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## **Report on UNCTAD assistance to the Palestinian people \***

**Prepared by the UNCTAD secretariat \*\***

### *Executive summary*

The vulnerability of the Palestinian economy to the impact of prolonged Israeli occupation and closure policies was heightened by donors and financial restrictions on the Palestinian Authority (PA) in 2006. "Separation" has isolated Palestinians in the West Bank and Gaza from Arab regional and world markets, and institutionalized fragmentation inside the occupied Palestinian territories. With economic decline, it is estimated that the Palestinian Authority lost nearly \$1.2 billion in revenues from 2000 to 2005. As donor support has decreased, tenuous Palestinian Authority financial solvency undercuts national fiscal policy to stabilize the economy in economic downturn via automatic stabilizers. Furthermore, in the absence of a strong international mediator, renewed confrontations have resulted in unprecedented restrictive measures on Palestinians. Viability of the economy is less an issue. Rather, the focus is increasingly on how to limit vulnerability and create an appropriate and effective policy space that minimizes the economic impact of Israeli security measures. The immediate economic priority is to sustain minimal levels of "effective demand" under greater isolation. The reversal of post-Oslo investor confidence and the trend towards de-formalization of the economy mean private sector stabilization will require an intensive Palestinian Authority trade policy fortified by expanded policy space in the areas of macroeconomic, trade and labour policy. There is an urgent need for comprehensive trade facilitation overhaul. Initial steps can take place regarding the urgent matter of trade flows and within a fuller analysis of re-routing costs, and the activation of transit agreements with Egypt and Jordan. The United Nations, including UNCTAD through its technical assistance and policy advice, and its international partners in Palestinian development need to continue to help the Palestinian people withstand this prolonged humanitarian and economic crisis.

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### **I. Political change impacts donor funding**

1. As anticipated in the secretariat's previous report on assistance to the Palestinian people (UNCTAD, 2006a), suspension of direct donor support to the Palestinian Authority following the Palestinian legislative elections of January 2006 has contributed to a further economic decline in the West Bank and Gaza. This reinforced the momentum of de-development triggered by repeated violent confrontations, and tightened Israeli restrictive measures and the closure policy which had been in place since September 2000. In 2006 and early 2007, Palestinians have suffered harsher travel restrictions, with increased checkpoints, expanded and deeper impact of the separation barrier in the West Bank, and greater restrictions on the mobility of people and goods.

2. The deterioration in movement and access in the West Bank increased in the last quarter of 2005, following Israeli unilateral disengagement from Gaza, and picked up momentum after the formulation of the first Government following the Palestinian Legislative Council elections in early 2006. The United Nations Office for the Coordination of Humanitarian Affairs (OCHA) counted 527 checkpoints and other obstacles by the end of December 2006, a 40 per cent increase since the Gaza disengagement benchmark. The situation in the Gaza Strip is particularly acute. Since 2000, when access to Israel for work began to decline, Gazans have depended on Palestinian Authority government payrolls for 45 per cent of total employment (OCHA, 2007). It is not surprising, therefore, that budgetary assistance has been described by the World Bank (2002) as the most efficient method for injecting cash into the landlocked and fragmented Palestinian territories. Recently, the World Bank (2007a) has underscored how Palestinian Authority achievements in transparency and accountability have been "undermined" by donor mechanisms to sidestep the Palestinian Authority.

3. Israeli withholding of Palestinian clearance revenues collected on behalf of the Palestinian Authority (in contravention of the Paris Protocol of 1994) and the absence of budget support from most Western nations have further reduced the already limited policy space available to Palestinian decision makers. This has effectively prevented the Palestinian Authority from paying the bulk of public employee salaries since April 2006, and when they have been paid, it has been only partially and irregularly. As a

result, public service strikes have been recurrent, affecting Palestinian Authority essential service delivery personnel such as doctors, nurses, teachers and local municipal workers. This in turn has deepened the ongoing socio-economic decline. An urgent redirecting of aid through the Palestinian Authority is needed so that it can address vital social and economic concerns. UNCTAD has already highlighted concern for a declining Palestinian Authority role in "guiding allocation of donors funds", affirming the importance of seeking all options to expand policy instruments available to the Palestinian Authority, especially the trade, fiscal and monetary arrangements of the 1994 Paris Protocol (UNCTAD, 2006a, b).

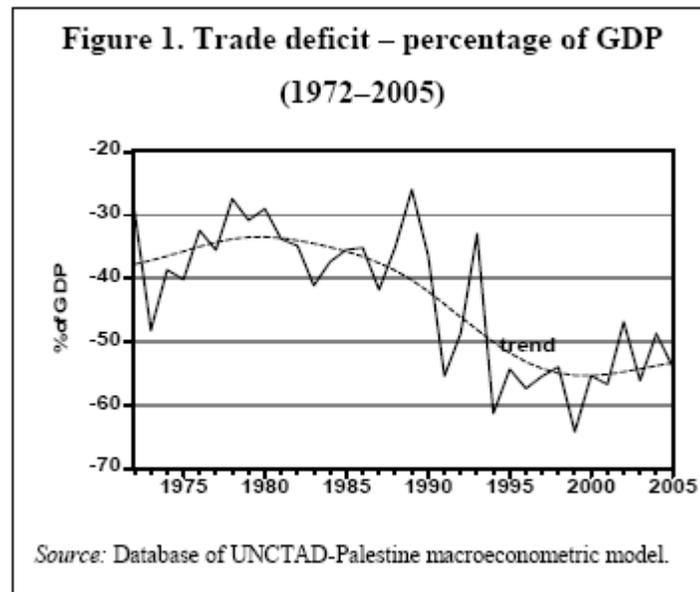
4. The UNCTAD secretariat has also emphasized that reversing Palestinian economic de-development requires dealing with the Israeli policy of asymmetric containment as a constraint to development (UNCTAD, 2006b). An essential step in addressing development distortions wrought by occupation and containment is for international support to be non-distorting. Ad hoc and extemporaneous aid can end up sustaining distortional development and occupation-generated structural deformation. Aid policies are therefore needed to address the different sources of Palestinian economic vulnerability and to break the isolation imposed on the occupied Palestinian territories. Comprehensive donor engagement should strive for unimpeded Palestinian trade flows to the outside world through alternative trading routes such as Egypt and Jordan. This report elaborates on the effectiveness of these alternatives.

