

Unlocking the Trade Potential of the Palestinian Economy

Immediate Measures and a Long-Term Vision to Improve Palestinian Trade and Economic Outcomes



Report No: ACS22471



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The Palestinian economy is severely hampered by trade-related restrictions, high logistics costs, cumbersome procedures and institutional inefficiencies. Operating within an uneven Customs Union arrangement with Israel, the Palestinian economy has accumulated an enormous trade deficit and overdependence on Israel's economy and has neither been able to develop dynamic export-oriented sectors nor to tap into larger and more competitive third markets. Over the years, this situation has contributed to slow growth, high unemployment, and stubborn persistence of poverty in the Palestinian economy. A bold reform agenda is urgently required to improve the Palestinian economy's trade outcomes. Immediate steps should be taken to reduce the burden of existing trade-related restrictions and transaction costs. The Palestinian economy should also begin the transition toward an autonomous trade regime, and be able to exercise control over its own customs territory, in line with its long-term economic interest. It should retain an open trade regime and develop its links with overseas markets. The economic relationship with Israel should be recast in a manner that is comprehensive and exploits the large synergies that exist between the two economies. Such a course will provide the Palestinian Authority with some of the tools and incentives to undertake far-reaching structural reforms. The proposed reform agenda will neither be a simple endeavor nor will it alone determine the success or failure of the Palestinian economy. This note proposes ideas that could, in the fullness of time, and with the assistance of international donors help overcome existing dysfunctions and improve trade-related economic outcomes in the Palestinian economy.

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ACRONYMS AND ABBREVIATIONS



AHS	effectively applied tariffs (Harmonized System) in preferential trade agreements
BoI	Bank of Israel
CLA	Coordination and Liaison Administration
COGAT	Coordination of Government Activities in the Territories
CU	customs union
DUG	dual-use goods
ECA	Eastern Europe and Central Asia
EU	European Union
EPA	economic partnership agreement
FTA	free trade agreement
GAFTA	Greater Arab Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
GoE	Government of Egypt
GoI	Government of Israel
GoJ	Government of Jordan
GPS	global positioning system
GRM	Gaza Reconstruction Mechanism
HS	Harmonized System
ICT	information and communication technology
IMF	International Monetary Fund
Km	kilometer
MENA	Middle East and North Africa
MFN	most-favored nation
Mm	millimeter
NES	National Export Strategy
NIS	new Israeli shekel
OECD	Organisation for Economic Co-Operation and Development
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics

TEU	20-foot equivalent units
UNCTAD	United Nations Conference for Trade and Development
UNOPS	United Nations Office for Project Services
US\$	United States dollar
UN Comtrade	United Nations Commodity Trade Statistics Database
VAT	value-added tax
WA	Wassenaar Arrangement
WB	West Bank
WITS	World Integrated Trade Solutions database
WTO	World Trade Organization

Currency Equivalents

(As of December 2016)

Currency Unit US\$1 = 3.83 NIS

Weights and Measures

1 dunum = 1,000 m² = 0.247 acre

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EXECUTIVE SUMMARY



Under the strain of pervasive restrictions on the movement of people and goods, high trade logistics costs, and without many of the instruments and freedom to conduct an independent economic policy, the Palestinian small and trade-reliant economy is falling behind that of its regional peers. The Palestinian economy is failing to provide rising living standards and sufficient jobs adequately and sustainably for its people, and has not established a sound financial base for the provision of public services and for the purchase of essential imports from abroad. The Palestinian economy's exports of goods and nonfactor services as a share of GDP are less than half those of a comparable group of countries, and its trade deficit as a share of GDP is more than double those of comparable countries; at 41% it is one of the highest, or the highest, in the world.

Various estimates of the impact of easing trade and other ongoing restrictions on the normal functioning of the Palestinian economy show the potential for significantly improving economic conditions, growth, jobs and trade. A companion World Bank report suggests that, based on a general equilibrium model, **the removal of restrictions, including improved access to all the Palestinian economy's natural resources found mainly in Area C, could triple the economy's growth rate by 2025** to growth rates in the 8–10% range and vastly reduce unemployment. Such growth rates would enable the Palestinian economy to roughly double in size between 2017 and 2025. Easing the extreme restrictions on trade in the Gaza strip would help rebuild its infrastructure and restart the economy, and could lead to additional cumulative growth in the range of 32 percent by 2025. **Relaxing the procedures under the dual use list, and rationalizing the list, alone would have a substantial growth impact on the West Bank and an even larger one on Gaza (i.e., an increase in cumulative growth of 6% and 11% respectively, by 2025).** Moreover, a gravity model of trade between the Palestinian economy and the rest of the World would suggest that, based on its size, income and proximity to large markets such as Israel, Italy and the Gulf States, **Palestinian exports could be twice their current levels, with a large impact on national income—also enabling increased imports.**

The underperformance of the Palestinian economy has important bearing on the region. To start with, Israelis are deprived of a dynamic and cost-effective trading partner at their doorstep, are incurring large direct and indirect costs, and are falling far short of achieving a mutually beneficial relationship with the Palestinian economy. Budget-constrained international donors, facing multiple challenges elsewhere in the Middle East and North Africa (MENA) region and around the world, see little prospect that their large aid contributions to Palestine will pay off in terms of political and social stability and sustained reduction in poverty.

A bold reform agenda is urgently required to exploit the potential of Palestinian trade. The Palestinian economy operates within a customs union (CU) regime with Israel, formalized by the Oslo Accords (and minor adjustments in the Oslo II Accord) and the ensuing Paris Protocol on Economic Relations in 1994. The CU was devised as a transitional format to take the Palestinian economy from where it had been in 1967–94, a dependent element of the Israeli economy, toward greater economic sovereignty in the context of increased stability and peaceful relations. However, as restrictions mounted, separation barriers were erected and trade costs soared, and the CU effectively broke down. Even though no tariff walls separate the markets of the Palestinian and Israeli economies today, physical walls, bureaucratic processes, various nontariff barriers such as standards and licenses, and checkpoints do, and the transaction costs of crossing these barriers are high enough to severely restrict and distort trade—rendering the CU an uneven arrangement vis-à-vis Israel, entrenching Palestinian dependence and market captivity.

Measures addressing well-known impediments to trade should be implemented as soon as possible. These include: eliminating existing trade restrictions and reducing their burden, improving the trade logistics infrastructure, alleviating cumbersome procedures, and fostering the capacity and transparency of trade-related institutions. Some of the measures are solely under Palestinian control, some require cooperation between the Palestinian Authority and the Government of Israel, while others entail unilateral Israeli actions. In all cases, success will hinge on a renewed economic partnership with Israel—reflecting Palestinian economic interests—and the support of the international community.

The Palestinian economy should also begin the transition toward a reformed trade regime, in line with its economic ambition, and as part of a broader political agreement with Israel. This vision would entail the Palestinian Authority having effective control over its customs territory eliminating the restrictions imposed by Israel. Control over the custom territory represents an essential building block for an independent trade policy and—since border duties represent the largest part of the Palestinian Authority fiscal revenue—ultimately, for developing a viable fiscal policy in the Palestinian economy. Such a course will also provide the Palestinian Authority with some of the tools and incentives

to undertake far-reaching structural reforms. This transition would include the Palestinian Authority's ability over time to autonomously exercise effective control of its borders, set and collect value-added tax (VAT), excise taxes and import tariffs, and set and enforce sanitary and phytosanitary as well as industry standards.

A careful evaluation of the pros and cons of alternative trading arrangements between Israel and a separate Palestinian customs territory concludes that the best course is to move toward a new comprehensive agreement on economic relations. Such an arrangement would replace the outdated Paris Protocol; would include a formalized, bilateral agreement on labor movement, transit of goods, and subsequent cooperation on energy, water utilities, infrastructure, and other areas; and would also include but go beyond a narrow free trade agreement (FTA). It is desirable and possible to gradually reduce the Palestinian economy's extraordinary and partly artificial dependence on Israel. This can be achieved by undertaking a set of reforms that improve the Palestinian economy's ability to compete and to integrate much more effectively with the rest of the world, without severing its many ties with Israel. In a scenario of more conventional arm's-length economic relations, ties with Israel can facilitate, rather than impede, the Palestinian economy's integration with the rest of the world. Indeed, given the existing deep integration between the two economies, a sharp and sudden reduction in their exchanges would probably trigger a dangerous economic crisis, whose magnitude could match some of the worst crises currently observed in other parts of the MENA region.

The proposed reform agenda will neither be a simple endeavor nor will it alone determine the success or failure of the Palestinian economy. Without more conventional and constructive economic ties between Israelis and Palestinians, and the continued support of the international community, it is doubtful that the Palestinian economy can develop satisfactorily, whatever the trade regime—whether an improved CU, a preferential FTA with Israel, or one based on arm's-length nondiscriminatory trade relations under the World Trade Organization (WTO). However, after 22 years of failure and given the deteriorating social and economic conditions, it is clear that existing trade arrangements must be reexamined, and the efforts to alleviate the trade constraints should be intensified. This note intends to propose ideas that could, in the fullness of time and with the assistance of international donors, help everyone overcome these obvious dysfunctions.

The analysis and recommendations are intended to support consultations with public and private Palestinian and Israeli stakeholders. Such consultations will be required to confirm the nature and desirability of the immediate measures and long-term vision, and to identify in greater detail the steps, means, and responsible institutions required to implement the reforms.

1. INTRODUCTION: MOTIVATION AND STRUCTURE

Under the strain of pervasive restrictions on the movement of people and goods, high trade logistics costs, and without many of the instruments and freedoms to conduct an independent economic policy, the Palestinian small and trade-reliant economy is falling behind that of its regional peers. It is failing to provide rising living standards and sufficient jobs adequately and sustainably for its people, and has not established a sound financial base for the provision of public services and for the purchase of essential imports from abroad. Meanwhile, Israelis are deprived of a dynamic and cost-effective trading partner at their doorstep, are incurring large direct and indirect costs,¹ and are falling far short of achieving a mutually beneficial relationship with the Palestinian economy. Budget-constrained international donors, facing multiple challenges elsewhere in the MENA region and around the world, see little prospect that their large aid contributions to the Palestinian economy will pay off in terms of political and social stability and sustained reduction in poverty, and have reduced aid to the Palestinian Authority in recent years.

The Palestinian economy is a small, open economy that relies heavily on international trade. It operates within a CU² regime with Israel, and as formalized by the

1. Israel's defense costs as a share of gross domestic product (GDP) have declined, but are still about double those of the Organisation for Economic Co-operation and Development (OECD) average. This estimate includes only direct costs; indirect costs, including the cost of long compulsory service, among others, are much larger. Though the direct costs of occupation are significant, its end would not necessarily lead to a large decline in Israeli defense spending. However, insofar as the end of occupation would result in an easing of regional tensions and in a collaborative relationship between Palestine and Israel, large reductions in defense spending over time would become possible. See, for example, Arnon and Bamyá (2015).

2. The regime is not, strictly speaking, a full customs union, since Palestinians are permitted to establish their own tariffs on a small list of products, including (1) List A1, comprising imports from Egypt and Jordan (subject to quota restrictions); (2) List A2, mainly agricultural products, which can be imported from any country (subject to quota restrictions); and (3) List B, capital goods and equipment and parts, inputs, and pharmaceutical products (subject not to quotas, but to Israeli standards) (Appendix 1). While the Palestinian Authority is entitled to negotiate its own separate trade agreements with third countries, in practice both its legal and de facto room for applying tariffs different than Israel's is very limited. Moreover, Israel does not recognize these agreements in practice, and the aforementioned lists have not been modified over many years; thus, they now account for very little trade. For these reasons, the rest of this note will refer to the present arrangement as a customs union *tout court*.

Paris Protocol on Economic Relations in 1994.³ The Paris Protocol was explicitly written as a transitional 5-year arrangement, to take the Palestinian economy from where it had been during 1967–94 (that is, a fully integrated and dependent element of the Israeli economy) toward greater economic autonomy. However, the Protocol was never completely implemented as envisaged, and its implementation has been distorted by Israeli unilateral actions.

The Paris Protocol reflected the preexisting de facto CU—with Israel in full control of borders—and established procedures for customs revenue collection and distribution. It also covered the establishment of a tax regime in which VAT levels are equal or nearly equal and a means of transfer of a proportion of income tax collected by Israel from Palestinian workers to the Palestinian Authority. Under the signed Paris Protocol, the Palestinian Authority was to have autonomy over the import of selected goods from neighboring states. These goods were summarized in three lists numbered A1, A2, and B (Appendix 1), which were formulated recognizing Palestinian market demands and the ability of the Arab states to supply those goods back in 1994. There were minor adjustments to these lists in 1999, but they otherwise remain unchanged. Under the terms of the agreement, constraints on trade in agriculture were to be gradually lifted, and the Palestinian Authority was to set up its own food safety (sanitary and phytosanitary standards) on goods included in lists A1 and A2, while abiding by international practice, with mutual recognition of standards once the Palestinian Authority had developed technical competence in that area.

Although intended as a mechanism to gradually enhance Palestinian economic autonomy, the CU regime has formalized the preexisting economic asymmetry and its administration has been overtaken by unilateral Israeli actions and restrictions, leading to exorbitant logistics costs. In the years following 1967 and during a number of relatively peaceful intervals since then, a surge in trade and in the movement of Palestinian workers became possible under the de facto CU regime, with large benefits from these exchanges accruing to both Palestinians and Israelis. However, these peaceful intervals did not last. As restrictions mounted, separation barriers were erected and trade costs soared, and the CU effectively broke down.⁴ Even though no tariff walls separate the markets of the Palestinian and Israeli economies today, physical walls, bureaucratic processes, and checkpoints do, and the transaction costs of crossing these barriers are high enough to severely restrict and distort trade. The effect is that Israel effectively has assumed

3. The Paris Protocol was an Annex to the 1993 Oslo Accords, with subsequent minor adjustments in 1995 (Oslo II). The entire Oslo Accords structure was expected to last for five years, after which the Palestinian Authority and the Government of Israel would establish more independent functioning.

4. As with many of the other technical issues covered by the Oslo Accords, the Paris Protocol established a joint committee to resolve any conflicts, to adjust the levels of taxation, and so forth. This committee system soon broke down in the context of more extensive difficulties in political relations and outbreaks of violence.

the power to unilaterally set VAT levels that the Palestinian Authority has to comply with, set tariffs on imports, and transfer or withhold due payments on duties and income tax collected. Israeli standards are applied to all imports to the Palestinian economy except for goods on lists A1 and A2, with testing under Israeli control.

This policy note examines the Palestinian economy’s trade-related economic outcomes, identifies measures to alleviate trade constraints and proposes an alternative long-term vision for its trade regime. Navigating within a most challenging external and internal environment, the analysis and recommendations are intended as input to policy making, with the ultimate objective of reducing poverty and unemployment and also paving the way for a sustained rise of living standards in the Palestinian economy.

This note is structured as follows:

- » **The first section examines the performance of the Palestinian economy as determined by its current trade relationship with Israel and the rest of the world.** This section highlights the failure to establish a viable Palestinian export sector, and in so doing, provides a capsulized diagnosis of the impediments to Palestinian development and, more narrowly, to its trade. We then review the economic mechanisms that have made the Palestinian economy excessively and artificially dependent on Israel’s economy.
- » **The second section reviews immediate measures aimed at improving the Palestinian economy’s trade-related economic outcomes.** These measures relate to well-known impediments to Palestinian trade, which should be addressed as soon as possible, and foster trust among the Palestinians and Israelis for further and deeper reforms down the line. These include: reducing the burden of existing restrictions, improving the trade logistics infrastructure, alleviating cumbersome procedures, and fostering the capacity and transparency of trade-related institutions. Specific recommendations include revising the special goods lists, revising the dual-use goods (DUG) lists and processes, ensuring the compatibility of industrial standards and their efficient management, facilitating flows across border crossings, and reducing costs through containerization. Some of the measures are solely under Palestinian control, some require cooperation between the Palestinian Authority and the Government of Israel, while others entail unilateral Israeli actions. In all cases, success will hinge on a renewed economic partnership with Israel—reflecting the Palestinian economic interests—and the support of the international community.
- » **The third section examines options for a reformed trade regime in the Palestinian economy that could be part of a broader political agreement with Israel.** It presents a renewed vision that goes beyond the Paris Protocol and that could help establish a sounder basis for sustained growth and a more workable framework for economic relations with Israel, as well as improved trade relations

with regional and more distant trading partners. This section argues for the Palestinian Authority to gain effective control over its customs territory as an essential building block to exercise an independent trade and economic policy, evaluates the pros and cons of alternative trading arrangements between Israel and the Palestinian customs territory, and proposes the key features of a new comprehensive arrangement on economic relations. The note recognizes the fraught politics entailed by the delineation of borders. For example, crossings that are located east of the Green Line are regarded by the Palestinian Authority as being politically unacceptable. However, such a renewed trade framework, as long as there are sufficient assurances that it would be in effect a temporary solution without prejudice to border delineation, would be consistent with the aspirations for greater Palestinian economic sovereignty in the context of increased stability and peaceful relations with Israel.

- » **The concluding section discusses the sequencing of proposed reforms and next steps.** There is no claim that assuring the Palestinian Authority the conditions to exercise full control over its custom territory and renegotiating a comprehensive agreement on economic relations would likely prove to be quick or easy, nor even that these measures would be ensured of success. But, as we argue in this note, unless the parties are willing to tolerate rising unemployment, the Palestinian Authority is willing and able to engage in more budget cuts, or the Palestinian Authority is willing to become even more dependent on international donors (and they agree to increase their aid), or the parties are willing to run the risk of new outbreaks of violence, a different approach must be tried.

This note recognizes that recommended trade-related reforms alone will not determine the success or failure of the Palestinian economy. This is particularly so, given the extremely challenging external environment and deteriorating socio-economic conditions. Without more conventional economic ties between Israelis and Palestinians entailing a significant reduction if not complete elimination of Israeli imposed restrictions to trade, it is doubtful that the Palestinian economy can develop satisfactorily, whatever the trade regime—whether a CU, preferential FTA with Israel, or one based on nondiscriminatory trade relations under the WTO. The converse is not necessarily true however: under a scenario of more typical economic relations, the trade regime matters greatly. There can be very good reasons to prefer, for example, an FTA between Israel and the Palestinian economy to a CU, to adopt a more or less open trade regime, and to include in or exclude from the agreement regularized movement of Palestinian workers. In fact, these are precisely the kinds of questions at the heart of the Brexit debate currently dominating international headlines. Given the fraught political context, the recommendations in this note may be viewed by some on both the Israeli and the Palestinian sides as unwelcome and premature, if not overreaching. However, after 22 years of failure, and given deteriorating social and economic conditions, it is clear that the trade arrangements under the

Paris Protocol must be reexamined, and the efforts to alleviate the resultant existing constraints should be intensified. This note intends to propose ideas that could, in the fullness of time, help everyone overcome these obvious dysfunctions.

The analysis that follows builds on a wide range of previous work conducted by the World Bank, the International Monetary Fund (IMF), the Palestinian Authority, and many prominent Israeli and Palestinian researchers, as well as think tanks inside and outside the region. Researchers have already painstakingly documented the Palestinian economy's extraordinarily high trade costs, have modeled the effects of different arrangements under alternative assumptions, and have envisaged a variety of possible futures. Indeed, even though the Palestinian economy is a small economy, the appropriateness of its macroeconomic framework and of its trade regime is now among the best researched issues in contemporary economic policy. This note aims to interpret this large body of work and to draw out its implications based on recent data. The note also draws on extensive interviews we have conducted with interested parties, and is based on the latest available economic and demographic projections. The analysis and recommendations are intended to support consultations with public and private Palestinian and Israeli stakeholders. Such consultations will be required to confirm the nature and desirability of the short-to medium-term measures and long-term vision, and to identify in greater detail the steps, means, and responsible institutions required to implement the reforms. (See Table 9 on the proposed staging of reforms.)

