the links where appropriate, this report has endeavored to avoid making any recommendations that might imply prejudging the status of Jerusalem.

3.6 Regarding links to the outside world, in economic terms, the option of turning inwards would clearly be very costly for a small economy such as that of the West Bank and Gaza. It would mean major efficiency losses and a sharp decline in living standards. The opening up of external markets to exports from the OT is important if the economy is to achieve sustainable development. However, the external economic relations would need to be shifted from almost complete dependence on Israel, as at present, to interdependence with a range of economies, including Israel.

3.7 Given the close economic relations with Israel that have evolved over the past 25 years, the economies of the OT and Israel are bound to be inextricably interwoven for the foreseeable future. While a major reorientation in trade -- to the region and to the rest of the world -- should occur over the medium term, any sharp cut in trade in goods to Israel could have large short-run costs, because of Israel's predominance as a trading partner. This implies the desirability of mutually beneficial arrangements between Israeli and OT authorities regarding the flow of goods, services, financial resources, labor and visitors in the post-peace period. Even if the loss of substantial labor access to Israel is permanent, it would make sense for the West Bank and Gaza to not only maintain, but expand trade access to the Israeli market. The key issue in the Israeli market is agriculture. The opening of the Israeli market to agricultural products from the West Bank and Gaza, where they are highly competitive, would have a significant positive impact on OT agriculture by both increasing production and eliminating rents from illegal trade. Israeli consumers would also benefit significantly from easier access to OT produce.

3.8 Equally important, for export diversification by product and by destination, trade links to Israel should be complemented by increased access to both the traditional Arab markets and to nontraditional markets in Europe and North America. As noted earlier, the various restrictions on trade with and via Jordan have significantly reduced trade with the Arab countries. The removal of these restrictions should lead to increased production and exports, particularly of manufactured goods, as well as the importation of certain inputs--such as fertilizers and construction materials--at significantly reduced prices. An important issue for OECD markets concerns how far the OT can participate in the current free trade agreements which Israel has with the EC and the US. (The EC agreement is already applicable to the OT).

3.9 From the perspective of the West Bank and Gaza, a strategy that attempted to open up opportunities elsewhere, especially with Jordan, Egypt and the Gulf countries while maintaining open trade relations with Israel, would make sense. A possible approach to consider would be a free trade area with Israel, linked with a significant opening of trade to Jordan and Egypt. This would differ from the present (partial) customs union in allowing the OT to have different tariffs from Israel for trade with rest of the world. It would maintain open trading relations with Israel, but would potentially avoid protectionist aspects of Israel's trade regime that may not be suited to the economic structure of the OT. The opening of trade to Jordan, Egypt and the rest of the Arab world would allow the OT to diversify its export base, thus reducing its vulnerability to external shocks. However, while a free trade area, perhaps involving Jordan, is attractive in principle, there may be problems in practice linked to the establishment of customs borders and the "leakiness" of such borders. Equitable distribution of gains from free trade among the various partners may also require some transitional arrangements to enable the infant OT enterprises to compete on an equal footing.

3.10 Promoting regional infrastructural networks in electricity, transport, telecommunication, petroleum and gas pipelines and water would offer other opportunities for strengthening interdependence and benefitting from complementarities and economies of scale, which may not be available to the OT in the absence of such cooperation. Because of the poor endowment of natural resources, the landlocked location of the West Bank and the small size of the economy, many infrastructure services in the OT are likely to be lower cost if regional solutions are adopted. Regional power interconnection would be of high priority to the OT because of the lower cost sources of supply in Israel, Egypt and, perhaps, Jordan and the improved reliability of supply to all participating parties. Similar economies of scale and the utilization of existing capacity are possible with highways and ports. Since water resources are common to both the OT and Israel, an attractive long-term solution would be the joint management of the shared resource.

3.11 Choices concerning the respective roles of the public and private sectors would be entirely up to the decision-makers in the OT, however, the choices concerning economic links would necessarily involve other parties and would depend upon negotiations between the OT, Israel, Jordan and other regional and non-regional parties. The international community and particularly the OT's neighbors could make an important contribution to economic growth in the OT by providing improved market access to OT exports and by supporting economically viable regional infrastructural investments.

3.12 Other strategic choices, dependent upon the outcome of the ongoing bilateral negotiations, concern the feasibility and desirability of an independent macroeconomic policy for the OT, including a separate currency. *Prima facie*, there are a number of reasons why an independent policy would make sense: it would allow the OT to deal better with real and nominal shocks, gain seignorage revenues and facilitate financial intermediation through financial sector development. Preliminary analysis suggests, however, that:

- In some areas, the pursuit of an independent macroeconomic policy is likely to be fruitless, e.g., attempts to have independent interest rates, given the degree of capital mobility in the region.

- In a second set of areas (e.g., managing "excessive" capital inflows, borrowing at home and abroad and supervising/providing liquidity to banks), independent policy is desirable but does not necessarily require a separate currency.

- Seignorage is traditionally important in the region but is unlikely to be so for the OT because of the likely initial low level of credibility of a new currency and the high capital mobility.

- Finally, there are areas for which a domestic currency is necessary, e.g., avoiding imported nominal shocks from other members of a currency union and facilitating real wage declines.

3.13 The above must be seen in the context of credibility, something that is hard to earn but that can be obtained by being in a currency union(s) with a disciplined core or by establishing a track record of prudent macroeconomic, and especially, fiscal management. The OT do not have such a history, and new institutions of macroeconomic management are likely to be both fragile and under pressure. If a domestic currency is chosen, it might be desirable to start with a relatively restricted version, as in a Currency Board, that could gradually evolve to a fully fledged currency once discipline, and the associated demand for the currency, was well established. Decisions concerning an independent OT currency may have significant repercussions for both Israel and Jordan, particularly the latter since the JD currently in circulation in the OT may be a significant fraction of the total money supply in Jordan. Accordingly, retiring the Israeli and Jordanian currencies from the OT, may have to be done in a phased manner in consultation with the Israeli and the Jordanian authorities. The international community may also have a role to play in that respect.

Some Scenarios for the Future

3.14 Forecasting the pattern of growth is a highly uncertain business. However, assuming sound economic management, it would be reasonable to expect a relative expansion of domestic over external employment. Over time, a substantial diversification in economic relations would also be probable, with greater interdependence among economies in the region and an expansion in trading relations outside the region, notably with Europe. As regards the likely changes in the production structure of the economy, undoubtedly there is some room for expansion in agricultural and industrial production, once the present constraints on private sector development are removed, including access to outside markets. However, this point should not be overemphasized. Diminishing water resources throughout the region will constrain the development of the agricultural sector, with future growth limited to high-value export crops catering to niche markets. Given the paucity of industrial raw materials and the small market size, heavy industry is unlikely to be a major contributor to future growth. Instead, skill-based, light- and medium-sized industries would appear to be more promising. Above all, the economy of the West Bank and Gaza is likely to remain mainly a service-oriented economy with an important contribution made by the tourism sector.

3.15 A range of scenarios was developed to explore the potential trajectory of the economy in the future. These are illustrative only since little is known about either future conditions or economic responses. A critical factor in the scenarios is the overall "policy," encompassing a range of likely influences on future development. "Good policy" would include, *inter alia*, a peace agreement that resolves strategic uncertainty sufficiently to provide the basis for private capital inflows and investment in productive activities; a relaxation of supply-side constraints, including deregulation and improvements in the supply of economic infrastructure and industrial land; trade arrangements that allow substantial trade expansion (in the region and elsewhere); a strong public finance framework with substantially expanded revenues (including taxes now accruing to the Israeli treasury); a major strengthening of the administrative and policy-formulating capability of the emerging, interim self-governing authority; and a strengthening of the human resource base both by stepped-up training programs and by access to entrepreneurial and professional skills of the Palestinians living abroad.

3.16 Preliminary analysis suggests that, assuming a "good policy," a growth rate in excess of 3 percent in per capita incomes is sustainable, with a total rise in incomes on the order of 40 percent in a decade, provided the phaseout from the Israeli labor market is managed in a "smooth" fashion and provided there are adequate external public and private capital inflows (about $2,500 million during the five-year transition period). [3] In case there is a "sharp" reduction in employment in Israel--for example, if employment does not rise above the 45,000 prevailing in June 1993--the short-run situation is likely to be much worse, with potentially large rises in unemployment and falls in wages and incomes. That would require short-run action, in terms of additional external inflows (a total of about US$350 million over the five-year period) and poverty-related spending by the public sector to moderate welfare declines. [4]

3/ To the extent there is any net immigration into the OT following a peace agreement, the need for external inflows would be higher and depend, in part, on the asset base of the returnees.

4/ The external inflows stipulated in these scenarios do not include labor income earnings in Israel, which are assumed to decline over time in both scenarios--but from a much lower level in the "sharp" reduction scenario.

However, with "good policies," the income levels would recover to the pre-cutoff period after about three years, and the economy could then again be on a steady growth path, with GNP per capita exceeding US$2,300 after 10 years (compared to US$1,715 in 1991).

3.17 By contrast, if policies are not sound, the outlook would appear to be grim. There could easily be declines in income per capita–on the order of 20 percent in a decade–even with a "smooth" labor decline. The outlook would be worse, especially in the short run, in case of a "sharp" reduction. Such growth scenarios would undoubtedly be associated with rising poverty, worsening social conditions and, potentially, rising violence. "Poor policy" could be offset by official capital inflows, but only for a while, since private capital is unlikely to flow in while the political uncertainties remain unresolved, and policy conditions are not perceived to be investor friendly.

3.18 An attempt has also been made to estimate the public sector financing requirements assuming "good policy". The analysis also assumes that:

- The new self-governing entity would reach agreement with Israel on a mechanism to ensure that the budget of the new entity receives all the taxes paid by the OT residents.
- The UNRWA operations would continue to function alongside the new entity during a five-year transition period.
- Of the public sector investment needs identified in Chapter V for the medium-term, 85 percent would, in fact, be implemented in that period.
- The revenue effort would be enhanced by 2 percentage points of GNP in the first five years, rising from 18 percent in the base year to 20 percent in year five as tax administration capabilities are improved and as cost recovery mechanisms are put in place.
- The current expenditures would also rise by about 2.5 percentage points of GNP in the five years, from 16.5 percent to 19 percent to support the gradual expansion and improvement in service and maintenance levels.

3.19 Under these assumptions, the external financing requirements of the public sector (including UNRWA) in nominal terms for the five-year transition period would be about US$1,500 million under the "smooth" scenario and US$1,750 million if the labor reduction is "sharp." The latter scenario would, furthermore, require some front-loading of the external assistance. It should be noted that external donors, including UNRWA, currently spend about US$175 million annually in the OT. Thus, external aid flows would have to be roughly doubled from present levels to meet the financing needs of the public sector. As regards external private inflows, the requirements would be about US$200-250 million per annum. With about 200,000 Palestinian workers in the Gulf states and the OECD countries, the implied remittances per worker would be about US$1,000 annually, a very plausible amount.

3.20 The above discussion raises the issue of the terms on which the external aid to the OT would be extended during the transitional period. Currently, all official aid to the OT--whether through UNRWA or from other sources--is in the form of grants, as the aid is mostly of a humanitarian nature, and there is no legal entity to lend to. In view of the large uncertainties involved at this stage, the study has not analyzed the external borrowing capacity of the OT in the transitional period and beyond. As the OT does not currently have any external debt, there is clearly some scope for borrowing in the period ahead. Care should be taken, however, not to overburden the economy and strain future growth, nor to use funds for unproductive purposes. Given the likely fragility of the public sector revenues and of exports during the transition period, it would be prudent if the external assistance to the OT over the medium term included some element of concessionality. Tentatively, it is estimated that if UNRWA financing was to continue in the form of grants and if there was a 20 percent grant element in the remaining external flows to the public sector, the debt services burden would remain manageable over the medium to long term.

3.21 The above scenarios should be treated as indicative. However, they do help illustrate the main implication of much of the analysis in these volumes: the OT have the potential to recover from both the loss in past sources of growth and from distortions in the pattern of development, and to become a viable, growing economy, provided that the policy and structural conditions are right. In the absence of a sound domestic policy, continuing strategic uncertainty and inadequate donor support, the OT could enter instead into a period of sustained decline in incomes, employment and welfare. Also, the initial recession caused by the "sharp" reduction in employment in Israel could generate internal social instability and rising violence, deterring private foreign investors. The faltering private investment could further accentuate social tensions leading to a vicious cycle of low growth, low revenues and inadequate public spending.

3.22 It should also be remembered that the OT economy has a number of limitations which leave policy makers with little room for maneuver. The limited natural resource base, the high degree of vulnerability to external shocks, and the fragility of the political situation following years of conflict, make the management of the transitional period a very delicate and difficult undertaking. Policy slippages could impose a heavy toll on an already fragile economy; a careful stewardship of the economy would, therefore, be necessary--a task which would be greatly facilitated by internal consensus among the Palestinians on a vision for the future OT economy.

3.23 To **sum up**, the OT economy appears capable of generating sustainable economic growth provided there is peace and stability in the region and provided the economy is soundly managed with a mix of prudent macroeconomic policies, expanded public services, support for private sector expansion and an expansion of trade to the region and the rest of the world. Significant external capital flows will be needed during the take-off period--partly to help overcome the existing deficiencies in public infrastructure and services and partly to augment the production base for private sector activities. It should be noted, however, that there are many downside risks which if not guarded against could easily trap the OT economy into a low level equilibrium.

IV. POLICY AND INSTITUTIONAL IMPERATIVES

4.1 There are seven key institutional and policy areas where adjustments are needed in order to create a climate conducive to sustainable economic and social development: (i) the legal and regulatory framework; (ii) the management of public finances; (iii) the management of public infrastructure; (iv) financial sector development; (v) the management of natural resources; (vi) the provision of social services; and (vii) local government and public administration. These are considered below.

Legal and Regulatory Framework

4.2 As noted earlier, future economic growth and development in the OT is critically dependent upon the performance of the private sector. Unleashing this potential requires the creation of a legal and regulatory environment that supports private sector initiative. The legal system should provide a set of rules that govern property rights, their exchange and the settlement of disputes. More importantly, the rules should be perceived as transparent, stable and enforceable, through mechanisms that are seen to be fair and efficient. Despite some improvements in the recent past, there remains a widespread perception among OT entrepreneurs that the current business environment is ambiguous, complex and unpredictable. Trust in the ability of the legal system to provide an expeditious and effective appeals process also remains low. Particularly constraining to entrepreneurial activities are perceived barriers to entry, restrictions on the conduct of import and export activities, restrictions on the movement of people and goods and the perceived insecurity of property rights. These perceptions make investments in long-term fixed assets risky and unattractive, especially in high technology areas with a high probability of rapid obsolescence.

4.3 Progress in the current peace negotiations and agreements on self-governing arrangements should make possible a thorough review and overhaul of the existing legal and regulatory framework to provide the private sector with a sounder legal basis for commercial transactions. Some of the priority areas for review and revision include the commercial code, joint-stock company law, bankruptcy law, collateral law, municipal zoning laws, business licenses, export/import licenses and regulations concerning the movement of people and goods. A strengthening of the appeals process would be another priority. The implementation of a supportive legal and regulatory framework requires credible institutions, the development of which is as much of a priority as the restructuring of current laws and regulations.

Management of Public Finances

4.4 International experience suggests that establishing a sound system of public finances in the West Bank and Gaza will be necessary in creating an environment conducive to private sector development and in attracting external assistance. Establishing such a system will mean ensuring that adequate revenues are collected/received by future authorities in the West Bank and Gaza and that the resources, including those that might be obtained from external sources, are managed properly.

4.5 On the revenue side, five key issues need to be addressed:

- *The Legitimacy of the Tax System.* Currently, there is a widespread perception among the Palestinian population that the existing system of taxation lacks transparency and due process and is administered in an arbitrary fashion. These negative perceptions materially reinforce tendencies for tax evasion and noncompliance, which exist, at least latently, in all societies. To a large extent, the negative perceptions are directly related to the current military occupation; and the emergence of a self-governing authority as

part of the peace settlement should help change the situation significantly. That would, however, in no way obviate the need for creating an efficient tax administration system that is perceived to be fair by the population. The current tax administration system would need to be completely overhauled, including the establishment of transparent rules and enforcement mechanisms for tax assessments; the rationalization of advance payments of income taxes; and the introduction of a credible and efficient institutional mechanism for the settlement of tax disputes. The role of accounting and auditing professionals would also need to be clarified in this context.

- *Fiscal Transfers Between Israel and the OT.* Under the current tax and trade arrangements between Israel and the OT, some OT taxes (primarily, the value-added tax (VAT) and other taxes on net OT imports from Israel and custom duties on imports through Israel) are accruing to the Israeli treasury. Given the absence of customs borders between the OT and Israel, the "origin principle" of indirect taxation is applied with respect to trade between the two, whereby taxes are collected where the goods are produced rather than consumed. Since the OT have a large trade deficit with Israel, there is a net revenue loss to the OT. Conversely, Israel also incurs expenditures in the territories from its own budget that are of benefit to the Palestinians (e.g., the subsidization of essential food items; Palestinian use of subsidized infrastructure and services in Israel). The Israeli and the OT authorities would need to agree on methodologies for estimating such transfers, as well as to devise suitable mechanisms for offsetting payments. Several alternative solutions appear feasible but would need to be considered in the context of the overall future economic relations between Israel and the OT. In any event, what is important is that all the revenues and expenditures and their financing are stated explicitly in the budget for the new OT entity.

- *The Appropriateness of the Domestic Tax Effort.* Despite perceptions of high tax rates among many Palestinians, the economy of the OT does not appear to be highly taxed. Even when all taxes paid by Palestinians are counted (including those currently accruing to the Israeli treasury), the tax effort is about 22 percent of GDP, compared with 27 percent in Jordan and 39 percent in Israel. In view of the need to strengthen public administration and expand public services, mobilization of additional domestic resources would be essential. It is true that the effective personal income tax rates are currently higher in the OT than in either Israel or Jordan. However, the tax effort in relation to the GDP is lower for several reasons, including the exemption of agricultural income from the tax net and probably a high incidence of tax evasion. The question of the tax effort, therefore, will have to be examined in relation to the ability of the emerging entity to expand the tax base to protect its overall fiscal position, as well as its ability to harmonize tax policies with neighboring countries. This brings to the fore the importance of providing a very strong system of tax administration that can help widen the tax base and improve tax collection.

- *Cost Recovery.* An important aspect of domestic resource mobilization mentioned above concerns the establishment of mechanisms for cost recovery for the expanded public sector operations. User fees would be an important instrument to help cover the operations and maintenance costs and the debt servicing associated with new public sector investments in the transport, communications and solid waste disposal areas. Similarly, it would be important for the electric and water utilities that are being recommended to operate as commercially oriented autonomous entities, i.e., to charge tariffs that would make their operations financially viable without the need for any budgetary support.

- *Management of External Assistance*. To get the maximum benefit from the international assistance that might become available in the wake of a peace agreement, an efficient mechanism for directing and coordinating this assistance will be needed, balancing, in particular, donor interests and preferences with the developmental priorities of the OT. A careful monitoring of external borrowing will also be necessary to avoid any debt service problems in the future.

4.6 On the expenditure side, the key issues to be addressed are:

- *The Balance Between Current and Capital Expenditures*. A significant increase in the investment program during the transitional period would necessitate a commensurate increase in current expenditures on operations and maintenance to ensure that the capital stock would be adequately maintained. The budgeting process and the estimation of the financing requirements should, therefore, take into account the need for such expenditures. Experience suggests that this is often an overlooked item, with undesirable consequences.

- *The Sustainability of Expenditures*. As has been noted earlier, the direct role of the public sector should be mainly to provide basic infrastructural and social services, including a limited and well-targeted safety net for the poorest segments of the population. Care should be taken not to enlarge the bureaucracy of the public sector unduly, and the public sector must not act as the residual employer. The post-peace period could see large pressures for expanded public spending, both in areas that are well justified (roads) and some that are not (excessive civil service growth). The likely temporary easing of financing constraints following a peace agreement could mask imprudent spending and borrowing policies for some years. Strong, conservative control will, therefore, be important for avoiding unsustainable level of expenditures, which would be difficult to reverse in the future.

Management of Public Infrastructure

4.7 Well-functioning public utilities will be essential to plan, implement and operate infrastructural investments on the scale needed in the OT. An early priority for the emerging self-governing entity in the OT would be to decide on how the ownership of utilities is to be structured and how the regulatory and policy-making roles are to be organized. The legal framework for these arrangements will also need to be established, taking into account the special circumstances involved.

4.8 To provide a sound basis for autonomy, accountability and efficiency, it is recommended that commercially oriented utility companies be established. Municipal governments should disengage from the direct role of provider of water and electricity, to the indirect role of owner. Since the legal framework covering the transitional period is not yet clear, the simplest legal basis for the new, reconstituted utilities would be the prevailing companies law, with the shares held in the public sector. This would not only provide a framework for enterprise autonomy and commercial orientation, but would also facilitate partial or total privatization in the future. It is also recommended that: (a) the roles of policy-making, ownership and regulation be separated among different institutions; and (b) the ownership (shareholdings) be spread as widely as possible among different municipalities, pension funds and other public or private agencies. The new entity should also try to define the regulatory system for the public utilities. Some of the key issues that need to be addressed are : (a) one multisectoral regulatory agency *vis-a-vis* several sector specific regulatory bodies; and (b) the basis for utility price setting.

Financial Sector Development

4.9 The present legal and regulatory framework, a patchwork of Jordanian, Egyptian, Palestinian mandate and Israeli legislation, is not conducive to the expansion of existing financial institutions or the establishment of new ones. This framework needs to be replaced with transparent, coherent legislation covering the West Bank and Gaza that: (i) sets clear criteria for licensing banks, insurance companies and other regulated financial intermediaries and establishes uniform standards as to capital requirements, liquidity and solvency; and (ii) establishes a new regulatory framework, consistent with international standards, for the supervision of financial intermediaries.

4.10 Within the above context, several steps are needed to strengthen the process of financial intermediation. First, entry barriers should be eliminated and existing banks in Gaza and the West Bank should be allowed to expand in either region to facilitate the economic integration of the two territories. Second, mechanisms should be devised to enhance or supplement the collateral of local investors by tapping the value of unmortgaged real estate. Third, the multiplicity of inefficient, small-scale, subsidized credit programs with unsustainable recovery rates need to be reformed and moved towards regular financial operations at market interest rates. Lastly, given the need for strengthening medium and long-term financial intermediation, establishment of an investment bank, preferably with foreign participation should be encouraged. Considering the strong financial and skill base of the Palestinians in the OT and abroad, every effort should be made to keep the ownership and management of such an institution entirely in the private sector. However, in case this is not feasible, as a last resort, some limited equity participation by the public sector may also be considered for the initial years.

Management of Natural Resources

4.11 While the question of access to natural resources ultimately depends on the outcome of the political negotiations, there are some measures that can be taken to ensure conservation and a better utilization of natural resources. Of special importance is the preparation of an environmental action plan underpinned by a comprehensive framework for environmentally sustainable development in the post-peace period. Other areas for priority attention include:

- Establishing, initially, a coordinating mechanism and, later, a management agency to oversee the development of the region's water resources in cooperation with the other riparians. Sharing data on the region's land and water resources would be a good beginning.
- Relaxing regulations governing the rehabilitation of irrigation wells.
- Addressing the severe quality problems of the municipal water supply in Gaza.
- Relaxing constraints in the use of grazing lands.
- Relaxing constraints on the harvesting of marine fisheries resources.
- Reforming the regulatory framework (land use planning, building standards, minimum lot sizes, the taxation of vacant land, rent controls, etc.) regarding the use and development of urban lands.

- Providing adequate infrastructure to, first, encourage the use of vacant urban land and, second, to extend municipal boundaries to provide adequate, affordable, serviced land for residential and commercial purposes.

- Establishing adequate arrangements for the collection and disposal of solid waste to prevent ground water pollution and an unhealthy and unsightly urban environment.

- Establishing institutions and a regulatory framework for the protection of antiquities and cultural property.

Provision of Social Services

4.12 The broad outlines of a sound social policy for the OT are clear. Basic health services should be made more accessible and hospital services and high technology health care should be deemphasized. Education and training should be strengthened in areas, such as curriculum development and teacher training, to enable the system to improve the quality of instruction and, thus, to improve the productivity and employability of Palestinian labor. The social security systems now operated by the CA, Israeli employers and UNRWA should be harmonized and unified; the system of private transfers should be supported through the development of appropriate financial institutions.

4.13 Present inefficiencies in the health sector are rooted in the fragmentation of responsibility, not only for the delivery of health care, but also for the management of subsidies to the sector from the government budget and external donors. A responsible body must be created to develop a sound health policy and to coordinate activities in the sector. Policies should, at the same time, seek to interrupt the link between refugee or employment status and entitlement to subsidized health care; instead, such care should be targeted to the needy. In assembling a set of policies, issues of health care finance, service standards, investment in technology and quality assurance should be addressed.

4.14 An extensive education planning process should be initiated to consider the goals, possibilities and resources for a unified education system for the Gaza Strip and West Bank. Planners, administrators and curriculum experts should be given training in carrying out these tasks. A revised curriculum should be developed that can be adopted on both the West Bank and the Gaza Strip. It should not only give attention to the modernization of content and teaching methods, but should also link curricula to broad economic, social and cultural objectives. As the development of curricula is time-consuming and costly, in the short term, consideration should be given to adapting materials from other countries, especially in the sciences and mathematics. Personnel exchanges across institutions could prove useful in this endeavor.

4.15 Resources to support a comprehensive social welfare program are unlikely to become available to the OT entity within the foreseeable future. Nonetheless, in time, the OT authorities would be called upon to replace the benefits provided to the very needy by UNRWA and the CA. The targeting of the programs would, therefore, be essential. The OT would have to develop a basic program of social protections and ensure that this program received broad political endorsement. The program should provide for the handicapped, elderly, orphaned and widowed, but it should not seek to replace reliance on private transfers and personal savings. The OT should also encourage the development of private institutions that supply financial services, including health and life insurance companies and pension schemes.

Local Government and Public Administration

4.16 The policy and program agenda that the new OT entity will face in the coming years would constitute a big challenge to any public sector apparatus. The OT entity, emerging in a period of transition with little experience in self-government, will be especially challenged. Institutional strengthening would, therefore, be critical both at the local level and at the territory-wide level.

4.17 Local governments in the OT are generally weak and ineffective. The legal environment in which they operate is complex, overregulated and nontransparent. Moreover, local public finances are largely controlled by the CA; local governments have little authority over taxes and fees and, as a result, are unable to finance recurrent expenditures adequately. Allocations of funds for capital investments, mostly financed with transfers from the CA, are also nontransparent. Improving the effectiveness of local governments would require, *inter alia*:

- The introduction of a rational legal foundation that clearly assigns an appropriate degree of local discretion over issues of local interest.
- The provision of greater local autonomy over user charges and local taxes.
- The introduction of more systematic and transparent criteria for the allocation of capital transfers.
- Technical assistance and staff training to promote institutional change and facilitate policy development relating to local government issues.

4.18 In addition to the strengthened role of the local government bodies, institutions would have to be developed to formulate, coordinate and implement policies at the territory-wide level. To develop these capabilities, the emerging self-governing authority needs a strong and efficient system of public administration responsive to the needs of the local population. Suitable mechanisms would also have to be devised to ensure the accountability of the public administration. The 20,000 Palestinians currently employed by the CA could become the nucleus of the administrative structure for the emerging self-governing authority. However, the likely difficulties in molding the current CA establishment into an administrative structure suited to the needs of the self-governing authority should not be under-estimated. For the longer term, integrating the UNRWA establishment into the normal administrative structure of the OT would be another major challenge.

Phasing the Policy and Institutional Agenda

4.19 The above agenda of institutional and policy reform is clearly extensive and complex, and some phasing of the various reform measures would be necessary. A preliminary outline for such a phasing is shown in the Table 4.1 below. The definition of short and medium term is linked to the peace process, as explained in Chapter V. Basically, the short term covers the period up to end-1993, and the medium term covers the period 1994-98. It should be noted that the implementation of some of the actions for the short term is already underway. For example, business licensing procedures have been significantly liberalized recently, and impediments to exports to Jordan have been reduced. Tax changes to encourage investment in the OT have also been initiated. Areas open to Palestinian fishermen have been expanded. Some training and TA programs to strengthen institutional capabilities have also been initiated by several donors as part of the ongoing peace process.

Table 4.1: Phasing of Institutional and Policy Reforms

Area of Reform	Short-Term	Medium-Term
Regulatory and Legal Framework	o Publish all regulations in Arabic o Review all commercial laws with a view to harmonize and modernize o Relax licensing requirements for foreign trade and for businesses o Simplify procedures for trade with Jordan	o Develop market-friendly commercial laws o Ease restrictions on movement of goods and people
Fiscal System	o Relax advance income tax requirements o Reform income tax reporting and compliance provisions o Reform tax assessment practices	o Develop a budgetary framework o Agree on mechanisms for fiscal transfers with Israel o Establish mechanism for management of external assistance o Design new taxation structure and develop tax administration capability o Establish cost-recovery mechanisms for public services
Public Utilities	o Study issues concerning ownership and regulation of utilities o Initiate training programs for utilities	o Establish financially autonomous, commercially-oriented utilities
Financial Sector	o Eliminate barriers to entry and expansion o Establish payment clearing system	o Create an enabling legal framework for financial system o Establish a single regulatory authority o Encourage establishment of an investment bank

(continued to next page)

Area of Reform	Short-Term	Medium-Term
Natural Resources	o Relax regulations governing rehab of irrigation wells o Study alternative to address drinking water quality problems in Gaza o Relax constraints to grazing lands use o Develop environment action plan o Share data on natural resources	o Establish agency to coordinate and oversee water resource development o Reform regulatory framework for development of urban lands o Establish mechanisms for protection of antiquities and cultural property o Establish an environment management organization
Social Services	o Articulate sectoral policy framework o Launch socioeconomic studies	o Adopt coherent policies for social sectors o Create health sector coordinating body o Start preparation for a census o Modernize educational curriculum
Local Government and Public Administration	o Review laws and regulations affecting local government operations o Launch studies on trade, monetary and fiscal issues o Initiate training programs	o Revise legal framework governing local governments o Provide greater financial autonomy to local governments o Prepare strategies for regularizing UNRWA establishment over the longer term o Establish a development policy institute

V. INVESTMENT AND TECHNICAL ASSISTANCE NEEDS

5.1 A critical element of the strategy for achieving sustained economic and social development in the OT is the major upgrading of physical and social infrastructural services. This is a function to be undertaken mainly by the public sector and is important not only for improving the quality of life in the OT, but also for providing an enabling environment that supports the growth of a dynamic private sector. Since private sector investment will be the result of decisions by many individual entrepreneurs, using primarily private capital flows, the focus here is only on public sector investments. Thus, private sector investment needs in areas such as agriculture, industry, tourism and housing are not included in the following estimates. Investments in telecommunications and petroleum and gas pipelines are also expected to be through the private sector and, hence, not considered here.

5.2 In assessing the future investment and TA needs of the OT, three main phases have been distinguished linked to the likely time frame of the ongoing peace negotiations: Phase I, the *short term*, extends to the time when an agreement is reached in the bilateral peace talks on interim self-government arrangements. Phase II, the *medium term*, covers the period from the end of Phase I until the time when final political arrangements regarding the OT are in place. Phase III, the *long-term*, refers to the post-peace period, following agreement on the final political arrangements. The duration of these phases will depend upon progress in the peace talks. However, for the purposes of this report, it is assumed that the short term will not extend beyond mid-1994 and that the medium term will last for a period of five years thereafter.

5.3 The analysis of investment and TA needs is based on the assumption that there would be no large population movements in the periods under consideration. The investment requirements would be larger to the extent that the Palestinians living abroad are allowed to return and choose to do so. The requirements indicated below may need to be modified in the future after agreement is reached between the concerned parties on this issue.

5.4 The following framework forms the basis for the prioritizing and phasing of various investment and TA programs being considered for the OT:

- Public sector investments should support rather than preempt private initiative. Accordingly, only those investments where the private sector is unlikely to be interested for sometime to come would be undertaken by the public sector. Even then, where possible, the investments should be designed in a manner so as to facilitate privatization at a later date.

- Because of the relatively short time-horizon for Phase I, it is unlikely that significant new external assistance for financing investments in the OT would be available during this phase, and, hence, no investments have been proposed for this period. It should be noted that some of the rehabilitation works in water supply, sewerage, education, transport and electricity could be taken up without additional technical studies. Accordingly, the implementation of such investments could be launched as soon as the financing is mobilized.

- It would not be feasible during the medium term to implement investments whose design and viability depend upon agreement on the eventual political arrangements; accordingly, such investments are considered for implementation only in Phase III.

- The investment program for the medium term would also need to recognize the limited institutional capacity, especially during the early years. In some cases, therefore, even investments that do not

depend upon resolution of political uncertainty might need to be spread over a longer period, thus spilling into Phase III.

- All feasibility studies and project preparation work for investments during the first 2-3 years of the "self-governing" arrangements are taken up in the short-term while those concerning the rest are included for financing in the medium-term.

- To lay the foundation for sustainable development, TA and training to support institution-building, manpower development, improvements in the OT database and analytical work to sharpen policy choices facing the OT should be launched as early as possible.

Investment Needs

5.5 Based on the above framework, the public sector investments (in constant 1993 prices) are estimated at US$1,350 million for the medium term and US$1,600 million for the long term (Table 5.1). The focus during the medium term will be on the rehabilitation and upgrading of the local level public infrastructure and services in water supply, sewerage, solid waste, road transport, electricity, education and health. In addition, some support would be needed for strengthening agricultural support services and for improving natural resource management through erosion control measures and forestry development. The tentative priorities for the long term include, besides the completion of the rehabilitation works started in Phase II, power generation facilities (preferably as part of a regional power grid), selective capacity expansion in the main road network, capacity expansion in health and education systems, the design of a modern education curriculum, the strengthening of university education and the improvement/construction of airport facilities.

Table 5.1: Public Sector Investment Needs in the OT[1/]
(US$ million, constant 1993 prices)

Item	Medium Term [2/] (7/94-6/99)	Long Term (7/99-6/04)
Water & Wastewater	280	200
Transport	330	500
Power	350	600
Solid Wastes	100	
Education	190	160
Health	60	90
Agric. Supp. Services	20	10
Nat. Res. Management	20	40
TOTAL	1,350	1,600

1/ Figures shown are for commitments during the indicated period. Actual disbursements may lag commitments by up to three years.

2/ About US$70M of these investments could be launched as soon as financing is available.

5.6 The above investment estimates are, in most cases, based on very limited data. Systematic assessments of the current conditions of the existing infrastructure or their rehabilitation needs are generally unavailable. Accurate unit cost data is also lacking in most cases, and the available figures often require adjustments to reflect experience in neighboring countries. Finally, very few of the proposed investments have been subjected to rigorous financial and economic viability tests. Accordingly, the estimates here are merely indicative of the broad investment priorities and the likely investment magnitudes. The picture is particularly cloudy in this respect for long-term investments where the usual data limitations are further compounded by design uncertainties related to the outcome of the ongoing bilateral negotiations.

5.7 Preliminary analysis indicates that the investments proposed for the medium term should directly generate about 70,000 man-years of employment in construction works, i.e., the equivalent of about 14,000 full time jobs for the 5-year period of Phase II . Considering that many of the Palestinians employed in Israel have been construction workers, the implementation of the proposed program should, thus, help reduce significantly the adverse effects of the shrinking employment opportunities in Israel.

Technical Assistance Needs

5.8 To ensure that the scarce aid resources make the greatest possible contribution to improved living standards in the area, detailed project feasibility studies are needed in most cases. In addition, there are technical assistance and training are needed to foster institutional development and enhance implementation capacity. The cost of the preparatory studies, technical assistance and training proposed for launching in the short term is estimated at US$35 million. A further US$50 million of TA would be needed over the medium term (Table 5.2). Much of the second phase TA could perhaps be "piggybacked" to investment operations resulting from the TA proposed for the short term.

5.9 Slightly over half of the TA would be for project preparation and feasibility studies, done in sufficient detail so that the resulting projects and programs would be ready for appraisals by the donor community. The rest would be used for institutional development activities including, *inter alia*, the following:

- Studies and training to strengthen local governments and public administration in the OT.
- Studies on trade, monetary and fiscal choices facing the OT in the medium-term.
- Studies to decide on the future organizational structure of the electric and water utilities in the OT.
- Training programs for the Palestinian staff in the electric, water, highways and sanitary sectors.
- The review and revision of the legal and regulatory environment affecting private sector activities.
- Studies to modernize and strengthen the financial sector.
- Studies to help develop housing sector policies and institutions.
- The development of an action plan and building capacity for environmental management.
- Socioeconomic surveys and the preparation for a population census.
- The strengthening of the agriculture database.

Table 5.2: Technical Assistance Needs in the OT[1/]
(US$ million, constant 1993 prices)

Item	Short Term [2/,3/] (to 6/94)	Medium Term [3/] (7/94-6/99)
Water & Wastewater	8.0 (6.5)	10.0 (8.5)
Transport	6.0 (4.5)	12.0 (8.5)
Power	7.0 (3.0)	7.0 (5.0)
Solid Wastes	1.5 (1.0)	
Education	4.0 (3.5)	1.5 (1.5)
Health	1.0 (1.0)	1.0 (1.0)
Agriculture	1.5 (0.5)	2.5 (0.5)
Local Govt. & Public Administration	1.0	3.0
Housing	0.5	2.0
Monetary, Fiscal and Trade Issues	0.5	0.5
Inst. Framework for Public Utilities	1.0	1.5
Env. Action Plan and Management	0.5	5.0
Socioeconomic Studies and Surveys	2.0	2.5
Business Support Services	0.5	1.5
TOTAL	35.0 (20.0)	50.0 (25.0)

1/ Figures shown are for commitments during the indicated period. Actual disbursements may lag commitments by up to two years.

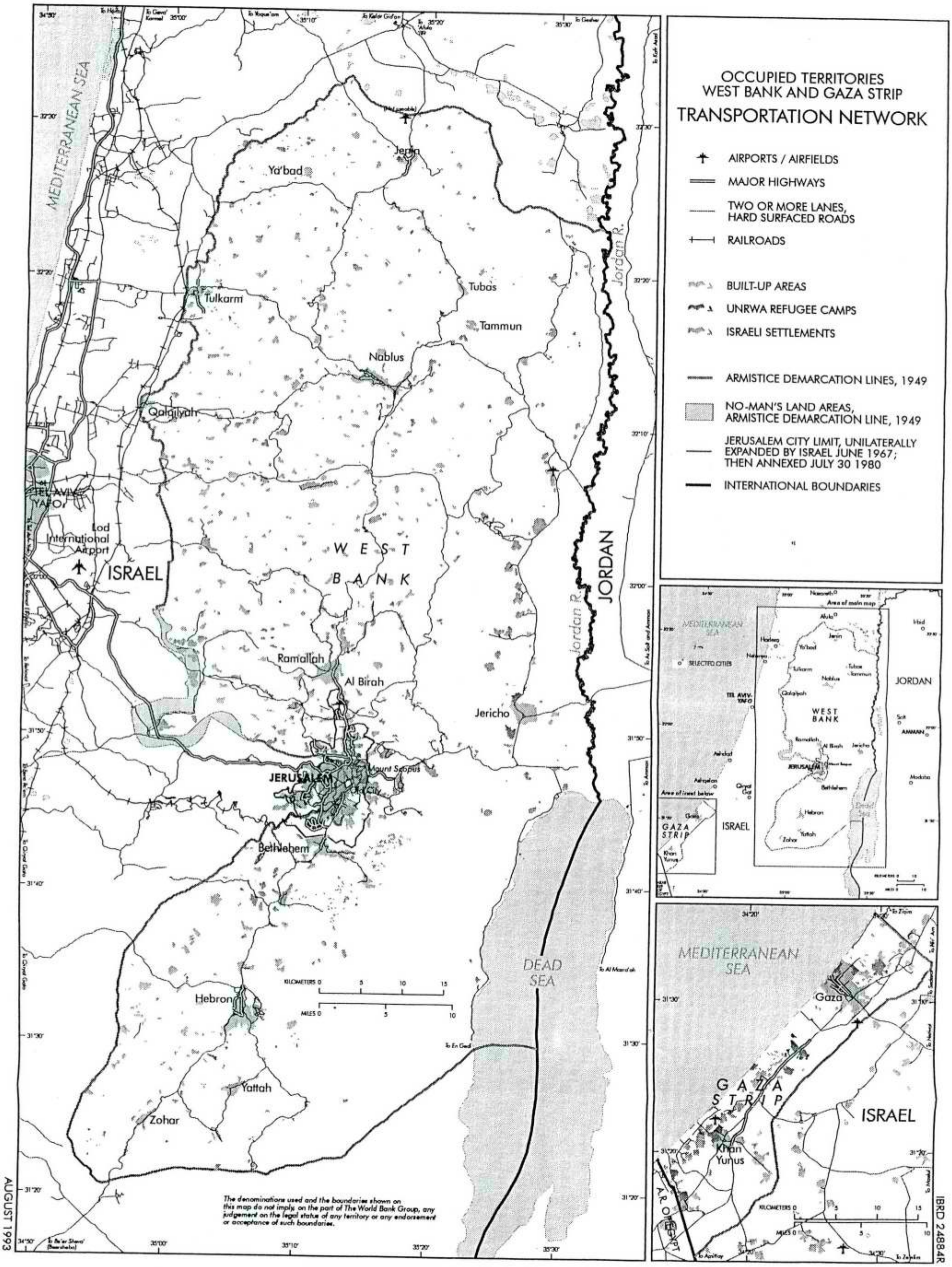
2/ Some of this TA may have been initiated recently with support from bilateral and multilateral donors.

3/ Figures in parenthesis are the respective TA amounts required for project feasibility studies and project preparation work.

Next Steps

5.10 To have a shelf of priority projects ready for implementation as soon as adequate progress is made in the bilateral negotiations, and to strengthen institutional capacity, it is important that the preparatory studies and institutional development activities be initiated without delay. Provided there is a broad agreement among the concerned parties on the analysis and findings of this report, the next step would be for the donor community to mobilize funds to the tune of US$35 million to help launch the TA activities proposed for the short term.

5.11 Because of the relatively large size of the proposed TA program and the lack of experience in the OT in managing such programs, careful attention would need to be paid to the implementation arrangements. For the TA to be relevant and useful, clearly the Palestinians would need to have a major decision-making role in the design and administration. Equally important, the success of the TA program, for the short term, would require significant support from the CA; the implementation arrangements would, therefore, also need to be developed in close cooperation with the CA. Ensuring accountability in the use of TA funds would be another important consideration in designing the implementation arrangements.



AUGUST 1993

IBRD 24884R

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Report No. 11958
(6 Volumes)

DEVELOPING THE OCCUPIED TERRITORIES

AN INVESTMENT IN PEACE

VOLUME II: ECONOMIC STRUCTURE AND MACROECONOMY: PAST PATTERNS AND FUTURE OPTIONS

AUGUST 17, 1993

Middle East Department
Middle East and North Africa Region
World Bank

CURRENCY EQUIVALENTS
(As of January 1, 1993)

NIS 1.00 = US$ 0.361
US$ 1.00 = NIS 2.764
JD 1.00 = US$ 1.453
US$ 1.00 = JD 0.688

GLOSSARY OF ABBREVIATIONS

CB	=	Currency Board
CBS	=	Central Bureau of Statistics
CFA	=	Communaute Financiere Africaine
CU	=	Customs Union
EC	=	European Community
EFTA	=	European Free Trade Association
FTA	=	Free Trade Area
GDP	=	Gross Domestic Product
GNP	=	Gross National Product
ILO	=	International Labour Organization
JD	=	Jordanian Dinar
JPC	=	Jordanian-Palestinian Committee for the Steadfastness of the Palestinian People in the Occupied Homeland
NAFTA	=	North American Free Trade Area
NGO	=	Non-Governmental Organization
NIS	=	New Israeli Shekel
OECD	=	Organization for Economic Cooperation and Development
PLO	=	Palestine Liberation Organization
ROW	=	Rest of the world
TFP	=	Total Factor Productivity
UNDP	=	United Nations Development Project
UNRWA	=	United Nations Relief and Works Agency
VAT	=	Value-Added Tax
WBG	=	West Bank and Gaza
WHO	=	World Health Organization

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PREFACE

1. At the request of the sponsors and organizers of the Middle East Peace Talks, the World Bank has been supporting the work of the Multilateral Working Group on Economic Development and Regional Cooperation by providing analyses of the key economic issues and developmental challenges facing the Middle East region. At its second meeting in Paris in October 1992, the Working Group requested the Bank to expand its contribution to include, *inter alia*, an assessment of the development needs and prospects of the economies of the West Bank and the Gaza Strip (commonly referred to as the Occupied Territories). In response to this request, a Bank mission visited the Occupied Territories during the period January 21-February 24, 1993. The mission comprised five teams focusing on the following areas: Private Sector Development, Agriculture, Human Resources, Infrastructure and Macroeconomics. Each team was in the field for about two weeks. The mission was led by Prem Garg who, together with Samir El-Khouri, stayed in the field throughout to provide continuity and guidance to the five teams. The staffing of the five teams was as follows:

Agriculture:	Gert van Santen (Team Leader) Ulrich Kuffner (Water Resource Engineer) Merle Jensen[1] (Horticulture Specialist)
Human Resources:	Fredrick Golladay (Team Leader) Maureen Field[1] (Education Specialist) Radwan Ali Shaban[1] (Human Resource Economist)
Infrastructure:	Alastair McKechnie (Team Leader) Ulrich Kuffner (Water Resource Engineer) Lawrence Hannah (Urban Specialist) Nail Cengiz Yucel (Transport Sector Specialist) Ted Moore[1] (Power Engineer)
Macroeconomics:	Michael Walton (Team Leader) Samir El-Khouri (Fiscal Analyst) Ishac Diwan (Macroeconomist)
Private Sector Development:	Albert Martinez (Team Leader) Robert Mertz (Financial Sector Specialist) Joseph Saba (Legal Specialist) Dileep Hurry[1] (Regulatory Environment and Tourism Specialist)

2. Mission members travelled extensively in the West Bank and Gaza, visiting municipalities, farms, businesses, industries, academic institutions, refugee camps and NGO-run facilities. Mission members also travelled in Israel, as needed, and paid several visits to Amman. The representatives of the key bilateral and multilateral donors in Jerusalem, Tel Aviv and Amman responsible for the Occupied Territories were kept briefed about the work of the mission. Close contact was also maintained with the field staff of UN agencies.

1/ Bank consultant.

3. The Bank mission was received warmly by all sides, who took keen interest in the work of the mission and provided superb logistical and counterpart support for the field work. The main counterparts on the Israeli side were the Bank of Israel and the Civil Administration in charge of the Occupied Territories. On the Palestinian side, the main counterparts were the Technical Committees of the Palestinian Team to the Peace Conference, consisting mainly of Palestinians who are members of the bilateral or multilateral peace teams. The Ministry of Planning was the main contact on the Jordanian side. The Bank would like to thank all concerned parties, especially the Israeli, Jordanian and Palestinian hosts, for the excellent support and cooperation that the Bank mission received for this field work.

4. This report is based on the findings of the above mission. The report is in six volumes:

- **Volume I** provides a summary ***overview*** of the key findings and recommendations of the study. After commenting selectively on the current socioeconomic situation in the OT and its evolution over time, it discusses prospects for sustainable development in the future and outlines the priority agenda of policies and programs needed to promote such development.

- **Volume II** explores the strategic choices at the ***macro*** level that will be faced by the OT in the future and the implications for economic relations between the OT and the rest of the region. The study looks at the current situation and its evolution over the past 25 years. The study then examines several policy choices for the future affecting the structure of development in the OT. Finally, it outlines some illustrative scenarios for the future, focussing on the consequences of current developments in the region.

- **Volume III** reviews the performance of the ***private sector*** (including, in particular, the industry and tourism sectors) in the OT. The study assesses the environment in which the private sector operates and its future prospects and makes recommendations for accelerating private sector development in the future.

- **Volume IV** reviews the evolution and structure of the ***agricultural*** sector in the OT; analyzes its current characteristics; assesses OT competitiveness in the immediate and longer term; outlines the main policy options and their implications; and provides a preliminary assessment of sectoral financial and technical assistance (TA) needs.

- **Volume V** assesses the current situation in the ***infrastructure*** sectors (electricity, water supply and sanitation, transport, housing and solid waste services) in the OT; identifies the major issues confronting these sectors; and outlines priorities for TA and investment needs. As local authorities are major institutions in the delivery of public services in these sectors, the study also includes a review of their current situation and makes recommendations for improving the functioning of municipalities.

- **Volume VI** reviews the current status as regards ***human resource*** development; analyzes options for enhancing individual welfare and labor productivity in the OT; and outlines investment and TA priorities for strengthening existing programs and for laying the foundation for later reforms.

5. It is worth highlighting two limitations of this study right at the outset. First, a number of key issues bearing upon the future development of the OT (e.g., the allocation of land and water resources, the disposition of Israeli settlements in the OT, the future status of expatriate Palestinians, the territorial issues surrounding Jerusalem and, most importantly, the nature of the proposed "self-governing" arrangements for the OT) are the subject of ongoing bilateral negotiations between the Israelis and the Palestinians. The resolution of these issues is likely to be based primarily on political and security considerations. As the Bank mission to the OT was a *technical mission*, with neither the mandate nor the expertise to deal with political or security aspects, this study does not take any positions on issues that are on the agenda for bilateral negotiations. The focus instead is on policies, institutions and investments--where optimal choices are largely invariant to the eventual political arrangements to be agreed at the bilateral negotiations. Thus, for example, while analysing, where appropriate, the economic links between East Jerusalem on the one hand and the West Bank and Gaza on the other, the report avoids making any judgements regarding the future status of East Jerusalem.

6. Second, the study has had to cope with very serious *data gaps and inconsistencies*. Much of the data on the OT are, directly or indirectly, from official Israeli sources. There are, however, serious gaps in the OT data base. A population census has not been carried out in the OT for more than 25 years. As a result, most of the demographic and labor force data are based on extrapolations and on sample surveys, the reliability of which are undermined by problems of nonresponse, especially since the onset of the *Intifada* (popular uprising) in 1987. Data on East Jerusalem and on Israeli settlements in the OT, both of which are treated as part of Israel by the official Israeli sources, are mostly unavailable. Data available on trade between the OT and Israel and on the profitability and competitiveness of the agricultural, industrial and service enterprises are also very limited. Data on the OT from Palestinian and Israeli nonofficial sources are sparse and selective. Also, Palestinian data, when they exist, are often based on *ad hoc* surveys that do not lend themselves easily to cross-sectional or longitudinal comparisons. In many instances, data differ between sources, and, even when the same source is used, there are gaps and apparent inconsistencies. Given these data problems, the report uses estimates that appear most plausible in light of the mission's field observations. In cases where the data differences among various sources are particularly sharp (e.g., population, unemployment and social indicators), the report attempts, where possible, to examine the reasons for these differences and to indicate the implications of alternative estimates for the results of the analysis.

7. In view of the limitations on the mission mandate, the data difficulties and the time and resource constraints, this study can only be considered a beginning. The analysis in the study, especially for the longer term, is necessarily incomplete; as, and when, progress is made in the bilateral negotiations, the study will need to be updated and expanded to take account of the agreements reached. Also, notwithstanding the care exercised in locating and interpreting the data from various sources, the empirical underpinnings of this study leave something to be desired, and, therefore, the conclusions of the study should be treated only as indicative of broad trends and priorities. Further, in-depth studies and project feasibility work will be required before the findings of this report could be used to make operational decisions.

8. An earlier draft of this report was discussed with the Israeli, Jordanian and Palestinian authorities by a Bank mission to the region during July 12-26, 1993. Where appropriate, the report has been revised to incorporate the comments received by the mission during the July discussions.

I. OVERVIEW AND SUMMARY

A. Introduction

1.1 The economy of the West Bank and Gaza is presently in a state of crisis. Following the Gulf war in January 1991 there was a substantial reduction in Palestinian employment in most Gulf states. With the partial closure of the border in March 1993 employment in Israel fell drastically and in June was still less than half of previous levels. Municipalities are starved of cash. Many public services are in disarray: power outages are frequent, drinking water is often below WHO health standards, and garbage rots on the streets in refugee camps in Gaza. Meanwhile, urban land prices have gone through the roof in West Bank towns and Gaza City.

1.2 The present crisis in the Occupied Territories is in sharp contrast to a history of large increases in incomes, which are now about three times the level of 25 years ago. Household conditions improved substantially, with a many-fold rise in possession of consumer durables (albeit many second hand) and in water and electricity connections, including in relatively disadvantaged refugee camps and villages. There was also a substantial reduction in infant mortality and rise in school enrollments. Since unskilled labor played a central role in past growth, it is almost certainly the case that the poor participated in the gains implying a large reduction in poverty.

1.3 This report attempts to analyze the issues and choices thrown up by the current state of development in the OT and the agreement which is expected to emerge from the on-going peace negotiations. The report attempts to adhere to a strictly economic perspective, recognizing that many of the questions will be subject to bilateral negotiations between the Israelis and Palestinians. The companion volumes on economic infrastructure, human resources and social services, private sector development and agriculture examine sectoral conditions and policy choices. As with the other volumes, this report must contend with uncertainty surrounding the outcomes of present and future negotiations.

B. Past Pattern of Development in the Occupied Territories

1.4 Chapter 2 of the report analyzes the economic history of the OT during the past 25 years and relates the present crisis to the uneven pace and somewhat distorted nature of growth in the past. Throughout the 1970s growth was extraordinarily fast, and most of the gains in incomes occurred then. The burst of growth in the 1970s was largely due to two phenomena: the economic gains from a sudden opening up of opportunities in Israel—especially for labor employment, but also for trade in many (but not all) goods; and the growing employment opportunities for Palestinians in the booming Gulf countries during the second half of the decade. These developments contributed to rapidly rising money incomes, strong demand-led growth in some domestic economic activities, and high savings, with a large portion of savings financing investment in housing.

1.5 Growth stalled in the early 1980s, and decline set in during the second half of the 1980's. These changes reflected changes in the external environment, some of which were associated with the region-wide slowdown in growth. Chapter 2 surveys the sequence of adverse economic shocks experienced by the West Bank and Gaza during the 1980s. Some of these were temporary or once-and-for-all: the Israeli high inflation and related devaluations, the border closure during the Gulf war, and the devaluation of the Jordanian dinar. More important for the future are the apparently permanent shocks, that add up to a cumulative and rising loss in past sources of income and growth. Gulf labor demand slackened with

the weakening of the oil market in the mid-1980s, contributing to the decline in employment opportunities for skilled Palestinians. Israeli demand for Palestinian employment leveled off in the 1980s--and after the *Intifada* would have declined further if large falls in employment in manufacturing and in services had not been offset by rising construction employment, boosted by the boom in housing for immigrants to Israel.

1.6 Incomes appear to have held up surprisingly well given the scale of these shocks. Two factors explain this: first, domestic production was reasonably robust, and to some extent substituted for incomes from abroad; and second, there is evidence of large drawdowns of savings held domestically and abroad, especially in 1991 and 1992. Drawing down savings is not sustainable of course and additional capital inflows were generated by returnees from the Gulf, partially motivated by expectations of peace in 1992. Indeed this appears to have generated a mini-boom in some parts of the OT during this period, especially in domestic construction.

1.7 In addition to an uneven pace of growth, the Occupied Territories display an unusual, skewed pattern of development in comparison with other economies. Investment has been high, at 25 percent of GNP in the West Bank, at some points up to 40 percent in Gaza, but this investment created no new jobs until the late 1980s--an unusually high proportion went into investment in housing. Private investment in directly productive activities has been low, and industrialization, at 7 percent of GDP in the West Bank and 10 percent in Gaza, is way below other economies of the same income level. Trade in goods is highly concentrated on Israel, as a result of the abnormal condition associated with the occupation. And there is an enormous trade imbalance, of the order of 28 percent of GNP.

1.8 There are also imbalances in the provision of public goods. Public investment in economic and social infrastructure has been unusually low at less than 3 percent of GDP. Some of the imbalance in social services was made up by UNRWA and, especially in health, by unusually high spending by the private and non-governmental sectors, but this has been at the cost of a proliferation of disparate services, without any overall sectoral framework.

1.9 Many factors explain the past pattern of development. Political uncertainty over the long-run future of the West Bank and Gaza undoubtedly played a role: investment in human capital is more secure than investment in machines when the economic future looks uncertain; and large investment in housing seems related to the lack of other savings instruments, and possibly to the urge to establish stronger property rights on land. In addition, four features of the policy environment (including the structure of international economic relations) appear to have been of major importance:

- asymmetric trading relations
- regulatory constraints
- fiscal compression.
- declining access to natural resources

1.10 Trading opportunities were distorted, in large part by the regional political situation. Manual labor and manufactures had fairly free access to Israel, as did skilled labor elsewhere; but both agriculture and the *expansion* of manufactures were restricted. All goods had restricted access to much of the region, because of the Arab boycott, restrictions on trade with Jordan (from both sides), practical difficulties of trading through Israel and inadequate trading infrastructure. There are no restrictions on imports of Israeli goods into the Occupied Territories, but for imports from the rest of the world the economy

operates under the quite protectionist Israeli trade regime. Israel has, however, embarked on an ambitious program of trade liberalization.

1.11 An adverse regulatory environment, especially in terms of investment approvals, and an uncertain legal and tax framework inhibited the expansion of parts of the private sector, for example of medium and large scale industrial firms. The lack of a strong formal financial system did not help. It is notable, however, that where the private sector did grow--in agriculture and small-scale manufactures, the impressionistic evidence is of a productive private sector with substantial rises in labor productivity. In the period of rapid growth in the 1970s total factor productivity growth was very high, at around 5 percent per annum, accounting for almost two-thirds of total growth.

1.12 Low spending on public goods has been due to fiscal compression, which was in turn a consequence of low tax receipts, a close to balanced budget practice for the civil administration and municipalities, and the inability of utilities to borrow to invest (in contrast to international practice). Low public sector revenues compared with other economies – at 16 percent of GDP and 11 percent of GNP -- are due in part to the fact that some tax payments by Palestinians accrue to the Israeli treasury (tentatively estimated at 8 percent of GDP for 1991). Even after including the gross estimates of taxes accruing to the Israeli treasury, the tax effort is still relatively low.

1.13 Current restrictions on access to water, including administrative limitations on surface and aquifer water harvesting, and the high costs of water caused by difficulties to renew inefficient and worn-out wells have meant stagnation of the amount of water used for Palestinian cultivation. In selected areas, notably in the Gaza, increasing salinity levels caused by excessive extraction have virtually halted agricultural production. Loss of land to settlements has increased during 1980s and early 1990s. In addition to built-up areas, this involves some traditionally irrigated land in the Jordan Valley, and areas which are currently irrigated in the West Bank and Gaza. The lack of clear zoning regulations and public land utilization policy has also created uncertainty and has become a barrier to industrial expansion. The freeze on the building of housing on land beyond the municipal boundaries has acted to distort land prices.

C. Post-Peace Economic Strategy

1.14 A peace agreement, when it occurs, is expected to lead to a transition period of several years. This will open up new options for the West Bank and Gaza. Some will become choices for the self-governing authority, which is expected to take over from the Civil Administration. Others will be the product of present and future negotiations between the Palestinians and governments in the region. However we assume that in the interim period there will be one integrated economy, that implementation of economic strategy will be by a self-governing authority with command over economy-wide and sectoral decision-making, but that,in some areas (e.g. trade policy), economic conditions will be a function of joint decisions with Israel, Jordan and other parties (notably Arab and OECD states for trade options).

1.15 Within these parameters there are a broad range of possibilities. Chapter 3 of the report examines how policy options affect the structure of development. Should the West Bank and Gaza be moving to disengagement from Israel or continued integration on different terms? What would be required to get economic growth going in the wake of the series of adverse shocks the economies have received? Is it

desirable (and feasible) to have an independent trade and tax policy? How can public spending be financed? Would a separate currency help or hinder macroeconomic stability and the environment for growth? And what is the role of official and private foreign resources in financing development? While it would be premature to make definite prescriptions, Chapter 3 attempts to explore some of the benefits, costs and implications of these choices as summarized below.

1.16 In addition to setting the basis for recovery and sustainable growth, there is also a need for measures to tackle short-run crisis conditions, especially if the restricted employment in Israel continues. The present crisis has short and longer-term dimensions. The short-run cutoff in employment, if maintained, would require emergency measures (such as employment schemes) to prevent significant drops in incomes. Some measures could be taken prior to a peace agreement, but this is a political matter that falls outside the domain of this report. In the medium to longer-term, there is a need to effect a reorientation of economic activity to rectify current imbalances, and develop new sources of growth. This will depend critically on private investment – from within and from abroad – and especially investment in productive activities. International experience indicates that such private investment does not occur in situations of strategic uncertainty, but can respond swiftly once conditions are supportive, as in much of Latin America in the early 1990s, or more recently in Lebanon. Some measures can be undertaken in the short run, but the resolution of economic issues is unlikely to be possible without a peace agreement.