5. Lifting the Palestinian people out of the recent wave of hardship by empowering officially-recognized national institutions is critical for realizing a region where two States – Israel and Palestine – live side by side within secure and recognized borders as envisioned by the relevant United Nations resolutions. The Palestinian Authority should, therefore, be supported to implement national economic policies that seek to address emerging needs generated by the crisis. Above all, reducing restrictions on Palestinian access to the rest of the world will be the *sine qua non* for economic stabilization and the cornerstone of an economic foundation for peace.

6. If this is to happen, Palestinian Authority trade policy – supported by appropriate macroeconomic and labour policies – will have to address manifold contorted imbalances imposed upon the Palestinian economy. Contextualizing the work of UNCTAD within this environment, this report briefs the Board on the rationale, scope and thrust of operational activities currently under way, as well as future orientations. It also attests to the continued interest and support from the donor community and UNCTAD members for the secretariat's technical cooperation activities, while also highlighting policy recommendations in areas of UNCTAD technical assistance activities.

## **II. Prolonged economic deterioration A. Economic aggregates**

7. Preliminary Palestinian Central Bureau of Statistics (PCBS) data suggest that per capita gross national income (GNI) declined 15 per cent in 2006 (table 1), while gross domestic product (GDP) is estimated to have declined by 6.6 per cent. Other estimates suggest that the decline could be even worse, by as much as three to four percentage points (World Bank, 2007a). Israeli security measures and mobility restrictions imposed on goods and people have squeezed the economy to a size smaller than a decade ago, with debilitating conditions, and have caused investment levels to plummet. Existing enterprises are facing precarious conditions, evidenced by enterprise closings and the expansion of the informal sector. In 2006, exports declined 3 per cent while imports rose 20 per cent. These changes reflect greater Palestinian isolation from regional and world markets, a widening trade deficit and increased vulnerability. The trade deficit has reached unprecedented proportions of 73 per cent of GDP – 30 per cent higher than its 30-year average (figures 1 and 3).



8. Poverty has reached unprecedented levels, with around 53 per cent of households (with an average size of six members) living below the national poverty line of \$385 per household per month in 2005. Donor support, however, helped reduce consumption-measured poverty to 30 per cent by March 2006 (PCBS, 2006). The depletion of coping strategies and severe pockets of poverty and unemployment have created a near-total dependency on donor aid for large sections of the population (World Bank, 2007a). According to the World Bank, an estimated 71 per cent of public employees fall under the poverty line based on income estimates, and 46 per cent do not have enough food to meet basic needs. The number of people in deep poverty nearly doubled in 2006, to more than 1 million (OCHA, 2007). Moreover, 53 per cent of Gazan households reported that their incomes declined in the last year by more than half (Oxfam, 2007).

9. Unemployment in 2006 remained high, at 30 per cent. The lack of employment opportunities forced 10,000 people to resort to unpaid activities with family members, while another 10,000 left the labour market in 2006. There was also an increase of 100,000 people who could not find employment yet continued looking in 2006. The decline has hit certain regions disproportionately, with continued disparity between Gaza and the West Bank. The unemployment rate in Gaza is 6 per cent higher than the national average.

10. Long-term structural deterioration is illustrated in a 10-year comparison of the agricultural and manufacturing sectors. Between 1996 and 2006, agricultural output declined 19 per cent, but in 2006 this sector employed 80 per cent more people than it did in 1996. Similarly, manufacturing value added declined 7 per cent over 10 years, yet employment in the sector increased 3 per cent.

## **B. Isolated economy with a weak domestic demand**

11. After nearly seven years, economic siege has reduced Palestinian exports not only to Israel, but to the rest of the world as well (figure 2). This reflects not so much domestic economic structural weaknesses, but increasing isolation from world and Arab markets, imposed under an ostensible "separation" policy. In 2006, imports as a percentage of GDP surged to 86 per cent, up from 75 per cent in 2005. This change equates to a \$500 million loss to the economy. As observed and anticipated in

previous UNCTAD reports, the anomaly of reduced GDP and higher imports means that the collapse of aggregate demand can be attributed to Israeli closure policies and the loss of local production to imports, notably from Israel. The latter accounts for more than 55 per cent of the Palestinian trade deficit. This means that the equivalent of 50 per cent of West Bank and Gaza GDP was needed to pay for the trade deficit with Israel in 2006.



12. During 2006, Israeli authorities withheld, for the second time since 2002, more than \$800 million in Palestinian tax revenue collected on behalf of the Palestinian Authority (OCHA, 2007). As a result, Palestinian Authority revenues, which were less than \$600 million, were more than 50 per cent lower in 2006 than in 2005. Consequently, the Palestinian Authority reduced its expenditures to \$655 million – 30 per cent below its level in 2005. The budget deficit in 2006 is estimated at \$791 million (19 per cent of GDP), as compared to \$761 million in 2005 (17 per cent of GDP). This gap was partly met by an increase in external budget support in the range of \$137 million in 2006. Nevertheless, the irregular flow of donor support prevented the Palestinian Authority from meeting its periodical obligations.

13. The combined losses of reduced Palestinian Authority expenditure and increased imports in 2006 were the equivalent of 27 per cent of GDP. Had this magnitude worked through the economy, without offsetting factors, its negative impact would have been much larger, with harsher implications for poverty and food security. Among the factors that compensated for these substantial losses was a surge of external capital inflows. However, it seems that a significant portion of these funds was transferred, by both donors and private households, through non-Palestinian Authority decentralized channels, thereby further undermining the role of the Palestinian Authority as well as the financial intermediation and monetary supervision systems. Estimates based on a simple macroeconomic accounting framework suggest that to have achieved the reported 6.6 per cent decline in GDP, capital inflows would have to have reached \$900 million. This figure tallies with that reported by the former Palestinian Authority Minister of Finance at the United Nations seminar on assistance to the Palestinian people, Doha, Qatar, 5–6 February 200 (<http://www.un.org/News/Press/docs/2007/gapal1032.doc.htm>).