2. THE PALESTINIAN TRADE PERFORMANCE: A DIAGNOSIS

This section analyzes the performance of the Palestinian economy as determined by its current trade relationship with Israel and the rest of the world. We begin by highlighting the failure to establish a viable Palestinian export sector, and in so doing, provide a capsulized diagnosis of the impediments to the development of the Palestinian economy and, more narrowly, to its trade. We then review the economic mechanisms that have made the Palestinian economy excessively and artificially dependent on Israel's economy.

2.1 THE PALESTINIAN ECONOMY: THE IMPORT ECONOMY

The underperformance of the Palestinian economy can be illustrated in three main ways. First, according to World Bank data, the Palestinian economy's per capita income growth rate has failed to match that of its nonoil-exporting Arab comparators by a significant margin (World Bank 2016b). Thus, between 1997 and 2015—a period that includes the years of the Arab Spring, the Second Intifada, the takeover of Gaza in 2007, and the Gaza wars in 2012 and 2014—real income per capita grew at 1.8 percent in the Palestinian economy, while it grew at rates of 1.9 percent in Jordan, 2.4 percent in Egypt, 2.6 percent in Tunisia, and 3.2 percent in Morocco. Over this period, the Palestinian economy's income per capita growth barely exceeded that of Israel (whose real per capita income grew at 1.6 percent a year), indicating that there was very little catch-up with its much richer neighbor, despite the high degree of integration. The Palestinian economy's growth rate has also been extremely volatile, sometimes exhibiting variations in the range of plus or minus 5 percent a year or more, making any point-to-point comparison unreliable (Astrup and Dessus 2001; World Bank 2002; Dessus 2004).

Second, and perhaps more meaningful, in 2015, the Palestinian economy's GDP per capita, adjusted for purchasing power, was less than half that of its comparators, such as Jordan, Egypt, and Tunisia. The comparison with neighboring Jordan is particularly striking since the Palestinian economy's GDP per capita was roughly the same

during 1994 to 2000 prior to the First Intifada and the tightening of restrictions, and there is little evidence that the quality of the domestic business environment in Jordan is markedly different than that of the Palestinian economy.⁵ These outcomes also contrast sharply with the Palestinian economy's higher share of people in tertiary education than people in Egypt and Tunisia, and also with its health indicators, which are comparable across the sample. The Palestinian economy's low GDP per capita is closely related to low labor productivity, but also reflects low productivity of capital and land. For example, agriculture employs 11 percent of the working population in the Palestinian economy, compared with 1.7 percent in Jordan, yielding 0.6 metric tons of produce per dunam compared with 1.7 metric tons per dunam in Jordan, and the return per full-time-equivalent worker is US\$5,700 compared with US\$16,700, respectively.⁶

Third, even though the latest official poverty rate figures for the Palestinian economy (25.8%) date back to 2011 (PCBS 2011b),⁷ various correlates such as employment (on which more recent data are available) indicate that poverty levels have increased over recent years. The situation is much worse in Gaza than in the West Bank, especially in the wake of the war in 2014, but per capita income in the Palestinian economy as a whole had been in decline, even in 2013 and 2014 before the war began.

Examining the performance of the Palestinian economy more closely raises serious doubts with regard to its sustainability. At the very least, looking forward, it is difficult to see a sustained acceleration of economic growth and reduction in unemployment. The Palestinian economy, as we discuss further in this note, has a very small export sector and depends approximately equally on three main sources for foreign currency: (1) Palestinian unskilled and semiskilled workers in Israel, (2) workers in third countries (mainly skilled workers in the Gulf States), and (3) foreign aid. These three sources account directly for about 30 percent of Palestinians' income and, indirectly, drive a much larger share of the Palestinian economy's GDP. Yet, Israeli policies and low oil prices in the Gulf will continue to dampen demand for Palestinian workers, and this revenue flow remains subject to considerable uncertainty because of the risk of closures in Israel and the vagaries of oil markets. Meanwhile, donors (which include Gulf countries) have to contend with tighter budgets and pressing new demands from countries that are receiving a large flow of refugees, explaining why aid flows have been on a sharply declining path since the outbreak of the financial crisis. Funds for reconstruction in Gaza are running far behind pledges and will, at best, rebuild only part of the territory's depleted capital stock.

5. See World Bank (2017) "Palestine—Prospects for Growth and Jobs: A General Equilibrium Analysis."

6. See Office of the Quartet Representative (2014) "Initiative for the Palestine Economy: Summary Overview."

7. See PCBS 2011b. Poverty Rates of individuals in the Palestinian Territory (25.8%), West Bank (17.8%) and Gaza Strip (38.8%). http://www.pcbs.gov.ps/site/lang__en/881/default.aspx

Accordingly, in its fiscal projections, the IMF assumes that the Palestinian economy will—in the absence of major shocks—grow at just 3 percent a year up to 2020, barely above the rate of population growth (IMF 2015b). A more recent World Bank model projection suggests that growth could be even lower.⁸ All projections are to be treated with care, but it is noteworthy that, should they prove to be in the ballpark, these forecasts imply a rate of growth entirely insufficient to provide jobs for the Palestinian economy’s rapidly increasing labor force.⁹ A 2016 report by the Prime Minister’s Office and the United Nations Population Fund¹⁰ projects that the total size of the population in the Palestinian economy would double from 4.75 million in 2015 to 6.9 in 2030 and to 9.5 million in 2050, whereas the active-age population (those older than 15) would grow from 2.9 million in 2015 to 7.2 million in 2050 (thus a multiplication by 2.5). Accordingly, the number of jobs that should be created each year will increase from 58,000 in 2015 to 76,000 in 2035–40. Assuming very modest labor productivity growth of 2 percent a year—about half that registered by developing countries over 2000–2014 (McGowan et al. 2015)—absorbing these workers would require a growth rate double that projected by the IMF. Even then, growth would not be sufficient to reabsorb the existing large cohort of unemployed workers—currently 26 percent of the total (Gaza Strip and West Bank) labor force—nor would it address the need to provide for a rise in the extremely low labor participation of the Palestinian economy’s increasingly well-educated women.

The reasons for the Palestinian economy’s underperformance are multiple, and have been analyzed in depth in several preceding reports. It is important to understand that the shortcomings in trade performance are symptoms of deeper problems, and although reforming the trade regime can help, merely changing it will not cure the disease. According to the latest IMF (2015b) estimates, Palestinian exports of goods and nonfactor services accounted for just 18.3 percent of GDP in 2015, while imports of goods and nonfactor services amounted to 59.2 percent of GDP, implying an external trade deficit of 41.1 percent of GDP—one of the highest, if not the highest, in the world. Comparing the Palestinian economy with a sample which includes 10 other economies of similar size and GDP per capita and Jordan (whose GDP is three times larger) reveals that while the Palestinian economy’s imports as a share of GDP are in line with the median, its export share of GDP is less than half the median and its trade deficit in goods and nonfactor services is over twice the median. (see Table 1). A preliminary gravity model analysis carried out by the World Bank trade team in 2017 would suggest that, based on its size, income and proximity to large markets such as Israel, Italy and the Gulf States, the Palestinian economy’s

8. See World Bank (2017) “Palestine—Prospects for Growth and Jobs: A General Equilibrium Analysis.”

9. It is also noteworthy that projections made by the United Nations Conference on Trade and Development (UNCTAD) a decade ago covered some of the same ground as this assessment and predicted, correctly, a dim growth outlook for the Palestinian economy (UNCTAD 2006, 2007).

10. Prime Minister’s Office, State of Palestine and United Nations Population Fund, UNFPA. 2016.

TABLE 1: Comparison of the Palestinian Trade Outcomes

Country	GDP (2015 US\$ million)	GDP PPP per capita (US\$)	Exports of Goods and Services, (US\$ million)	Imports of Goods and Services (US\$ million)	Trade Balance/ GDP	Export of Goods and Services/ GDP	Import of Goods and Services/ GDP
Palestinian territories	12,680	5,080	2,322.7	7,501.7	-0.41	18%	59%
Median	12,686.5	8,611	4,937.3	7,263.9	-0.185	37%	57%
Albania	11,393	11,284.4	3,104	5,069.4	-0.17	27%	44%
Armenia	10,529	8,492	3,137.4	4,418.4	-0.12	30%	42%
Bosnia	16,251	4,206.6	5,603.8	8,625.9	-0.19	34%	53%
Georgia	13,996	9,600.8	6,288.4	9,062.4	-0.2	45%	65%
Honduras	20,729	5,093.8	9,520.5	13,059.3	-0.17	46%	63%
Jamaica	14,218	8,771.9	4,250.8	6,441.4	-0.15	30%	45%
Jordan	37,517	8,730	13,362	23,495	-0.27	36%	63%
Moldova	6,496	1,828.3	3,568.3	5,817.9	-0.35	55%	90%
Mongolia	11,718	1,2178.5	5,283.8	4,943.5	0.03	45%	42%
Namibia	11,497	1,1224.4	5,121.5	7,885	-0.24	45%	69%
Nicaragua	12,693	5,200.3	4,753.1	7,026.1	-0.18	37%	55%

exports and imports could be a multiple of their current levels, by a factor of at least two, and possibly more.¹¹

This deficit was partly financed by net factor income of 10.9 percent of GDP—essentially earnings of Palestinians in Israel; private transfers of 10.82 percent of GDP—mainly remittances of Palestinian workers in third countries; and official transfers of 5.6 percent of GDP—mainly (declining) government aid from bilateral donors.¹² The net effect was an estimated current account deficit of 13.5 percent of GDP in 2015. Imbalances of this magnitude prompt us to refer to the Palestinian economy as an “import economy.”

How, then, did the Palestinian economy come to be an economy that imports 3.2 times more than it exports? As is argued in a companion report, there are important domestic policy and institutional shortcomings that impede the Palestinian economy’s

11. See Appendix 4: Gravity Modeling of the Palestinian Economy’s Trade Potential.

12. The residual balancing item, amounting to 11 percent of GDP, is not specified in IMF (2015b). The Palestinian Central Bureau of Statistics offers a somewhat different presentation of the balance of payments. See, for example, PCBS (2016).

productivity.¹³ In addition, five causes directly connected to the restrictions and political deadlock can be identified: (1) political uncertainty and physical insecurity, which undermine the confidence of investors and are especially damaging in the tradable sector; (2) political restrictions on investment, especially in Area C; (3) restrictions on movement of goods and people, which raise trade costs, impede the movement of people, and undermine productivity; (4) reliance on transfers from abroad instead of on the economy's domestic productive apparatus; and (5) fiscal constraints, which lie at the root of inadequate provision of public goods (World Bank 2014b). Note that none of these causes are exclusively or directly related to the CU arrangement per se, while Israeli restrictions are the most prevalent. However, as argued further in this note, the Palestinian Authority's inability to control its own customs territory, trade policy, and a large part of its fiscal revenues is a major source of the dysfunction. Moreover, were all restrictions to disappear overnight, the optimality of the CU arrangement would still be in question, as already mentioned and further developed in the section of this note on the long-term vision of the Palestinian economy's trade regime. All these aspects of the Palestinian growth problem have been reviewed to a greater or lesser extent in the literature, so this note only sketches them in outline. What is perhaps less understood is how these factors mutually reinforce each other.

The *investor confidence* problem arises from repeated instances of violence and outbreaks of conflict, and is most evident (1) in the low rate of investment, which is about 40 percent lower than that of dynamic middle-income economies (Niksic, Eddin, and Cali 2014), and (2) in very low levels of inward foreign direct investment, around 1 percent of GDP, which is also mainly in construction and services.

Political uncertainty and physical insecurity are especially damaging to manufacturing, which—unlike many service and construction activities which require physical proximity—is footloose and can locate anywhere in the world or in the surrounding region. According to data from the Palestinian Central Bureau of Statistics (PCBS), nonbuilding investment declined from 10–14 percent of GDP in 1997–99 to 4–6 percent in 2008–11. As illustrated in a recent World Bank report (Niksic, Eddin and Cali 2014), the share of manufacturing in the Palestinian economy's GDP declined from 19 percent in 1994 to 10 percent in 2011.

A major constraint for the Palestinian economy is the status of Area C—formally representing over half of the West Bank's land and the only area of the West Bank that is geographically continuous. Control of Area C has not been transferred from Israeli to Palestinian authority, in violation of the Interim Agreement. Its economic development is hampered by restrictions on access and investment, including the

13. These include: low domestic savings rates, the political divisions between West Bank and Gaza, governance and institutional shortcomings, weaknesses in the education system, restrictive business regulations, slow land registration, wasteful water and energy subsidies, and weak tax collection. See World Bank (2017) "Palastine—Prospects for Growth and Jobs: A General Equilibrium Analysis."

refusal of authorizing building permits and business licenses. A World Bank analysis shows that lifting the restrictions in Area C would open up large opportunities in agriculture, Dead Sea minerals, stone mining and quarrying, and tourism, among others. According to this analysis, the direct benefits to Palestinian GDP alone could amount to 23 percent of GDP, and indirect benefits such as easier communication and induced demand, which are more difficult to quantify, would also be substantial (Niksic, Eddin and Cali 2014).

The economic impact of unpredictable *restrictions* and slow processing, which impede trade and the movement of people, is massive (see Box 1). The CU formalized under the 1994 Paris Protocol granted Palestinian and Israeli traders equal treatment at Israeli border points, and allowed for Palestinian imports and exports to enter or

Box 1: The Impact of Trade Restrictions

Israeli checkpoints, roadblocks, and customs and transport procedures (including cumbersome and costly procedures at the ports) have imposed prohibitive transaction costs on Palestinian exporters and importers. These have weakened the competitiveness of Palestinian goods, with trade barriers of greater effect than tariffs (e.g., dual-use goods lists restrictions; limited working hours and uncertain operations; back-to-back operations leading to delays and damage; lack of information dissemination system; lack of face-to-face contact and Palestinian brokers; inadequate infrastructure; and pervasive security inspections). Israeli-imposed restrictions also severely limit the movement of Palestinians within the West Bank (WB) and in and out of Gaza, and severely limit movement of goods and people between the WB and Gaza. These restrictions are imposed through physical impediments, including checkpoints, road gates, roadblocks, earth mounds, trenches, road barriers, and earth walls; the most recently collected data indicated a total of 542 obstacles, including 61 staffed checkpoints (excluding those along the Green Line), 25 partially staffed checkpoints, and 436 unstaffed physical obstacles. Underlying these physical restrictions is a cumbersome and elaborate permit system that controls the movement of Palestinians between Areas A, B, and C and between these areas of the West Bank and East Jerusalem, the Jordan Valley, the Gaza Strip, the settlements, and the outside world.

While the total annual costs of the movement and access restrictions of Palestinians in the West Bank amount to around USD 185 million (Anthony et al., 2015), various reports and studies estimate the impact of restrictions on Palestinian trade. For example, a 50-percent reduction in import, export, and domestic transaction costs, i.e., as a return to the pre-Second Intifada levels, would increase GDP by around \$2 billion (Eltalla and Hens 2009). The Palestinian Shippers Council (PSC 2012b) estimates that lengthy security delays can increase costs by an average of USD 538 (NIS 2,034) per shipment, while the Doing Business (World Bank 2015a) reports that the cost of exporting and importing a container is two and three times higher for a Palestinian than for an Israeli firm, and the required delay between two to four times higher. A study on Trade Transaction Costs (Peres Center for Peace 2015) reports that delays at ports related to customs inspections incurred by Palestinian Shippers range from 1.5 to 10 days, while standards inspections and security inspections were identified as causing the most delays and expenses. It is estimated that containerization of traded merchandise would result in a 30 percent increase in projected traffic volume through the Allenby/King Hussein Bridge (Office of the Quartet 2015; Netherland Embassy in Tel Aviv, Israel 2016). The Applied Research Institute–Jerusalem (ARIJ 2011), estimates the annual cost of DUG restrictions to be USD 142 m in agriculture, USD 60 m for ICT, and USD 60 m for manufacturing—and calculated that the total cost of the blockade in 2010 for the Gaza economy to be USD 1.908 billion at current 2010 prices (or, over 25% of total Palestinian GDP).

exit Israel either by sea through the Ashdod and Haifa Ports, via land through the KHB/Allenby Bridge into Jordan, or via Ben Gurion Airport.¹⁴ However, with the onset of the Second Intifada in September 2000, Israel took administrative, logistical measures and controls which have become serious obstacles to Palestinian trade and movement and collectively operate as a nontariff barrier for Palestinian trade. Today, all imports and exports passing through Israeli ports must first go through one of the Commercial Crossings (CCs) operated by Israel and built along the route of the Israeli–West Bank Separation Barrier. Officially, Palestinian traders may transfer goods between the West Bank and Israel only through four crossings (from north to south, see map on page xii): Jalameh, Taybeh, Betunia and Tarqumiya. Other crossings used on an unofficial basis include Bisan and Meitar. Between the West Bank and Jordan, goods can be transferred only through the KHB/Allenby Bridge. While trade through KHB would seem to offer significant time and cost savings for Palestinian shippers (due to their close proximity to the WBG), the procedures and restrictions adopted by Israel make it an unattractive alternative to the Israeli ports of Ashdod and Haifa. This is just one example of how restrictions, combined with Israeli control of all of West Bank and Gaza’s commercial crossings, have not only increased the Palestinian economy’s trade costs but also made it difficult for the Palestinian economy to trade with the rest of the world, accentuating its dependence on Israel.

It is striking, for example, that worker productivity in the median firm in East Jerusalem, where Palestinian residents face relatively few trade or movement restrictions, is twice that in the West Bank and almost three times that in Gaza, where they face the most severe restrictions (UNCTAD 2016). Another telling example is the cost of delivering a container of products destined to or originating in the Palestinian economy, compared with a container destined to or originating in Israel (World Bank 2015a), which is three times in the case of imports (from third parties) and twice in the case of exports (to third parties). Analysis by the Aix Group suggests that, as a result of this feature alone, productivity in the Palestinian processed food industry could be 11 percent lower than it would otherwise be, and productivity of agricultural produce could be 34–45 percent lower (Arnon and Bamyra 2015). The enforcement by Israeli authorities of import restrictions on select dual-use goods and material has been estimated to account for a 4.5% loss in aggregate output value in the West Bank over the 2008–2012 period, as well as a disproportionate fall in wages in dual-use input intensive sectors (Amodio, Baccini and Di Maio 2016).

The reliance on transfers from abroad is evident in the preceding discussion of how the Palestinian trade deficit is financed. Although these transfers are vital for the subsistence of Palestinians, one consequence is “Dutch disease,” named after the adverse effects of large gas finds on the competitiveness of manufacturing in the Netherlands in the

14. As well as through the Damia Bridge, which was closed in 2005.

late 1950s. The Dutch disease syndrome includes increased domestic absorption; a higher domestic price level (higher price of nontradable goods and services relative to traded goods and services); and a raising of domestic wages above the nation's production capacity, making the traded sector markedly less competitive. The most obvious manifestation of Dutch disease in the Palestinian economy is the aforementioned decline in manufacturing (for example, Hakeem and Eltalia 2014). Palestinian unskilled and semiskilled workers can earn roughly twice as much in Israel compared with what they would earn in the Palestinian labor market, raising their reservation wage.¹⁵ In international comparisons, public sector workers (funded in part by aid flows) in the Palestinian economy earn very high wages relative to the territory's average per capita income (World Bank 2015b). These Dutch disease effects are aggravated by the appreciation of the shekel in real terms—a result of the Israeli economy's strong performance since the financial crisis and recent gas finds (IMF 2015a).¹⁶ While the effect of very large foreign transfers to the Palestinian Authority budget is to penalize production in the tradable sector (even though they raise demand for these same products), they also allow higher living standards for Palestinians and provide impetus for construction and more generally for non-tradables, such as cafes and restaurants; however, the rate of productivity growth tends to be lower in these sectors. So, as long as they last, foreign transfers raise the average Palestinian's income level above what it otherwise would be, and raise the level of GDP, but they also reduce the economy's potential growth rate.