1.17 The reduced political uncertainty that should follow a peace agreement would provide the preconditions for a sustainable recovery. As the 1992 boom illustrates, private money quickly followed expectations of peace, though it probably went mainly into real estate. Resolution of strategic uncertainty will require policy changes to support the kind of adjustment and restructuring required for future growth. Each of the four areas noted above would need to be tackled: asymmetric trading relations; the regulatory environment; fiscal compression; and declining natural resources. A start has already been made by the civil administration in the significant deregulation and improvement in the investment environment introduced in 1992. The companion volume on private sector development concludes that effects on business activity has, so far, been limited and outlines what more would be necessary to provide a sound legal and business environment. Equally important will be redressal of some of the shortages of public goods: for example in power, in water supply and sewerage, in industrial land and in education. As the volumes on economic and social infrastructure discuss, these will require rehabilitation programs, new investments, and establishment of the institutional framework for sound sectoral policy.

D. Trade and Structural Policy Options

1.18 While action on the regulatory framework and availability of public goods will be necessary to lift economic activity under any circumstances, the reorientation of economic activity will be conditioned by choices over the structure of international economic relations and domestic incentives. Some changes have already been made for the Palestinians, with the loss of employment in the Gulf and Israel. Trade in goods will have to substitute for movement in labor for sustained growth. What approach should be adopted on the direction of economic activity? The West Bank and Gaza face, in principle, a range of choices, from free trade with neighboring countries, to running a much more closed import regime to attempt to foster domestic industry. (Some of these choices will, of course, be subject to the ongoing negotiations).

1.19 Chapter 4 of this report lays out some of the alternatives for trade and incentive policy. There are two guiding principles. First, the small size and location of the West Bank and Gaza strongly support the desirability of a strategy based on trade expansion rather than restriction. There is especial interest in trade expansion to Jordan and the rest of the Arab world. Second, while a major reorientation in trade – to the region and to the rest of the world – would be expected to occur over the medium term, any sharp cut in trade in goods to Israel could have large short-run costs, because of Israel's predominance as a trading partner. From the perspective of the West Bank and Gaza a strategy that attempted to open up opportunities elsewhere whilst maintaining quite open trade relations with the Israeli market would make sense.

1.20 An approach that might meet these principles is a free trade area with Israel linked with a significant opening of trade to Jordan. A free trade area with Israel would differ from the present (partial) customs union in allowing the West Bank and Gaza to have different tariffs from Israel with third countries. It would maintain open trading relations with Israel, but would potentially avoid protectionist aspects of Israel's trade regime that are ill-suited to the economic structure of the economy of the Occupied Territories. This should be linked with an opening up of trade with Jordan, including the possibility of a free trade area with Jordan as well. From Israel's point of view, the trade diversion that is likely to take place would be compensated by trade creation linked to the termination of the Arab boycott. The success of any trade strategy would ultimately depend on how far new markets can be opened up: in the region, in the OECD, and in Israel. Opening of regional markets will depend both on the overall process of negotiations (since it is unlikely that trade with the West Bank and Gaza can be politically separated from trade with Israel, even if it can technically). An important issue for OECD markets concerns how far the Occupied Territories can participate in the current free trade agreements Israel has with the EC, EFTA and the US. (The EC agreement is already applicable to the Occupied Territories). The key issue in the Israeli market is agriculture, which remains protected, but where Palestinian producers have significant comparative advantage.

1.21 While a free trade area, perhaps involving Jordan, is attractive in principle, there may be problems in practice. First, there is no agreement on the location of a border between the West Bank and Israel. Second, any border will be leaky, and while an "invisible" border based on company accounts is feasible in principle, it may be costly to implement. Leakiness is likely to be of concern to Israel on grounds of lost revenue and lost protection, if the Occupied Territories were to have lower tax rates. Some of these practical difficulties are primarily of importance for an interim period. In the longer term, a border will presumably be agreed. Also protection should matter less to Israel if it sticks to its planned liberalization. By contrast, any changes in relations with the West Bank and Gaza that increases the risk of evasion of VAT would remain an issue of important concern for Israel, in view of the importance of this tax instrument. There may need to be closer harmonization of VAT rates than customs tariffs. Third, there is the question of the level-playing field in terms of ability of OT products to compete in markets where locally-produced goods are subsidized.

1.22 An approach that seeks to utilize the potential gains from interdependence also influences policy on infrastructure. In power, transport and telecommunications, as in trade, the West Bank and Gaza probably stand to gain most, and to acquire greater security, not through seeking economic "independence" in an autarkic sense, but through playing a role in interdependent networks in the region -- linking both to Israel and the Arab World. Similarly, maintenance of investment in human capital will remain crucial to support the traditional comparative advantage of Palestinians in the region.

1.23 Although in some areas pursuit of an independent macroeconomic policy is likely to be fruitless–e.g., attempts to have independent interest rates, given the degree of capital mobility–there are a number of other areas where macroeconomic policy makes sense: to deal with real and nominal shocks; to gain seignorage revenues; and to facilitate financial sector development and borrowing by governments and companies. Some of these require an independent currency and monetary policy, e.g., avoiding imported nominal shocks from other members of a currency union, facilitating real wage declines and perhaps, exceptionally, defaulting. There are, however, advantages and disadvantages associated with a separate currency. It provides additional discretion in some areas of policy, but is only likely to be effective once both the currency and overall macroeconomic policy acquire credibility. In a second set of areas independent policy is desirable and is commonly associated with a separate currency, but such a link is by no means necessary, e.g., managing "excessive" capital inflows, borrowing at home and abroad, and supervising/providing liquidity to banks, all of which can be managed by other instruments or without an independent currency. Seignorage is traditionally large in the region, but is unlikely to be so for the West Bank and Gaza (especially initially), because of the likely initial low level of credibility of a new currency, and high capital mobility.

1.24 The most precious commodity of macroeconomic management is credibility, something that is hard to earn, but can be obtained by being in a currency union(s) with a disciplined core or by establishing a track record of prudent macroeconomic, and especially fiscal, management. The Occupied Territories do not have such a history, and new institutions of macroeconomic management are likely to be both fragile and under pressure. If a currency is chosen, it could be desirable to start with a relatively restricted version, as in a Currency Board. This could gradually evolve to a fully fledged currency that brought greater discretion once discipline, and the associated demand for the currency, was well established.

1.25 The introduction of a currency would be an issue of concern for both Israel and Jordan, given the substantial holdings of Shekels and Jordanian Dinars by Palestinians. As Palestinians purchase a new currency with the two existing currencies, a new monetary authority or currency board would acquire potentially large quantities of Shekels and JDs, probably way in excess of the amounts that it would make sense to hold as foreign exchange. Yet redeeming these for other currencies would be a large shock (for monetary and foreign exchange management), especially for Jordan, given the estimated size of Palestinian holdings of JDs relatively to both total money and foreign exchange holdings in Jordan. The phasing and terms of any such large-scale conversion would have to be worked in the context of any currency reform.

1.26 Decisions over the role of the public sector will cut across many policy areas. There will be a need for a substantial strengthening of public action in many areas, including macroeconomic management, tax administration, the regulatory framework, the supervision of the banking system, the direct provision of public services and the design and implementation of sectoral policies. This will require strong support for institutional development in the public sector.

1.27 Strengthening of the public sector should not, however, imply pursuit of a highly interventionist strategy for economic development. International experience indicates that differentiated patterns of protection, activist industrial policy or public channelling of money via the financial system too frequently lead to economic disaster. In East Asia, where interventions were relatively common, they were bounded by a strong commitment to exporting and strong public sector institutions. And even in East Asian countries, the evidence suggests industrial policy failed to increase the share of promoted industries. Elsewhere promotion has rather led to a higher share of rents from protected inefficient activities. The

private sector volume discusses the desirable reforms in the legal, regulatory and financial systems to support strong private sector growth.

1.28 A further lesson of international experience is the centrality of fiscal discipline. Fast-growing East Asian economies are again distinguished by fiscal management that is prudent and pragmatic. Loss of fiscal discipline elsewhere has invariably led, sooner or later, to macroeconomic difficulties. Public spending is likely to be under great pressure to expand (notably for public employment), to avoid tough tax administration issues and, at least for a while, may face a soft budget constraint due to external capital inflows.

E. Scenarios for the Interim Period and Beyond

1.29 Chapter 5 of the report presents a range of scenarios that were developed to explore the potential trajectory of the economy in the future. These are illustrative, since little is known both about future conditions and economic responses. A critical factor in the scenarios is overall "policy": this encompasses a range of likely influences on future development. Good "policy" would include: a peace agreement that sufficiently resolves strategic uncertainty to provide the basis for private capital inflows and private investment in economic activities; relaxation of supply-side constraints, including deregulation, improvements in supply of economic infrastructure and industrial land and, over the long term, technical training; trade arrangements that allow substantial trade expansion (in the region and elsewhere); and a strong public finance framework with substantially expanded revenues (including taxes now accruing to the Israeli treasury) that both finance expanded public services and support rising public savings.

1.30 Under conditions of good "policy", gradual reduction of employment in Israel and adequate external public and private capital inflows, a growth rate in excess of 3 percent in per capita incomes is sustainable, with a total rise in incomes of the order of 40 percent in a decade. This requires initial inflows of $300 million per annum of official money in the first five years, declining to $200 million in the second half of the decade. Even with a low grant content of new money, debt indicators show no signs of problems of solvency.

1.31 If there is an abrupt labor cutoff with Israel--for example if employment were to stay at the 45,000 prevailing in June 1993 (it had risen slightly to 49,000 in July), the short-run situation is much worse, with potentially large rises in unemployment and falls in wages and incomes. This would justify short-run action, in terms of additional external inflows and poverty-related spending by the public sector, to moderate welfare declines. However, if policy conditions are strong, the economy could recover and again get onto a steady growth path in the medium term, with a rise in per capita incomes of the order of 3 percent per annum.

1.32 By contrast, if policy conditions are not resolved the outlook is grim. There could easily be declines in income per capita-- of the order of 20 percent in a decade-- even with smooth labor return, with a worse outlook, especially in the short run, if there is an abrupt labor cutoff. Such a growth scenario would undoubtedly be associated with rises in poverty, worsening social conditions, and, potentially, rising violence. Poor "policy" could be offset by official capital inflows, but only for a while, since private capital is unlikely to flow in when the political and policy conditions are uncertain or weak and little more than stagnation appears feasible.

1.33 The scenarios should be treated as indicative. But they help illustrate the main implication of much of the analysis in these volumes: the West Bank and Gaza have the potential to recover from both the loss in past sources of growth and from distortions in the pattern of development, and to become viable, growing economies, provided that the policy and structural conditions are right. In the absence of sound domestic policy, adequate trading opportunities with other economies or foreign capital, they could enter a period of sustained decline in incomes, employment and welfare.

F. Implementation

1.34 In order to translate the broad-brush policy recommendations contained in this report into workable solutions, it will be necessary to carry out further detailed studies in a number of areas to establish the practical, technical implications of economic reform and to deepen and expand local capabilities in economic policy-making as well as data-collection and statistical analysis.

1.35 The following list identifies seven areas requiring further in-depth analysis:

i) The technical and economic implications of alternative trade choices between Israel, the Occupied Territories and Jordan. This could be combined with the study of agricultural trade options among the three economies recommended in volume IV: The Agriculture Sector.

ii) The design and development of economic management capabilities (institutions and personnel) in the areas of a) current and development budgets, b) development policy and, possibly, c) central banking.

iii) Tax options and tax administration.

iv) Monetary and financial sector management issues. This could be combined with the study on financial sector institutional development proposed in volume III: Private Sector Development.

v) The design of borrowing instruments (e.g., bond issues) and overall borrowing strategy for the external and public sector, including donor coordination and the appropriate mix of concessional and market borrowing.

vi) The design of short-run safety measures to ease adjustment within the labor market. These might include public works schemes and their linkage to a rehabilitation program.

vii) Techniques of data-collection and statistical analysis at the macro-, sectoral and household levels.

1.36 In order to meet the goal of deepening local capabilities in these seven areas, it is essential that the analysis be carried out by local experts supported by international technical assistance. It is also important that the experience already possessed by those Palestinians working for the Israeli statistical offices in the West Bank and Gaza as well as various non-governmental research centers be used as a foundation on which to build.

1.37 In addition to close and sustained collaboration between local and foreign experts, the process of acquiring and deepening expertise in the various areas should include study tours to other countries exhibiting desirable economic and statistical practice in the relevant areas, exposure to international survey techniques (such as the Living Standards Measurement Survey, appropriate labor survey techniques, etc.), as well as other forms of "on-the-job" training.

1.38 The coordination and smooth execution of this program would be greatly enhanced by the existence of a single institution based in the West Bank and/or Gaza with a mandate to supervise the collection and publication of economic data and coordinate research into the relevant areas of economic policy.

II. ECONOMIC HISTORY SINCE 1967

2.1 The economies of the West Bank and Gaza are in a state of crisis. Real per capita income levels in 1990-91 were only marginally higher than a decade earlier. Following an apparent recovery in 1992, the present year of 1993 appears to be witnessing renewed decline due mainly to the border closures with Israel. Economy-wide economic difficulties affect many households via the labor market[1]. The available labor supply rose by 10 percent between 1987 and 1991 while employment has grown by only 3 percent. Unemployment (using a narrow definition) rose from 2-3 percent in the 1980s to 10 percent in the West Bank before dropping back in 1992. Open unemployment in Gaza is less severe, at 4 percent according to CBS numbers, but underemployment is probably much worse.[2] Hours worked per day fell by about 20 percent (See Figure 1). The premium on skills has virtually vanished: many well-educated Palestinians are paid no more than unskilled workers, and graduate unemployment is rising fast.[3] Many public services are in disarray: municipalities are starved of cash; power outages are frequent; public water supply is below WHO quality standards; and garbage rots on the streets in refugee camps in Gaza. Meanwhile land prices have gone through the roof (notably in the Ramallah industrial estate and other West Bank towns and in the wealthier parts of Gaza city) making new industrial investment immensely costly.

2.2 The vulnerability of the economies to relations with Israel is vividly shown by the consequences of the border closures of March/April 1993. In 1991, nearly 40 percent of Gaza's labor force and over 30 percent of the West Bank's labor force worked in Israel. Every day of complete closure to labor and products leads to a loss in income of almost $700,000 in labor earnings and $250,000 in exports for Gaza, out of a daily national income of $3 million. For the West Bank, every day of closure leads to a loss of income of $1.1 million in labor earnings and almost $600,000 in exports, out of a daily national income of $7 million. Currently, the closure is only partial, but its impact is still severe.

2.3 This picture of crisis contrasts sharply with a longer-term view of past development. The Occupied Territories were among the top ten fastest growing economies in the world during the 1970s period when measured in terms of GNP growth (Figure 2). The expansion in GDP per capita was somewhat lower, but was still large by international standards.

2.4 There has also been rapid progress in other factors affecting living standards. In Gaza, the refugee camps are relatively disadvantaged, yet 95 percent of households had running water and 100 percent had electricity in 1992, compared with 3 percent with water and 14 percent with electricity in 1974. Similarly, in 1992, 91 percent of all households in Gaza had television sets, 95 percent had radios and 17 percent had cars, as opposed to 8 percent with televisions, 85 percent with radios and 2 percent

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[1] There are cases where there is evidence of statistical bias in the reported data: population data may well underestimate actual population levels, and unemployment rates may be understated, though much of the difference may be definitional (see Shaban, 1993). These possible biases should not, however, affect analysis of changes over time.

[2] This is based on the ILO definition of unemployment used in the CBS labor force surveys. Some observers find higher unemployment rates (for example, Abu Shokor, 1990 found a rate of unemployment of 10 percent from a small survey in 1985, substantially higher than that found in the labor force surveys), though much of the difference could be definitional.

[3] See Angrist (1992) for an analysis of the premium on skills.

with cars in 1972. In the West Bank, villages are relatively poor; yet 79 percent of households had running water and 75 percent electricity in 1992, compared with 28 percent with water and 46 percent with electricity in 1974. Likewise, in 1992, 89 percent had television sets, 82 percent had radios and 16 percent had cars, compared to 10 percent with televisions, 75 percent with radios and 2 percent with cars in 1972. While much of the durable ownership is of second hand goods this still represents gains in welfare.

2.5 The Palestinians have traditionally enjoyed higher educational and health standards. Child mortality statistics are subject to some controversy in the Occupied Territories and it is difficult to quantify trends over time precisely given the range of estimates. (See the companion volume on Human Resources and Social Policy for further details on health and education.) Nevertheless the available evidence does suggest that mortality rates fell by more than two thirds between 1970 and 1990. The current overall infant mortality rate is estimated to be about 45 deaths per thousand live births in Gaza and 40-45 in the West Bank.[4] As regards education, the absolute position improved substantially in the past 25 years with large increases in primary and secondary enrollments. The gross enrollment ratio for basic education (grades 1-8) is about 102 percent and about 46 percent of children aged 15-19 were enrolled in post-primary schools in 1990. Illiteracy remains a significant problem with 28.5 percent of women within the age group 35-44 illiterate, compared to 7.4 percent of men in the same age group. There are now eight universities.

A. The Past Pattern of Growth

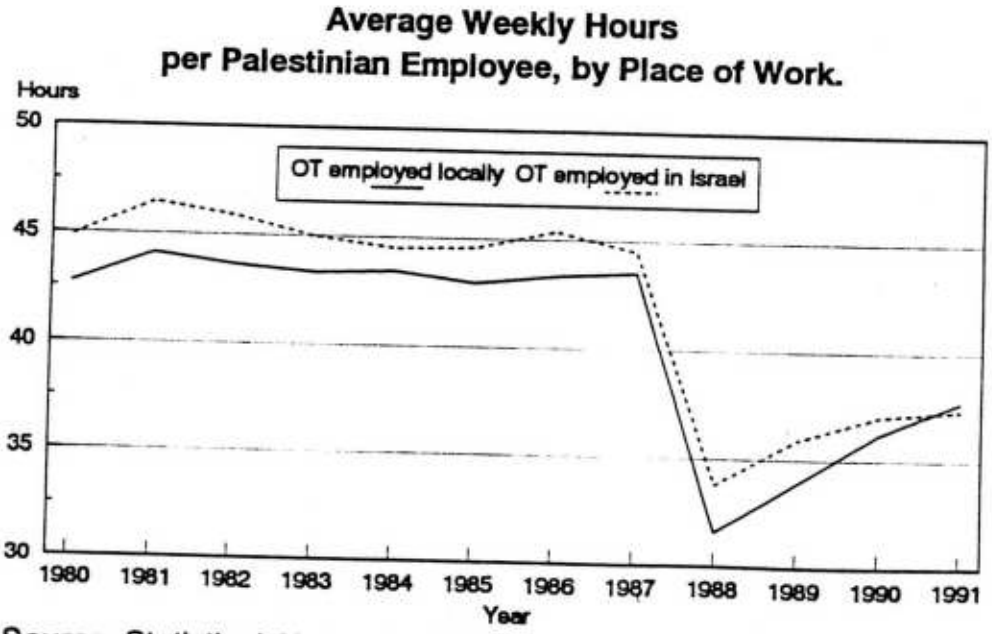
2.6 The above two descriptions look like two different economies, yet both are correct. At first sight, it might be tempting to attribute the current malaise to the *Intifada*, which began in December 1987, but this would be a mistake. The *Intifada* certainly led to disruptions in economic relations with Israel. Whether due to periodic border closures or strikes, curfews or shop closures, employment and trading activity has been adversely affected. Exports from Gaza fell by 37.5 percent between 1987 and 1988 and have not yet recovered, and, as noted above, there was a roughly 20 percent decline in employment in terms of hours worked, in both domestic and Israeli employment. Yet growth had already stalled in the early 1980s. The pattern illustrated in Figure 3 actually throws up two questions: Why was growth so fast in the 1970s? And why did it then slow so much from the early 1980s? (The highly cyclical character of the West Bank's growth displayed in Figure 3 is due to the biannual olive cycle.) The following paragraphs examine these questions as well as two other aspects of past development: unusual features in the structure of growth and the likely relationship with poverty.

Overall Growth: High in the 1970s, Stalled in the 1980s

2.7 Broadly speaking, the pattern of growth since 1967 can be broken into four phases: very rapid growth to the mid-1970s; slightly less rapid growth to the early eighties; stagnation until the onset

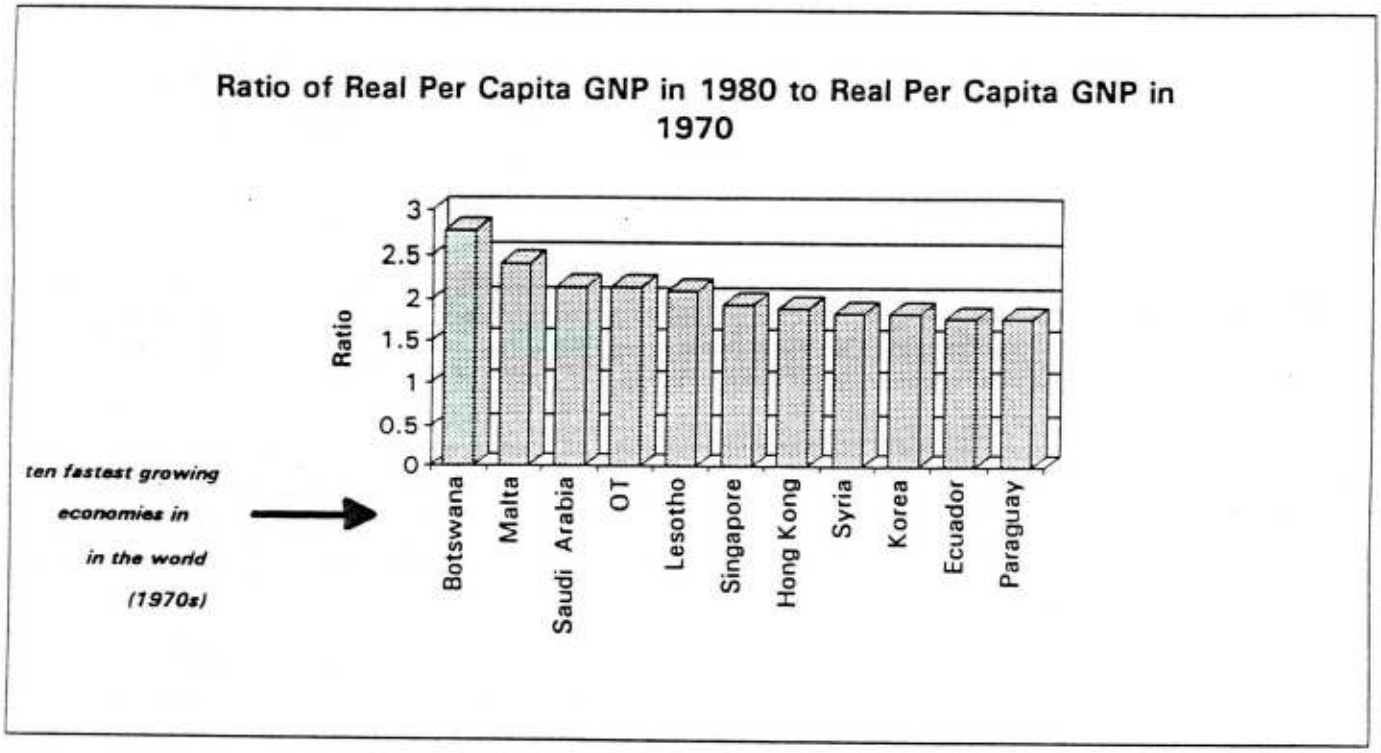
[4] Average of 1989 and 1990 figures. Source: World Development Reports, 1990 and 1993.

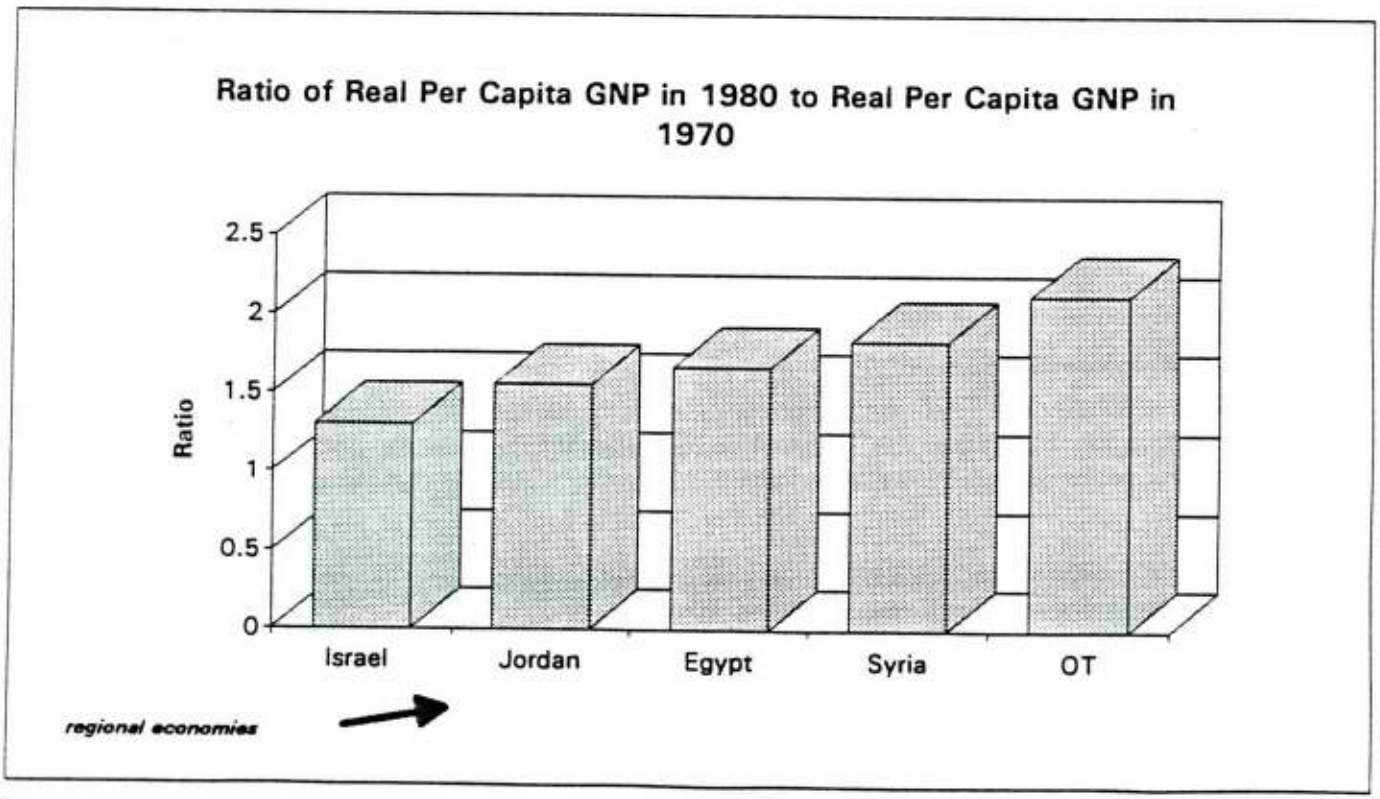
Figure 1: Occupied Territory Unemployment



Source: Statistical Abstracts of Israel, 1981-1992, Central Bureau of Statistics.

Figure 2: Growth in the 1970s





Source: World Bank Economic and Social Database

of the *Intifada* in 1987; and a decline thereafter (see Figure 3).[5] During the initial phase, growth in the Occupied Territories was driven by two major new sources of income growth: the consequences of integration with Israel, and the beginnings of the Gulf boom. The opening of the Israeli market to manual Palestinian labor brought a huge expansion in employment in Israeli firms. New trade and technological opportunities and reallocation of factors, helped generate almost equally rapid growth in domestic production. A reduction in low productivity agricultural employment (and cyclical unemployment) as well as more intensive marketization, especially in rural areas, further contributed to the fast growth rates.

2.8 The second phase which lasted till the early eighties also saw rapid growth. Remittances from the Gulf, together with foreign official transfers, continued to be buoyant: Gaza achieved a 1979 peak in per capita income which, with the exception of 1987, it has never recaptured. However a number of factors acted as a restraint on the previously very high rates of growth: slower growth in Israel following the 1979 oil shock negatively affected Palestinian growth; and the process of labor substitution away from low productivity agriculture toward employment in Israel was slowing down.

2.9 Overall, growth in output in the Occupied Territories during the first two phases was rapid, substantially exceeding growth in Israel during this period (Figure 4). Such rapid growth is a predictable consequence of sudden integration with a larger, richer, and technologically more advanced, neighbor.[6] (It is, however, worth noting that there remain large differences in levels, of about 8 times, between per capita GNP in Israel and that in the Occupied Territories. While growth in Israel slowed in the mid-1970s, growth in incomes and output in the Occupied Territories continued because skilled Palestinians were increasingly finding employment in the Gulf. International employment was well-diversified for the changing regional labor market: when the oil price rose, this hurt the Israeli economy, but boosted remittances from Palestinian workers and transfers from oil-rich Arab countries, offsetting weaker economic opportunities in oil-dependent Israel.[7]

2.10 The third phase lasted from the early eighties until 1987 during which growth stagnated. Although the data is weak here, the collapse of the regional oil boom almost certainly prompted a decline in worker remittances from the Gulf.[8] Other factors were also at work. While continued growth in Israel (Figure 4) actually provided some cushioning from the regional slowdown, the once-off gains from integration were already achieved, and employment growth in Israel was virtually flat from the mid-1980s. After the start of the *Intifada*, employment in manufacturing and services declined significantly, but this was offset by a rise in construction employment due to the housing boom in Israel associated with a surge of immigration. Recession and near hyperinflation in Israel had a serious impact now that a large proportion, 35 percent, of the Palestinian labor force worked in Israel and the major part of Palestinian trade was

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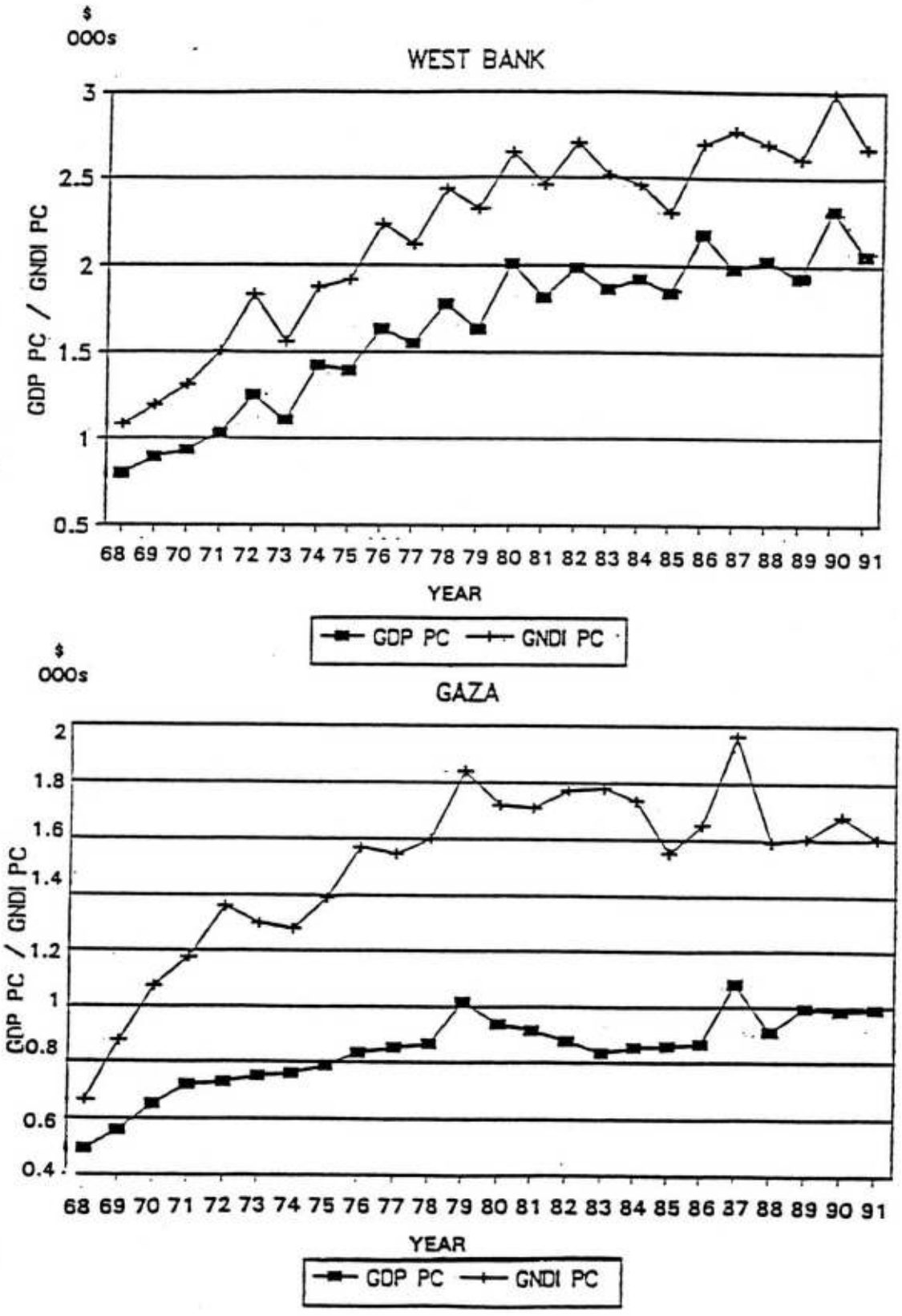
[5] Note that growth in 1991 was negatively affected by the Gulf War and the extended closure of the Occupied Territories. See Samir Abdallah Saleh (1993) for further discussion of patterns of growth in the Occupied Territories since 1967. See also Ephraim Kleiman (1991) for a general review.

[6] It is noteworthy that Lesotho was another fast-growing economy: it is a small labor-reserve economy, relatively well-educated in the African context, totally dependent on South Africa, in a customs and currency union with its large, dominant neighbor. Like the Occupied Territories, it grew significantly faster than its richer neighbor.

[7] See UNDP (1993) for further information on levels of official Arab transfers.

[8] See further Zakai (1986) for data on the decline in remittance.

Figure 3: Per Capita Gross Domestic Product & National Disposable Income



Source: Statistical Abstracts of Israel, 1981-1992, Central Bureau of Statistics

linked to the Israeli economy. It is also reported that the regulatory framework for production in the West Bank and Gaza was more restrictive in the 1980s than in the 1970s. There is indeed plenty of anecdotal evidence that the regulatory environment has not been supportive of private sector production (see the companion volume on the private sector). While it is difficult to document whether changes in the regulatory framework contributed to a slowing in growth, it is likely that internal constraints became more binding once work opportunities abroad declined, leading to increased pressures to employ workers at home.

2.11 During the fourth phase, following the outbreak of the *Intifada* in 1987, a decline in output set in due to commercial and labor strikes and repression of economic activity. Political and economic uncertainty prevailed. Meanwhile with the return of 25,000 workers from the Gulf, remittances collapsed. A recovery in 1992, apparently fueled by drawdowns of savings and expectations of peace appears to have been followed by renewed decline in 1993.

2.12 It is important to view the changes in past growth in a regional context. In the 1970s, growth in GNP per capita was over double that in Israel, but only slightly faster than in neighboring Arab countries (Figure 4). All economies slowed in the 1980s. The difference in growth rates between the two periods was about 6 percentage points for the Occupied Territories as well as its Arab neighbors. Although growth in Israel slowed earlier (in 1973), the fall-off was less pronounced than in the other economies, and its income growth exceeded that of its neighbors in the 1980s.

The Structure of Growth: Patterns and Productivity

2.13 The rise and fall in the overall growth rate is one notable feature of the past. There are also a number of striking characteristics of the pattern of growth.

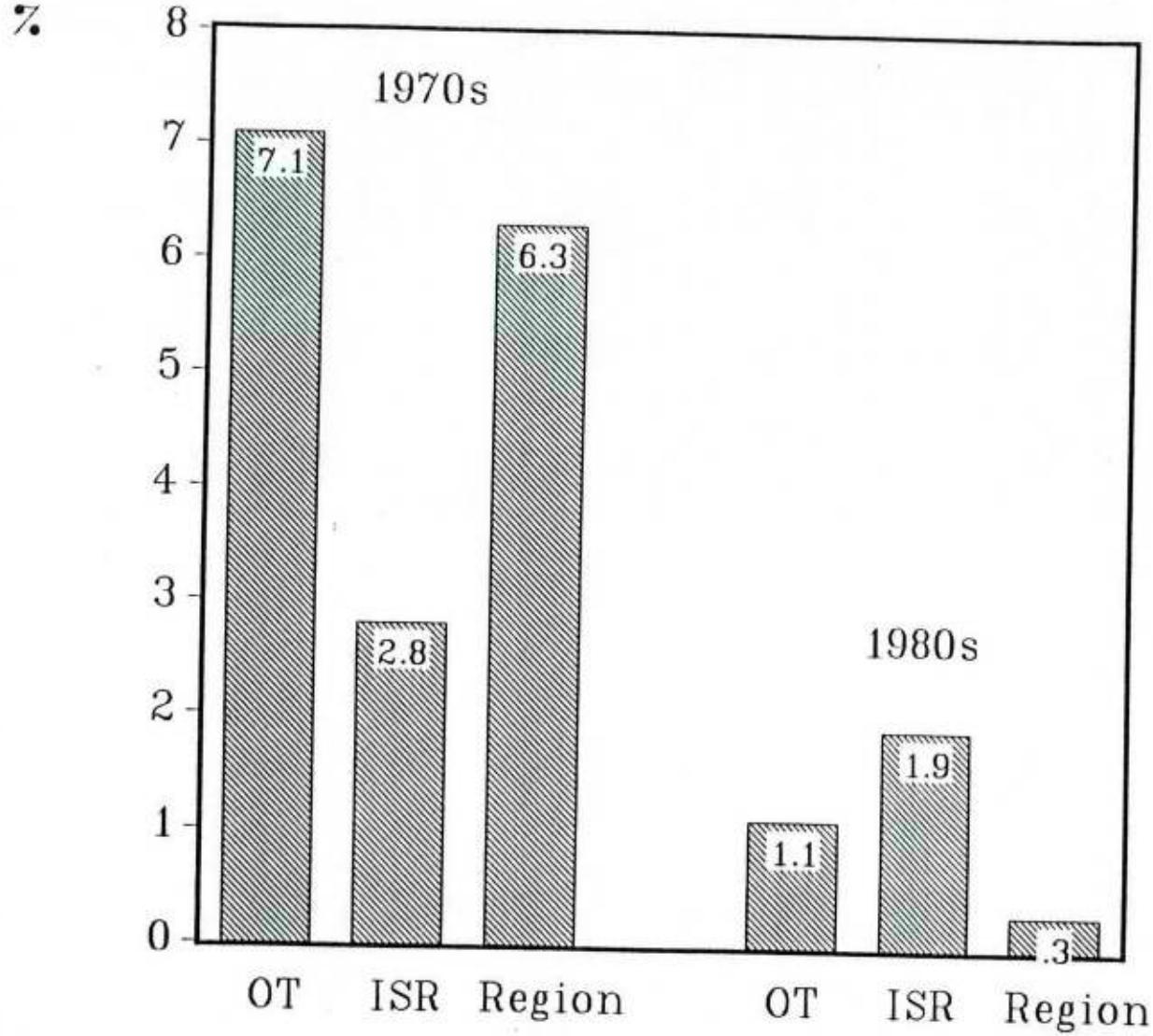
- The Occupied Territories enjoyed investment and savings rates worthy of fast-growing East Asian economies. Investment was around 30 percent of GDP in the West Bank and exceeded 40 percent of GDP in Gaza in the mid-1980s, before a decline in the late 1980s (Figure 5).

- Investment is low in machines and high in houses. Investment in machinery and equipment declined from 12 percent of GDP in the West Bank in 1970 to 4 percent after 1975, while in Gaza it hovered around 4 percent of GDP throughout the period until dropping to 1 percent after 1987. Even if an adjustment is made for industrial and commercial building, the preponderance of investment in residential housing is high and has risen in the late 1980s. (See Figure 6--"other" investment is equal to the sum of investment in equipment and machinery and in industrial and commercial buildings.)

- Industrialization is unusually low. Industries did indeed grow in response to overall growth, especially in Gaza in the 1970s. But the share of industrial production in output of 10 percent in Gaza and 7 percent in the West Bank is way below other economies of a similar income level (Figure 7). Mauritius, like the Occupied Territories, is a small open economy with a significant agricultural sector. It had almost exactly the same income level as the Occupied Territories, but a share of industry in GDP over three times as high.

- The level of provision of government services is substantially below that in economies of a comparable income level. Provision of water, sanitation, roads and electric power

Figure 4: Growth Rates of Per Capita GNP in the 1970s and 1980s: Occupied Territories, Israel and Region



Region: Weighted average of growth rates of Egypt, Jordan, & Syria

Source: Bank Economic and Social Database

are all below expected levels in quality and/or quantity (see the infrastructure report). Public investment at 3 percent of GDP is remarkably low, and especially so in the context of an overall investment rate of 30-odd percent of GDP.

- Domestic fiscal deficits have traditionally been small, but the external trade deficit was immense, at 26 percent of GNP in the 1985-87 period.

2.14 These patterns reflect, in large part, the sources of growth in the past. Fast growth in money incomes spurred savings and investment. Palestinians specialized in manual labor in Israel and skilled labor in the Gulf rather than in industries in the West Bank and Gaza. Labor income from Israel and remittances from elsewhere financed imports greatly in excess of exports. The current account deficit was largely in balance for most of the period (though this may have changed in the early 1990s--see Chapter 3). In Chapter 2 we examine some of the policy and structural factors that contributed to the skewed pattern of past growth.

2.15 Growth in production has been unusual and led by incomes from employment abroad. Industrialization is low, which might be expected to lead to low productivity growth. However, the evidence suggests the opposite was true, at least until growth stalled. There were certainly large increases in labor productivity, in agriculture, manufacturing and construction (Figure 8). This was consistent with rising wages, as employment was drawn outside, and high domestic investment rates. There is also evidence of rapid increase in total factor productivity growth (TFP) in the 1970s, that is the growth in output over and above that explained by an expansion in the factors of production. This is based on some preliminary work, but the results, shown in Table 1, are consistent with some of the stylized facts. Total factor productivity growth was actually the major contributor to total growth in the 1970s in both the West Bank and Gaza. This can be interpreted as a mixture of technological catch-up, and the gains from factor reallocations to different lines of production. In the 1980s, by contrast, the contribution to growth declined to less than one percent per annum in the West Bank (that is close to international norms) and actually turned negative in Gaza, which was harder hit by the overall slowdown and probably had lower capacity utilization.

2.16 This picture of the sources of growth in the West Bank and Gaza complements that of the rise and fall of growth rates. When growth was very rapid, including the integration phase, there were large rises in productivity. When it stalled, so did productivity growth. Throughout the period the pattern of growth displays relatively low levels of industrialization and of provision of public goods.[9]

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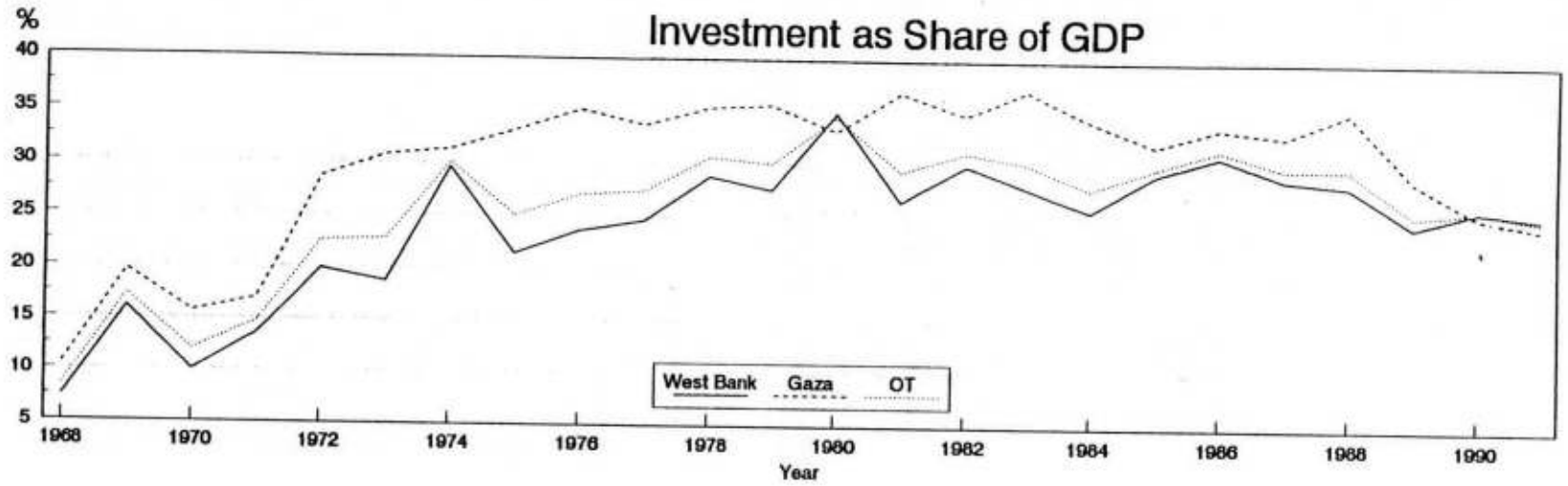
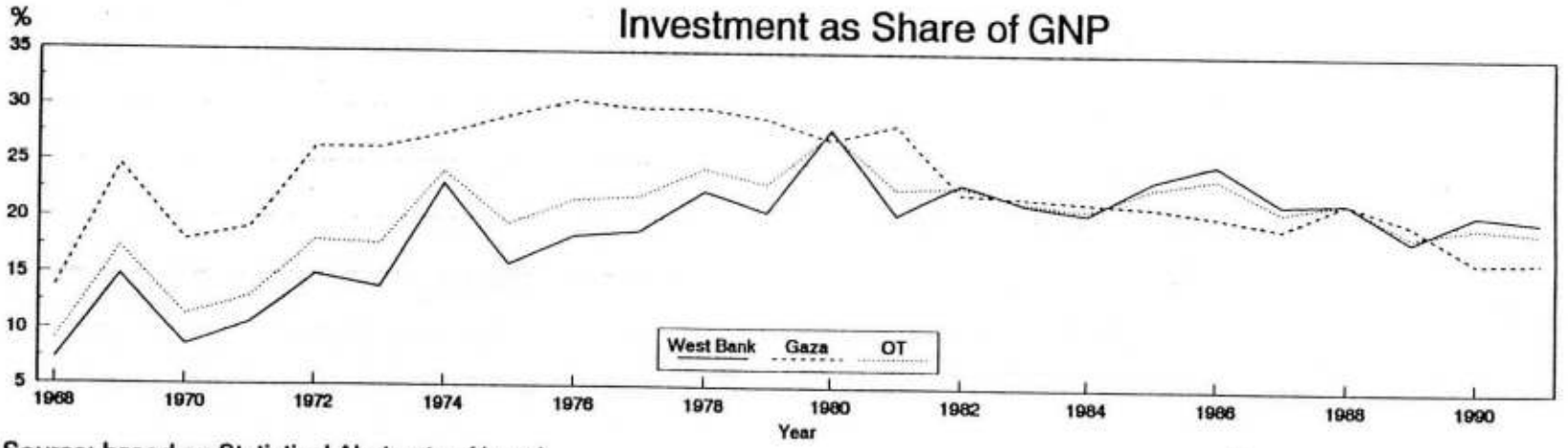
[9] Metzer (1992) has estimated TFP for the period 1972-82 at 0.5% (contributing 8.1% to growth), i.e., considerably lower than the estimates computed in this report. One possible explanation for the discrepancy is the different periods considered: growth was particularly marked in the short period between 1967 and 1972 whereas it slowed down dramatically after 1980. A further explanation may lie in the use of different capital stock series. In this report, the capital stock series was derived from investment data using the standard perpetual inventory method.

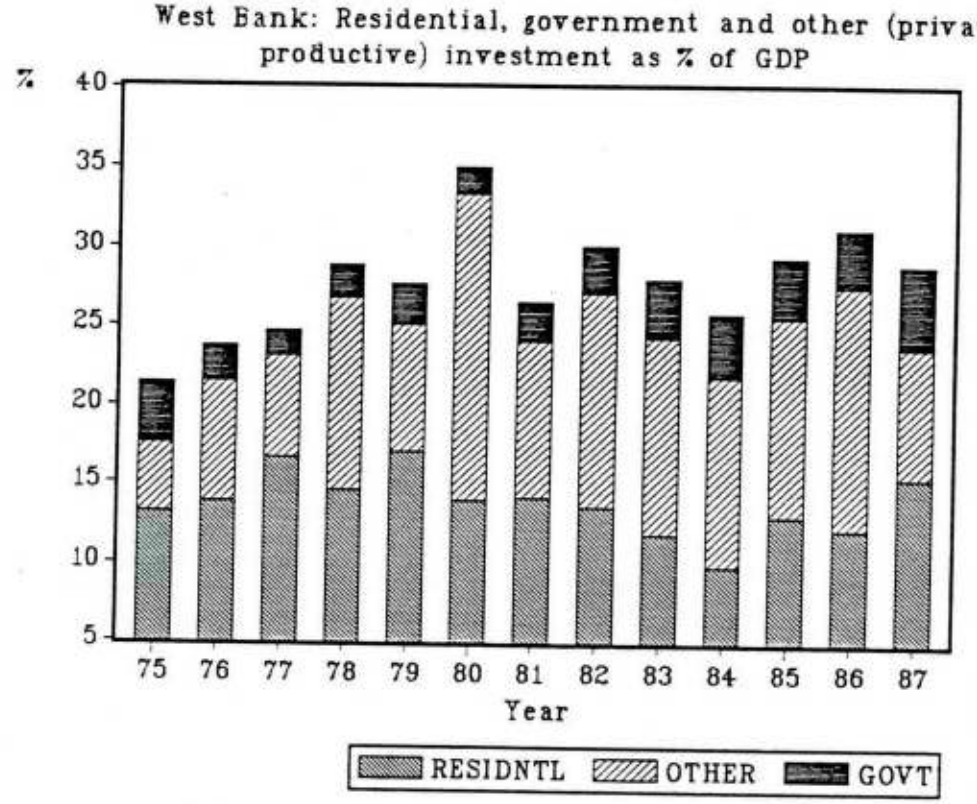
Figure 5: Investment as Share of GDP, GNP for 1968-1991.

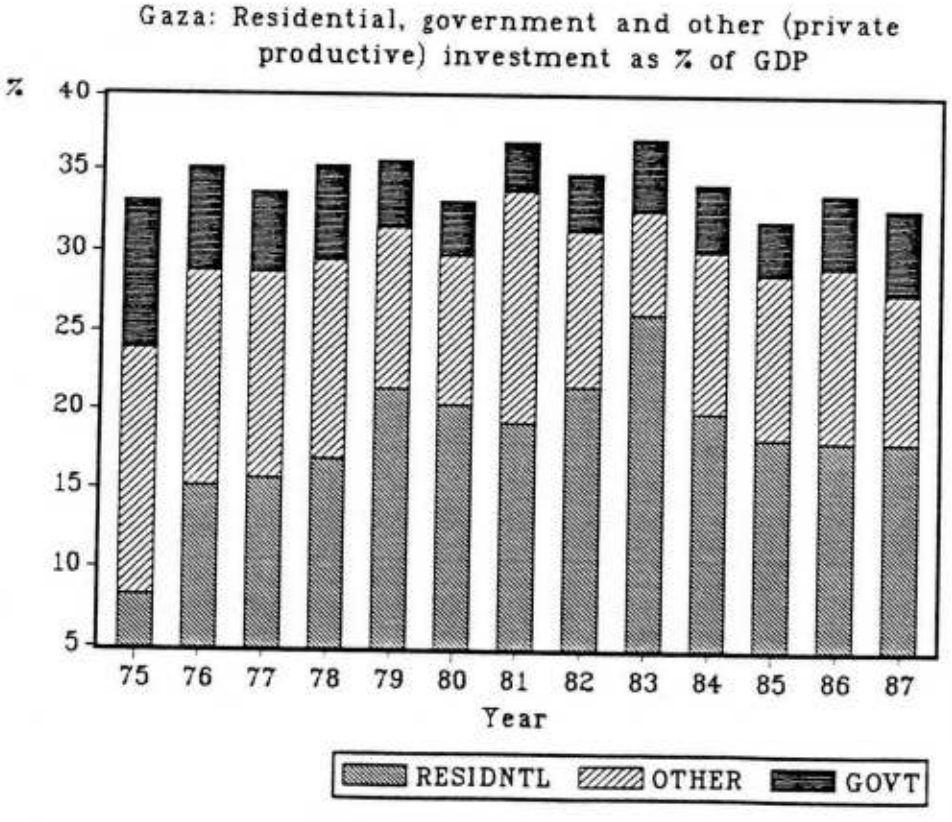




Source: based on Statistical Abstracts of Israel 1972-1992,Central Bureau of Statistics

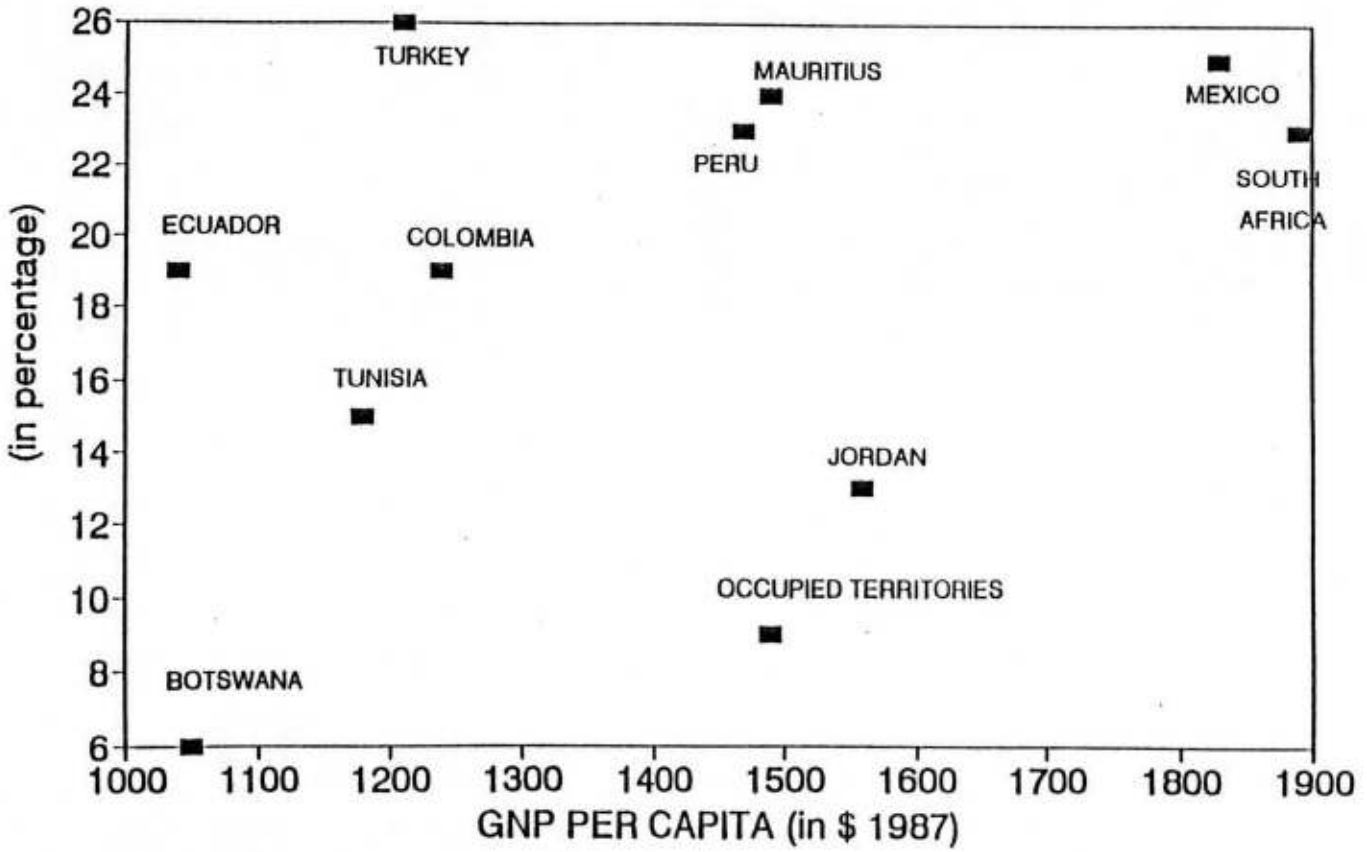
Figure 6: Composition of Fixed Capital Formation





Source: Statistical Abstracts of Israel, 1972-1992, Central Bureau of Statistics

Figure 7: Share of Manufacturing in GDP



SOURCE : WORLD DEVELOPMENT REPORT 1987

Table 1: Growth in GDP, Factors and Total Factor Productivity (in percent per annum)

	West Bank		Gaza	
	1970-79	1980-87	1970-79	1980-87
Annual growth:				
GDP	8.54	3.56	6.27	1.57
Capital a/	8.87	7.95	6.07	6.09
Labor	-0.63	-0.95	-0.74	-0.45
Contribution to GDP growth of:				
Capital	3.55	3.18	2.43	2.44
Labor	-0.38	-0.57	-0.44	0.27
TFP b/	5.37	0.95	4.29	-0.60
TFP as a percent of growth in GDP	63	27	69	-38

a/ Based on a series constructed from national accounts statistics on investment.
b/ This is the residual of the growth accounting equation, assuming a 40 percent capital share.

Source: Mission estimates.

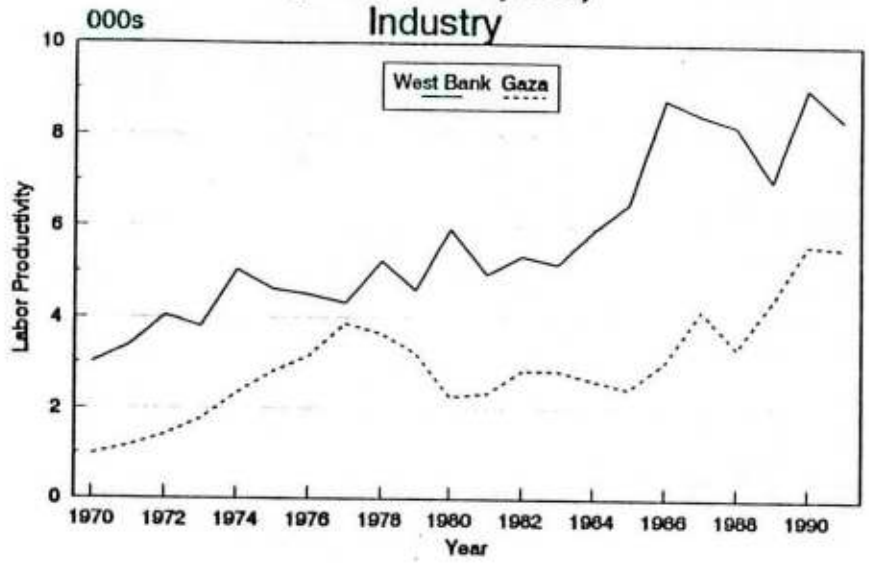
Poverty and Growth

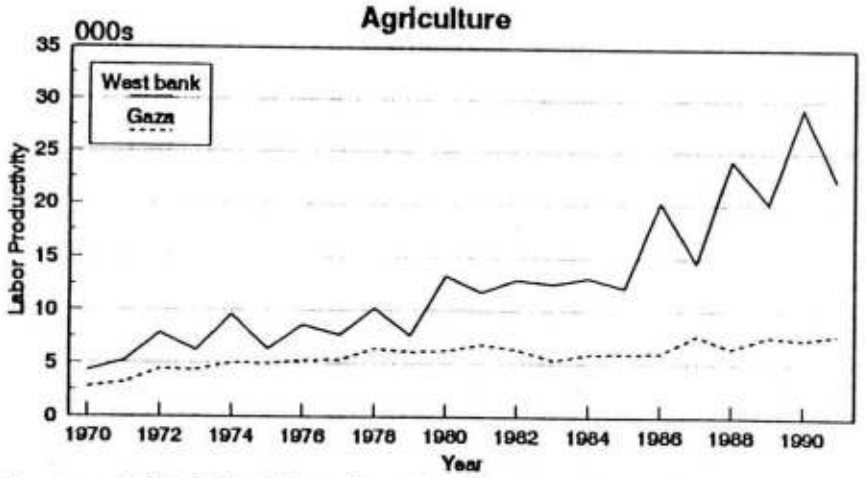
2.17 There are no comprehensive surveys of incomes or expenditure in the Occupied Territories, so it is difficult to assess the severity of poverty and changes over time. Qualitative impressions suggest that both the West Bank and Gaza have always had large differences between the rich and poor: traditionally landowners, merchants and a few industrialists have been amongst the rich, while land-poor rural households and households dependent on unskilled labor have accounted for the bulk of the relatively poor. The large number of refugee households is an additional important factor. One small, but valuable, survey (by Abu Shokor in 1985) found a level of inequality roughly in the middle of developing countries: less unequal than in Latin America and Africa, but more unequal than in countries such as Indonesia or formerly socialist countries.[10] This survey also found that most of the poor were from laboring and farming households, with the latter often having members working in the wage sector in addition to farm work. Unemployment tended to be concentrated amongst the poor, but was not severe, at about 11 percent (compared with 10 percent overall--a higher level than from the labor force surveys, perhaps due to definitional issues). Poverty did not seem to be significantly higher in refugee camps, a finding consistent with the results of the household survey of durables that finds households in refugee camps have roughly comparable levels of household wealth.

