

The Political Economy of the West Bank

13 December 2012

AN ATTEMPT TO EXPLAIN THE ECONOMIC PROTESTS IN SEPTEMBER 2012

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Since early 2011, West Bank-wide demonstrations have markedly increased. Apart from the protest in November 2012 against the latest military escalation in Gaza, demonstrations across the West Bank also took place in March 2011, July and September 2012. Mahmoud Abbas, the President of the Palestinian Authority, stated at a meeting with Arab League ministers in Cairo in September 2012 that "The Palestinian Spring has begun, and we are in line with what the people say and what they want"¹. Despite the fact that the increase of coordinated protests over the course of the last two years and the demands that people utter towards their own authority can be interpreted as spill-overs of the developments in Egypt and Tunisia, the protests addressed different topics and should therefore also be interpreted individually.

This country report explores the economic protests in September as an entry point in order to present a political economy analysis of the situation in the West Bank. These protests took place in many cities across the West Bank in the first half of the month: Ramallah, Bethlehem, Hebron, Jenin, Nablus, Tulkarem and Jericho. In Hebron and Nablus, the protests turned into violent encounters with the Palestinian police – government buildings and police stations were attacked.

The September Protests: Who did what why?

The protests were triggered by rising fuel and basic food prices that have had a strong socio-economic effect on many Palestinians. Some goods have become dramatically more expensive over the last few months: The price of flour increased by 10% between June and September of this year, diesel and kerosene have become 8%, petrol and gas 13% more expensive between July and September.²

The demonstrators' discontent was mainly directed against the technocratic Palestinian Prime Minister Salam Fayyad and his government. Overwhelmingly, people called for an improvement in living conditions and the resignation of Fayyad. A few protesters even called for the resignation of Abbas, realizing that Fayyad could not promote policies without Abbas' agreement. In Ramallah, for instance, protesters were chanting "I can't fuel my car, so Fayyad can take it," or "We were looking for Palestine, but now we are looking for a sack of flour".³

Initiated by public transport unions due to the risen fuel prices, the protests were predominantly supported by students and professional unions demanding higher wages and their timely payment. Yet, as a poll conducted by the Palestinian Centre for Policy and Survey Research (PSR) in cooperation with the Konrad-Adenauer-Stiftung Ramallah

¹ Cf. Ma'an (2012) 'President says Palestinian Spring has begun.', Ma'an News, 5 September. <http://www.maannews.net/eng/ViewDetails.aspx?ID=517618> [12 November 2012].

² Cf. The Portland Trust (2012) 'Palestinian Economic Bulletin.', September 2012 (72).

³ Ma'an (2012) 'President says Palestinian Spring has begun.', Ma'an News, 5 September. <http://www.maannews.net/eng/ViewDetails.aspx?ID=517618> [12 November 2012].

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suggests, two-thirds of the Palestinian population feel that the protests are necessary because of people's inability to improve their lives in the future.⁴

As a response to the protests, on the 11 September, the Palestinian Authority (PA) announced that measures will be taken to lower the mounting living costs: diesel, kerosene and gas prices would be lowered to August levels and the raised VAT would be partly abstained from. Furthermore, it was promised that top officials' salaries would be cut. In October and the beginning of November, these measures came into effect, as the Ministry of Finance announced lower fuel and gas prices and told sellers and distributors to adjust prices accordingly. Beyond that, Israel ordered an advance payment of the taxes and customs duties it collected for the PA and stated that 5000 additional permits for Palestinians to work in Israel would be issued. However, this act should not primarily be interpreted as a kindness of Israel. Due to the close relationship between the PA and Israel when it comes to security coordination, Israel needs the PA to function, even if it is only to stop potential aggressions towards Israel.

However, also after Fayyad announced VAT cuts and the lowering of the fuel prices, protests continued for a couple of days, not least because some protesters were not satisfied with the announced measures and criticized the PA on a more fundamental level: issues like the PA's security coordination with Israel and the Paris Protocol, regulating the Israeli-Palestinian economic relations under the Oslo Accords were brought up.

In order to establish the links between economics and the political context, as well as to arrive at a closer understanding of the immediate and underlying reasons for the economic protests this September, a political economy analysis is key. More concretely, this involves firstly an exploration of the reasons for the rising prices and the wider economic developments in the West Bank.