The inadequate provision of public goods is evident in low and declining rates of public investment. Leaving aside Israeli constraints on development, this shortfall results in inadequate road infrastructure in towns and cities, inadequate urban utility networks, and variable education and health provision across municipalities—all of which are features of the Palestinian economy. In 2006–07, public investment spending amounted to slightly more than 5.5 percent of GDP; however, in 2012–14, this level was reduced gradually to an average of 2.0 percent (World Bank 2015b). These low levels of public investment are the result of variable and declining aid flows to the Palestinian Authority, difficulties in building an adequate domestic tax base, tax leakages in transfers of fiscal resources from indirect taxes on imports levied by Israel on behalf of Palestinians, Israeli constraints on development, weak Palestinian Authority administrative structure, and even at times Israel's withholding of this revenue—which represents most of the Palestinian Authority's revenue from Israel.

These five features accounting for the Palestinian economy's weak growth performance not only work in isolation but also reinforce each other in a vicious circle.

And it is their constant interaction that best explains how the Palestinian economy became an import economy. Low confidence, and investment and trade restrictions constrain

15. One econometric study shows that wages in the Palestinian economy are significantly correlated with wages in Israel (UNCTAD 2006).

16. Israel's own Dutch disease may soon worsen and exacerbate the Palestinian economy's disease.

productivity and impede investment, especially in the traded sectors. The scarcity of job opportunities, which is one result, encourages workers to seek employment in Israel or elsewhere outside of the Palestinian territories. The thinness of the private enterprise sector and exodus of workers narrow the tax base, impeding public investment and making the government dependent on international donors. The inadequate infrastructure further reduces the returns to private investment. Aid flows, remittances from workers overseas, and the earnings of Palestinian manual workers in Israel, which are spent in Palestinian markets, raise prices across the non-tradable sector in the Palestinian economy and also raise wages above where they otherwise would be. These transfers raise the demand for imports, but also make the system even less competitive, and further discourage investment in the tradable sector. And the vicious circle continues to spin.

Box 2: Palestinian Labor in Israel

Before the outbreak of the Second Intifada in 2000, there was a fairly free flow of Palestinians working in Israel. Initially, the workers' lack of Hebrew meant that most jobs went to semiskilled and unskilled workers in agriculture and construction. In 1996, soon after the signing of the Oslo Accords, the Government of Israel instituted a requirement for work permits for Palestinians working in Israel or in Israeli settlements. At that point, the focus on manual labor was institutionalized, with only a few skilled Palestinian workers in teaching and health care working in East Jerusalem allowed to cross the wall.

Since then, the process and infrastructure for issuing and checking such permits have been elaborated and intensified. Sophisticated pedestrian checkpoints penetrate the "separation wall" in proximity to Palestinian centers of population, allowing farmworkers and laborers to get to work under constraint. Access for workers has been routinely cut off following security incidents. However, the current Israeli army strategy seems to recognize that this restriction could be counterproductive, so blanket bans are now imposed only around the time of Israeli holidays.

The structure of the system, the number of permits issued, and who receives them are unilaterally decided by the Israeli army. Applying for a permit is linked to having a specific job with a specific Israeli employer, limiting job mobility and leaving workers vulnerable to exploitation. The requirements of the Israeli economy for workers and the perceived security threat are weighed against each other. At the same time, Israelis recognize that the flow of Palestinian laborers into Israel is important for stability in the Palestinian territories and, consequently, for security.

The Government of Israel decides on the total number of permits and allocates them to Israeli industries in relation to labor needs in the Israeli economy. The Bank of Israel (BoI) has published several analyses of the advantages and disadvantages of the Palestinian economy as a source of manual labor (versus Thai and Filipino workers). The BoI acknowledges that few attacks in Israel have been carried out by workers with permits. Around 90,000 Palestinians have permits to work in Israel at present—a number that has been gradually increased in the last two to three years. There is no vocational training for these workers, and their access to health care and insurance, while prescribed by Israeli law, is limited. In addition to the permitted workers are an estimated 20,000 migrants who walk into Israel or are smuggled in by Israelis and work for Israeli employers illegally.

Workers put up with the difficulties of obtaining a permit and the daily crowded checkpoint crossing because they can bring home around twice the salary that workers in a similar job in the Palestinian labor market can get—if they can get a job at all.

2.2 TRADE CONCENTRATION ON ISRAEL

Two additional features of the Palestinian economy's import economy that are highly relevant to an examination of the Palestinian economy's trade regime are (1) the extreme concentration of its trade with Israel, and (2) its large trade deficit with Israel. Although Israel is a medium sized economy that accounts for only 0.2 percent of world GDP, in 2014, according to BoI estimates, imports from Israel accounted for 56 percent of Palestinian imports of goods and nonfactor services, not including energy, while Israel accounted for 55 percent of Palestinian exports of goods and nonfactor services (BoI 2014). Data from UN Comtrade, which are based on data from the PCBS, indicate higher bilateral trade shares, with 79 percent of Palestinian exports destined to Israel and 63 percent of Palestinian imports originating in Israel (UNCTAD and World Bank 2016). Unfortunately, all data on the Palestinian economy's bilateral trade with Israel and with other countries must be considered tentative and approximate. This is because, since the Palestinian and Israeli economies form a CU, there are no provisions for declaring or measuring origin, so one cannot be certain about how much of the Palestinian economy's imports from Israel consists of products produced in Israel, or how much represents *entrepôt* trade (meaning trade with third parties through Israeli companies, rather than trade with Israel). Data on bilateral trade within the CU are based on sales invoices, which do not specify origin. Thus, while a sizable part of Israeli sales to the Palestinian economy consists of automobiles and oil products, which are known to be almost wholly imported through Israeli companies from third parties, the origin of many other Palestinian imports from Israel is not known. In addition, Israeli and Palestinian statistics may delineate the Palestinian territories differently, depending, for example, on whether one includes or excludes East Jerusalem. As in all bilateral trade relations, the most economically meaningful measure of Israel's exports to the Palestinian economy is the value added in Israel. This, too, cannot be known with any certainty, and was estimated by a BoI analysis to account for 0.8–1.2 percent of Israeli GDP in 2012, equivalent to about 20–30 percent of Palestinian GDP (BOI 2014). The large difference between the low and high estimates in these calculations vividly illustrates the imprecision of data relating to the Palestinian economy's bilateral trade with Israel.

It is also difficult to assess what share of Palestinian exports to Israel actually represents exports to third parties, intermediates that are processed in Israel (such as stone and marble), or goods and services that are consumed in Israel. Still, whatever the source of statistics, the concentration on Israel is remarkable, since the Palestinian territories share a border with Jordan and (through Gaza) a border with Egypt and would have, in more normal circumstances, access to the sea for trade. Equally remarkable is that the Palestinian economy's trade deficit with Israel is estimated by UNCTAD to account for 75 percent of its total trade deficit, amounting to more than 30 percent of

Palestinian GDP (Elkhafif, Misyeef and Elagraa 2014).¹⁷ Our estimate for 2014, based on IMF and on a Bank of Israel document, indicates a smaller bilateral trade deficit of about 22 percent of Palestinian GDP—still a very large number.¹⁸ It should be noted that, insofar as prices inside the customs union are higher than world prices, reflecting the external tariff, this bilateral trade deficit implies a significant transfer from the Palestinian economy to Israel. The size of the transfer is equal to the trade deficit times the difference between internal and world prices of Israel’s trade with the Palestinian economy. Based on the customs union’s external tariffs and the composition of the Palestinian economy’s two-way trade with Israel, this difference is probably in a range of 2% to 5%, implying a transfer equal to some 0.4% to 1.0% of Palestinian GDP each year. But the artificially high trade costs that the Palestinian economy faces in trading with Israel and even higher prices it faces in trading with the rest of the world imply that the transfer is much higher.

It is common for a smaller economy to trade heavily with a much larger neighboring economy with which it has a preferential trade agreement. Witness the concentration of Morocco’s trade with the European Union, the concentration of Luxembourg’s trade with Germany and France, and the concentration of Canada’s and Mexico’s (both relatively large economies) trade with the United States. However, a bilateral trade deficit of this size is highly unusual (it is difficult to find other examples anywhere), and, in any case, Israel is not a giant economy like the European Union or the United States, which provide vast domestic markets and exhibit a diverse export base across a large span of products and services. Using UN Comtrade data, which may overestimate the size of bilateral trade between the Palestinian and Israeli economies, Table 2 shows that in 2014, Israel exported almost as much to the Palestinian economy as it did to Turkey, Cyprus, Greece, Egypt, and Jordan combined—countries in its geographic proximity with which Israel has FTAs and whose combined GDP is more than 100 times that of the Palestinian economy. The Palestinian economy exports seven times more to Israel than to all these countries combined, even though Israel’s GDP is less than one-quarter that of the group combined. Using its own trade estimates, BoI reports that the share of Israel–Palestinian trade in the trade of the two parties is about two times larger than predicted by a standard gravity model (BoI 2014).

The heavy concentration of Palestinian trade with Israel, however measured, is much larger than predicted by considerations of relative size, distance, and type of specialization. This points to the artificial substitution of imports from less costly or more efficient third parties, known commonly as “trade diversion.” Israel’s comparative advantage at the global level is narrow and lies principally in very

17. UNCTAD estimates that the Palestinian economy’s trade deficit with Israel has more than doubled since 1999 (Elkhafif, Misyeef and Elagraa 2014).

18. See IMF (2016) and also Bank of Israel (2014), drawing on Israel Central Bureau of Statistics data. <http://www.boi.org.il/he/NewsAndPublications/PressReleases/Documents/Israel-Palestinian%20trade.pdf>

TABLE 2: Neighboring Trading Partners of the Palestinian and Israeli Economies Exports of Goods and Services

Trading Partners	Israel Exports (US\$ billion 2014)	Palestinian Exports (US\$ billion 2014)	Partner's GDP (US\$ billion 2014)	Air Distance (miles from Lod/Ben Gurion Airport)
Turkey	2.70	*	822	700
Cyprus	0.9	*	22	200
Greece	0.46	*	250	750
Egypt	0.15	*	288	250
Jordan	0.10	0.1	34	50
Palestinian territories	4.00	0	13	*
Israel	0.00	1.2	290	*

Sources: UNCTAD and World Bank 2016; BoI 2014.

Notes: This table indicates the overrepresentation of Palestinian trade in the Israeli economy, compared with geographically close and relatively wealthy trading partners. * = exports are less than US\$10 million.

specialized high-tech manufactures and services, chemicals and pharmaceuticals, and polished diamonds. Most of these products do not typically constitute a large share of the imports of a lower-middle-income developing country, such as the Palestinian economy. So, not surprisingly, Israel's large exports to the Palestinian economy do not conform to its comparative advantage at the global level; they consist mainly of fuel, food products, and low- and medium-technology manufactures (BoI 2014). Table 3 shows that, except for a few items, such as electrical machinery, plastics, and fruit and nuts, there is little correspondence between the Palestinian economy's main imports from Israel and what Israel exports to the world. Note that UN Comtrade, the source of the data, does not report Israel's exports to the Palestinian economy. However, Israel's reported global exports of mineral fuels and other products in 2014 are much smaller than the imports from Israel reported by the Palestinian Authority.¹⁹

The term *trade diversion* is usually employed to describe the effects of tariff preferences on the pattern of trade. In the specific case of the Palestinian economy, however, the trade diversion is the result not only of tariff preferences but also of trade costs that apply differentially and that artificially favor trade with Israel. One can identify five separate factors that can cause trade diversion of Palestinian

19. This discrepancy could be due to (1) Israel not including mineral fuels imported from abroad and re-exported to the Palestinian economy in its export statistics; (2) a difference in geographic definition of the West Bank and Gaza and Israel; or (3) the Palestinian economy including imports of electricity from Israel in this mineral fuels category, while normally it would be included in services trade.

TABLE 3: Palestinian Imports from Israel
and Israel's Exports to the World

% of Palestinian Imports from Israel	% of Israeli Exports to the World	Product Description
46.2	1.1	Mineral fuels, mineral oils, and products of their distillation; bituminous substances; mineral waxes
4.4	0	Residues and waste from the food industries; prepared animal fodder
4.1	0.3	Salt, sulphur, earths and stone, plastering materials, lime, and cement
4.0	0	Cereals
3.2	12.9	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television image and sound recorders and reproducers, and parts and accessories of such articles
2.8	6.6	Nuclear reactors, boilers, machinery, and mechanical appliances; parts thereof
2.3	0	Beverages, spirits, and vinegar
2.2	0	Wood and articles of wood; wood charcoal
2.1	0	Live animals, animal products
1.9	0.8	Edible fruit and nuts, peel of citrus fruit or melons
1.9	3.6	Plastics and articles thereof
1.8	0	Dairy produce; birds' eggs; natural honey; edible products of animal origin, not elsewhere specified or included
1.8	0.2	Paper and paperboard; articles of paper pulp, of paper, or of paperboard
1.6	0.2	Vehicles other than railway or tramway rolling-stock, and parts and accessories thereof
1.5	9	Pharmaceutical products
1.5	0	Tobacco and manufactured tobacco substitutes
1.2	0.2	Iron and steel
1.1	0	Products of the milling industry; malt; starches; inulin; wheat gluten
1.0	0.1	Sugars and sugar confectionery

Source: UNCTAD and World Bank 2016.

Notes: All two-digit categories in Harmonized System, 2007 nomenclature that represent more than 1 percent of Palestinian imports from Israel are included in the table. Numbers less than 0.1 percent of Israeli exports are rounded to 0.

TABLE 4: Tariff Schedules 2011–15

Trading Partners	Simple Average, MFN			Actual Applied (AHS)	
	Bound	Applied	>15%	2014	2004
Egypt	36.9	16.8	19.2	7.4	10.6
Israel	22.4	4.6	4.3	2.1	1.2
Jordan	16.2	9.5	29.6	4.0	11.2
Morocco	41.3	12.9	32.2	3.0	13
Tunisia	52.9	15.5	36.9	3.9	22

Source: WTO Tariff Profiles and WITS databases (UNCTAD and World Bank 2016).

Notes: AHS = effectively applied tariff under the Harmonized System, which is a lower applied tariff under all regional and WTO agreements, including all unilateral preferences, trade weighted; MFN = most favored nation.

imports that favors Israel. First, even though the trade regime between the Palestinian and Israeli economies is relatively liberal on average, it is highly protective and includes many tariff peaks in staple products, such as dairy, fruits and vegetables, beverages and tobacco, cereals and preparation, and fish products. More than 4 percent of Israel’s tariff lines have applied most-favored nation (MFN) tariffs in excess of 15 percent (Table 4). This is trade diversion as it is normally understood, and it can work in favor of Palestinian producers selling to Israel (who are, however, at a competitive disadvantage for the reasons set out in paragraphs on pages 9 and 12–13), as well as Israeli producers selling in Palestinian markets.²⁰ Second, elaborated on further in this note, Arab countries’ reluctance to trade with or through Israel tends to separate the Palestinian economy from several of its natural trading partners. Third, as explained further, there is considerable evidence of smuggling of products originating in Israel into the Palestinian economy for the purpose of avoiding VAT. Fourth, Israel applies sanitary, phytosanitary, safety, and technical standards that are in line with those of the most advanced countries, which are typically more exacting than those normally applied in developing countries and can, intentionally or unintentionally, have the effect of protecting domestic producers, especially in agriculture. In addition to these demanding standards, the process used for standards approvals for Palestinian trade is slow and unpredictable, adding to transaction costs. Fifth, and probably most important, Israeli restrictions (including “dual-use” regulations), high transport costs, and cumbersome customs clearance procedures tend to disproportionately impede Palestinians and make it easier, cheaper, and simpler to buy from an Israeli trader than directly from overseas. Because of these restrictions, it is also often easier to sell to Israel than to sell abroad, and, if selling abroad, to sell through Israeli intermediaries. As already mentioned, the cost of delivering a container of products destined to or originating in the Palestinian economy

20. In normal circumstances, it could favor Palestinian exports of staple products to Israel, as well as imports from Israel.

and to or from third parties, compared with a container destined to or originating in Israel, is three times in the case of imports and twice in the case of exports (World Bank 2015a).²¹

Intraregional trade in the countries of the Levant is already the lowest in the world, and the reluctance of Arab countries to trade with Israel or through Israel (and Israel's reciprocation) aggravates the Palestinian economy's trade diversion problem considerably (World Bank 2014a). Many Muslim-majority states will not accept any goods that have been in transit through Israel, including Palestinian goods using Israeli ports on the Mediterranean or an Israeli airport. Both Israel and the Palestinian economies derive losses from the frictions associated with trade with Arab countries, and both trade more with each other than they would if trade with Arab countries were more open. However, while Israel can direct its high-tech and diamond exports to the world, these missed opportunities weigh especially heavily on the Palestinian economy, given its cultural and language links to Arab countries. The Palestinian large diaspora in Jordan, the Gulf, and other countries of the region, as well as general Arab solidarity markets, should be a source of more intense relations, not only in trade but through foreign investment (Dadush 2015). It is possible, moreover, that in a scenario where the Palestinian economy traded freely with other Arab countries, it might obtain gas and oil imports from Greater Arab Free Trade Agreement (GAFTA) partners at favorable prices, as do Jordan and Egypt.²² As things stand, the only direct land link between the Palestinian economy and the Arab countries is the Allenby/King Hussein Bridge linking the West Bank to Jordan. The Palestinian territories have no airport of their own, and the only independent airport, in Gaza, was destroyed during a military confrontation with Israel. Impediments of moving goods and people between the Palestinian economy—which has access to the sea, but is in effect blockaded—make trade with Arab countries even more difficult. In the section on short-term measures later in this note, we address the Allenby bottleneck in greater detail.

The official PCBS figures relating to Palestinian exports to GAFTA partners indicate that they may account for about 15 percent of total Palestinian merchandise exports (Appendix Table 3.1). However, when exports through Israel and third countries are included, the share is likely much higher. A recent survey of Palestinian exporters suggests that, despite the many restrictions, GAFTA partners (which have an FTA that includes the Palestinian economy but that Israel does not recognize) might be the final destination of around half

21. See the World Bank (2015a) chart on comparative costs and time required to import and export a container.

22. GAFTA includes 18 economies (Jordan, Morocco, Kuwait, United Arab Emirates, Bahrain, Saudi Arabia, Oman, Qatar, Syria, Lebanon, Iraq, Egypt, Tunisia, Libya, Sudan, Yemen, Algeria as well as the Palestinian economy) contributing to establishing the Arab Common Market. GAFTA involves full trade liberalization of goods (full exemption of customs duties and charges, having equivalent effect among all members). Through GAFTA, Palestinian exports are duty free and quota free for all goods (including all industrial and agricultural products) (Palestinian Authority 2014, 48).