**Table 1. Palestinian economy (West Bank and Gaza Strip)<sup>a</sup>**  
Key indicators, selected years

	1995	1999	2002 <sup>rev.</sup>	2003 <sup>rev.</sup>	2004 <sup>rev.</sup>	2005 <sup>prl.</sup>	2006 <sup>est.</sup>
<b>Macroeconomic performance</b>							
Real GDP growth (%)	6.1	8.6	-3.8	8.5	6.3	4.9	-6.6
GDP (million \$)	4 511	4 261	3 556	3 995	4 248	4 443	4 150
GNI (million \$)	3 699	4 932	3 835	4 251	4 884	5 119	4 522
GNDI <sup>*</sup> (million \$)	-	-	4 455	4 640	4 842	5 441	5 421
GDP per capita (\$)	1 380	1 478	1 146	1 221	1 264	1 258	1 134
GNI per capita (\$)	1 583	1 736	1 215	1 298	1 441	1 452	1 236
Real GNI per capita growth (%)	7.9	4.1	-8.9	6.2	1.5	-1	-14.9
Domestic expenditure (% of GDP)	151.8	163.0	145.8	150.2	150.7	154.5	173
<b>Population and labour</b>							
Population (million)	2.34	2.84	3.16	3.27	3.39	3.53	3.66
Unemployment (% of labour force) <sup>b</sup>	26.6	21.2	41.3	33.4	32.5	29.0	29.6
Total employment (thousand)	417	588	477	564	578	633	666
In public sector	51	103	115	119	131	145	164
In Israel and settlements	50	127	49	55	50	63	64
<b>Fiscal balance (% of GDP)</b>							
Government revenue	13.2	23.8	8.2	19.1	20.5	27.7	13.9
Current expenditure	15.3	22.5	27.6	31.4	32.0	43.6	31.9
Total expenditure	25.5	29.8	28.2	32.3	32.8	44.9	33
Recurrent balance	-2.1	1.3	-19.4	-12.3	-11.5	15.9	18.0
Overall balance	-12.3	-6.0	-20.0	-13.2	-12.3	17.2	19.1
<b>External trade</b>							
Exports of goods and services (million \$)	499	684	420	433	482	665	581
Imports of goods and services (million \$)	2 176	3 353	2 130	2 404	2 751	3 352	3 631
Trade balance (% of GDP)	-52.0	-63.6	-47.2	-49.3	-53	-60.4	-73
Trade balance with Israel (million \$)	-1 388	-1 766	-1 149	-1 370	-1 623	-1 943	1 999
Trade balance with Israel (% of GDP)	-43.0	-42.0	-31.8	-34.3	-37.9	-43.7	48.2
Imports from Israel/PA private consumption (%)	56.5	54.5	43.6	43.4	44.6	51.5	43.5
Total PA trade with Israel/total Israeli trade (%) <sup>c</sup>	3.7	3.7	2.1	2.2	2.2	2.4	3.1
PA trade with Israel/total PA trade (%) <sup>c</sup>	78.8	68.0	69.0	69.1	70.3	70.1	66

*Sources:* Historical data are from the PCBS; 2006 data are estimated by the UNCTAD secretariat on the basis of recently released PCBS data (PCBS, 2007); fiscal data for 2005–2006 is from OCHA (2007).

<sup>\*</sup> gross national disposable income

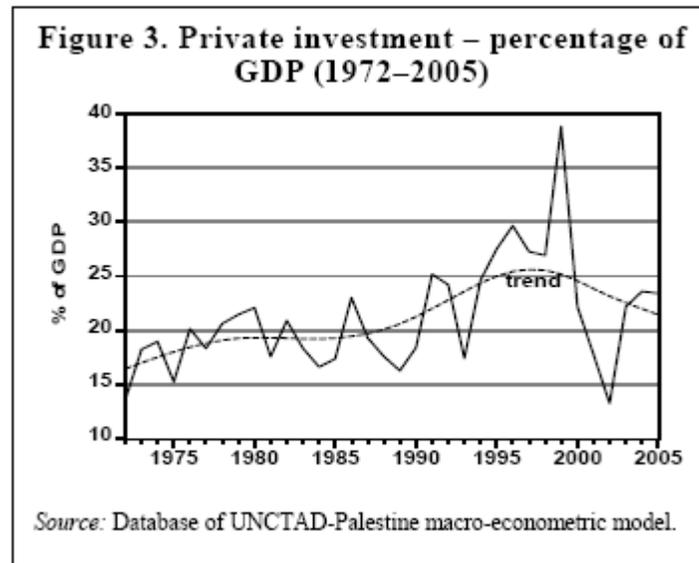
<sup>a</sup> All data exclude east Jerusalem.

<sup>b</sup> Unemployment rates include discouraged workers according to the ILO relaxed definition (PCBS, 2006).

<sup>c</sup> Total Palestinian and Israeli trade data refer to goods, and non-factor and factor services.

14. In this discouraging environment, private investors are unlikely to invest above current levels, which are already relatively high by historical trends (figure 3). The post-Oslo investment surge can be seen as exceptionally high investment levels reflecting an optimistic environment and high expectations of the peace process. However, this surge was followed by extraordinary Israeli restrictive measures and the destruction and losses of up to one third of the existing physical capital and productive capacity

(UNCTAD, 2006b). It would be imprudent from a public policy perspective, therefore, to anticipate or rely on changes in private sector behaviour, given the current circumstances of occupation and closure policy.