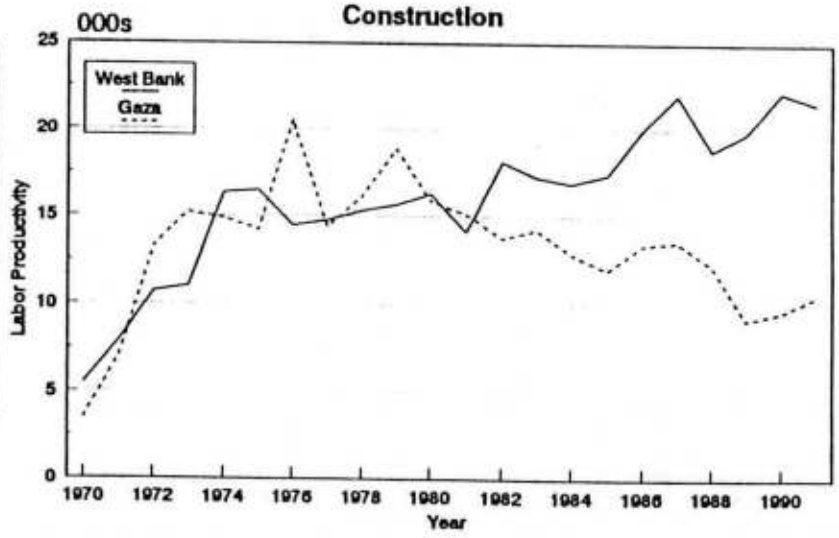
[10] See Abu Shokor (1990). He calculated a Gini coefficient of 0.42 for the West Bank and 0.45 for the Gaza Strip.

Figure 8: Labor Productivity (1970-1991)

(in NIS at 1986 prices)







Source: Calculations based on data extracted from the Statistical Abstracts of Israel, 73-92 Central Bureau of Statistics.

2.18 Assessing changes in poverty is even riskier than assessing levels since the existing small-scale surveys are not comparable over time. However, some preliminary conclusions can be drawn from examining the characteristics of the poor as well as the course of development. First, in every country (for which data is available) where there has been substantial growth there has been substantial poverty reduction. Income distributions tend to be highly stable over time. There is no reason to expect that income distribution worsened in the West Bank and Gaza (more likely the opposite occurred). This implies that the more than doubling in incomes illustrated in Figure 3 between 1970 and 1990 almost certainly brought a large reduction in poverty. It also suggests that the stalling in income growth since the 1980s led to a stalling in progress in poverty reduction.

2.19 Second, the fact that the primary structural change in earnings was the rise in the demand for unskilled labor (due to growth in employment in Israel and the associated rise in unskilled wages within the Occupied Territories), provides further indirect support for the view that poor households participated in the growth process. Indeed, for those Palestinians who stayed and worked in the Occupied Territories and Israel, there was probably a relatively compressed distribution of earnings, though better educated households were able to gain from high earnings in the Gulf (and indeed many emigrated to even greater wealth throughout the world).

2.20 Third, potentially vulnerable households would, until recently, have been disproportionately those without access to the predominantly male unskilled labor markets–that is those without able bodied young men, including families that had lost the male breadwinner. If there is now a generalized reduction in labor demand, a much broader group of working households could be vulnerable to falling into poverty.

2.21 Fourth, all the qualitative impressions, and some quantitative evidence, indicates that Palestinian society is a high transfer one, with the relatively needy being assisted through transfers from the better off, often within extended family networks. The labor force surveys finds that the unemployed and those outside the labor force disproportionately receive transfers.[11] This is exactly what happens in Jordan, which is reasonably similar culturally and in economic structure: households with low earnings receive much higher proportions of their income in terms of inter-household transfers than do non-poor and/or wealthier working households.[12]

2.22 Much more work is needed on poverty, including surveys of household living standards and expenditures. Coping mechanisms are probably strong, but the stalling in growth in incomes and employment is almost certainly leading to rises in poverty. This should be an important focus of the economic management in the interim period.

Conclusion

2.23 The above analysis suggests that the past course of growth did indeed bring large income gains for most Palestinians, but it both had built-in distortions and is not sustainable in the economic environment likely to be faced in the 1990s. The most striking aspects of economic specialization of Palestinian labor over the past 25 years have been in two areas: manual work in Israel; and in higher-skill

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[11] See Shaban (1993).

[12] This is based on preliminary analysis of household survey data from Jordan in the early 1990s.

services throughout the world, but most especially in the Gulf. While the past pattern of specialization constituted a powerful spur to economic growth in the past it has left a problematic heritage. Future growth potential on the historical path now looks very limited–Gulf demand is gone, Israeli labor demand may be substantially cut, and in any case the rise in Israeli construction demand is likely to fade after the current immigration wave subsides. Without growth in domestic production the future outlook for incomes and employment will be grim, while labor supply will be surging ahead. The remainder of this chapter examines the policy and structural reasons behind the past pattern of growth in terms of structural relations with other economies and policy choices, followed by a discussion of past external shocks that contributed to the stalling of growth.

B. Economic Relations, Policies and the Pattern of Development

2.24 Growth in the Occupied Territories was rapid in the 1970s; it is now stalled. Investment has been unusually high, but with a high concentration in housing and a relatively low payoff in growth after the 1980s. Changes in the pattern of specialization in employment and production, and rising wages, were an unavoidable consequence of integration with Israel; these were the mechanisms behind the growth spurt of the 1970s. It is, however, highly unlikely that the West Bank and Gaza economies would have experienced such a skewed pattern of development if it were not for four unusual features of their policy environment:

- Asymmetric market relations with Israel and other countries that caused a bias towards export of labor (and raised domestic wages);
- Regulatory restrictions that held back the expansion of the private productive sector;
- Fiscal compression that led to under-provision of public goods.
- A declining natural resource base.

2.25 These four factors in the policy environment were mutually reinforcing. Difficulties in getting permits for industries potentially competitive with Israeli firms (until the recent liberalization), problems of electricity supply and biases in trade relations all contributed to the character of past development: the dependence on outside sources for employment and the relatively weak development of domestic production whether in measured terms of public capital or private investment in productive activity.

2.26 The skewed pattern of investment–toward housing and with little in machinery and equipment (Figure 8)–is another aspect of the same story. The policy factors also interacted with other features of the economy: high savings due to rapidly growing money incomes and remittances; lack of alternative investment opportunities for households due to the underdeveloped state of the financial system; and overall political uncertainty. The latter may have been central to the picture, though is difficult to evaluate: it is plausible that strategic uncertainty over the political future of the Occupied Territories was a major deterrent to productive investment. On the other hand, housing was relatively secure, and rising demand was a natural consequence of rapid population growth. Jordan also has a large level of investment in housing (10 percent of GDP in the early 1990s), suggesting that the skewed pattern is only partly due to the unusual political and policy circumstances of the West Bank and Gaza. While the overall political uncertainty is clearly important, we focus here on the areas relating to policy and relations since it is in these areas that there could be future policy choices.

Trade in Labor and Goods

2.27 Palestinians have been free to sell unskilled labor to Israel and skilled labor to the Gulf, but they have been restricted, partially or completely, from selling many goods to Israel and most goods to the rest of the world. In 1967 the West Bank and Gaza had no relations with Israel. The June 1967 war was severely disruptive, of course, and was followed by the outward migration of some 300,000 people, mostly to Jordan, out of a population of 1.3 million prior to the occupation. After the occupation, a difficult set of economic opportunities opened up with access to the much larger economy of Israel. This brought huge increases in the movement of both labor and goods.

2.28 The number of Palestinians working in Israel rose from zero to 66,000 in 1975 and 109,000 by 1987, accounting for 35 percent of the employed population in the West Bank and 45 percent in Gaza. (Figure 9). Amongst Palestinians who stayed in the Occupied Territories, this source of growth accounted for all the growth in the labor force until the *Intifada*. (A roughly equal number also emigrated to work abroad.) Palestinians from the Occupied Territories accounted for 7 percent of total employment in Israel by the mid-1970s--a share that has been fairly stable ever since. Employment was overwhelmingly in unskilled and semi-skilled work. Construction has always been the largest sector of employment.

2.29 Palestinian wages in Israel are about $450 per month, in the neighborhood of the Israeli minimum wage. Earnings vary from a third of earnings of Israelis in industry and construction to over 40 percent in agriculture (Figure 10). Wages in Israel are also above those within the Occupied Territories--the domestic average wage is about $310 per month. However, much of the difference is offset by the costs of transportation to Israel in transportation and taxes. The long-run trend was toward convergence, such that by the mid-1980s there was little difference in average wages between net earnings from work in Israel and within the Occupied Territories (especially the West Bank); this similarity, however, almost certainly hides a continuing divergence for work at the same skill level since the average skill level of Palestinians within the Occupied Territories is higher. Since the mid-1980s the ratio has tended to widen again, under the dual pressure of returnees from the Gulf and lower demand in Israel (Figure 11).

2.30 Patterns of movement amongst skilled Palestinians were completely different. Very few work in Israel: only 2 percent in professional, technical and clerical occupations compared with about 10 percent in the Occupied Territories. Market factors probably worked in tandem with preferences. Skilled labor is relatively abundant in Israel, so Palestinian skilled workers are much more likely to substitute for Israelis. During the eighties educated Palestinians lost the wage premium they previously enjoyed. While in the first half of the eighties, men with 13-15 years schooling enjoyed a daily wage premium of about 15 percent, by 1987 this had been eliminated. Men with 16 years of schooling or more also experienced a marked decline (over 50%) in their wage premium over the same period.[13] The mid-eighties recession and hyperinflation in Israel were probable causes, as well as the excess supply of new graduates. In addition, it is probable that Israeli employers are relatively reluctant to hire Palestinians for higher positions. Things were quite different in the Gulf states. There the highest demand was for skills, and many Palestinians worked there, earning substantially higher salaries than those in the West Bank and Gaza. Data in this area is weaker. It is, however, apparent that there have been substantial fluctuations in Gulf demand.

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[13] Angrist (1992)

2.31 Trade also expanded hugely. Much of this was financed, of course, by wage payments to Palestinian workers in Israel and elsewhere. But exports also expanded. There are two particularly striking aspects of the pattern of trade: its orientation toward Israel (90 percent of imports and 70 plus percent of exports) and its concentration in industrial products: the share of industrial products in trade is unusually high for its income level, way above Mauritius, which is a successful manufacturing exporter (Figure 12). The dependence of trade with Israel is a function of both trade diversion and trade creation. Trade diversion occurred from Jordan and Egypt through the imposition of a customs union in 1967: imports of manufactured goods from all countries except Israel became subject to a more than fourfold increase in duties in that year. Israel has also come to dominate other countries as a direct market for West Bank and Gaza goods. Trade creation between Israel and the West Bank and Gaza was the result of cheap transportation costs and the absence of customs on goods passing into the West Bank and Gaza.[14]

2.32 The patterns are clear: export of manual labor to Israel; of skilled labor to the Gulf; and trade in manufactures predominantly with Israel. These patterns correspond to the pattern of restrictions: some agricultural goods and skilled labor don't go to Israel; skilled labor used to be able to go to the Gulf, but has largely lost that market; and almost all goods face barriers or costs in going anywhere else. As discussed in Chapter 3, the pattern of trade that would have occurred without restrictions looks very different.

2.33 Central to the functioning of the Occupied Territories is the workings of labor market interactions with Israel. This study's interpretation of the facts leads to the following account of how the labor market functions. Wages for Palestinians in Israel are held up by (or close to) the minimum wage; but they are lower than Israeli wages, even at the same skill level, because employers consider that the employment of Palestinians comes with a cost. Kleiman (1992) finds an overall differential between Israelis and Palestinians working in Israel of 50 percent, but an "unexplained" wedge of 20 percent, after attempting to allow for occupation and skill differences. This could, for example, be due to security fears or concerns over disruptions of supply (especially post-*Intifada*). The wage exceeds the domestic wage in the West Bank or Gaza for the same work, even after transportation and other costs are taken into account, so Palestinians are rationed in their employment in Israel. Thus employment in Israel has been determined by demand at the prevailing wage, and employment within the Occupied Territories has been a residual. Only when the domestic wage (net of costs to workers) rises to the Israeli level, will increased domestic labor demand be a source of reduced employment in Israel. In some of the scenarios explored in Chapter 5 there is some convergence, but in none do the Occupied Territories reach a point of equalization and pulling back of labor from Israel (as opposed to Israeli reduction in demand).

Regulatory Restrictions

2.34 The regulatory environment for private sector activity is discussed in detail in the companion report on private sector development. Restrictions on permits for industry, the legal framework for conducting business and on the growth in the financial sector has seriously constrained the expansion of private business (probably especially in areas potentially competitive with Israeli production, until the recent liberalization). Here we note how this fits in with the overall pattern of asymmetric integration. With respect to investment, large scale expansion has been held back both by the difficulty in getting

[14] See Ephraim Kleiman (1991) for further discussion of the issue of trade diversion versus trade creation.

permits for activities competitive with Israeli producers. and the lack of business support services. Uncertain legal conditions and sharply rising prices of industrial land have added to the disincentives for expansion of productive activities. There has been significant entrepreneurial dynamism, but this has been largely in the small-scale sector.

2.35 In 1992 the Civil Administration introduced a quite significant liberalization of the regulatory framework, including the encouragement of applications for permits, the dropping of the *de facto* difficulties of receiving permits for industrial activities competitive with Israeli firms and the introduction of new tax incentives. There has indeed been a surge in permit approvals, though the bulk of this appears to be for existing (technically illegal) businesses. It is too early to assess whether there have been significant real effects.

Fiscal Compression

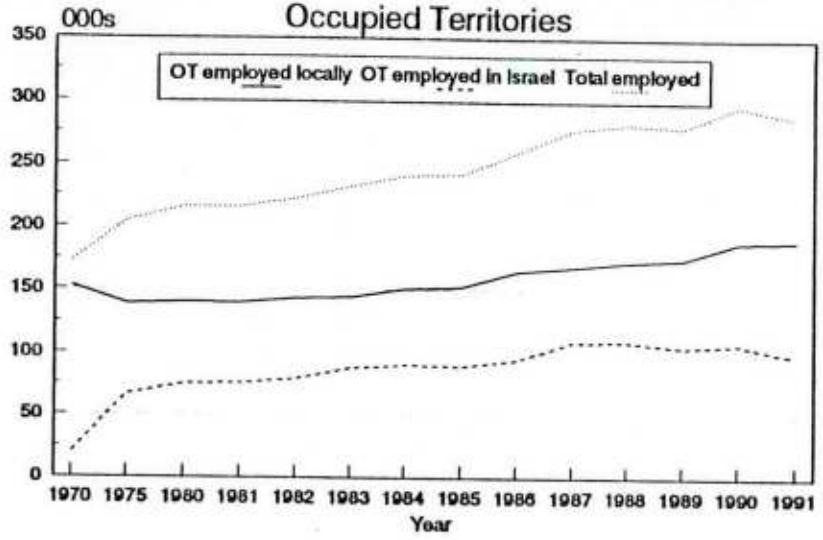
2.36 Public provision of services has been broadly limited to available revenues: to taxes and fees collected by, or assigned to, the Civil Administration and municipalities for government activities; and, at most, to retained earnings for the public utilities that are owned by the municipalities. Deficits have been negligible (though they appear to have been much higher in the 1970s). Low revenues and the inability to borrow have been the primary reason for the low levels of service provision. Annex 2 develops detailed consolidated accounts for the public finances of the Occupied Territories since 1987.

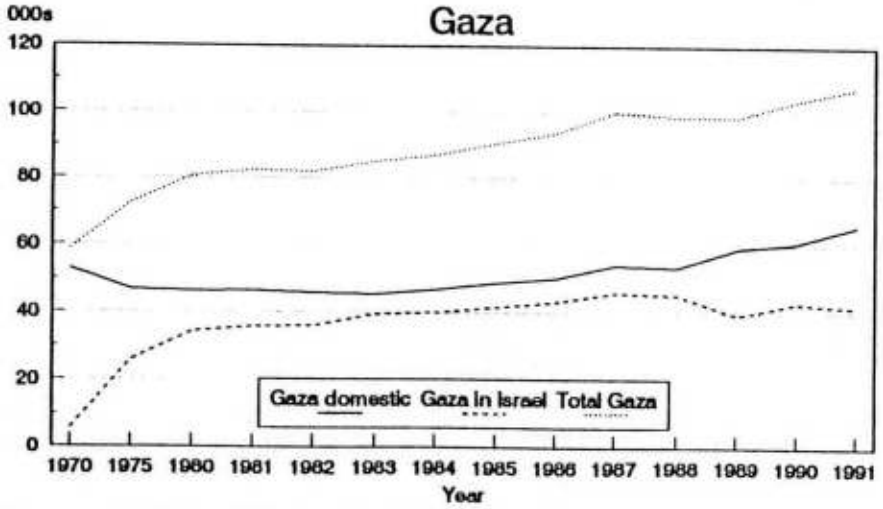
2.37 Both revenues and spending by the Civil Administration and the municipalities are low by international standards, at about 16 percent of GDP or a mere 12 percent of GNP in the 1987-91 period, with no clear trend. On the other hand, statutory income tax rates are significantly higher in the Occupied Territories than in Israel (see the discussion in the private sector report). There are two major adjustments that have be made to revenue and spending levels by the Civil Administration and the municipalities. First, other agencies, both official and private, have responded to fill the gaps left by the weak governmental effort. Second, there are complex interrelations, on both the revenue and spending side, with the Israeli government. We take up each in turn (Table 2 summarizes the results).

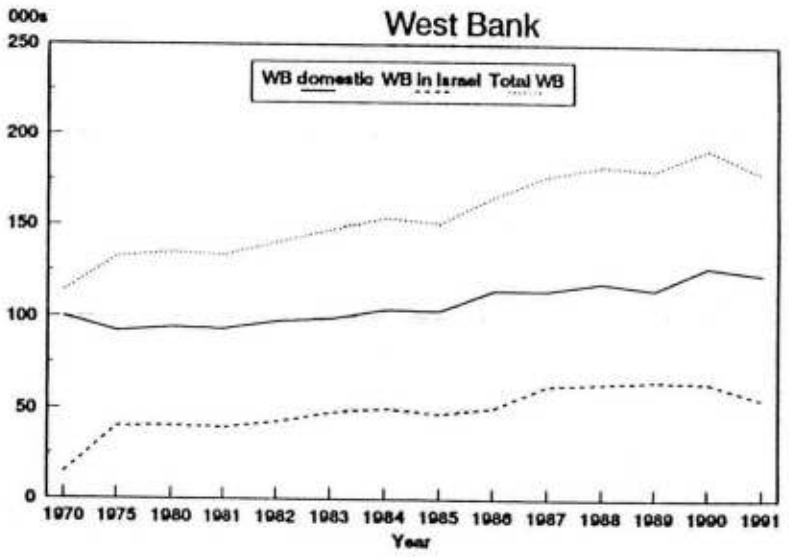
2.38 Many organizations operating in the Occupied Territories provide quasi-public services. Foremost amongst these is the United Nations Relief and Works Agency (UNRWA), which provides basic services to the approximately 40 percent of West Bank and 60 percent of Gaza residents that have refugee status. UNRWA has spent US$100 million annually in the recent past, equivalent to 4.5 percent of GDP, of which 85 percent went on education and health. Jordanian aid amounted to an estimated $50 million per annum until 1988, dropping to $15 million thereafter; identified aid by other Arab governments provided an estimated $15 million per annum in 1988-89; and other Arab non-government agencies, UNDP, EC and a large number of non-Arab NGOs, also provided resources or services. These funds are treated as near-government capital inflows and spending.

2.39 More controversial are the fiscal transfers between the Occupied Territories and Israel. Palestinians pay some taxes that accrue to the Israeli treasury, and Israel provides services. There are no available statistics on these transfers. This report made direct estimates of indirect taxes paid by Palestinians that were not passed back to the Civil Administration budget--mainly due to the VAT, tariffs, excises, fuel taxes and purchase taxes. On reasonably conservative estimates of the base and of rates, these amounted to some NIS 400 million in 1991, equivalent to 8 percent of GDP (Annex 2). This does not include income tax paid by Palestinians working in Israel since it is the usual international practice

Figure 9: Number of Employed West Bank and Gaza Residents by Place of Employment, 1970-1991

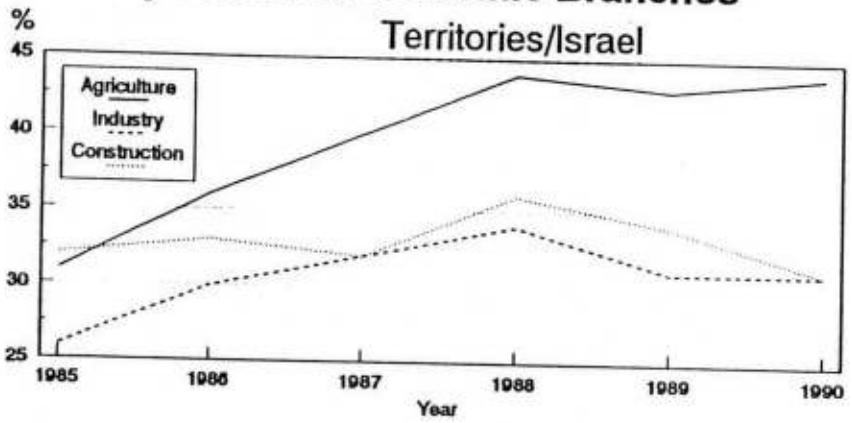


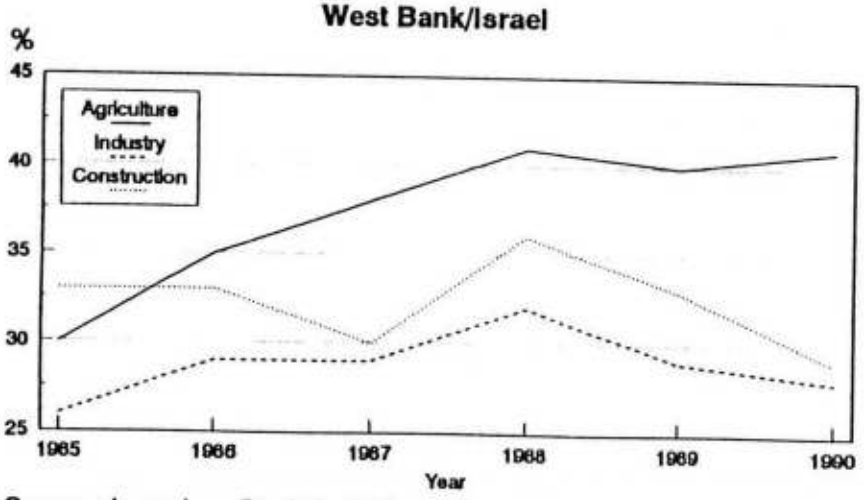


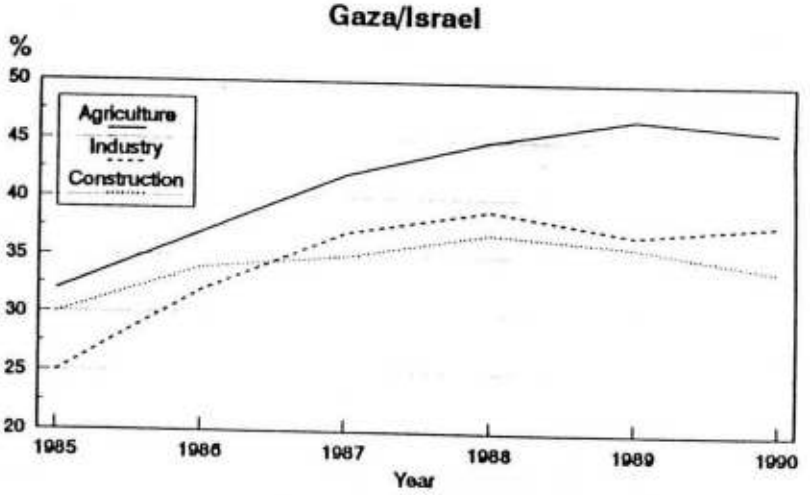


Source: Statistical Abstracts of Israel, 1983-1992, Central Bureau of Statistics, Jerusalem.

Figure 10: Palestinian Daily Wage as a Percentage of Israeli Daily Wage by Selected Economic Branches

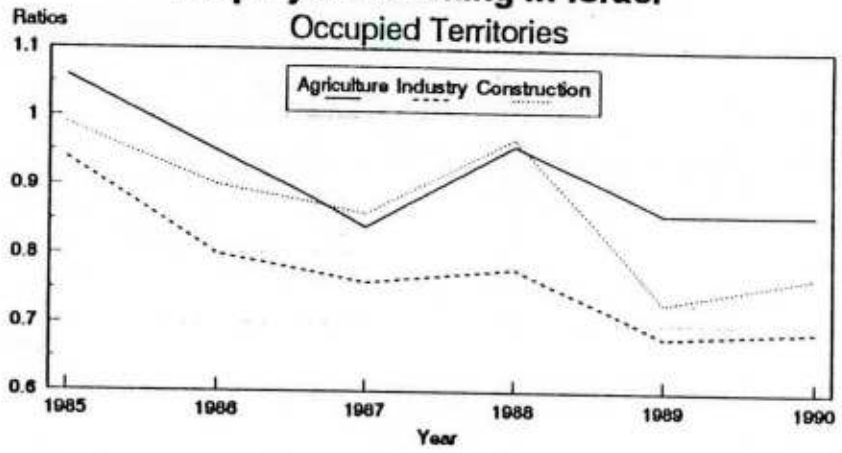


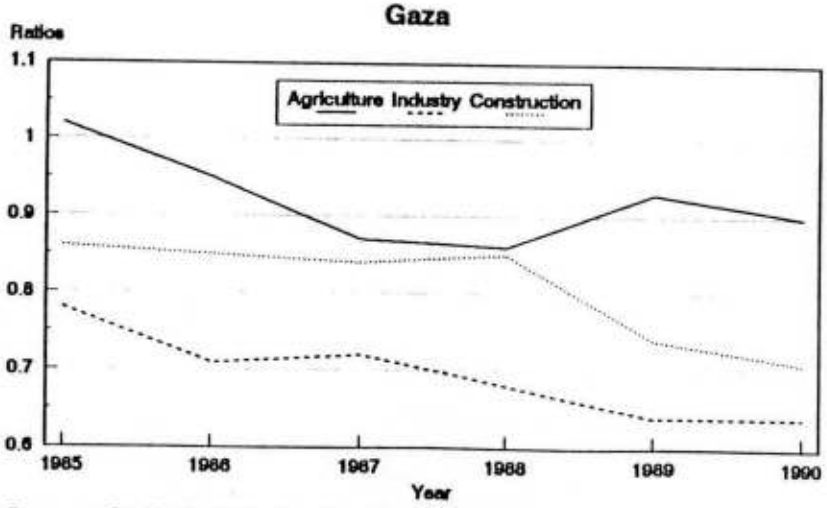


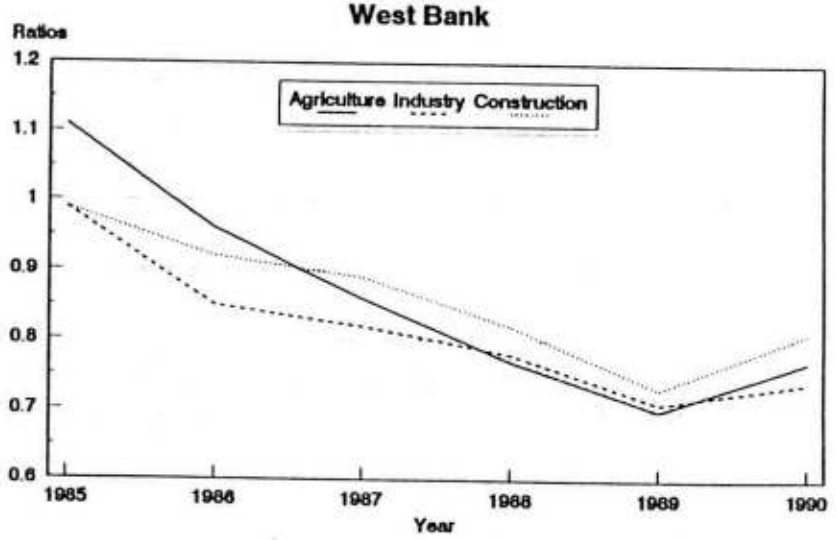


Source: based on Statistical Abstracts of Israel 1971-1991, Central Bureau of Statistics, Jerusalem.

Figure 11: Daily Wage Ratios of Palestinian Employees Working Domestically to Palestinian Employees Working in Israel

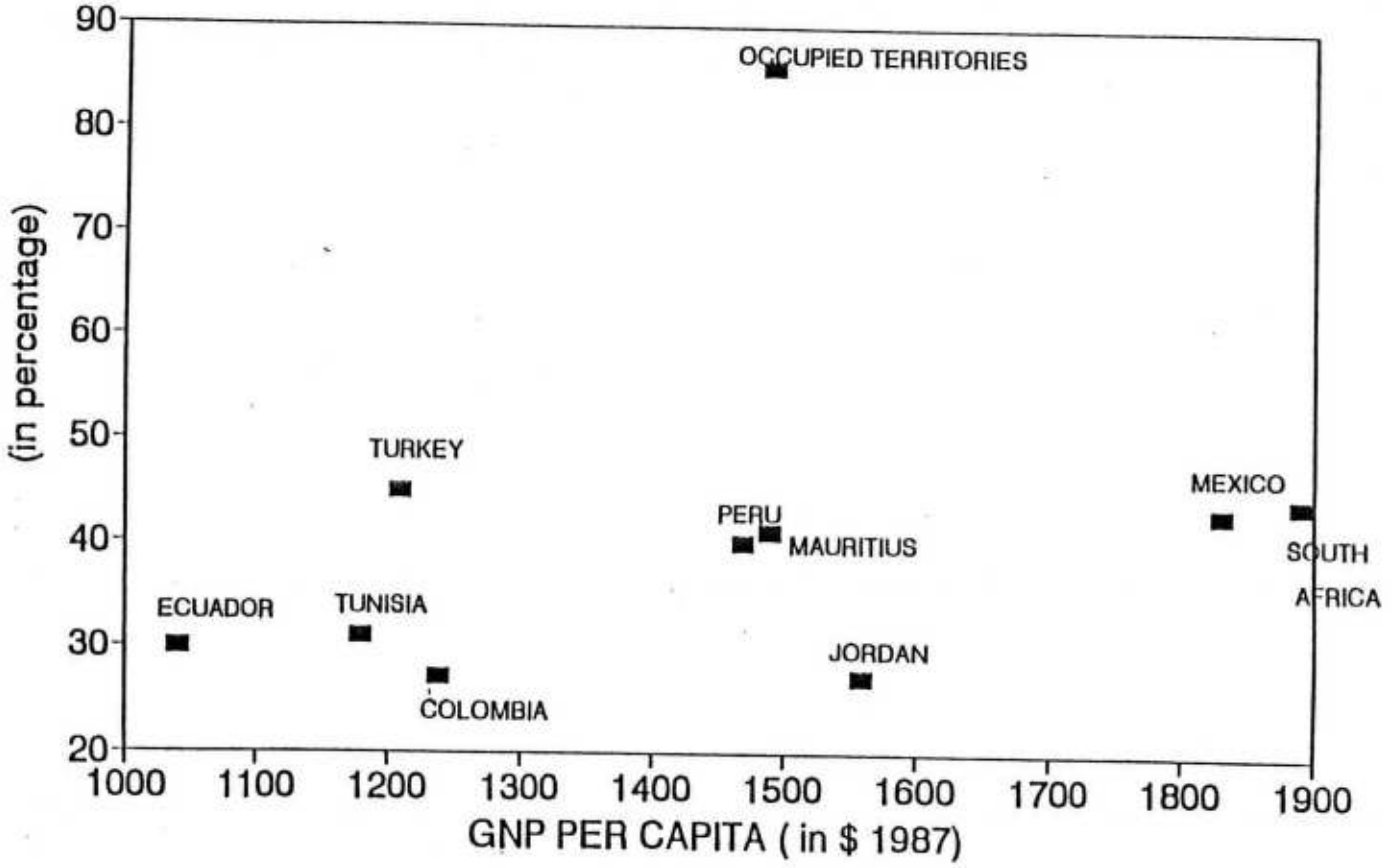






Source: Statistical Abstracts of Israel, 1985-90
Central Bureau of Statistics, Jerusalem.

Figure 12: Share of Industrial Product in Trade



SOURCE: WORLD DEVELOPMEN REPORT 1987

for this to accrue to the treasury of the territory in which a person works. Nor does it include any indirect costs, such as the price-raising effects of tariff protection on Israeli production. By contrast, in the Southern African Customs Union, the sharing formula for customs revenues between the Republic of South Africa and the other members of the union (including Lesotho and Swaziland) *does* include such an adjustment.

2.40 Palestinian consumption of Israeli services is even more difficult to assess: the estimates of the Israeli Government are included in the appendix. Defense and security spending is estimated by the Israeli Government at NIS 1 billion, or 20 percent of GDP. We include outlays on subsidized goods and the use of public hospitals, in which there is a direct fiscal outlay that would not have otherwise occurred–these amount to some NIS 65 million, or 1.2 percent of GDP. In addition, some direct capital spending comes from the Israeli budget and is included. This is estimated at 0.8 percent of GDP. Thus, the Israeli non-security contribution is estimated at 2 percent of GDP.

2.41 The consolidated picture is of significantly higher revenues paid by Palestinians (24 percent of GDP, or 22 percent if the receipts of utilities are taken out as is done in most countries) and higher spending (26 percent of GDP, 24 percent if current outlays of utilities are deducted). At 22 percent of GDP, revenues look only moderately below those in other countries: Egypt's revenues were 23 percent of GDP; Jordan's were 27 percent; and a sample of 43 developing countries revenues amounted to 22 percent of GDP; Israel's, however, were much larger at 39 percent. (See Table 3; note that for the larger sample the information is limited to the central government.) As a share of GNP, revenues are only 16 percent for the Occupied Territories, far below that of the other countries. Which is the more appropriate for comparison depends on the tax: for indirect taxes, it is GNP (which will determine spending), while for direct taxes it is GDP, since these taxes are levied on domestic labor earnings.

2.42 Spending is much lower than international norms because of the absence of normal deficit finance. Total non-defense spending amounted to 24 percent of GDP (and 18 percent of GNP), compared with 37 percent for both Egypt and Israel; 31 percent for Jordan; and 26 percent for the same sample of developing countries. While this figure is quite low with respect to current spending, the radical differences lie in development (i.e., investment-related) spending. The 3.5 percent of GDP allocated to this item in the Occupied Territories is a small fraction of the spending levels in the other countries (with the partial exception of Israel).

2.43 Both revenues paid by Palestinians and spending on public services are higher than the accounts of the Civil Administration and the municipalities. But some of the revenues paid accrue to the Israeli treasury, and some services are there from quasi or non-government sources. Even if everything is included, a picture remains of current spending that is low for the income level of the population and development spending that is extremely low. This is completely consistent with the picture that emerges from the sectoral reviews (especially of economic infrastructure) of inadequate service levels.

Declining Natural Resource Base

2.44 A fourth constraint which has acted to distort the pattern of development is the stagnation or shrinking of the land and water resources base in the face of a large population increase over the past 25 years. Annually renewable groundwater resources in the West Bank and Gaza amount to about 750 million cubic meters, while annual use by the Palestinians has remained capped at about 200 million cubic meters–the pre-1973 level. Current restrictions on access to water, including administrative limitations on surface water harvesting, and the high costs of water caused by difficulties to renew inefficient and

Table 2: Integrated Public Sector Finances, 1987-91

	Public Sector Average 1987-91	Integrated Public Sector Average 1987-91
Revenue	16.1	24.1
Expenditure excluding defense	16.3	25.8
Current Expenditure	14.1	22.3
of which: UNRWA	-	4.5
Other quasi-government	-	2.5
Israeli budget	-	1.2
Development Expenditure	2.2	3.5
of which: Israeli budget		0.8
Other quasi-government		0.5
Overall deficit (-)/surplus(+)	-0.2	-1.7
Financing	0.2	1.7
Israel	0.2	2.2
UNRWA	–	4.5
Other external sources	0.1	3.1
Increase in cash balances (-)	-0.1	-8.1[a]

a/ This increase, basically reflects the revenue foregone by the Civil Administration.

worn-out wells have meant a modest expansion of the irrigated area under Palestinian cultivation. In selected areas, notably in some areas in Gaza, increasing salinity levels in wells caused by excessive extraction have virtually halted agricultural production. Loss of land to settlements has increased during 1980s and early 1990s. Access of Palestinian sheep and goat farmers to military land and land declared nature reserve has been restricted. While the area cultivated by Israeli settlers in the West Bank is unknown, in Gaza settlers occupy about 10 percent of the cultivated area. The lack of clear zoning regulations and public land utilization policy has also created uncertainty and has become a barrier to industrial expansion. The freeze on the building of housing on land beyond the municipal boundaries has acted to distort land prices. Security-related restrictions affecting the fishing areas in which Gaza fishermen can operate have been limiting fish production to a fraction of the pre-1967 levels.

C. Shocks and Responses

2.45 In addition to the structural factors described above, economic performance of the West Bank and Gaza has been heavily influenced by a sequence of external shocks. The post-1967 change in regional economic relations was of course the largest shock to the OT economy, which provided the backdrop for all subsequent changes. As small open economies, the West Bank and Gaza are highly prone to imported shocks, both real and nominal. In particular, the structural distortions described in the previous section have rendered the Occupied Territories economy very susceptible to economic conditions in Israel, the Gulf states, Jordan and other countries in the Middle East (which are important markets for Occupied Territories exports and its labor), and to the effects of political protest and military action. The following is a list of some of the main shocks (positive as well as negative) that have affected the Occupied Territories since 1967:

- the slowdown in Israeli growth in the mid-1970s after the first oil shock led to weaker demand in the dominant market for both labor and goods.
- the Gulf oil boom led to both strong demand for skilled Palestinian labor (and a steady stream of remittances) and contributed to substantial levels of transfers from Palestinian and other Arab sources overseas; this helped pick up the slack from Israel's poorer economic condition.
- the subsequent collapse of oil prices contributed to the first period of stagnation in the Occupied Territories in the early 1980s.
- Israeli high inflation was almost completely imported into the Occupied Territories (Figure 13) and the consequent Israeli shekel devaluation led to large real losses for the Palestinians.
- the *Intifada* had a pervasive influence on the Occupied Territories: it contributed to reduced labor demand in Israel outside construction, reduced labor supply and economic activity due to strikes, periodic border closures (and higher costs of movement), and the increased enforcement of firms for taxes, all of which slowed growth.
- the Jordanian withdrawal of public sector salary payments after 1988 and the devaluation of the Jordanian Dinar during 1988-90 were linked shocks that hit many Palestinians in the West Bank hard, many of whom traditionally have used Jordanian Dinars for savings.
- the Gulf war with Iraq led to drastic short-run effects through the closure of the border for 40 days in early 1991, followed by permanent losses due to the expulsion of Palestinians from several Gulf states, the loss of Arab grants and reduced transfers from a cash-starved PLO.
- Immigration to Israel was a large positive influence on the demand for Palestinian construction employment (new immigrants need houses but usually aren't good at construction), totally offsetting the reduced demand in industry and services.
- expectations of a peace settlement in 1992 fueled a small boom, especially in property, generally reckoned to be financed by drawdowns in savings of Palestinian families with household members returning from the Gulf. Savings repatriation may have been facilitated by relaxed restrictions by the Civil Administration.

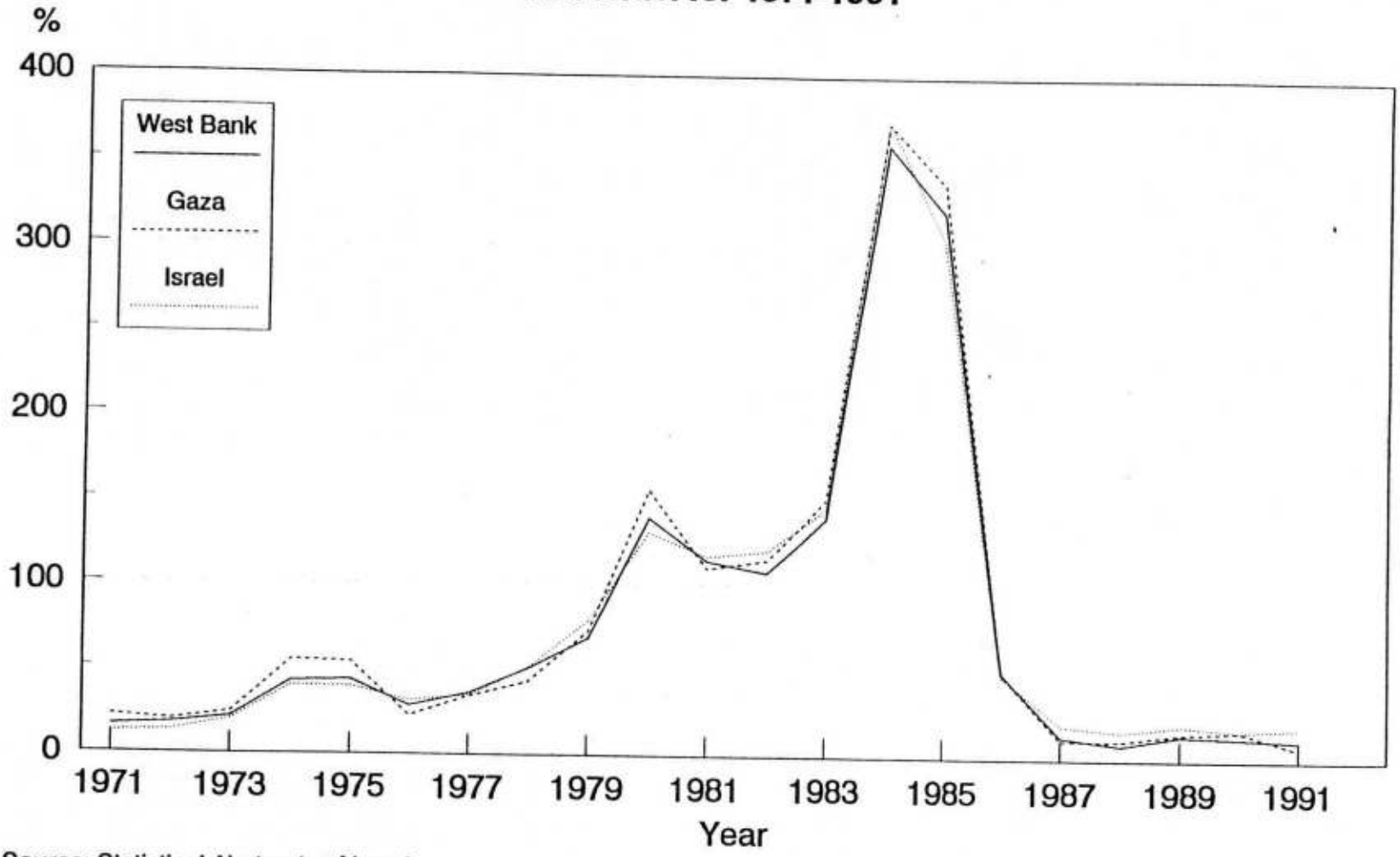
Table 3: Revenue and Expenditure Comparisons: Egypt, Israel, Jordan, Occupied Territories and Developing Countries

Average: 1987-91

	Egypt	Israel	Jordan	OT	OT 1/ Adjusted	Developing Countries
			(In percent of GDP)			
Revenue	23.1	38.6	27.2	24.1	21.7	22.1
Tax revenue	15.2	33.9	14.3	16.1	16.1	17.5
Direct taxes	5.7	17.5	3.4	4.2	4.2	5.4
Indirect taxes	9.5	16.4	10.9	11.9	11.9	12.1
Nontax revenue	7.9	4.7	12.9	8.0	5.6	4.6
Expenditure	42.2	50.2	46.4			28.0
Current expenditure	28.9	45.7	37.2			21.0
Development expenditure	13.3	4.5	9.2			7.0
Expenditure excluding defense	37.2	36.8	30.5	25.8	23.6	25.6
Current expenditure excluding defense	23.9	32.3	21.3	22.3	20.1	18.6
Development expenditure	13.3	4.5	9.2	3.5	3.5	7.0
			(In percent of GNP)			
Memorandum Items						
Revenue	21.7	39.4	28.9	17.8	16.2	23.3
of which: Indirect taxes	8.9	16.7	11.6	8.9	8.9	12.7

1/ Excludes revenues and spending of utilities.

Figure 13: Inflation for West Bank, Gaza, and Israel for 1971-1991



Source: Statistical Abstracts of Israel 1972-1992, Central Bureau of Statistics.
Inflation is rates of change in the CPI.

- the March 1993 cut in employment in Israel is causing a sharp reduction in labor incomes.

2.46 In addition to the above, the West Bank is prone to agricultural shocks, especially for olive crops. While the olive crop usually rises in even years and drops in odd years, the exact nature of the variation is more complex. The variations in the olive crop are huge and have aggregate effects. However, of much greater importance for future economic policy are the other, potentially permanent shocks such as loss in external employment earnings opportunities. We examine the shocks from the viewpoint of the macroeconomy, households and money using the shocks to explore some of the monetary history of the economies.

Shocks and the Macroeconomy

2.47 These shocks have resulted in a serious instability in incomes, both of a cyclical character, as in the olive cycle, and in the form of a permanent slowdown, as with the *intifada* and Gulf war. At an aggregate level, three mechanisms can be used to help moderate the influence of the shocks: income diversification, changes in net transfers from abroad and domestic adjustments.

2.48 The Occupied Territories have, fortuitously, done reasonably well through income diversification during many periods. Having part of the labor force in oil-importing Israel and part in the oil-exporting Gulf was an important source of risk-spreading and helps explain the continuation of growth in the late 1970s after the Israeli economy slowed. However, adverse shocks to external income sources have tended to pile on top of each other since the late 1980s. The *Intifada's* tendency to reduce income from Israel (from labor and exports), the decline in Gulf labor income and the recent sharp cutoff in employment have all hit hard. The weak diversification of trade beyond Israel make the economy highly vulnerable to this restriction.

2.49 External transfers, by contrast, have probably only weakly offset the effects of these shocks. The Occupied Territories have not been able to have an active policy in this area (though it should be added that the evidence is mixed on how successful governments elsewhere have used external transfers counter cyclically–some use higher borrowing capacity in boom times to exacerbate rather than dampen the influence of shocks). Many of the transfers also tend to be associated with other shocks. Defense apart, Israel has not increased transfers to the Occupied Territories to offset the post-*Intifada* slowing of economic activity. Arab aid (JPC)[15] declined sharply after 1985. Aid from Jordan amounted to about US$ 25 million annually, rose to an average of about US$ 50 million during 1987-88, and then dropped sharply afterwards following the disengagement in mid-1988. Aid from the Gulf States was discontinued after 1990. Aid from the US rose from 1983 to 1987, and aid from the EEC has been modest but picked up considerably after the Gulf War. Transfers from the PLO have also certainly tailed off since the Gulf war because of a lack of funds. Overall, the total amount of grants has been quite variable and appears to have been on a declining path since the late 1980s.

2.50 Finally, domestic adjustment has borne a large part of the burden of adjustment. While there are neither cyclical stabilizers nor national insurance schemes, there are some significant adjustment mechanisms. This is clearly seen for the most predictable source of income variability: the olive cycle. Despite quite large annual changes in GDP, consumption follows a smooth path. Changes in income are smoothed through changes in inventories (Figure 14) and in savings.

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[15] Jordanian-Palestinian Committee for the Steadfastness of the Palestinian People in the Occupied Homeland.

2.51 The picture is less clear for the recent sequence of adverse shocks. Declines in investment (and probably domestic savings, though the data is not available) in the initial post-*Intifada* period helped maintain consumption. The substantial drawdown of savings held abroad - spurred by the return of Palestinians from the Gulf - appears to have given an important positive impulse to the West Bank and Gaza economies in 1991 and 1992.

Shocks and Households

2.52 The economic shocks of recent years have had pervasive effects on Palestinian households. Of particular importance are the effects of adverse labor market shocks, especially the loss of employment in the Gulf and Israel. Because of the preponderance of unskilled workers employed in Israel, the recent reduction in employment is likely to hit poorer households relatively hard. It will, in the short run, also have significant multiplier effects throughout the economies.

2.53 There is no formal social security system, but at least three coping mechanisms appear to be important in the West Bank and Gaza:

(a) Alternative employment: workers move back into agriculture or construction. There is some evidence that domestic construction activity moves counter cyclically to employment in Israel, suggesting that when construction labor is more plentiful, there is greater domestic spending on housing.

(b) Running down savings: households have traditionally had high savings, a consequence of the fast growth in money incomes and the uncertainty over future incomes. These are drawn down in bad years; indeed, reduced savings in 1992 appears to have contributed to an actual expansion in activity, especially in the construction sector.

(c) Transfers: as discussed above, transfers are significant and especially for households suffering from unemployment or without active labor force participants.

Shocks and money

2.54 It is useful to review the recent monetary history of the Occupied Territories. It provides a good context in which to review the effects of the recent shocks, and it is possible to develop a picture of the role of money balances in smoothing these shocks. The West Bank and Gaza have neither their own currency, nor a central bank. The New Israeli Shekel and the Jordanian Dinar are legal tender, while the US dollar and some European currencies circulate widely as a more secure store of value. Cash seems to be the primary means of payment, and monetary savings are primarily in foreign currency (some of which is held abroad) and precious metals.

2.55 In the absence of a monetary authority and an active banking system, the money supply is primarily determined by capital inflows and outflows related to foreign trade, net factor income and net transfers. Because these sources have been very unstable in the past, the money supply must have fluctuated widely over time. At the same time, circumstances in the Occupied Territories necessitate large cash balances: cash in advance transactions predominate; large precautionary cash balances are held as shock absorbers because of the difficulties in securing short-term credit; and investment is mostly self-financed, requiring the accumulation of cash savings.

2.56 The size of monetary holdings in the West Bank and Gaza is not known. For the sake of comparison, M1 (which includes currency in circulation and sight deposits) is 57 percent of GDP in Jordan (of which 32 percent of GDP was currency in circulation and the remainder, demand deposits); 6.3 percent in Israel (of which 2.5 percent in currency); 15 percent in Lebanon (o/w 10 percent in currency); and 22 percent in Egypt (o/w 11 percent in currency). Clearly, the size of both the ratios of M1 to GDP and currency to GDP make Jordan an outlier in the region. The principal explanation for this anomaly is that the residents of the West Bank hold Dinar balances, especially in the form of currency. We explored the implications of a range of assumptions for Palestinian holdings of Shekels and Jordanian Dinars (from similar holdings relative to GDP shares to a third more in relative terms, given the relative scarcity of alternative financial assets). This produces a range of the ratio of M1 to GDP of 30-55 percent and an adjusted ratio for Jordan of 30 to 45 percent.

2.57 One could, in principle, get a better sense of the way in which the Occupied Territories reacted to the various monetary and real shocks between 1985 and today by looking at the changes in money supply over time. For an economy without a central bank, this can be achieved by estimating capital movements from the balance of payments. We attempt such an exercise in spite of the severe data limitations. We estimate the total residual from the balance of payments to try and develop some picture of the flow of funds between the Occupied Territories and the rest of the world.

2.58 Starting from the balance of goods, services and identifiable transfers and capital flows (factor income, and transfers from UNRWA, EEC, USA, Jordan, JPC, and Islamic organizations), any residual surplus (deficit) must be offset by unrecorded capital outflows or reserve accumulation (capital inflows and reserve depletions). Other possible deviations can be due to the under-reporting of trade (especially with Israel) and of labor income (from Israel and especially from the Gulf), and changes in supplier credit (especially from Israeli suppliers). The analysis suggests the following results (see Figure 15):

(a) The current account (including official and private net transfers) of the Occupied Territories has traditionally recorded a surplus with Jordan and a deficit with Israel and the rest of the world. The overall position was usually in surplus, at least until the mid-1980s reflecting the domestic accumulation of foreign cash balances. The estimates also reveal that the JD holdings to GNP ratio was consistently over 50 percent, a large ratio by international standards.

(b) During the Israeli high inflation episode of 1983-85, real money balances fell, probably with an increased substitution away from the Israeli Shekel and towards the Jordanian Dinar (note that unrecorded capital flows cannot have been large in this period since the regional oil boom had collapsed by 1983). The fall in cash holdings can be explained by several factors. First, coming on the heels of a prolonged period of growth, the level of reserves must have been high in 1985, and portfolio rebalancing could not, in the aggregate, be accommodated with a net shift from Israeli Shekel to Jordanian Dinar, given that neither currency was easily convertible into foreign currencies. Second, transfers from abroad started declining as real wages fell in Israel, employment stagnated in the Gulf and the Iran-Iraq and Lebanese wars raged in the region. Third, the slowdown of the economies of Israel and Jordan made it difficult to increase exports, while imports, especially of consumer goods, continued to trend upwards. Fourth, because economic activity was stagnating, the need for real balances may have declined. While it is not possible to estimate the real losses suffered by Palestinians as a result of the Israeli Shekel inflation, it is unlikely that this loss was great for West Bank residents because they had started shifting to other currencies since the early

1980s.[16] The residents of Gaza, however, where the scope for shifting may have been less since the Jordanian Dinar is not legal tender, may have suffered larger losses. In any event, this episode must have eroded and unbalanced cash balances. In the following two years, households replenished their balances substantially.

(c) The available evidence indicates that the Jordanian Dinar devaluation at the end of 1988 and in early 1989 must have come as a surprise to the residents of the Occupied Territories. In the past, the Jordanian Dinar had been the preferred store of value in the West Bank because of its historic stability, which was reinforced by the Israeli high inflation of 1983-85. (See Figure 16 for the relative stability of the JD.)

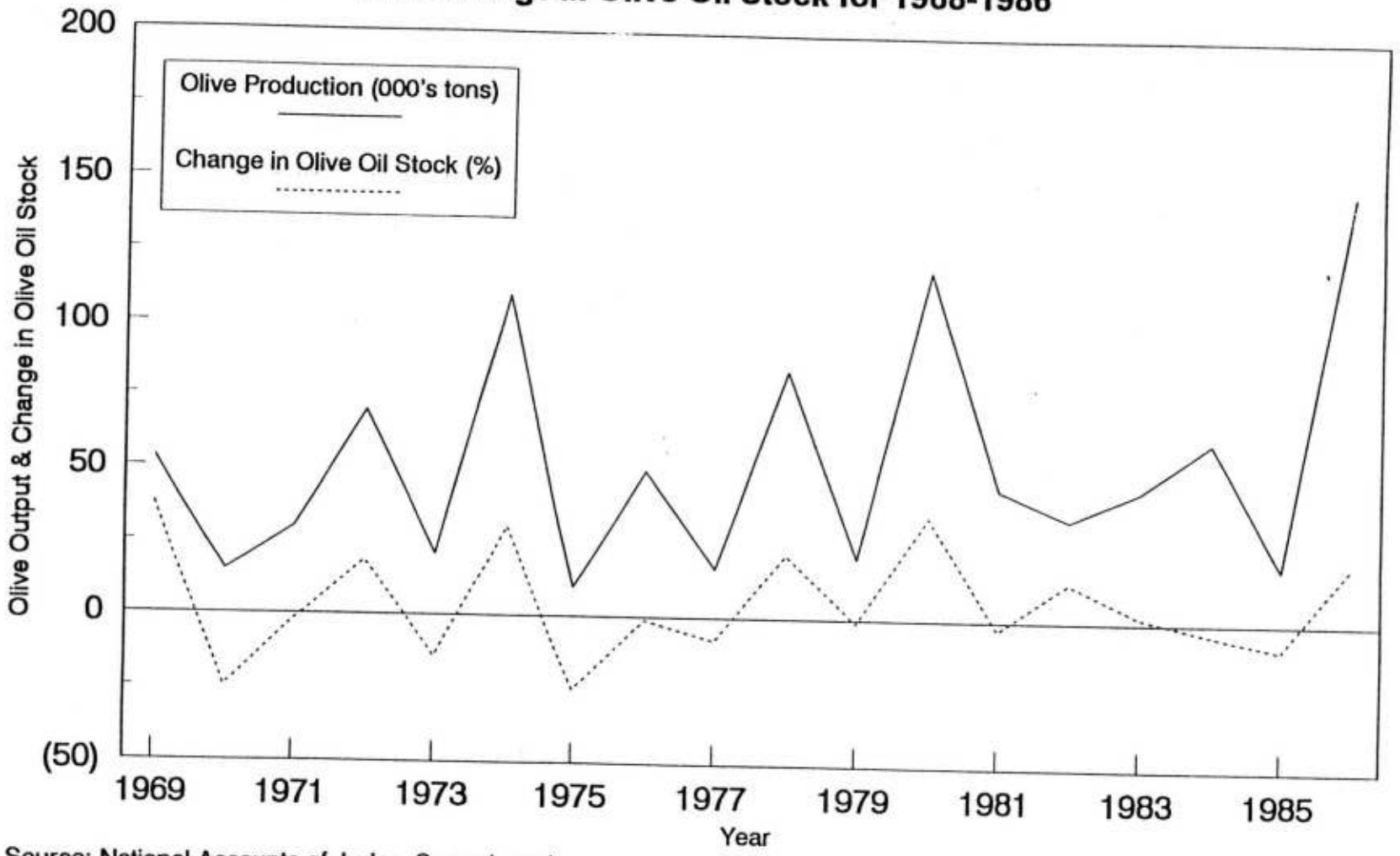
(d) During 1990-92, cash balances seem to have fallen considerably in spite of large transfers of savings from Kuwait. In 1991, the last year with reasonably good data, reserve drawdowns and unrecorded private sector capital inflow were about 10% of GNP. This was probably a major source of the short-run smoothing of the adverse shocks of the early 1990s. They provided the financial basis for what appears to have been a minor boom in 1992, but they are unlikely to be sustainable for more than a few years. A similar phenomenon occurred in Jordan and Yemen.

Conclusion

2.59 The economies of the Occupied Territories are characterized by an unusual dependence on external sources of economic growth. As a result, they are also vulnerable to external shocks, although the net effect of past shocks has not been to generate large fluctuations in the overall level of economic activity since the shocks have often worked in opposite senses. Nevertheless the changes that have occurred in the past several years–from the Gulf to Israel–all add up to a large and probably permanent adverse change in these external sources of income growth. To offset adverse external developments, future income growth will have to depend on an expansion of production based in domestic centers of economic activity. This was clearly true prior to the sharp reduction in employment in Israel in March 1993. If this reduction is permanent, the need to reorient the economy will be much more urgent. In the past, the economy has not had the structural policy options to support such a reorientation of the pattern of development. Indeed all the underlying policies and structural realities have pulled in the opposite direction, and the economy has not had the macroeconomic policy instruments to manage shocks. In the future, policies will be central to a reorientation in the pattern of development.