Box 3: Preferential Market Access Provided by Free Trade Agreements

Trade agreements with the Arab States (GAFTA), the European Communities, the European Free Trade Association, Turkey, and Canada provide preferential access to most goods originating in these countries to the Palestinian market. The same applies, on a reciprocal unilateral basis, to goods from the United States. Despite the significant level of potential market access granted by preferential trade agreements, Palestinian companies have generally been unable to grow or expand into new export destinations, resulting in a minimal use of these arrangements. This is the result of, among other things, the lack of recognition by Israel, trade facilitation and logistics constraints (hampering the movement of goods and products in Israeli ports), complicated rules of origin, nonacceptance of Palestinian certificates of origin, and domestic competitiveness constraints (Palestinian Authority 2014, 44 and 51).

of total Palestinian exports (Peres Center for Peace 2015). In 2015, that would be equal to around US\$1.2 billion, or US\$270 per person. Even so, and in contrast, Jordan, a small, open economy of similar population size and with similar endowments, directed more than US\$900 of exports per person to Arab countries (this number relates to 2012).²³

Taken together, these impediments mean that not only should the Palestinian economy be trading more than it is, but it is also paying more than it should for many of its imports, and getting less than it should for its exports. Artificially high trade costs depress all Palestinian trade. In addition, Palestinian trade costs with the rest of the world are higher than the costs associated with trading with Israel, limiting competition. Big losers in this arrangement are Palestinian consumers, who face higher prices than they would otherwise, particularly for staple products, since the external tariff and the bulk/value ratio are highest for those products, so trade costs are likely to represent a larger component of the price at the retail level. Palestinian exporters are also losers on account of both higher trade costs and reduced geographic reach. Palestinian producers pay more for their imported inputs, which in light of the wedge in trade costs and (in some instances) tariffs, may be sourced more cheaply abroad than in Israel.

Israeli consumers of Palestinian products and Israeli exporters to the Palestinian economy also have to bear higher trade costs than they should. However, their losses are less, since trade with the Palestinian economy represents a relatively small part of Israel's market and consumer spending. Israeli producers who compete directly with Palestinian producers, as in agriculture and labor-intensive manufactures, may also be net gainers from current arrangements that supply them with cheaper labor. Last, but not least, Israeli sectors that employ large numbers of Palestinians, such as construction, agriculture, and basic service providers, are gainers on account of the limited employment opportunities in the Palestinian economy and the low cost of employing these laborers in

23. Calculation based on Government of Jordan Department of Statistics, external trade statistics, online database (http://www.dos.gov.jo/dos_home_e/main/linked-html/ex_trad.htm).

Israel. Taking the Israeli construction sector as an example, 15 percent of its workforce is Palestinian (BoI 2014). It should be noted that Palestinian labor is also less expensive for the Israeli state. Palestinian workers take their social, health, and other problems home at night; the alternative source of cheap labor from East and Southeast Asia, predominantly Thailand and the Philippines, comes with the associated costs of health care, social support, and administration. It is important to note, however, that this assessment of gainers and losers is static, in the sense that it assumes that today's economic relationships will persist forever. In reality, over the long run, most Israelis are likely to be losers from current arrangements, since they are more likely to gain from trading with a prosperous and dynamic neighboring Palestinian economy than from continuation of the dysfunction.

3. IMPROVING TRADE OUTCOMES: IMMEDIATE MEASURES

Palestinian merchandise trade is currently regulated by the Paris Protocol²⁴—an economic trade agreement between the Palestinian Authority and the Government of Israel establishing the basic principles of free trade between the two parties. Under the Interim Agreement of 1995 which followed on the heels of the Protocol, the Palestinian Authority can sign FTAs and set its own conditions—within certain limits—for importing a selected number of goods deemed as strategic for the Palestinian economy and grouped into three lists denominated A1, A2, and B (detailed in Appendix 1).

The Paris Protocol establishes a customs envelope based on the following three basic principles (Palestine Trade Center n.d.):

- » Free exchange of goods between both parties with no tariff or nontariff barriers whatsoever between the two parties.
- » Adoption of a tariff regime by both parties, which allows Palestine to apply higher tariffs than Israel (but not lower),²⁵ and also customs determination on a limited list

24. Signed on April 29, 1994, the Paris Protocol (also called the “Protocol on Economic Relations between the Government of the State of Israel and the P.L.O., representing the Palestinian people”) was part of the Gaza–Jericho Agreement (signed in Paris five days later on May 4, 1994) and constitutes the framework establishing the interim-period economic relations between the Palestinian and Israeli economies. The Gaza–Jericho Agreement simultaneously established the Palestinian Authority, which is responsible for the Palestinian obligations concerning the Paris Protocol. The protocol was incorporated, with minor amendments, into Article XXIV of the Oslo II Accord of September 1995. The amendments to the protocol (*Supplement to the Protocol on Economic Relations*) were annexed as Annex V of the Oslo II Accord and contain only some changes on the clearance of revenues and some technical changes on the taxes issue. While the protocol initially applied to the Gaza Strip and the Jericho Area, its jurisdiction was extended to all of the Palestinian territories in the Oslo II Accord.

25. In practice Palestine cannot apply higher tariffs than Israel since goods from Israel enter freely into Palestine.

of strategic goods (Lists A1, A2, and B) and has the right to determine specifications for Lists A1 and A2.

- A1: Goods imported must be locally produced in Jordan and Egypt.²⁶
 - A2: Goods may be imported from Arab, Islamic, or other countries.²⁷
 - B: Goods imported are not subject to quantitative restrictions, but are subject to Israeli standards.²⁸
- » Sharing of revenues in customs clearance, including VAT and excise taxes, where the Israeli customs are responsible for clearing the Palestinian imports on behalf of Palestinian customs (based on the customs envelope) and then transferring the revenues to the Palestinian Authority.

In practice, Palestinian trade is restricted in multiple ways (see also Box 1). Israel controls the West Bank's inbound and outbound flows of merchandise trade that transits through Israeli seaports and airports that cross the Green Line, as well as the West Bank's international border crossing at Allenby/King Hussein Bridge. The Palestinian economy is prevented by the Government of Israel from building its own airport/seaport. All imports and exports passing through Israeli ports must first go through one of the Commercial Crossings (CCs) operated by Israel²⁹ and built along the route of the Israeli–West Bank Separation Barrier. Israel maintains very tight controls on access of goods to Gaza and prevents connectivity between Gaza and the West Bank. The Rafah crossing between Egypt and Gaza is under Egyptian control and has been effectively closed for people and goods over the last few years. A trickle of people and a very small flow of building materials have crossed into Gaza from Egypt. As such, Israel has complete control over all the channels through which products can enter and exit the Palestinian territories. Israel also has control over import duties and VAT intended to be transferred to the Palestinian Authority, and

26. List A1 includes 67 Israeli tariff positions, which have to be produced particularly in Egypt or Jordan. The Palestinian economy may import in quantities agreed by both sides up to Palestinian market needs (Palestinian Authority 2014, 44).

27. Goods in List A2 may be imported subject to quota restrictions from any country. The list is composed mainly of agricultural products, and includes 36 Israeli tariff positions (Palestinian Authority 2014, 44).

28. List B includes a wide range of basic food items and other goods for the Palestinian economic development program, including capital goods and equipment and parts, inputs, and pharmaceutical products. Approximately 240 tariff positions are identified in the list (Palestinian Authority 2014, 44).

29. Peres Center for Peace (2015) on pg. 50 notes: “Over the past decade, the crossings went through a process of “civilianization,” or privatization, in which authority over their operation has been transferred from the Israel Defense Forces (IDF) to civilian authorities. Betunia is operated by Israeli police, and the other three crossings are under the authority of the Crossing Ports Authority (CPA), within the Ministry of Defense. Representatives of the IDF, the Coordination of Government Activities in the Territories (COGAT) and the Police are present at all these crossings but on-ground operation is performed by private operators. The CCs also host representatives of the Israeli Customs Authority and Ministry of Agriculture, which perform commercial and standardization clearance procedures. The status and operation of the crossings is governed by a collection of administrative regulations issued by the various authorities involved. This creates a general problem of uncertainty and lack of regulatory coordination. Certain aspects of the CCs have salient effect on transaction costs of export (. . .)”

TABLE 5: Overview of Proposed Short-term Measures

Area	Impact	Ease of Implementation
Revising the special goods list	Low impact in the short term, unless coupled with other reforms	High
Revising the DUG list	High impact, as much as 5% of GDP, annually	Medium
Removal of trade restrictions at border crossings/commercial crossings, as well as WB-Gaza trade	Very high impact, particularly for Gaza could lead to 25% increase of Palestinian GDP	Medium
Containerization	High, could lead to increase in 30% flows through Allenby/KHB	Medium
Institutional capacity building	High	High

restricts trade flows through the administration of the strategic goods lists (A1, A2, and B) and the DUG lists.

This section reviews immediate measures aimed at improving the Palestinian economy's trade-related economic outcomes. These measures relate to well-known impediments to Palestinian trade that should be addressed as soon as possible. These include: removing or significantly reducing the burden of existing restrictions within the CU (e.g., revising the special goods and DUG lists and processes), improving trade logistics infrastructure and processes through border crossings (including containerization), fostering the capacity and transparency of trade-related institutions (including with regard to standards, customs, and border management). Some of the measures are solely under Palestinian control, some require cooperation between the Palestinian Authority and the Government of Israel, while others entail unilateral Israeli decisions. In all cases, success will hinge on a renewed economic partnership with Israel—reflecting Palestinian economic interests—and the support of the international community.

3.1 RELIEVING RESTRICTIONS UNDER THE CUSTOMS UNION

3.1.1 UPDATING THE SPECIAL GOODS LISTS (A1, A2, B)

The A1, A2, and B lists established under the Paris Protocol in 1994 were designed as an exception to the CU's common external tariff, granting the Palestinian Authority autonomy to determine the most appropriate regime (tariffs and standards for List A1 and A2, tariffs for List B) governing the import of specific

products originating in Jordan, Egypt, and other states. These lists could be seen as a first step toward the eventual establishment of an independent Palestinian tariff book. As part of the protocol, the Palestinian Authority retains the power and responsibilities to independently determine and change the rates of customs, purchase taxes, levies, excises, and other charges with respect to the goods contained in the lists. The Palestinian Authority decided to set its tariffs at the same level as that of Israel (except for motor vehicles, where a different regime is in place and rates are lower). The decision to follow Israeli tariffs with regard to the goods on the lists has implied a progressive liberalization of trade in the Palestinian economy. Since 2000, the simple average applied MFN tariff has fallen from 10.8 percent to 8.9 percent. The MFN simple tariff average on agricultural goods is 30 percent (most goods in List A1 and all goods in List A2) and 5 percent for nonagricultural products (goods in List B). The maximum tariff of 560 percent affects very few products. About 50 percent of all tariff lines and 73 percent of nonagricultural product tariff lines are duty free.

In practice, the lists—originally intended as a means to grant the Palestinian Authority more flexibility in its trade policy—have come to be perceived as a unique form of restriction on what the Palestinian economy may import, where it may import from, what quantity of a good may be imported, and the amount of tariff that may be applied. (See limitations and requirements in Appendix 1.) In fact, the lists impose limitations on the quantity of merchandise imported from Jordan, Egypt, and Arab and other countries, mainly based on Palestinian market needs as determined more than 20 years ago. The Government of Jordan views the protocol as a trade barrier to Jordanian exports to the Palestinian economy. There is no possibility for the Palestinian economy to set its own tariff on imports of other goods from Arab countries or goods from third countries, even in the case of signed trade agreements or if, for example, goods from those countries are cheaper than those available from Israel. The Palestinian Authority needs to negotiate with the Government of Israel each time for the inclusion of products not included in the lists. Similarly, the Palestinian Authority needs to negotiate with Israel quotas for products not in List A2. (For example, the quota for cheese and eggs is the same as that established in 2004.) This inevitably leads to restricted supply and dependence on Israeli products. Even when the Palestinian Authority retains control of the tariff applied, it is not in charge of the customs and entry points for goods. Ultimately, Israel can still exert control over the Palestinian Authority by simply restricting the entry of goods into the country, including important products like barley and corn, among many others. This situation entails two problematic consequences. First, Palestinian consumers cannot enjoy low prices from open competition between Israel and third-party producers of the same products—restricting Palestinian consumption, especially in goods with high demand price elasticity. And second, the Palestinian Authority is unable to directly collect revenues from import taxes. Unfortunately, the number of goods specified in Lists A1 and A2 has barely

grown since 1994, even though data show total Palestinian imports have increased more than threefold since then to US\$5 billion.³⁰

A revision of the special goods lists is warranted. The lists do not have any significant security implications, and revisions can be negotiated in a relatively short period of time. The PP calls for annual reviews and updates of the special good lists, but new goods have not been added, and the quantities of some of the specified goods allowed have only been increased twice—both times in 1999 and not since (Rasgon 2015). As a result, the goods and quotas determined on the lists do not even come close to current Palestinian market demand. The Palestinian population has nearly doubled since the protocol was signed in 1994 (PCBS 2015). A comprehensive revision of the lists would reaffirm the Palestinian Authority’s policy domain and institutional capacity, its ability to determine the most appropriate regime governing the import of products, in essence enabling the Palestinian economy to operate as a separate customs territory.

The exercise should aim at a complete review of the three lists including:

- » Expanding the products covered, increasing in consumer welfare through lower prices and cheaper inputs for the Palestinian productive sectors.
- » Removing quotas as much as possible, and where kept for a limited number of products include an automatic increase mechanism.
- » Including the list of countries/trading blocks from which products can be imported based on Palestinian trade policy.
- » Considering in List B those products subject to specific technical regulations.
- » Avoiding confusion as to applicable trade rules.

The economic impact of quota removal is expected to be limited in the immediate term, but, over time, is expected to create significant welfare benefits for Palestinians (Abugattas 2016). The impact of quota removal would be higher if reflective of Palestinian growing market needs and provided nontariff barriers (which have for example impeded the entry of Jordanian products to the Palestinian market) are mitigated. Over time, the elimination of the List A1 quota on imports would enhance trade diversification and competition with existing suppliers from Israel and other markets, accruing benefits for consumer welfare. The Palestinian economy currently constitutes an important destination market for only a few products from Jordan and Egypt (for example, cement, mineral water, and pigments exports to the Palestinian economy represent a significant share of total Jordanian exports), with most products not having registered any significant trade flows in recent years. In a number of cases high custom duties imposed by Israel on Jordanian

30. World Bank’s calculations based on UN Comtrade 2014 data.

products entering the Palestinian economy may have restrained potential trade flows (for example, tariffs on dairy products ranges are 40–162 percent; biscuits, up to 112 percent; oils and fats, 28 percent; and vegetables preserved in vinegar, up to 40 percent). In principle, an expansion of the list and the elimination of quotas would enhance the Palestinian Authority’s trade policy autonomy, increase potential competition to existing exporters (mainly Israel), and help diversify the Palestinian economy’s sources of trade—with positive welfare effects for the Palestinian economy. However, reexports of products that originate from third parties constitute a significant and increasing share of total Jordanian exports to the Palestinian economy (from 21.0 percent in 2011 to 38.9 percent in 2014), and any treatment to products covered in List A1 should be limited to products satisfying rules of origin, such as those applied under GAFTA. The agreement of rules of origin for products covered by the lists is one of the unfinished issues of the Paris Protocol. In addition, the revision of the list could take into consideration the future expansion and diversification of trade relationships for the Palestinian economy, and include a list of countries/trading blocks from which products can be imported based on Palestinian trade policy.

Recommendations: The Palestinian Authority should pursue the elimination of quotas under the lists and also seek an expansion of the coverage of the lists.

Analysis undertaken on the potential effects of expanding the Paris Protocol lists and quota eliminations suggest that there could be important benefits for the economy, especially for those products where trade creation is likely to be greatest.³¹ However, two issues need to be underscored:

- » Given the current prevalence of nontariff barriers to trade, the material benefits deriving to the Palestinian economy from the revision of the A lists is expected to yield benefits only in a few products. Perhaps more significantly, this revision would be an opportunity to increase the policy autonomy of the Palestinian Authority, including with regard to the exercise of rules of origin.
- » Successful negotiation with the Government of Israel to agree on changes will require accompanying efforts to reduce logistics and high transaction costs. Without such measures, it is unlikely that the reforms would generate any significant impact on the origin, value, and volume of current trade flows.

3.1.2 REDUCING THE DUAL-USE GOODS LISTS AND PROCESSES

Israel, along with most other technologically advanced countries, controls the export of manufactured goods, chemicals, and weapons and munitions that

31. Luis Abugattas (2017). “Note on the Expansion of the Paris Protocol Lists” EU Support to the Ministry of National Economy for Trade Policy Formulation and WTO Accession; March. Project Number 133879/C/SER/PS.

Box 4: International Context of Dual-Use Export Control

Controls on export of dual-use items are now implemented by most developed countries. The controls typically require licensing on the export of specific items that have dual-use capacity, and most controls for the most easily militarized goods, such as munitions and firearms, include consideration for who the end user is. Controls on nuclear material, chemical and biological weapon precursors, arms and munitions, and civilian products that can be weaponized typically seek to balance economic export goals with transparency and security concerns.

The Wassenaar Arrangement (WA) (<http://www.wassenaar.org>) covers civilian products, some chemicals, some metallic raw materials, precision machinery, and munitions. The 41 participating countries include the Russian Federation, the United States, the United Kingdom, Slovenia, Sweden, and Turkey. In addition, other nonparticipating countries, including Israel, use the Wassenaar lists as the basis for their own dual-use licensing process. Trading and security blocs, such as the European Union and NATO, use the lists as a basis for directing their members on dual-use export conformity. The contents in the Wassenaar lists are highly specialized, referring to items with such precise areas as equipment capable of operating in space and computer chips that can resist high levels of radiation.

The Israeli DUG lists are applied to imports into the Palestinian economy from Israel and other countries. The lists are the only such lists (one for the West Bank and Gaza, and one for Gaza only, see Appendix 2) that refer to a specific region as the destination of the exports. Contrary to the precise definitions that maintain the export–security balance in the WA, the Israeli lists contain sweeping categories, such as “Communications equipment, communication support equipment, or equipment with communication functions” and “Metal pipes, with or without seams, whose circumference is under 333 mm.” The broad and vague natures of these definitions mean that many items can fall under these lists. Examples that seem to have little security risk attached, such as cell-phone chargers, fax machines, and printers, all may require a special license. The broad and vague definitions, which are so out of keeping with international practice, the nontransparent administrative process, and the fact that items are added to and deleted from the lists in response to Palestinian political and security changes make these lists function more as economic sanctions than as a necessary security process.³²

both can be used for nonthreatening civilian purposes and also can be converted to use as weapons, so-called DUG. Control of such items is conducted worldwide and (in accordance with the UN Security Council Resolution 1540, the Chemical Weapons Convention, and the Biological Weapons Convention), is part of trade regulations in many countries and trading blocs to manage the risks that these items may pose for international security (Box 4). The most common regulatory basis governing the movement of DUG is the 1996 Wassenaar Arrangement (WA), an international agreement aimed at increasing global stability through transparency and supervision of dual-use exports. States following the arrangement maintain national export controls on listed items. The lists, including

32. A recent analysis calls into question the effectiveness of these security measures, estimating that the dual-use list policy accounted for 18% of the violent political events occurring in the West Bank in 2008–2014. The enforcement of trade restrictions imposed under the DUG lists decreases firm performance and wages in select DUG intensive sectors, with disproportionate labor market effects on areas with higher concentration of dual-use intensive sectors. And episodes of political violence are shown to be more likely in such West Bank localities (Amodio, Baccini and Di Maio 2016).

those under the various categories of “Dual-Use Goods & Technology,” very narrowly describe items of concern and are updated annually by the WA secretariat (Peres Center for Peace 2015). Though not a signatory to the WA, Israel uses the WA lists to license the export for sale of all DUG manufactured or assembled in Israel, and more generally applies the lists for all products imported to the Palestinian economy.