ECONOMIC STAGNATION AND FINANCIAL CRISIS: INTERNAL + EXTERNAL REASONS FOR RISING PRICES

The Paris Protocol

Generally, as The Portland Trust's monthly *Palestinian Economic Bulletin* for September 2012 points out, the consumer price inflation index for the West Bank has increased by 13% since 2009.⁵ One of the main reasons for this is the *Protocol on Economic Relations between the Government of the State of Israel and the P.L.O., representing the Palestinian people*, better known as the Paris Protocol (PP). The Paris Protocol was signed by Israel and the Palestinian Liberation Organization (PLO) in 1994 in the course of the Oslo Accords. Even though it was supposed to last for five years as an interim agreement, it has regulated the economic relationship and interaction between Israel and the Palestinian Authority ever since.⁶ The six major areas in which it applies are

⁴ The most recent poll was conducted on the 13 - 15 September 2012. It can be found on the Palestinian Centre for Policy and Survey's webpage: <http://www.pcpsr.org/survey/polls/2012/p45efull.html> [12 November 2012].

⁵ Cf. The Portland Trust (2012) 'Palestinian Economic Bulletin.', September 2012 (72): 1.

⁶ On the 31 July 2012, shortly before the September protests, Israel and the PA agreed to further regulate taxation and bilateral trade, as a means of facilitating the implementation of existing economic agreements, most notably the Paris Protocol. However, the agreements will only take effect in January 2013. For further information see: Israel Ministry of Foreign Affairs (2012) 'Arrangements on taxation and transfer of goods between Israel and the PA.', 31 July. http://www.mfa.gov.il/MFA/Government/Communiques/2012/Arrangements_taxation_transfer_goods_Israel-PA_31-Jul-2012 [4 December 2012] or Stern, Y. (2012) 'The Israeli-Palestinian trade agreement – analysis by Yoav Stern.', Britain Israel Communications & Research Centre. <http://www.bicom.org.uk/analysis-article/8691/> [2 December 2012].

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customs, taxes, labour, agriculture, industry and tourism.⁷ Some of the most important parts of the agreements are the facilitation of the exchange of workers between Israel and the Palestinian Territories, the PA's right to establish a monetary authority and to levy taxes, as well as the Israeli supervision of Palestinian imports from and exports to third countries.⁸

One of the decisive practices established in the PP are that the customs taxes on goods imported to the Palestinian Territories as well as VAT and revenues of goods sold in Israel but consumed in the Palestinian Territories are collected by Israel and then transferred to the PA. Since these collected taxes account for around 70% of the PA's income (approx. \$100 million per month),⁹ a smooth operation of these financial flows is essential. Yet, in the past, Israel has used the withholding (or the threatening of withholding) of the collected taxes to exert pressure on the PA. For example, already in 1997, Israel has purposefully delayed the transfer of tax revenues to the PA.

In the eyes of many,¹⁰ this does not only depict the Palestinian Territories' dependence on Israel, but also an unbalanced power structure. Israel can allow itself non-compliance with the PP without having to fear negative repercussions. Fayyad alluded to this unequal power structure when he responded to calls for resignation: "I am not responsible for the Paris economic agreement."¹¹ That being said, even though the withholding of taxes did not cause the raise of prices in the West Bank in September, it could potentially contribute to such developments; especially taking into consideration that Israel is currently withholding the collected taxes from the PA and using them to pay off Palestinian debts mostly with the Israeli Electricity company, as a response to Palestine's status upgrade with the UN on the 29 November 2012.

Concerning the rising prices in the West Bank, the regulations in the PP regarding the Palestinian Value Added Tax (VAT) and fuel prices are essential. It is stated that the Palestinian VAT rate cannot be more than 2% lower than the Israeli VAT rate and that the fuel price in the Palestinian Territories cannot differ more than 15% from the Israeli price.¹² Hence, due to Israel's rise of the VAT and fuel prices at the end of August, the PA had to adjust theirs accordingly. Because the burden of the VAT is born disproportionately by poorer people, since they spend a bigger amount of their income on basic goods, this is problematic in the case of Israel and the Palestinian Territories.

⁷ Cf. Israel Ministry of Foreign Affairs (1994) 'The Gaza-Jericho Treaty Protocol, Annex IV.' <http://www.mfa.gov.il/MFA/Peace+Process/Guide+to+the+Peace+Process/Gaza-Jericho+Agreement+Annex+IV+-+Economic+Protoco.htm> [22 October 2012].

⁸ For further information on the Paris Protocol, see our Fact Sheet (forthcoming).

<http://www.kas.de/palaestinensische-gebiete/en/pages/11511/> [10 December 2012].