15. To offset the effects of the imposed isolation on the occupied Palestinian territories and reduce the risk to investors, Palestinian Authority policies will require intensive exchange programmes with neighbouring Arab countries and larger distant markets. There is also a need to re-establish and strengthen sensitive private sector links to the outside world. This will require time, international support and significant governmental guidance. Furthermore, rooting economic policies in a well-articulated national development vision and plan and setting the economy on the path to recovery require a comprehensive trade facilitation overhaul called for by UNCTAD (2003) and the World Bank (2004). However, until there are observed increases in exports that can induce private investment, aggregate demand will continue to depend on government expenditures which consist mainly of public employment.

16. Trade facilitation efforts should seek to diversify Palestinian trade away from its heavy dependence on Israel. These should be supported by measures to enable the private sector to enter Arab regional markets and allow Palestinian transit trade to pass through Egyptian and Jordanian ports and facilities, rather than depend completely on Israeli facilities. This will require an active and financially intensive Palestinian Authority trade policy and trade promotion programme. Similarly, to improve the investment environment, the World Bank (2007a) has recognized the need for "matching" investment funds to increase the likelihood of private sector investment. Such funds should be established by the Palestinian Authority and should target specific sectors with potential strategic priority.

### **C. Fiscal instability, policy space and economic performance**

17. The withholding of Palestinian tax revenues collected by Israel and the reluctance of donors to support the Palestinian Authority in 2006, on top of the debilitating economic impact of seven years of the Israeli systematic closure policy, have led directly to the tenuous fiscal position of the Palestinian

Authority. Simulations of UNCTAD's econometric model of the Palestinian economy estimate the cumulative opportunity costs in terms of the loss of potential income between 2000 and 2005 to be in the range of \$8.4 billion, or more than twice the size of today's economy. Physical capital loss amounts to one third of occupied Palestinian territories' 1998 productive capacity. Cumulative public revenue loss is estimated to be around \$1.2 billion between 2000 and 2005. Public revenue losses in 2006, excluding revenue withheld by Israel, could easily exceed \$250 million.

18. While these fiscal losses are substantial on their own, the uncertainty of public resources availability makes it extremely difficult for policymakers to fiscally manage any economy, not to mention the Palestinian war-torn economy. This represents further erosion of the already-limited policy space available to Palestinian policymakers under the prevailing fiscal, monetary and trade regime.

19. The Palestinian Authority has essentially inherited from the occupying power the fiscal challenge of rising expenditures to stabilize the economy under closure, but it has to do this with reduced and unpredictable revenues associated with economic decline and security measures. During periods of economic decline, responsible national economic policy requires increases in fiscal expenditures to cushion the economic slowdown/regression. Viewed from this perspective, the current Palestinian fiscal imbalance is not only to be anticipated, it should also be seen within a framework of necessary economic rehabilitation and stabilization, especially in the light of the continued decline in the other components of aggregate demand.

20. Notwithstanding the debilitated fiscal status of the Palestinian Authority and decimated productive capacity, the essential needs of the Palestinian people continue to grow. In addition to rising costs associated with social stabilization, private sector recovery will require generous public support. Within this environment and before signs of economic recovery, reducing government payrolls, as recently suggested by the World Bank (2007a), could lead to further economic deterioration and greater unemployment. It would therefore be counterproductive. "Repayment of arrears" (World Bank, 2007a) to the private sector is a necessary policy in itself, but if this reduces the capacity for regular Palestinian Authority expenditures, there would have to be a matched increase in private investment for output expansion to ensue. However, this is questionable under the present circumstances. Minimizing every risk of higher unemployment should be the number one priority.

21. This adverse environment suggests that any comprehensive review of Palestinian Authority fiscal expenditures needs to underscore the role of the public sector in overcoming the crisis. Reform measures in this area should be guided by an agenda that seeks to create the necessary institutions for addressing the population's evolving needs while building the institutions needed for sovereign economic functioning of the envisioned Palestinian State. Such measures should also ensure a greater role for trade policy in private sector development and enhancing the Palestinian Authority fiscal balance.

22. Continuous searching for efficiencies is a natural aim of any governmental institutional growth process. In this context, institutional growth is perhaps one of the most important activities determining the development of future state capacities. Prioritizing activities is inherently a national sovereign concern; in today's economic policy environment, urgent prioritization requires a balanced view of causality behind Palestinian Authority financial weakness and the root causes of economic decline. Efficiency gains via economic restructuring far outweigh any potential for savings that can be gained from scrutinizing details of the Government's current operations.

23. In addition, to manoeuvre the economy out of its war-torn conditions, there is an essential need to

equip Palestinian decision makers with a range of policy instruments wider than that offered by the Paris Protocol. Although expanded policy space on its own cannot immunize Palestinians to the impact of occupation, empowering national institutions is essential to enhancing the private sector's resilience in the face of crisis. The search for greater policy-implementing institutions should consider alternative trade regimes with Israel, Arab countries and the rest of the world, and how export policy can improve trade performance with government support measures *influencing the environment* in which the private sector operates.

24. With less restrictive donor institutional and policy benchmarking, the Palestinian Authority can effectively be empowered to minimize its vulnerability to Israeli measures and implement employment-generating economic policies. Sequencing and shifting focus from short- to medium- and long-term needs should take into consideration the need to rehabilitate, expand and increase use of productive capacity; capitalize on the role of the small and medium-sized enterprises and informal sector; and integrate and complement sectoral-targeted public and private investments. Within this framework, unemployment reduction should be the main benchmark guarding against further social and economic deterioration.

### **III. Re-routing Palestinian trade for economic recovery**

25. As previously discussed, the Palestinian economy's development prospects are bleak under the Israeli internal and external movement restrictions. However, lifting these restrictions alone is not sufficient to salvage the Palestinian economy, unless supported by concerted efforts to strengthen the Palestinian Authority's capacity and expand its policy space with a new trade regime. Supported by appropriate policies, trade can generate incentives for income diversification and create new public revenue sources for the Palestinian Authority, which in turn will broaden the room for Palestinian fiscal policy. This chapter argues that reaping such benefits requires re-routing and reorienting Palestinian trade within the context of regional transit transport agreements, and proposes elements for guiding the Palestinian Authority in establishing such agreements.