In addition to the WA, Israel imposed two further controls on DUG destined for Palestinian territory—in contradiction with the economic underpinnings of the CU with the Palestinian economy. Israel unilaterally applies these additional lists through the Defense Export Control Law 5766-2007 (passed in October 2007), which stipulates that the export from Israel of items specified on WA lists and on the additional Defense Export Control Order (dual-use) list require a special permit and reporting duties. It is worth highlighting that the term Export Control is misleading as these restrictions are imposed by Israel to all products entering the Palestinian economy, and not only those “exported” from Israel. The law was purportedly created by Israel in 2007 as a way of protecting Israel and Israelis from attacks using ordinance made with material initially intended for commercial, civilian use (details in Appendix 2). Despite the inherent contradiction with the economic rationale and arrangements of the CU, the Israeli Defense Export Control Order list has been progressively expanded to contain more products deemed as security threats by the Government of Israel. In addition to the Order’s list, Israel introduced an ill-defined list of goods that require dual-use control for entry to Gaza. The introduction of a list focusing on Gaza originated from a June 2010 Cabinet decision taken unilaterally by Israeli authorities; it includes reinforcing steel, cement, aggregates, insulating panels, timber for furniture manufacture, and many other goods. However, traders report that nearly any item can be deemed “dual use” at the entry to Gaza, even if the same items have been imported previously by the same importer with no special controls.

By defining the export of DUG to the Palestinian territory as a special category of Israeli exports (although as noted above, DUG lists are imposed by Israel on all imports to the Palestinian economy), the Israel law unilaterally created a system regulating the transfer of an extensive range of goods separate from and in addition to normal trade regulations. Goods not allowed into the Palestinian territory are described in the Defense Export Control Order in very broad, general definitions that include such items as simple as telephone battery chargers, hair dryers with built-in timers, and printers. These examples all fall under the list’s “electronic equipment” category and, as such, cannot be freely imported into the Palestinian economy. Instead, each such import needs a special authorization by the Coordination of Government Activities in the Territories’ (COGAT’s) Exceptions Committee. Approvals from this committee require a long, nontransparent, and unpredictable bureaucratic process, causing delays even for very common consumer products. In some cases, common electronic products belonging in the

DUG lists are freely imported from Israel by individuals traveling to Israel and buying them in Israeli shops, or by buying from Israeli middlemen who bring the goods into the West Bank through checkpoints where, as Israeli citizens, they are rarely questioned. The burden of applying for a DUG permit is revealed by the extent to which it is avoided. According to COGAT, 95 percent of permit requests for West Bank access are eventually approved, but in 2013, only 126 requests were submitted by fewer than 20 companies. It is likely that Palestinian traders do not rely on the DUG permit process because they find alternative ways to acquire the materials, including smuggling, which defeat the law's declared security purpose. Palestinian producers have addressed the issue through substitution, circumvention, or avoidance of specific types of production altogether (such as avoiding industries that required goods on the DUG list) (Peres Center for Peace 2015).

At the moment, import restrictions and transfers include materials as diverse as civilian machinery, equipment spare parts, chemicals, most medical equipment, most home appliances, and all telecommunications equipment. Palestinian firms that would like to have access to that capital equipment either are prevented from such access or have to face long and uncertain delays of several months or more at Israeli ports. As a consequence, Palestinian enterprises (mainly agriculture, industry, and information and communication technology (ICT)) are restrained on how they can replace worn or obsolete machinery, upgrade technology, or improve labor productivity.

Companies must submit a DUG request directly to the relevant officer in the Economic Branch of the COGAT. Permits are issued per importer and per shipment, are valid for 45 days from their issuance, and specify the maximum amount of the specific goods allowed. If for any reason the shipment is delayed beyond that time period, a new permit must be obtained. Unless companies obtain the goods through unofficial channels or substitute inputs, the DUG process and restrictions significantly limit Palestinian access to several intermediate input goods (Applied Research Institute–Jerusalem 2011). The uncertainty that surrounds the definition of DUG as a result of the broad, overly inclusive descriptions in the Israeli lists, in addition to a nontransparent process and the general lack of institutional communication, has led to a number of cases in which importers discover they must apply for a DUG import permit only after the shipment arrives at the entry port, leading to expensive storage. The final cost of substitution depends on the difference in the cost of substitute materials and the difference in the quality of the final product thereby obtained. The substitute can result in the final good failing to meet particular standard requirements, thus limiting market access and reducing competitiveness (Peres Center for Peace 2015).

The situation at entry to Gaza is more complex. In addition to customs agents and Israeli army Coordination and Liaison Administration (CLA) officials, counterintelligence officers from the Shabak (Sherut ha-Bitachon ha-Klali) also operate at the border. They

have the power of blocking any Gaza imports if they perceive the shipment to constitute a threat to Israeli security. Often, imports of DUG preapproved by the Israeli Ministry of Defense are confiscated at the Kerem Shalom/Kerm abu Salem border crossing (the sole commercial crossing for Gaza imports and exports) by the Shabak. Shabak officers conduct a four-level security check, including characteristics of the importer, intelligence on the importer's family, the importer's company, and the type of product. If one of these aspects does not pass the security check, the shipment is not allowed into Gaza. The status of any of these parameters can change without warning, and the result is importers facing the risk of high costs for storing, clearing, and returning confiscated shipments, whose possession in some instances has never been returned.

Israel has progressively added more materials, machinery, and equipment to the list of items considered dual use, and in many instances, it only allows lower quality, less effective substitutes, such as less concentrated fertilizers and chemicals. This eventually turns out to increase costs for Palestinian producers (UNCTAD 2015a). Three major macro sectors are particularly affected by the dual-use restrictions—agriculture, manufacturing, and ICT—and, in particular, the subsectors of food processing, beverages, metal fabrication, pharmaceuticals, textiles, leather, paints, detergents, and cosmetics (Applied Research Institute–Jerusalem 2011). The DUG lists include such items as fertilizers and chemicals (as presented in Appendix 1). Examples of items of relevance to these subsectors include hydrogen peroxide, at 37 percent (for sterilizing Tetra-Pac and similar beverage containers) (UNCTAD 2015a); nitric acid (for the leather industry); sulphuric acid (for treating metal before anodizing); glycerine (for pharmaceuticals); and metal pipes of all diameters. The lists also include a broad range of metal profiles, ball bearings, lathes and their parts, composite materials, hunting knives and machetes, optical equipment (such as lasers and night vision goggles), certain navigational aids, diving equipment, parachutes, gliders and other nonmotorized airborne vehicles, flares and fireworks, avionics and flight control equipment, missile-related computer technologies, and rock drills and equipment for drawing water from excavated sites.³³ Such items as precast concrete and cement which are required for Palestinian Authority–authorized projects in Gaza and have international support and supervision, are regarded as DUG (listed in Appendix 2).

The restrictions on fertilizers of standard concentration have been the most important limitation for Palestinian agriculture. Palestinian farmers use 40 percent of the amount of fertilizers used by Jordanian farmers in a comparative farming environment. Palestinian farmers are allowed to import only specific low concentration types of fertilizers. Comparing the costs for using appropriate, banned fertilizers vis-à-vis those for

33. The final report's findings are cited in the Applied Research Institute–Jerusalem (2011).

the permitted but less efficient substitutes shows that Palestinian farmers face two types of incurred costs: (1) direct costs from the use of the alternative fertilizers, since they are costlier per kilogram than a more efficient banned standard fertilizer mix, and greater volumes per hectare are required for optimal fertilization; and (2) indirect costs from the long-term loss of land productivity as a result of the “wrong” composition of the alternative fertilizers, relative to the banned ones (Applied Research Institute–Jerusalem 2011).

The Palestinian industrial sector is significantly affected by the broad constraint on imports. By restricting so many products under the DUG lists, Israeli authorities prevent the development of Palestinian productive sectors in the areas of steel, engineering, and pharmaceutical industries. For example, precision tools are not permitted, as they could be used to transform simple tubes into rockets or missile launchers with relatively increased accuracy. The textile sector is another sufferer from DUG constraints. Strict limitations on imports of standard-grade liquid oxygen prevent proper fabric dyeing. Instead, manufacturers may import only liquid oxygen with a low concentration (UNCTAD 2015a), which, in many cases, is not effective. Consequently, production and competitiveness are also affected.

The construction sector in Gaza is seriously hampered by a very limited supply of cement, wood, and steel, which are allowed into Gaza in a rationed way and on an approved project basis only by the Israeli army’s CLA, an entity in charge of conducting security screenings at border crossings in Gaza. Generally, humanitarian projects—facilitated by the United Nations Office for Project Services (UNOPS) Gaza Reconstruction Mechanism (GRM)—are approved and have access to cement and other materials. Private construction work projects need to be submitted to the Gazan Municipal Authority, and those approved are then transmitted to the Palestinian Ministry of Civil Affairs, which in turn submits the applications to COGAT for a final authorization. The approved projects are then included in an online GRM database to allow vendor suppliers in Gaza to release construction materials to clients who have been approved. According to the constructors’ union, meeting the huge need for housing in Gaza would lead to job creation. Jobs in the sector would double if the “approved-project” criteria were to be removed and could quadruple with no restrictions altogether.

Focusing the DUG lists on the higher-risk items, changing the lists from sweeping categories (such as telecommunications equipment) to specific items (such as satellite phones), and removing restrictions on materials that either are already available through other legitimate means or are of low security threat would allow Palestinian producers to import more capital equipment and intermediate materials necessary for manufacturing, agriculture, and other sectors of the economy. UNCTAD estimates that a shift to high-yield crops might lead to a 20-fold increase in

financial returns per area in a single season, if restrictions were eased (UNCTAD 2015a). Conservative estimates set reduction in land productivity from applying inappropriate fertilizers at 20 percent. Such loss, which is calculated on the value added by agricultural production from vegetable crops and fruit trees, amounted to US\$566.8 million in 2008, the latest year for which such data are available. For this reason, the indirect loss from DUG restrictions in agriculture in that year is estimated to be US\$113.4 million, not including direct costs (UNCTAD 2015a). Overall, it is estimated that concerted targeted interventions on the DUG lists to focus on some of the restrictions would save the Palestinian economy, particularly the West Bank, at least US\$160 million or about 5 percent of GDP a year, and could be achieved without reducing security (Nashashibi, Gal, and Rock 2015).³⁴

The current administration of the DUG lists reflects the predominance of Israel's security concerns over the economic needs of the Palestinian producers (Office of the Quartet 2016a). Lack of specificity and information regarding the items causes uncertainty and confusion, and the relevant military orders do not explain the application process or establish timelines for processing applications, making decisions, responding to appeals and resolving disputes. The COGAT Exceptions Committee meets infrequently with unclear timelines, and there seems to be limited staff in the Israeli administration to efficiently process applications. Bureaucracy and other regulatory constraints add to costs, which creates an incentive for smuggling of restricted goods and other illegal activities, creates costly delays, ensures the dependence of the Palestinian economy on the Israeli economy, and discourages investment in certain Palestinian productive sectors, especially ICT (UNCTAD 2015b).

Recommendations: The unilateral and discretionary imposition of DUG restrictions is imposing significant economic costs on the Palestinian economy and is in contradiction with the economic underpinning of the CU. The following actions could mitigate the adverse effect stemming from the administration of the DUG lists (UNCTAD 2015b), while ensuring mutually agreed and predictable mechanisms to control and supervise the trade of restricted goods.³⁵

- » Revising and refining the Israeli DUG lists to be more specific; easily identifiable on the basis of the Harmonized System (HS) and readily available in the web. This would clarify what goods need special licensing; would reduce the number of goods included in the lists, and eliminate those already available by alternative means

34. Another analysis estimates that DUG restrictions since 2008 have accounted for a 4.5% loss in aggregate output value in the West Bank, and a decrease in wages in dual-use input-intensive sectors (Amodio, Baccini and Di Maio 2016)

35. See, for example, recommendations from the Middle East Partnership Initiative—Peres Center for Peace (2015).

(such as compasses and global positioning system (GPS) devices that are available as smartphone apps); and would allow for greater efficiency and focus for Israeli officials checking applications. The system would be freed up from licensing television screens and phone chargers to focus on medium- and high-risk items.

- » Ensuring predictable and clear administrative procedures, including a specific timeline in which the DUG screening system would need to issue a response to a licensing request, or otherwise deem it automatically approved. This would maintain the same level of security while reducing the economic risk for Palestinian traders.

3.2 TRADE FACILITATION: BORDER CROSSINGS, CONTAINERIZATION, PORTS

3.2.1 ALLENBY/KING HUSSEIN BRIDGE AND KEREM SHALOM/ KERM ABU SALEM CROSSING

The Allenby/King Hussein Bridge is the only international border crossing in the West Bank allowed by Israeli authorities. The bridge is used for both Palestinian international trade and movement of people (excluding Israeli citizens) between the West Bank and Jordan. With special permission from the Israeli army and Jordanian intelligence, people and goods from Gaza may also cross the bridge. The Palestinian side of the border crossing is under Israeli control, and the border facility itself is managed by the Israeli Airports Authority (Elagraa, Jamal and Elkhafif 2014). The facility thus offers Palestinian traders the only route for any land trade flows, not only with Jordan, but also with countries of the greater Middle East region, such as Iraq, Saudi Arabia, and other Gulf countries, and potentially, through the port of Aqaba and Queen Alia International Airport, with countries further eastward (Palestinian Shippers' Council 2012).

On average, the Allenby/King Hussein Bridge processes only about 43 outgoing truckloads and 83 incoming truckloads per working day (PCBS 2015 figures). Many Palestinian traders would prefer to use the Allenby/King Hussein Bridge, but the limited access there, the limitation to goods that can be loaded on pallets, and the consequent shallow market penetration to the east mean that most Palestinian trade goes through the Israeli seaports of Ashdod and Haifa, which together account for 75 percent of Palestinian trade with countries other than Israel (PCBS 2012). Trade in high-value, time-critical goods also goes through Ben Gurion Airport. The Allenby/King Hussein Bridge accounts for only 3.6 percent of total Palestinian trade. PCBS (2012) data reveal that the value of total Palestinian trade in 2010 was approximately US\$4.5 billion (US\$3.9 billion in imports and US\$0.6 billion in exports). Of this total, trade through the Allenby/King Hussein Bridge was only US\$166 million, about two-thirds of which was Palestinian imports, and the remaining 33 percent (US\$54 million) was exports to the rest of the world. Exports through the bridge were 3 percent by value of total Palestinian exports.

Kerem Shalom/Kerm abu Salem is the only crossing point in Gaza used for Palestinian–Israeli trade, and is managed by the Crossing Points Authority, a branch of the Israeli Ministry of Defense. The Kerem Shalom/Kerm abu Salemborder crossing is used to transfer goods from Israel to the Gaza Strip, and for the very minimal amount of goods sent out of Gaza to markets in the West Bank, Israel, or for export. In 2012, the rate of traffic was around 250 truckloads a day, almost all of it imports. In 2015 there was one outbound truckload for every 150 truckloads entering Gaza. Since 2010, The Government of Israel has invested new Israeli shekel (NIS) 75 million in upgrading and expanding the crossing, and the Netherlands government has donated two gantry scanners, so it is now capable of handling 450 truckloads or more a day. The logistics operation on the Palestinian side of the crossing is run by two businesses who were granted a franchise by the Palestinian Authority. The Palestinian Authority Ministry of Trade and Industry has an office in Gaza that coordinates logistics and approval activity with Israel. The two sides of the crossing are 400 meters apart, and on each side is a dropoff zone for loading and unloading goods. In 2014, the Government of Egypt eased restrictions on the import of building materials, allowing the intermittent transfer of aggregates and base course gravel from Egypt at the Rafah crossing.

Trade opportunities along the Allenby/King Hussein Bridge and the Kerem Shalom/Kerm abu Salem routes are currently vastly under exploited because of a number of critical issues. These issues include (1) lack of Palestinian representation and involvement in the bridge’s control; (2) cumbersome and inefficient logistics, administrative, and security procedures (back-to-back transfer of goods); (3) limited information and resources for shippers; (4) inadequate infrastructure to meet current and future demand; (5) Israeli imposed limits on hours of operation and load configuration (load height limits), and the Israeli and Jordanian inaction on containerization; and (6) stringent Israeli restrictions on access to goods, particularly from Gaza. Following is a discussion of each key issue, along with related recommendations.

- a. ***Issue 1: Lack of Palestinian involvement in the bridge’s control and lack of Palestinian representation.*** In violation of both the 1993 Oslo Accords and the Israeli–Palestinian Interim Agreement of 1995,³⁶ which stipulate operations and crossings at the Allenby/King Hussein Bridge should be under joint Palestinian–

36. According to the Israeli–Palestinian Interim Agreement of 1995, Israel was to maintain responsibility for the overall security of the bridge and for the role of the Director General, who would have an Israeli and a Palestinian deputy to manage the respective sides of the facility. Specifically, Palestinian police, customs officials, and administrators would be responsible for West Bank Palestinian residents and visitors, and would control personal and document inspections in the presence of Israeli officials. Additionally, the agreement envisaged the creation of “special arrangements” for the passage of goods, buses, and private vehicles. Yet, upon the agreement’s signing, Palestinian customs agents were never employed at the Allenby/King Hussein Bridge. Finally, in the aftermath of the Second Intifada in September 2000, any other Palestinian presence or operation at the bridge was permanently suspended. Since then, Israel has had sole control of the bridge.

Israeli control, Israel has had full control over security and operations at the facility since the Second Intifada in 2002. The lack of a Palestinian presence—either civilian customs brokers or customs officials—at the border crossing restricts the ability of Palestinian shippers to acquire accurate and timely information. The shippers have no option other than being represented by Israeli customs agents on the Israeli side and Jordanian customs agents on the Jordanian side, usually with a Palestinian agent in Ramallah who acts to represent the licensed agents at the border.

Recommendation: Move to ensure the presence of Palestinian customs officials at the border crossing. Palestinian representation would provide critical on-site support to Palestinian shippers who, for example, face such issues as customs valuation and rejected consignments, act as accessible points of contact for inquiries and coordination on the status of their shipments, investigate the reason for any cargo refused by Israeli customs, and receive updates on crossing procedures to improve predictability and awareness of any changes in export and import requirements.³⁷

- b. ***Issue 2: Cumbersome and inefficient logistics, administrative, and security procedures (back-to-back transfer of goods).*** Palestinian import and export goods are required to go through a cumbersome “back-to-back” process at the Allenby/King Hussein Bridge,³⁸ as well as lengthy security and clearance procedures (Table 6). Each exporter needs to obtain an advance Israeli security clearance (taking a minimum of two and up to five business days). For each shipment, exporters must obtain the necessary documents from several Palestinian Authority agencies for export (certificate of origin, export license, and others), a process that can take up to several days. Truck drivers wishing to ensure their place in the queue on either side leave for the terminal as early as 4:30 A.M., while the average waiting time to first enter the commercial crossing from Road 90 is 30–60 minutes (Palestinian’ Shippers Council 2012). All trucks must carry goods on shipping pallets and to a limited height, and shipping containers are banned. After a second security check and another wait, the Palestinian trucks arriving at the crossing are unloaded in a large, exposed, secured working area without any option of refrigeration. Goods are then subject to security checks on the ground and the customs process for export is completed. The Palestinian truck driver is allowed to enter the holding area with the goods and communicate with customs and security authorities to certify them.

37. An official Palestinian presence at the Kerem Shalom/Kerm abu Salem crossing is currently largely impossible.

38. Israeli authorities describe the back-to-back system as being necessary to reduce the security risk to the load itself, and no security checks are necessary on the vehicle if it does not cross into Israel or the Israeli-controlled territory in the West Bank. They also hold that Israeli technical standards for truck safety are much higher than those that pertain to the Palestinian-controlled truck fleet, so Palestinian trucks cannot enter Israel proper.