⁹ Cf. RT (2012) 'Israel withholds \$120mn in Palestinian tax funds as revenge for UN vote.', RT news, 2 December. <http://rt.com/news/israel-withholds-tax-funds-084/> [6 December 2012].

¹⁰ See, for instance: Arnon, A und A. Spivak (1998) 'Economic Aspects of the Oslo Process.', Palestine-Israel Journal, 5(3&4). <http://www.pij.org/details.php?id=388> [5 December 2012].

¹¹ Jaradat, A. (2012) 'Economic is political: Palestinians know why they are protesting.', Alternative Information Center. <http://www.alternativenews.org/english/index.php/news/opinion/5234-economic-is-political-palestinians-know-why-they-are-protesting.html> [19 November 2012].

¹² Beyond the arranging of the economic relationship between Israel and the Palestinian Territories, the importance of the PP also lies in it being an integral part of Netanyahu's "Economic Peace Theory". The idea of economic peace has been promoted by Netanyahu and is based on the notion of economic development as a means of conflict transformation. Essentially, heavily relying on rational actors theory, the idea behind the economic peace theory is that economic development is conducive to peace building, since the predominant interest of decision makers lies in the prosperity of their countries and they will thus not have an interest in initiation violent conflicts if the cost-benefit trade-off is negative. The 1994 PP lays out the specifics how this "economic peace" should be brought about. In practice, however, Israel's policies obstructed the economic growth in the Palestinian Territories in many respects, for instance when it comes to investment in the Territories or imports and exports. For further information see, for example: Feldman, N. (2009) 'Economic Peace: Theory versus Reality.', Strategic Assessment, 12(3).

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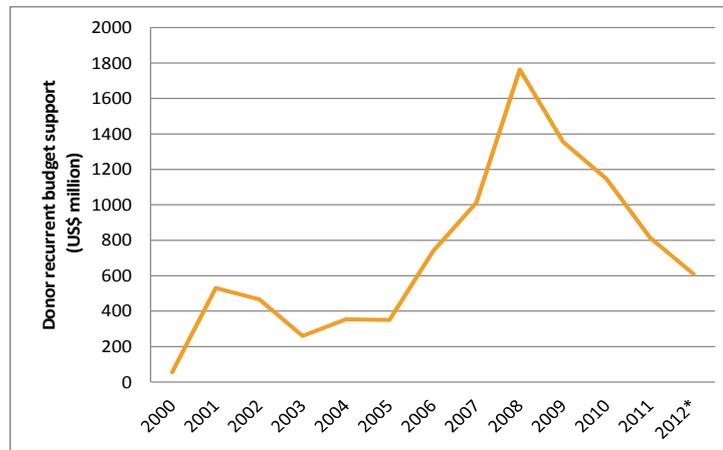
According to a former deputy of the Bank of Israel: The average wage of a Palestinian in the West Bank is around 2.5 to 3 times lower than an Israeli minimum wage.¹³

As a response to protesters' calls for renegotiation or abolition of the PP, the Civil Affairs Minister al-Sheikh was quoted saying that "the Palestinian Authority officially requests the reopening of the Paris Protocol which is not compatible with the current economic situation"¹⁴. Yet, the PA's demand for renewed negotiations of the Protocol was immediately turned down by Israel.

Economic Downturn and Donor Funds

Another reason for the raise in prices is the fiscal crisis in Palestine. According to a recent report of the International Monetary Fund (IMF), a substantial financial gap, projected at \$0.4 billion (as of Mid-September 2012), exists.¹⁵ Arguably, the fiscal crisis is caused by essentially two developments in recent years: economic stagnation and a dramatic drop in donor money. With regard to donor money, numbers are pretty clear: between 2008 and 2011, the percentage of the Palestinian Territories' GDP that foreign aid accounts for had dropped from 21% to 11%. This drop is mainly attributable to fewer donations from the US and Arab countries, whereas the assistance of the European Community remained relatively constant. In absolute numbers, international aid to the PA had dropped from \$1.8 billion in 2008 to \$1.1 billion in 2010.¹⁶ Arab countries, for instance, reduced their assistance from \$500 million in 2008 and 2009 to \$200 million in 2011 and 2012 (until September 2012).¹⁷

Figure 1: Donor recurrent budget support (US\$ million)



* 2012 figure is based on International Monetary Fund (IMF) projections
Source: PA MoF, IMF, and World Bank

Source: The World Bank (2012) 'Stagnation or Revival? Palestinian Economic Prospects.', Economic Monitoring Report to the Ad Hoc Liaison Committee, 21 March: 9.