#### **A. Imperatives for re-routing Palestinian trade**

26. Re-routing Palestinian trade gains much importance as a critical element for breaking the isolation of the Palestinian economy. This isolation is associated with the occupied Palestinian territories' landlocked status, owing to the absence of a natural seaport, not to the absence of coastal fronts. In addition, Israel's control of the main borders and transport routes renders Palestinian trade totally dependent on political considerations. It should be emphasized that re-routing Palestinian trade should be considered a second-best solution until circumstances allow for the best option, which is the construction of a Palestinian seaport in Gaza (Arnon, Spivak and Sussman, 2000).

27. At present, Palestinian enterprises are mainly dependent on Israeli port facilities for participating in international trade. On top of this, since 2000 Israel has been imposing complex security measures, including a system of checkpoints/roadblocks, and cumbersome customs and overland transport procedures at all crossing points. As a result, market access benefits are siphoned away by the prohibitive transaction costs facing Palestinian shippers (exporters and importers). This has been eroding the competitiveness of Palestinian exports, posing trade barriers of greater significance than tariffs. It is estimated that Palestinian trade-related transaction costs in 2003 were already at least 30 per cent higher than those accrued at the eve of the crisis (September 2000). Transaction costs associated with imports from Jordan were estimated at \$494 per average Palestinian shipment, and

those associated with imports from Egypt at \$550 per shipment. The costs of exporting products originating in Gaza to Jordan were estimated at \$630 per shipment (UNCTAD, 2003).

28. The imperative of re-routing Palestinian trade becomes clearer in the light of the need to re-orient the economy towards more balanced relations with Israel through further integration with Arab regional and global markets. As shown in table 2, Israel accounted for 92 per cent of the total value of occupied Palestinian territories' trade with its main partners, representing 92 per cent of total imports and 91 per cent of exports. In contrast, the occupied Palestinian territories' second bilateral trade partner, Jordan, accounted for only 2 per cent of Palestinian trade with main partners, followed by Egypt with a share of 1 per cent. At the regional level, Europe stood as the occupied Palestinian territories' main partner, with a 3 per cent share of both imports and exports. Asian non-Arab countries ranked second.

29. The reported value of Palestinian trade with the rest of the world does not include indirect imports purchased by Israeli firms and re-exported to the occupied Palestinian territories. These are registered as part of Palestinian imports from Israel, since they are declared at the source as destined to Israel. According to the World Bank (2002), Palestinian indirect imports account for one third of Palestinian imports from Israel, rendering it necessary to include these imports in the re-routing exercise.

**Table 2. Occupied Palestinian territories' main trade partners by value of trade, 2005**  
(millions of \$)

Region	Imports		Exports		Total Trade	
	\$	%	\$	%	\$	%
Israel	2 333	92	413	91	2 746	92
Jordan	40	2	16	4	56	2
Egypt	28	1	0.1	0	28	1
Remaining Arab countries	1	0.0	3	1	4	0.1
Europe	69	3	15	3	84	3
Asia, excl. Arab countries	45	2	5	1	50	2
American countries	9	0.3	5	1	14	0.5
Total trade: main partners	2 524	100	457	100	2 980	100
Grand Total	3 352		665		4 017	

*Sources:* United Nations Commodity Trade Statistics Database (UN COMTRADE). Statistics on the occupied Palestinian territories' trade with Israel are obtained from the Israeli Central Bureau of Statistics (Monthly Bulletin of Statistics).

30. Re-routing Palestinian trade to reduce dependence on Israeli transport facilities has increasingly featured in the Palestinian Authority's agenda, in response to Israeli mobility restrictions and subsequent measures to effect unilateral separation from the occupied Palestinian territories since September 2000. In 2001, upon request from the Palestinian Authority, the secretariat undertook a quantitative assessment of the costs associated with diverting Palestinian trade (exports and imports) with the rest of the world, which transits Israeli ports, through alternative regional maritime routes. The assessment recommended a framework for guiding the Palestinian Authority in establishing transit transport agreements with transit Arab countries.

## **B. Cost of re-routing Palestinian trade**

31. The secretariat's study (UNCTAD, 2003) applied a cost-benefit analysis to assess the impact of using Port Said in Egypt as an alternative transit point for trade destined to or originating from Gaza, and using the Port of Aqaba in Jordan as an alternative route for West Bank trade. It is assumed that goods destined to or coming from the Gaza Strip would be re-routed from the Israeli ports to Port Said in Egypt, while those destined to or coming from the West Bank would be re-routed to the Port of Aqaba in Jordan.

32. Tables 3 and 4 provide estimated costs (2003) of re-routing Palestinian trade with the rest of the world from Israeli ports by route, type of shipment and geographical orientation. These costs involve maritime, port and other shipping costs, and expenses related to overland transport and border crossing points. As shown in table 3, total annual costs of re-routing Palestinian trade are estimated at around \$35 million, including \$23.7 million for imports and \$11.3 million for exports. This is equivalent to \$10 per ton on average, \$8.8 per ton for imports and \$20.6 per ton for exports (table 4). The implication for Palestinian policymakers and traders is that they should diversify the re-routing process by cargo type and port, so as to reap the highest possible cost savings. For example, even under the present circumstances and cost parameters, re-routing Gaza liquid bulk imports to Port Said would reduce annual transport costs associated with this type of import by \$230,000 (table 3), and generate \$2.4 per ton in savings (table 4).

**Table 3. Estimated annual cost of re-routing**  
(millions of \$)

Type of shipment	I m p o r t s		E x p o r t s		Total
	Gaza	West Bank	Gaza	West Bank	
General cargo	4.71	9.25	0.40	7.66	22.02
Containers	4.88	1.85	0.23	0.79	7.75
Dry bulk	0.44	1.42	0.05	0.99	2.90
Liquid bulk	-0.23	1.04	0.04	1.11	1.95
<b>Total</b>	<b>9.80</b>	<b>13.55</b>	<b>0.71</b>	<b>10.54</b>	<b>34.61</b>

Source: UNCTAD (2003).