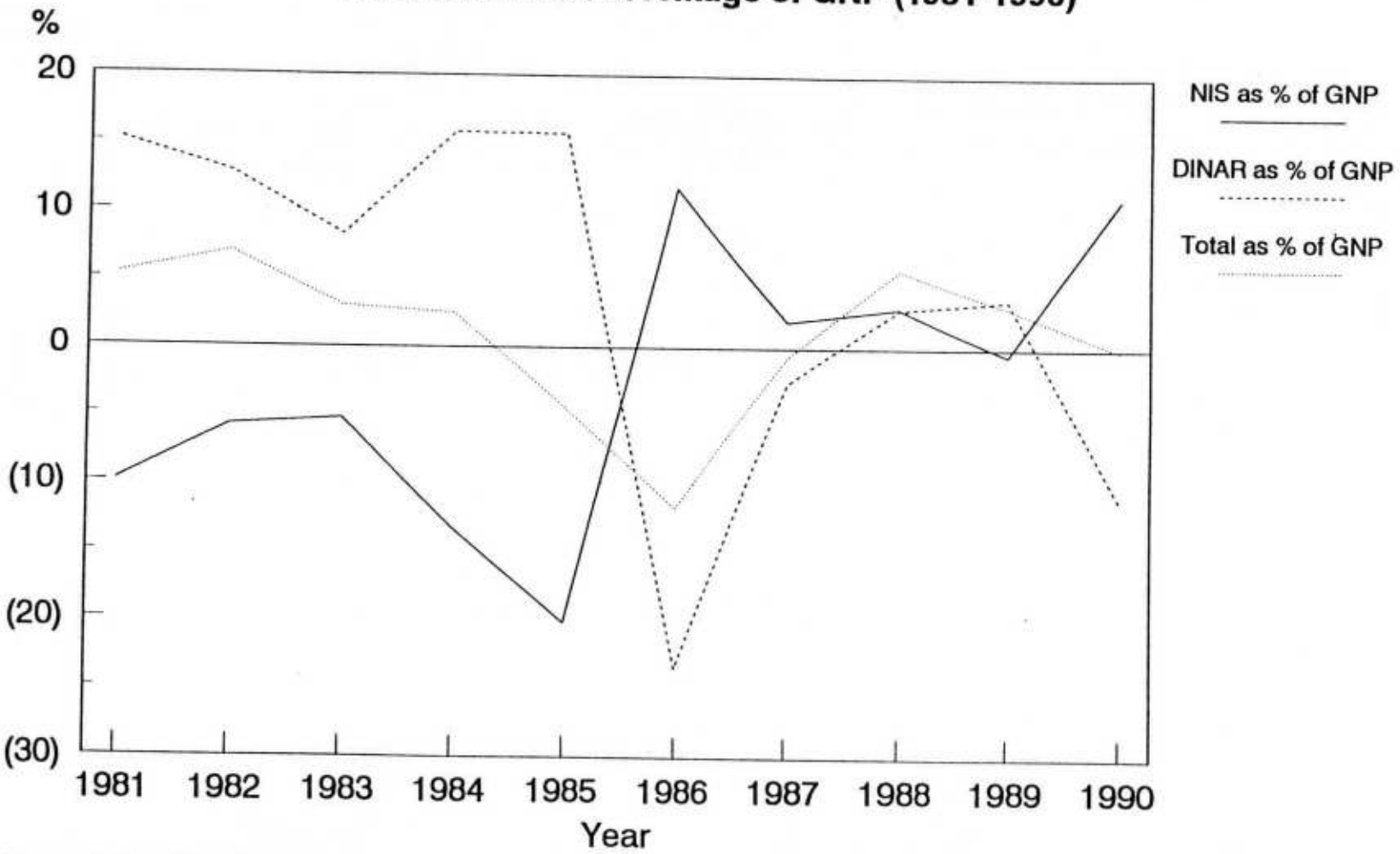
[16] Hamed and Shaban (1992) calculate that–in the absence of currency substitution–seignorage on Shekel holdings would have amounted to about 5 percent of GDP during 1984-85. Since there clearly was currency substitution, actual seignorage would have been lower. On the other hand, seignorage on JD holdings could have been substantial.

Figure 14: West Bank Olive Production and Change in Olive Oil Stock for 1968-1986



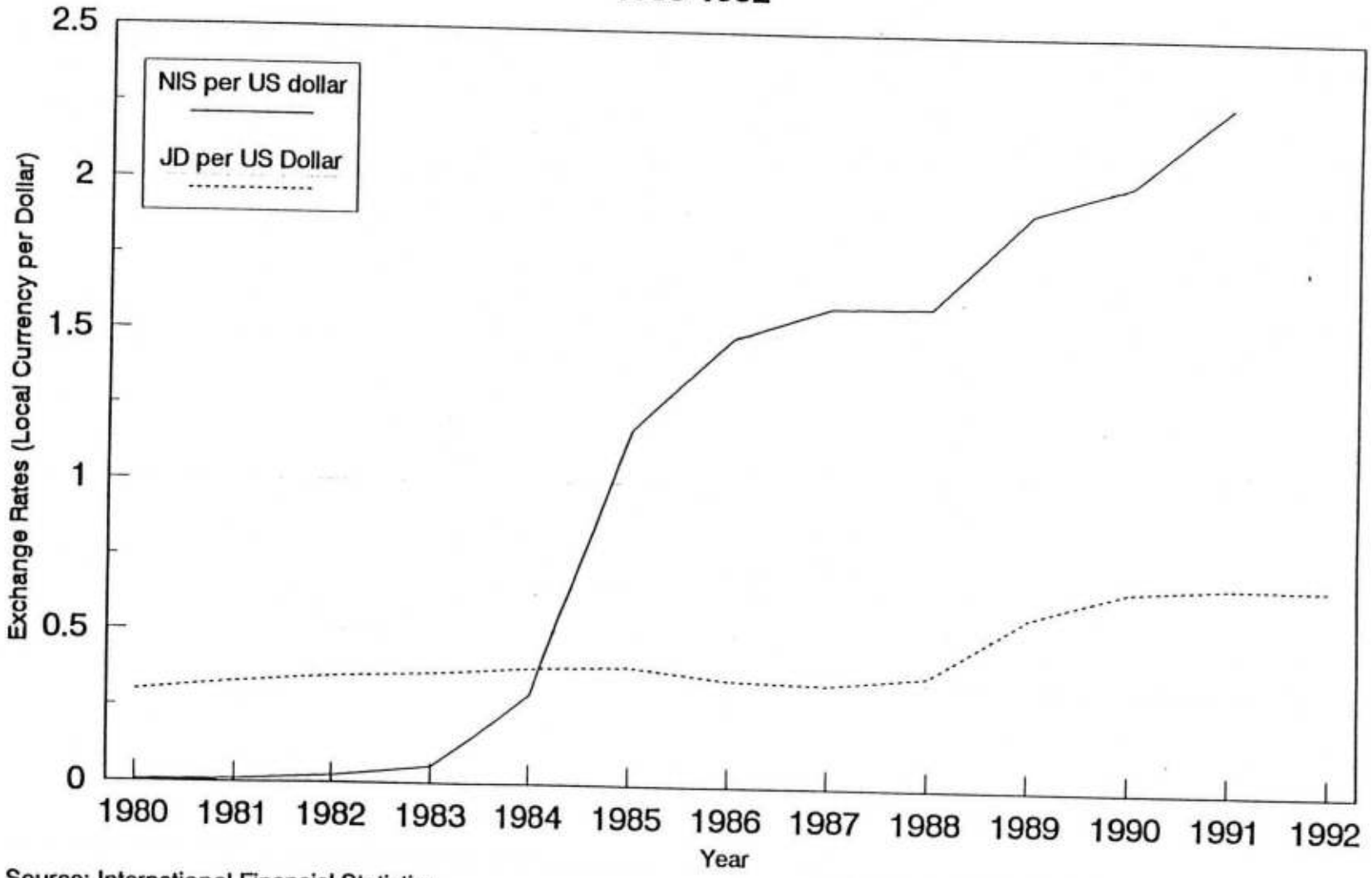
Source: National Accounts of Judea, Samaria and Gaza Area, 1968-1986
Central Bureau of Statistics,Special Series 818

Figure 15: Change in Money Balances in Occupied Territories as a Percentage of GNP (1981-1990)



Source:Calculations based on data extracted from
Statistical Abstracts of Israel, 1970-92.
Central Bureau of Statistics.

Figure 16: NIS: $US and JD: $US Exchange Rates 1980-1992



Source: International Financial Statistics, IMF, 1992.

III. STRUCTURAL POLICY CHOICES FOR THE FUTURE

3.1 In Chapter II it was argued that the past pattern of development for the Occupied Territories was conditioned by four factors: asymmetric trade relations (with Israel and the rest of the world); regulatory constraints that restricted private sector activity; fiscal compression that reduced the public provision of social and economic infrastructure; and a declining access to natural resources. Structural policy reform is about change in each of these areas. The primary focus here is on the first: on policies affecting relations with Israel and other countries. The second is discussed in detail in the private sector development report, the third in the reports on social development and economic infrastructure and the last in the report on agriculture. We briefly outline the issues covered in those reports to place them in the overall context of economic growth and development.

A. Trade Without Restrictions

3.2 If trade in the Middle East were not governed heavily by restrictions, what might the pattern look like? Would there be a major reorientation of Israeli and Occupied Territories trade? To explore potential trade patterns, a simple approach (a gravity model) was employed to explain trading patterns in terms of a few key variables: the size of economies; the economic distance between them; and other variables, such as common language. (See Annex 3 for a description of the model and empirical estimation.) Results should be treated only as indicative. The model probably does a relatively poor job of catching the consequences of very short trading distances to Israel of almost all locations in the Occupied Territories. The model does not also address the question of what happens to overall trade levels, but simply trade shares. It does not examine relative competitiveness, and it is almost entirely policy-free: the exception is that indications of the consequences of free trade areas can be given based on experience elsewhere. However, it is the only model with any success in explaining international trading flows. (It has been used, for example, to examine whether Eastern European trading patterns would be expected to be very different after the quantitative ties within Comecon were released).

3.3 The results indicate that the extent to which the Occupied Territories are oriented toward Israel in their trading patterns is way above what would have been expected from international experience. Even under a scenario that assumes a common language (that is interpreted here as a proxy for the persistence of the history of economic interaction) and a free trade area (for all goods), the West Bank and Gaza would only purchase 36 percent of total imports from Israel and have 20 percent of its exports, compared with 90 percent of imports and 75 percent of exports in the mid-1980s.[1] (See Table 4) As might be expected, trade with the rest of the Arab World would be expected to be proportionately much higher at 40 percent of total exports, but a rise in trade with Europe, to 15 percent of total exports, would also occur. This assumes, in effect, that Arab countries had a trade regime similar to that of other countries of similar income level.

3.4 A measure of what might have happened in the absence of the post-1967 integration with Israel is given by the share of trade assuming neither a common language nor a free trade area (but still a common border). International experience suggests that the share of both exports and imports with Israel

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[1] This is based on Israeli statistics that may underestimate trade that passes through Israel to the rest of the world.

Table 4: Predicted Shares of Occupied Territory Trade Under Alternative Assumptions				
	Sharing Border & Language & FTA with Israel		Sharing Only Common Border with Israel	
Partner	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)
Israel	36.2	20.2	2.3	1.5
Egypt	4.5	6.8	4.5	6.3
Jordan	2.2	3.9	5.8	6.4
Other Arab	10.4	28.8	18.3	36.3
Europe	16.3	15.6	26.0	18.3
North America	14.9	6.2	20.8	9.9
Other	15.5	18.5	22.3	21.3
Total	100.0	100.0	100.0	100.0

would have been a mere 2 percent under these assumptions (see the second column of Table 3.) To the extent there is an "immediate neighbor" effect, for example if such proximity avoids fixed costs of trading above a certain distance, this may understate likely trade. Yet it illustrates that trade patterns would be expected to be substantially different. Experience of other near-neighbors is mixed: The Benelux countries have 56% of their trade with non-neighbors; Singapore has 86%. The orientation toward the region is stronger, but under this scenario over 50 percent of total trade would be outside the region, with a high share with Europe.

3.5 A comparable exercise was undertaken from Israel's perspective (Table 5). The consequences of opening the Occupied Territories to trade with the Arab World extends to its effects on the Israeli economy. If Israel and the Occupied Territories stay in a common customs area, then opening the Occupied Territories borders is virtually synonymous with opening Israel's borders in the same direction. Indeed, under almost any scenario, the implications of opening the Occupied Territories borders is likely to extend to the Israeli economy. In this exercise, actual distances were used, but the assumption of a common language with other countries was not made, since there has been so little interchange in the past. The results suggest that in the absence of restrictions, Arab economies (excluding the Occupied Territories) would account for over 6 percent of Israel's exports and over 7 percent of imports, compared with zero now. This is a substantial, but hardly overwhelming, reorientation of trade. Israel would continue to be mainly oriented to developed countries, with 50 percent of exports and 70 percent of imports to or from Europe and the USA.

3.6 These results should be interpreted with caution. They represent a plausible picture of how trading patterns might look in the long term, if trade behaved as it does in other countries with similar income levels. They do, nevertheless, strongly support the intuition that Palestinian trade would be much

more diversified in the absence of historical restrictions on trade. They also suggest that the hopes (or fears) that Israeli goods would have a large impact on regional trade if the boycott were lifted are exaggerated. This is consistent with the view that Arab countries would continue to import their manufactured goods largely from more efficient developed or developing countries and shows the potentially powerful influence of free trade arrangements in fostering trade. What will actually happen is influenced by policy, to which we now turn.

B. Trade Policy Choices

3.7 The movement in labor and the trade in goods are intimately associated for the Occupied Territories. As discussed in Part A, the West Bank and Gaza exported labor in the place of goods, partly because of an asymmetric structure of incentives. This, in combination with explicit trading restrictions to some markets and the high costs of trade to others, also contributed to the extraordinarily high orientation of trade toward Israel just analyzed and to the unusually low level of production of industrial goods illustrated in Figure 6.

3.8 The illustrative vision of the *direction* of trade in goods we have just shown would most certainly be associated with a substantially higher *level* of exports of goods, lower exports of labor and shifts in the *structure* of trade. Such changes in the trading structure would also involve, over time, substantial changes in the structure of production, with most probably a relative expansion in industry in some services (notably tourism) and in some agricultural goods. (As noted in Chapter II, the share of agricultural goods in both exports and total trade was unusually low by international standards.) While

Table 5: Actual and Predicted Export and Import Shares for Israel

	Imports		Exports	
Partner	Actual Share (%)	Predicted Share (%)	Actual Share (%)	Predicted Share (%)
Egypt	0.0	3.1	0.0	1.2
Occupied Territories	2.6	2.2	9.3	4.3
Jordan	0.0	0.5	0.0	0.4
Other Arab	0.0	3.9	0.0	4.8
Europe	68.0	63.8	37.1	34.5
North America	20.5	14.5	33.1	16.2
Other	8.9	12.0	20.5	38.6
Total	100.0	100.0	100.0	100.0

it is neither possible nor particularly useful to predict the actual future composition of trade and production, it is clear that this type of reorientation is entirely in line with the strategic objective of shifting to domestic sources of economic growth.

3.9 Exploring trade options for the Occupied Territories is an activity that has a feeling of paradox. On the one hand there is a bewildering range of choices of trade options, ranging from the status quo of an incomplete customs union with Israel, to alternatives with Jordan, with or without Israel, to Free Trade Areas as variants of these, to going it alone with an independent trade and industrial policy. On the other hand, actual choices will at any point of time be highly restricted, by the political outcomes of the negotiations and (at least for now) by the costs and difficulties of having a customs border between Israel and the West Bank.

3.10 In this report we lay out a number of the alternatives that could become available in principle, and outline some of the issues associated with them. From an economic perspective, these alternatives should be evaluated with respect to four objectives:

- building on the base of the established major market of Israel;
- the aggressive pursuit of new markets (in the region and elsewhere);
- movement toward a more rational price structure than now prevails, largely imported from the Israel incentive regime, and
- the longer term impetus to growth and development.

3.11 Figure 17 presents a number of alternatives, which should be analyzed in the context of the objectives. The various alternatives focus especially on relations with Israel and relations with Jordan, as the two principal other actors for trade relations. For each, the costs, benefits and some practical issues or implications are outlined. Most could apply, in differing degrees, either under a scenario of sudden reduction of employment in Israel or smooth decline.

3.12 Scenarios (1) to (2) focus on relations with Israel within two alternative forms of preferential trading arrangement--a customs union and a free trading area. Both have the advantage of maintaining access to the dominant present market and both could in principle facilitate access to the EC, EFTA and the USA on the back of Israel's free-trade arrangements. (Access to the EC already exists for Palestinian production, but use is still low). The customs union is closest to present arrangements. It would be most advantageous if extended to include agricultural goods. It has the disadvantage of continuing to involve operating within the relatively differentiated Israeli trade regime--though this would decline if Israel keeps to its ambitious liberalization schedule.

3.13 Converting the customs union to a free trade area has the potential advantage of combining access to the Israeli market (subject, perhaps, to continued restrictions on agricultural products) whilst allowing the West Bank and Gaza to have a different trade and tax regime, as Mexico would have a different regime from the United States in NAFTA. Just as Mexico's trade regime is probably more rational than that of the United States, so the West Bank and Gaza would then be able to put in place a simpler and more uniform system of protection. The key question is whether an independent trade and tax policy is feasible.

3.14 Scenarios (3) and (4) turn to the issue of opening up to trade relations with Jordan--an issue that could be even more important, for example, if some form of confederation were chosen in a political settlement. In principle, it would be possible to either have some form of open trading arrangement (customs union or FTA) without a confederation, or a confederation without open trade--but it is likely that political and economic directions will move together.

3.15 The key issue is whether the option involves a three-way preferential trading area involving Israel, the Occupied Territories and Jordan, or one that was only two-way, and involved the Occupied Territories leaving the Israeli area. The former is potentially more economically attractive from the perspective of the Occupied Territories, since it would bring opening to Jordan without the economic costs of any loss of the Israeli market. It would involve, however, significant issues of adjustment over time. It would involve, eventually, free or near-free movement of goods between Israel and Jordan. Because of the restricted interactions between the economies, this could raise larger transitional issues for adjustment of producers in either economy. It is likely that interim arrangements would be preferred, with a transitional period maintaining economic border controls. Finally, under either option, but especially a two-way one between the Occupied Territories and Jordan, the economic attractiveness would depend on the extent to which Jordan has a rational price structure. Since this report did not assess the Jordanian trade regime or other forms of interventions, we can only raise this as an issue, without drawing any firm conclusions.

3.16 Scenarios (5) and (6) involve leaving the union with Israel and having an independent trade policy (e.g., lower tariffs to all countries). This is most in line with trade reorientation but leads to the loss of duty-free access to the Israeli market and probably increases the probability of lower access to the Israeli labor market. It again raises the practical issue of running a different tariff/tax regime. One version of this would be differential tariffs to run a proactive industrial policy, e.g., having a tariff regime that targets certain lines of activity, but other instruments, such as domestic tax/subsidy policy, are also available. The case for some activism in the West Bank and Gaza is that a push is needed after decades of adverse incentives; the potential problems are of protecting inefficient activities (particularly costly for a small, open economy) and the fiscal burden of a "favorable" tax-subsidy policy. International experience suggests that most attempts at activist industrial policy produce inefficient industries rather than dynamic industrialization - and a small, open economy with hardly any administrative tradition will be particularly ill-placed to get onto a desirable path.

Does the Incentive Regime Have to be Harmonized with Israel's?

3.17 In many of these areas there is a question of how far the Occupied Territories can have an incentive regime that is different from the one in Israel. One view is that this is impossible: the open border implies that the West Bank and Gaza would have to have the same tariff and indirect tax structure as Israel. A review of experience elsewhere (notably in the European Community where there is an ongoing debate on the issue) suggests that a border is feasible but has difficulties. First, it is feasible to have customs gates, and although there is no overwhelming practical reason why this should not be done, there may well be political reasons especially during the interim period of self-governing arrangements. Second, it is possible to have an invisible border for tax purposes, and the VAT infrastructure, which is already based on company accounts, could be used to manage this. However, it would be costly to do this for small farms. Third, direct taxes can be used as an alternative instrument for some purposes. There are, of course, limits to non-harmonization: any border, visible or invisible, is subject to a degree of leakage, and some movement will occur (as it does now in agricultural goods). This is a cost for Israel if the Occupied Territories were to have lower tax rates.

Figure 17. Alternative Options for International Economic Relations

Policy	Advantages	Disadvantages	Issues/Implications
(1) Customs union with Israel	Access to Occupied Territories's biggest market (about 90% of its imports and 70% of its exports). Potential to join Israel in its preferential access to EC, US and EFTA markets.	Trade diversion because of Israeli trade regime, buying expensive Israeli rather than cheaper ROW (at least until 1998). Israeli competition may make it harder for industries to get started, though some industries may gain from complementary production with Israeli industry.	- How to insure access to EC, US and EFTA markets. - Link with Israel could push up wages; though competitiveness of OT industry will depend more on macro and labor policies. - Potential advantage depends in part on access to Israeli agricultural market;
(2) Reconstruction of current (partial) customs union as a free trade area, with differential external tariffs.	Could, in principle, combine free trade with Israel and avoidance of areas of excessive Israeli industrial protection.	Scope for independent action will be constrained by conditions of free trade area. Administrative difficulties with respect to border controls and rules of certificates of origin.	- Requires a non-harmonized incentive regime to lead to gains over customs union. - Potential advantage depends in part on access to Israeli agricultural market;
(3) Preferential trading area (customs union or FTA) with Israel & Jordan.	Preserves access to Israel while opening to Jordan, encouraging integration with a close neighbor.	Jordanian competition could lead to short-run costs to some Palestinian producers.	- Implies free flow of goods between Israel and Jordan; convergence to CU or FTA may have to be gradual. - Need for harmonization with Jordan of direct tax/subsidy policy.

Figure 17. Alternative Options for International Economic Relations (continued)

Policy	Advantages	Disadvantages	Issues/Implications
(4) CU or FTA solely with Jordan.	Increased integration with a close neighbor.	Some loss of larger Israeli market. Possible greater loss of labor access to Israel. Especially with a CU, greater likelihood than (3) of having Jordanian incentive policies.	- Requires a non-harmonized incentive regime with Israel.
(5) Leave union; moderate tariffs with ROW.	Cheaper ROW imports, but not by much after 1998 if Israeli liberalization stays on track. Infant industries would get moderate protection from Israeli competitors.	Access to Israeli market reduced, though not by much after 1998. Possible loss of access to Israeli labor market. Industrial protection may be a cost more than a benefit.	- Requires a non-harmonized incentive regime with Israel.
(6) Industrial protection policy.	Assuming externalities, protection will help internalize them and will help the sector develop.	Possible retaliation by Israel. Possible loss of access to Israeli labor market. Temporary protection may be co-opted by interested parties and may lead to inefficient industries and wasteful rent-seeking.	- In principle industrial policy can be affected by direct taxes and subsidies, but weak administrative capability to run any industrial policy makes it problematic.

3.18 If administrative feasibility is not a constraint, how should these choices be assessed? There is no clear-cut answer, in part because it depends on what Israel and other parties may be willing to offer and, in part, because some questions still need to be answered: Does the present wage structure render the productive sectors significantly uncompetitive in world markets, or are relatively high wages offset by high productivity? Also, is there a need for a push, beyond market opening and deregulation, to initiate the growth and reorientation of the productive sectors after decades of operating under a particular set of biases?

Is There Going to be a Problem of Competitiveness?

3.19 One of the features of past development was a sharp rise in wages, especially in the early period of integration with Israel. Employment in Israel helped pull up wages within the Occupied Territories, through reducing the supply of labor to the domestic market. By 1980, wages in agriculture, industry and construction were substantially above those prevailing in 1970. (Figure 18) Wages in the West Bank and Gaza probably now fall in the upper part of the regional wage structure: below Israel's wages, but significantly above Jordanian wages, which are, in turn, much higher than Egyptian wages. Palestinian unskilled labor was exceptional in having access to the relatively high-paying Israeli market. Low-cost Egyptian labor was also highly mobile but to other Arab states, including Jordan. Palestinian industries and farmers would have to compete with cheaper labor elsewhere, if there is an opening to the regional market.

3.20 Simple wage comparisons can be highly misleading since wage costs only account for part of the cost of production (well under half for most industries), and there can be huge differences in productivity and product quality. Italian wages in garments are a multiple of wages of garment producers in Hong Kong that are, in turn, a multiple of those in Bangladesh even though all produce garments for the international market. We have insufficient information to assess whether competitiveness is a problem. Too much emphasis on studying the present situation to assess competitiveness would in any case be inappropriate since firms adjust when faced with new markets or competitors; the process of opening up would itself lead to dynamic change. However, two pieces of indirect information suggest that the West Bank and Gaza economies have not gone seriously off course.

3.21 First, there is no evidence that the Occupied Territories developed a severe Dutch Disease [2]. A key indicator is not the real wage but changes in unit labor costs--wages adjusted for the growth of labor productivity. Over the 1970-90 period, unit labor costs show, if anything, a downward trend for industry in the West Bank and Gaza and for agriculture in the West Bank and no long-run trend for agriculture is evident for Gaza (Figure 19). Rises in labor productivity (See Figure 7 in Chapter II) offset rises in wages. The only sector with evidence of a large increase is Gaza construction, which is relatively unimportant for international competitiveness. This evidence needs to be treated with some caution: in particular, it assumes that wages in the market (for which we have information) equal implicit wages in household enterprises, where a significant part of employment occurs. However, a serious adverse change would be expected to show up in the indicator constructed here.

3.22 Second, the private sector report undertook some comparisons of efficiency of production of selected industries. These were also reassuring: the price and efficiency comparisons suggest much of

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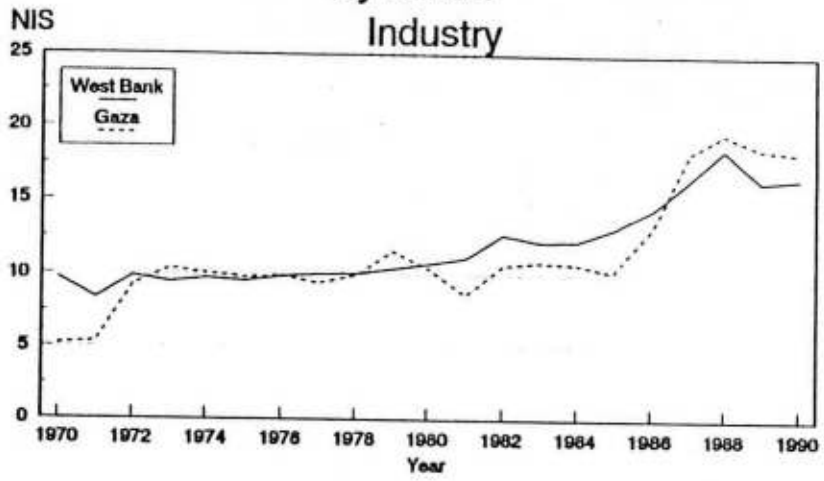
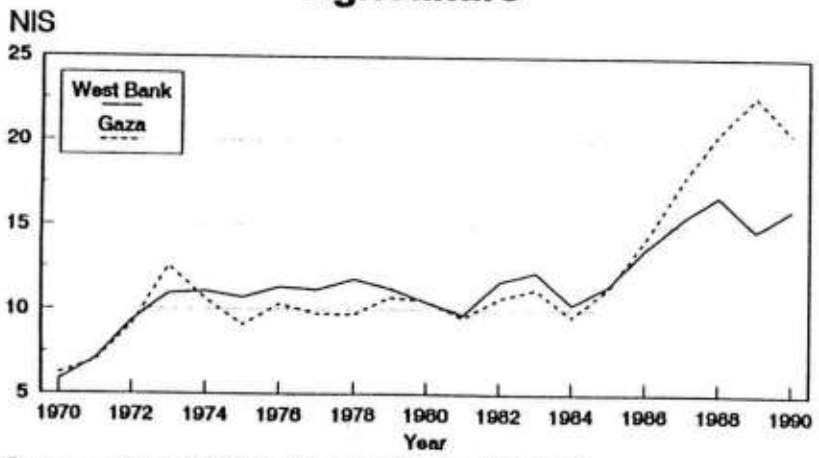
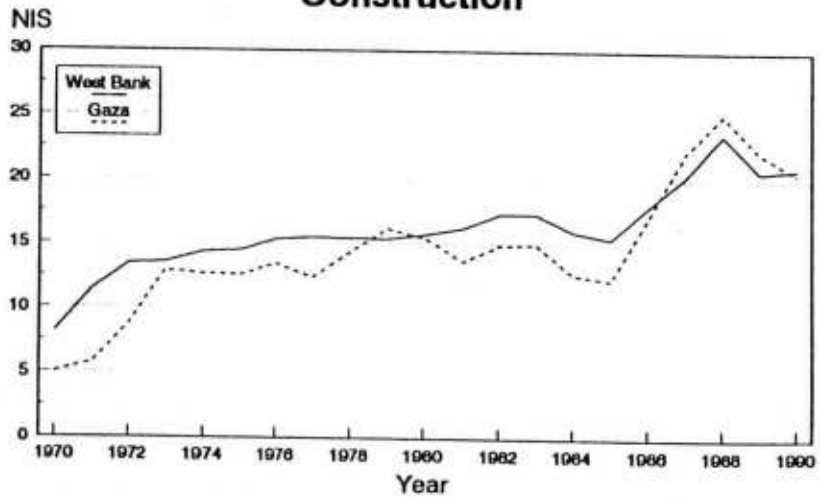
[2] Oil exporters, having enjoyed an exchange rate appreciation and real wage increases in the boom phase, are left with uncompetitive tradeable goods after the oil starts running out.

Figure 18: West Bank, Gaza Daily Average Real Wage Levels, 1970-1990 (NIS at 1986 prices) by Sector

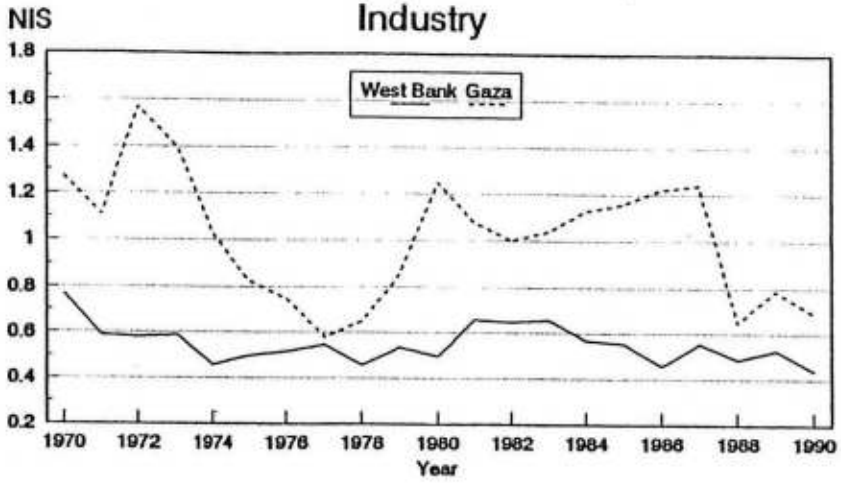


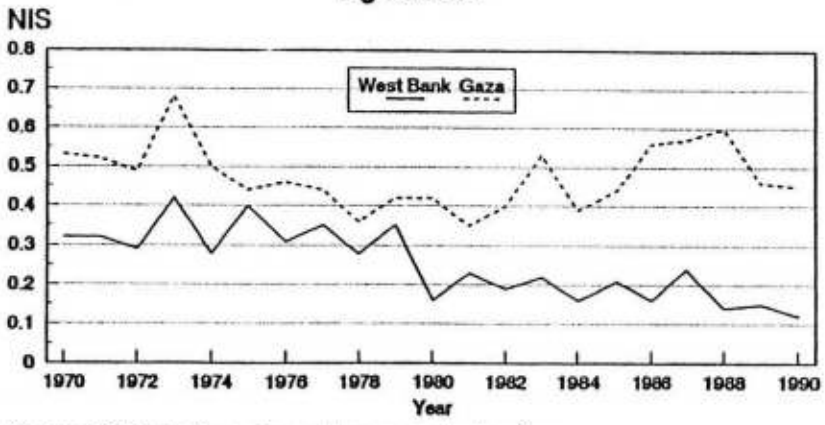


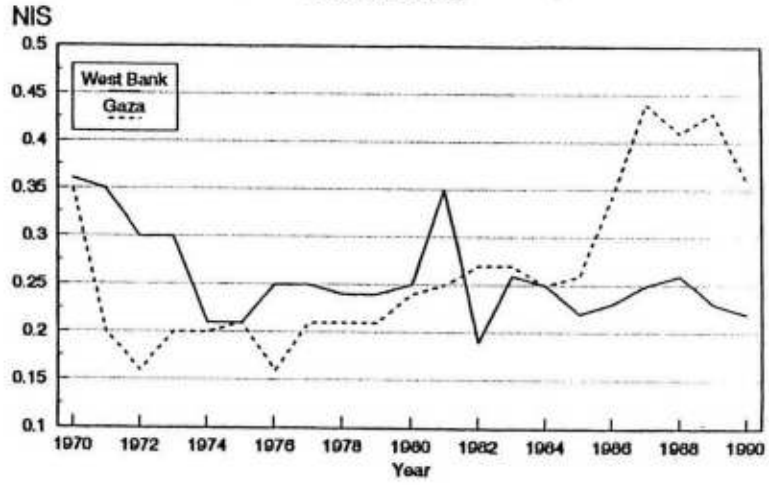


Source: Statistical Abstracts of Israel 1975-92
Central Bureau of Statistics

Figure 19: Unit Labor Costs 1970-1990, by Sector (in NIS at 1986 prices)







Source:Calculations based on constant prices wages & value Added figures.Total monthly work-days are assumed to be 20 days/month.
Statistical Abstracts of Israel,CBS.

Palestinian industry is reasonably efficient and could, in principle, compete on international markets. Questions have been raised as to whether Palestinian farmers can compete with Jordanian farmers (discussed in the agriculture report), but at this stage we have too little empirical information to form a clear view on this.

3.23 Of equal importance to the issue of current efficiency is the question of whether the economies will adjust easily or with difficulty to greater openness to non-Israeli markets. The labor market appears to be quite flexible, and firms appear to be responsive to changes in economic circumstances. This would suggest that wages would adjust and that firms and farmers would respond to changes in market conditions, increased openness to the outside world or a cutoff in labor. Flexibility may prove to be a necessary part of adjustment if the cutoff in labor is maintained (though the projections in Chapter VI suggest there could be a recovery in wages with good policy and adequate capital inflows). The extent of this flexibility has not, however, been tested in the past, and it is quite possible that the labor market will initially respond with a large rise in unemployment and a small fall in wages. In countries with an independent currency, adjustment can be facilitated by exchange rate devaluation - this may or may not be an option in the future for the West and Bank and Gaza (see Chapter V). Option (e) above is an alternative strategy for ensuring greater competitiveness through lower domestic wages, whether through taxing labor exports or allowing inflows of cheap unskilled labor. There would be distributional issues to assess: while the economy as a whole would likely benefit under either of these strategies, Palestinians with few skills may suffer relative to entrepreneurs and skilled workers. It is also recognized that even temporary inflows of labor are likely to be a politically sensitive issue for many of the parties involved.

Which Approach is Best?

3.24 In this section we have avoided a definite ranking of alternatives since too little is known and much must still be determined at the negotiating table. However, a few conclusions can be drawn. First, an appropriate overall strategy is to maximize new trading opportunities without causing significant losses in the principal market of Israel. Second, it is not clear that either the harmonization or the competitiveness issue is an overarching constraint–though a border may not be feasible in the interim period and there will remain significant administrative implications and bounds on incentive choices in the long term. Third, the extent to which it is advantageous to remain in a union or free trade area with Israel depends on two questions: (a) how far Israel will adhere to the basic principle of symmetry in such an arrangement by allowing free competition in labor-intensive activities, including both new industries and agriculture; and (b) whether Israel stays on course with its ambitious liberalization plans. Fourth, international experience raises a number of warning signs regarding the pursuit of an activist industrial policy, such as highly differentiated tariffs; broad support for exports is likely to make more sense. A free trade area (if it becomes an option), with an incentive regime somewhat more uniform than Israel's but converging together by 1998, looks an attractive option in light of these considerations. Some of the actions on the labor market may be an additional option, although this does not look to be a pressing issue now, if reduced employment in Israel is maintained.

3.25 Another possibility is to extend either the customs union or free trade area to other countries, notably Jordan, possibly Lebanon. International experience suggests this would give a substantial boost to trade with Jordan. This is desirable and may foster regional cooperation and reduce the probability of future conflict.

C. Lifting the Regulatory Burden

3.26 Changing the structure of market opportunities is essential to economic reorientation, but structural changes will not occur if the private sector does not respond. A theme of the past pattern of development, which is expanded in the companion report on private sector development - is that a range of features of the business environment have held back private entrepreneurs, especially in the medium- to large-scale sectors. These include an uncertain legal framework, restrictions on investing, uncertain tax liabilities, limited financial services and poor access to trading networks that link into the international economy.

3.27 The kinds of policies that can be changed to improve the business environment can be usefully divided into two: lifting regulatory burdens and building institutions. Lifting regulatory burdens can often be undertaken swiftly. As noted already, the Civil Administration has taken action to reduce the burden through a streamlined approval of investment permits, dropping the *de facto* difficulties in getting approval for industrial activities that compete with Israeli firms and providing tax incentives for investment. Considerable uncertainty remains, and a new self-governing authority would need to take further steps to solidify these initial moves, as discussed in the private sector development report. Building institutions, by contrast, takes time (see Vol. III). In particular, sound financial systems need to be carefully fostered. Absence of financial services will be a short-run constraint on activity. Some checking services are already being provided with apparent efficiency by money lenders, and almost everywhere in the world, equity is the primary source of finance for expansion. However, a sound banking system is of great importance to future development, to support the mobilization of household deposits and provide working capital and other financial services to an expanding business community.

D. Public Spending and the Regional Pattern of Comparative Advantage

3.28 Providing a strong basis for recovery on the supply side will also require redressing some of the shortages of public goods: for example in power, in water supply and sewerage, in industrial land and in education (perhaps especially in technical education expense). As discussed in the reports on economic and social infrastructure, this will require the rehabilitation and expansion of investments and the establishment of the institutional framework for sound sectoral policy. In the short run, action on economic infrastructure will play a vital role in removing constraints or costs to business expansion, e.g., in expanding industrial land and in making electric power, roads and water available to the business sector. This may require policy changes (e.g., on land allocation decisions) or a crash investment program.

3.29 In the medium to longer term, *both* economic infrastructure and social development are central in maintaining the historical comparative advantages of Palestinians (in skills, entrepreneurship) and in supporting the steady reorientation of comparative advantage in favor of greater interdependence. There is a parallel between infrastructure and trade. The West Bank and Gaza economies can potentially exploit their geographic and, to some extent, political position in between Israel and the major Arab states. The technical analysis of the infrastructure team suggests that for some infrastructure sectors (notably regional transport and electric power) the rational economic strategy would be to exploit this intermediary location, for example linking into power networks in Jordan and Egypt, in addition to Israel, as well as taking advantage of some peaking capacity within the West Bank. This would also tend to increase the degree of mutual interdependence amongst economies, which would increase the security of the West Bank and Gaza. For social services, the issue is a little different. Palestinians are probably ahead now in skills within the Arab world; it is important that this advantage be maintained by promoting a sensible education

strategy to allow for an expanded role in regional inter-relationships.

E. Mobilizing taxes.

3.30 If the additional public spending to strengthen the physical and social infrastructure is to be undertaken, the question arises as to how is it going to be financed and in particular whether the domestic tax effort needs to be strengthened. As pointed out earlier, some of the taxes paid by the Palestinians currently accrue to the Israeli treasury and these need to be explicitly recognized as part of the domestic tax effort. The reason for the present leakage is that, in the absence of customs borders between the Occupied Territories and Israel, the "origin principle" of indirect taxation is applied with respect to trade between the two, whereby taxes are collected where goods are produced rather than consumed. Since the Occupied Territories have a large trade deficit with Israel, there is a net revenue loss. In the transitional period, agreement would have to be reached with Israel on how the budget of the new self-governing entity would capture these taxes. If a customs border between the Occupied Territories and Israel is both desirable and feasible, then the "destination principle" could be applied to trade between the two, and the revenues would automatically accrue to the budgets of the taxpayers. If a customs border cannot, for one reason or the other, be maintained, then agreement should be reached between the two parties on how to compensate for any tax leakage either based on company accounts or estimation of trade flows. It should be noted, however, that the availability of such revenues to the new self-governing entity is contingent on the entity having a trade deficit with Israel. If this is not the case, then alternative revenue sources would need to be mobilized.

3.31 As has been pointed out earlier, even under conditions of trade deficit with Israel and proper accounting for all taxes paid by Palestinians, the Occupied Territories economy does not appear to be overly taxed. The revenue/GDP ratio is lower than in Israel or in Jordan (and the revenue/GNP ratio much more so), both with respect to direct taxes and indirect taxes. With respect to the income tax, the personal income tax rates are higher in the Occupied Territories than in Israel or Jordan. With respect to indirect taxes, the rates for the VAT, purchase and excise taxes are the same in the Occupied Territories as in Israel, while Jordan has an independent tax structure. Depending on the trade arrangements in the interim period, there might be some scope for increasing revenues from trade taxes. Another avenue for strengthening the revenue effort is through boosting non-tax revenues (fees, charges, etc.) by instituting cost recovery mechanisms for covering the operations and maintenance costs and debt servicing associated with the new public sector investments.

3.32 The substantially lower indirect tax/GDP ratio in the Occupied Territories compared with Israel despite the general closeness of the tax structures may be partly due to the non-application of taxes to agricultural production, (which constitutes a much larger proportion of the GDP in the West Bank than in Israel), but also suggests that tax evasion might be a problem facing the Occupied Territories at the present time. There is probably an underground economy that goes untaxed, and a major challenge for the emerging self-governing entity would be to widen the tax base. This is an even bigger challenge considering that the new entity would have almost no experience in the methods of tax administration and collection as the Israeli-led Civil Administration currently undertakes this effort. In these circumstances, a critical task for the new entity would be setting up a strong system of tax administration to ensure that adequate revenues are being collected. Foreign official upflows should complement, not substitute for, domestic tax effort. Unless there is progress on the domestic front to mobilize resources for development, there will be little chance that external finance in the interim could set the Occupied Territories in a path of external dependency (and vulnerability to debt crises) and not sustainable development.

F. Natural Resources

3.33 Current Israeli policies on natural resources are being perceived by the Palestinians as key factors in determining the performance of the agricultural and to a lesser extent other sectors. However, although the use of natural resources has been constrained, agricultural growth has been considerable. Nevertheless, improved access to traditional grazing areas would allow extensive animal husbandry operations to expand beyond current levels. Increased access to water resources could allow expansion of high value, irrigated agriculture. Liberalization of constraints on fishing operations would allow increase in fisheries catch.

3.34 However, the situation with respect to natural resources cannot be separated from the broad picture involving limited natural resources. For water the riparian rights of countries, the sources of surface and ground water and various categories of users over time need to be taken into account. In the long run, absolute shortages will largely determine the costs of water, its real price, and its most effective application. Consequently water users will have to continue to maximize returns from the increasingly costly water available. While land resources are limited, land may be not be as critical a variable as water. Nevertheless, with considerable areas of land in the OT having no or only restricted Palestinian access, increased access to land would assist future economic performance. A long term vision is also needed for fish resources management; access to fish resources in international waters to OT fishermen has recently been expanded, but further relaxation of regulations, and control based on sustainable resource exploitation may be considered. Forests have a particular role to play in the fragile ecosystem of the OT, and their expansion in combination with selected forms of rain-fed agriculture could substantially assist erosion control and aquifer replenishment.

G. Conclusion

3.35 Increasing economic autonomy and self-sustaining development in the Occupied Territories means diversifying trading patterns and relations, shifting from dependence on a few external sources of growth, that are now in decline, to a broader interdependence with other parts of the region and the world. The West Bank and Gaza have potentially large advantages in their geographic location and intermediary position in the Middle East. Turning inward is clearly a non-starter for a small, open economy. The choices range from remaining predominantly linked to Israel in trading terms to severing links to Israel and turning elsewhere. An assessment of the options suggests that all have costs and benefits. However, it is likely that extreme options have high costs and, therefore, that some form of intermediate position will be both preferable and feasible. Even if the loss of substantial labor access to Israel is permanent, it makes sense to maintain trade access to the most important market (and if possible to expand this to agricultural goods). It also makes good sense to open the Occupied Territories to the region, and especially Jordan, and to the rest of the world, especially Europe. Doing this will involve tackling some of the trade policy choices laid out in this chapter for trade. If it is possible to shift from a customs union to a free trade area, this could combine the advantage of maintaining duty-free access to Israel (for most goods) with some discretion for different incentive policies. Of equal importance to the structure of economic opportunities is the urgent need to tackle some of the regulatory, legal, economic infrastructure and social development issues that are described in greater depth in the companion reports.

(a) Continued strategic uncertainty, slow progress on opening up trading opportunities or worsening internal social conditions leads to no shift in production possibilities;

(b) A convincing peace agreement, removal of supply side restrictions and opening of markets to the Arab world and the rest of World allows a one-time outward shift in production potential, assumed to be 20 percent, that is spread over a number of years, following by growth of productivity at 1 percent per annum (that is consistent with international norms). The extent of this shift depends, of course, on both the efficacy of domestic policy change on the supply side (as discussed in the companion piece on private sector development) and the extent to which foreign market possibilities are opened up (as discussed in Chapter III).

Relations with Israel

5.14 We explore two alternative sets of assumptions:

(a) the early-1993 restrictions in labor movement are converted into a permanent arrangement with much lower levels of Palestinian employment in Israel–we assume 45,000 workers in the first year;

(b) the early-1993 restrictions are lifted; immigration into Israel continues at about the 1992 pace for the next five years, and Palestinian labor maintains its strong comparative advantage in Israeli construction; other manufacturing and services industries continue to substitute away from Palestinian labor, and the net effect is a gradual reduction in Palestinian employment in Israel; current trading relations in goods are improved.

Capital Inflows

5.15 In the absence of strategic resolution, official flows continue at past levels. With a peace agreement, however, the international community responds with substantial additional flows of capital, that supports investment in public infrastructural and social services by the new governmental entities (as discussed in the companion pieces on infrastructure and social development). Technical assistance in setting institutions, formulating policies, and implementing programs is also provided.

5.16 The extent to which private capital responds will be a function of both domestic policy and external conditions. Here we explore two possibilities:

(a) A strong response from both domestic and foreign (including expatriate Palestinian) investors, with a strong orientation toward productive investment;

(b) A large initial response, but with a bias toward land and housing, that tapers off because of the absence of a strong policy environment for growth.

Model Structure

5.17 The simulation models are built around several blocks (see Annex 4).

IV. Macroeconomic Policies for the Future

4.1 In this section we explore the scope and desirability of an independent macroeconomic policy in the Occupied Territories. There are several reasons why macro policy can be useful:

(a) to smooth real shocks, and avoid the nominal shocks of imported inflation and devaluation; and

(b) to obtain revenue from seignorage and the inflation tax.

In addition, the institutions generally involved in macro policy play important roles in:

(c) supervising the financial system and acting as lender of last resort,

(d) facilitating access to external borrowing by the public and private sectors.

4.2 These objectives can be carried out with diverse institutional arrangements. The choices are linked to the question of an independent currency. Some of the functions can be carried out irrespective of whether the Occupied Territories issue a domestic currency, but others necessitate the ability to issue reserve money. Still others may be achieved better in the absence of a domestic currency. In this context, we explore the usefulness and desirability of various types of monetary arrangements and compare the current currency arrangements (with the residents of the West Bank, at least, allowed a rather free choice between the Israeli Shekel, the Jordanian Dinar; and in both the West Bank and Gaza relatively easy use of other foreign currencies) and the costs and benefits of introducing a separate currency. We also explore the mechanics of independent fiscal policy and the potential for borrowing by public entities from the Israeli capital market and the international capital market.

4.3 This section examines each of the four policy objectives in turn, assessing the case for a macropolicy, alternative instruments and a separate currency. A special type of fixed exchange rate arrangement, that of a Currency Board, is then described and analyzed because of its potential interest to the Occupied Territories, especially during the transition period of self-government.

A. The Scope for Public Policy Action on the Real Side

4.4 Could the public sector smooth the shocks described in Chapter II better than households did? How would an independent stabilization policy have operated? Shedding some light on these questions will help in formulating what is feasible for the future.

4.5 Predictable variations, such as the olive cycle, are generally smoothed effectively by households and firms. However, it is important to note first the limits of household adjustment to shocks. National accounts data suggest that households have high savings rates, diversification of migrants also diversifies risks, and that there are probably extensive inter-household transfers, especially within extended families. However, these mechanisms have costs: the carrying of large inventories of liquid foreign assets is costly in efficiency terms since these are resources that could have been invested productively instead; and the migration of household members leads to the dislocations of families and to hardship. More fundamentally, such mechanisms break down precisely when they are needed most, when there are widespread coincident and permanent shocks–i.e., shocks that hit large numbers of households (such as the collapse of the Israeli and Gulf labor markets).

4.6 In retrospect, government intervention could have taken many useful forms, even in the absence of an independent monetary policy. Aggregate but temporary shocks, such as those affecting grants to Non-Governmental Organizations (NGOs), could have been smoothed with fiscal policy had a government been able to borrow abroad (especially since local residents did not have access to external credit). The negative effects of the new Israeli Shekel and Jordanian Dinar devaluations could have been moderated with a more sophisticated financial system that allowed for more diversified portfolios (and reduced the need for large money balances). The recent Gulf shock would have required the increased provision of social services, as well as measures to encourage the productive employment of accumulated savings (as happened in Jordan, for example, and, to a much lesser extent, in Yemen). However, in each of these cases, the goals of stabilization could have been achieved by other means than an independent currency.

4.7 Let us compare now how effective an independent monetary policy would be if it could be used as a stabilization tool. In general, monetary policy can be useful in maintaining a stable price level and stabilizing the business cycle. In the context of the Occupied Territories, monetary policy has potentially three specific roles to play: (i) helping to get activity going by lowering domestic interest rates; (ii) facilitating adjustment to a negative shock by lowering real wages (through devaluation); and (iii) defending against appreciation of the currency in the case of large capital inflows. Note at the outset that the time span and effectiveness of monetary policy in controlling prices is directly related to the existence of adjustment costs on the part of these factors. But monetary policy is unable to achieve any of these goals for prolonged periods in an environment of free factor mobility (in particular, capital and labor mobility). With these principles in mind, we explore the feasibility of each of these goals in turn.

Interest Rates and Domestic Activity

4.8 Under perfect capital mobility, attempts to lower local interest rates will result in capital outflows rather than in the availability of cheaper domestic credit. While capital mobility can be restrained with capital controls, this is almost certainly neither feasible nor desirable for the Occupied Territories, given the accumulated know-how of financial operators used to moving money in between the West Bank, Gaza, Jordan, Israel and many other parts of the region and world. Thus, unless economic integration within the region and the rest of the world is sharply reduced, and capital controls imposed and enforced, the potential of monetary policy to affect local interest rates is likely to remain low.

Wages

4.9 With perfect labor mobility, unexpected inflation would not lead to permanent changes in real wages, since labor would move until wages equalized. Thus, with an open labor market characterized by small adjustment costs, exchange rate policy could only be independent in the short run. However, as argued in Annex 1, it appears to be more accurate to characterize the labor market in the West Bank and Gaza as operating with a different wage-setting regime than in Israel, with rationing of employment opportunities in Israel. This is clearly the case if the March 1993 restrictions are maintained. It is difficult to assess how flexible the domestic labor market is: the general impression is of a high degree of flexibility, but this has not been proven through significant real (let alone nominal) wage declines in the past. Devaluation can be a useful tool in speeding adjustment in the case of large shock to the labor market (as happens with a large increase in the labor supply, whether from reduced employment in Israel or returnees, either of which could require a sizable wage drop to equilibrate the labor market).

The Scope for Sterilization

4.10 Typically, large inflows of resources into a country (i.e., a large current account deficit) lead to an increase in the prices of non-tradables relative to those of tradable goods (i.e, to a real appreciation of the real exchange rate). Land prices in particular are likely to rise (they already fluctuate widely with the ups and down of the peace process). The phenomena can occur even in the absence of a domestic currency. Sterilization's aim is then to delay real investment, if the economy is perceived to be overheating, or to neutralize it if it is perceived to be speculative and temporary.

4.11 In particular, one can easily imagine a perverse post-peace scenario where excessive optimism leads initially to a boom in land prices, which then deters real investment and industrialization, ultimately leading to a collapse in prices and a sharp contraction in business activity. Another possibility is that wages would rise too fast and get stuck at a too high real level, reducing the competitiveness of production.

4.12 Given the potential size of the inflows relative to the size of the economy and the adjustments required on the real side before the capacity of the Occupied Territories to absorb investment rises, intervention can be useful. Large speculative flows are not unusual in the region, given the very large amounts of capital accumulated abroad by residents. For example, about $2 billion rushed into Lebanese pound denominated assets during the two weeks after the appointment of a new government in 1992. Larger amounts entered Egypt in 1991 when the capital markets were liberalized and debt relief granted. In both cases, sterilization was helpful in preventing a sharp appreciation in the exchange rate.

4.13 Sterilization, however, is useful only when the public sector possesses an information advantage over the private sector. In addition, sterilization cannot permanently keep asset prices below their long-term level because the fiscal costs of doing so soon become excessive. Finally, delaying tactics would be very expensive when capital is very mobile, which is likely to be the case for the Occupied Territories.

4.14 Two possible strategies can be followed to stabilize inflows without inordinate costs, neither of which requires the existence of a domestic currency.

(a) Intervention can be targeted to the appreciating asset, rather than conducted at the macro level. This can be done by taxing destination investments of short-term capital flows while, at the same time, encouraging long term investment. For example, land sales can be taxed, but real investment can receive tax credits. This would reduce the likelihood of sudden reversals of capital flows.

(b) Compensating action can be taken elsewhere to prevent rapid growth in the relative prices of particular assets. For example, land can be made more abundant through relaxing supply-side restrictions, or labor can be made more abundant if there is a higher return of Palestinian labor, now working in Israel or elsewhere.

4.15 The possibility exists that the gains in monetary independence to help manage shocks would be dwarfed by the new sources of instability related to discretionary monetary policy. For macro policy to be successfully independent, it requires independent credibility, and there is the potential for a significant trade-off with discipline. With so much uncertainty about the ultimate future of the Occupied Territories, and so little domestic expertise in governmental aspects of finance, it is difficult to imagine a Palestinian

currency solidifying quickly without drastic limits on monetary discretion. Even if the authorities were willing to exercise discretion wisely, they could find it enormously difficult to gain public confidence in the crucial initial period at a time when reconstruction needs are enormous. More likely, investors would demand a hefty risk premium. At the same time, financial stability and capital inflows will be crucial to ensure rapid growth since most Palestinian savings are presently abroad.

B. The Potential for Seignorage Revenues

4.16 Seignorage revenue is revenue that can be raised by the ability of government to issue high-powered money. Money issued is also a liability of the central bank, and, as such, it is not truly a source of revenue since operators can decide to reduce their monetary holdings. Nevertheless, in a stable monetary environment, seignorage can generate a stable cash-flow to the central bank. In addition, reserves generally do not earn interest, and, thus the foregone interest on reserves is a true source of revenue to the central bank (which in effect pays for the liquidity service that is provided by demand deposits accounts, which are themselves backed by reserves deposited at the central bank). Finally, inflation acts as a tax on nominal balances by eroding their real value, and this can be considered a true source of revenue (subject to the usual Laffer curve effects).

4.17 In order not to be purely inflationary, the nominal supply of money must be desired as real balances in portfolios. In general, the real demand for money (currency in circulation and sight deposits, or M1) depends on a multitude of factors. It usually drops during inflationary periods, when real interest rates are high, and with innovations in the financial system because the alternative return on resources is then higher. To the extent that the economy grows, real money balances can also be expected to grow, allowing for the issuance of additional high-powered money. Real balances typically get depleted in periods of inflation and then rise when there is credible disinflation, as agents replenish their balances back to their desired levels. The international experience suggests that seignorage is a small, but not insignificant, source of public sector revenue (1 percent on average for the OECD countries and 2 percent on average for developing economies).

4.18 Table 6 summarizes the main aggregates for Israel, Jordan, Egypt and Lebanon. Clearly, the experience with inflation, the extent of financial repression and the sophistication of the financial system have affected money supply differently in these countries. However, seignorage has been an important source of finance in the region, especially in years of high inflation (or devaluations). This is not unrelated to the fact that devaluations, when they occur, come in a large burst, rather than slowly and over time. As a result, they have often taken agents by surprise. In Lebanon, monetary revenues have been sometimes low when large devaluations took place (as in 1987) but not always (e.g., 1992). In Israel, seignorage was significant only in 1985 when the success of a sharp stabilization convinced agents to rebuild their balances.

4.19 A second observation is that real monetary holdings (M1/GDP) tend to shrink after periods of inflation. This is clearest in Israel and Lebanon, two countries that have experienced periods of high inflation and that have a sophisticated financial system. For example, M1/GDP increased by 70 percent in Israel between 1985, when inflation was at its height, and 1992. In Lebanon, M1/GDP more than tripled between 1987 and 1989 (there was a large devaluation in 1987), and it went down in 1990 and 1992, two years in which the pound depreciated markedly. Such a phenomenon can be also observed in Egypt (e.g., in 1987) although there also seems to be a secular reduction in the money ratio. This is most likely related to the development of the financial system and the increased availability of saving

deposit accounts paying positive real interest rates. Somewhat surprisingly, however, the money ratio has remained high and has even increased in Jordan after its large devaluations of 1988-89.

4.20 What do these observations imply for seignorage as a potential source of revenue for the Occupied Territories? Assume that M1 stabilizes at 20 percent of GDP in the Occupied Territories (somewhere between the corrected Jordanian figures and the Lebanese figure). This represents the upper bound of the one-shot revenue that can be collected by the central bank. At the same time, such a build-up of domestic currency balances is unlikely to occur immediately in the absence of substantial foreign exchange reserve holdings by the central bank to back the domestic currency. The presence of foreign exchange reserves will reduce seignorage revenues by their amount, minus the interest earned on these reserves. On the other hand, in the absence of large foreign exchange reserves, it is unlikely that domestic money holdings will be very large until the central bank and the treasury build some track record, and money demand would remain low in the short term, reducing seignorage revenues. Overall, it is unlikely that the one-shot stock-related revenue can be very large, even under favorable conditions. Assuming conservatively that all of the reserves are backed by foreign exchange, and that the international interest rates average 6 percent, the overall stock effect is reduced to about 1.2 percent of GDP.

4.21 Seignorage revenues may be a more important source of revenue over time as the economy expands and the real demand for money grows. In particular, in a growing economy, the public sector can obtain seignorage without creating inflation. For example, with a growth rate of 5 percent a year and an inflation rate of 10 percent on average, the flow revenue would be 3 percent of GDP with zero foreign exchange reserve backup. In the presence of foreign exchange backup, smaller growth, or lower inflation, the flow revenue would be smaller. Of course, additional revenues may be collected temporarily if inflation increases unexpectedly, but this would tend to reduce the future ability to collect seignorage.

C. Facilitating the Mobilization of Resources

Domestic Borrowings

4.22 The absence of a domestic currency does not prevent the raising of funds by the public sector. In fact, it may even reinforce the ability of the public sector to borrow domestically since this is then accompanied by a commitment not to inflate these claims away. The other side of the coin, however, is that inflation can be a useful and flexible tool to tax money holders and to default partially on domestic public borrowing following negative shocks. The alternative, an outright default on obligations denominated in a foreign currency, can be more costly in terms of penalties. The example of Lebanon is instructive in this respect. During a prolonged period where government control and revenues collapsed (1980-90), the state was able to finance parts of its activity on the domestic market and without major recourse to external debt. Large inflation ultimately eroded these debts substantially. While such behavior should not to be encouraged on an ex-ante basis (domestic finance would dry up), in retrospect this added flexibility has allowed the government to deal with a difficult situation. Monetization does come at a cost–it reduces money demand and leads to high risk premia on government securities. Such costs can be minimized if inflation is kept low in normal circumstances and inflationary episodes only occur in periods of unusual strain.

Table 6: Seignorage in the Middle East

Monetary Developments in the Region: 83-92

	1983	1985	1987	1988	1989	1990	1991	1992
Israel								
M1-FXD/GDP	4.4%	3.7%	5.9%	5.4%	6.9%	6.8%	6.9%	6.9%
Cur./GDP	1.6%	1.7%	2.4%	2.4%	2.6%	2.7%	2.5%	2.5%
Inflation	120.0%	305.0%	20.3%	15.7%	20.4%	17.3%	11.8%	11.8%
Devaluation	219.9%	134.8%	4.1%	9.1%	16.7%	4.1%	16.0%	16.0%
Monetary revenues	2.1%	6.7%	2.2%	-1.4%	0.7%	0.5%	1.2%	1.2%
Jordan								
M1/GDP	61.1%	53.9%	45.9%	52.2%	54.2%	54.4%	58.7%	55.0%
Cur./GDP	36.3%	33.8%	30.7%	36.3%	36.2%	38.4%	35.4%	32.9%
Inflation	5.2%	3.2%	-0.2%	6.6%	25.8%	16.1%	8.2%	2.9%
Devaluation	-3.9%	10.2%	4.5%	-31.0%	-26.3%	-2.6%	-1.3%	-2.7%
Monetary revenues	4.7%	1.6%	2.3%	7.1%	7.2%	5.5%	13.4%	-1.7%
Lebanon								
M1/GDP	75.9%	n.a	4.3%	9.6%	15.4%	14.1%	19.1%	15.2%
Cur./GDP	41.4%	n.a	2.5%	6.1%	10.3%	10.4%	13.4%	10.1%
Devaluation	44.7%	n.a	423.0%	15.5%	-4.7%	66.7%	4.4%	109.1%
GDP in dollars	310.0%	n.a	350.0%	360.0%	370.0%	380.0%	410.0%	430.0%
Monetary revenues	8.4%	n.a	2.0%	2.0%	7.3%	5.5%	8.1%	9.1%
Egypt								
M1/GDP	44.1%	43.0%	29.3%	33.6%	31.2%	29.9%	25.8%	22.6%
Cur./GDP	25.8%	24.0%	15.3%	17.0%	15.2%	14.1%	12.2%	11.2%
Inflation	16.7%	13.4%	19.4%	17.6%	21.3%	17.1%	19.8%	13.5%
Devaluation	0.0%	-41.7%	0.0%	0.0%	57.1%	81.8%	65.0%	0.0%
Monetary revenues	10.5%	6.7%	1.8%	1.1%	2.2%	7.0%	4.7%	2.5%

Borrowing Abroad

4.23 The ability of the public sector to borrow abroad is ultimately determined by its ability to tax in the future: the ability of the private sector to borrow externally is determined by the financial credibility of private firms and the credibility of the government in guaranteeing that it will neither interfere with external loan payments not expropriate private property. Neither for the public nor private sector is external borrowing necessarily linked to a separate currency. There are, however, two sets of issues to be considered: the external borrowing strategy and relations with Israel and Jordan.