¹³ Cf. 'Is Economic Integration with Israel the Best Path to Palestinian Prosperity?', Israel Knowledge @ Wharton. <http://kw.wharton.upenn.edu/israel/professor-eckstein-on-incentives-for-a-vibrant-palestinian-economy/> [4 December 2012].

¹⁴ Ben Gedalyahu, T. (2012) 'PA Wants Israel To Tear Apart Oslo Economic Pact', Israel National News, 9 September. <http://www.israelnationalnews.com/News/News.aspx/159785> [14 November 2012].

¹⁵ Cf. IMF (2012) 'Recent Experience and Prospects of the Economy of the West Bank and Gaza.', Staff Report Prepared for the Meeting of the Ad Hoc Liaison Committee, 23 September: 3. <http://www.imf.org/external/country/WBG/RR/2012/091912.pdf> [4 December 2012].

¹⁶ Cf. *ibid.*

¹⁷ Cf. Kershner, I. (2012) 'Financial Strains Said to Threaten Stability of Palestinian Authority.', New York Times, 17 September. http://www.nytimes.com/2012/09/18/world/middleeast/palestinian-authoritys-stability-threatened-by-financial-strains.html?pagewanted=all&_r=0 [4 December 2012].

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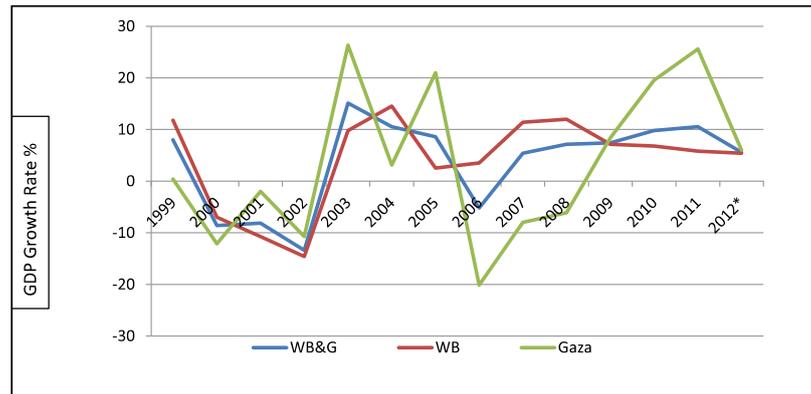
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Figure 1. Real GDP Growth Rate 1999-2012



* Based on preliminary data for the first quarter of 2012, Source: PCBS, National Accounts

Source: The World Bank (2012) 'Fiscal Crisis, Economic Prospects: The Imperative for Economic Cohesion in the Palestinian Territories.', Economic Monitoring Report to the Ad Hoc Liaison Committee, 23 September: 5.

The economic slowdown is a result of diverse developments: decline of said donor contributions, the global financial and economic crisis, but also tighter restrictions on Palestinian exports to Israel imposed by Israel – causing a drop of such exports by 24% between 2008 and 2011.¹⁸ According to a study cited by The World Bank, the export restrictions imposed by Israel are estimated to have caused a cost of 85% of the Palestinian GDP in 2010.¹⁹ Furthermore, a just recently published report on Europe's help in economically sustaining Israeli settlements in the West Bank through policies in general and import practices more specifically, claims that Israel's imposed restrictions on the Palestinian economy and its settlement policies are the reason for the West Bank's donor dependency.²⁰

Maybe surprisingly, corruption in the PA is not one of the reasons suggested for the tight financial situation in any of the reports. Despite the fact that corruption is existent within the PA, Fayyad's government has acted hard on corruption – ministers have been tried for corruption, an Anti-Corruption Commission was established in 2010 and the perception of corruption has decreased.²¹ As The World Bank even asserts, "Corruption [...] does not seem to be a significant problem in doing business in the West Bank and Gaza"²².

These statements again also point to the Paris Protocol, as it regulates Palestinian trade with other countries. Since Israeli approval is necessary in practice in order to conduct cross-border trade (as it is channelled through Israel or Israeli controlled crossings), frequent delays, for instance, make it practically impossible for Palestinian agricultural products to be exported into third countries.

¹⁸ Cf. IMF (2012) 'Recent Experience and Prospects of the Economy of the West Bank and Gaza.', Staff Report Prepared for the Meeting of the Ad Hoc Liaison Committee, 21 March: 5. www.imf.org/external/country/WBG/RR/2012/032112.pdf [4 December 2012].