**Table 4. Estimated additional unit cost of re-routing**  
(\$ per ton)

Type of shipment	I m p o r t s			E x p o r t s		
	Gaza	West Bank	Total	Gaza	West Bank	Total
General cargo	6.7	8.7	7.9	6.7	22.9	20.5
Containers	26.4	6.7	14.5	27.8	16.7	18.4
Dry bulk	5.6	12.1	9.5	7.4	26.2	23.4
Liquid bulk	-2.4	7.2	3.4	4.5	23.8	20.9
<b>Total</b>	<b>9.2</b>	<b>8.5</b>	<b>8.8</b>	<b>8.7</b>	<b>22.7</b>	<b>20.6</b>

Source: UNCTAD (2003).

33. Yet another important feature emerging from the cost-benefit analysis is the significant share of overland transport costs in the total transaction costs accrued by Palestinian traders. The occupied Palestinian territories' poor overland transport facilities aside, the analysis reveals that around 50 to 60 per cent of these costs are associated with Israeli security measures. Moreover, overland transport costs in Jordan and Egypt were found to be significantly higher, owing to the longer distances and poor

physical infrastructures. This shortfall can be overcome with improved transport infrastructure, road networks and trade-related facilities.

34. The study highlights the fact that total annual costs of re-routing Palestinian trade could be decreased by \$19 million from its 1999 level, assuming a mere 20 per cent reduction in overland transport costs in Jordan and Egypt. The costs of containers coming via Port Said are slated for an additional 50 per cent reduction if transported via the Suez Canal Container Terminal (SCCT) <sup>1/</sup> Using this terminal would generate \$22 million in additional savings for the Palestinians per year, equivalent to an average of \$6.7 per ton, at \$8 for imports and \$6 for exports. If Palestinians re-route indirect imports through Israel, the annual savings could be doubled to \$38 million, assuming a 20 per cent reduction in overland costs, and \$44 million if SCCT is used.

35. Recent estimates by the World Bank (2007b) concur with those of UNCTAD, showing Egypt's port facilities providing services which are competitive in terms of time and quality, at costs generally equivalent to or below those associated with those of Israel. The results also show Egypt's airports as providing competitive rates to the Palestinian trading community, as well as greater frequency by permitting transport cargo on passenger aircraft. Similar to UNCTAD, the World Bank found that, in view of the lack of developed trade-related infrastructures, re-routing benefits could be offset by high overland transport costs.

36. Achieving gains from re-routing Palestinian trade requires concerted efforts at the national and regional levels to develop trade-related physical infrastructures and institutions, in addition to improving and unifying regional transit transport procedures. Activating regional transit-transport agreements will provide a common policy framework for guiding regional trade facilitation efforts and ensuring the Governments' commitment based on the principle of reciprocal treatment.

### **C. Ongoing efforts to re-route Palestinian trade**

37. Ongoing efforts to re-route Palestinian trade involve the establishment of trade corridors between the occupied Palestinian territories and their immediate neighbours Jordan and Egypt. Among the proposals under consideration by the Palestinian Authority is using the Rafah border crossing as part of a trade corridor for the transit of Palestinian trade through Egypt, with a view to providing Palestinian enterprises with direct access to the countries of the Gulf Cooperation Council (GCC), the Middle East and Europe. Advanced by the World Bank (2007b), this proposal designates the Rafah crossing point (RCP) as an entry point to Egypt, with goods transported overland along specific roads through Egypt's ports at the entrance of the Suez Canal, through Cairo International Airport and Al-Arish Airport, and through the Gulf of Aqaba to destinations in the GCC.

38. It is suggested that the establishment of the Rafah corridor should proceed within the context of a phased approach which limits initial operations to exports in transit. This is because these operations "have very limited security issues and do not impact the existing quasi-Customs union between the occupied Palestinian territories and Israel". As systems and procedures are instituted, corridor activities would be expanded gradually and in response to demand. This phased approach is highlighted as being in harmony with the terms of the 2005 Agreement on Movement and Access between the Palestinian Authority and Israel. This agreement stipulates limiting the use of the RCP for exports only and using the nearby Israeli-controlled Kerem Shalom crossing for imports from or transiting through Egypt.

39. To jump-start operations at the RCP, the Palestinian Authority and Egypt could also consider a "special arrangement" similar to that followed in 2006, featuring intensive coordination between the

Palestinian Authority and Egyptian authorities, with the participation of the European Union Border Assistance Mission at Rafah (EU BAM) as a monitoring party. Israeli security concerns could be addressed through a "cross-docking" facility for transferring Palestinian goods into Egyptian trucks. In addition, a "one-stop/single operation" could be established for document handling, with minimal additional documents for goods in transit. It is also proposed to outsource non-regulatory operations and establish a joint Palestinian–Egyptian dispute settlement mechanism that brings together representatives from the public and private sectors.

40. These arrangements need to be supported by a "transit protocol" between the Palestinian Authority and Egypt. The protocol should be consistent with the revised Kyoto Convention and incorporate a simple guarantee system, such as the "Transports Internationaux Routiers" system, to cover liability for duty on the goods if they fail to exit the country. In the long run, the corridor activities should be expanded to include imports based on appropriate protocols between Egypt, Israel and the Palestinian Authority. Rafah could also be developed to become a free trade zone, if the corridor develops as an efficient and reliable link between Gaza and Egypt.

41. However, there is the risk that RCP may operate at a capacity that does not achieve economies of scale, especially if it does not service the more significant flow of imports. Concerns have also been raised regarding the need for a commitment from Israel to guarantee the regularity and predictability of the corridor's operations. Moreover, Egyptian security concerns have yet to be adequately considered, and the EU BAM is accorded a leading role, despite the fact that it has a temporary mandate that would need to be reformulated.