Financial Strategy

4.24 In terms of instruments for attracting foreign inflows, it is likely that the public sector will initially tend to be strongly oriented toward bilateral and multilateral borrowings; the private sector will probably favor foreign banks (especially for trade credit) and direct foreign investment. There is almost certainly a case for central management and rationing for public borrowings--which should be conducted with careful attention to debt servicing implications, especially in the initial years when debt burdens are very low and some borrowing agencies (e.g., public utilities) are financially inexperienced. For the

private sector, central management and rationing is probably neither desirable nor feasible. It will also be important to prepare for borrowings and explore new instruments as new governments (e.g., Zimbabwe in 1980) have been disappointed at how commitments, especially from official sources, fail to turn quickly into disbursements and have been puzzled at the lengthy procedures of different agencies. Moreover, alternative instruments, such as Palestinian bonds targeted at the Palestinian diaspora, could prove a useful means of mobilizing foreign resources.

Relations with Israel and Jordan

4.25 If the future economy does not have a separate currency, trading relations with Israel (and possibly Jordan) would be facilitated, but relations with the Israeli and Jordanian monetary authorities would be complicated. If the West Bank and Gaza enter in a trading agreement with Israel, Jordan, or both, the absence of an independent currency will make it more difficult to impose sudden trade restrictions with these countries. The private production of goods for these markets will be enhanced since the expectation of a trade breakdown is minimized. Although public and private sector entities will be borrowing NIS and JD, Israeli and Jordanian monetary authorities need not be concerned about monitoring and restricting lending to agents in the Occupied Territories. The market is not going to be unduly eager to lend to future entities in the West Bank and Gaza: if anything, the opposite is true now. Such concerns as might arise can be dealt with through standard instruments of financial management (e.g. the risk classification of assets in the West Bank and Gaza).

4.26 The lack of a domestic currency may, however, restrict external borrowing for other reasons. Large capital flows and fast growth in the Occupied Territories are bound to affect the Israeli and Jordanian economies. However, growth is directly related to future developments on the real side, rather than on the monetary side--and will occur irrespective of the existing monetary arrangements. Presently, while the size of the economy of the Occupied Territories is much larger in relation to Jordan than in relation to Israel, it has sizable trading relations with Israel and not with Jordan. If a large boom was to occur now, both the Jordanian and Israeli economies would not be seriously affected. However, if trade relations with Jordan expanded significantly, a boom in the Occupied Territories would certainly have an impact in Jordan; if present trade relations with Israel were to continue, but the capital inflow was very large (say $500 million a year over current flows), then some aggregate effects would also be felt in Israel.

4.27 Dutch disease type problems--if important--may prompt the Israeli and/or Jordanian authorities to intervene in an attempt to prevent their economy from overheating. If the Occupied Territories were part of the same currency union, it would be directly affected by such (sterilization) operations since the cost of funds would rise. In addition, the leverage exercised by the controlling monetary authorities, especially if they were also to regulate domestic banks, could also directly affect the Occupied Territories. For example, Israel or Jordan may want to impose restrictions on external transactions of entities in exchange for allowing the West Bank and Gaza to use its own currency. A related issue concerning borrowing abroad by the West Bank and Gaza is that it may increase the country risk of the country that is perceived to be the ultimate backer of these credits. In the presence of a quid pro quo, the only credible way for Jordan or Israel to commit not to intervene in the case of a failure to repay may well be the existence of a Palestinian independent currency.

D. Provision of Liquidity and Supervision

4.28 It is often assumed that providing liquidity and supervising a financial system require an independent central bank. In fact, these functions can be carried out, to some extent, irrespective of the type of monetary arrangement chosen. Regulators can be empowered with the supervision of the financial sector, even in the absence of a domestic currency. Supervision would include ensuring that financial operators investing the resources of the public had a sufficient stake in the success of the operations they undertook (imposing reserve requirements and capital adequacy requirements) and ensuring the smooth functioning of a bankruptcy system.

4.29 Temporary assistance to a troubled institution can be in the form of foreign exchange. This can be provided by some large financial institution (domestic or foreign), by a regulatory body that can borrow on the domestic and international markets and use part of the reserves levied on foreign exchange accounts, or directly by the treasury. The problem, however, is that foreign borrowers would be unwilling to lend when country risk was perceived to be too great. An international credit crunch could arise, for example, if the political situation deteriorates or if external debt became too high. In such circumstances, it would be very difficult for a government to play the role of a lender of last resort if access to money creation was not available because of the small size of the domestic financial market. These difficulties would be exacerbated if the liquidity crisis was due to an aggregate shock that hit large segments of the economy, as for example would occur in the midst of political upheaval. On the other hand, since most banks would be new, they would probably be well capitalized. This makes the role of lender of last resort initially less crucial, but the need for good supervision more so. In addition, if private inflows of capital came in a boom, it would be imperative to tighten the banking regulatory framework and prudential regulation in order to reduce the risks associated with excessive liquidity, such as increased leverage by firms and increased risk-taking by banks.

4.30 The Jordanian or Israeli monetary authorities could also assume the lender-of-last-resort function. In this case, they would likely also want to supervise the financial system. Clearly, a commitment from these institutions to play such a role could go a long way in preventing bank runs on and, thus, the emergence of liquidity crises. The question, however, is whether these institutions would feel compelled to play this role in case of a financial crisis in the Occupied Territories, and whether the markets would take seriously their commitment to do so. The role of lender-of-last-resort comes at a cost. The dividing line between illiquidity and solvency is often blurred, and, while a domestic agency may want to take risks in the short term in order to save institutions that may turn out to be solvent once an in-depth analysis of their balance sheet is conducted, an external agency may prefer to allow failure more often. This may be good from a disciplinary point of view, but it can also lead to unnecessary financial instability. In addition, political considerations may complicate this relation further. Finally, the Jordanian or Israeli monetary authorities may simply refuse to play this role in order to reduce their potential liabilities.

E. Speculating on the Choice of an Exchange Rate Regime

4.31 The current exchange system with a free choice between currencies has its merits, especially if the financial system is allowed to develop. With the good information flows and financial knowhow that a sophisticated financial system provides, such a liberal environment could be an important factor in attracting the private capital accumulated abroad by the Palestinian diaspora. We have seen that in each of the four areas–smoothing shocks, securing seignorage, facilitating borrowing and supervising the

financial system--a separate currency may be useful, but it is not essential. Figure 20 summarizes the discussion.

Figure 20: Macro Policy With and Without and Independent Currency

Policy Area	With an Independent Currency	Without an Independent Currency
Enhancing Capital Inflows	Issue domestic and foreign debt without interference by other governments; can raise some (initially limited) revenues through seignorage.	Greater commitment to fiscal discipline because deficits cannot be monetized.
Managing Capital Flows	Can sterilize flows which may be useful in the short term if the government has an informational advantage over the private sector.	Structural policy can achieve similar results in a more substantial way.
Dealing with Shocks	Useful in the short term to reduce real wages when nominal wages are rigid, or to default partially on domestic government debts if creditworthiness is eroded.	Can use fiscal policy only.
Enhancing Trade	Policy of devaluation can improve competitiveness.	Greater commitment to remain in common trade area, which increases private incentives for long-term investments in the production of goods in demand in trading bloc partners.
Regulating the Financial System	Role of lender of last resort improved.	May have to abandon the supervision role to Israeli or Jordanian authorities.

4.32 The introduction of a domestic currency in the Occupied Territories may still become desirable, or even necessary, in the future. The question then is what type of exchange rate arrangement to choose. The pros and cons of different regimes are summarized in Figure 21 and discussed below. We also discuss the important issue of implications for Jordan and Israel. A system of freely floating exchange rates is unwarranted in the short and medium term, unless no reserves can be found to back the new currency. And if such a situation arose, the advantages of creating a separate currency would be severely undermined. A freely floating exchange rate would generate large uncertainties given the volatile

environment and the smallness and unsophisticated nature of the financial market. The recent example of Bulgaria is instructive in this respect. The market-determined exchange rate devaluation overshot, because of the inability of the country to provide sufficient backing to their currency. This can be related to self-fulfilling prophesies about reversal in the current account or capital account convertibility. In contrast, the exchange rate in Poland, where a sizable stabilization fund was put in place with the assistance of the international community, was more stable. This stability helped fuel prolonged export expansion and served as a useful nominal anchor to combat inflation.

4.33 We are, thus, led to examine the choice of a pegged exchange rate, which can be fixed with respect to a basket of currencies at reasonable levels that can be defended. Such a system would need to be backed by a stabilization fund. Within the family of pegged exchange rates, a Currency Board may be an interesting option for the Occupied Territories, at least as a transitory arrangement, for several reasons: (i) it is easy to manage and can be established very quickly; (ii) as long as it remains in operation, it forces financial discipline; (iii) while discretionary monetary policy becomes impossible, its scope is limited, in any case, given the circumstances of the Occupied Territories; (iv) it allows for some seignorage; and (v) it can evolve towards a more flexible system as the economy matures and the financial system grows.

Currency Boards

4.34 Currency Boards, once a common arrangement, are being considered again (Hong Kong and Singapore have had a board for some time; Estonia's is less than a year old). Under a Currency Board arrangement, the monetary institution agrees to supply or redeem local currency bank notes (and possibly, reserve deposits of commercial banks held at the Currency Board) for another currency at an established exchange rate and without limitation. Moreover, the Currency Board will exchange local currency at no other terms (such as against local claims on other institutions).

4.35 A Currency Board is easy to administer. In a sense, the foreign reserves become the domestic currency, but the Currency Board intercepts the seignorage and retains flexibility for a future change in the exchange rate or the expansion into a full-fledged central bank. However, for a Currency Board to work, the government must relinquish its discretionary right to print money, and the banking system must retain adequate reserves of foreign exchange assets. This is not too costly since the initial reserves of new banks are bound to come largely from abroad (or to be in the form of foreign exchange). The sacrificed exchange rate flexibility, a useful first defense mechanism against unexpected shocks, is likely to pale next to the potential loss implied by a weak and volatile currency.

4.36 The decision to set up a Currency Board involves four main issues:

(i) What liabilities to back, only bank notes, or more? In Hong Kong, the Currency Board has no role in commercial bank clearing operations. In contrast, the coverage extends to reserve deposits in Estonia where such deposits, being the liability of the Bank of Estonia and interchangeable with cash, have to be backed in the same way as cash. In the Occupied Territories, while it may not be necessary for a Currency Board to develop a system of interbank clearing immediately, reserve requirements for new banks are likely to be necessary, and, thus, deposits with the Currency Board should also be backed. But this is not necessary. In Singapore, for example, a separate monetary agency has been set up alongside the Currency Board to monitor commercial banks and provide a discount window (it does not, however, engage in open market operations).

(ii) How much backing to provide? To instill confidence that it can honor its pledge of convertibility, the Currency Board should start with sufficient foreign exchange reserves to back a significant portion of the liabilities at the relevant exchange rate.[1]

(iii) What to back with and peg to? This will depend mostly on prospective trading relationships. In principle, the exchange rate could be adjusted, but this rarely occurs under the stricter Currency Board. Once the certainty of the exchange rate is removed, the integrity of the exchange rate would be compromised. Thus, domestic interest rates would rise above the international rates to include a devaluation-related risk premium. In Singapore, the Currency Board retains the authority to appreciate but not to depreciate.

(iv) Who can have access to the board? In Hong Kong only banks with note-issuing authority can convert cash into foreign exchange. Individuals and enterprises must rely on a competitive banking system to ensure equivalent rates. In the Occupied Territories, the system would probably have to be open to all until the banking sector developed sufficiently (as in Estonia).

Implications for Jordan and Israel

4.37 The introduction of a currency would be an issue of concern for both Jordan and Israel, given the substantial holdings of Jordanian Dinars and Shekels by Palestinians. If a new currency were introduced, Palestinians would purchase it in exchange for the two existing currencies, and a new monetary authority or currency board would acquire potentially large quantities of JDs and Shekels. These could, in principle, be used to back the Palestinian currency, but they would probably be way in excess of the amounts that it would make sense to hold as foreign exchange: the monetary authority would undoubtedly prefer to hold a high proportion of currencies of OECD countries. Yet if these were redeemed automatically for foreign exchange by the Jordanian and Israeli monetary authorities it would be a shock to both monetary and foreign exchange management–and potentially a large shock for Jordan, given the estimated size of Palestinian holdings of JDs relatively to both total money and foreign exchange holdings in Jordan. The phasing and terms of any such large-scale conversion would have to be worked out in the context of any currency reform. The international community may also have a role to play.

Other Implications

4.38 Supervision of the financial system. Currency Boards can vary from relatively pure systems (as in Hong Kong), where there is no central bank, to more hybrid schemes that retain some limited central bank functions. However, the two functions must be clearly delineated.[2] To maintain the integrity of

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[1] The Hong Kong and Estonia systems started with 100 percent backing; Argentina backs only the new issues of high-powered money.

[2] For example, the Bank of Estonia was divided into two departments: the issue department, which operates the CB under whose liabilities are those qualifying for the guarantee of exchange and assets are the foreign exchange sufficient to match its liabilities, and a banking department, which represent the policy side of the CB (but which cannot lend more than its own reserves in order

Figure 21: Choice of an Exchange Rate Regime			
Exchange Rate Regime	**Advantage**	**Disadvantage**	**Examples**
Currency Union	Fiscal discipline enhanced; encourages capital inflows and investments; and reduces risk premia on government issued debt.	Risk associated with active monetary policies of other countries where shocks may be unrelated to policy needs at home; inability to conduct independent monetary policy.	Panama uses the US dollar. Members of the CFA zone pegged to the French franc. This contributed to greater, stability until the 1980s when the appreciation of the French Franc with respect to the dollar contributed to a sharp reduction in competitiveness.
Free Floating	Reflects short-run scarcities best.	Leads to high exchange rate instability in the absence of a well-developed financial system.	Bulgaria, Latvia.
Pegged to Basket	Enhances the stability of the economy in the face of speculative attacks and short-term instability.	Needs the backing of a stabilization fund; lads to inefficient resource allocation if a "wrong" peg is used.	Poland.
Currency Board	Fiscal discipline is enhanced, encouraging capital inflows and investments and reducing risk premia on government issued debt.	Precludes the use of monetary policy.	Hong Kong, Singapore, Estonia.

not to compromise the CB). The seignorage earned by the issue department (as interest on reserves) is transferred to the banking department.

the Currency Board, it must be prevented from general discretionary lending. Occasional intervention to offset exceptional fluctuations in liquidity or to provide temporary assistance to a bank are feasible if confined to those resources available to the authorities (and in excess of the requirement of the Currency Board). The difficulty in influencing interest rates also limits the ability of the authorities as guarantors of the banking system. Any assistance to weak banks must be confined to the amount of excess foreign reserves. In a sense, this becomes a fiscal responsibility.

4.39 Growth. As the economy grows, so would the demand for real balances. This does not mean, however, that a current account surplus must be achieved to increase domestic liquidity, since liquidity can be supplied through the capital account as well as the current account. For Hong Kong, one of the principal financial centers of the Pacific, capital is very mobile, and the economy is always assured sufficient liquidity by the international capital market. For the Occupied Territories, such conditions are also expected to prevail, at least until a large external debt is accumulated and creditworthiness deteriorates. In Estonia, to take another extreme case, capital is not at all mobile. This implies a severe financial squeeze as the price level is forced to adjust to the note issue, rather than the other way around.[3]

4.40 Monetary Policy. A Currency Board can be viewed as a pegged exchange rate where open market operations are prohibited. One of the basic conditions of a Currency Board is that it cannot lend to the government. If this were to happen, the Currency Board would find its liabilities backed by domestic claims, which would undermine the viability of the peg. This deprives the authorities of any meaningful ability to sterilize foreign exchange flows and, thus, inflation and interest rates (although the system could evolve over time and become more flexible).

4.41 Administrative Price Controls. Control through administrative action is also ruled out under a Currency Board arrangement. Any attempt by the government to control interest rates would quickly lead to the collapse of the system. If interest rates are too low, for example, banks would be subject to excess withdrawal, leading eventually to their collapse.

F. Conclusion

4.42 We have surveyed a range of areas where independent policy action at a macroeconomic level could be desirable and have structured the analysis over when this might require an independent currency. The results can be summarized as follows:

- In some areas, the pursuit of an independent macroeconomic policy is likely to be fruitless, e.g., attempts to have independent interest rates, given the degree of capital mobility.

- In other areas independent policy is desirable, and is commonly associated with a separate currency, but such a link is by no means necessary, e.g., managing "excessive" capital inflows, borrowing at home and abroad and supervising/providing liquidity to banks.

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[3] However, it is important to note that it is only the growth of base money that is restricted under a CB; since cash is only one component of the money supply, a decline in the ratio of cash to money ratio would allow money to increase via the money multiplier.

- Seignorage is traditionally large in the region, but it is unlikely to be so for the West Bank and Gaza (especially initially) because of the likely initial low level of credibility of a new currency and the high capital mobility.

- There are areas for which a domestic currency is necessary, e.g., avoiding imported nominal shocks from other members of a currency union, facilitating real wage declines and, under extraordinary circumstances, defaulting.

- If a currency were introduced, there would need to be attention to the impact on Jordan and Israel; special arrangements may need to be worked out.

4.43 All this has to be set in the context of discipline, something that is hard to earn but that can be obtained by being in a currency union(s) with a disciplined core. We conclude by suggesting that if a domestic currency is chosen, it could be desirable to start with a relatively restricted version, as in a Currency Board, which could gradually evolve to a fully fledged currency that brought greater discretion once discipline, and the associated demand for the currency, was well established.

V. Scenarios for the 1990s

5.1 Three factors will have a determining influence on the economic welfare of Palestinians in the 1990s: the level of wages; the level and allocation of private capital; and the provision of public services. Concerns over employment prospects and problems with the provision of services have been at the center of the economic crisis in the past few years. Fears of a severe worsening in employment came to a head with the border closure of March 1993; many now expect that future employment prospects in Israel will be much more tightly rationed than in the past. Will unemployment soar and wages collapse, or can alternative domestic employment opportunities be found? Will private capital–from within and without the West Bank and Gaza–be invested in employment creating activities? And what level of public resources–from domestic and foreign sources–are desirable to improve service levels and provide the infrastructural basis for private sector growth?

5.2 We conclude by developing scenarios for the West Bank and Gaza, based on alternative assumptions for external factors, domestic policy choices and foreign private and official financial flows. These are based on an analysis of the workings of the economy now, but they should be treated as illustrative: too little is known about how a rapidly changing economy will respond to large changes in both its environment and policy direction. The focus is on the transition to the medium term, starting not with a specific year but with the signing of an agreement that gives some form of economic autonomy to a new Palestinian entity. Rather than attempt to construct what has happened in 1992 and 1993 we compare the future with economic conditions in 1991, that is the last year for which we have reasonably precise data. A description of the model is given in Annex 4.

5.3 While the primary focus is on the medium term, writing this in 1993 makes it impossible to avoid the issue of the short-run dynamics for Palestinians of an abrupt reduction in employment in Israel. The chapter first discusses this issue to set the stage for the examination of medium-term issues. It then describes alternative scenarios based on different assumptions for relations with Israel and Jordan, the international community and domestic conditions; including aggregate financing needs. And it finally presents an indicative scenario for public finance and foreign official financing.

A. What Happens When Employment in Israel is Lost?

5.4 The movement of labor to Israel has been central to the economic functioning of the Occupied Territories, as Part A has documented. Severing this tie will have important consequences. At present, it is unclear how far employment will be allowed to rise, following the closure of the border in March 1993, but much tighter rationing of employment numbers has now become one of the probable scenarios. This has a radical impact on assessments of the future: up to the beginning of 1993, it would have been reasonable to take the view that reduction in employment in Israel was a likely, and perhaps desirable, prospect for the medium term but that an abrupt cessation was highly undesirable because of the severe disruptions to incomes in the West Bank and Gaza.

5.5 Incomes will be affected both directly and indirectly. The easiest part to assess is the impact of sharp cuts in employment in Israel. This amounts to 30 percent of total employment and over 16 percent of GNP for the West Bank; and almost 40 percent of employment and 23 percent of GNP for Gaza. The total effect then depends on the consequences for domestic production and incomes. Two patterns of change are likely to occur, working in opposite directions:

- Internal multiplier effects–the lost labor income leads to lower spending on domestic goods that then multiplies through lower incomes for the sellers of these domestic goods, further losses in spending and *reduced* domestic output.

- The reallocation of labor to domestic production–with the loss of labor opportunities in Israel, workers shift to work in domestic activities. This leads to *expanded* domestic production but a lower income, at least initially, since the value added of the reallocated workers is less than their previous earnings in Israel (that is why they migrated there in the first place). The initial shortfall in income would be mitigated in the short run by consumption-smoothing by households through running down savings.

5.6 A closely related issue concerns how the labor market adjusts: do wages fall to clear the market (so encouraging fast, short-run adjustments in employment and, therefore, small initial falls in incomes) or does unemployment rise, as workers hold out for the wages they were earning before (whether in Israel or the Occupied Territories)? The importance of this is that unemployment magnifies the effects of the shock: in addition to an initial loss of income equal to the productivity differentials between jobs at home and in Israel, the whole potential output of the unemployed is lost as long as unemployment persists.

5.7 Even if the economy ultimately reaches full employment, the initial magnification of the shock is likely to have lasting effects. Domestic savings also decrease initially, and, as a result, capital stocks are accumulated at a slower speed. Long spells of unemployment leave scars on displaced workers, reducing their productivity. These effects make it likely that transitory unemployment would pull the whole intertemporal income stream down.

5.8 The past is only a weak guide to what will happen if labor opportunities in Israel are lost since there has been no "long" episode in which there was the prospect of a major, permanent decline in employment in Israel. After the *Intifida* broke out, the numbers of Palestinians employed in Israel stayed constant at about 109,000 between 1987 and 1988. Hours worked dropped significantly (see Figure 1), but this was probably primarily due to labor supply effects, as strikes reduced the availability of workers (as opposed to the availability of work).[1] In the first three months after the Gulf war broke out, there was near total border closure, with Palestinian employment in Israel dropping drastically, but this was an exceptional situation, quite different from the prospect of a major, permanent decline in employment.

5.9 While direct evidence is lacking, there are some partial indications from the past as to how the economies will react to lost labor opportunities in Israel:

(a) The overall picture of the labor market reflects a high degree of flexibility but some short-run sluggishness. Open unemployment rates are low, at 1-2 percent of the labor force when times are good, and at 3-4 percent when demand is slack. However, at the turn of the decade, unemployment rose substantially in the West Bank, peaking at 10 percent before dropping to 5 percent in 1992 (preliminary); changes have been much lower in Gaza, despite the greater reduction in income. (See Figure 1 in Chapter II.) At the same time daily wages have shown a high degree of stability.

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[1] The fall in hours worked in the Occupied Territories was similar for workers in the Occupied Territories and for Palestinians in Israel.

(b) There is also evidence of short-run resilience and of the West Bank and Gaza economies operating, to some degree, counter cyclically to the incomes from Israel. In the early 1980s labor income from abroad slowed, but GDP slowed by less than the remitted earnings. Construction employment in the Occupied Territories is somewhat contra cyclical to construction employment in Israel, suggesting availability of construction workers influences the pace of activity in the sector. There was an increase in employment in the occupied territories after the *Intifada*, with hardly any fall in daily wages, and a substantial expansion in agricultural production in both the West Bank and Gaza.

5.10 As a working basis for examining the future we take the following view. The economies of the West Bank and Gaza are reasonably flexible, and as economic opportunities in Israel are cut there will be reallocations to domestic activities. This is likely to be underwritten by consumption-smoothing: savings appear to be high in the aggregate and will be run down to smooth income shocks at the household level (just as they were run down to invest in land and housing in 1992, supporting an apparently large expansion in employment within the Occupied Territories). The prevailing view is that extended family and kinship networks are strong, so inter-household transfers would be expected to rise to help those hardest hit. Both effects will help sustain domestic demand. However, labor market adjustment will certainly not be instantaneous, and we would expect temporary rises in unemployment, followed by declines (as in the West Bank in 1991 to 1992) as wages move slowly to a new, market-clearing position.

5.11 The scale of any decline will of course be heavily influenced by two other factors. In the short run, the availability of spending from other sources--especially official spending by the new self-governing authority, the municipalities and by agencies such as UNRWA--can have an important Keynesian influence on labor demand and incomes. In the medium to long term, both inflows of productive capital and improvement in productivity--due to the availability of trading options abroad, a freer regulatory regime, or a good set of policy actions--will speed the process of creating new permanent jobs and will have a powerful influence on wages, unemployment and welfare. We now turn to illustrative scenarios.

B. Alternative Scenarios After a Peace Agreement

5.12 The scenarios are developed around alternative assumptions in three areas: production possibilities, as influenced by policy and structural conditions; employment in Israel; and capital inflows. The key welfare variables are the unskilled wage rate, the rate of unemployment, and the level of per capita income. The alternative assumptions are as follows.

Economic Functioning and Production Possibilities

5.13 The labor market functions in line with our interpretation of the past (see Chapter II and Annex 1). Employment in Israel is rationed and Palestinians working in Israel are paid close to the Israeli minimum wage (that is higher than the domestic wage). The domestic labor market is flexible, but wages move to a market-clearing position only over time, leading to temporary rises in unemployment if labor demand falls. We then explore two alternatives for the potential efficiency of production:

(a) Continued strategic uncertainty, slow progress on opening up trading opportunities or worsening internal social conditions leads to no shift in production possibilities;

(b) A convincing peace agreement, removal of supply side restrictions and opening of markets to the Arab world and the rest of World allows a one-time outward shift in production potential, assumed to be 20 percent, that is spread over a number of years, following by growth of productivity at 1 percent per annum (that is consistent with international norms). The extent of this shift depends, of course, on both the efficacy of domestic policy change on the supply side (as discussed in the companion piece on private sector development) and the extent to which foreign market possibilities are opened up (as discussed in Chapter III).

Relations with Israel

5.14 We explore two alternative sets of assumptions:

(a) the early-1993 restrictions in labor movement are converted into a permanent arrangement with much lower levels of Palestinian employment in Israel--we assume 45,000 workers in the first year;

(b) the early-1993 restrictions are lifted; immigration into Israel continues at about the 1992 pace for the next five years, and Palestinian labor maintains its strong comparative advantage in Israeli construction; other manufacturing and services industries continue to substitute away from Palestinian labor, and the net effect is a gradual reduction in Palestinian employment in Israel; current trading relations in goods are improved.

Capital Inflows

5.15 In the absence of strategic resolution, official flows continue at past levels. With a peace agreement, however, the international community responds with substantial additional flows of capital, that supports investment in public infrastructural and social services by the new governmental entities (as discussed in the companion pieces on infrastructure and social development). Technical assistance in setting institutions, formulating policies, and implementing programs is also provided.

5.16 The extent to which private capital responds will be a function of both domestic policy and external conditions. Here we explore two possibilities:

(a) A strong response from both domestic and foreign (including expatriate Palestinian) investors, with a strong orientation toward productive investment;

(b) A large initial response, but with a bias toward land and housing, that tapers off because of the absence of a strong policy environment for growth.

Model Structure

5.17 The simulation models are built around several blocks (see Annex 4).

(a) A work-force module projects population growth, and changes in demographics with associated changes in labor participation (these are all taken from the human development report).

(b) Domestic production is modelled using an estimated aggregate production function with two factors of production--labor and capital--and a shift factor to control for the quality of the incentive framework (or more loosely, the quality of "policy").

(c) A labor module incorporates several possible regimes associated with the different ways the labor market can function, depending on internal and external circumstances. When there is no unemployment and the labor demand is known, a labor market equation computes wages at home for a given combination of capital stocks (as the marginal productivity of labor). When wages are expected to be above their full employment, market-clearing levels, the unemployment rate that equilibrates the labor market is computed given exogenous assumptions about the likely behavior of wages. When labor productivity at home reaches the minimum wage in Israel and there are no binding restrictions on labor movement, the model solves for the share of the labor-force that must work at home to achieve wage equalization.

(d) A consolidated government budget module constrains public consumption and investment to the level of fiscal resources that are expected to be available. When expenditures (including public debt service) exceed government revenues, the budget deficit must be financed with external grants and loans, and with domestic borrowing.

(e) A private sector saving/investment module closes the model. The private's sector disposable income is taken to be the Gross National Product (which includes the remittances from Palestinian workers in Israel and further abroad), plus external transfers accruing to the private sector (including from private reserves), minus domestic transfers to the government (taxes and loans). Private income is allocated between consumption and investment according to a private saving rate, which is assumed to adjust so as to smooth consumption over time and circumstances. Some of the external transfers are taken to be inflows of capital from the Palestinian diaspora and other foreign direct investors seeking to finance domestic projects (including housing), or the purchase of land.

Overview of the Scenarios

5.18 The scenario analysis suggests that the future evolution of the economy of the Occupied Territories could be reasonably bright or it could be bleak (see Figures 22 and 23). We first outline the good policy scenarios. Securing a combination of improvement in "policy" (that encompasses expanded opportunities for trade) with international capital inflows could set the economy on to a path of sustained growth over the medium to long term. This applies to both the scenario of smooth labor reduction in Israel and the scenario of abrupt cut-off in employment opportunities to 45,000 workers. In both it appears to be feasible to achieve medium-term growth rates in income per capita excess of 3 percent per annum (Table 7). The short run is much worse under the abrupt labor cutoff scenario, and significant falls in GNP per capita are projected and lower total financing of the trade deficit, that includes labor income from work in Israel ("remittances", see Figure 23). Growth then recovers as the economy adjusts, but from a lower base. After ten years, income per head rise by over 40 percent in the smooth labor reduction case, and by 36 percent in the abrupt labor cutoff case, compared with the baseline

income estimate US$1715 (the level in 1991). Under both scenarios, growth is associated with steady rise in investment and quite large net transfers of foreign resources, that decline steadily over time. In both cases, declining labor income form Israel is compensated by substantial inflows of external finance, going to both the public and private sector. Over time the sum or remittances and net transfers of external capital falls, as growth in exports allows the trade balance to decline. (See below for the public and external finance numbers).

5.19 We next turn to the bad scenarios. Failure to tackle the policy conditions for growth leads to a very different outlook. Under the assumption that there is not even enough progress on a peace agreement to get any additional capital inflows, there is a significant initial decline in incomes, even with smooth reduction of employment in Israel, followed by steady, further decline. After a decade, incomes per head have fallen by 12 percent. The initial decline is a consequence of the delayed effects of the shock of the loss in employment in the Gulf. Growth was financed in part by what is estimated to be a large repatriation of savings abroad (of over 10 percent of GDP) and it is assumed that this is not sustainable. Slow medium to long-term growth is associated with stagnant investment, weak productivity growth and low inflows of external capital (Figure 22). Under a situation of abrupt labor cut-off the situation is even worse, owing to a sharper reduction in initial incomes per capita. The initial fall under this scenario is only moderately worse than in the favorable policy case, but the growth paths subsequently diverge greatly (Figure 23).

5.20 The scenarios of "bad policy and faltering capital" represent potentially important intermediate cases. These could be thought of in terms of a sufficiently convincing Peace agreement to secure an initial inflow of foreign capital--from both official and private sources--but a failure, on the part of the new governmental entity, the international community or Israel, to put in place the policy and structural conditions that would sustain rapid growth. There are many ways in which this could occur, as the discussion of the previous chapters and the companion volumes illustrates. There could be inadequate resolution of the supply-side constraints on growth, whether in the form of the legal framework for private sector activity or tackling the infrastructural bottlenecks. Trading opportunities might remain restricted, whether due to failures to improve access in the Arab world, the OECD or Israel, or to an attempt to spur industrialization through high protection by a Palestinian governmental entity. Public savings could stall, owing to failures in revenue mobilization or excessive current spending rises, and there could be public investment in inefficient and unproductive activities. The model is not designed to distinguish amongst the wide range of alternative ways the economy could go off course, but represents such a possibility in terms of a failure to reap the productivity increases assumed in the good "policy" scenarios. This is also reflected in the behavior of private capital that is treated as being responsive to both the overall rate of growth and the policy environment. A plausible scenario is for quite substantial initial inflows that mainly go into real estate (as appears to have occurred in 1992) with little into productivity-enhancing capital. With a combination of weaker economic opportunities and lower growth, private capital falters over the medium term, leading to lower total financing in the second five years, as shown in Figures 22 and 23.

5.21 The scenarios illustrate an important result. For the medium term, the most powerful determinant of growth in incomes is the extent to which the economy succeeds in getting on to a growth path that encourages accumulation in productive capital (both physical and, over the longer term, human capital) and provides the environment for productivity growth. Failure to achieve this can lead to sustained decline. Increased capital alone will help in the short run, but only temporarily, especially as private capital will only keep flowing if economic conditions are good.

Table 7: Growth in GNP per capita under alternative scenarios (in percent per annum)

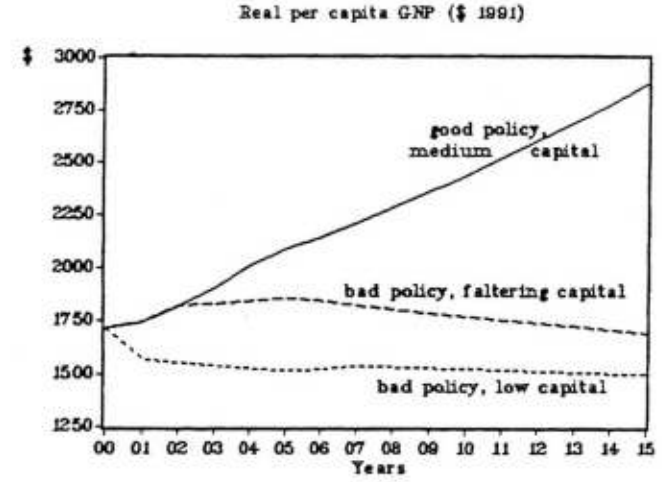
	Av. annual growth in per capita GNP, years 0-5	Av. annual growth in per capita GNP, years 6-10	Av. annual growth in per capita GNP years 11-15	Real Per capita GNP after 10 years (1991: $1715)
Smooth Labor Cut-Off Scenarios				
Good policy, medium capital	4.0%	3.1%	3.4%	2436
Bad policy, faltering capital	1.6%	-1.0%	-0.9%	1768
Bad policy, low capital	-2.4%	0.1%	-0.3%	1523
Abrupt Labor Cut-Off Scenarios				
Good policy, medium capital	2.4%	3.8%	3.6%	2331
Bad policy, faltering capital	0.4%	-0.3%	-0.8%	1718
Bad policy, low capital	-3.0%	-0.1%	-1.1%	1462

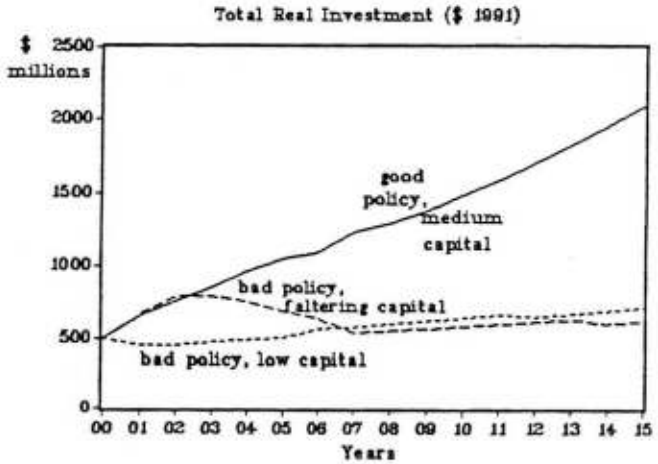
The Labor Market and the Composition of Capital Inflows and Investment.

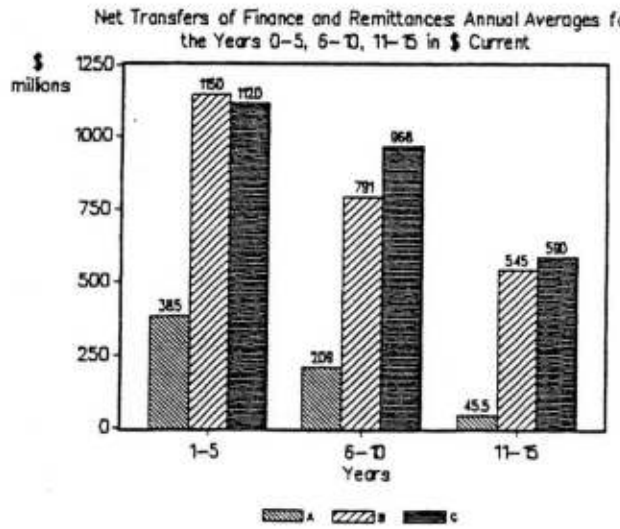
5.22 The scenarios are associated with significant changes in the labor market. This is illustrated here for the two good "policy" cases (Figures 24 and 25). Under both scenarios there is, over time, a large absolute and relative rise in employment within the domestic economy--faster, of course in the abrupt scenario, but also true of the smooth cut-off scenario. With a growing supply of labor to the domestic market, wages are virtually constant, or falling slightly, in the smooth case, before rising gradually in the medium to long term. A fall of wages of the order of 10 percent occurs with abrupt labor cutoff, spread over time, on the assumption that there is sluggishness in wage adjustment. The other side of this is a sharp, short run rise in the unemployment rate to a peak of about 15 percent of the labor force, with a gradual subsequent decline as wages adjust downwards and the economy grows. Under the scenarios of poor policy (not shown) the labor market situation deteriorates much more drastically, with large rises in unemployment in the short run, and large declines in wages over the medium term.

5.23 The key determinant of the pace of income and employment growth is investment. It is expected that growth in public investment will play an important part in the short run. This plays a dual role: catching up on neglected investments in social and economic infrastructure and providing an impulse for income and employment growth. Over the medium term private investment would rise steadily and

Figure 22: Overview of Scenarios: SMOOTH Labor Cut–Off

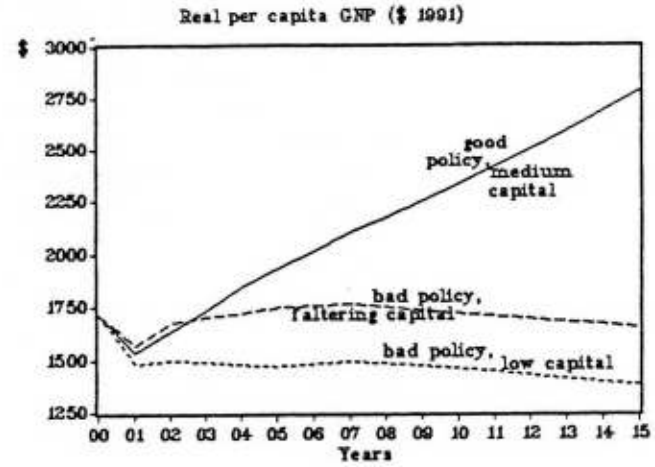


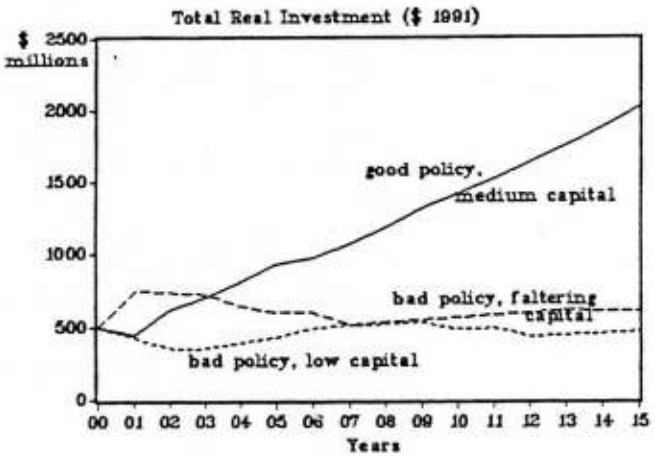


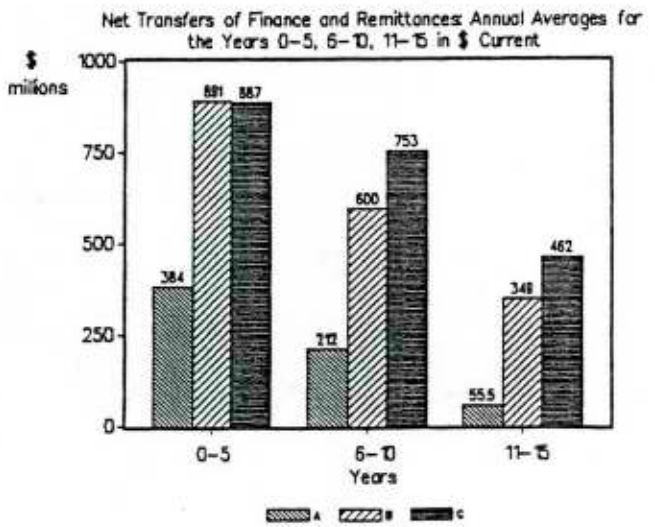


A: bad "policy", low capital B: bad "policy", faltering capital
C: good "policy", medium capital

Figure 23: Overview of Scenarios: ABRUPT Labor Cut-Off







A: bad "policy", low capital B: bad "policy", faltering capital
C: good "policy", medium capital

account for a large part of total investment. Foreign finance and remittances fall in both scenario, i.e., there is a steady decline in the trade balance as exports rise. Remittances from work in Israel fall in line with the change in employment. Finance going to the public sector rises sharply in the short-run peaks in year five and then declines--quite significantly in real terms. Private finance is expected to follow a different path, with a moderate initial increase after a peace agreement that then tapers off, but is followed by a second rise in the medium term as growth in private investment is perceived to be robust. It then drops in the long term, in line with the dynamics of net transfers (i.e. as debt service increases).

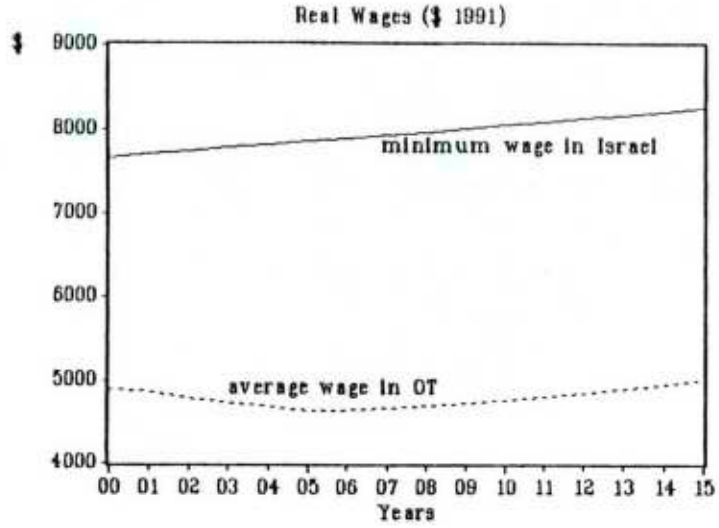
Managing the Transition Under an Abrupt Labor Cutoff

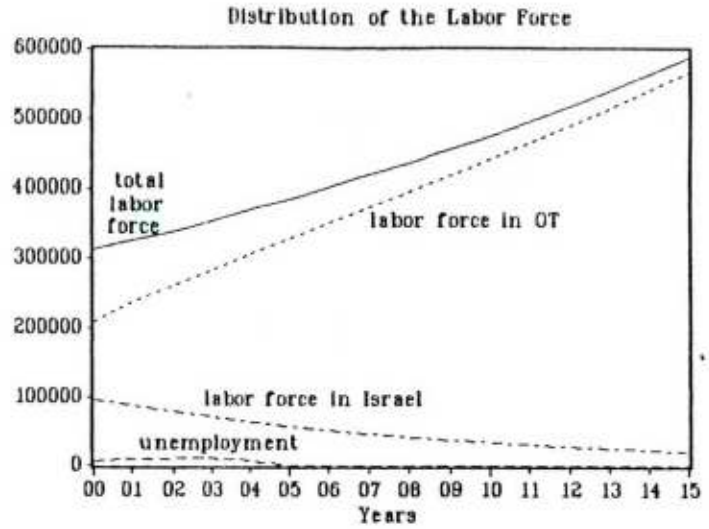
5.24 If policy and trading relations are good the medium term outlook looks hopeful even under a scenario of abrupt labor cut-off. However, managing the transition could be critical to success. Rising unemployment and falling wages could itself jeopardize the formation of the conditions necessary for growth, through the potential consequences for social unrest and violence, and the risks that it will encourage short-run policies that hamper long-run growth, such as an excessive expansion of civil service employment or inefficient "employment-creating" industries. What kinds of action would be open to a new government and the international community to try and offset the shock of the labor cutoff? There are two alternative strategies, that could be complementary to each other. First, it could be desirable to increase public spending on labor-intensive construction activities or other mechanisms to transfer income to households, for example through accelerating catch-up spending in rehabilitation of social and economic infrastructure, to smooth the shock and reduce poverty increases. Such spending would have to be financed by grants and borrowing--primarily from abroad. Second, there may be potential for accelerating the process of improving the quality of the "policy" regime, through greater opening of trading opportunities that could form part of the negotiation process (e.g. enhanced access to Europe or US, faster opening of Israeli agricultural markets). In the absence of strong policy money alone cannot realistically take care of the problem of labor cut-off. For example, limiting the decline in wages in such a situation to no more than 10 percent would require an implausibly high inflow of US$800 million per annum, compared with of the order of US$ 500 million under the good policy cases developed here.

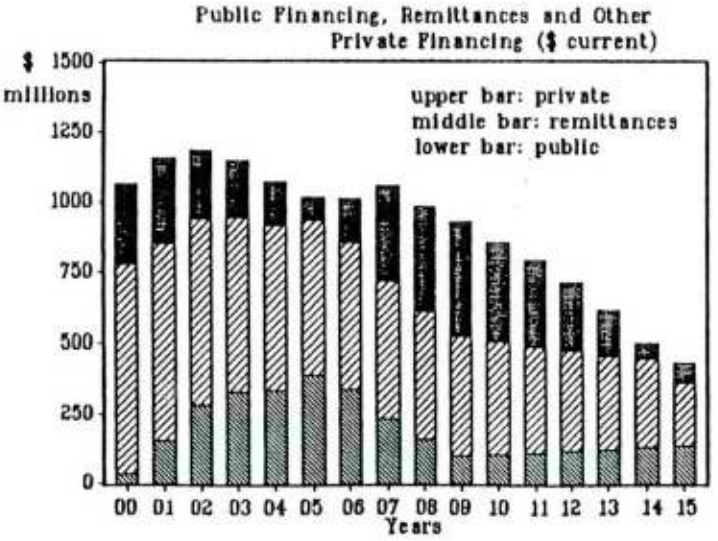
The Issue of Returnees.

5.25 Large numbers of Palestinians from the West Bank and Gaza now live abroad. Some have maintained residence rights and are, in principle, free to return (some 13 thousand returned in 1990 and 1991, net of outflows), while the return of others will be subject to the bilateral negotiations between Israel and the Palestinians. This report takes no view on the outcome of these, but it is nevertheless of interest to ask what the impact would be on growth and the labor market if there were to be a substantial return migration in the future. From the labor market perspective this is directly analogous to the question of labor cutoff examined above, since both amount to an increased labor supply to the domestic market. Whether this leads to unemployment and labor market problems or a spur to growth depends crucially on whether increased labor is accompanied by productive capital, sound domestic policies and market opening abroad. Unlike workers who lose jobs in Israel, returnees have demands for social services and other public goods. Success here depends on complementary action with respect to public capital investment (and adequate progress on public institutional capabilities). To avoid labor market adjustment problems, there is a case for attracting back relatively unskilled Palestinians only as the economy recovers and takes off.

Figure 24: Baseline Scenario: SMOOTH Labor Cut-Off, Medium Capital, Good "Policy"







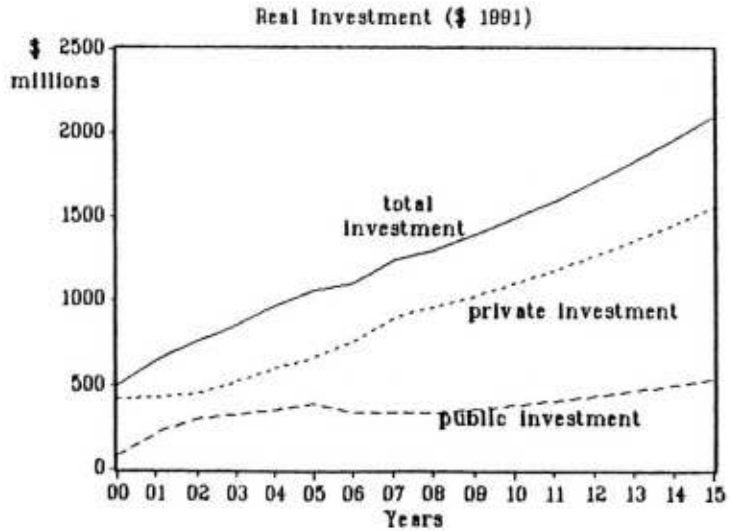
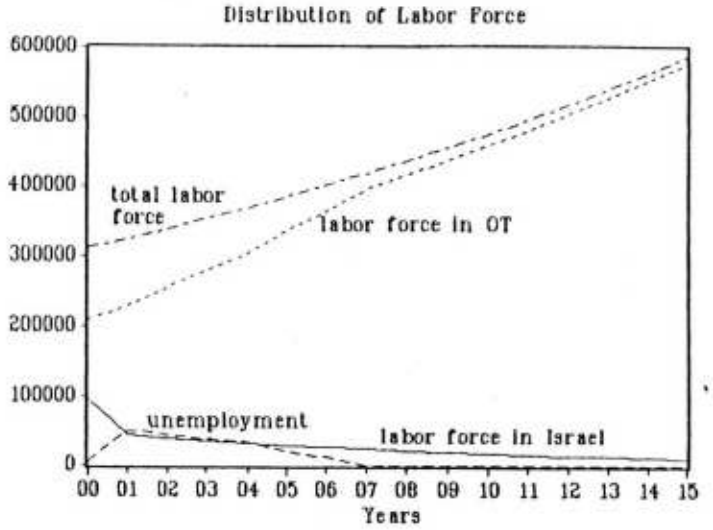
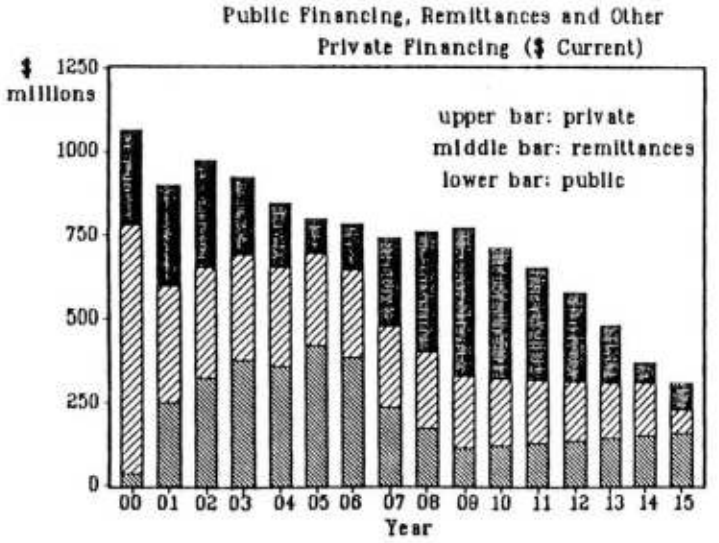
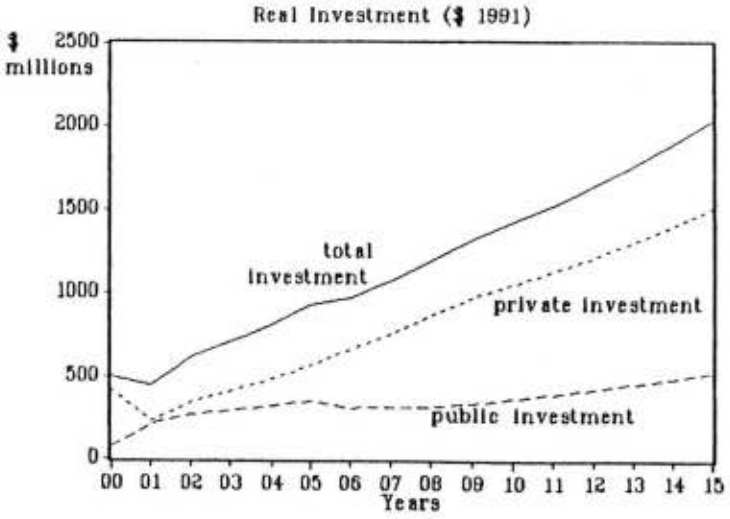


Figure 25: Baseline Scenario: ABRUPT Labor Cut-Off, Medium Capital, Good "Policy"







C. Public Finance and Official Financing Requirements

5.26 The scenarios presented above illustrate overall developments for incomes, labor and capital. Within any scenario for the future, public finance will play a central role. The biggest shortfall now lies in the provision of public goods, not in the consumption of private goods. However, while there is potential for ample private inflows--if the conditions are right--securing adequate public resources could be tougher, especially for current spending needs. There may be important tradeoffs here: there has been some discussion of having a low tax economy, as a means of getting growth going, but this may be in conflict with adequate finance for public services. Even if all taxes paid by Palestinians are included (including those accruing to the Israeli government) the Occupied Territories do not appear to be highly taxed; the tax effort is sharply lower than in Israel and also lower than in Jordan (see Chapter II). While it would almost certainly make sense to have a lower tax effort than Israel--the scale of fiscal redistribution is probably neither feasible nor desirable given the income levels of the West Bank and Gaza--the need to expand and maintain public services make it imperative that domestic revenue mobilization be improved.

5.27 The point of departure for the public finance scenarios is the integrated picture of public finances discussed in Chapter II (see Table 2). This includes both the civil administration and municipalities and the near-government activities of UNRWA. It also includes an estimate of taxes paid by Palestinians accruing to the Israeli Treasury. We take the view that these should form part of the revenue base of the Occupied Territories. But as noted earlier, the availability of such revenues depends on the trade outcome with Israel. There are also undoubtedly issues of the extent to which a self-governing entity should pay Israel for services consumed by Palestinians, as discussed in Annex 2, but this is an issue for the negotiations that we do not take a position on. In this presentation, we adopt the figure of net transfers of 6 percent of GDP (or 4.5 percent of GNP) representing the difference between revenues accruing to the Israeli Treasury (6 percent of GDP) and payments for services rendered by Israel (2 percent of GDP), and assume it to extend to the future. The public finance scenarios were developed under the assumptions of "good policy", and medium capital inflows outlined above: the first scenario relates to a smooth reduction in Palestinian employment in Israel and the second to an abrupt cutoff to an initial level of 45,000 workers. These correspond to the two good "policy" cases shown in the previous section. To support such development scenarios, both the analysis of the sector teams and simple international comparisons indicates the necessity for a significant expansion in public spending, including:

- A large increase in development spending, to catch up with past neglect in transport, water and sanitation, electric power, and schools in particular;
- An increase in current spending, to support the gradual expansion in service levels, to improve maintenance levels and (more tentatively) to allow some catch up in skilled wages (e.g. of teachers). Under the scenario where only 45,000 workers are allowed to work in Israel, additional current spending is contemplated to smooth the shock on private incomes and help in reduce poverty increases.

5.28 The projections were done in relation to GNP for the years 1994, 1998 and 2003 (See Table 8 for a summary). Development spending is projected to rise significantly under both scenarios based on the indicative estimates of needs from the agricultural, human resources and physical infrastructure teams. Under the abrupt labor cutoff scenario, development spending will be accelerated in the initial years.

5.29 Current spending, including UNRWA, is projected to rise gradually under the "smooth labor" scenario. Under the abrupt cutoff scenario, it is assumed that there will be a temporarily faster rise in current spending oriented toward moderated the scale of the shock of employment reduction. The instruments for this would have to be worked out: it could, for example, take the form of transfers via public employment schemes, as utilized in Chile in its period of unusually high employment. Any such scheme would, of course, have to be carefully assessed with respect to administrative capability and risks of leakage. Under both scenarios current spending will then stabilize in later years.

5.30 These are only indicative estimates of desirable spending levels, but the scale of increase--to the tune of 7-10 percent of GNP during the first five years--is immense. This raises the questions of whether it can it be financed. There are three potential sources of finance:

- Increased taxes. The need to maintain and improve tax effort is clear. It is assumed that the revenue/GNP ratio would rise significantly but gradually over the next ten years as administrative capabilities are built and as tax reform programs are implemented.

Table 8: Public Sector Finances, 1994-2003
(in percent of GNP

	Average 1987-91	Smooth Labor Reduction 1994	1998	2003	Sharp Labor Cut-off 1994	1998	2003
Revenue [a]	17.9	19	20	24	19	20	24
Expenditures excluding defense	19.1	24	28	26	28	29	27
Current Expenditure	16.5	17	19	19	20	20	20
of which: UNRWA	(3.3)	(3)	(2)	(0)	(3)	(2)	(0)
Development Expenditure	2.6	7	9	7	8	9	7
Overall Deficit	-1.2	-5	-8	-2	-9	-9	-3
Financing	1.2	5	8	2	9	9	3
Domestic	–	0	0	1	0	0	1
UNWRA	3.3	3	2	0	3	2	0
Other external	-4.5	2	6	1	6	7	2

[a] Includes an estimate of tax payments by Palestinians now accruing to the Israeli Treasury and contributions by the Israeli treasury to expenditures.

- Domestic borrowing. There is some scope for domestic borrowing by an autonomous governmental (including a moderate amount of seignorage, should a new currency be

introduced), but this is unlikely to be large in the transition period, until the government develops the credibility and the institutions to manage this. An indicative figure of 1 percent of GNP per year is assumed for the years 6-10.

- Foreign inflows. There is no question that the international community will play a role in the transition. The prospect of an expansion in UNRWA resources is low, and it is assumed that UNRWA spending will amount to US$ 100 million annually in the interim and disappear afterwards. This leaves a total public financing requirement from abroad of 6 percent of GNP in 1998 to decline afterwards to 1-2 percent of GNP in 2003..

5.31 Foreign financing for the budget will form part of the overall foreign inflows that is a critical part of the growth and labor market scenarios developed above. In current prices it is estimated that the medium capital inflow cases would involve inflows (on a net transfer basis) of the order of US$500-570 million annually in the first five years, and US$440-480 million in the following five years (Table 9). Of this total, public sector financing requirements (including UNRWA) would average US$300-350 million annually in the first five years, declining afterwards to US$130-165 million annually. Some of the external financing for the public sector might also come from private sources, such as "Palestinian bonds".

Table 9: External Financing Requirements, 1994-2003

	Smooth Labor Reduction		Sharp Labor Cut-off	
	Average 1994-98	Average 1999-2003	Average 1994-98	Average 1999-2003
(in percent of GNP)				
Total external financing	12.6	6.2	16.2	7.0
Public Sector Financing Requirements	7.2	1.8	9.4	2.4
UNRWA *	(2.4)	-	(2.8)	-
Other	(4.8)	(1.8)	(6.6)	(2.4)
Private Sector Financing	5.4	4.4	6.8	4.6
(in millions of U.S. Dollars)				
Total external financing	500	440	570	480
Public Sector Financing Requirement	300	130	350	165
UNWRA *	(100)	(0)	(100)	–
Other	(200)	(130)	(250)	(165)
Private Sector Financing	200	310	220	315

* No assumption was made on the continuation of UNRWA after the transition period.

5.32 Private sector financing is assumed to run at US$200-220 million in the first five years, rising to US$310-315 million in the next five years. This would be in addition to labor income from Israel and would include such items as remittances from Palestinians in the Arab and OECD countries, equity investment and other private capital inflows and transfers.

D. Conclusion

5.33 The West Bank and Gaza could shift to a pattern of autonomous growth based on expansion of domestic production, increased trade in goods and reduced exports of labor. Over time there is the potential for steady growth in labor earnings–a key indicator of private welfare of the population–combined with the expansion of both economic infrastructure and social services. But this scenario depends on securing the domestic environment and international trading opportunities that will provide the institutional basis for a large expansion in the public sector and adequate incentives and security to encourage major investments in productive activities by the private sector. Failures could lead the economies to go off course, with a post-peace boom quickly fizzling out. The situation is more difficult with a sudden cutoff in labor opportunities in Israel. This leads to an immediate reduction in welfare. Subsequent growth is still feasible, provided, again, there is a convincing overall agreement, sound domestic policies, expanded trading opportunities and official capital inflows. But there are even larger risks of the process of recovery and expansion unravelling under these conditions.