¹⁹ Cf. 22 Organizations (2012) 'Trading away Peace: How Europe sustains illegal Israeli settlements.' <http://www.fidh.org/IMG/pdf/trading.pdf> [31 October 2012].

²⁰ Cf. *ibid.*: 19.

²¹ See, for instance: The World Bank (2011) 'West Bank and Gaza: Improving Governance and Reducing Corruption.' <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/GovernanceReportWBGEngMay18.2011.pdf> [10 December 2012].

²² The World Bank (2011) 'West Bank and Gaza: Institutional Capacity.', July 2011: 11. http://www.lacs.ps/documentsShow.aspx?ATT_ID=6018 [10 December 2012].

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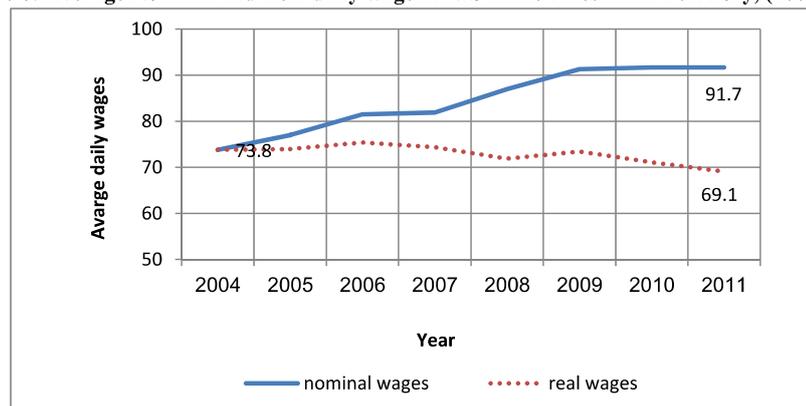
As a result of declining financial resources, the PA has not managed to pay the salaries of its employees – which make between 19% and 25% of West Bank employees – “on time or in full for over a year”²³. Hence, an increase in the PA’s state revenue was desperately needed. The solution that the PA perceived as the most feasible and immediate was the raise of taxes on goods, which added its share to the rising prices, however, is not the main reason for the substantial increase of the consumer price inflation index over the last years.

A FURTHER REASON FOR THE PUBLIC EXPRESSION OF DISSATISFACTION

Non-inclusive and unsustainable growth

A new study by the Palestine Economic Policy Research Institute-MAS – and the first one systematically analysing the effects of the period of economic growth in the Palestinian Territories between 2006 and 2010 – gives an insight in the unequal distribution of the dividends of GDP growth in the Palestinian Territories. In 2010, real GDP in the Palestinian Territories was 33% higher than its 2006 level, despite the fact that the Gaza Strip had gone through a deep recession.²⁴ Yet, the average daily wage in the West Bank had fallen by 3%.

Figure 6: Average Nominal and Real daily wage in NIS in the Palestinian Territory, (2004-2011)



Source: Palestinian Central Bureau of Statistics (2012), ‘Performance of the Palestinian Economy, 2011.’: 21. http://www.pcbs.gov.ps/Portals/_PCBS/Downloads/book1883.pdf [4 December 2012].

As their data suggests, not predominantly the productive industry grew, but the real estate and the ‘transport, storage and communication’ sector. As could be noted already in 2008, the unsustainable growth triggered a raise of real estate prices, especially in Ramallah. Similarly, the employment ratio (ER) in the Palestinian economy – measuring the proportion of a working age population that is employed²⁵ – is the lowest reported ER in the world. All in all, the study concludes that “the disproportionate beneficiaries of growth during the period were the recipients of non-labour incomes such as profit, interest and rent”²⁶. For many employees, nominal wages did not rise as fast as the consumer price inflation index and thus, the purchasing power of the average wage fell, in the West Bank by 3.3%. In other words,

²³ Strickland, P. O. (2012) ‘Echoes of the Past: Palestine in Protest.’, CounterPunch Weekend Edition, 7-9 September. <http://www.counterpunch.org/2012/09/07/palestine-in-protest/> [12 November 2012]. Cf. also Larudee, M. (2012) ‘A new study: Who Shared the Fruits of Growth in the Palestinian Economy, 2006-2010?’, Palestine Economic Policy Research Institute-MAS.

²⁴ Cf. Larudee, M. (2012) ‘A new study: Who Shared the Fruits of Growth in the Palestinian Economy, 2006-2010?’, Palestine Economic Policy Research Institute-MAS: np.

²⁵ This number does not say much about the state of an economy if not interpreted together with further indicators. However, it can still provide a partial insight.