TABLE 6: Process for Export of Goods
at the Allenby/King Hussein Bridge

Palestinian Side	Jordanian Side
Palestinian trader collects paperwork (export license, certificate of origin, agriculture certificate, Euro1 certificate for EU countries) from several Palestinian Authority ministries and agencies—1 day	
Palestinian trader submits paperwork through customs agent in Ramallah to Israeli customs broker—1–2 days to receive a day for transfer	
Goods on pallets are loaded onto Palestinian truck. Truck drives to bridge.	Jordanian truck departs Amman.
Palestinian truck waits on side of Road 90, then undergoes two security checks to enter Israeli facility. Waits again for available slot in work area.	Jordanian truck waits on approach road to Jordanian facility (2–4 hours, possibly 1–2 days).
Palestinian truck is called into work area, customs documents are processed.	Jordanian truck is called to cross the bridge to the Israeli facility, and is released to do so by Jordanian customs.
Goods undergo visual inspection for security and customs purposes.	
Goods are transferred to Jordanian truck.	Jordanian truck enters the work area, and receives the load and customs documents.
Palestinian truck departs facility to return to West Bank.	Jordanian truck is released from Israeli facility, and crosses the bridge to the Jordanian facility.
	Jordanian customs conduct customs, standards, and security checks. Goods remain on the truck.
	Jordanian truck is released by Jordanian customs and drives to its destination in Jordan or the port of Aqaba.

Source: Consultations between the authors and the Palestine Trade Center.

Note: For imports, there is an additional step of scanning palletized goods, one pallet at a time, by Israeli security during the back-to-back process. The Jordanian security check may include scanning goods with a truck scanner (donated by the U.S. government) without removing them from the truck.

At that point, the Jordanian counterpart truck will be called across the bridge from the Jordanian terminal and allowed to enter the holding area to load the goods. The Palestinian truck then returns to the West Bank. The reverse process is the same for imports, except that the goods entering the West Bank are put through a pallet-sized scanner during the back-to-back process. Palestinian shippers estimate

that the paperwork required to enter the cargo terminal on the Jordanian side can take anywhere between two and six hours to complete. The lack of a truck booking system on the Jordanian side also means that trucks wait in long lines (sometimes several hundred trucks at once) on the side of the road, waiting for their turn to drop off or pick up goods.

In Gaza, the back-to-back aspect of the procedure is even more complicated, as it involves three trucks, one of which operates as a “sterile” vehicle, which always remains within the complex. Israeli trucks transporting goods destined for Gaza are scanned by x-ray, and then transfer their load onto the ground in a walled area or “room” for security and customs checks. Goods are then loaded onto the “sterile” truck inside the terminal, which then proceeds to the other side and unloads into a second fenced-in “room.” When that area is full, the gates to the Israeli side are closed and locked, and a third Palestinian truck will enter for each load, and the goods are loaded and delivered to Gaza. A pilot project, announced at the beginning of 2016, to allow sealed containers from Ashdod (Israeli commercial seaport) directly into Gaza with goods for humanitarian agencies has not been implemented so far. Containerization has security advantages for Israel. When goods are removed from a container at the port and stacked on pallets for trucking to Gaza, the security of the load is broken. The load can be tampered with, and illegal items can be inserted. A container scanned and sealed at the port and delivered unopened to its Gaza destination avoids this risk. The reverse process, with more stringent security checks, is applied to goods leaving Gaza to Israeli destinations or to transit Israel to the West Bank or for export. The back-to-back process on pallets limits the size of goods that can cross at the Allenby/King Hussein Bridge or at Kerem Shalom/Kerm abu Salem, risks damage from the multiple handlings, and rules out transfer of many products that would be damaged by heat, dust, or, in the winter, rain.

Recommendation: Enable a door-to-door solution or establish a trailer exchange system. Rather than the slow, costly back-to-back system, which entails unloading a shipment from the trailer of a Palestinian truck and reloading it onto a Jordanian truck after it has been scanned for security reasons, authorities at the Allenby/King Hussein Bridge could enable the door-to-door solution, which allows a truck to travel from the shipment’s originating point to its final destination, without unloading and reloading at the Allenby/King Hussein Bridge. Another option is to allow Palestinian trucks to directly exchange trailers³⁹ with Jordanian trucks and have both the shipment and the trailer scanned at the same time.⁴⁰ These options would save a significant amount of

39. Trailer exchange is an established technique used at other border crossings in the world, most notably at the Mexican–U.S. border.

40. The Government of the Netherlands has donated a gantry scanner capable of scanning a full truck and load, in a container or on pallets, to be operated by the Israeli authorities at the Allenby/King Hussein

time; reduce the risk of damage from the loading and reloading process; allow for the transfer of larger items, such as furniture products and items that require chilling or refrigeration; and allow increased traffic per unit of time.

- c. **Issue 3: Limited access to information and resources for shippers.** Palestinian shippers operating through Israeli-controlled crossings often do not have advance warning about any changes in the procedures and requirements at commercial crossing points by Israeli authorities. This may result in shipments rejected by Israeli officials, payments of fees at the facility or other costly alternatives, or something as simple in changes in hours. Generally, information is not available, not updated, or published in Hebrew only (not in Arabic or English) (Palestinian' Shippers Council 2012). Shippers and drivers rely on informal channels to know what is happening. An ongoing initiative supported by the Peres Center for Peace aims at aggregating Israeli up-to-date regulations, requirements, and relevant information concerning trade-related operations through the commercial crossings in a web portal.

Recommendation: Publish Israeli and Jordanian trade- and crossing-related information in Arabic and English, in addition to Hebrew. This would increase familiarity with rules and regulations at border crossings; laws, regulations, and procedures applicable to Palestinian imports and exports; customs rules, regulations, and rates; and operating hours and potential changes in schedule.

- d. **Issue 4: Inadequate infrastructure to meet current and future demand.** Steps are being taken both at the Israeli logistics area and on the Jordanian side of the Allenby/King Hussein Bridge, to allow for containerized goods to cross. Scanners that can handle containers are already in place at Kerem Shalom/Kerm abu Salem and some of the commercial crossings between Israel and the West Bank. With these in place, exporters have the option for goods at the commercial crossing to be containerized or palletized, depending on the cost-benefit calculation for each load and its destination. Shipping in containers from the Palestinian source factory or warehouse is very attractive financially and in terms of reduced damage (particularly if goods are destined for a ship at Aqaba or an Israeli port, if they are very large, or if they require refrigeration). Pallets are a better option for more robust articles on shorter, overland routes. Containerization at the Allenby/King Hussein

Bridge. The Israeli Airports Authority and Israeli customs are constructing a working area and building to house the scanner. The due completion date in February 2016 was postponed to December 2016, but this opening date has now been further delayed. The U.S. government donated a truck-mounted scanner to the Government of Jordan (GoJ) (Public Safety Directorate) in February 2016 to scan truckloads, including in containers, of goods entering Jordan at the bridge. This scanner is being used to scan truckloads on pallets, but the GoJ has not yet instituted containerized export trade, even though the Government of Israel has agreed to cooperate for exports.

Bridge is long overdue, much has already been invested toward making it possible, and it must be expedited. Containerization will also eliminate the current special case of import products that cannot be palletized because of their size and shape (for example, air conditioning equipment or furniture). When the shipment is diverted, it must be escorted for a fee by Israeli security to the Sheik Hussein Bridge (which is 92.5 kilometers (km) north of the Allenby/King Hussein Bridge) for inspection and scanning, which adds time and cost to the logistics chain. Containerization will mean that goods will no longer be exposed to outdoor conditions, such as dust, sun, and rain, which may now cause damage to perishable goods (World Bank 2008a). This creates problems, because not all food commodities can be easily palletized, and other items, such as fruits and vegetables, cannot be packed efficiently in pallets.

- e. ***Issue 5: Israeli imposed limits on hours of operation and load configuration (load height limits), and the Israeli and Jordanian inaction on containerization.*** Limited hours reduce flexibility, such as access to the Queen Alia International Airport for high-value, perishable items like herbs and other fresh vegetables. Cargo flights are usually scheduled for early morning, and just-in-time delivery to the airport is not possible with present bridge operating hours. The Allenby/King Hussein Bridge is already under heavy demand for the facilities available, with around 1.8 million passenger crossings and nearly 30,000 truckloads of goods in 2014 (Office of the Quartet 2015). Demand has increased by 6 percent per year over the last six years for passengers, and by an average of 15 percent per year for goods. Project this increase forward to 2020, and the demand will be around 60,000 truckloads (Office of the Quartet 2015). The current four-lane bridge at the crossing was constructed in 2002 by the Government of Japan. Although passenger facilities have been refurbished and new ones are planned on both sides of the river, development of facilities and processes for both goods and passengers on both sides of the Allenby/King Hussein Bridge has lagged behind demand. The three authorities with an interest in the crossing (the Palestinian Authority, Government of Jordan, and the Government of Israel) all recognize the demand at the bridge will continue to rise in the coming years, and the facilities and system of operations in place need to be improved ahead of the curve.

Recommendation: Conform procedures and infrastructure facilities at the Allenby/King Hussein Bridge to international standards.⁴¹ The facility should be operated 24 hours a day (seven days a week) and should include on-site offices for the administration of health and agricultural standards, and containerized trade in accordance with international standards. The infrastructure on both sides of the river would need to be expanded

41. The WTO Trade Facilitation Agreement encapsulates the features of standards of operation of international border crossing points.

to allow for easy and fast access to export and import transit, separated from noncommercial traffic (movement of people); additional cargo processing and inspection areas and equipment; and additional space for operations, including waiting space. Finally, the overall time required for security inspections by Israelis should be reduced by improving the efficiency of the methods used.

f. **Issue 6: Stringent Israeli restrictions on access to goods, particularly from Gaza.**

- » **Closing of the Damya/Adom Bridge.** The Damya/Adom Bridge is parallel to the Allenby/King Hussein Bridge, approximately 40 km to the north. It was designated in the past for Palestinian exports—mainly agricultural goods as well as stone and marble. However, the Israeli army declared the bridge a “closed military zone,” and since its closure in 2005, Palestinian exporters have been forced to transit all their trade through the Allenby/King Hussein Bridge. While this closure created a short-term efficiency of operating only one crossing, it now has created an overload on the infrastructure and processes at Allenby/King Hussein, which already has limited capacity for handling imports and exports (Trade Corridors’ Facilitation Project 2009). This inefficiency could be temporarily reduced by moving to 24-hour operations, but given the trend in trade at the bridge this would be only a stop-gap measure.

Recommendation: Plan to reopen the Damya/Adom Bridge in the short term. In the near future, the Allenby/King Hussein Bridge and surrounding approach roads will reach a maximum capacity, even with the measures on hours, containerization, and infrastructure described above. A second crossing will be needed. Reopening the Damya/Adom Bridge seems like a straightforward short-term option that would dramatically reduce the overload on the Allenby/King Hussein Bridge. This option would require long-term planning toward rebuilding or extensively repairing or replacing the existing buildings on each side of the bridge, constructing a new bridge (the current single-lane military bridge has a maximum capacity of only 25 tons), and reconstructing 11 km of paved road connecting the infrastructure at the riverside to main roads on either bank of the river.

- » **Restriction of crossing points between Gaza and Israel, and restricted movement between Gaza and the West Bank.** As already mentioned, Kerem Shalom/Kerm abu Salem is the only crossing point in Gaza used for Palestinian–Israeli trade and for Gaza trade through Israel. The closure of the Karni crossing (adjacent to the Gaza Industrial Estate Project) and other crossings, represents a substantial constraint in terms of transport and transaction costs, as imports need to travel from Ashdod, north of Gaza, to the southern side of the Gaza Strip, and

then travel back northward to Gaza City. More generally, the blockade imposed on Gaza's economy severely restricts movement and the economic integration between Gaza and the West Bank.

Recommendation: Reopen Karni and other crossings, ensuring the territorial unity and economic integration of the Gaza strip and the West Bank. Reopening Karni would address this issue by providing both the industrial pole and Gaza City (where the majority of producers are located) with an easier access to imports, while substantially reducing distances. This should be expanded to reopening other crossing points to facilitate movement in and out of Gaza and ensuring effective economic links and territorial unity between Gaza and the West Bank.

3.2.2 CONTAINERIZATION

Israeli authorities restrict Palestinian traders from using containerized shipments crossing the Green Line and borders. Containers may be used for some goods at Green Line crossing points to and from the seaports of Haifa and Ashdod (Elagraa, Jamal and Elkhafif 2014), but may not be used at all at Allenby/King Hussein or Kerem Shalom/Kerm abu Salem. The alternative use of palletized shipments with strict packing regulations severely limits the quantity of goods transported in each shipment and increases costs.⁴² Each pallet is limited to (1) a height of 1.6 meters at Allenby/King Hussein and only 1 meter for exports at Gaza, and (2) only one type of product per pallet. Palletization means greater costs for some shipments, prevents scale economies, and exposes shipments to thefts. As a consequence, palletization constitutes a high opportunity cost to Palestinians, as it keeps traders from enjoying much higher gains. **As one example, it is estimated that containerization of traded merchandise would result in a 30 percent increase in projected traffic volume through the Allenby/King Hussein Bridge** (Figure 2 and Table 7) (Office of the Quartet 2015; Netherland Embassy in Tel Aviv, Israel 2016).

42. The unparalleled increase in global trade and dramatic fall in trade costs and, hence, merchandise prices, were exclusively attributable to containerized trade in the late 1960s. The immediate effect observed at the outset of containerization was a steep fall in prices, starting with the cost of loading and unloading, which decreased from US\$5.83 per ton before containerization to US\$0.16 per ton with containerized shipments. Eventually, Bernhofen, El-Sahli and Kneller (2013) have been able to quantify the value of containerization by isolating its impact on trade from that of trade deals. By looking at 22 industrialized countries, their analysis finds containerization is associated with a 320 percent increase in bilateral trade over the first 5 years and 790 percent over 20 years. In contrast, a bilateral FTA boosts trade by 45 percent over 20 years, and membership in the GATT raises it by 285 percent. In other words, containers have boosted globalization more than all trade agreements in the past 50 years put together. The effects of containerization were so beneficial that, between 1966 and 1983, the share of countries with container ports rose from about 1 percent to nearly 90 percent, coinciding with a takeoff in global trade (Bernhofen, El-Sahli and Kneller 2013).

Beyond palletization and the damage from manual inspection of shipped merchandise, transaction costs for Palestinian trade include cumbersome clearance, paperwork, and transportation procedures (Elagraa, Jamal and Elkhafif 2014).

Upon completing security and reloading operations at ports, import truckloads transit through West Bank commercial crossing points, where they may undergo another set of security procedures. Security procedures at the West Bank commercial crossing points are neither consistent nor standardized. Imports from Ashdod and Haifa are sometimes permitted to pass without scanning and manual inspection, but all goods must be offloaded from the Israeli truck and reloaded into a truck with Palestinian registration (“the back-to-back system”). Conversely, Palestinian exports must first pass through the relevant West Bank commercial crossing points and go through the inspection process, and are then transported to the relevant Israeli port. The goods that are not permitted to be shipped in containers are required to arrive at the port at least 48–72 hours before the expected departure date to undergo expensive stuffing into containers.

The World Bank’s Doing Business indicators quantify figures on the financial impact for both exports and imports, by benchmarking Palestinian transaction costs against the MENA average and Israel (Figure 1) (World Bank 2015a).

Since 2008, Allenby has been equipped with one pallet scanner with a limited pallet height capacity of 1.6 meters (Trade Corridors’ Facilitation Project 2010a). In 2012, the Netherlands donated a gantry scanner for containers to be placed at the Allenby/ King Hussein Bridge to be operated by Israel (Office of the Quartet 2015). The Allenby/ King Hussein Bridge should have started operations between October and December 2016, but completion has now been delayed. In February 2016, the U.S. government donated a

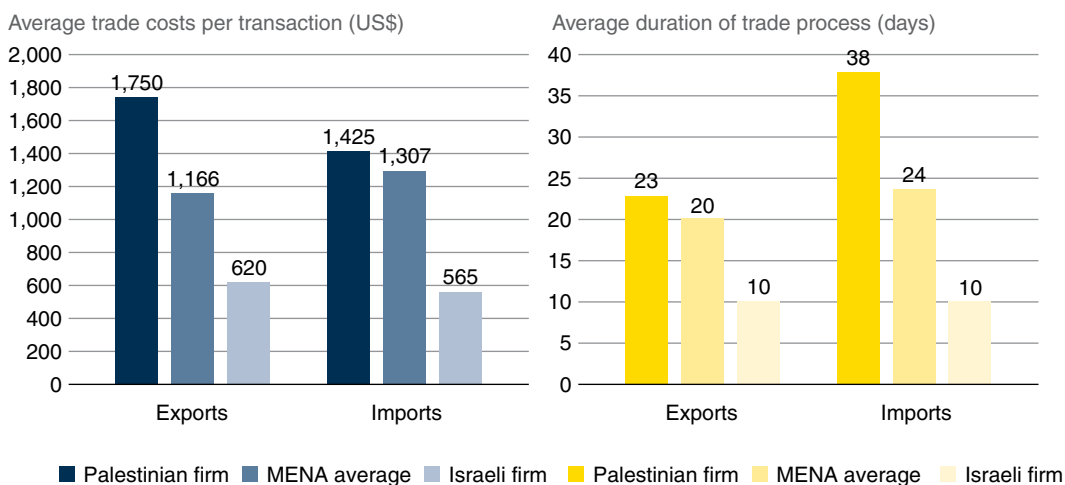


Figure 1: Trade Costs and Process Duration Comparison

Source: World Bank 2015a.

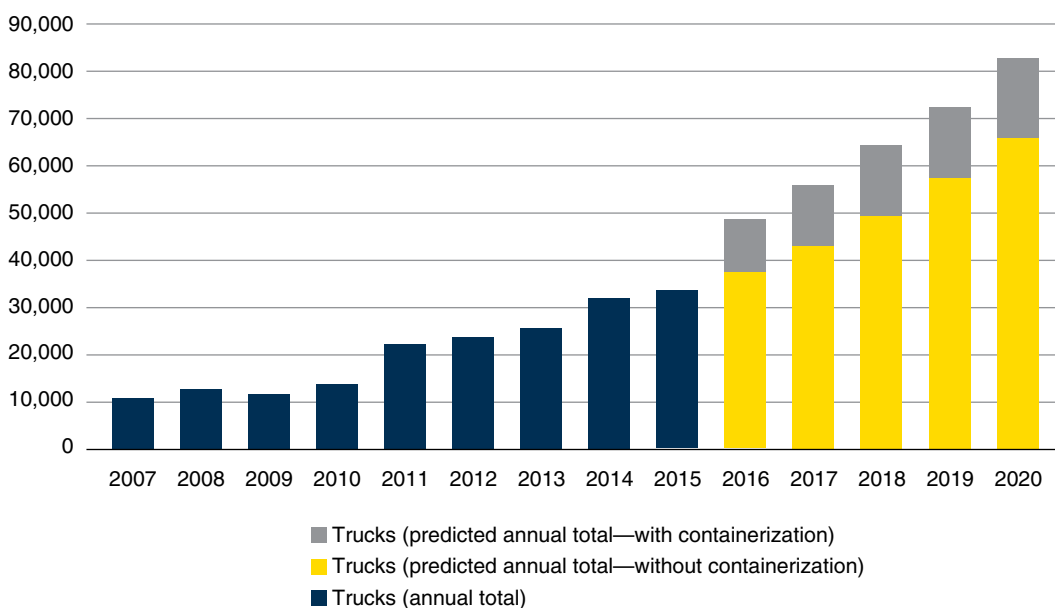


Figure 2: Volume of Trucks at Allenby/King Hussein Bridge

Source: Office of the Quartet 2015.

Note: Gray shades indicate projected values.