Annex 1. The Workings of the Labor Market in the Occupied Territories

The following is a framework which characterizes, in a simplified form, the functioning of the Palestinian labor market. The possibilities of working in Israel are integrated in the analysis. We take as given that skilled jobs in Israel are not open for Palestinian workers and we expect that to continue to be the case in the future. The segment of the Israeli labor market which is relevant for Palestinian workers is mainly agricultural, construction and some jobs in the industrial and service sectors.

Let $D^p(T, K, F, R)$ be the domestic demand function for labor, which is defined for particular given trade regime (T), capital stock (K), structure of financial institutions (F) and various existing regulations and exogenous factors (R). The total Palestinian labor supply function is denoted by $S^p(E_0)$ where E is a vector of exogenous variables affecting the supply of labor. The effective domestic supply, S^{pd}, is the residual supply over the ones employed in Israel (Q^{pi}).

The Israeli labor market of the relevant sectors (agricultural, construction industry and services) is characterized by the labor demand function D^i (I, E_1) defined for a given level of immigration, I (mainly from the former Soviet Union), various monetary and fiscal policies, developments in relevant world markets and any other exogenous factors affecting the labor demand all are captured by E_1. The immigration variable affects the demand for labor in these sectors through its effect on the demand for housing, textile, agricultural and other goods. The Israeli labor supply to these relevant sectors is denoted by S^i (I, U, E_2) where I is the level of immigration U is the total Israeli unemployment rate and E_2 is a vector of exogenous factors affecting the supply of labor. The reason for including the overall Israeli unemployment rate is that many Israelis, even unemployed ones, do not wish to work in agricultural, construction and in some tasks in the industrial sector and services. However, for high levels of unemployment there will not be much choice and, therefore, supply of Israeli labor to these sectors will increase, and vice-versa.

We will discuss two cases of labor market integration. The first, the constrained case, is depicted in Figure 1, where the Israeli minimum wage leads to endogenous "rationing" of Palestinian employment in Israel. The second case we consider is the non-binding constraint, where every Palestinian who wishes to work in Israel, is able to find a job. The current form of labor market integration is better represented by the first case. The second case reflects the form of integration to occur in the future if the domestic market expands substantially. This may occur as enough capital flows into the domestic market, regulations on trade are lifted, etc.

Case 1: Binding Constraint

Figure 1 presents the first form of labor market integration. The domestic labor market is characterized by a significant lower value of marginal product of labor (due, for example, to lower level of capital) and by a lower value of workers reservation wage (due, for example, to lack of a social safety net), than the Israeli market. In particular, we assume the maximum value of the marginal product of labor to be below the Israeli minimum wage. Under these conditions the ones who are able to get a job, work in Israel while the rest offer their services domestically. This is demonstrated in Figure 1, where $S^t(S^i, S^p$ (T, C) $W_{min})$ is the total supply of labor to the relevant Israeli sectors. This supply is obtained by horizontal aggregation of the Israeli supply of labor (S^i (I, U, E_2)) with the Palestinian labor supply which is adjusted for two key factors: (1) Various costs involved in employing a Palestinian worker

compared to an Israeli one. These costs are captured by the parameter T, and reflect, for example, risk premium (which is expected to be high during tense periods). (2) Transportation costs to Israel, C. Thus, the total supply of labor to the Israeli market is $S^i(S^i, S^p(T,C)\ W_{min})$, which is the bold line in Figure 1, where W_{min} is the institutionally imposed minimum wage in Israel.

The equilibrium in the Israeli market is denoted by (Q^i, W^i; Q^{pi}, W^{pi}) which is the employment-wage combination of Israelis and Palestinian workers in Israel respectively. Note that W^{pi} is the wage paid for Palestinians working in Israel but their effective wage is lower by C, the transportation costs. The domestic labor market equilibrium is denoted by (Q^{pd}, W^{pd}). The model implies an internal employment solution for Palestinians in both markets and three wage levels can be sustained where $w^i \geq w^{pi} \geq w^{pd} + C$; the average wage in Israel per sector for Israeli worker is equal to, or above, the wage for Palestinians who are working in Israel whereas the latter is equal to, or above, the respective domestic Palestinian wage, even when adjusted for transportation costs.

The wage gap between Israelis and Palestinians working in Israel (the same skills and in the same economic branch) is mainly determined by T, the added costs from the employer's perspective, of hiring a Palestinian worker rather than an Israeli. The larger is T, as is expected in period of political and military tension, the larger is the wage gap (although note that the costs to the employer are the same).

There are several key factors that determine the wage gap between Palestinians working domestically and in Israel:

(1) The institutionally determined minimum wage - W_m. The Israeli minimum wage is the only source for a consistently sustained wage gap in the model. If there had not been an institutionally set minimum wage, then all Palestinians wishing to work in Israel would be employed. Flow of Palestinian workers to Israel would continue until the domestic and Israeli effective wage for Palestinians (appropriately adjusted for transportation costs) would equalize (using the aggregate supply as we are doing here would not be appropriate in such a case). Existence of an effective minimum wage results in rationing of Palestinian employment in Israel. Not all of the ones who wish to work at this wage can get a job. (We assume that the ones who are employed are a faithful sample of the total supply.) As long as the minimum wage is high enough to be effective, then the higher it is, the higher is the wage gap between the Israeli and the domestic wage for Palestinian workers.

(2) The transportation costs - C. As long as the minimum wage is effective, the actual wage gap (statistically measured) is independent of the transportation costs. The gap in the effective wage, however, is smaller the more costly it becomes to get to work in Israel.

(3) Changes in the domestic economy. For given transportation costs and minimum wage, demand shocks (e.g., change in foreign investment) and supply shocks (e.g., change in migration to other Arab countries) directly affect the wage gap as they change the domestic wage without affecting the wage paid to Palestinians working in Israel (as long as the minimum wage remains an effective constraint).

Using this framework one can also look at the workers from the West Bank separately from those from Gaza. Differences in T between the groups, different transportation costs and different domestic conditions will lead to differences between the two groups of workers in the wages paid in Israel and in their respective domestic wages as well as in their respective employment.

Case 2: Non-binding Constraint

We analyze this case by focusing on changes in capital inflow. However, opening of new trade possibilities, less restrictive regulations, etc., would have a similar dynamic effect as they change labor demand vis-à-vis their effect on the product market. As capital inflow increases, the marginal productivity of labor increases, shifting outward the domestic demand of labor.

As capital increases, but not yet to the point where the marginal productivity of labor reaches the minimum wage, the economy is at a stage of transition from the constrained to the unconstrained state, during which there is a gradual increase in both wage and employment in the domestic market, but no change in the Palestinian employment level and wage in Israel. As domestic capital increases further, we reach the point of wage equalization. Here, there is first a range where additional capital will not affect the wage. At that point the wage is equal to the Israeli minimum wage both domestically and in Israel. However, at that range any increase in capital is accompanied by a flow of Palestinian workers from Israel back to the territories. This trend will continue until the Israeli minimum wage is not an effective constraint any longer in the Israeli labor market; from that point there is no rationing and every Palestinian who wishes to work in Israel can get a job. As domestic capital continues to increase, the domestic wage continues to rise, more labor flows back from Israel to the domestic market, putting some pressure on wage to fall while the wage Palestinians are getting in Israel rises, so that it equalizes across the two regions -- but at a wage which is above the minimum wage level. This trend continues as capital increases. At the extreme, the domestic capital is reaching such high levels as to imply a marginal productivity of labor in the territories (in autarky) equal to, or above, the Israeli wage (in autarky). At that point all Palestinian labor is employed domestically.

The Facts (for 1990)

The availability of wage data of Palestinians working domestically, Palestinians working in Israel, and Israeli workers, by selected economic branch, enable us to locate (partially) the state of the current form of labor market integration, within the context of our conceptual framework. It is only partial since the wage data does not account for differences in occupational mix within the economic branch selected. Since Israelis work in more skilled jobs (see Tables 4.b and 4.c) the "true" wage ratio between Palestinians working in Israel and Israelis, by sectors, is clearly above the one reported (in Figure 6). Accounting for that bias, the data suggest that the state of labor market integration can be approximated by Case 1 - the binding constraint:

The average wage Palestinians earn in Israel is about $450 which is in the neighborhood of the Israeli minimum wage. The domestic average Palestinian wage is about $310. This is an overestimate of the relevant wage since the workers employed domestically are more skilled than the ones who work in Israel (Tables 4.a and 4.c). Thus the "true" wage gap is even larger than reported. Such a significant gap cannot be explained merely by transportation costs. We suggest that the Israeli minimum wage is an effective constraint, the employment of Palestinian labor in Israel is demand driven, and the current form of labor market integration is as presented in case 1.[1]

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1. The average Israeli wage is significantly above the wage Palestinians get in Israel, which supports the case as well. However, as stated previously, that reflects the different skill composition, as well as the added costs incurred by Israeli employers from employing a Palestinian rather than the equivalent Israeli worker.

Analysis

The present framework is used as a simple tool to analyze the qualitative effects of changes in economic scenarios and various shocks, on wage and employment of Palestinians. The events to be considered include both ones that occurred already (e.g. intifada, Gulf war, recession in Israel, beginning of mass migration to Israel). It formed the basis for the framework for analyzing future scenarios described in Chapter 6 and Annex 4.

Past Shocks

II.1 Intifada

The *Intifada*, which started in December 1987, involved a general deterioration in security, frequent strikes, demonstrations and curfews. It had the direct effect of an increase in T, the parameter which captures the added costs, from the Israeli employer's perspective, of hiring a Palestinian worker rather than an Israeli.

Transportation costs to work in Israel, C, increased as well, as time to get to work increased mainly due to imposed road checks. The combined effect is a shift upward of the adjusted labor supply of Palestinians to the Israeli market. The resulting changes are a decline in effective employment, which is the number employed adjusted by the average number of hours worked (see Figure 2 for the number employed and Figure 3 for average weekly work hours); an increase in the wage paid to Israelis; a decrease in the wage of Palestinians employed in Israel relative to that of Israelis and an increase in employers' costs. In the domestic market, the effective supply shifts outward - leading to an increase in effective employment, lower domestic wages and a decrease in the relative wage between Palestinians working domestically and those working in Israel (Figure 7). Strikes and demonstrations imposed work interruptions too and these may have dominated the net effect on both employment and wage.

The effect of the *Intifada* is expected to be transitory, and its extent is closely linked to the extent of the political-military disturbances. The data (Figures 2 and 3) behave as expected with respect to employment. Although the number of employed in Israel in the period following the outbreak of the *Intifada* fell only slightly, the weekly work hours per Palestinian employee in Israel decreased sharply. Domestic employment during that period went up, although domestic weekly work hours per employee went down by as much as in Israel. With respect to wages, Figure 6 shows the ratio, over time, of Palestinian daily wages in Israel to Israeli daily wages by selected economic branches. This ratio is declining in the period following the beginning of the *Intifada*, in all major economic branches. Note, however, that this data remains pertinent only if there is no significant change in the skill mix between Palestinians and Israelis within the selected economic branches. The reason is that the reported wage ratio does not control for a different occupational mix within the branches. For that same reason, one should not consider the reported wage ratio to represent the true one. Still, since we only look at the change of the wage ratio over time, it is appropriate to do so as long as the occupational mix within the branch did not change over that period. The occupational data reported in tables 4.b and 4.c (although not by branch) lead us to believe that indeed there was not a significant change in the skill mix.

Figure 7 provides the pattern of the wage ratios of Palestinian employees working domestically to the ones working in Israel, by selected economic branch. As expected, the wage ratio is declining following the start of the Intifada. Angrist's finding (1992), that the premium paid for working in Israel rose steeply in the late 1980s, is consistent with the qualitative analysis.

II.2 The Gulf War

The Gulf war affected Palestinian labor through several internal channels. First, as in the case of the *Intifada*, it increased T, and shifted the effective supply to the Israeli market, while the residual supply to the local market increased. That tended to reduce the domestic wage and increased the Palestinian wage in Israel. Second, the employment possibilities for Palestinians in the Gulf states diminished considerably, leading to an increase in Palestinian labor force. That increased the effective supply to Israel, which at least partially offset the first effect (and, perhaps, more than offset it), and also increased the domestic labor supply, which enhances the first effect. Thus, the net effect on the domestic market is an increase in employment and reduction in wage, whereas the effect on Palestinian employment and wages in Israel is ambiguous. Unlike the *Intifada* which seems to have mainly a transitory effect, the Gulf war is likely to have lasting effects on the domestic labor market -- mainly because the current situation, where there are many fewer employment possibilities in the Gulf than before the war, is likely to continue.

The empirical effect of the Gulf War on Palestinian labor cannot be established at this stage of the analysis since the Gulf War occurred while mass immigration in Israel was already occurring. The data at that period reflect the effects of both shocks. Since, as we discuss next, the aggregate effect of the immigration is ambiguous - as it affects Palestinian labor both through an increased demand for goods and an increased labor supply - more detailed empirical analysis is required in order to differentiate between the effects of the two shocks and to verify the analytical predictions presented.

II.3 Immigration

The end of 1989 marked the beginning of a mass wave of migration to Israel from the former Soviet Republics, reaching about 200,000 by the end of 1991, or about 8 percent of the Israeli population. The massive immigration has had, and will continue to have, a profound and permanent effect on both the Israeli and the Palestinian markets. The immigration affects Palestinian labor via dual changes in Israeli labor demand and supply, within the relevant sectors. The net effect on Palestinian wages and employment depends on the relative increase in the supply of, and demand for, labor and on the extent to which the immigrants are substitutes for, or complements to, Palestinian workers in the Israeli labor market.

Table 5 presents quarterly data for 1990 and 1991, a period which covers both the Gulf war and the acceleration in immigration. After a steep drop in the fourth quarter of 1990, and in the first quarter of 1991, the number and proportion of employed persons from the Occupied Territories, began to rise until reaching the same point as before the Gulf crisis. The entry of immigrants into the labor force affected the sectoral distribution of workers from the Occupied Territories rather than their number. In particular, construction remains the main source of employment, and in this sector the number and proportion of employed workers from the territories has not fallen. The proportion of the workers from the territories employed in the trade, hotel industry and services did fall. They were replaced, in part, by Israelis and new immigrants. It thus appears that the workers from the territories and the immigrants are substitutes in the industrial sector, and trade and services industries, but not in construction. Therefore, the labor market opportunities of workers from the territories in Israel depend almost entirely on one sector -- construction. With expectations for continuing immigration, and with the agricultural sector shrinking, employment prospects in the remaining sectors that used to employ workers from the territories -- services, industry, agriculture, trade and hotels -- seem poor for the future. However,

increased demand for housing due to the immigration suggests that, at least in the short run, demand in the construction sector for workers from the territories will continue to be high.

Complements or Substitutes?

Within the context of an aggregate production function, Palestinian workers compete with low-skilled Israeli workers as substitutes, while they are complements to more skilled workers. As long as there is an expansion in the sectors which primarily employ workers from the territories – construction, agriculture and services - more Palestinians are hired, and unskilled Israelis are improving their relative position. If there is contraction, the reverse occurs. Thus, the employment situation of Palestinians is very much dependent on the Israeli unemployment level and specific demand in agriculture and construction. The 1991 data, which already utilize information on the new immigrant workers (from the former Soviet Union) reveals this situation. The new immigrants have preferences for work in the industrial sector and in the service industry, while they object to working in construction and agriculture. Looking at quarterly data, it is evident that the immigrants substituted for Palestinian workers in industry and services while the share of Palestinian workers in construction and agriculture did not go down. At the aggregate level, as Figure 4 reveals, there is a negative correlation, as expected, between the Israeli unemployment rate and the share of Palestinians in total employment in Israel.

This analysis is fairly general. In order to establish substitutability/complementarity relationships a comprehensive econometric analysis would be needed where wage and employment effects are analyzed; such an analysis, however, extends beyond the scope of the present report.

FIGURE 1(1): LABOR MARKET INTEGRATION

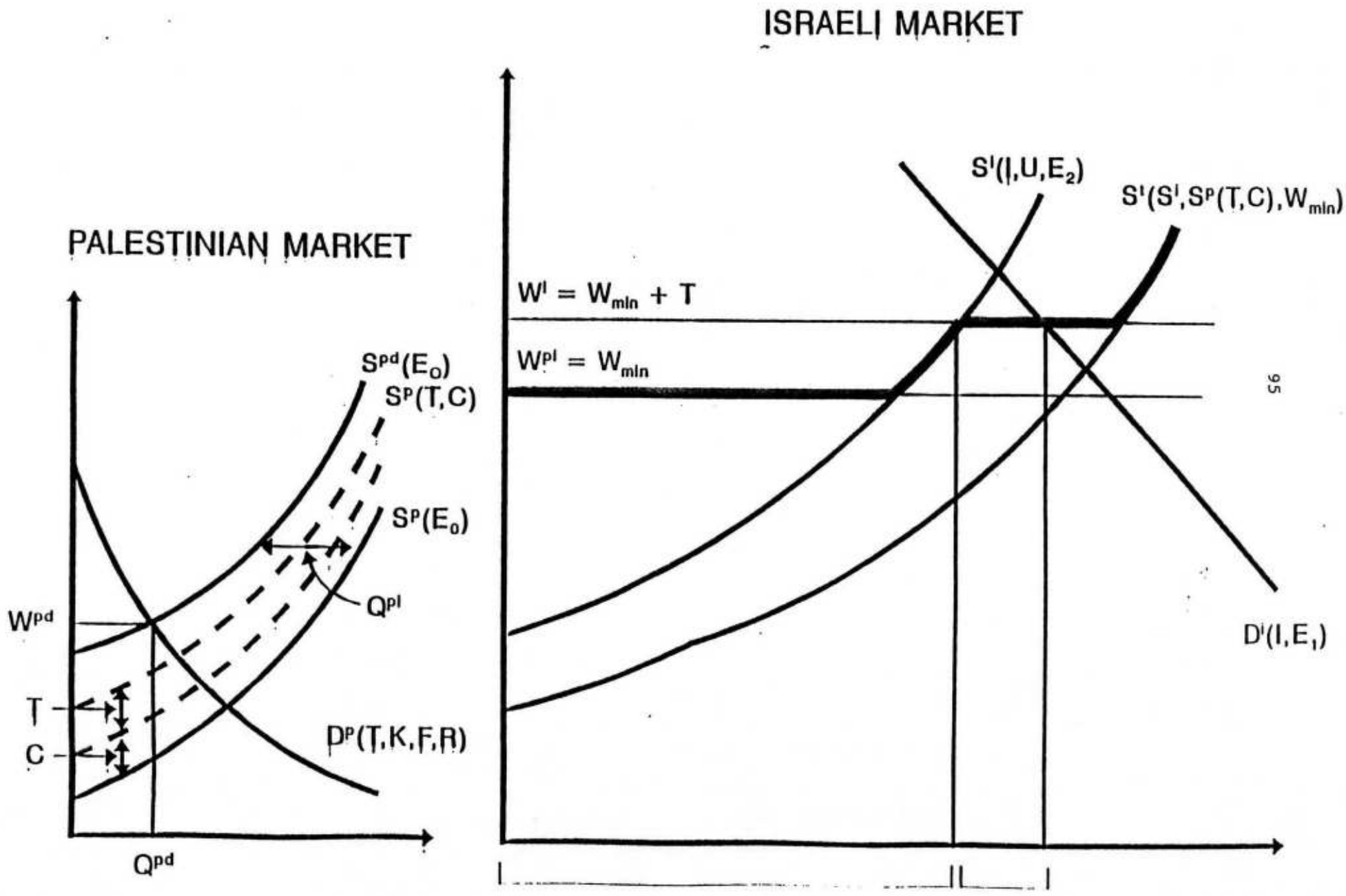
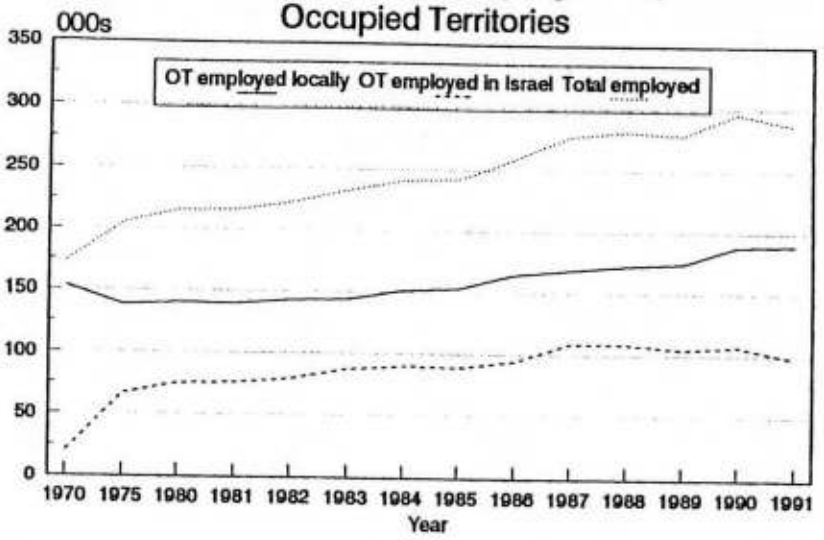
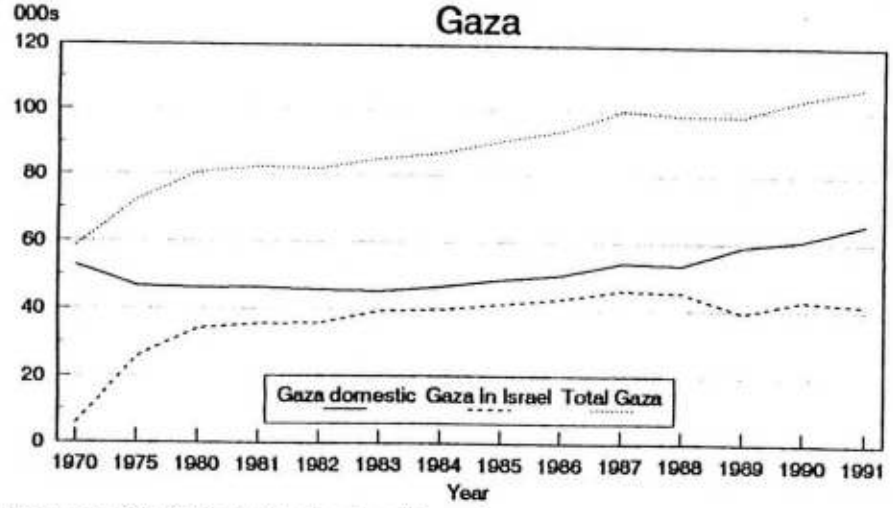
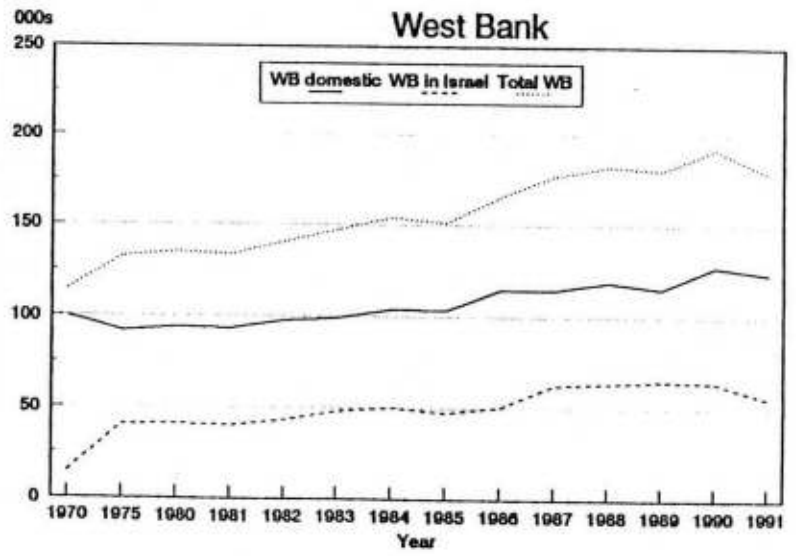


Figure 1(2): Number of Employed West Bank and Gaza Residents by Place of Employment, 1970-91

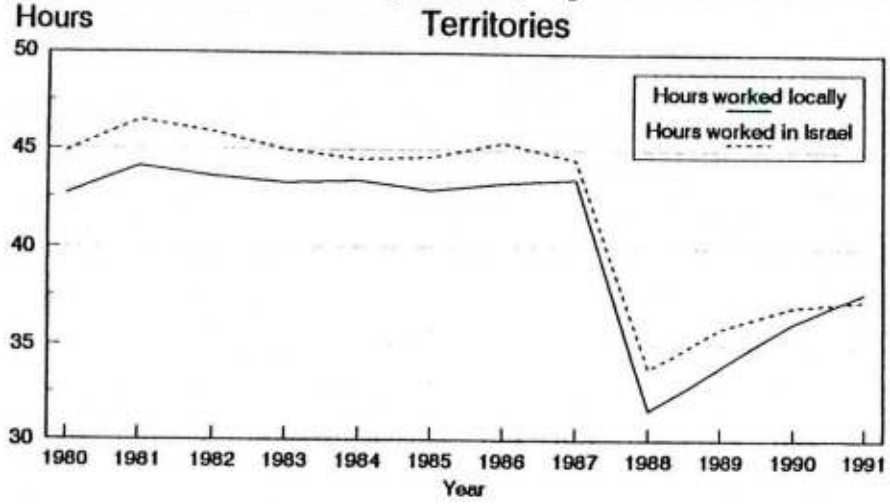


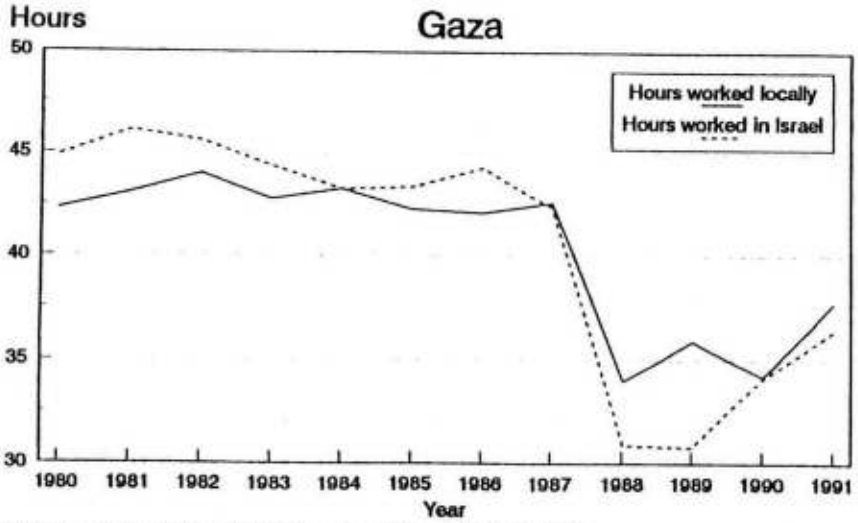


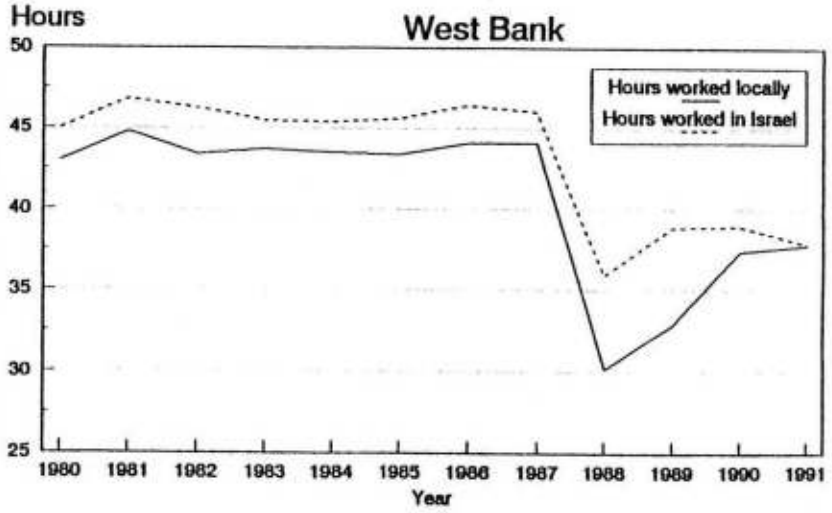


Source: Statistical Abstracts of Israel, 1983-1992, Central Bureau of Statistics, Jerusalem.

Figure 1(3): Average Weekly Hours per Palestinian Employee, by Place of Work.

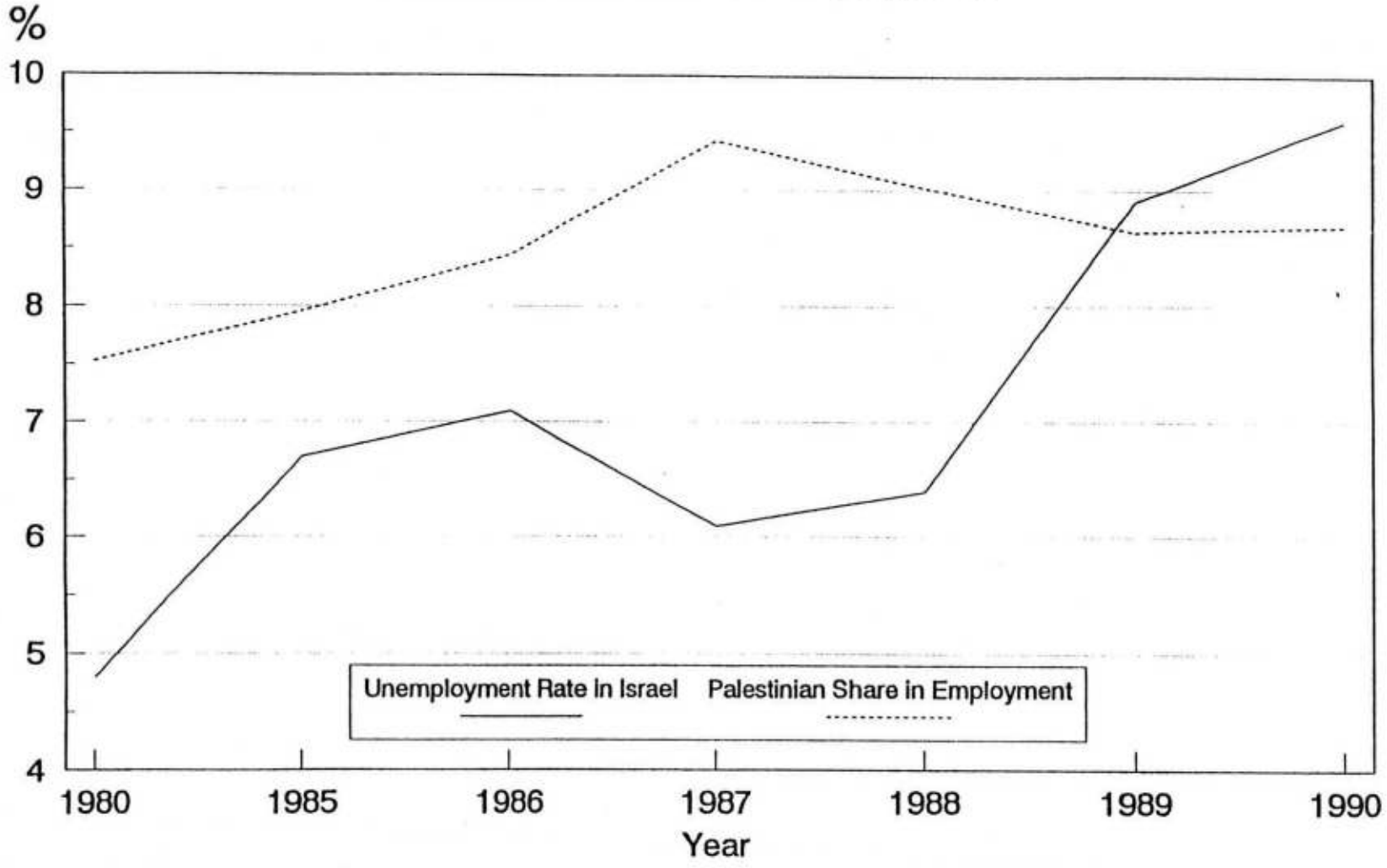






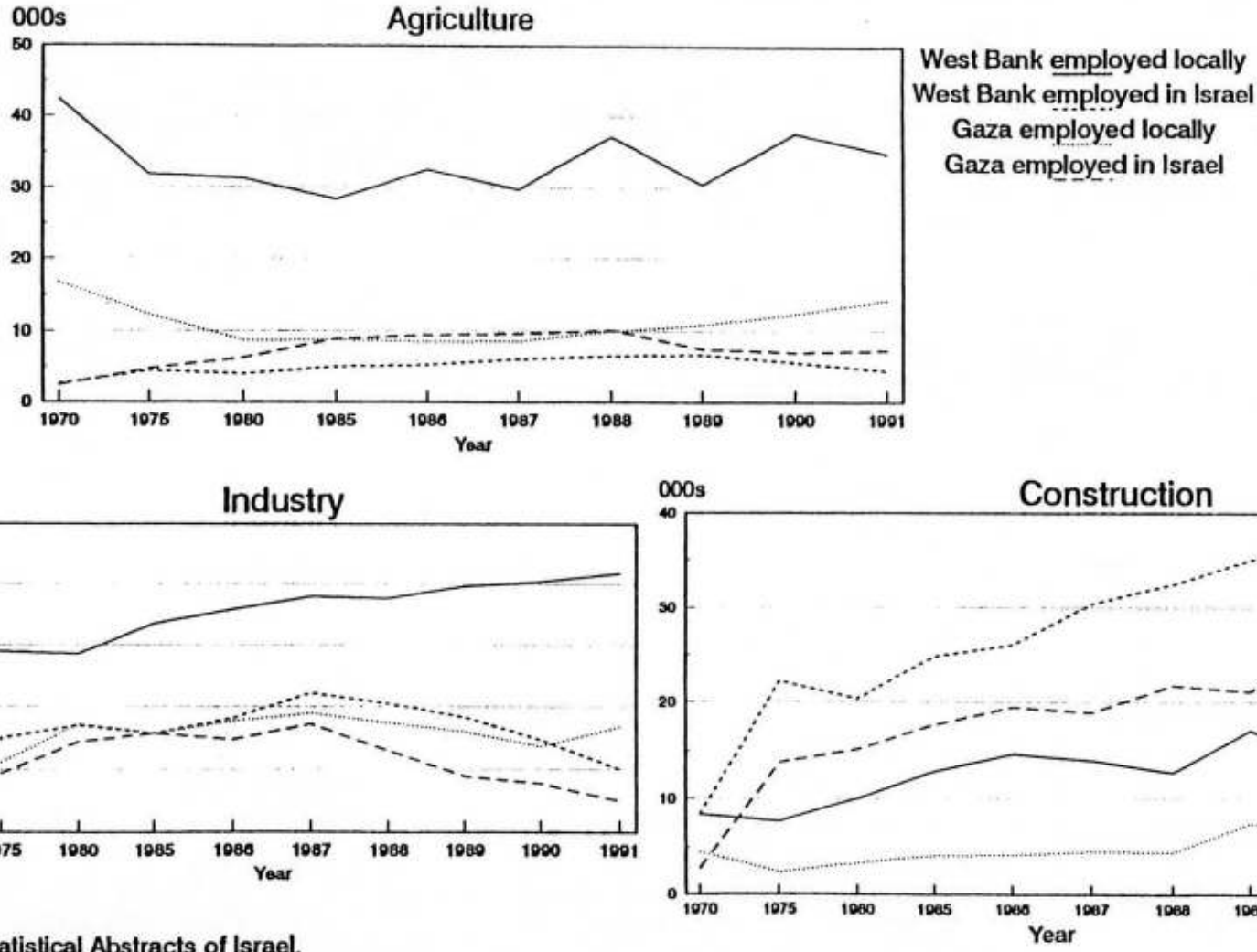
Source: Statistical Abstracts of Israel, 1985-92
Central Bureau of Statistics, Jerusalem.

Figure 1(4): Israeli Unemployment Rate and Palestinian Share in Total Employment.



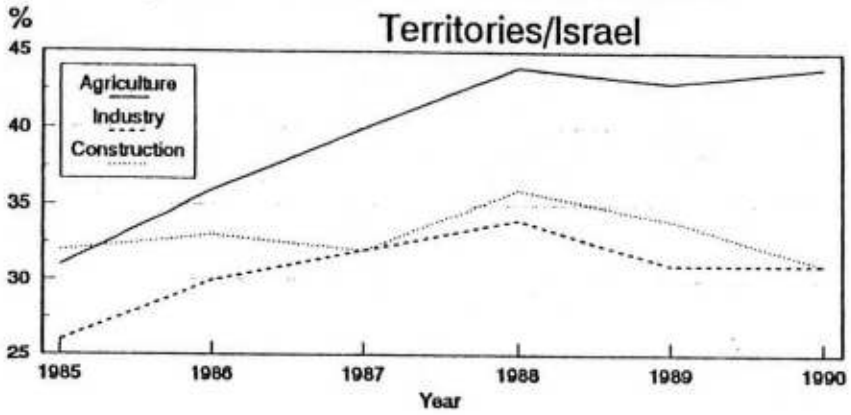
Source: Statistical Abstracts of Israel,1970-91, Central Bureau of Statistics, Jerusalem.

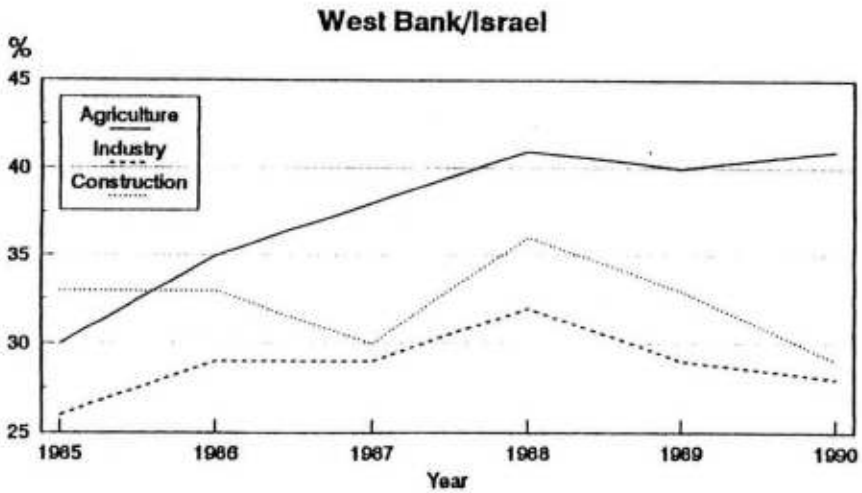
Figure 1(5): Employed West Bank and Gaza Residents by Sector and Place of Employment

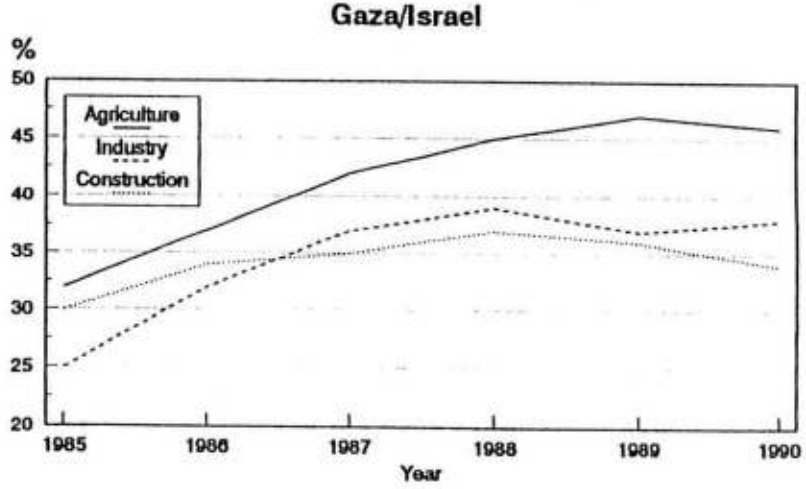


Source: Statistical Abstracts of Israel, 1986-1992, Central Bureau of Statistics, Jerusalem.

Figure 1(6): Palestinian Daily Wage as a Percentage of Israeli Daily Wage by Selected Economic Branches

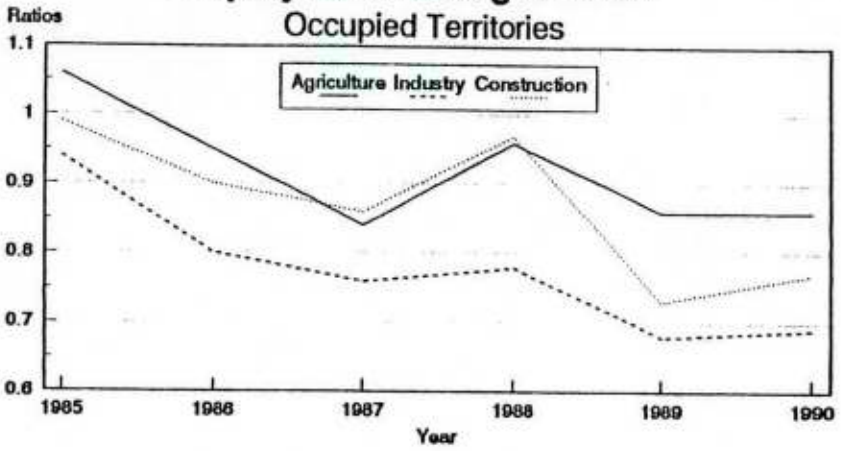


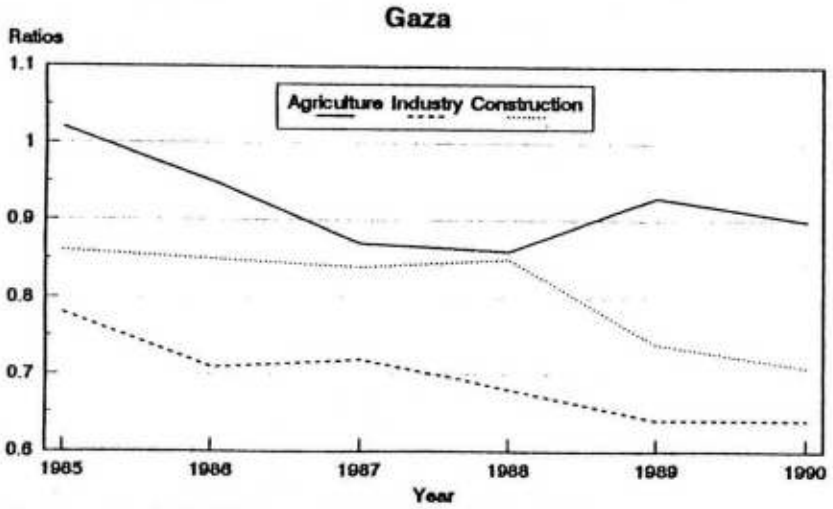


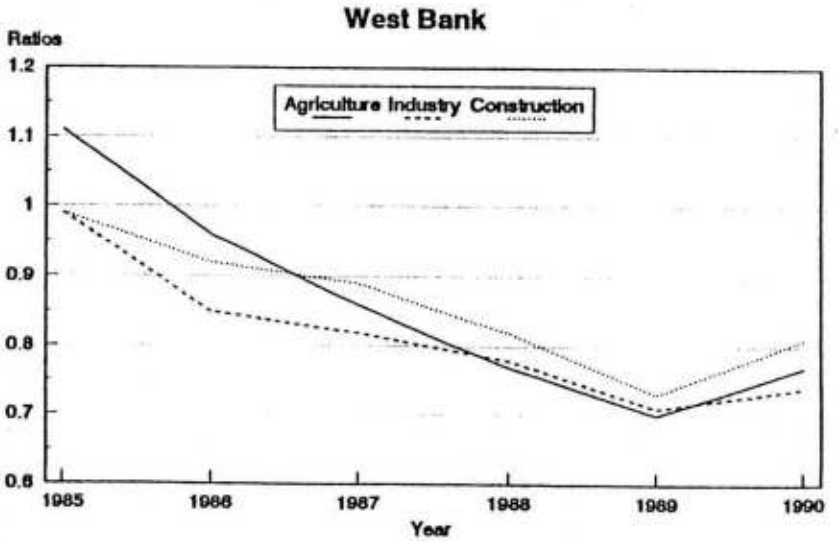


Source: based on Statistical Abstracts of Israel 1971-1991, Central Bureau of Statistics, Jerusalem.

Figure 1(7): Daily Wage Ratios of Palestinian Employees Working Domestically to Palestinian Employees Working In Israel







Source: Statistical Abstracts of Israel, 1985-90
Central Bureau of Statistics, Jerusalem.

Annex 2: Public Finances in the Occupied Territories

I. Budgetary Operations of the Public Sector

1. The public sector in the Occupied Territories consists of the Civil Administration and the municipalities. The budget for the Civil Administration does not include expenditures on security or expenditures on Israeli settlers in the Occupied Territories. The budget is prepared on an annual basis and has to be approved by the Israeli Kenneset. At the time the budget is being prepared, forecasts are made for revenues and expenditures in each of the west Bank and Gaza, and the two are then combined into one budget (hereafter referred to as the Civil Administration Budget). The municipalities and village councils are also required to prepare annual budgets. Since 1992, the fiscal year coincided with the calendar year; prior to that, the fiscal year ended March 31. An interim budget was prepared for the period April-December 1991.

2. In what follows below, the structure of the Civil Administration Budget as well as actual budgetary developments during the period 1987/88-1991, are analyzed. A similar analysis is then conducted for the municipalities, after which a picture for the public sector as a whole is presented.

A. Civil Administration Budget

3. The actual outcome for the Civil Administration Budget for 1987/88-91 as well as the budgets for 1992 and 1993 are presented in Table 1. According to the available presentation, revenues are broken into receipts from the income tax, the Value Added Tax (VAT), customs and excise duties and purchase taxes, health fees, other fees and charges, as well as receipts from the "deduction fund". The income tax consists of a tax on individuals and a tax on corporations. The individual income tax is progressive with the highest rate being 45 percent. The income tax brackets are adjusted upwards twice a year according to the inflation rate. The corporate tax rate is 38 percent. Data is not available on the breakdown on income tax receipts between the individual income tax and the corporate income tax, nor is any information available on the number of taxpayers at either the individual or corporate level. The VAT tax is applied at the same rate as in Israel (currently, the rate is 17 percent). Sales of agricultural products by producers is not subject to the VAT tax, nor are the services provided in touristic establishments. A zero rate is applicable to exports. Customs duties are the same as those applicable in Israel, and so are the excise duties on domestic production (mainly tobacco and beverages) and the purchase taxes (applicable to a number of domestically-produced and imported goods). No information is available on the breakdown of receipts between these various kinds of taxes.

4. Regarding non-tax revenue, receipts are broken into health fees and other fees and charges. Health fees represent fees paid by employees of the Civil Administration as well as by whoever wants to join on a voluntary basis the health plan of the Civil Administration. The fee is currently NIS 64/month. Other fees and charges comprise a large variety of levies on things such as bridge crossings, car registration, departure fees, etc. Some of those fees are in fact in the nature of taxes such as the motor vehicle taxes, but no data is available on the breakdown of these receipts.

5. Receipts from the "deduction fund" are related to the social security payments made in connection with the Palestinian workers working in Israel and the benefits they are entitled to. The total employer and employee social security contribution is 12.7 percent of salary, broken down into 7.4 percent for the employer and 5.3 percent for the employee. The Palestinian workers in Israel are entitled to benefits worth 0.9 percent of salary, and the remainder 11.8 percent that he is not entitled to is remitted back to

the Civil Administration. These amounts remitted back constitute the receipts of the "deduction fund". A detailed description of the system of benefits is provided in Attachment I .

6. Expenditures are classified into two main categories: current and developmental. Current expenditures are broken separately into expenditures on health, education and welfare, and other current expenditure, but no breakdown of the latter is available. There is also no economic classification available of current expenditure (e.g. wages and salaries, transfers, etc.). The only separate category provided under development expenditure relates to transfers to the budgets of the municipalities.

7. Overall budgetary developments. As can be seen from Table 1 , the overall position of budget of the Civil Administration fluctuated between a deficit of 1.0 percent of GDP in 1987/88 and an (annualized) surplus of 1.6 percent of GDP in 1991. While revenues stagnated in relation to GDP in 1988/89 following the start of the Intifada, development expenditures declined sharply and the overall budgetary position reached a virtual balance. The budgetary position strengthened further in both 1989/90 and 1991, while in 1990/91 it was in balance. Thus, recourse to financing by the Israeli Treasury was resorted to only in 1987/88.

8. Revenue developments. Over the period 1987/88-91, the revenue/GDP ratio fluctuated between 12.2 and 13.5 percent of GDP. Receipts from the income tax and the VAT exhibited generally rising trends and averaged 3.7 percent and 2 percent of GDP, respectively. Revenues from customs and excises were relatively stable at 1.5 percent of GDP while those from fees and charges fluctuated considerably. Revenues from the "deduction fund" averaged about 1.2 percent of GDP.

9. Expenditure developments. The expenditure/GDP ratio remained in the 12-13 percent range during the 1987/88-91 period. Current expenditures averaged 10.5 percent of GDP, with expenditures on education averaging 3.3 percent and those on health 2.3 percent. Development expenditures declined in 1988/89, but started rising afterwards. On average, development expenditures exceeded slightly 2.0 percent of GDP.

B. Budgets of Municipalities

10. The budgets for the municipalities include the revenues and expenditures of the electricity and water utilities. The consolidated budget for the municipalities is broken into ordinary and extraordinary budgets. The ordinary budget consists of current revenues and expenditures, while the extraordinary budget covers mainly development expenditures and their sources of financing. Current revenues can be divided into three main categories: taxes (property and fuel) and fees; water charges; and electricity charges. Similarly, current expenditures consist of expenditures on general services as well as expenditures by the water and electricity utilities. The main source of financing for the development expenditures are loans and grants from the civil administration, while financing from external sources is small.

11. As can be seen from Table 2, the budgets of the municipalities experienced deficits ranging between 0.5 percent and 1.2 percent of GDP during the period 1987/88-1991. Revenues averaged about 3.5 percent of GDP, with more than 60 percent of revenues emanating from electricity charges, 25 percent from taxes and fees, and the remaining 15 percent from water charges. Similarly, about 50 percent of current expenditures were by the electric utilities, 15 percent by the water utilities, and the remaining 35 percent on general government services. Development expenditures averaged slightly below 0.5 percent of GDP.

C. Consolidated Budget for the Public Sector

12. When the budget for the Civil Administration is incorporated with that for the municipalities and eliminating the transfers between the two, the following picture emerges for the public sector finances during the period 1987/88-91 (Table 3): an overall budgetary position which is virtually balanced over the five-year period with an overall deficit of 1.2 percent of GDP in 1987/88 followed by alternating very small deficits or surpluses; financing from the Israeli Treasury which averaged 0.2 percent of GDP; and financing from external sources which was even lower averaging only 0.1 percent of GDP.

13. On the revenue side, the revenue/GDP ratio fluctuated between 15 and 17 percent of GDP and averaged about 16.1 percent. Revenues were almost equally split between tax and non-tax (fees and charges including those related to electricity and water) revenue, with each accounting for about 8 percent of GDP. On the other hand, tax revenue was also almost equally split between direct taxes (taxes on income and property, and indirect taxes (customs duties, excise duties and purchase taxes). On the expenditure side, the average expenditure/GDP ratio during the period was 16.1 percent, with a current expenditure/GDP ratio of 13.9 percent and a development expenditure/GDP ratio of only 2.2 percent.

II. Expenditures by UNRWA and Other Organizations

14. The United Nations Refugee and Works Agency (UNRWA) is a major provider of health, education and other social services to residents of the Occupied Territories. About 40 percent of residents of the West Bank and 60 percent of the residents of Gaza have the status of "refugees" and therefore entitled to the benefits provided by UNRWA. Over the period 1987-91, UNRWA expenditures in the West Bank and Gaza averaged US$ 100 million annually, representing about 4.5 percent of the GDP of the Occupied Territories; expenditures in Gaza were about 60 percent of the total. About 50 percent of total UNRWA expenditures was on education, 20 percent on health, and the remainder on other activities.

15. Several other organizations, including the United Nations Development Program (UNDP), the European Community(EC), Arab countries and organizations, as well as various Western non-governmental organizations (NGOs) have also extended assistance to the Occupied Territories. UNDP expenditures averaged about US$ 7 million annually over the five year period 1987-91, and EC aid averaged about US$ 15 million during the same period. Assistance from Jordan, mainly in the form of salaries to civil servants was high up to 1988 (averaging about US$ 50 million a year during 1987-88), but declined sharply afterwards to about US$ 15 million annually as a result of the disengagement in June 1988. Other identifiable Arab government aid averaged about US$ 15 million annually during 1988-89, but no figures are available after that. No figures are also available on Arab non-government aid (for e.g. aid from the PLO and various Arab organizations). Western governments extend assistance mainly through a variety of non-governmental organizations, but no precise data are available on such disbursements.

16. In sum, there are various organizations that extend assistance to the Occupied Territories, which is used to provide services to residents of the type which are usually provided by governments. Foremost among these is UNRWA, which has a special status because of the refugee problem. In the aftermath of the Gulf war, the EC has increased sharply its assistance, but this might have only partly offset a possible large decline in Arab aid.

III. Fiscal Transfers between the Occupied Territories and Israel

17. This section deals with the issue of the fiscal transfers between the Occupied Territories and Israel. First, we will try to estimate the magnitude of the taxes paid by the residents of the Occupied Territories and which do not accrue to the budget of the Civil Administration. Second, we present estimates by the Israeli authorities of the benefits accruing to the Palestinian residents of the Occupied Territories from interaction with Israel. Finally, some issues regarding fiscal transfers are presented.

A. Tax Payments by Palestinians Accruing to Israel

18. There are no economic boundaries between Israel and the occupied territories. Goods produced in Israel and purchased by residents of the occupied territories are subject to tax in Israel, while goods produced in the occupied territories and purchased by residents of Israel are subject to tax in the occupied territories. Goods exported out of Israel and the occupied territories to third parties are zero-rated, while those imported to them from third parties are taxed (at the same rates) at the point of entry. The following represents an estimation of the revenues which should have been returned to the benefit of the Palestinians (calculations are for 1991):

19. **Revenue from taxes on imports via Israel.** Imports by the Occupied Territories via Israel amounted to NIS 105 million in 1991. Assuming that these goods are consumer goods, the amount of the various taxes on these imports (i.e. customs duties, surcharges, purchase taxes, and VAT) would be equivalent to 62 percent of the value of these imports, or NIS 65 million. As only revenues from taxes on imports of cars (estimated at NIS 5 million in 1991) accrue to the budget of the Civil Administration, the loss from this source is estimated at NIS 60 million.

20. **Revenue from taxes on "trade" with Israel.** There are several losses which are enumerated below. As noted earlier, the VAT on good produced in Israel and purchased by residents of the territories is paid into the Israeli Treasury, while the VAT on goods produced in the occupied territories and purchased by Israel's residents accrues to the budget of the Civil Administration. Some of the trade between the occupied territories and Israel, such as agricultural and second hand goods, is not subject to VAT. According to 1987 data, imports of agricultural goods constituted about 15 percent of the imports of the occupied territories from Israel, but no details on the other imports which are not subject to VAT are available. Assuming another 20 percent of the trade between the Occupied Territories and Israel is not subject to VAT, the budgetary loss to the civil administration from the VAT tax on trade with Israel would be equivalent to the VAT tax rate multiplied by 65 percent of the magnitude of trade deficit of the occupied territories with Israel. Data on trade between the West Bank and Israel is not available after 1987. However, in Israel's balance of payments, an estimate is provided for trade with the occupied territories. For 1991, the trade deficit with Israel was estimated at NIS 1790 million which, although it might be an overestimate, is the only figure that can be presently used. Applying an 18 percent VAT rate (the rate applicable in 1991) on 65 percent of the trade deficit means a revenue loss to the budget of the Civil Administration of NIS 210 million. Another revenue loss in this connection would be the import duties (customs duties and purchase taxes) on the imported inputs that enter into the Israeli goods that are being purchased by residents of the territories. The ratio of imports of production inputs to GDP in Israel was about 20 percent in 1991 and the ratio of customs duties and purchase taxes to imports of intermediate goods is estimated at about 5 percent; the resulting duties therefore constitute about 1 percent of the value of the goods. Applying the 1 percent rate to the trade deficit with Israel results in an additional revenue loss of about NIS 17 million.

21. Revenue from fuel taxes, excise taxes (mainly tobacco, beverages and cement) and purchase taxes on domestic production. These goods are again taxed at the source. In Israel's budget, revenues from fuel taxes were estimated at NIS 1650 in 1991, those from excise duties at NIS 450 million, and those from purchase taxes at NIS 800 million. The economy of the occupied territories is about 5 percent of the size of the economy of Israel. As far as fuel taxes are concerned, the intensity of energy use in the Occupied Territories is lower than that in Israel. Assuming 3 percent of the fuel use is by the occupied territories, and allowing for the fact that a small amount of revenues from the fuel tax (NIS 5-10 million) accrues to the budgets of the municipalities, the revenue loss from the fuel tax source would be about NIS 40 million. Regarding excise duties, only a part of the production of goods subject to these taxes constitutes alcoholic drinks. Given that the consumption of alcoholic drinks in the Occupied Territories is generally lower than that in Israel, it can be assumed that the revenue loss relating to the excise duties is about 4 percent of the revenues from excise duties collected in Israel, or about NIS 18 million. As far as purchase taxes are concerned, it can be assumed that 5 percent of the purchase taxes collected on domestic production in Israel (i.e. NIS 40 million) represents a revenue loss to the Civil Administration.

22. Revenue from electricity. Expenditures by the municipalities on electricity amounted to about NIS 80 million in 1991. Assuming 95 percent of the electricity is bought from the Israeli electricity company, and applying the 18 percent VAT rate would mean an additional revenue loss of about NIS 15 million. Table 4 gives a summary of these revenue losses.

23. Adding-up the losses from all these sources (60+210+17+40+18+40+15) results in a total loss of NIS 400 million to the budget of the civil administration in 1991. Had these accrued to the Civil Administration budget, they would have resulted in a significant increase in 1991 revenue. Even if the GDP figure is adjusted upwards to reflect the higher amount of indirect taxes, the revenue loss would still have amounted to over 8 percent of 1991 GDP.

B. Benefits Accruing to Residents of Occupied Territories from Interaction with Israel

24. The Israeli authorities have provided the Bank staff with estimates of the benefits accruing to residents of the Occupied Territories as a result of the interaction of the two economies. The following represents a summary of the Israeli presentation:

25. Expenditures on security. According to the Israelis, under international law, the occupying power may require the local population to defray the cost of governing it. Since the Intifada, the cost of security operations have increased sharply. The expenses incurred by the Israeli army in connection with the uprising amounted to NIS 600 million annually. Additional expenses not associated with the uprising, and expenses incurred by other security organizations have brought the total security expenditures to about NIS 1 billion annually in recent years.

26. Use of roads. There are 150 kilometers of roads in the occupied territories whose construction has been financed by the Israeli budget at a cost of NIS 500 million. The annual cost of capital is 8 percent and the volume of traffic of Palestinians using them is estimated at 80 percent of total use. The value of their annual use by Palestinians is therefore estimated at about NIS 30 million. Furthermore, using the same methodology, the annual value of the use by Palestinians of Israel's road network of 15,000 kilometers had been estimated at NIS 180 million (assuming Palestinian use is about 5 percent of total use).

27. Movement of manpower. Each day about 120,000 workers from the territories enter Israel and about 80,000 of them are employed on a regular basis. According to the Israelis, in effect, the export of labor services from the represents the import of unemployment into Israel. Assuming the rate of substitution of workers from the territories for Israelis is two to one, payment of unemployment benefit to some 60,000 persons arises from the export of unemployment from the territories into Israel. The resulting cost to the Israeli budget is NIS 90 million annually.

28. Benefits from Israeli-subsidized goods. Goods that are subsidized by Israel are also available to the residents of the occupied territories. Subsidies on basic commodities and agricultural produce amount to about 1.2 billion annually in Israel. Assuming that the residents of the occupied territories consume about 5 percent of such goods, the benefits accruing to them are estimated at NIS 60 million annually.

29. Technology and know-how. According to the Israelis, as a result of the contact with Israel, the occupied territories have acquired new technologies of production. Expenditures on research and development in Israel is estimated at NIS 1.2 billion annually, and the benefits to the residents of the occupied territories from Israeli R&D was estimated at NIS 40 million annually.

30. Additional benefits. Several other benefits accrue to the residents of the occupied territories from services provided by Israel: (a) use of subsidized health services: NIS 5 million; (b) use of Israel's sea and airports for international trade: NIS 6 million; (c) benefits of Israel's protective tariff system: NIS 9 million; and (d) consumption of agricultural goods subsidized through Israeli-government investment in agricultural capital:NIS 6 million.