42. The proposed open-ended phased approach also risks disintegrating the corridor facilities from the total transports sector and logistics chain. It is mainly focused on developing border facilities and guarantee systems, with little attention paid so far to the logistical requirements, including modern intermediary services (i.e. truck fleets and clearing agents), transport infrastructures and auxiliary services (e.g. roads, specialized banking services and insurance schemes). These services should form the focus of regional transit cooperation agreements.

43. Another re-routing option under consideration is the Joint Palestinian– Jordanian Economic Committee's proposal to develop Damya Bridge (also referred to as Prince Mohammed or Adam Bridge) between the West Bank and Jordan. The proposal is advanced as part of a broader project to establish a joint Palestinian– Jordanian industrial area on the Palestinian side of the Jordan Valley for the development of the agricultural sector and agri-industries. The project, sponsored by the Government of Japan, involves the establishment of distribution centres on the Jordanian side, and the construction of modern transport facilities for transporting Palestinian products for distribution in Jordan.

44. The Joint Palestinian–Jordanian Economic Committee's proposal complements and should be considered as a parallel step to the RCP initiative. It provides mechanisms for achieving economic recovery under the current circumstances. The industrial area, with its focus on promoting agricultural products, allows for linking relief to development efforts, given the sector's capacity to generate sustainable employment and export even under current conditions. Furthermore, the construction of modern transport infrastructures and distribution centres constitutes direct investment in regional non-border facilities. Accordingly, the Palestinian Authority could consider establishing a regional transit agreement with Jordan.

45. These proposals constitute an important step towards ending the occupied Palestinian territories'

isolation, through contributions to Palestinian trade facilitation efforts. They entail tangible measures for reducing Palestinian transaction costs, and cater to the necessity of establishing a strategic framework for guiding the re-routing process. However, much emphasis has been attached to adhering to the terms and conditions of the Agreement on Movement and Access as the reference framework for guiding the establishment of the re-routing process. This has led to a piecemeal approach overly focused on addressing Israel's security concerns to the detriment of Palestinian economic recovery. In view of the successive setbacks to hopes for renewed regional peace efforts, a sustained and expanded programme for Palestinian trade development is more imperative than ever.

#### **D. A framework for re-routing Palestinian trade**

46. The analysis shows that present efforts to re-route Palestinian trade stand to benefit from a more comprehensive approach which goes beyond the trade corridor approach to cater to the region's trade facilitation needs. This should not be understood as an attempt to achieve quantum leaps in an adverse political environment. Rather, interventions should be guided by a strategic framework that creates synergy between immediate and long-term objectives, including the commercial transport link between the West Bank and Gaza, while catering to the requirements of proper coordination at the regional level and adherence to international best practices. Also needed is a shift in the debate from security issues to ensuring the secure flow of trade across the region, and the establishment of bilateral and regional coordinating structures for dealing with security issues.

47. The strategic framework should be situated within a context of regional transit transport agreements that aim at establishing modern logistics services to connect the occupied Palestinian territories with neighbouring Arab countries. In particular, the agreements should include provisions for (a) infrastructure upgrades along the core corridors (road, rail and ports) and border crossing areas; (b) improving the efficiency and effectiveness of border control agencies and government transport-related agencies; (c) optimizing information flows among border agencies, across borders, within border agencies, and between those agencies and traders or transport operators; and (d) building the capacities of the private sector to provide logistic services.

48. The focus of these agreements should be on reducing the differences between national conditions governing transit trade across the region, including laws, administrative requirements, technical standards and commercial practices. Successful development experience shows that transit agreements should motivate member countries to operate simultaneously at three levels. At the highest level, neighbouring countries could consider subscribing to multilateral agreements and international conventions. At the middle level, these procedures could be embodied in bilateral agreements. Finally, at the level of individual transport organizations, there could be arrangements between neighbouring organizations for joint operations and associated facilities designed in harmony with global standards and regional specifications.

49. There is an evident need for a regional system vested with an overall mandate to integrate and coordinate the regulation, planning and management of the different elements of trade-supporting infrastructure. However, with so many bilateral and subregional arrangements already established, it would be inappropriate to propose yet another institution. Rather, efforts should focus on strengthening and rationalizing existing institutions as needed, with expertise and clear methods of inspection and enforcement. The Palestinian Authority and its transit neighbours might also consider establishing a coordinating committee at a senior level to assume the task of supervising the design of transit transport agreements.

50. For the Palestinian Authority, the following measures appear to be top priorities: (a) upgrading the transport fleet; (b) opening "safe passage" between Gaza and the West Bank; (c) establishing, at or near the border crossings, modern facilities such as warehouses, quality control laboratories, insurance companies, banks, post offices, parking and rest houses; and (d) establishing bonded houses at the border crossings. Many of these measures could be implemented even under present conditions. Of course, the support and involvement of the international and donor communities for the implementation of these priorities cannot be overemphasized. The Palestinian Authority could also consider constituting a national forum on trade facilitation which brings together all relevant parties in an ad hoc working group format to perform specific tasks. Such a forum could be mandated with the tasks of informing decisions on transit transport agreements and developing a national strategy for facilitating Palestinian trade.

## **IV. Milestones in UNCTAD assistance to the Palestinian people**

51. With a view to bolstering Palestinian public and private institutional and policymaking capacity and supporting the development and growth of the private sector, the UNCTAD programme of technical assistance to the Palestinian people is designed to achieve specific national objectives within four clusters: (a) development strategies and trade policy; (b) trade facilitation and logistics; (c) public finance modernization and reform; and (d) enterprise, investment and competition policy.

52. The programme is selective and flexible, so as to ensure responsiveness to the Palestinian people's evolving needs. Since 2001, and in close consultation with the Palestinian Authority, this has involved relevant activities aimed at achieving the objective of linking relief to development, drawing on the results of the secretariat's research work and inter-governmental consultations. UNCTAD has also continued to liaise closely with relevant international organizations to ensure a system-wide approach – including the United Nations Development Programme, United Nations Relief and Works Agency for Palestine Refugees, United Nations Special Coordinator for the Occupied Territories, United Nations Economic and Social Commission for Western Asia (UN-ESCWA), International Labour Organization (ILO) and the World Bank – as well as member States, research centres and civil society institutions.