TABLE 7: Estimated Increase of Trade Volumes Resulting from Containerization

Imports	Potential Increase (%)	Exports	Potential Increase (%)
Metal	133	Metal	21
Paint	0	Stones & marble	0
Plastic	36	Plastic	0
Food industries	85	Food industries	19
Medical supplies	17	Shoes	18
Agricultural products	17	Pharmaceuticals	0
Personal use	0	Agricultural products	22
Raw materials	78	Personal use	0
Packaging Items	0	Glass	0
School supplies	100	Mattresses	33

Source: Trade Corridors' Facilitation Project 2010a.

scanner to the Government of Jordan, which is installed on the Jordanian side of the river to receive export goods into and through Jordan. In 2013, the Netherlands also donated a container-capable scanner to the Kerem Shalom/Kerm abu Salem crossing between Gaza and Israel, and a second Netherlands-donated scanner was installed there in 2016. These scanners are used to scan pallet loads on trucks before the back-to-back process, but have never been used to their full potential to scan containers.

As noted above, enabling the door-to-door solution (allows a truck to travel from the shipment's originating point to its final destination, without unloading and reloading) is a recommended option to facilitate trade at the Allenby/King Hussein Bridge and other border crossings. Alternatively, the introduction of routine containerization and trailer exchange⁴³ at all border crossings and ports by use of the gantry scanners⁴⁴ and other standard security processes would increase the efficiency of the movement of goods (time and costs, replacing the long and costly back-to-back process and manual inspections); reduce the risk of damage to goods; allow transit of large items, such as furniture; and allow for the transportation of refrigerated and perishable items and improved packing of shipments, in terms of both diversity and quantity—thereby increasing the ability of Palestinian firms to compete in regional markets. Containerization along the entire supply chain to or from the Palestinian warehouse or factory eliminates the additional cost of container stuffing or unstuffing at the port of lading for ship bound trade. The increased efficiency would also decrease running costs to the Government of Israel and the Government of Jordan and maintain, if not increase, security for both Israel and Jordan.

3.4.3 TRADE THROUGH ISRAELI PORTS

As noted above, the Palestinian economy import and export transits through several international gateways under the complete control of Israeli authorities, including the Ashdod and Haifa Ports (by sea), the Allenby Bridge/KHB into Jordan (via land), or via Ben Gurion Airport (air). All imports and exports arriving through Israeli ports must first go through one official Commercial Crossings operated by Israeli authorities. The great majority of

43. Trailer exchange can be instituted at any crossing where containers can be scanned (currently 2 of the 3 main crossings between Israel and the West Bank, and at Kerem Shalom/Kerm abu Salem. Container scanning should also be operable at Allenby/King Hussein Bridge as soon as Q2 2017). A truck is a complex item and scanning and/or inspecting a truck for contraband or weapons is difficult: scanning a trailer and cargo is not. Trailer exchange also eliminates the regulatory issues of licensing and technical compliance of trucks in two or more states, and means that there are no immigration procedures as the drivers do not cross. It was proposed for Gaza in 2005.

44. There are two main types of scanners: the movable gantry scanner and the pass-through scanner. The former is less mobile than the latter, but provides better imaging. The pass-through scanner can scan more than 100 trucks per hour and uses less space. The pass-through scanner exhibits scanning economies of scale beyond a volume of 140,000 20-foot equivalent units (TEUs), while the movable gantry scanner exhibits scanning economies of scale until a volume of 140,000 TEUs is reached (Cullinane 2011).

trade (over 75%) is shipped through the Israeli ports (exports mostly use Ashdod, and much less Haifa; whereas imports arrive equally). A survey conducted by the Palestinian Shippers Council (PSC 2012b) notes a long list of technical, procedural and security constraints raising the cost of conducting trade through the Israeli ports—in addition to the lack of Palestinian customs brokers, and insufficient information on the trade and security procedures at Israeli ports. PSC concludes that incurred security delays can increase costs by an average of USD 538 (NIS 2,034) per shipment. Trade restrictions and costs imposed by Israeli authorities at Allenby/KHB dissuade Palestinian shippers, despite the close proximity to the WB. According to the Palestine Shippers Council estimates (PSC 2012b) Israeli ports offer a significant cost and time advantage for sea shipments to North America and Europe as opposed to Aqaba in Jordan (which would represent a 130% increase in cost).

A major issue faced by shippers is that any procedural delays (e.g., in inspections, customs, etc.) increase demurrage days and the costs of holding goods in storage facilities, as collateral is not accepted for the release of Palestinian goods at the ports. The lack of adequate storage space in general near the crossings and ports, and in particular near the Allenby/KHB crossing may cause goods to be transferred by truck to the Ashdod Port for storage and processing, or even back to Jordan. This causes increased transportation fees and extended wait times until the goods are released to the importer in the Palestinian Territory. This rerouting proves to be a major expense for Palestinian companies, both in terms of storage costs, time delays and handling by the intermediaries. Similarly, agents redirect goods to clear customs from Haifa to Ashdod (e.g., due to the lack of availability of bonded areas within the Port and storage facilities close to it). Palestinian shippers also face challenges due to the lack of information from agents during processes. (Peres Center for Peace 2015).

Authorities may consider the establishment of one or more bonded warehouses under a pilot approach devolving Palestinian control for customs clearance and other functions, provided it is effectively implemented and does not jeopardize customs revenues or increase transactions costs further. The proposed approach would entail significant change across many dimensions of existing trade processes and regulations and would need to be properly analyzed and structured. Design options for the new operating model (e.g., policy, legal, procedural, IT and HR requirements) should be considered against trade statistics and the expected impact on the authorities and private sector, and should include an assessment of required transitional arrangements and an implementation timeframe. A number of specific issues require consideration in developing the new operating model, such as:

- » **Nature of the bilateral arrangement between the Palestinian Authority and the Government of Israel.** A bonded warehouse system will be subject to a bilateral operating agreement (i.e., exactly which controls are executed where, and where and by who goods are cleared and applicable duties and taxes are collected). This implies that the two parties will have to develop a transit system—for example Israel

Customs could require a customs transit declaration and a guarantee (to prevent diversion) and the Palestinian Authority would require a customs declaration and payment or a bond. This will add an additional step (and the associated costs) to the current system, and may imply that Palestinian importers would need to appoint a clearing agent in Israel to lodge the transit declaration with Israel and manage the transit movement, and an agent in the Palestinian territory to clear the goods (unless the parties can develop another arrangement to also license or recognize Palestinian Authority clearing agents). There is also a need to consider other dimensions such as the treatment of goods moved from Israel into the Palestinian territory, and whether any change would be envisaged on the control of such goods and the payment of duties and taxes. For this system to operate the parties will have to map and agree on the process and consider issues around electronic data exchange, guarantees, cargo tracking, and so forth. This will need to be captured in an agreement to provide certainty and a legal basis.

- » **Legal basis for the Palestinian Authority to take over responsibilities.** There will be a need to ascertain whether the current legal framework of the Palestinian Authority provides for a range of customs-related issues (e.g., customs control, appointment of places of entry and customs controlled areas, submission of goods and cargo declarations by importers and carriers, licensing of clearing agents, licensing of warehouses, keeping of records, bonds, powers of customs officers, responsibilities of clients, etc.). Extensive legal provisions are required beyond clearance and warehousing.
- » **Licensing, registration, payment and guarantees.** The Palestinian Authority would need to develop conditions that applicants for warehouse licenses will need to comply with and this requires precision on the type of warehouses envisaged. By way of example, there are six types of customs warehouse licenses in the EU, each with its own conditions and procedures. There is also a need to design various customs control systems over warehouses depending on the models selected and the system for managing bonds. In addition, the Palestinian Authority will have to review (if already in place) its system for registering importers. This would require looking at the requirements for applicants, including ways of receiving third party data to verify the veracity of applications. The Palestinian Authority would also need to review (if already in place) its system for licensing clearing agents to ensure that this meets their future needs. Finally, an appropriate system should be developed for electronic payment of duties and taxes for goods cleared for home consumption and a guarantee system for goods moved under other customs procedure codes. Part of this consideration should be given to developing an Authorized Operator program to incentivize compliance. If an importer, agent or warehouse operator meets certain criteria then some of the benefits that could be extended to them include deferment of payment, period clearance, less inspections, and so forth.

- » **ICT instruments.** The Palestinian Authority is using Asycuda World. There will be a need to determine, on the basis of the eventual operating model, which modules are required to implement such models (e.g., goods clearance, cargo manifests, tariff, selectivity, valuation control, transit, warehousing, accounts and payment, etc.). An adequate period of time is required to install and test these modules and to train the customs and private sector users.
- » **Capacity building and implementation arrangements.** The operating model for the Palestinian Authority Customs controls would have to be mapped with detailed business processes. This will enable the development of a competency framework and staffing model (i.e., required human resources, skills, etc.) and the identification of equipment needed (e.g., scanners, inspection areas etc.). Some of the critical capacity areas would be: risk management, declaration verification (document checking—tariff, valuation and origin), audit, inspection and anti-smuggling. Of these, the consideration and implementation of an appropriate risk management system is perhaps the most critical initially, and various factors come into play: develop and implement a risk management methodology; identification, analysis and evaluation of risks; measures to treat and mitigate risks, and so forth. In turn, this requires the capacity to measure compliance levels of clients; segmentation of clients based on compliance level/behavior; development of risk profiles for commodities and clients and selectivity criteria for the processing system; communication mechanisms such as feedback loops on inspection results, and so forth. If not in place, then the new system could result in significant delays and costs.
- » **Coordinated border management.** The Palestinian Authority may not only take responsibility for customs controls but also control over restricted goods that need to comply with technical standards and SPS standards. This will need to be factored into the new operating model and carefully designed, otherwise it will add to the risk of delays and costs. Specific issues to consider are the design of a control and inspection model for these goods. Elements of this will be the application of risk management, the development of a single window to electronically link all control agencies, delegating a level of responsibility to customs to prevent too many front-line agencies, etc. It is assumed that the Palestinian Authority may also want to collect the excise duties on imported goods. For example, in the case of tobacco and motor vehicles, these commodities attract excise duties in addition to customs duties and taxes. There are a number of legal and procedural requirements that would need to be put in place to enable this.

Recommendations:

- » Increase availability of information (in Arabic) on procedures, standards, import/export processing and pricing, as well as tracking of goods, customer support centers and receipts (including an online platform), **and complaints, appeals and dispute settlement systems.**

- » Enable the partial release of a shipment (if another part of it is held up by procedural delays).
- » Authorize licensing of Palestinian customs brokers (currently only agents working through Israeli brokers).
- » Apply a door-to-door system for cargo traveling from WBG to Israeli ports, and institute a known-trader system (providing preferential treatment at the crossing for traders with high volumes of trade who meet specific security standards).
- » Consider the establishment of one or more bonded warehouses under Palestinian control for customs clearance and other functions. This solution would need to be effectively implemented and supported by strong collaboration between the Palestinian and Israeli authorities, as it carries the risk of increasing transaction costs and reducing customs revenues if not implemented well.

3.3 STRENGTHENING PALESTINIAN INSTITUTIONS

3.3.1 CUSTOMS, FISCAL AND BORDER MANAGEMENT: CAPACITY BUILDING AND COORDINATION

Customs and border management institutions are key features of the international trade system—with important roles regarding the oversight of the flow of merchandise trade, security proceedings, collection of duties and taxes, and import/export activities. Strengthening institutions involved in Customs and Border Management operations is a key element of Palestinian state building, so as to ensure transparent and efficient trade processes, and smooth coordination with Israeli authorities under the existing Customs Union.

Operations and crossings at the Allenby/King Hussein Bridge should be under joint Palestinian–Israeli control. However, in violation of the Oslo Accords and Israeli–Palestinian Interim Agreement of 1995,⁴⁵ border management functions are executed by Israeli officials. As noted earlier, the lack of a Palestinian presence—either civilian customs brokers or customs officials—at the border crossing restricts the ability of Palestinian shippers to acquire accurate and timely information.

Recommendations:

- » ***International border management functions should be exercised by Palestinian agents (police, customs, standards, administrators), in conjunction***

45. Upon the agreement's signing, Palestinian customs agents were never employed at the Allenby/King Hussein Bridge. Finally, in the aftermath of the Second Intifada in September 2000, any other Palestinian presence or operation at the bridge was permanently suspended. Since then, Israel has had sole control of the bridge.

with Israeli authorities. As noted earlier, this could include a transitional arrangement involving establishment of a bonded area under Palestinian control for customs clearance and other functions like standards enforcement, provided it is implemented effectively and does not jeopardize customs revenues or increases transaction costs.

- » **A targeted capacity building program would enable the Palestinian Authority to gradually deploy its staff at the borders, facilitating interactions with Palestinian traders.** The EU recently extended a program to build Palestinian capacity on all aspects of border management. The program is intended to build confidence between the Government of Israel and the Palestinian Authority, with a focus on the Rafah crossing point.

The clearance revenue mechanism (involving customs duties, VAT and petroleum excises) which came into effect as part of the Oslo accords and the Paris Protocol, stipulates that Israeli and Palestinian institutions would levy and collect direct and indirect taxes for a shared pool, with transfers made on a monthly basis after reconciliation of accounts. Israeli and Palestinian institutions are responsible for the collection of invoices from importers in their jurisdiction and enter the information in an electronic database, which is the basis for the transfer of revenues. Given that the Palestinian customs officials are not present at the points of entry, the Protocol defined specific arrangements through which the Government of Israel collects import taxes on Palestinian trade with third countries and shares them with the Palestinian Authority. Clearance revenues represent the majority of the Palestinian Authority's revenues, specifically, 73 percent in 2015. Nevertheless, the implementation of some of the revenue sharing arrangements has been less than optimal from the Palestinian Authority's perspective (with significant fiscal leakages⁴⁶ due to unreported indirect importing, undervaluation, fraud and smuggling,

46. See World Bank (2016a): pp. 17–19. “A large number of Palestinian businesses use Israeli middlemen to import goods from third countries because procedures are seen as simpler and less time consuming relative to those applied to direct imports. For example, Palestinian importers need to apply for an import license every time they import merchandise while Israeli importers are granted a one-year license. The same applies for standards licensing. This could result in favoring Israeli importers who can clear their goods faster and cheaper. Palestinian businesses also report that regulations governing direct importing are revised often by the Israeli authorities and are only available in Hebrew which makes it difficult for Palestinian importers to meet them. Therefore, they often end up not fulfilling import requirements, which results in delaying the clearance of their imported goods and raising storage and transaction costs. In practice, however, goods that originate from third countries are imported to Israel as the final destination and then resold to Palestinian traders as Israeli goods. This is enabled by the fact that Israeli importers, unlike Palestinian importers, are not required by law to sign a declaration stating that the imported goods will only be sold in their area. As a result, indirect imports enter the Palestinian market as Israeli goods, which makes the Palestinian Authority only eligible for VAT collected on them according to the Paris Protocol. Other import duties collected on these goods are retained by the Government of Israel, resulting in a fiscal loss for the Palestinian Authority. (. . .) Finally, revenue losses suffered by the Palestinian Authority because of underreporting by Palestinian businesses of VAT paid to Israel—either because businesses seek to minimize their tax obligation to the Palestinian Authority or as a result of the Palestinian Authority's inability to obtain invoices from businesses operating in Gaza—are estimated to be significant.”

and underreporting by Palestinian businesses of VAT paid to Israel). A recent World Bank report estimates that fiscal leakages amount to about 2.2 percent of Palestinian GDP, though this does not include lost fiscal revenue collected by the Government of Israel in Area C and losses from smuggling and fraud (World Bank 2016a).

Recommendations:

- » ***Enhancing the capacity of the Customs Management and Tax authority and fostering trust and cooperation with Israeli counterparts, would enhance the transparency and efficiency of revenue collection processes and facilitate trade and stakeholder confidence.*** A series of training programs have already been organized with the Palestinian and Israeli Customs under the aegis of the USAID Trade Facilitation Project—with a view of enabling the Palestinian Authority to operate at crossing points. This should be coupled with a reconsideration of the 3% administrative fee imposed by Israeli authorities (a high percentage in relation to the volume of transaction and in terms of the scope of its applicability, namely that it applies across the board even where there are no administration expenses on the Israeli side related to customs such as petroleum products).
- » ***Implementing the Protocol's provisions regarding information sharing and cooperation could significantly reduce tax leakages on bilateral trade.*** The Government of Israel and the Palestinian Authority would start exchanging full information on the invoices submitted to them by registered businesses. This exchange of information would inform each tax authority about the actual amount of VAT paid by its registered businesses. A similar arrangement for sharing information on Palestinian imports cleared through Israeli ports has already been introduced, helping Palestinian customs combat undervaluation of Palestinian imports from third countries. Expanding the already existing arrangement to include data on bilateral trade could generate similar benefits for both parties.⁴⁷
- » ***VAT on bilateral trade with Gaza would be transferred to the Palestinian Authority.*** The Palestinian Authority rarely receives information on purchases made by Gaza businesses from Israel because its tax officials have not operated in the Strip since the internal divide. Hence, the Palestinian Authority has been unable to claim VAT on the majority of these imports since 2007. Given that the Government of Israel can keep track of all Israeli goods that actually enter Gaza (the Israeli border with Gaza is completely sealed and there is only one controlled crossing), it may be in a position to estimate and transfer to the Palestinian Authority VAT collected on bilateral trade with Gaza.⁴⁸

47. Recommendations based on World Bank (2016a), pp. 22–23.

48. Recommendations based on World Bank (2016a), pp. 22–23.

- » ***Prohibit Israeli importers from reselling to the Palestinian market goods that have been declared to Israel as the final destination.*** Since 2000, the Government of Israel has enforced such arrangements on Palestinian importers, as it requires them to sign a binding declaration prohibiting them from reselling goods imported to the Palestinian territories in the Israeli market. Israeli importers may be required to sign an equivalent binding declaration. As for businesses that import in bulk for both markets, they may be required to store imported goods in bonded warehouses and release them only after issuing an import declaration specifying their final destination.⁴⁹

3.3.2 QUALITY INFRASTRUCTURE: ENABLING ACCESS OF PALESTINIAN PRODUCTS TO EXTERNAL MARKETS

Palestinian national standards, as in the case of other modern industrial economies, need to be compatible with the ones adopted by target markets—so as to enable domestic producers to tap into external markets. Additionally, the recognition of conformity assessments with key trading partners would significantly reduce the burden for exporters. Some initial work in this area has started. The Palestinian Authority has already signed a few mutual recognition agreements, for instance with its key trading partner Jordan and other countries. The Palestinian economy is also a member of the Arab Accreditation Cooperation (ARAC), which in turn is a member of the International Accreditation Forum (IAF) and International Laboratory Accreditation Cooperation (ILAC). ARAC is in the process of being a signatory to a Mutual Recognition Arrangement (MRA) and Multilateral Recognition Arrangement (MLA). Until it happens, it is impossible for ARAC economies, including the Palestinian economy to have the international recognition of conformity assessments produced by their accredited labs and other quality assurance entities. Palestinian producers intending to export to the EU market need to have their products tested and confirmed in another country whose labs are recognized internationally. In parallel, the Palestinian Authority is negotiating with the EU a separate Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA), focusing primarily on construction materials and pharmaceuticals. Although the full implications of the ACAA should be carefully considered, once signed, the Agreement would enable specified products to be exported to the EU with relevant conformity certificates issued in the Palestinian economy. As per the Paris Protocol, Israel and the Palestinian Authority agreed to mutual and reciprocal recognition of each other's standards testing and approval processes. However, this procedure has never been operational. All products

49. Recommendations based on World Bank (2016a), pp. 22–23.

imported to the Palestinian economy are subjected to Israeli controls at borders as well as Palestinian market controls to protect consumers—in a random and inefficient way. These procedures constitute an additional burden for importers. However, Palestine Standards Institution (PSI) claimed that Israeli authorities would not care much about the quality of products produced in Israel with the final consumption in the Palestinian economy.

The Palestinian economy needs a well-functioning quality infrastructure tailored to the demand of internal consumers and external markets.