31. Income tax credit points. By law, only residents of Israel are entitled to credit points against their income tax. However, under the government decision of October 8, 1970 regarding the equalization of employment conditions and net and gross wages between workers from the occupied territories and from Israel, the workers from the occupied territories were regarded as if they were residents of Israel and therefore were entitled to credit points. Assuming that 80,000 workers constitute registered workers and that each worker receives on average 3.25 credit points at a value of NIS 1,080 per credit point, it is estimated that the workers from the occupied territories who work in Israel receive about NIS 250 million annually as a result of credit points.

32. When the benefits to the territories from the use of the infrastructure and services provided by Israel are added up, they amount to NIS 1,426 million annually. To this would be added the income tax credit points of NIS 250 million annually.

C. Issues Regarding Fiscal Transfers

33. The above presentations are made not to dwell on the magnitude of fiscal transfers in the past but to highlight some of the issues that will undoubtedly be raised in the bilateral negotiations regarding the interim self-governing arrangements. In this context, the following points can be made. First, as far as the revenue losses are concerned, there seems to be no doubt that agreement should be reached between the two sides about the magnitude of these losses and on a formula for revenue-sharing or revenue transfers. More will be said on this point in a later section. Second, there is no doubt that expenditures on security in the Occupied Territories had constituted a burden on the Israeli budget. However, how much needs to be spent on security in the interim period and who is going to spend it, is a subject for negotiations at the bilateral level and the Bank is not taking a position on this issue.

34. Third, although residents of the Occupied Territories are benefiting from the use of Israeli infrastructure, this use does not result in itself in an incremental direct fiscal transfer from the Israeli Treasury to the Occupied Territories. The same applies to things like transfer of know-how and technology. Fourth, in so far as the unemployment benefits being paid to Israeli workers is concerned, this argument presupposes that the Palestinian labor has replaced Israeli labor, i.e. that the employment of Palestinians has resulted in increased unemployment in Israel. There is no empirical evidence to prove this hypothesis. In fact, past employment figures show that new immigrants to Israel, for example, tended to shy away from working in the construction and agricultural sectors where most of the Palestinian workers are employed. Therefore, Palestinian labor should be viewed as a complement rather than a substitute for Israeli labor. Fifth, while the availability of income tax credit points to Palestinian workers represents a loss of revenue for Israel, it is part of the Israeli decision of 1970 to equalize the employment conditions between Israeli labor and Palestinian labor, by imposing the same income tax and social security systems to both. The whole issue regarding the treatment of Palestinian labor versus Israeli labor is also a matter to be discussed in the negotiations. In this connection, the Israeli calculation that income tax credit points to Palestinian workers costs about NIS 250 million annually is based on the assumption that two-thirds of the Palestinian labor is registered. However, as pointed out in Attachment I, the percentage of registered workers --at least up to 1991-- was only about 30 percent. The cost of income tax credit points in 1991 would then be only about NIS 100 million.

35. For the above reasons, and for the sake of the analysis that follows below, it will be assumed that the current incremental non-security related fiscal transfers from the Israeli budget consist of the expenditures on consumer subsidies (NIS 60 million) and on medical services (NIS 5 million) provided to residents of the Occupied Territories. These expenditures amount to 1.2 percent of GDP. Furthermore, capital expenditures in the Occupied Territories financed by Israel are estimated at 0.8 percent of GDP (this being the difference between the figures from the national accounts and the figures from the Civil Administration and the municipalities). Altogether, the direct non-security related transfers amount to 2 percent of GDP. On the revenue side, it would be assumed that the revenues foregone amount to 8 percent of GDP. However, as explained earlier, these figures should be treated only as illustrative, and not as indicative of any position taken by the Bank regarding the negotiations between the various parties on these issues.

IV. Toward an Integrated View of Public Sector Finances

36. In light of the discussion in the previous sections, it is clear that the magnitude of the public sector finances in the Occupied Territories cannot be evaluated by simply taking the consolidated budgetary position of the Civil Administration and the municipalities. As indicated previously, the fiscal transfers between the Occupied Territories and Israel, especially on the revenue side, constitute an important element in the analysis of the fiscal stance. Furthermore, UNRWA, and some other multilateral, regional and bilateral donors have been partly financing activities that are usually undertaken by the public sector. These elements need to be merged to arrive at an integrated position of the public sector. While precise data on UNRWA operations is available, the magnitude of the operations of other organizations performing quasi-governmental activities is not known with any significant degree of precision. It will be arbitrarily assumed here that non-UNRWA quasi-governmental expenditures averaged annually 3 percent of GDP during 1987-91, divided into 2.5 percent of GDP as current expenditure and 0.5 percent of GDP as capital expenditure (other than those capital expenditures undertaken through the municipalities). These numbers would need to be ascertained during subsequent discussions.

37. Table 5 shows the position of the public sector finances before and after integrating the various fiscal elements indicated above. The revenue/GDP ratio would rise by 8 percentage points to 24.1 percent reflecting the addition of the estimated revenue losses of 8 percent of GDP. Current expenditures excluding security would rise by 8.2 percent of GDP, reflecting UNRWA operations of 4.5 percent of GDP, other operations of a quasi-governmental nature of 2.5 percent of GDP, and transfers from Israel of 1.2 percent of GDP. Regarding capital expenditure, they would rise by 1.3 percent of GDP to 3.5 percent reflecting Israel's contribution of 0.8 percent of GDP and other contributions of 0.5 percent of GDP.

38. While this integrated approach shows an increase in cash balances which goes to the Israeli Treasury, it should be kept in mind that such an approach does not take into account expenditures by Israel on security in the Occupied Territories. According to the Israeli authorities, such expenditures amounted to about 1 billion shekels a year since the beginning of the Intifada, which is well over 20 percent of GDP.

Palestinian Workers in Israel:
Social Security Payments and Benefits

This note discusses some issues related to social security payments made with respect to Palestinian workers in Israel, the benefits that these workers are entitled to, and the concept of the "deduction fund".

An Israeli government decision was taken in October 8, 1970 to try to equalize employment conditions between Israeli workers and Palestinian laborers working in Israel. The aim of the decision was in fact to remove the incentive of Israeli businesses to employ Palestinian workers over Israeli workers by requiring that social security payments be made towards Palestinian workers as well as Israeli workers. The total employer and employee contributions toward social security amount presently to 12.7 percent of salary, divided into 7.4 percent for the employer and 5.3 percent for the employee. The palestinian worker is entitled to benefits amounting to 0.9 percent of salary. The remaining 11.8 percent that he is not entitled to constitutes the "deduction fund" which is remitted to the Civil Administration. The Civil Administration uses these receipts to finance general expenditure, and not specific services directed towards the workers from whose salaries the deductions are made.

The following represents a listing of the various benefits and the corresponding employer and employee contributions:

Type of Benefit	Employer Contribution	Employee Contribution	Total
Old Age and Minor Pension	0.67	2.70	3.30
Family Allowance	0.81	–	0.81
Accidents Outside the Work Place	0.04	0.15	0.19
Unemployment Benefits	0.04	0.15	0.19
Disability Benefits	0.10	1.30	1.40
Reserve Benefits	0.47	0.45	0.92
Geriatric Services	0.02	0.10	0.12
Health Insurance in Israel	4.95	–	4.95
Maternity Benefits	0.04	0.60	0.64
Accidents in Work Place	0.23	–	0.23
Bankruptcy of Employer	0.02	–	0.02
Total	7.35	5.35	12.70

While the Israeli worker is entitled to all these benefits, the Palestinian worker in Israel is entitled to only the last three benefits, namely maternity benefits, benefits if an accident takes place in the work place, and benefits in case the employer goes into bankruptcy. As mentioned earlier, the contributions made towards those benefits that the workers are not entitled to receive are remitted to the budget of the Civil Administration. It should be noted, however, that this system of payments and benefits applies only to registered workers. If one takes into account the amounts that had been in fact remitted to the Civil Administration during 1987-91 and the estimated earnings by Palestinian workers (both registered and unregistered) in Israel during that period, one reaches the conclusion that only 30 percent of the workers had been registered. The Israeli authorities have said that enforcement of the regulations requiring the registration of workers in the recent past have been tightened significantly in the recent past especially in the aftermath of the Gulf war, and that receipts from the deduction fund should show a large increase.

It should also be noted that Palestinian workers in Israel pay income taxes on their earnings in accordance with Israeli income tax law. For that purpose, they are also considered as residents of Israel and are entitled to the income tax credit points which helps them reduce their income tax liability. The income tax payments which accrue to the Israeli Treasury, amounted to NIS 32 million in 1992.

ATTACHMENT II
Page 1 of 1

Individual Income Tax: Occupied Territories and Israel

1. Both the Occupied Territories and Israel have income tax schedules that are indexed to inflation. For the sake of comparison, we will take the schedules that had been prevailing in January 1992, and compare the amount of tax that an individual wage earner with a non-working wife and three children would have to pay on annual salaries of (a) NIS 12,000; (b) NIS 30,000.; and (c) NIS 48,000.

2. The tax schedules are shown in Tables 8 and 9. In Israel, the taxpayer first computes the amount of tax to be paid according to the tax schedule and before taking any deductions. The taxpayer then reduces his tax liability through a crediting mechanism, as given in the schedule which is also shown in Table 8. The taxpayer also then reduces his tax liability by taking additional credit points as follows: 2 credit points for being resident and 1 credit point for a non-working wife. Each credit point is worth (annually) NIS 1,128 (1992).

3. In the Occupied Territories, the taxpayer is entitled to the following deductions before arriving at the taxable income base: a fixed annual deduction of NIS 1,300; a resident annual deduction of NIS 3,100; deduction for non-working wife of NIS 1,550; and deductions per child of NIS 250 up to 5 children. After the taxable income is arrived at, the tax liability is calculated from the schedule.

4. A wage earner in Israel with a nonworking wife and three children with an annual income of NIS 12,000 pays no income tax, while in the Occupied Territories, he pays NIS 464, or about 4 percent of salary. On a salary of NIS 30,000, the Israeli taxpayer pays NIS 1,999, or about 7 percent of salary, while in the Occupied Territories, he pays NIS 5,088, or 17 percent of salary. With an NIS 48,000 salary, the Israeli taxpayer pays NIS 7,180 or about 15 percent of salary, while a resident of the Occupied Territories pays NIS 13,285, or about 28 percent of salary.

Table 1. Civil Administration Budget, 1987/88-1992

	Actuals					Budget
	1987/88	1988/89	1989/90	1990/91	II-IV. 91	1992
	(In millions of New Israeli Shekels)					
Revenue	345	368	462	546	577	727
Income tax	56	73	109	134	125	175
VAT	52	55	69	89	106	285
Customs and excises	44	43	55	73	72	0
Health fees	16	23	31	28	38	61
Other fees and charges	135	123	158	188	192	150
Deduction fund	42	51	40	34	44	56
Current expenditure	286	325	381	471	410	649
Health	67	73	84	96	91	130
Education	103	93	116	146	124	198
Welfare	23	15	14	17	18	28
Other	93	144	167	212	177	293
Development expenditure	86	41	49	75	87	119
Total expenditure	372	366	430	546	497	768
Overall deficit(-) or surplus	-27	2	32	0	80	-41
Financing	27	-2	-32	0	-80	41
Israeli Treasury	27	0	0	0	0	41
Increase in cash balances(-)	0	-2	-32	0	-80	
GDP at market prices	2837	3025	3442	4477	4884	
			(In percent of GDP)[1]			
Revenue	12.2	12.2	13.4	12.2	13.5	
Income tax	2.0	2.4	3.2	3.0	3.2	
VAT	1.8	1.8	2.0	2.0	2.6	
Customs and excises	1.6	1.8	1.6	1.6	1.8	
Health fees	0.6	0.8	0.9	0.6	1.0	
Other fees and charges	4.8	4.1	4.6	4.2	4.8	
Deduction fund	1.5	1.7	1.2	0.8	1.1	
Current expenditure	10.1	10.7	11.1	10.5	10.8	
Health	2.4	2.4	2.4	2.1	2.4	
Education	3.6	3.1	3.4	3.3	3.3	
Welfare	0.8	0.5	0.4	0.4	0.4	
Other	3.3	4.8	4.9	4.7	4.7	
Development expenditure	3.0	1.4	1.4	1.7	2.2	
Total expenditure	13.1	12.1	12.5	12.2	13.0	
Overall deficit(-) or surplus	-1.0	0.1	0.9	0.0	1.6	

Source: Civil Administration

1/ Anualized for 1991.

Table 2. Budgets of the Municipalities, 1987/88-1992

	Actuals				
	1987/88	1988/89	1989/90	1990/91	II-IV, 91
	(In millions of New Israeli Shekels)				
Revenues	127	90	110	134	134
Taxes and fees	59	27	30	33	38
Water and sewarage charges	15	14	15	18	19
Electricity charges	53	49	65	83	84
Current expenditure	118	94	124	142	138
General services	56	39	43	46	41
Water sewerage	14	12	17	19	14
Electricity	48	43	64	77	83
Development expenditure	44	16	14	16	19
Total expenditure	162	110	138	158	157
Overall deficit(-), surplus	-35	-20	-28	-24	-16
Financing	35	20	28	24	16
From civil administration	24	10	11	14	16
From external financing	4	1	3	5	2
Self-financing	10	3	3	3	1
Other	-3	6	11	2	-3
GDP at market prices	2837	3025	3442	4477	4884
	(In percent of GDP)				
Revenues	4.5	3.0	3.2	3.0	3.6
Taxes and fees	2.1	0.9	0.9	0.7	0.9
Water and sewarage charges	0.5	0.5	0.4	0.4	0.5
Electricity charges	1.9	1.6	1.9	1.9	2.1
Current expenditure	4.2	3.1	3.6	3.2	3.5
General services	2.0	1.3	1.2	1.0	1.1
Water and sewarage	0.5	0.4	0.5	0.4	0.4
Electricity	1.7	1.4	1.9	1.7	2.0
Development expenditure	1.6	0.5	0.4	0.4	0.5
Total expenditure	5.7	3.6	4.0	3.5	4.0
Overall deficit, surplus	-1.2	-0.7	-0.8	-0.5	-0.4

Source: Statistical Abstract of Israel, various issues

Table 3. Budgetary Operations of the Public Sector, 1987/88-91

	Actuals					
	1987/88	1988/89	1989/90	1990/91	II-IV,91	Average 1987-91
	(In percent of GDP)					
Revenue	16.7	15.2	16.6	15.2	17.1	16.2
Total expenditure	17.9	15.4	16.2	15.5	16.6	16.3
Current expenditure	14.2	13.8	14.7	13.7	14.3	14.1
Development expenditure	3.7	1.6	1.5	1.8	2.3	2.2
Overall budget surplus or deficit	-1.2	-0.2	0.4	-0.3	0.5	-0.2
Financing	1.2	0.2	-0.4	0.3	-0.5	0.2
From Israeli Treasury	0.9	0.0	0.0	0.0	0.0	0.2
From external sources	0.1	0.1	0.1	0.1	0.1	0.1
Change in balances	0.2	0.1	-0.5	0.2	-0.6	-0.1

Sources: Tables 1 and 2; and staff calculations.

Table 4. Losses from Tax Payments by Palestinians, 1991
(In millions of New Israeli Shekels)

Item	Loss
Taxes on imports via Israel	60
Taxes on trade with Israel	340
Value Added Tax	210
Customs duties on import content	17
Fuel taxes	40
Excise taxes	18
Purchase taxes	40
Electricity purchases	15
Total	400
Memorandum item:	
In percent of 1991 GDP	8

Source: Staff calculations

Table 5. Integrated Public Sector Finances, 1987-91

	Public Sector	Integrated Public Sector
	Average 1987-91	Average 1987-91
	(In percent of GDP)	
Revenue	16.1	24.1
Expenditure excluding defense	16.3	25.8
Current expenditure	14.1	22.3
Of which: UNRWA		4.5
Other quasi-government		2.5
Israeli budget		1.2
Development expenditure	2.2	3.5
Of which: Israeli budget		0.8
Other quasi-government		0.5
Overall deficit (-)/ surplus (+)	-0.2	-1.7
Financing	0.2	1.7
Israel	0.2	2.2
UNRWA	--	4.5
Other external sources	0.1	3.1
Increase in cash balances	-0.1	-8.1[1]

Sources: Tables 3 and 4; and staff calculations

1/ This increase, basically reflecting the revenue foregone by the Civil Administration, is more than offset by substantial expenditures by Israel on security in the Occupied Territories.

Table 6. Revenue and Expenditure Comparisons: Egypt, Israel, Jordan, OT and Developing Countries.

	Average: 1987-91					1989
	Egypt	Israel	Jordan	OT	OT Adjusted	Developing countries
				(In percent of GDP)		
Revenue	23.1	38.6	27.2	24.1	21.7	22.1
Tax revenue	15.2	33.9	14.3	16.1	16.1	17.5
Direct taxes	5.7	17.5	3.4	4.2	4.2	5.4
Indirect taxes	9.5	16.4	10.9	11.9	11.9	12.1
Nontax revenue	7.9	4.7	12.9	8.0	8.0	4.6
Expenditure	42.2	50.2	46.4			28.0
Current expenditure	28.9	45.7	37.2			21.0
Developemnt expenditure	13.3	4.5	9.2			7.0
Expenditure excluding defense	37.2	36.8	30.5	25.8	23.6	25.6
Current expenditure excluding defense	23.9	32.3	21.3	22.8	20.1	18.6
Development expenditure	13.3	4.5	9.2	3.5	3.5	7.0
				(In percent of GNP)		
Memorandum items						
Revenue	21.7	39.4	28.9	17.8	16.2	23.3
Of which: Indirect taxes	8.9	16.7	11.6	8.9	8.9	12.7

Attachment II, Table 7. Israel: Individual Income Tax, January 1992

Monthly Taxable Income (New Israeli Shekels)	Rate/Credit (percent)
Tax Rate	
0 - 2,050	21.00
2,051 - 3,380	31.50
3,381 - 4,820	36.75
4,821 - 7,480	47.25
Over 7,480	50.40
Tax Credit	
0 - 2,050	4.30
2,051 - 2,098	35.00
2,099 - 3,380	3.40
3,381 - 3,468	32.00
3,469 - 4,820	2.50
4,821 - 4,957	27.00
4,958 - 10,080	1.70
10,081 - 10,739	26.00
Over 10,739	NIL

Source: Kesselman and Kesselman Guide to Investment in Israel, 1992/3

Attachment II, Table 8. Occupied Territories: Individual Income Tax, January 1992

Monthly Taxable Income (New Israeli Shekels)	Tax Rate (Percent)
0 - 600	0
601 - 1,000	8
1,001 - 1,667	16
1,668 - 2,500	32
2,501 - 3,750	45
3,751 and up	48

Source: Civil Administration

Annex 3: Trading Patterns in a Less Restricted World
Results from a Gravity Model

Impact, Gravity Flow Estimation

As countries in the region move toward normalization of relations, it is natural to ask how their trading patterns will change. Our approach is based on a best-case scenario, in which the fundamental determinants of trade flows among the countries in the region become similar to those of present-day market economies. To that end, we rely on a gravity-type equation.[1] In its basic form, the equation is written as:

$$T_{ij}=\{TP_i, TP_j, TA_{ij}\}$$

where TP_{ij} refers to the trade potential of countries i and j, and TA_{ij} is the trade attraction between them. The gravity model specifies that a country's trade potential depends on its total output and the trade intensity of that output. Trade intensity depends on economic as well as geographic features of a country. The share of a particular partner depends on the partner's trade potential and the trade attraction. The trade attraction is a function of geographic proximity, economic similarity, the existence of preferential trading arrangements, and cultural similarities. In order to capture these factors, we specify the following equation:

$$\begin{aligned} T_{ij} = {} & \beta_1(dist_{ij}) + \beta_2(bord_{ij}) + \beta_3\{|LGDPPC_i - LGDPPC_j|\} \\ & \delta_1 LGDP_i + \delta_2 LGDPPC_i + \delta_3 Size_i + \delta_4 Island_i + \\ & \gamma_1 LGDP_j + \gamma_2 LGDPPC_j + \gamma_3 Size_j + \gamma_4 Island_j + \\ & \sum_{k=1}^{3} \alpha^k Region_k + \sum_{l=1}^{4} \lambda^l Language_l \end{aligned}$$

where T_{ij} refers to bilateral non-fuel import and export values in US$. The US$ per capita GDPs at purchasing power parity for the reporter and the partner countries are included in order to capture the effects of each country's level of development. The variables for distance between countries and the corresponding absolute difference in per capita GDPs (at purchasing power parity) capture the Linder hypothesis (1961).[2] The former refers to the distance between the economic centers of the two countries, and the latter is a proxy for economic similarity. The size of each country is measured by area in square

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[1]Gravity models have been applied successfully to different types of flows, such as migration, commuting, recreational traffic, and interregional and international trade.

[2]Linder (1961) postulates that the intensity of bilateral trade in manufactures is determined by similarities in demand structures (captured through similarities in per capita incomes), and geographical distance between importing and exporting countries.

kilometers, and separate dummy variables are included for islands and the existence of a common border. Separate dummy variables are also included when necessary for the EEC, LAFTA, and ASEAN.[3] Finally, a language dummy variable is included to proxy for cultural similarities. It assumes the value of one if the countries share a common language, otherwise its value is set to zero; separate dummy variables are included for English, Spanish, Portuguese and Arabic. Finally, it was assumed that all English-speaking reporter countries share the language with Israel.

Equation 2 has been estimated using data for 15 middle- to upper- income economies with substantial non-primary exports. The estimated coefficients for imports and exports along with other statistics are presented in Tables 1 and 2.[4] Nearly all the variables (with the exception of the per capita GDPs for the reporter and partner countries) have the expected sign and are quite significant. Trade increases with the level of GDP of the reporter and partner, and decreases with size. Sharing a common border or a common language enhances trade, while distance restrains it.

The estimated coefficients are then used along with the actual data for Israel and the Occupied Territories (OT) to project the direction of their trade. The results for Israel are presented in Tables 3 and 4 below. For the OT, four different scenarios are postulated, and their results are reported in Table 5. The first scenario assumes that the two countries share a common language in addition (Arabic). Scenario 3 adds to the second the assumption of a free trade area (FTA) between Israel and the OT. Finally, under scenario 4, Jordan is assumed to be a third member of the FTA.

The first two columns of Tables 3 and 4 indicate the actual 1989 volume of non-fuel trade and the corresponding partner's share, while the third column reports the predicted shares which are obtained from the simulation exercise. The last column shows what the predicted share represents for the partner countries' 1989 share in non-fuel trade assuming zero transport costs. In the case where the OT is the partner, actual trade figures refer to 1987, the latest year for which trade data were available. Due to lack of comprehensive partner country data for the OT, Table 5 reports only the predicted shares.

Finally, since our goal in this exercise is to simulate the redirection of trade of these two economies, rather than their trade potential, the predicted amounts of trade of Israel and the OT have been normalized to their actual levels.

On the import side, despite the fact that Israel's overall non-fuel import bill has been kept constant, the predicted changes in its redirection are quite significant. Israel is predicted to more than triple its import shares from its Arab neighbors (Table 3). This is anticipated to come at the expense of both the United States and the EEC. Egypt and the OT are project to supply more than half of Israel's imports that originate from the Arab Middle Eastern countries. With a 3% import share, Egypt is projected to emerge as Israel's most important import partner in the area. This translates into one-fifty of Egypt's total non-fuel 1989 exports. The OT are projected to follow with a 2.2% share in Israel's

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[3]For example, Aitken (1973) found European trade to be significantly influenced by membership in the EEC or EFTA and by being neighbors. Srivastava and Green (1986) found cultural similarity, political circumstances, economic union and former colonial status to be significant determinants of trade between nations.

[4]Variables with an "L" prefix have been converted to natural logarithms. Moreover, since the values of bilateral trade are only observed for non-negative values, ordinary least squares estimates will be inconsistent. Therefore, we use maximum likelihood estimation technique.

import bill (down from an actual of 2.6%). This translates into more than 67% of total 1987 OT's exports. This high share can be attributed to the OT's relatively small 1987 export base of $385 million. On the export side, the redirection of Israel's trade appears to be less dramatic. It is estimated that the Arab countries would combine to absorb only about 11% of Israel's exports, versus an actual figure of 9.3%. This results from intra-regional trade diversion--away from the OT and towards the other Arab countries in the region. The share of the OT in Israel's exports, while remaining the largest in the region, is projected to drop from 9.3% to 4.3%, with much of the slack being picked up mainly by the relatively small-sized countries in the region (Lebanon, Jordan and Syria).

Finally, applying the predicted trade shares of Israel to its actual non-fuel trade results in Israel experiencing, on balance, a trade deficit of about $50 million with the Arab countries. This result is largely driven by a projected $243 million deficit with Egypt,[5] and a $183 million surplus with the OT. Israel is project to run bilateral trade surpluses with countries like Lebanon, Jordan and Syria, while at the same time experiencing deficit with the rest of the Arab countries (mainly the Gulf Cooperating Council (GCC) and Maghreb countries).

Under the assumption that the OT and Israel would only share a common border with each other, it is project that the OT would be sourcing some 31% of their imports from their neighbors who, in their turn, are projected to absorb more than 50% of OT's total exports. Under this scenario, Jordan and Egypt are projected to be the single most important regional trading partners of the OT, and the GCC the most important trading bloc in the region. Under this scenario, Israel's share in OT's trade is projected to be the smallest in the region.

Adding the assumption of a common language between Israel and the OT would more than double their bilateral trade shares. However, Jordan and Egypt still emerge as the most valuable single partners for the OT, while the role of the GCC bloc remains basically unchanged.

Scenario 3 assesses the potential importance of creating an FTA between Israel and the OT. It does so by relying on the trade-weighted coefficient of integration reported in Tables 1 and 2 for the EEC, LAFTA, and ASEAN.[6] Under this scenario, Israel re-emerges to dominate OT's trade, while the position of Jordan in the OT's trade and to a lesser extent the GCC bloc are dramatically eroded. Finally, under the fourth scenario where Jordan is now assumed to have become a third member of the FTA, Israel is projected to cede its leading role in the OT's trade to Jordan. More than half of the OT's trade is projected to take place with its FTA partners. The OT's trade with the GCC bloc would suffer, and so would trade with North America and the EEC. Trade with Egypt appears to be resilient to change under differing scenarios.

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[5]This results in mainly due to two factors. Firstly, note from Tables 1 and 2 that trade is inversely related to size, with the coefficient estimate on the import side equal in absolute value to approximately one-fourth of the corresponding estimate on the export side. Secondly, and as is reported in Tables 1 and 2, the trade potential between any two countries is inversely related to the differences in their per capita income. The coefficient estimate on the import side is much larger than the corresponding export estimates. These two factors combine to create the noted deficit.

[6]Trade shares with the countries in the EEC. LAFTA and ASEAN are those of Israel.

Finally, and as would be expected from the simulation results at hand, the OT is expected in general to run a trade deficit with countries characterized by a relatively high per capita income, and the reverse with relatively lower per capita income countries.

Table 3: Actual and Predicted Non-Fuel Import Shares of Israel.

Partner	Actual Imports (US$ 000)	Actual Share (%)	Predicted Share (%)	Israel's Share in Partner (%)
Egypt	4,873	0.0	3.1	19.98
Occupied Territories[1]	303,700	2.6	2.2	67.76
Syria	0	0.0	1.1	9.71
Lebanon	0	0.0	0.3	8.72
Jordan	0	0.0	0.5	6.41
GCC[2]	0	0.0	0.9	2.11
Other Middle East[3]	0	0.0	0.5	N.A.
Other North Africa[4]	0	0.0	1.1	2.18
All Arab Countries	308,573	2.6	9.7	—
Iran	0	0.0	0.8	0.39
North America[5]	2,436,041	20.5	14.5	0.54
European Community	6,622,028	55.8	49.3	0.36
EFTA	1,451,675	12.2	5.3	0.46
Other Developed[6]	431,554	3.6	12.4	0.20
South & Central America	168,195	1.4	1.4	N.A.
Sub-Saharan Africa	30,247	0.3	0.8	0.23
Asia & Pacific	417,813	3.5	5.8	—
TOTAL	11,866,126	100.0	100.0	

[1]Includes both the West Bank and Gaza Strip.

[2]Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3]Includes Yemen, Sudan, and Iraq.

[4]Includes Yemen, Sudan and Iraq.

[5]Includes the United States and Canada.

[6]Includes Australia, Japan, New Zealand, South Africa and Turkey.

Table 4: Actual and Predicted Non-Fuel Export Shares of Israel.

Partner	Actual Exports (US$ 000)	Actual Share (%)	Predicted Share (%)	Israel's Share in Partner (%)
Egypt	4,480	0.0	1.2	1.70
Occupied Territories[1]	961,200	9.3	4.3	42.27
Syria	0	0.0	0.7	2.66
Lebanon	0	0.0	0.3	2.16
Jordan	0	0.0	0.4	2.40
GCC[2]	0	0.0	1.3	0.47
Other Middle East[3]	0	0.0	0.9	N.A.
Other North Africa[4]	0	0.0	1.6	0.94
All Arab Countries	965,680	9.3	10.7	---
Iran	0	0.0	0.7	N.A.
North America[5]	3,423,388	33.1	16.2	0.31
European Community	3,389,944	32.8	30.0	0.29
EFTA	447,908	4.3	4.5	0.25
Other Developed[6]	956,357	9.3	14.1	0.65
South & Central America	209,415	2.0	4.5	0.69
Sub-Saharan Africa	42,427	0.4	5.2	N.A.
Asia & Pacific	897,493	8.7	14.1	0.43
TOTAL	10,332,612	100.0	100.0	---

[1]Includes both the West Bank and Gaza Strip.

[2]Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3]Includes Yemen, Sudan, and Iraq.

[4]Includes Yemen, Sudan and Iraq.

[5]Includes the United States and Canada.

[6]Includes Australia, Japan, New Zealand, South Africa and Turkey.

Table 5: Predicted Non-Fuel Import & Export Shares of the Occupied Territories Under the Different Scenarios[1]

	Sharing Only Common Border with Israel		Sharing Border & Language with Israel		Sharing Border & Language & FTA with Israel		Sharing Border, Language & FTA with Israel & Jordan	
Partner	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)	Import Share (%)	Export Share (%)
Egypt	4.5	6.3	4.3	5.9	4.5	6.8	3.2	5.9
Israel	2.3	1.5	4.7	3.6	36.2	20.2	24.1	16.6
Syria	3.3	5.3	3.2	5.2	1.8	4.1	1.2	3.4
Lebanon	1.2	2.5	1.2	2.4	0.5	1.9	0.3	1.6
Jordan	5.8	6.4	5.7	5.3	2.2	3.9	34.2	20.5
GCC[2]	5.6	10.8	5.3	11.2	3.2	8.8	2.6	7.6
Other Middle East[3]	2.8	6.4	2.9	6.9	1.8	5.3	1.2	4.4
Other North Africa[4]	5.4	11.3	5.5	10.9	3.1	8.7	2.1	7.1
All Arab Countries	30.9	50.5	32.8	51.4	53.3	59.7	68.9	67.1
Iran	0.5	0.7	0.5	0.8	0.4	0.6	0.3	0.5
North America[5]	20.8	9.9	20.2	9.7	14.9	12.3	9.4	10.1
European Community	22.5	15.1	21.6	14.9	14.1	12.3	9.4	10.1
EFTA	3.5	3.2	2.9	2.8	2.2	3.3	1.5	2.7
Other Developed[6]	12.8	6.3	12.6	6.5	8.9	5.4	5.9	4.4
South & Central America	3.9	5.7	4.1	5.6	2.7	4.9	1.8	4.1
Sub-Saharan Africa	0.7	2.5	1.1	2.4	0.5	2.3	0.3	1.8
Asia & Pacific	4.4	6.1	4.3	5.9	3.1	5.3	2.1	4.3
TOTAL	100.0	100.0	100.0	100.0	100.1	100.0	100.1	100.1

[1] The predictions are based on the assumption that the West Bank is the "center of gravity" of the Occupied Territories. Again, Occupied Territories includes both the West Bank and Gaza Strip.

[2] Include only the following countries for which data were available: Saudi Arabia, Kuwait, The United Arab Emirates and Oman.

[3] Includes Yemen, Sudan and Iraq.

[4] Includes Morocco, Tunisia, Algeria and Libya.

[5] Includes the United States and Canada.

[6] Includes Australia, Japan, New Zealand.

Data Sources and Description

Trade

T is the average annual 1987-1989 US$ value of total non-fuel (SITC 0 through 9 less 3) imports or exports. The data were extracted from the UNSO COMTRADE data base.

Geography

Distance is the straightline distance between the economic centers of gravity of the respective countries, from Linneman (1966).

Border is equal to one if the countries share a border, zero otherwise.

Economic Activity

GDP is US$ GDP taken from the World Bank Atlas. The Atlas method uses a conversion factor other than the official rate when the latter is wildly distorted.

GDPPC is US$ GDP per capita from the World Bank Atlas.

Area is the land area in thousand square kilometers.

Island is equal to one if the country is an island, zero otherwise.

Trade Preference Arrangements

Region is equal to one if both countries are party to a preferential trading arrangement, zero otherwise. The arrangements included are: ASEAN, EEC, and LAFTA.

Cultural

Language is equal to one of both countries share a common language. The languages included are: Arabic, English, Portuguese, and Spanish.

The Sample

The partner countries used in both samples are 95 non-socialist economies with total imports of at least $450 million in 1987. The reporter economies chosen were: Greece, Ireland, Korea, Portugal, Spain, Uruguay, Venezuela, Singapore, Hong Kong, Taiwan, Italy, Austria, Tunisia and Morocco.

Annex 4: Simulation Models

The simulation models are built around several blocks which are described here.

1. **Population.** In line with the human resources chapter, population is assumed to grow at a rate of 3.5 percent a year in the West Bank, and 4.0 percent in Gaza. The overall labor participation ratio is assumed to start at 20 percent and to increase over time to 21 percent.

2. **Work in Israel.** Initially, labor working in Israel is taken to be 97,000, its level in 1991. In the base case scenarios with smooth labor cut-off, we assume that the labor force working in Israel shrinks by 10 percent a year. In the labor cut-off scenarios, we assume that the labor force in Israel drops to 50 percent of its 1991 level in year 1, and shrinks by 10 percent a year afterwards. The minimum wage in Israel, which is the wage earned on average by Palestinian working in Israel, is taken to be $7660 per year in 1991, and we assume that it grows at a average rate of half a percent a year.

3. **Aggregate domestic production and aggregate income** is modelled using a Cobb-Douglas production function of the form: $F = AK^{a}L^{(1-a)}$, where L is the labor force at work, and K is the total capital stock, which should be taken in this context as a measure of the total productive capital stock, including machinery, inventories, land, and real estate. The calibration is done to fit the situation in the base year, 1991, and is taken to be the solution to a system of three equations:

(i) we set the actual domestic product per worker ($9958) equal to F/L.

(ii) we set the actual average domestic yearly wage rate ($4900) equal to the first derivative of the production function with respect to labor, $A(1-a)k^{a}$, where k is the capital to labor ratio, $k = \frac{K}{L}$

(iii) we estimate independently the shadow cost of capital at 15 percent, and set it equal to the first derivative of the production function with respect to capital, $Aak^{(1-a)}$.

The three equations are solved for A, k, and a. The solution to this system yields: a=0.5, A=50, and k=$33,000.

GDP is defined as the value of domestic production F. GNP is defined as GDP plus workers remittances.

4. **Productivity Gains.** In the scenarios that assume future productivity gains, we increase A over time. In the scenarios with "good policy", A is increased by 5 percent a year for four years in a row and by 1% per year thereafter. In the scenarios with "medium policy", A is increased by 5 percent a year for two years in a row only.

5. **Labor and Unemployment.** Let TL be total labor force, L(H) and L(I) be labor demand at home, and Israeli demand for Palestinian workers, and U be the number of unemployed. Technically, the projections require the use of one of two procedures:

(I) labor demand is taken as given, and the wage rate is computed as the marginal productivity of labor $A(1-a)k^a$;

(II) the wage rate is taken as given, and the labor demand at this wage is computed by solving $A(1-a)k^a = w$ for L.

We consider several possible regimes.

a. Constrained labor mobility with flexible wages at home (full employment). In this case, technique (I) is used, with labor demand at home set to TL-L(I).

b. Constrained labor mobility with inflexible wages at home (unemployment). In this case, the unemployment rate is set exogenously (so that after the occurrence of a negative shock, the initial wage drop is deemed realistic) and labor demand at home is set to TL-L(I)-U.

c. Unconstrained labor mobility. In this case, II is used to compute the pair [L(H), L(I)] that make the domestic wage equal to the Israeli minimum wage. In case L(I) is negative, it is set to zero, and the regime shifts to one with full employment of the total labor force at home, with wages determined by technique I.

6. **Savings and Investment.** A consolidated government budget module constrains public consumption and investment to the level of fiscal resources that are expected to be available. When expenditures (including public debt service) exceed government revenues, the budget deficit must be financed with external grants and loans, and with domestic borrowing.

A private sector saving/investment module closes the model. The private sector's disposable income is taken to be the Gross National Product (which includes the remittances from Palestinian workers in Israel and further abroad), plus external transfers accruing to the provate sector (including from private reserves), minus domestic transfers to the government (taxes and loans). Private income is allocated between consumption and investment according to a private saving rate, which is assumed to adjust so as to smooth consumption over time and circumstances. Some of the external transfers are taken to be inflows of capital from the Palestinian diaspora and other foreign direct investors seeking to finance domestic projects (including housing), or the purchase of land.

Annex 5: Statistical Appendix
List of Tables

OCCUPIED TERRITORIES: STATISTICAL APPENDIX

Explanatory Notes

1) Credibility of the Data

In view of the difficulties in data acquisitions and availability, it is important to clarify and emphasize the limitations of the Data produced in the appendix.

According to the Central Bureau of Statistics of Israel and in reference to its publication relating to Judea, Samaria and Gaza area statistics, Vol. XX, 1991.

The "free" movement of residents and goods and the close ties between the Israeli economy and those of Judea, Samaria and the Gaza area, make it difficult to measure the volume of transactions between the residents of those regions and residents of Israel. Furthermore, there are no comprehensive statistics throughout the Accounts. Consequently, some of the estimates are based on partial data and evaluation.

The low reliability of the following items should be particularly noted: imports and exports of goods and services from Israel; private consumption of goods and services from Israel; payments to employees from Judea, Samaria and the Gaza Area working in Israel; consumption of services of non-profit institutions; revenue from industry and data on the construction branch."

Other Publications of the CBS (such as the statistical Abstracts of Israel and National Accounts of Judea, Samaria and Gaza area 1968-1986) do refer to the low reliability of the data. However, in view of these problems, the staff found it necessary to use its best judgement and make estimates (particularly for the period 1987-1991).

2) Methodology

In reference to Table 1 of the appendix, and particularly to GNP at 1991 prices in US$
The following rebasing method was applied.

* Using a series of current GNP (in NIS) for the period of 1968-1991.

(a) a deflator series (for 1986) was developed; dividing the current series of GNP by the GNP at 1986 prices in NIS.

(b) a new deflator series (for 1991) was developed; dividing the 1986 deflator series by the value of the deflator 86 series in the year 1991.

(c) a new 1991 GNP series in NIS was developed dividing the current GNP series by the new deflator 91 series.

(d) the 1991 GNP series in NIS was converted into dollars by using the NIS per $ value of 1991.

Table 1: Occupied Territories, National Accounts Statistics, Selected Indicators (1968-1991).

	Population (in 000's)	G.N.P Current (US$ million)	GNP at 91 prices (US$ million)	GNP/Capita 91 prices (US$)	GDP/Capita 91 prices (US$)	GNP 86 prices (NIS million)	GNP/Capita 86 prices (NIS)	GDP 86 prices (NIS million)	GDP/Capita 86 prices (NIS)
1968	939900.0	137.2	561.99	597.9	575.37	696.0	740.5	689.3	733.4
1969	961800.0	174.3	663.89	690.3	630.55	822.2	854.9	773.0	803.7
1970	977800.0	211.4	777.91	795.6	688.35	963.4	985.3	857.9	877.4
1971	1001400.0	285.3	942.71	941.4	765.52	1167.5	1165.9	977.1	975.7
1972	1020500.0	381.9	1191.81	1167.9	878.50	1476.0	1446.3	1142.7	1119.7
1973	1053900.0	501.2	1170.17	1110.3	816.94	1449.2	1375.1	1097.4	1041.3
1974	1083700.0	1101.1	1367.59	1262.0	970.18	1693.7	1562.9	1340.1	1236.6
1975	1100700.0	788.6	1435.74	1304.4	965.89	1778.1	1615.4	1355.1	1231.1
1976	1120700.0	1034.0	1604.82	1432.0	1093.56	1987.5	1773.4	1562.1	1393.9
1977	1146500.0	1081.3	1597.64	1393.5	1058.07	1978.6	1725.8	1546.2	1348.6
1978	1171000.0	1566.8	1800.47	1537.6	1169.06	2229.8	1904.2	1744.9	1490.1
1979	1163300.0	1251.5	1841.09	1582.6	1158.18	2280.1	1960.0	1717.3	1476.2
1980	1180800.0	1452.0	2008.72	1701.1	1307.59	2487.7	2106.8	1968.0	1666.7
1981	1200700.0	1413.7	1953.08	1626.6	1205.55	2418.8	2014.5	1845.0	1536.6
1982	1226600.0	1500.0	2191.36	1786.5	1281.54	2713.9	2212.5	2003.6	1633.5
1983	1266300.0	1602.8	2165.61	1710.2	1193.96	2682.0	2118.0	1927.1	1521.8
1984	1303300.0	1491.1	2182.40	1674.5	1218.64	2702.8	2073.8	2024.4	1553.3
1985	1342500.0	1370.0	2125.96	1583.6	1175.28	2632.9	1961.2	2011.1	1498.0
1986	1382700.0	2142.9	2574.66	1862.1	1361.55	3188.6	2306.1	2399.6	1735.4
1987	1433700.0	2502.5	2693.20	1878.5	1278.53	3335.4	2326.4	2336.4	1629.6
1988	1483900.0	2594.2	2585.65	1742.5	1240.83	3202.2	2158.0	2346.9	1581.6
1989	1526400.0	2485.5	2590.97	1697.4	1217.49	3208.8	2102.2	2368.7	1551.8
1990	1599700.0	3014.0	3023.29	1889.9	1394.12	3744.2	2340.6	2842.6	1777.0
1991	1681700.0	2885.2	2885.21	1715.7	1273.80	3573.2	2124.8	2730.4	1623.6

Source: based on data extracted from the Statistical Abstracts of Israel (1970-92), and the National Accounts of Judea, Samaria and Gaza Area (1968-1986), special series No. 818 of 1988, Central Bureau of Statistics, Israel.

**All Statistics published after 1986, in the Statistical Abstracts of Israel, are Estimations.

Table 2: Occupied Territories, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+) Exports of goods & services	(-) Imports of goods & services	Total GDP
1968	740.10	121.70	58.30	162.10	394.70	689.30
1969	881.80	138.36	133.40	153.20	512.10	773.00
1970	1001.50	161.00	102.60	159.60	539.10	857.90
1971	1099.00	168.70	143.60	227.70	659.90	977.10
1972	1329.70	179.20	258.50	272.90	880.00	1142.70
1973	1383.20	182.60	250.50	263.00	957.70	1097.40
1974	1507.80	185.90	403.20	319.10	1050.80	1340.10
1975	1640.00	182.20	340.10	401.20	1202.70	1355.10
1976	1748.70	187.30	422.90	461.60	1260.40	1562.10
1977	1839.00	188.30	425.20	475.60	1383.40	1546.20
1978	1870.20	192.20	536.30	535.20	1394.10	1744.90
1979	1961.30	197.60	519.20	502.90	1450.30	1717.30
1980	1966.60	193.70	680.40	547.20	1435.70	1968.00
1981	2036.90	196.20	544.90	631.20	1591.80	1845.00
1982	2100.90	196.10	626.70	609.10	1557.20	2003.60
1983	2125.90	201.30	584.20	583.20	1578.90	1927.10
1984	2206.20	207.70	565.80	540.80	1507.10	2024.40
1985	2203.60	208.50	604.10	522.20	1530.40	2011.10
1986	2543.10	233.10	761.50	620.10	1758.10	2399.60
1987	2727.60	252.30	660.00	594.20	1936.00	2336.40
1988	2553.35	223.00	702.15	635.70	1411.40	2346.90
1989	2520.70	238.30	606.00	255.20	1223.50	2368.70
1990	2885.90	303.40	741.80	340.70	1399.30	2842.60
1991	3174.60	295.20	690.30	378.30	1762.00	2730.40

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992 Central Bureau of Statistics

Table 3: West Bank, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels, at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+)Exports of goods & services	(-)Imports of goods & services	Total GDP
1968	517.50	79.70	33.70	125.10	290.50	456.30
1969	618.40	87.50	84.30	115.30	363.10	524.20
1970	691.50	100.00	55.40	106.70	364.40	556.70
1971	766.60	107.70	86.00	136.50	431.30	639.00
1972	918.10	115.40	157.30	176.10	557.20	790.00
1973	949.90	116.50	135.20	158.20	610.40	723.00
1974	1032.90	119.80	280.90	201.50	654.90	949.60
1975	1108.20	118.20	200.60	245.20	715.00	935.10
1976	1216.90	121.40	262.70	279.60	749.90	1107.00
1977	1223.20	123.30	263.60	268.00	781.90	1067.80
1978	1255.30	124.00	360.20	330.70	802.10	1246.80
1979	1345.80	131.10	322.20	307.70	905.00	1165.20
1980	1358.60	130.40	506.50	339.80	881.30	1445.20
1981	1419.80	133.30	350.60	377.40	954.10	1319.20
1982	1470.10	133.30	450.10	374.20	931.30	1497.80
1983	1471.20	138.40	404.60	360.70	925.60	1444.40
1984	1521.00	142.10	394.30	352.60	889.90	1526.20
1985	1501.30	145.40	439.80	321.90	908.60	1499.70
1986	1767.30	165.10	577.80	388.30	1042.40	1856.10
1987	1894.60	177.90	496.90	349.00	1192.70	1720.60
1988	1762.00	151.00	514.00	215.00	829.00	1813.50
1989	1771.00	163.00	431.00	199.00	802.00	1762.70
1990	2077.00	226.00	580.00	264.00	935.80	2211.20
1991	2229.00	213.00	527.00	265.00	1171.00	2063.00

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992, Central Bureau of Statistics

Table 4: Gaza Strip, Gross Domestic Product by Type of Expenditure. 1968-1991 (Millions of New Israeli Shekels at 1986 prices).

	Private Final Consumption	General Government Expenditure	Gross Domestic Capital Formation	(+)Exports of goods & services	(-)Imports of goods & services	Total GDP
1968	222.60	42.00	24.60	37.00	104.20	233.00
1969	263.40	50.86	49.10	37.90	149.00	248.80
1970	310.00	61.00	47.20	52.90	174.70	301.20
1971	332.40	61.00	57.60	91.20	228.60	338.10
1972	411.60	63.80	101.20	96.80	322.80	352.70
1973	433.30	66.10	115.30	104.80	347.30	374.40
1974	474.90	66.10	122.30	117.60	395.90	390.50
1975	531.80	64.00	139.50	156.00	487.70	420.00
1976	531.80	65.90	160.20	182.00	510.50	455.10
1977	615.80	65.00	161.60	207.60	601.50	478.40
1978	614.90	68.20	176.10	204.50	592.00	498.10
1979	615.50	66.50	197.00	195.20	545.30	552.10
1980	608.00	63.30	173.90	207.40	554.40	522.80
1981	617.10	62.90	194.30	253.80	637.70	525.80
1982	630.80	62.80	176.60	234.90	625.90	505.80
1983	654.70	62.90	179.60	222.50	653.30	482.70
1984	685.20	65.60	171.50	188.20	617.20	498.20
1985	702.30	63.10	164.30	200.30	621.80	511.40
1986	775.80	68.00	183.70	231.80	715.70	543.50
1987	833.00	74.40	201.30	245.20	743.30	610.70
1988	791.35	72.00	188.15	150.70	582.40	533.40
1989	749.70	75.30	175.00	56.20	421.50	606.00
1990	808.90	77.40	161.80	76.70	463.50	631.40
1991	945.60	82.20	163.30	113.30	591.00	667.40

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992, Central Bureau of Statistics

Table 5: Occupied Territories, National Disposable Income (in millions of NIS at 1986 prices), 1968-1991.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	National Disposable Income
1968	689.300	23.300	16.600	6.700	696.000	216.700	912.700
1969	773.000	70.000	20.800	49.200	822.200	219.200	1041.400
1970	857.900	128.400	22.900	105.500	963.400	240.600	1204.000
1971	977.100	217.100	26.700	190.400	1167.500	222.800	1390.300
1972	1142.700	360.000	26.700	333.300	1476.000	194.200	1670.200
1973	1098.100	379.400	28.300	351.100	1449.200	71.700	1520.900
1974	1340.100	381.900	28.300	353.600	1693.700	70.300	1764.000
1975	1355.100	447.500	24.500	423.000	1778.100	94.200	1872.300
1976	1562.100	448.000	22.600	425.400	1987.500	275.200	2262.700
1977	1546.200	452.400	20.000	432.400	1978.600	263.800	2242.400
1978	1744.900	504.800	19.900	484.900	2229.800	345.900	2575.700
1979	1717.300	582.800	20.000	562.800	2280.100	301.800	2581.900
1980	1968.000	539.700	20.000	519.700	2487.700	296.700	2784.400
1981	1845.000	594.900	21.100	573.800	2418.800	213.900	2632.700
1982	2003.600	729.900	19.600	710.300	2713.900	246.900	2960.800
1983	1927.100	775.700	20.800	754.900	2682.000	212.200	2894.200
1984	2024.400	702.500	24.100	678.400	2702.800	190.900	2893.700
1985	2011.100	639.000	17.200	621.800	2632.900	152.700	2785.600
1986	2399.600	804.800	15.900	788.900	3188.500	174.300	3362.800
1987	2336.100	1010.700	19.300	999.300	3335.400	221.700	3557.100
1988	2346.900	829.641	25.659	855.300	3202.200	170.100	3372.300
1989	2368.700	814.897	25.203	840.100	3208.800	174.900	3383.700
1990	2842.600	874.552	27.048	901.600	3744.200	197.800	3942.000
1991	2730.400	817.516	25.284	842.800	3573.200	199.400	3772.600

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.

* Figures for the period 1987-91 are estimations.

Table 6: West Bank, National Disposable Income (in millions of NIS at 1986 prices), 1968-91.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	National Disposable Income
1968	456.300	21.600	12.600	9.000	465.300	162.000	627.300
1969	524.200	62.300	16.800	45.500	569.700	137.000	706.700
1970	556.700	104.700	16.800	87.900	644.600	144.300	788.900
1971	639.000	184.600	18.600	166.000	805.000	120.500	925.500
1972	790.000	278.000	18.600	259.400	1049.400	97.200	1146.600
1973	723.700	269.600	20.200	249.400	973.100	31.500	1004.600
1974	949.600	277.400	18.900	258.500	1208.100	27.700	1235.800
1975	935.100	335.600	16.000	319.600	1254.700	23.200	1277.900
1976	1107.000	323.200	15.400	307.800	1414.800	116.700	1531.500
1977	1067.800	329.700	13.300	316.400	1384.200	105.600	1489.800
1978	1246.800	356.600	12.900	343.700	1590.500	165.100	1755.600
1979	1165.200	397.600	12.800	384.800	1550.000	146.300	1696.300
1980	1445.200	364.100	12.800	351.300	1796.500	141.900	1938.400
1981	1319.200	391.600	14.200	377.400	1696.600	111.000	1807.600
1982	1497.800	433.100	14.200	418.900	1916.700	116.400	2033.100
1983	1444.400	435.500	15.300	420.200	1864.600	89.100	1953.700
1984	1526.200	389.700	16.500	373.200	1899.400	67.000	1966.400
1985	1499.700	369.100	12.000	357.100	1856.800	65.400	1922.200
1986	1856.100	447.200	11.100	436.100	2292.200	71.400	2363.600
1987	1725.700	582.600	13.500	577.000	2302.700	121.300	2424.000
1988	1813.500	515.458	15.942	531.400	2344.900	77.900	2422.800
1989	1762.700	552.512	17.088	569.600	2332.300	63.900	2396.200
1990	2211.200	544.267	16.833	561.100	2772.300	86.400	2858.700
1991	2063.000	514.294	15.906	530.200	2593.200	91.100	2684.300
1992	2581.5		n/a	n/a	n/a	n/a	3444.5

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.

*. Figures for the period 1987-92 are estimations.

Table 7: Gaza, National Disposable Income (in millions of NIS at 1986 prices),1968-1991.

	Gross Domestic Product	Factor Income from Abroad	Factor payments to Abroad	Net Factor Income	Gross @ National Product	Net Current Transfers from Abroad	National Disposable Income
1968	233.000	1.700	4.000	-2.300	230.700	54.700	285.400
1969	248.800	7.700	4.000	3.700	252.500	82.200	334.700
1970	301.200	23.800	6.100	17.700	318.900	96.300	415.200
1971	338.100	32.500	8.100	24.400	362.500	102.300	464.800
1972	352.700	82.000	8.100	73.900	426.600	97.000	523.600
1973	374.400	109.800	8.100	101.700	476.100	40.200	516.300
1974	390.500	104.500	9.400	95.100	485.600	42.600	528.200
1975	420.000	111.900	8.500	103.400	523.400	71.000	594.400
1976	455.100	124.800	7.200	117.600	572.700	158.500	731.200
1977	478.400	122.700	6.700	116.000	594.400	158.200	752.600
1978	498.100	148.200	7.000	141.200	639.300	180.800	820.100
1979	552.100	185.200	7.200	178.000	730.100	155.500	885.600
1980	522.800	175.600	7.200	168.400	691.200	154.800	846.000
1981	525.800	203.300	6.900	196.400	722.200	102.900	825.100
1982	505.800	296.800	5.400	291.400	797.200	130.500	927.700
1983	482.700	340.200	5.500	334.700	817.400	123.100	940.500
1984	498.200	312.800	7.600	305.200	803.400	123.900	927.300
1985	511.400	269.900	5.200	264.700	776.100	87.300	863.400
1986	543.500	357.600	4.800	352.800	896.300	102.900	999.200
1987	610.400	428.100	5.800	422.300	1032.700	100.400	1133.100
1988	533.400	317.422	6.478	323.900	857.300	92.200	949.500
1989	606.000	265.090	5.410	270.500	876.500	111.000	987.500
1990	631.400	333.690	6.810	340.500	971.900	111.400	1083.300
1991	667.400	306.348	6.252	312.600	980.000	108.300	1088.300
1992	808.5	n/a	n/a	n/a	n/a	n/a	1261.5

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.
@. For earlier years, GNP figures have been adjusted to equal the sum of GDP and net factor income from abroad. This results in an automatic adjustment in the figures for National Disposable Income.
*. Figures for the period 1987-92 are estimations.

Table 8: West Bank, Balance of Payments 1970-1991, (in million of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	76.3	42.8	33.5	115.2	93.2	22.0	-50.3	22.1	63 !	24.2
1971	83.3	35.6	47.6	9.2	67.7	24.5	-32.0	38.4	27.8	18.8
1972	130.7	52.8	77.9	135.6	100.6	35.0	-47.8	66.9	28.1	23.2
1973	156.0	60.2	95.8	174.8	130.0	44.8	-69.8	83.5	12.7	-6.1
1974	219.1	94.7	124.4	264.1	196.6	67.5	-102.0	108.1	11.9	-33.1
1975	245.1	109.4	135.6	295.9	229.4	66.4	-120.0	116.0	2.0	-48.8
1976	280.2	128.5	151.7	335.3	247.7	87.6	-119.3	134.9	40.2	-14.9
1977	286.1	124.5	161.4	365.9	269.6	96.3	-145.1	143.1	35.2	-44.7
1978	305.7	144.1	161.6	346.5	253.2	93.4	-109.1	144.7	49.0	8.2
1979	371.2	154.9	216.4	476.9	356.9	120.0	-202.0	192.6	53.3	-52.4
1980	438.3	198.4	239.8	553.9	409.9	144.0	-211.5	211.7	60.2	-55.5
1981	469.1	217.4	251.7	586.9	436.8	150.1	-219.4	223.4	57.5	-60.4
1982	495.7	206.9	288.8	578.9	423.7	155.2	-216.8	263.8	55.8	-27.4
1983	540.5	211.1	329.4	620.3	459.4	160.9	-248.3	299.4	54.4	-25.4
1984	476.3	190.1	286.2	555.2	410.6	144.6	-220.5	259.1	44.7	-34.2
1985	405.4	172.0	233.4	529.7	389.4	140.3	-217.4	207.6	31.5	-92.8
1986	560.9	244.6	316.3	680.7	513.3	167.4	-268.7	286.1	34.4	-85.4
1987	670.1	234.7	435.4	841.9	639.8	202.1	-405.1	410.6	86.1	-85.7
1988	592.0	142.0	451.0	662.0	453.0	209.0	-311.0	411.0	55.2	-22.0
1989	607.0	125.0	482.0	644.0	432.0	212.0	-307.0	444.0	43.7	3.0
1990	699.0	180.0	520.0	816.0	574.0	242.0	-394.0	474.0	72.5	-46.0
1991	664.0	173.0	491.0	1000.0	777.0	222.0	-604.0	444.0	74.7	-263.0

Source: Based on Statistical Abstracts of Israel, 1969-1992, Central Bureau of statistics, Jerusalem. Statistics for 1968 and 1969 are not available (only Global BOP are available for these years). All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 9: Gaza Strip, Balance of Payments 1970-1991, (in million of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	23.8	14.7	9.1	42.5	34.7	7.8	-20.0	6.7	28.4	9.7
1971	35.4	23.5	11.9	49.5	40.6	8.9	-17.0	9.0	26.1	12.1
1972	68.1	34.8	33.2	81.6	67.2	14.4	-32.4	28.9	26.3	12.7
1973	100.2	43.1	57.1	103.7	83.5	20.3	-40.3	50.9	11.3	7.8
1974	130.5	61.1	69.4	167.3	136.3	31.0	-75.2	59.6	18.2	-18.5
1975	154.9	82.7	72.2	206.5	175.3	31.3	-92.5	62.1	13.9	-37.7
1976	188.4	104.0	84.4	224.5	186.5	38.0	-82.6	76.3	52.3	16.2
1977	220.9	133.6	87.4	277.9	237.2	40.7	-103.7	78.1	52.0	-5.0
1978	218.0	122.6	95.4	248.8	205.8	43.0	-83.2	86.0	42.0	11.2
1979	264.6	122.2	142.4	277.2	221.0	56.2	-98.7	130.0	41.6	29.0
1980	318.6	155.0	163.5	339.8	269.5	70.4	-114.4	148.3	50.8	29.6
1981	379.5	191.8	187.6	387.9	313.3	74.7	-121.5	172.1	54.0	45.6
1982	393.8	191.6	202.6	388.7	310.6	78.1	-119.0	191.4	50.8	55.9
1983	447.2	182.3	264.9	427.1	332.4	34.7	-150.1	247.5	45.9	66.0
1984	349.3	116.6	232.7	365.2	279.7	85.5	-163.1	217.3	45.0	29.1
1985	276.3	109.1	167.2	364.2	281.6	82.6	-172.5	150.9	39.3	-48.6
1986	393.8	142.8	251.0	484.2	378.2	106.0	-235.4	230.4	42.5	-47.9
1987	492.6	160.3	332.3	528.8	412.4	116.4	-252.1	314.0	76.8	40.6
1988	358.0	67.0	291.0	343.0	223.0	120.0	-156.0	264.0	80.1	84.0
1989	278.0	32.0	246.0	302.0	200.0	102.0	-168.0	219.0	79.8	50.0
1990	375.0	51.0	324.0	386.0	269.0	120.0	-218.0	293.0	81.7	66.0
1991	378.0	75.0	303.0	500.0	371.0	130.0	-296.0	271.0	81.8	-44.0

Source: Statistical Abstracts of Israel, 1971-1992, Central Bureau of Statitics, Jerusalem, Statistics for 1968 and 1969 are not available (only Global BOP are available for these Years) Statistics from 1970 to 1980 are for Gaza and Sinai. All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 10: Occupied Territories, Balance of Payments, 1970-1991, (in millions of current US dollars).