53. Drawing on the experience of the secretariat as a whole, the programme is managed by the Assistance to the Palestinian People Unit, which relies on voluntary contributions by bilateral, multilateral and United Nations system funding sources for financing technical assistance activities. In line with the United Nations 2006–2007 Strategic Framework and paragraph 35 of the São Paulo Consensus, and to ensure the intensification of assistance called for under the Bangkok Plan of Action, a special arrangement was made to retain the third professional staff member attached to the unit since 2001. This has enabled the secretariat to achieve significant progress in 2006–2007, as it continues to develop its selective and flexible operational mode to circumvent the extremely adverse field conditions.

54. With funds from the European Commission (EC), UNCTAD technical assistance activities in the area of public finance and modernization are expected to enter a new phase with the launching of *ASYCUDA (Automated SYstem for CUstoms DAta) Phase I*. The project will see the complete rollout of the ASYCUDA++ system over three years to serve as the backbone of the modernized Palestinian Customs and Border Management. Main activities involve the introduction of tailor-made components for risk management and selectivity, along with ASYCUDAWorld, which will allow Palestinian Customs to join the world of e-customs. The project national team will be further strengthened with technical and functional training to facilitate complete national ownership by the end of project

implementation, and ensure technical self-sufficiency in future system enhancement and operation.

55. UNCTAD was also requested by the Palestinian Authority Ministry of Finance to support the ongoing preparations for observer status for Palestine at the World Customs Organization (WCO). UNCTAD will assist the Palestinian Authority in preparing the request for observer status, including a needs assessment in the area of capacity development. The secretariat will also participate in the design and possible implementation of a technical assistance project to strengthen Palestinian customs capacity in preparation for Palestine's eventual accession to WCO.

56. The secretariat is actively involved in supporting Palestinian public and private sector capacity-building efforts. Within this context, UNCTAD has been requested by the Government of Indonesia, as the host of the 2005 Asia–Africa summit, to assist in the preparations for a ministerial meeting to be convened in Jakarta within the context of the New Asian–African Strategic Partnership. The conference will explore tailor-made technical assistance activities by Asian and African countries to meet Palestinian capacity-building needs. The secretariat will also pool efforts with UN-ESCWA to design a framework for informing Palestinian public and private sector capacity-building efforts in the areas of public finance and development strategies, trade policy and trade facilitation, and investment promotion and enterprise support institutions and development.

57. UNCTAD activities in the area of trade facilitation and logistics intensified in 2007. The secretariat was approached by Palestinian Customs and Border Management, in cooperation with concerned donor agencies (EC), to contribute to the ongoing efforts to re-route Palestinian trade. In this context, an UNCTAD expert mission to Egypt in June 2007 advised the Palestinian Authority in discussions with the Egyptian authorities concerning the use of the RCP as a trade corridor for Palestinian exports originating from Gaza. The secretariat was called upon to consider facilitating quarterly meetings between the Palestinian Authority and Egypt within the context of the ASYCUDA project. The secretariat will assist the two parties in setting out the main principles for guiding the establishment of a bilateral transit agreement, and in ensuring proper implementation of agreed measures.

58. Furthermore, steady progress has been made under the EC-funded establishment of the Palestinian Shippers' Council (PSC) project. The PSC has a growing membership, with more than 200 shippers from across the Palestinian territory. They benefit from the PSC's tailor-made training services and advice on daily problems. The PSC's technical conference in January 2007 consolidated these achievements, bringing together 185 Palestinian shippers and public and private stakeholders for a one-day interactive dialogue with national and international experts on solutions to the complex Palestinian trade facilitation problems. In June 2007, the Constituting Assembly of the legally-constituted PSC was convened and elected the council's first board of directors.

59. However, recurrent funding shortfalls have forced UNCTAD to suspend planned activities for the Support for Small and Medium-Sized Enterprise (SME) Development (EMPRETEC Palestine) programme. Completing and sustaining this programme in the West Bank, extending it to Gaza and ensuring full national ownership require support from the donor community.

60. The secretariat may also not be able to implement activities planned for the Investment Retention Programme. With funding from the Government of Norway, the design of this programme began in late 2004, and is presently in its final stages. The proposed follow-up project involves introducing and operationalizing the investment retention strategy in cooperation with the Palestinian Investment Promotion Agency. However, without continued donor support, implementation of the programme remains uncertain.

61. Also with funding from the Government of Norway, significant progress has been achieved under the Capacities in Debt Monitoring and Financial Analysis project, with the introduction of new components in 2006. This involved assisting the Ministry of Finance in bridging the budget to the development plan through the medium-term expenditure framework. However, project components in Gaza, including capacity-building for Palestinian Authority staff, experienced delay, owing to the deteriorating security conditions. The donor has decided to freeze the remaining funds allocated to UNCTAD to finance project activities, and it is not clear if planned activities can be completed.

62. The ability of UNCTAD to capitalize on the above-mentioned achievements continues to be undermined by mobility restrictions affecting field access of UNCTAD staff, experts and project personnel. This is especially the case for Gaza-based projects. The lack of predictable extrabudgetary resources constitutes another impediment, rendering it difficult to respond to the emerging needs generated by the crisis. This risks further weakening the institutional capacity needed for the envisioned Palestinian State, and contrasts with the requirements of enhancing the private sector's resilience and its role in development.

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\*\* The information in this document should not be quoted by the press **before 30 August 2007**.

1/ The terminal is located to the north-east of the Suez Canal. It services third-generation vessels carrying 2,000 to 3,000 containers. It has been operational since October 2004, and uses modern technologies and multi-mode transport systems. Further details can be found on the SCCT website: <http://www.scctportsaid.com>.