²⁶ The Portland Trust (2012) ‘Palestinian Economic Bulletin.’, November 2012 (74): 1.

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even though the non-inflation-adjusted nominal wage rose, the inflation-adjusted real wage declined. As a consequence, the people in the West Bank, on average, had less money available, despite GDP growth. When the prices rose again in early September due to Israel's rise of the VAT and fuel prices, Palestinians who spend a disproportionate amount of their money on basic goods and fuel (taxi drivers, bus conductors, students) stated very clearly, that they could not bear these prices anymore.

IMPLICATIONS

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The reasons for the September protests in the West Bank are diverse. On a first level, the reasons are economic: rising prices, a widening socio-economic gap and a budget deficit. However, on a closer look, the political dimension becomes central, the West Bank's economy, is severely restricted by the Paris Protocol and other forms of Israeli control. The Paris Protocol sets out that the PA has to adjust the VAT as well as fuel prices according to Israel's, even though the income gap between the two areas is tremendous. Furthermore, Israel's imposition of restrictions and obstacles to exports from the West Bank limits the potential of economic development considerably. And beyond this, Israel has the power to deviate from the Protocol, without having to fear serious repercussions.

As seen during the protests in early September, together with the stagnation of the Palestinian economy and rising prices, the public opinion of the PA has changed to the worse. As the public polls conducted by the Center for Policy and Survey Research in cooperation with the KAS Ramallah indicate, the popularity of President Abbas has dropped from roughly 60% in March to 50% in the West Bank in September.²⁷ However, despite the fact that for the moment, attention was mainly focused on the PA's inability to keep an acceptable balance between living costs and salaries, Palestinians also recognize the centrality of Israel's role, the Paris Protocol and the PA's limited room for manoeuvre: Almost half of the Palestinians believe that the economic crisis is manufactured.

Nonetheless, neither the PA nor the Israeli government at the moment have a real interest in addressing these issues, as they both pursue ideas of rapid economic development in order to realize – or, as a cynic would say, to replace for – political goals.²⁸ Similarly, because the PA is one of the main addressees of the protesters and in order to fulfil their security contracts with Israel, they have two reasons to go hard against protesters: Israel and their own interest of survival. Moreover, Israel is also depending on a functioning security coordination with the PA, which implies that a financial collapse of the PA is dreaded by both the PA and the Israeli government.

Still, during the September protests, Palestinians have experienced that they can influence the PA's decisions, however maybe rather through protests than a democratic process as the relatively low participation in the local elections on the 20 October 2012 has shown. Furthermore, it seems that the PA is very much aware of the discontent and tries to suppress the public expression of discontent – as seen in a radio show that was shut down as soon as a contributor started criticizing the PA.

²⁷ Cf. the results of the recent polls on the PSR Webpage, <http://www.pcpsr.org/> [28 November 2012].

²⁸ These strategies are often referred to as 'Fayyadism' and Netanyahu's economic peace theory, respectively. See Ahren, R. (2008) 'Netanyahu: Economics, not politics, is the key to peace.', Haaretz, 20 November. <http://www.haaretz.com/print-edition/news/netanyahu-economics-not-politics-is-the-key-to-peace-1.257617> [8 November 2012].

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Despite the serious external constraints, internal reforms in the West Bank are essential. Apart from the necessary closure of the financial gap – rendering international contributions decisive – in order to relief the pressure on Palestinian's situation in the context of rising prices, a social security system is absolutely key. Fayyad, as former economist with the International Monetary Fund (IMF) strongly supported by the international community, has managed to create considerable economic growth in the West Bank and acted hard on corruption, however, has disregarded the importance of solidarity and social security systems for a successful, competitive social market economy. By calling for his resignation, the protesters in September powerfully reminded him of that: decreasing real wages and increasing prices have severe socio-economic effects on a large part of the Palestinian population.

In the long term, however, these internal reforms cannot subdue the structural political causes of the dire economic situation of the West Bank. To truly deal with the reasons for the rising prices and the economic protests in September, negotiations between Israel and Palestine are absolutely necessary: the structural obstacles to development imposed by the Paris Protocol have to be addressed. That is to say that at least with regard to the dependence of the Palestinian VAT and fuel prices, as well as Israel's collection of Palestinian owned taxes reforms crucial.

The importance of such reforms goes beyond the prospects for economic development in the West Bank, for neither Israel nor the Palestinian Authority can afford a deterioration of the situation. Consequentially, an unaltered Paris Protocol is an obstacle to peace.



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