	Exports of Goods & Services	Merchandise	Services	Imports of Goods & Services	Merchandise	Services	Trade Balance	Net Factor Income	Net Transfer Payments	Current Account
1970	100.1	57.5	42.6	157.7	127.8	29.8	-70.3	6.7	91.5	34.0
1971	118.7	59.2	59.5	141.6	108.3	33.4	-49.1	9.0	53.9	30.9
1972	198.8	87.6	111.1	217.2	167.8	49.4	-80.2	28.9	54.3	35.9
1973	256.2	103.3	152.9	278.5	213.5	65.0	-110.1	50.9	24.0	1.7
1974	349.6	155.8	193.8	431.4	333.0	98.4	-177.2	59.6	30.2	-51.6
1975	400.0	192.2	207.8	502.4	404.7	97.7	-212.6	62.1	15.9	-86.6
1976	468.6	232.4	236.2	559.8	434.3	125.6	-201.8	76.3	92.6	1.3
1977	507.0	258.1	248.8	643.8	506.8	137.0	-248.8	78.1	87.2	-49.7
1978	523.7	266.6	257.1	595.3	459.0	136.3	-192.3	86.0	91.0	19.4
1979	635.8	277.1	358.8	754.1	577.8	176.3	-300.7	130.0	94.9	-23.4
1980	756.8	353.5	403.4	893.7	679.4	214.4	-325.9	148.3	111.0	-25.9
1981	848.6	409.2	439.3	974.8	750.1	224.8	-340.9	172.1	111.5	-14.8
1982	889.5	398.5	491.4	967.6	734.3	233.3	-335.8	191.4	106.6	28.5
1983	987.7	393.4	594.3	1047.4	791.8	195.6	-398.4	546.9	100.3	40.6
1984	825.6	306.7	518.9	920.4	690.3	230.1	-383.6	476.4	89.7	-5.1
1985	681.7	281.1	400.6	893.9	671.0	222.9	-389.9	358.5	70.8	-141.4
1986	954.7	387.4	567.3	1164.9	891.5	273.4	-504.1	516.5	76.9	-133.3
1987	1162.7	395.0	767.7	1370.7	1052.2	318.5	-657.2	314.0	162.9	-45.2
1988	950.0	209.0	742.0	1005.0	676.0	329.0	-467.0	675.0	135.3	62.0
1989	885.0	157.0	728.0	946.0	632.0	314.0	-475.0	663.0	123.6	53.0
1990	1074.0	231.0	844.0	1202.0	843.0	362.0	-612.0	767.0	154.2	20.0
1991	1042.0	248.0	794.0	1500.0	1148.0	352.0	-900.0	715.0	156.5	-307.0

Source: Statistical Abstracts of Israel, 1971-1992, Central Bureau of Statitics, Jerusalem
Statistics for 1968 and 1969 are not available (only Global BOP are available for these Years)
Statistics from 1970 to 1980 are for Gaza and Sinai. All figures for 1970-1981 originally expressed in Israeli currency have been converted into U.S. dollars, using the annual average exchange rate as published in the IMF's IFS, 1992 yearbook.

Table 11: Occupied Territories, Inflation Rates (1971-1991) (in percent).

	West Bank (%)	Gaza (%)	Israel (%)
1971	16.1	21.9	12.0
1972	17.6	19.5	12.9
1973	21.5	24.3	20.0
1974	42.6	54.7	39.7
1975	43.2	53.8	39.3
1976	28.1	22.3	31.3
1977	36.0	33.8	34.6
1978	50.4	42.8	50.6
1979	68.1	72.4	78.3
1980	139.4	156.0	131.0
1981	114.0	109.5	116.8
1982	107.4	114.6	120.3
1983	139.8	151.2	145.7
1984	360.3	373.0	373.8
1985	320.9	337.6	304.6
1986	50.0	49.6	48.1
1987	13.1	11.0	19.9
1988	8.7	11.1	16.3
1989	14.5	15.7	20.2
1990	13.0	16.9	17.2
1991	11.5	7.0	19.0
1992	13.9	14.1	12.0

Source: calculations based on data extracted from the Statistical Abstracts of Israel, 1974-1992. Central Bureau of Statistics
*.inflation Rates refer to the change Rate in the CPI.

Table 12: Gross Domestic Capital Formation in Gaza, by Sector and type of Asset at 1986 prices (in NIS, Million).

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total
1968	9.40	6.30	21.20	5.20	24.60	24.60
1969	7.50	10.50	23.80	19.60	49.10	49.10
1970	9.40	8.70	23.80	18.30	47.20	47.20
1971	13.20	11.20	31.80	20.70	57.60	57.60
1972	41.40	17.30	68.80	28.30	101.20	101.20
1973	61.30	17.30	85.00	27.30	115.30	115.30
1974	63.40	18.80	89.60	29.40	122.30	122.30
1975	69.90	18.40	95.00	39.10	139.50	139.50
1976	109.10	17.70	129.00	29.10	160.20	160.20
1977	110.40	21.50	136.30	24.30	161.60	161.60
1978	127.40	17.80	145.50	29.10	176.10	176.10
1979	163.10	14.80	174.20	22.80	197.00	197.00
1980	145.80	13.60	156.20	18.10	173.90	173.90
1981	167.80	15.50	179.70	16.00	194.30	194.30
1982	147.40	14.90	159.60	17.60	176.60	176.60
1983	144.50	15.60	157.70	21.70	179.60	179.60
1984	134.90	16.70	150.00	21.20	171.50	171.50
1985	126.90	20.70	147.20	17.60	164.30	164.30
1986	134.30	24.50	158.80	25.00	183.70	183.70
1987	129.00	39.60	168.70	32.60	201.30	201.30
1988	142.20	n/a	n/a	24.00	n/a	n/a
1989	159.70	12.00	155.00	20.00	174.00	174.00
1990	148.00	11.00	142.00	15.00	157.00	157.00
1991	n/a	n/a	n/a	n/a	n/a	n/a

Source: Statistical Abstracts of Israel, Various Issues Judea, Samaria and Gaza Area Statistics 1992 Central Bureau of Statistics.

Table 13: Gross Domestic Capital Formation in the West Bank, by Sector and type of Asset at 1986 prices (in NIS, Million):

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total@
1968	10.40	22.70	23.50	16.20	45.30	33.70
1969	22.00	68.20	57.90	20.80	83.80	84.30
1970	25.70	80.90	68.10	19.70	91.70	55.40
1971	42.40	80.90	90.70	17.80	110.10	86.00
1972	77.80	83.80	137.40	19.50	156.60	157.30
1973	107.40	48.20	154.00	21.10	174.30	135.20
1974	156.10	47.30	202.80	27.80	229.60	280.90
1975	186.30	42.10	227.60	36.20	263.60	200.60
1976	208.50	34.50	241.00	24.90	263.30	262.70
1977	236.00	39.30	273.10	17.20	285.20	263.60
1978	248.30	62.40	310.90	26.40	332.80	360.20
1979	274.60	71.50	346.50	29.70	371.30	322.20
1980	264.80	60.90	325.40	24.90	345.00	506.50
1981	250.40	48.60	298.50	32.90	328.70	350.60
1982	277.40	55.20	332.10	44.70	375.30	450.10
1983	251.70	63.50	315.00	54.10	370.30	404.60
1984	242.20	54.10	296.30	61.70	361.40	394.30
1985	284.50	57.10	341.00	56.00	397.00	439.80
1986	333.70	78.40	412.10	67.40	479.60	577.80
1987	344.50	91.70	436.10	89.30	525.40	496.90
1988	n/a	n/a	n/a	43.00	n/a	n/a
1989	n/a	n/a	n/a	34.00	n/a	n/a
1990	n/a	n/a	n/a	42.00	n/a	n/a
1991	n/a	n/a	n/a	n/a	n/a	n/a

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-92,Central Bureau of statistics @:Fixed capital formation and increase in stocks of olive oil in the West Bank
No estimate was made for other stock components.

Table 14: Occupied Territories, Gross Domestic Capital Formation, by sector and type of asset; at 1986 prices (in NIS, Million).

	Construction	Machinery Transport & Other Equipment	Total Private Sector	Government	GDCF Total	Grand Total@
1968	19.80	29.00	44.70	21.40	69.90	58.30
1969	29.50	78.70	81.70	40.40	132.90	133.40
1970	35.10	89.60	91.90	38.00	138.90	102.60
1971	55.60	92.10	122.50	38.50	167.70	143.60
1972	119.20	101.10	206.20	47.80	257.80	258.50
1973	168.70	65.50	239.00	48.40	289.60	250.50
1974	219.50	66.10	292.40	57.20	351.90	403.20
1975	256.20	60.50	322.60	75.30	403.10	340.10
1976	317.60	52.20	370.00	54.00	423.50	422.90
1977	346.40	60.80	409.40	41.50	446.80	425.20
1978	375.70	80.20	456.40	55.50	508.90	536.30
1979	437.70	86.30	520.70	52.50	568.30	519.20
1980	410.60	74.50	481.60	43.00	518.90	680.40
1981	418.20	64.10	478.20	48.90	523.00	544.90
1982	424.80	70.10	491.70	62.30	551.90	626.70
1983	396.20	79.10	472.70	75.80	549.90	584.20
1984	377.10	70.80	446.30	82.90	532.90	565.80
1985	411.40	77.80	488.20	73.60	561.30	604.10
1986	468.00	102.90	570.90	92.40	663.30	761.50
1987	473.50	131.30	604.80	121.90	726.70	698.20
1988	142.20	n/a	n/a	67.00	n/a	n/a
1989	159.70	12.00	155.00	54.00	174.00	174.00
1990	148.00	11.00	142.00	57.00	157.00	157.00
1991	n/a	n/a	n/a	n/a	n/a	n/a

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-92
Central Bureau of statistics

@:Fixed capital formation and increase in stocks of olive oil in the West Bank

No estimate was made for other stock components, 1988-90 construction figures are for Gaza only; 1989-90 machinery figures are for Gaza only, 1989-90 total private sector figures are for Gaza only,and 1989-90 total & grand total figures are for Gaza only.

Table 15: West Bank, Contribution of Main Economic Branches to GDP (at Factor Cost) 1968-1991 at 1986 Prices (in NIS Million and in Percentage).

	Gross Domestic Product	Agriculture Forestry & Fishing		Industry		Construction Building & Public Works		Public & Community Services		Other Services	
		NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent
1968	436.9	163.1	37.3	30.9	7.1	25.8	5.9	9.8	2.2	207.3	47.4
1969	501.7	205.7	41.0	40.4	8.1	42.2	8.4	5.6	1.1	207.8	41.4
1970	533.3	185.4	34.8	44.1	8.3	46.4	8.7	4.5	0.8	252.9	47.4
1971	612.6	211.7	34.6	49.9	8.1	48.2	7.9	6.0	1.0	296.8	48.4
1972	757.5	298.2	39.4	59.2	7.8	77.4	10.2	7.8	1.0	314.9	41.6
1973	693.7	214.7	30.9	62.7	9.0	83.9	12.1	11.2	1.6	321.2	46.3
1974	910.5	364.9	40.1	76.4	8.4	114.4	12.6	16.6	1.8	338.2	37.1
1975	896.8	220.5	24.6	73.2	8.2	138.3	15.4	28.1	3.1	436.7	48.7
1976	1061.7	293.7	27.7	67.3	6.3	145.0	13.7	54.7	5.2	501.0	47.2
1977	1024.1	258.3	25.2	65.6	6.4	153.8	15.0	132.7	13.0	413.7	40.4
1978	1195.7	353.3	29.5	79.9	6.7	167.2	14.0	144.0	12.0	451.3	37.7
1979	1117.6	241.9	21.6	73.5	6.6	184.9	16.5	145.1	13.0	472.2	42.3
1980	1386.1	442.4	31.9	90.3	6.5	174.3	12.6	140.7	10.2	538.4	38.8
1981	1267.4	359.2	28.3	78.1	6.2	168.4	13.3	142.4	11.2	519.3	41.0
1982	1439.9	415.6	28.9	85.4	5.9	192.2	13.3	145.8	10.1	600.9	41.7
1983	1588.5	371.5	23.4	83.7	5.3	189.6	11.9	150.3	9.5	793.4	49.9
1984	1467.1	373.6	25.5	94.3	6.4	190.9	13.0	157.4	10.7	650.9	44.4
1985	1441.6	333.3	23.1	105.4	7.3	215.8	15.0	158.7	11.0	628.4	43.6
1986	1856.1	575.0	31.0	138.2	7.4	256.7	13.8	165.1	8.9	721.1	38.9
1987	1720.6	379.4	22.1	140.4	8.2	268.6	15.6	167.4	9.7	764.8	44.4
1988	1813.5	757.5	41.8	130.6	7.2	201.4	11.1	117.2	6.5	606.8	33.5
1989	1762.7	534.0	30.3	121.0	6.9	218.1	12.4	138.0	7.8	751.6	42.6
1990	2211.2	865.1	39.1	143.3	6.5	242.3	11.0	184.8	8.4	775.7	35.1
1991	2063.0	629.8	30.5	141.5	6.9	226.3	11.0	186.8	9.1	878.6	42.6
1992	2481.5	1087	43.8	185	7.4	n/a	n/a	214	8.6	n/a	n/a

Source: Statistical Abstracts of Israel, 1970-1992 Central Bureau of Statistics

*.Other Services include: Transport, Trade and other services (including ownership of Dwellings and errors & ommissions)

Figures for the period 1987-92 are estimates.

Table 16: Gaza, Contribution of Main Economic Branches to GDP (at Factor Cost) 1968-1991 at 1986 Prices, NIS Million and in percentage

	Gross Domestic Product	Agriculture Forestry & Fishing NIS Million	Percent	Industry NIS Million	Percent	Construction Building & Public Works NIS Million	Percent	Public & Community Services NIS Million	Percent	Other Services NIS Million	Percent
1968	217.2	67.3	31.0	4.3	2.0	14.9	6.9	n/a	n/a	130.7	60.2
1969	232.3	76.7	33.0	6.5	2.8	29.8	12.8	n/a	n/a	119.3	51.4
1970	280.6	88.5	31.5	11.9	4.2	29.8	10.6	n/a	n/a	150.4	53.6
1971	315.7	100.6	31.9	14.1	4.5	32.3	10.2	n/a	n/a	168.7	53.4
1972	329.7	110.3	33.5	17.8	5.4	54.5	16.5	n/a	n/a	147.1	44.6
1973	350.5	113.4	32.4	22.5	6.4	59.3	16.9	n/a	n/a	155.3	44.3
1974	365.8	126.1	34.5	28.6	7.8	61.1	16.7	n/a	n/a	150.0	41.0
1975	393.6	131.8	33.5	34.0	8.6	72.5	18.4	n/a	n/a	155.3	39.5
1976	326.5	141.8	43.4	42.8	13.1	94.6	29.0	n/a	n/a	47.3	14.5
1977	448.3	135.1	30.1	48.5	10.8	96.6	21.5	102.0	22.8	66.1	14.7
1978	466.7	136.1	29.2	56.3	12.1	113.0	24.2	101.7	21.8	59.6	12.8
1979	517.3	129.1	25.0	59.0	11.4	132.1	25.5	88.3	17.1	108.8	21.0
1980	489.8	117.4	24.0	42.5	8.7	115.9	23.7	90.2	18.4	123.8	25.3
1981	494.9	122.2	24.7	38.7	7.8	127.3	25.7	93.2	18.8	113.5	22.9
1982	476.1	114.0	23.9	42.3	8.9	117.1	24.6	93.5	19.6	109.2	22.9
1983	454.1	103.2	22.7	43.4	9.6	117.0	25.8	95.1	20.9	95.4	21.0
1984	469.6	98.6	21.0	45.3	9.6	109.6	23.3	101.4	21.6	114.7	24.4
1985	481.9	108.3	22.5	39.9	8.3	100.9	20.9	104.0	21.6	128.8	26.7
1986	543.5	102.5	18.9	54.0	9.9	111.3	20.5	106.7	19.6	169.0	31.1
1987	610.4	123.4	20.2	73.4	12.0	114.1	18.7	109.6	18.0	189.9	31.1
1988	533.4	122.1	22.9	54.8	10.3	103.0	19.3	99.3	18.6	154.2	28.9
1989	606.0	140.8	23.2	59.8	9.9	115.6	19.1	104.9	17.3	184.9	30.5
1990	631.4	151.7	24.0	63.7	10.1	107.0	16.9	111.6	17.7	197.4	31.3
1991	667.4	170.0	25.5	70.8	10.6	105.2	15.8	117.2	17.6	204.2	30.6
1992	764	198	25.9	84.5	11.08	158.5	20.7	125	16.3	198.5	25.98

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

*.. Figures for Public & Community Services are not available for the period 68-76(for these years,they are included in other services)

Figures for the period 1987-1992 are estimates.

Table 17: Occupied Territories, Contribution of Main Economic Branches to GDP (at Factor Cost), 1968-1991 at 1986 Prices, (in NIS Million and in Percentage).

	Gross Domestic Product	Agriculture Forestry & Fishing		Industry		Construction Building & Public Works		Public & Community Services		Other Services	
		NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent	NIS Million	Percent
1968	654.1	230.4	35.2	35.2	5.4	40.7	6.2	9.8	1.5	338.0	51.7
1969	734.0	282.4	38.5	46.9	6.4	72.0	9.8	5.6	0.8	327.1	44.6
1970	813.9	273.9	33.7	56.0	6.9	76.2	9.4	4.5	0.6	403.3	49.6
1971	928.3	312.3	33.6	64.0	6.9	80.5	8.7	6.0	0.6	465.5	50.1
1972	1087.2	408.5	37.6	77.0	7.1	131.9	12.1	7.8	0.7	462.0	42.5
1973	1044.2	328.1	31.4	85.2	8.2	143.2	13.7	11.2	1.1	476.5	45.6
1974	1276.3	491.0	38.5	105.0	8.2	175.5	13.8	16.6	1.3	488.2	38.3
1975	1290.4	352.3	27.3	107.2	8.3	210.8	16.3	28.1	2.2	592.0	45.9
1976	1388.2	435.5	31.4	110.1	7.9	239.6	17.3	54.7	3.9	548.3	39.5
1977	1472.4	393.4	26.7	114.1	7.7	250.4	17.0	234.7	15.9	479.8	32.6
1978	1662.4	489.4	29.4	136.2	8.2	280.2	16.9	245.7	14.8	510.9	30.7
1979	1634.9	371.0	22.7	132.5	8.1	317.0	19.4	233.4	14.3	581.0	35.5
1980	1875.9	559.8	29.8	132.8	7.1	290.2	15.5	230.9	12.3	662.2	35.3
1981	1762.3	481.4	27.3	116.8	6.6	295.7	16.8	235.6	13.4	632.8	35.9
1982	1916.0	529.6	27.6	127.7	6.7	309.3	16.1	239.3	12.5	710.1	37.1
1983	2042.6	474.7	23.2	127.1	6.2	306.6	15.0	245.4	12.0	888.8	43.5
1984	1936.7	472.2	24.4	139.6	7.2	300.5	15.5	258.8	13.4	765.6	39.5
1985	1923.5	441.6	23.0	145.3	7.6	316.7	16.5	262.7	13.7	757.2	39.4
1986	2399.6	677.5	28.2	192.2	8.0	368.0	15.3	271.8	11.3	890.1	37.1
1987	2331.3	502.8	21.6	211.4	9.1	382.4	16.4	277.0	11.9	957.7	41.1
1988	2346.9	879.6	37.5	185.4	7.9	304.4	13.0	216.5	9.2	761.0	32.4
1989	2368.7	674.8	28.5	180.8	7.6	333.7	14.1	242.9	10.3	936.5	39.5
1990	2842.6	1016.8	35.8	207.0	7.3	349.3	12.3	196.4	6.9	1073.1	37.8
1991	2730.4	799.8	29.3	212.3	7.8	331.5	12.1	304.0	11.1	1082.8	39.7

Source: Statistical Abstracts of Israel, 1970-1992, Central Bureau of Statistics.

*Figures for Public & Community Services from 68-76 are only for the West Bank

*.Other Services include: Transport, Trade and other services (including ownership of Dwellings and errors & ommissions)

Table 18: West Bank, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	218.8	159.9	171.1	541.6	1.0	517.5
1969	240.2	192.4	185.0	613.4	-21.6	618.4
1970	289.6	206.2	193.3	680.7	-27.7	691.5
1971	329.5	234.3	206.3	762.0	-25.8	766.6
1972	380.3	288.9	224.6	891.1	-45.2	918.1
1973	367.6	298.3	227.0	893.1	-66.4	949.9
1974	429.5	298.3	236.2	957.2	-82.1	1032.9
1975	432.8	330.2	248.5	1010.4	-100.7	1108.2
1976	503.8	345.6	260.2	1102.3	-116.5	1216.9
1977	472.1	352.6	277.7	1098.0	-125.4	1223.2
1978	511.2	318.8	302.4	1115.7	-137.9	1255.3
1979	484.5	401.9	218.2	1199.8	-144.9	1345.8
1980	496.6	387.7	324.7	1203.0	-153.1	1358.6
1981	543.2	374.0	337.9	1246.6	-169.3	1419.8
1982	529.0	406.8	356.9	1286.4	-179.1	1470.1
1983	528.9	398.1	376.9	1297.2	-170.7	1471.2
1984	559.9	407.2	396.2	1354.7	-164.3	1521.0
1985	519.4	417.3	404.4	1339.9	-159.5	1501.3
1986	651.6	527.1	423.0	1601.7	-165.5	1767.3
1987	642.1	634.4	445.2	1721.7	-172.9	1894.6
1988	n/a	n/a	n/a	n/a	n/a	n/a
1989	n/a	n/a	n/a	n/a	n/a	n/a
1990	n/a	n/a	n/a	n/a	n/a	n/a
1991	n/a	n/a	n/a	n/a	n/a	n/a

Source: Statistical Abstracts of Israel, Various Issues
Judea, Samaria and Gaza Area Statistics 1988-1992
Central Bureau of Statistics

Table 19: Gaza, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	99.0	71.8	79.7	239.4	2.0	222.6
1969	99.0	90.7	79.7	264.1	-5.2	263.4
1970	108.9	108.4	92.6	306.1	-9.4	310.0
1971	112.8	122.3	90.8	326.0	-11.7	332.4
1972	129.7	158.5	104.7	397.2	-18.9	411.6
1973	134.7	164.3	107.1	410.6	-25.2	433.3
1974	141.7	182.9	113.5	443.7	-32.2	474.9
1975	175.6	195.7	117.8	491.9	-40.0	531.8
1976	174.6	188.4	123.1	487.8	-43.2	531.8
1977	175.4	243.3	127.9	556.5	-56.6	615.8
1978	184.9	216.6	136.9	541.7	-71.4	614.9
1979	173.8	220.0	136.5	536.1	-77.6	615.5
1980	170.8	208.2	141.3	524.0	-82.2	608.0
1981	192.5	187.8	146.1	521.8	-94.5	617.1
1982	193.8	190.6	152.9	533.0	-97.0	630.8
1983	203.0	204.6	155.3	559.0	-94.8	654.7
1984	222.0	209.7	163.6	589.2	-95.4	685.2
1985	236.0	216.0	167.5	612.1	-90.1	702.3
1986	229.0	275.8	175.0	679.8	-96.0	775.8
1987	268.8	294.8	181.5	745.1	-88.0	833.0
1988	n/a	n/a	n/a	n/a	n/a	n/a
1989	309.0	192.0	190.0	685.0	-66.0	750.0
1990	321.0	219.0	203.0	740.0	-77.0	816.0
1991	414.0	262.0	211.0	873.0	-74.0	946.0

Source:Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992

Table 20: Occupied Territories, Private Consumption Expenditure of Goods and Services in NIS Million at 1986 prices

	Agricultural Goods	Industrial Goods	Services	Total	Net Consumption by Non-Residents	Total:Private Consumption Expenditure
1968	317.8	231.7	250.8	781.0	3.0	740.1
1969	339.2	283.1	264.7	877.5	-26.8	881.8
1970	398.5	314.6	285.9	986.8	-37.1	1001.5
1971	442.3	356.6	297.1	1088.0	-37.5	1099.0
1972	510.0	447.4	329.3	1288.3	-64.1	1329.7
1973	502.3	462.6	334.1	1303.7	-91.6	1383.2
1974	571.2	481.2	349.7	1400.9	-114.3	1507.8
1975	608.4	525.9	366.3	1502.3	-140.7	1640.0
1976	678.4	534.0	383.3	1590.1	-159.7	1748.7
1977	647.5	595.9	405.6	1654.5	-182.0	1839.0
1978	696.1	535.4	439.3	1657.4	-209.3	1870.2
1979	658.3	621.9	354.7	1735.9	-222.5	1961.3
1980	667.4	595.9	466.0	1727.0	-235.3	1966.6
1981	735.7	561.8	484.0	1768.4	-263.8	2036.9
1982	722.8	597.4	509.8	1819.4	-276.1	2100.9
1983	731.9	602.7	532.2	1856.2	-265.5	2125.9
1984	781.9	616.9	559.8	1943.9	-259.7	2206.2
1985	755.4	633.3	571.9	1952.0	-249.6	2203.6
1986	880.6	802.9	598.0	2281.5	-261.5	2543.1
1987	910.9	929.2	626.7	2466.8	-260.9	2727.6
1988	n/a	n/a	n/a	n/a	n/a	n/a
1989	309.0	192.0	190.0	685.0	-66.0	750.0
1990	321.0	219.0	203.0	740.0	-77.0	816.0
1991	414.0	262.0	211.0	873.0	-74.0	946.0

Source: Statistical Abstracts of Israel, Various Issues, Judea, Samaria and Gaza Area Statistics 1988-1992
*. 1989-1991 figures are for Gaza only.

Table 21: West Bank, GDP (at factor cost), by Economic Branch and Disposable Private Income in NIS Million at current prices.

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Agriculture	2.50	5.30	10.90	43.00	167.00	575.00	384.00	650.00	463.00	737.00	582.60
Industry	0.50	1.20	2.90	15.00	64.00	134.00	153.00	142.00	143.00	188.00	228.00
Construction	1.20	2.90	7.30	34.00	137.00	257.00	342.00	308.00	369.00	468.30	489.60
Public and Community Services	1.00	2.30	6.40	36.00	116.00	165.00	206.00	188.00	251.00	318.00	379.50
Transport, Trade and Other Services	2.25	6.00	14.11	84.00	349.00	643.00	940.00	942.00	1224.00	1688.70	1946.00
GDP: Total	7.45	17.60	41.62	213.00	833.00	1774.00	2025.00	2230.00	2450.00	3400.00	3625.70
Factor payments from abroad	2.75	6.70	17.50	72.00	257.00	447.00	661.00	705.00	908.00	1027.00	1050.00
Less:factor payments to abroad	0.10	0.23	0.61	3.00	8.00	11.00	15.00	18.00	23.00	30.00	31.50
Gross National Income	10.00	24.10	58.50	282.00	1081.00	2210.00	2671.00	2917.00	3335.00	4447.00	4644.20
Transfers from Gvt and Local authorities											
Less:Income Tax and transfers to the Government	0.43	1.06	3.45	17.00	49.00	70.00	96.00	93.00	114.00	132.00	201.00
Gross Disposable Private Income from Domestic Sources	9.75	23.30	55.60	266.00	1037.00	2147.00	2598.00	2831.00	3232.00	4333.00	4463.20
Transfers to private persons from abroad	0.49	0.95	2.20	10.00	42.00	60.00	63.00	66.00	109.00	122.00	155.00
Gross Disposable Private Income from all sources	10.25	24.25	57.80	276.00	1079.00	2207.00	2661.00	2897.00	3341.00	4455.00	4618.20

Source: Statistical Abstracts of Israel, 1982-1992
Central Buraeu of Statistics

Table 22: Gaza, GDP (at factor cost), by Economic Branch and Disposable Private Income in NIS Million at current prices.

	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Agriculture	0.69	1.13	2.70	11.00	55.00	103.00	122.00	135.00	152.00	167.00	199.80
Industry	0.29	0.65	1.66	7.00	26.00	54.00	95.00	80.00	103.00	128.50	157.00
Construction	0.79	1.65	3.97	17.00	55.00	111.00	155.00	163.00	196.00	198.00	215.00
Public and Community Services	0.73	1.59	4.16	24.00	78.00	107.00	136.00	160.00	196.00	237.00	271.80
Transport, Trade and Other Services	0.87	2.04	4.27	18.00	72.00	143.00	197.00	206.00	276.00	350.50	413.90
GDP: Total	3.37	7.07	16.76	77.00	286.00	517.00	704.00	744.00	923.00	1081.00	1257.50
Factor payments from abroad	2.11	4.83	14.14	59.00	186.00	358.00	508.00	446.00	451.00	629.00	641.70
Less:factor payments to abroad	0.04	0.09	0.23	1.00	4.00	5.00	7.00	10.00	14.00	19.00	12.00
Gross National Income	5.44	11.81	30.67	134.00	468.00	870.00	1204.00	1180.00	1360.00	1691.00	1887.20
Transfers from Gvt and Local authorities	0.08	0.18	0.49	1.00	4.00	8.00	14.00	12.00	12.00	14.00	24.00
Less:Income Tax and transfers to the Government	0.34	0.77	2.32	10.00	26.00	45.00	56.00	66.00	84.00	92.00	124.00
Gross Disposable Private Income from Domestic Sources	5.18	11.22	28.90	125.00	446.00	833.00	1162.00	1126.00	1288.00	1613.00	1787.20
Transfers to private persons from abroad	0.57	1.30	2.90	14.00	55.00	77.00	79.00	96.00	156.00	168.00	186.00
Gross Disposable Private Income from all sources	5.75	12.52	31.74	139.00	501.00	910.00	1241.00	1222.00	1444.00	1781.00	1973.20

Source: Statistical Abstracts of Israel, 1982-1992, Central Buraeu of Statistics

Table 23: West Bank, Disposable Private Income, at current prices (NIS Million)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
GDP at Market Prices	2.0	5.2	10.6	25.1	60.5	304.6	1131.6	2292.2	2774.2	2935.0	3360.0	4331	4604.0
Net Indirect Taxes on Domestic Production	1.0	0.1	0.4	1.0	7.5	21.2	53.1	72.0	78.7	44.0	77.0	111.0	176.0
Gross National Income at factor cost	2.0	5.0	10.3	24.1	53.0	283.4	1078.5	2220.2	2695.5	2891.0	3283.0	4220.5	4428.0
Transfers from Gvt and Local Authorities	0.0	0.0	0.1	0.2	0.3	1.3	4.2	7.4	23.4	7.0	11.0	19.0	20.0
Income Tax and Transfers to the Government	0.1	0.2	0.4	1.0	2.8	16.3	48.7	69.5	96.4	93.0	114.0	132.0	201.0
Gross Disposable private Income from Domestic Sources	1.9	4.9	9.9	23.3	50.5	268.4	1034.0	2158.2	2622.5	2805.0	3180.0	4107.5	4247.0
Private Transfers from Abroad	0.2	0.4	0.7	1.2	2.8	11.7	49.7	85.1	85.6	78.0	99.0	109.0	155.0
Gross Disposable private Income from All Sources	2.1	5.2	10.6	24.5	53.3	280.1	1083.7	2243.3	2708.1	2883.0	3279.0	4216.5	4402.0
Private Savings	0.4	1.2	1.6	5.5	6.1	38.8	132.4	476.1	471.2	--	--	--	--
Gross Disposable private Income per Capita (NIS)	2.9	7.3	14.6	33.1	70.1	357.9	1347.0	2713.6	3175.2	3270.5	3623.5	4507.5	4491.0
Gross Disposable private Income per Capita at 86 prices (NIS)	2354.2	2445.8	2303.7	2557.8	2186.2	2256.6	2125.9	2713.6	2689.3	--	--	--	--
GDPI/Capita (in current US$)	1141.3	1424.7	1277.2	1364.0	1247.0	1220.6	1142.5	1823.7	1990.7	2045.3	1891.2	2235.9	1970.5
GDPI/Capita (in US $ at 86 prices)	1582.1	1643.7	1548.2	1719.0	1469.2	1516.5	1428.7	1823.7	1807.3	--	--	--	--

Source: Statistical Abstracts of Israel 1982-1992, & Judea, Samaria and Gaza Area Statistics, 1988-1992
Central bureau of Statistics.

Table 24: Gaza, Disposable Private Income, at current prices (NIS Million)

	1979	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
GDP at Market Prices	1.0	2.3	5.4	11.4	29.5	132.8	483.6	896.4	1217.2	1181.5	1361.5	1699.0	1914.0
Net Indirect Taxes on Domestic Production	0.0	0.0	0.0	0.1	0.5	3.2	19.1	30.1	32.3	31.0	29.0	34.0	59.0
Gross National Income at factor cost	1.0	2.2	5.4	11.3	29.0	129.6	464.5	866.3	1184.9	1150.5	1332.5	1665.0	1855.0
Transfers from Gvt and Local Authorities	0.0	0.0	0.1	0.1	0.2	1.1	3.9	7.9	14.3	12.0	12.0	14.0	24.0
Income Tax and Transfers to the Government	0.1	0.1	0.3	0.6	1.6	8.8	25.6	45.1	55.9	66.0	84.0	92.0	124.0
Gross Disposable private Income from Domestic Sources	0.9	2.1	5.1	10.8	27.6	121.8	442.8	829.1	1143.3	1096.5	1260.5	1587.0	1755.0
Private Transfers from Abroad	0.2	0.4	0.9	1.8	4.0	17.2	66.2	115.8	113.0	115.0	142.0	148.0	186.0
Gross Disposable private Income from All Sources	1.1	2.6	6.0	12.6	31.6	139.0	509.0	944.9	1256.3	1211.5	1402.5	1735.0	1941.0
Private Savings	0.4	0.9	2.3	4.6	10.3	32.9	60.5	169.2	291.4	--	336.5	409.0	244.0
Gross Disposable private Income per Capita (NIS)	2.5	5.7	13.0	26.5	65.1	276.8	981.8	1762.9	2264.4	2098.0	2335.0	2764.5	2939.5
Gross Disposable private Income per Capita at 86 prices (NIS)	2236.5	2114.1	2177.8	2106.5	1998.9	1787.6	1537.2	1762.9	1953.2	--	1638	1683.5	1644.5
GDPI/Capita (in current US $)	983.9	1112.4	1137.3	1092.0	1158.1	944.0	832.7	1184.7	1419.7	1312.1	1218.7	1371.3	1289.8
GDPI/Capita (in US $ at 86 prices)	1503.0	1420.8	1463.6	1415.7	1343.3	1201.3	1033.1	1184.7	1312.6	--	1100.8	1131.4	1105.2

Source: Statistical Abstracts of Israel 1982-1992 & Judea, Samaria and Gaza Area Statistics, 1988-1992, Central bureau of Statistics.

Table 25: Occupied Territories (West Bank and Gaza Strip), Value of Merchandise Trade. 1968-1991, (Millions of US Dollars)

Year	Imports	Exports	Balance
1968	69.90	35.50	-34.40
1969	90.80	41.00	-49.80
1970	99.50	45.20	-54.30
1971	124.90	68.20	-56.70
1972	162.80	83.50	-79.30
1973	215.80	100.90	-114.90
1974	322.00	146.90	-175.10
1975	406.90	192.90	-214.00
1976	433.90	227.30	-206.60
1977	507.10	255.30	-251.80
1978	455.80	263.10	-192.70
1979	567.80	271.50	-296.30
1980	664.60	343.20	-321.40
1981	737.20	403.00	-334.20
1982	728.90	390.60	-338.30
1983	784.80	381.60	-403.20
1984	686.20	289.00	-397.20
1985	668.00	272.40	-395.60
1986	890.00	379.80	-510.20
1987	1060.10	385.30	-674.80
1988	676.00	209.00	-467.00
1989	632.00	157.00	-475.00
1990	843.00	231.00	-612.00
1991	1148.00	248.00	-900.00

Source: Statistical Abstract of Israel, 1992, No. 43, Central Bureau of Statistics.
Notes: Data for 1989, 1990 & 1991 are only estimates.

Table 26: Occupied Territories (West Bank and Gaza Strip), Trade by Destination, 1968-1991 (Millions of US Dollars).

	Trade with Israel			Trade with Jordan			Trade with Other Countries		
	Imports	Exports	Balance	Imports	Exports	Balance	Imports	Exports	Balance
1968	53.50	15.30	-38.20	5.20	15.50	10.30	11.20	4.70	-6.50
1969	72.80	15.00	-57.80	7.20	19.70	12.50	10.80	6.30	-4.50
1970	83.20	20.90	-62.30	3.70	17.20	13.50	12.60	7.10	-5.50
1971	102.00	30.40	-71.60	3.90	22.30	18.40	19.00	15.50	-3.50
1972	138.30	40.80	-97.50	4.60	28.80	24.20	19.90	13.90	-6.00
1973	194.40	66.70	-127.70	4.00	20.30	16.30	17.40	13.90	-3.50
1974	287.60	98.40	-189.20	4.90	35.60	30.70	29.80	12.90	-16.90
1975	371.20	123.30	-247.90	5.20	51.70	46.50	30.50	17.90	-12.60
1976	391.90	143.20	-248.70	3.80	67.70	63.90	38.20	16.40	-21.80
1977	463.40	154.10	-309.30	4.70	88.20	83.50	39.00	13.00	-26.00
1978	403.80	157.80	-246.00	5.00	95.30	90.30	47.00	10.00	-37.00
1979	492.90	169.00	-323.90	5.00	92.10	87.10	69.90	10.40	-59.50
1980	582.40	226.40	-356.00	5.50	107.30	101.80	76.70	11.50	-65.20
1981	664.40	288.70	-375.70	7.30	105.40	98.10	65.50	8.90	-56.60
1982	648.40	258.50	-389.90	8.90	125.00	116.10	71.60	7.10	-64.50
1983	712.60	285.10	-427.50	6.80	88.40	81.60	65.40	8.10	-57.30
1984	619.90	185.30	-434.60	8.20	98.40	90.20	58.10	5.30	-52.80
1985	598.00	181.30	-416.70	8.70	85.40	76.70	61.20	5.70	-55.50
1986	797.80	274.60	-523.20	10.90	102.10	91.20	81.30	3.10	-78.20
1987	970.10	303.70	-666.40	9.40	78.20	68.80	80.60	3.40	-77.20
1988	597.10	154.30	-443.10	9.50	52.40	42.90	69.10	2.30	-66.80
1989	521.10	112.70	-408.40	8.50	40.40	31.90	102.40	3.90	-98.50
1990	715.00	190.20	-524.80	9.30	32.20	22.90	118.70	8.60	-110.10
1991	1004.60	200.60	-804.00	9.20	38.50	29.30	134.20	9.50	-124.7
1992	--	--	--	9.5	37.5	28.0	96.8	5.1	-91.7

Source:Statistical Abstract of Israel,1992, Central Bureau of Statistics, figures,for 1988-1991, are estimated.
Figures for the period 1987-92 are estimates.

Table 27: Occupied Territories, (West Bank and Gaza Strip). Industrial Exports by Market and commodity composition 1977, 1980-1986 (Million of current US dollars).

INDUSTRIAL EXPORTS.

	JORDAN						ISRAEL	OTHER COUNTRIES	
	Olive Oil & Olives	Stone and Marble	Samna Soap	and Dairy	Other	Total	Total	Total	TOTAL
1977	2.2	2.1	4.1	9.8	4.7	22.9	120.9	1.0	144.8
1980	31.00	4.80	4.40	15.10	3.10	58.4	177.30	1.60	237.30
1981	25.50	6.30	4.10	13.90	2.90	52.7	243.00	1.50	297.20
1982	37.00	8.00	4.90	22.60	6.60	79.1	226.60	0.80	306.50
1983	15.80	7.90	3.60	13.70	2.20	43.2	244.90	1.10	289.20
1984	28.50	10.60	3.50	17.70	1.80	62.1	171.80	1.10	235.00
1985	0.70	12.00	3.40	18.70	2.10	36.9	167.20	1.00	205.10
1986	24.70	11.80	3.60	15.80	2.10	58	258.40	0.90	317.30

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip). UNCTAD, United Nations, 1989.

Table 28: Occupied Territories, (West Bank and Gaza Strip). Agricultural Exports by Market and commodity composition 1977, 1980-1986 (Million of current US dollars).

	JORDAN					ISRAEL	OTHER COUNTRIES	
	Vegetables	Citrus Fruit	Other Fruit	Others	Total	Total	(All Citrus) Total	TOTAL
1977	4.0	52.8	4.5	0.4	61.7	33.3	12.4	107.4
1980	3.20	37.40	7.50	0.10	48.20	50.70	9.50	108.40
1981	5.20	34.50	10.10	0.50	50.20	45.30	7.00	102.50
1982	8.20	39.30	12.60	0.30	60.40	34.10	5.20	99.70
1983	4.00	25.70	12.90	0.60	43.10	40.20	7.00	90.30
1984	5.20	17.80	12.60	0.60	36.30	23.90	4.20	64.40
1985	8.30	24.20	15.80	0.50	48.80	25.00	4.70	78.50
1986	4.90	23.10	13.50	1.10	42.60	30.60	2.20	75.40

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip). UNCTAD, United Nations,1989.

Table 29: **Occupied Territories, (West Bank and Gaza Strip), Agricultural Imports by Market. 1977, 1980-1986 (Million of current US dollars).**

AGRICULTURAL IMPORTS

	JORDAN	ISRAEL	OTHER COUNTRIES	TOTAL
1977	0.3	74.0	14.9	89.2
1980	0.5	90.4	5.9	96.8
1981	0.2	91.3	5.0	96.5
1982	0.4	75.3	10.9	86.6
1983	0.3	89.6	12.1	102.0
1984	0.1	98.2	10.0	108.3
1985	0.3	87.8	14.0	102.1
1986	0.2	114.4	15.6	130.2

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory,(West Bank and Gaza Strip).UNCTAD, United Nations, 1989.

Table 30: Occupied Territories, (West Bank and Gaza Strip). Industrial Imports by Market and commodity composition, 1980-1986 (Million of current US dollars).

INDUSTRIAL IMPORTS

	Jordan					Israel	Other Countries Via Israel								Total
	Oils Dairy Prod.	Paper and Printing	Text. and Cotton	Iron & Steel Prod.	Total		Oils	Food Prod.	Soap & Plastic	Wood, Paper & Card-board	Textiles	Iron & Steel Prod.	Mach. Electr. Equip.	Total	Total
1980	4.3	0.2	0.1	0.2	4.9	506.8	12.9	18.8	1.8	2.0	5.0	4.3	12.1	76.7	588.4
1981	6.0	0.3	0.3	0.3	7.0	581.3	8.8	11.3	2.5	2.3	5.8	2.8	8.1	65.5	653.8
1982	7.8	0.2	0.1	0.3	8.5	573.1	8.5	14.6	2.3	3.6	4.6	2.5	10.7	71.6	653.2
1983	5.5	0.2	0.2	0.3	6.5	623.0	5.4	8.5	3.0	4.8	4.5	2.9	10.0	65.4	694.9
1984	7.4	0.2	0.1	0.3	8.1	521.7	6.0	11.6	2.7	4.8	3.3	1.8	8.0	58.1	587.9
1985	7.3	0.3	0.1	0.5	8.3	510.2	10.1	10.6	2.0	5.2	3.7	2.1	7.7	61.2	579.7
1986	9.1	0.5	0.3	0.6	10.8	665.9	7.1	12.6	3.8	3.1	4.5	3.2	15.7	81.0	757.7

Source: Selected Statistical Tables on the Economy of the Occupied Palestinian Territory, (West Bank and Gaza Strip), UNCTAD, United Nations, 1989.

Table 31: Occupied Territories. Labor Force, Selected Data, 1970, 75, 80, 85-1991.

Total for Occupied Territories

	1970	1975	1980	1985	1986	1987	1988	1989	1990	1991	1992
Total (000s)											
Working-age population	519.7	591.9	643.7	722.7	718.3	738.3	751.5	770.7	804.0	833.9	851.8
Labor force	180.8	206.0	218.5	251.5	267.3	284.0	289.4	290.3	307.8	312.1	333.3
Employed persons	173.3	204.3	215.7	242.2	259.4	277.8	281.9	279.3	296.5	287.4	219.2
Unemployed	7.5	1.7	9.1	9.1	7.9	6.2	7.5	10.8	11.2	24.7	14.1
Percentages											
Participation rate	34.8	34.9	34.8	34.8	37.2	38.5	38.5	37.7	38.3	37.4	38.2
Unemployment rate	4.1	0.8	3.6	3.6	3.0	2.2	2.6	3.7	3.7	7.9	4.2
Employment rate	33.3	34.5	33.5	33.5	36.1	37.6	37.5	37.0	37.0	34.5	37.2
Men (000s)											
Working-age population	255.6	282.5	309.1	349.4	347.7	358.4	364.7	376.3	394.4	408.3	420.2
Labor force	151.4	177.3	187.3	225.4	238.3	257.4	261.2	266.9	280.3	286.5	303.3
Employed persons	145.6	176.0	185.3	217,8	238.3	252.2	254.5	257.0	270.3	262.5	289.3
Unemployed	5.8	1.3	2.0	7.6	6.0	5.1	6.7	9.9	10.3	24.0	13.5
Percentages											
Participation rate	62.0	62.9	60.6	64.5	68.5	71.8	71.6	70.9	71.1	70.2	72.2
Unemployment rate	3.8	0.7	1.1	3.4	2.5	2.0	2.6	3.7	3.7	8.4	4.4
Employment rate	57.0	62.3	59.5	62.3	66.8	70.4	69.8	68.3	68.5	64.3	69.0
Women (000s)											
Working-age population	275.6	309.9	334.4	373.3	370.6	379.9	386.4	394.4	409.6	425.6	437.6
Labor force	29.4	28.7	29.9	25.9	29.0	26.7	28.2	23.5	27.5	25.6	30.0
Employed persons	27.7	28.3	29.9	24.4	27.1	25.6	27.4	22.5	26.5	24.6	29.4
Unemployed	1.7	0.4	0.5	1.5	1.9	1.1	0.8	0.9	0.9	0.7	0.6
Percentages											
Participation rate	10.7	9.3	8.9	6.9	7.8	7.0	7.3	5.9	6.7	6.0	6.9
Unemployment rate	5.8	1.4	1.7	5.8	6.6	4.1	2.8	3.8	3.7	2.7	2.0
Employment rate	10.1	9.1	8.9	6.5	7.3	6.7	7.1	5.7	6.5	5.9	6.7

Source: Judea, Samaria, and Gaza Area Statistics; Volumes XVIII,XIX and XX for 1988,1989-90,1991, Israel Central Bureau of Statistics, Jerusalem.
*. Working Age population is age 15+ from 1986-1990.
Data for 1992 are estimates.

Table 32: Occupied Territories, Employees by Place of Work and Selected Economic Branches.

	WEST BANK/EMPLOYEES			GAZA/EMPLOYEES			TOTAL/OCCUPIED TERRITORIES		
	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION
1970	7700	8600	6600	2500	10600	4300	10200	19200	10900
1971	7800	6700	3900	2800	10400	2200	10600	17100	6100
1972	7500	5600	4300	2900	7500	1600	10400	13100	6000
1973	7100	3900	4300	2300	7100	1500	9300	11000	5900
1974	7900	3500	5100	2000	6200	1400	9900	9700	6400
1975	7500	3000	6000	2700	6700	1800	10200	9700	7800
1976	7800	2500	7000	3500	5800	1800	11300	8300	8800
1977	7900	2400	7700	3000	5300	2300	10900	7700	10000
1978	8400	1800	8200	3400	3100	2200	11800	4900	10200
1979	8500	1800	8400	3400	2000	1800	11900	3800	9800
1980	8200	2400	7500	3500	1700	2000	11700	4100	9500
1981	7900	2400	7900	3300	1900	2500	11200	4300	10400
1982	9100	2300	10300	3100	2300	2600	12200	4600	12900
1983	8800	2100	8200	2800	1900	1900	11600	4000	10100
1984	9700	2200	9400	3400	1800	1900	13100	4000	11300
1985	9925	2470	9900	3502	2080	1800	13427	4550	11700
1986	11000	2300	11300	4200	1900	2500	15200	4200	13800
1987	11800	2700	10600	4700	1500	2100	16500	4200	12700
1988	11500	2500	8900	4000	2000	2000	15500	4500	10900
1989	12300	1800	9300	3300	3200	4300	15600	5000	13600
1990	12700	1800	10700	2900	3700	3900	15600	5500	14600
1991	12200	2200	10000	4400	4200	3800	16400	6400	13800
1992	13700	2600	10800	4800	2900	5500	18500	5500	16300

Source: Statistical Abstracts of Israel, Various Issues, Central Bureau of Statistics.
Data for 1992 are estimates.

Table 33: Occupied Territories, Employed by Place of Work and Selected Economic Branches.

	WEST BANK/EMPLOYEES			GAZA/EMPLOYEES			TOTAL/OCCUPIED TERRITORIES		
	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION	INDUSTRY	AGRICULTURE	CONSTRUCTION
1970	14600	42500	8400	12100	31600	8500	26700	74100	16900
1971	14700	40200	6100	12200	31100	4600	26900	71300	10700
1972	14600	38000	7200	12600	24800	4100	27200	62800	11300
1973	16400	34200	7600	12700	25700	3900	29100	59900	11500
1974	15100	37900	7000	12200	24800	4100	27300	62700	11100
1975	15800	34600	8400	12000	26300	5100	27800	60900	13500
1976	14900	33900	10000	13500	26500	4600	28400	60400	14600
1977	15100	33400	10400	12500	25100	6700	27600	58500	17100
1978	15200	34400	10900	15400	21100	7000	30600	55500	17900
1979	15900	31500	11800	18200	21100	7000	34100	52600	18800
1980	15200	33200	10700	18600	18800	7300	33800	52000	18000
1981	15700	30500	11900	16500	18000	8400	32200	48500	20300
1982	15900	32100	10600	14800	17900	8500	30700	50000	19100
1983	16100	29500	11000	15200	19200	8200	31300	48700	19200
1984	15900	28500	11300	17100	16500	8500	33000	45000	19800
1985	16200	27300	12400	16200	18000	8400	32400	45300	20800
1986	15700	28400	12800	17600	16900	8300	33300	45300	21100
1987	16600	26000	12200	17500	16000	8400	34100	42000	20600
1988	15900	31200	10700	16300	18600	8400	32200	49800	19100
1989	17200	26400	11000	13500	18400	12600	30700	44800	23600
1990	15800	29500	10900	11300	20400	11100	27100	49900	22000
1991	16900	28100	10500	12700	21600	10000	29600	49700	20500

Source: Statistical Abstracts of Israel, Various Issues. Central Bureau of Statistics.

*.Employed include Employees and Self employed.

Table 34: Average Daily Wage of Employees of the West Bank and Gaza Area by place of work and selected economic branches.

Average Daily Wage per Employee (NIS, at current prices), Occupied Territories.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.17	0.42	2.06	8.60	14.05	19.07	24.47	23.66	27.00
Agriculture, Forestry & Fishing	0.16	0.41	1.66	7.76	13.91	18.30	27.04	27.44	30.41
Construction (building & public works)	0.24	0.62	2.73	10.39	17.85	23.30	34.62	29.75	33.40
Public Services	0.28	0.63	3.37	12.07	18.73	22.91	25.76	25.20	29.13
Other Branches	0.18	0.43	2.20	8.41	13.35	16.24	26.21	20.78	22.80
Total	0.22	0.54	2.74	10.24	16.67	21.16	29.40	25.37	28.85

Average Daily Wage per Employee (NIS, at current prices), West Bank.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.18	0.43	2.15	9.14	14.41	18.57	22.82	23.05	26.32
Agriculture, Forestry & Fishing	0.17	0.43	1.80	7.82	13.64	17.48	20.64	20.83	25.49
Construction (building & public works)	0.25	0.64	2.82	10.76	18.00	23.02	29.01	29.11	33.22
Public Services	0.24	0.57	3.03	11.26	17.81	21.86	23.88	22.48	26.97
Other Branches	0.18	0.45	2.07	7.19	14.64	16.23	19.99	19.28	22.29
Total	0.22	0.53	2.64	10.17	16.49	20.50	24.02	23.56	27.45

Average Daily Wage per Employee (NIS, at current prices), Gaza Area.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.15	0.39	1.82	7.10	13.15	20.34	24.10	26.37	30.45
Agriculture, Forestry & Fishing	0.16	0.38	1.51	7.68	14.23	19.66	25.25	32.29	34.07
Construction (building & public works)	0.22	0.58	2.32	8.58	17.21	24.70	30.95	31.52	34.09
Public Services	0.30	0.73	4.00	13.38	20.28	24.63	28.08	29.77	32.98
Other Branches	0.17	0.38	1.76	5.19	10.83	17.37	22.19	24.97	24.10
Total	0.24	0.58	2.97	10.41	17.08	22.65	26.91	29.47	32.29

Source: Judea, Samaria and Gaza Area Statistics, Vol XVI, XVIII, XIX and XX, Israel Central Bureau of Statistics, 1986, 1988, 1989-90, and 1991.

*.Comparison with data from previous years should be treated with caution. Other Branches include:Electricity, Water, Financing, Business Services and Personal Services, they were presented together due to the low number of employed persons in these branches.

Table 35: Employment of Palestinians in Israel by Selected Economic Branches. 1970, 1975, 1980-1991 (in 000's)

	EMPLOYEES FROM THE WEST BANK				EMPLOYEES FROM GAZA				TOTAL EMPLOYEES FROM O.T.			
	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other
1970	2.6	1.9	8.0	1.5	2.4	0.5	2.8	0.1	5.0	2.41	0.8	1.6
1975	4.2	7.3	21.5	5.3	5.0	4.6	13.7	2.3	9.2	11.9	35.2	7.6
1980	3.9	8.4	19.9	7.0	6.3	7.2	15.2	5.3	10.2	15.6	35.1	12.3
1981	3.7	7.1	20.3	7.3	5.7	6.6	17.9	5.3	9.4	13.7	38.2	12.6
1982	3.9	7.5	22.5	7.3	6.0	6.3	18.5	4.6	9.9	13.8	41.0	11.9
1983	3.9	8.5	24.8	8.4	6.6	7.5	18.5	6.1	10.5	16.0	43.3	14.5
1984	4.8	8.8	24.8	9.1	7.8	7.3	18.0	6.3	12.6	16.1	42.8	15.4
1985	4.9	7.8	23.9	8.6	9.0	7.9	17.4	6.6	13.9	15.7	41.3	15.2
1986	5.3	8.9	25.3	9.4	9.4	7.4	19.1	6.6	14.7	16.3	44.4	16.0
1987	6.1	11.0	29.6	13.2	9.5	8.6	18.8	7.8	15.6	19.6	48.4	21.0
1988	6.5	10.2	31.4	12.7	9.7	6.3	20.6	6.3	16.2	16.5	52.0	19.0
1989	6.6	9.0	34.1	12.8	7.4	4.4	20.6	5.9	14.0	13.4	54.7	18.7
1990	5.5	7.3	36.7	12.4	6.8	3.8	26.1	5.1	12.3	11.1	62.8	17.5
1991	4.4	4.9	37.2	7.5	7.2	2.4	28.9	2.4	11.6	7.3	66.1	9.9
1992	4.0	4.0	52.8	8.6	6.4	1.8	31.5	2.0	10.3	6.8	84.3	10.3

	EMPLOYEES FROM THE WEST BANK				EMPLOYEES FROM GAZA				TOTAL EMPLOYEES FROM O.T.			
	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other	Agriculture	Industry	Construction	Other
1970	2.6	1.9	8.3	1.8	2.4	0.5	2.8	0.2	5.0	2.4	11.1	2.0
1975	4.4	7.5	22.2	6.3	4.8	4.7	13.8	2.6	9.2	12.2	36.0	8.9
1980	4.0	8.5	20.3	7.7	6.3	7.2	15.2	5.8	10.3	15.7	35.5	13.5
1981	3.7	7.2	21.0	7.9	5.8	6.6	17.8	5.7	9.5	13.8	38.8	13.6
1982	4.0	7.7	23.3	8.0	6.1	6.3	18.5	5.2	10.1	14.0	41.7	13.2
1983	4.0	8.8	25.7	9.6	6.6	7.6	18.6	6.9	10.7	16.3	44.3	16.5
1984	4.9	9.0	25.6	10.7	7.9	7.3	18.1	6.9	12.8	16.2	43.7	17.6
1985	5.1	7.9	24.8	9.7	9.0	7.9	17.6	7.1	14.1	15.8	42.5	16.8
1986	5.3	9.1	26.1	10.6	9.5	7.4	19.4	7.1	14.8	16.5	45.5	17.7
1987	6.2	11.1	30.4	15.2	9.7	8.6	19.3	8.5	15.8	19.7	49.7	23.6
1988	6.6	10.3	32.4	14.7	10.1	6.5	21.7	7.0	16.7	16.8	54.2	21.7
1989	6.7	9.1	35.0	14.6	7.5	4.5	21.1	6.4	14.2	13.6	56.1	21.0
1990	5.6	7.4	37.6	14.0	7.0	3.9	26.5	5.6	12.6	11.2	64.1	19.7
1991	4.4	5.0	37.6	8.8	7.3	2.5	29.3	2.8	11.7	7.5	66.9	11.6
1992	4.0	5.0	53.4	10.0	6.4	(1.8)	32.5	2.3	10.4	6.8	85.9	12.3

Source: Statistical Abstracts of Israel, 1986, 1988, 1989, 1991, and 1992 Central Bureau of Statistics.
*.Until 1985 data refer to persons aged 14+

Table 36: Average Daily Wage of Employees of the West Bank and Gaza Area who work in Israel, by selected economic branches.

Average Daily Wage per Employee (NIS,at current prices), from the Occupied Territories.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.24	0.58	2.31	9.15	17.65	25.01	31.55	34.83	39.20
Agriculture, Forestry & Fishing	0.19	0.48	1.68	7.35	14.65	21.76	28.31	31.97	35.52
Construction (building & public works)	0.27	0.65	2.56	10.47	19.85	27.17	35.78	40.86	43.52
Other Branches	0.23	0.57	2.37	9.59	17.95	24.18	30.05	33.43	36.91
Total	0.25	0.60	2.36	9.59	18.30	25.37	32.81	37.36	40.91

Average Daily Wage per Employee (NIS, at current prices), from the West Bank.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.23	0.55	2.27	9.24	16.97	22.63	29.41	32.40	35.58
Agriculture, Forestry & Fishing	0.19	0.47	1.66	7.05	14.16	20.41	26.79	29.69	33.22
Construction (building & public works)	0.27	0.66	2.61	10.84	19.60	25.82	35.34	40.07	40.87
Other Branches	0.23	0.58	2.44	10.13	17.72	22.75	28.33	31.20	34.42
Total	0.25	0.61	2.42	10.04	18.18	24.00	31.81	35.90	38.15

Average Daily Wage per Employee (NIS,at current prices), from the Gaza Area.

	1982	1983	1984	1985	1986	1987	1988	1989	1990
Economic Branch									
Industry (mining & manufacturing)	0.25	0.61	2.36	9.06	18.45	28.19	35.45	41.35	47.87
Agriculture, Forestry & Fishing	0.19	0.49	1.69	7.51	14.91	22.62	29.37	34.64	37.82
Construction (building & public works)	0.27	0.64	2.50	9.96	20.18	29.37	36.53	42.63	48.19
Other Branches	0.24	0.57	2.27	8.85	18.28	26.79	34.20	40.15	44.82
Total	0.25	0.60	2.28	9.10	18.43	27.30	34.42	40.61	46.13

Source: Judea, Samaria and Gaza Area Statistics, Vol XVI,XVIII,XIX and XX, Israel Central Bureau of Statistics, 1986, 1988, 1988-90 and 1991.

*.Comparison with data from previous years should be treated with caution. Other Branches include:Electricity, Water, Financing, Business Services and Personal Services, they were presented together due to the low number of employed persons in these branches.

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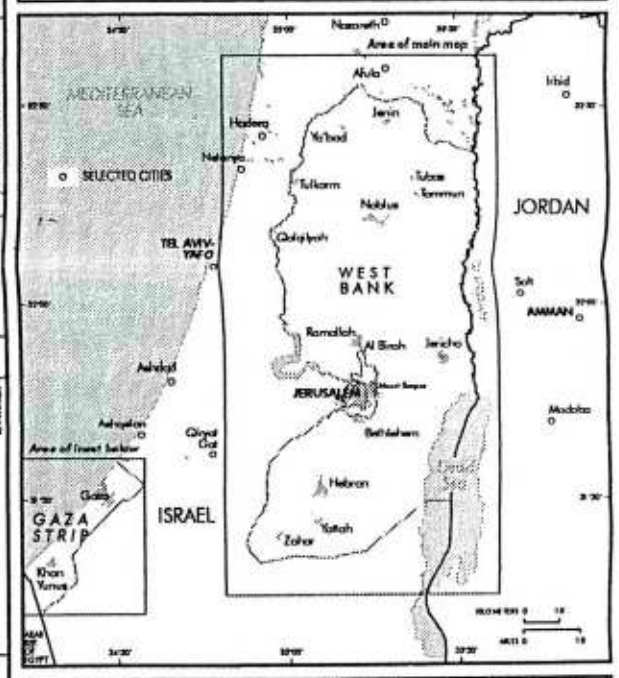
OCCUPIED TERRITORIES
WEST BANK AND GAZA STRIP
TRANSPORTATION NETWORK

- AIRPORTS / AIRFIELDS
- MAJOR HIGHWAYS
- TWO OR MORE LANES, HARD SURFACED ROADS
- RAILROADS
- BUILT-UP AREAS
- UNRWA REFUGEE CAMPS
- ISRAELI SETTLEMENTS
- ARMISTICE DEMARCATION LINES, 1949
- NO-MAN'S LAND AREAS, ARMISTICE DEMARCATION LINE, 1949
- JERUSALEM CITY LIMIT, UNILATERALLY EXPANDED BY ISRAEL JUNE 1967; THEN ANNEXED JULY 30 1980
- INTERNATIONAL BOUNDARIES



AUGUST 1993

IBRD 24884R