The Palestinian economy is in the process of building needed institutions to assure the quality of products and services. Currently, the PSI (established in 1994 under the Ministry of National Economy) performs most functions, including the issuing of technical regulations (these should be administered separately to avoid conflicts of interest). In addition to its core function of developing and setting National Standards, the PSI also serves as a metrology institute, enforces mandatory technical regulations, and provides quality assurance services to the private sector. The accreditation body has moved away from PSI and is structured as an independent unit in the Ministry of National Economy (MNE), which is still a semi-optimal solution. As the MNE has its own labs, the principle of impartiality is compromised and may create a conflict of interest in cases when the accreditation unit may be forced to treat the MNE-owned labs more favorably compared to private labs during the accreditation. Market surveillance is also a separate function of a Consumer Protection department of the MNE. Finally, a national technical regulation committee was formed and chaired by the MNE. However, its work is still handled by PSI and does not include the representatives of the private sector. On a positive note, the national quality policy envisages the establishment of a metrology institute to perform legal metrology and calibration services under the PSI umbrella.

A quality policy and legal framework is being developed.

The Palestinian Authority adopted its National Quality Policy (the Policy) in 2014. It aims to *establish and maintain an effective and efficient Quality infrastructure that is internationally recognized*. Overall, the Policy document is well written and reflects well internationally recognized QI good practices. It was prepared with a support of BMZ and implemented by PTB; the metrology Institute of Germany. It also has a detailed implementation plan (some reforms are already delayed though, such as the output of technical regulation from PSI). The QI priorities are also highlighted in the Export Strategy. The MNE is also finalizing the Food Safety Strategy, which would be submitted to the Cabinet soon. The Law on Metrology and Standards was adopted in 2000. It already needs to be amended as some provisions block the reforms agreed upon in the Policy. For instance, institutional mandates of PSI need to be updated. Additionally, the law allows to accredit only laboratories, so other entities (e.g., certification bodies, inspection bodies, etc.) cannot legally get accreditation. There are 69 technical

mandatory regulations introduced through Ministerial decrees, which are mandatory for producers and importers. Consumer Protection laws seems to be adequate.

The quality assurance services should meet the demand of Palestinian producers.

There are both public and private providers of quality assurance services in the Palestinian economy. These providers are mostly laboratories within universities or ministries. Medical labs are mostly with hospitals and in the private sector. Currently, there are 37 accredited laboratories (mostly testing, calibration, and medical labs). Private labs are mostly driven by the demand for testing services in sectors where the volume is the largest such as in construction materials (cement, plastic, etc.) or in testing for household appliances. Based on the size of the economy, there is a clear market failure because for most sectors/products having a relevant laboratory inside the country may not be commercially viable. To address this market failure the government may need to subsidize potential private labs for most important sectors or have recourse to government labs. Additionally, producers can use the labs in other countries (as is already the case, with products tested in Israel and Jordan).

The process used by Israel for standards approvals begins with the Palestinian trader sending the specifications of type of goods in each shipment to the Israeli army (Civil Administration for the West Bank trader, CLA for the Gaza sector), which then either approves the shipment against the standards or distributes the information to the relevant Israeli ministry for approval.

This first part of the process is on paper; there is no electronic access. If successful, the trader will, at an undefined time, receive approval to import the goods as far as the Israeli port. Each approval pertains to a single, specific shipment. Once a shipment is at the Israeli port, a sample may be taken from it and may be sent to a laboratory for a check against the standard, while the shipment is held in an expensive storage facility in the port. Insurance is an additional expense. There are no limits or guidelines on how long the process should take; ICT equipment, in particular, can be held for months at a time. The Israeli customs agents who handle the shipment for standards clearance receive a commission from the storage facility, so there is no incentive for those agents to work to clear shipments quickly. This process is very different from the efficient and cost-effective process that is available to Israeli importers, who can obtain approval for a product type that covers a year and can submit a sample in advance; if goods must be held, they can be stored in the importer's warehouse until released (Peres Center for Peace 2015). As is reported elsewhere in this paper, Palestinian shippers incur much greater costs and time delays to import goods, much of which can be attributed to the standards process.

The inefficiencies in this system have endured for many years with little improvement. The authorities who handle the process have little incentive to change. Beyond the

point of entry with the Israeli army, the system is a “black box” to Palestinian traders, who have to access it through their Israeli customs agent. A modern, electronic, “single window” to the process could increase the efficiency of the system, reduce the cost to the Israeli government, and reduce the cost to the Palestinian trader and the Palestinian economy.

Recommendations:

- » The Palestinian Authority needs to continue the implementation of the National Quality policy and particularly to finalize the reassigning of the institutional mandates for quality assurance of various agencies in line with international practices.
- » The Palestinian Authority needs to review and strengthen systems and laws related to the administration of its quality infrastructure.
- » The Palestinian Authority needs to continue ongoing work toward mutual recognition of the conformity assessments with key trading partners and also to unilaterally recognize the conformity assessment of imported products coming from advance markets such as the EU, which have established mechanisms for quality assurance.
- » The Palestinian Authority needs to continuously monitor the demand for quality assurance services and ensure the adequate supply of such services to market participants.
- » The Palestinian Authority needs to effectively adopt mutual and reciprocal recognition of Israeli and Palestinian conformity assessments, specifically for products with high volume of trade between the two sides where national standards are compatible.
- » The Israeli system would benefit from a bilingual (Arabic and Hebrew) electronic portal through which Palestinian businesses can submit applications to enter standards-relevant goods.
- » Time limits within which Israeli authorities are required to respond to an application should be published.
- » The Palestinian Authority should work toward an electronic portal capable of sending data to the Israeli system.

4 REFORMING THE PALESTINIAN TRADE REGIME: A LONG-TERM VISION

4.1 IS AN IMPROVED CUSTOMS UNION THE BEST FUTURE REGIME FOR THE PALESTINIAN ECONOMY?

The preceding sections provided a diagnosis of the Palestinian trade economy and illustrated immediate steps that should be taken to reduce the burden of trade—barriers and transaction costs—enabling over time the effective operation of the Palestinian economy as a separate custom territory. The dysfunctional CU arrangements, in the context of restrictions and low investor confidence, have led the Palestinian economy to becoming an import economy, one that exports too little. The Palestinian economy is also overly dependent on Israel in the sense that high trade costs and distorted incentives (costs of trading with the rest of the world are artificially higher than costs of trading with Israel) have diverted trade toward Israel that would otherwise not occur or that would be more profitably undertaken directly with third parties. These artificially high prices, combined with the large trade deficit that the Palestinian economy runs with Israel, imply that there is a sizeable transfer from the Palestinian economy to Israel every year. Without embarking on a comprehensive data and modeling exercise, it is not possible to quantify this transfer with any accuracy. If one were to assume that the combination of trade costs with the rest of the world and the external tariff adds 10% to the price that Palestinians pay on Israeli products compared to what they would pay abroad—which many would say is a conservative estimate—and the Palestinian economy’s trade deficit with Israel is assumed at 25% of the Palestinian economy’s GDP, that would imply an annual transfer of about 2.5% of the Palestinian economy’s GDP. This calculation ignores the fiscal leakage associated with the CU, which will be discussed further below.

A more efficiently functioning CU could lead to improved economic outcomes for the Palestinian economy. On the face of it, the CU has inherent advantages vis-à-vis alternative trading arrangements, since it eliminates all tariffs between Israel and the

Palestinian economy, minimizes paperwork (such as establishing the origin of products) and the external tariff is set at a low level, minimizing diversion of trade that places the world's most competitive suppliers at a disadvantage. It is true, moreover, that if the political situation was vastly improved and if restrictions were significantly reduced, as was the case before the run-up to the First Intifada in the mid-1980s, the CU would work better. Not only would the uncertainty and restrictions that deter investment in the Palestinian economy be reduced, but trade costs would decline and the Palestinian economy would export more to Israel and to the rest of the world. Israel's relations with Arab countries would improve and the Palestinian economy would be able to trade more freely with them. In that case, the annual transfer from the Palestinian economy to Israel could be cut dramatically since the Palestinian economy's trade deficit with Israel would fall and so would trade costs.

Such a scenario appears distant at present. But assume it came to pass, is a customs union with Israel in the long-term interest of the Palestinian economy? We believe that the answer is no. A panoramic of trading arrangements around the world is set out in Box 5. There is no example of a poor (lower-middle-income) country entering into a customs union with a high-income country in recent history. While the per capita income gap between Israel and the Palestinian economy is about 6 to 1, the gap between Turkey and the European Union (the closest comparator we could identify among all parties to a CU) is about 2 to 1.⁵⁰

Operation of a customs union requires cooperation in border management. In addition, it requires reaching mutual agreement across three important policy questions: the common external tariff, negotiation of trade agreements with third countries, and allocation of customs revenue. Given the large differences in that Israeli's and the Palestinian's economic income, size, and stage of development, it is inevitable that Israel's priorities will largely determine policy in the customs union, as has in fact occurred. At the same time, there are big differences between the Israeli and Palestinian economy in economic structure, revenue raising capacity, availability of social safety nets, poverty incidence and vulnerability of its poor; therefore, the CU's common trade policy is unlikely to conform to the Palestinian economy's development needs and priorities.

The disagreements over how the CU should operate—including over the level of the external tariff (which is a crucial source of revenue for the Palestinian Authority) standards, border procedures, negotiations of new trade agreements, the A1, A2, B, and DUG lists (as discussed in Section 4)—are themselves major contributors to the ongoing frictions.

50. The South African Customs Union (SACU), between South Africa, Botswana, Lesotho, Namibia, and Swaziland, is the oldest in the world, having been established by Great Britain in 1910, long before independence was granted. SACU contains countries at different stages of development. South Africa is the CU's largest economy by far. Its per capita income (PPP adjusted) is around \$13,000 and is about four times that of Lesotho, its poorest member. SACU allocates customs revenue proportionally to the size of trade, but then gives the poorest member a higher share.

Box 5: Alternative Trade Arrangements: The Global Picture

Currently, 160 countries and customs territories are WTO members and account for about 98 percent of world trade. The WTO regulates trade among members based on the fundamental principle of nondiscrimination, which takes two forms: (1) the MFN principle, which requires that members apply the lowest tariff to each other; and (2) National Treatment, which requires that, once they have crossed the border, goods and services originating in another WTO member country are subject to the same domestic rules, regulations, and taxes as domestically produced goods and services. WTO members can commit to a “bound” tariff, which they will never exceed; they also commit that their “applied” tariff (which they can change so long as it does not exceed the bound tariff) will apply to all other WTO members. Under the aegis of the WTO and its predecessor, the General Agreement on Tariffs and Trade (GATT), the MFN tariffs applied by WTO members have declined dramatically in the postwar period. Moreover, many countries—including nearly all advanced countries—have bound all their tariffs, often at very low levels.

Under WTO rules, members can depart from the MFN principle and grant each other preferential treatment by concluding a preferential trade agreement, provided (1) the agreement covers substantially all trade, and (2) it does not imply raising tariffs against nonmembers. Today, nearly all WTO members are parties to preferential trade agreements, of which some 500 have been notified to the WTO. Approximately half of world trade now occurs under these preferential agreements. This means that the lowest applicable tariff, the AHS rate (which is the tariff rate effectively applied under the Harmonized System nomenclature in preferential trade agreements) is found to be far below the MFN applied rate. For example, in the case of Jordan, during 2011–14, the average bound tariff rate was 16.2 percent and the average MFN applied rate was 9.5 percent, but the AHS rate was just 4.0 percent (trade-weighted average), reflecting Jordan’s several free trade agreements (FTAs) with the United States, European Union, and GAFTA.

Preferential trade agreements take two main forms: (1) FTAs, where the parties eliminate tariffs on trade between them; and (2) customs unions (CUs), where the parties eliminate tariffs on trade between them, but also adopt a common external tariff. The most prominent example of an FTA is NAFTA, and the most prominent example of a CU is the European Union. Some 85 percent of preferential agreements notified to the WTO are FTAs, and several of these include both developing and advanced country members. As a general rule, CUs tend to be concluded among parties at similar stages of development.

Although WTO members have shown a pronounced preference for FTAs rather than CUs, the literature on the comparative benefits and costs of the two arrangements does not provide a definitive or general indication (Andrimananjara 2011; Clausing 2000). The biggest advantage of CUs is the avoidance of rules of origin, which are needed in FTAs to prevent transshipment of goods from the party with the lower tariff to the party with the higher tariff. Rules of origin distort trade, their administration can be cumbersome and costly, and they can also be used for protectionist purposes. Moreover, insofar as the CU’s common external tariff is set at a level lower than the average of the parties, it can be shown to create more trade than an FTA (Krueger 1997). However, in addition to the management of borders, CUs require a high degree of political and administrative coordination in three crucial areas: the setting of the common external tariff, the negotiation of free trade agreements with third parties, and the division of tariff revenues.

These coordination challenges exist among partners of the European Union, but, for the most part, they appear to have been met quite successfully, given the strong political motive behind the European Project and the establishment of elaborate mechanisms that govern the union. However, the same cannot be said in many other instances, such as in Mercosur and various CU agreements in Africa. The adoption of a common external tariff has been especially problematic, often leading to numerous exceptions and exemptions

(continued)

Box 5: Continued

and to covert protection where the parties cannot agree on exceptions. Large bilateral trade deficits within a customs union have also been a source of friction (including, for example, within the Eurozone), as have trade negotiations with third parties. Also, the division of tariff revenue has often been problematic: on whom and where should the tariff be levied, on what basis should the revenue be allocated, and how should the cost of administering customs be divided? Among developing WTO member countries, which often rely heavily on tariff revenue, the resolution of these issues is critical.

The successful management of a CU requires above all a high level of political commitment, usually including a commitment to increased political as well as economic cooperation, and a high level of trust among the parties. Obviously, these conditions are more difficult to satisfy in instances where there is a large asymmetry of size, power, and world view, where there are large bilateral trade imbalances, and where economic policy priorities vastly differ. For these reasons, WTO members resort much less frequently to CUs than to FTAs, and CUs tend to be prevalent only among parties at similar levels of development.

In no area are the frictions more evident than over the allocation of customs clearance revenue. This is the revenue owed to the Palestinian Authority on import taxes collected by Israel on its behalf, which in practice account for all of the Palestinian economy's import taxes, since Israeli customs controls all crossing points, including the Allenby/King Hussein Bridge, which links the West Bank to Jordan. Since the Palestinian Authority relies on this revenue for more than half of its budget, the issue is of “revenue leakage” is extremely sensitive and has long been a bone of contention. This issue has also been widely analyzed, including in an extensive report by UNCTAD (Elkhafif, Misyef and Elagraa 2014).

Although the numbers are—in essence—speculative, and estimates of the impact are subject to many heroic assumptions, these leakages are large and, according to UNCTAD, may amount to more than 3 percent of Palestinian GDP and 18 percent of the Palestinian Authority's tax revenue (Elkhafif, Misyef and Elagraa 2014). The first source of revenue leakage is smuggling of Israeli goods imported to Israel from third parties into the Palestinian economy (police reported 11,967 such instances in 2009–11 and intercepted \$240 million of smuggled goods), depriving the Palestinian Authority of both VAT revenue on the shipments originating from Israel and purchase tax revenue and tariff revenue on goods imported from third countries. The second source of revenue leakage is from imports into Israel from third countries (or components imported from third countries, which represent a large part of the value added of Israeli assembled goods⁵¹), which enter the Palestinian economy officially as goods of Israeli origin. Since Israel's sales to the Palestinian economy are accounted for using VAT invoices (except for

51. Rules of origin typically dictate that a good has to have at least 40 percent of domestic value added to be attributed origin.

sales of agricultural products not subject to VAT and reported separately by Israel's Ministry of Agriculture), and these invoices do not specify the origin of the goods, there is plenty of room for error. The effect is to deprive the Palestinian Authority of tariff and purchase tax revenue due on these imports,⁵² which accrues, instead, to the Israeli treasury.

A more recent estimate of fiscal leakages prepared by the World Bank presents somewhat smaller figures, amounting to about 2.2 percent of Palestinian GDP, but does not change the underlying picture. Moreover, the World Bank numbers are explicitly presented as underestimates, since they do not include revenue collected by the Government of Israel in Area C and also do not include losses from smuggling and fraud (World Bank 2016a). **The revenue clearance issue is politically very sensitive, not only because of its size relative to the Palestinian Authority's budget, but also because Israel has at times resorted to withholding clearance revenue as a means of putting pressure on the Palestinian Authority.** Moreover, Israel often makes changes to its tariff and purchase tax regime for its own reasons, unilaterally and without consultations with the Palestinian Authority.⁵³ Generally, these reforms have been in the direction of liberalization, reducing the scope both of tariffs and of purchase taxes. While this helps Palestinian consumers, it deprives the Palestinian Authority of critically needed revenues.

In evaluating the operation of the CU between Israel and the Palestinian economy, it is natural to ask whether the dysfunction is due to shortcomings in the design and operation of the CU or whether it is due to the political tensions between the parties and the restrictions that accompany them. The answer is that it is not possible to neatly separate the two, as both feed on each other and the CU is by its nature a highly collaborative exercise.

It is important to carefully evaluate possible alternatives to the Customs Union that could be the subject of a broader political agreement. The analysis of alternative trade regimes that follows is intended to help policy makers visualize a trade framework under which the Palestinian Authority can regain its capacity to conduct economic policy and escape from its stunted development path. Such a vision could also help provide a more propitious setting for mutually beneficial economic relations with Israel, as well as enhance the prospects for improved stability and security for both sides, and better political relations, whatever shape they might take. Such a renewed trade framework would be consistent with the aspirations of the Oslo Accords (and minor adjustments in Oslo II)—and the ensuing 1994 Paris Protocol on Economic Relations—written

52. In addition, VAT revenue on these taxes represents a leakage, since VAT is payable on the value of the shipment, including applicable tariff and purchase tax.

53. The Joint Economic Commission, provided for in the Paris Protocol as a forum where issues of joint economic interest should be discussed, has not met for many years.

as a transitional format to take the Palestinian economy from where it had been during 1967–94 as a dependent of Israel, toward greater economic sovereignty in the context of increased stability and peaceful relations. This would include the Palestinian Authority’s ability over time to effectively control its custom territory, and, among other things, autonomously exercise effective control of its borders, set and collect VAT and import tariffs, and set and enforce industry standards.

4.2 ALTERNATIVE TRADE REGIMES

Short of a potentially disastrous clean break in economic relations between the Palestinian and Israeli economies, there are two realistic alternatives to the current CU that might be agreed on: an MFN regime and an FTA. The first alternative is an MFN regime under the WTO, where Israel and the Palestinian economy trade at arm’s length and without discrimination. The second alternative is to negotiate an FTA between Israel and the Palestinian economy, with both of them in control of their customs territories and retaining their right to independently set tariffs vis-à-vis third parties.

Addressing the question of whether the parties should enter into an FTA requires making an assumption about what the Palestinian economy’s MFN regime will look like once the CU is dissolved.⁵⁴ For discussion purposes, we will assume that the Palestinian economy’s trade regime will look like Jordan’s, which is a relatively liberal trade regime (See Table 4 and Box 5 for definitions of terms.) This assumption is somewhat arbitrary, of course. However, Jordan’s example is highly pertinent for the Palestinian economy, not only because of the similarities between the two economies in terms of endowments and proximity, but also because Jordan, like the Palestinian economy, has already negotiated trade agreements with the United States, European Union, GAFTA, Egypt and Jordan. Note (Table 4) that Jordan’s effectively applied tariff (AHS)—the lowest applicable rate accounting for all its bilateral trade agreements and the composition of its trade—is

54. Clearly, if the Palestinian economy were to adopt a zero MFN tariff (a policy that no WTO member has adopted, with the exception of the Hong Kong province of China), then the question of an FTA with Israel would be moot. Indeed, it could be argued on purely conceptual grounds that complete free trade is superior to any kind of preferential agreement for any country, and the Palestinian economy is no exception. However, desirable as it may be in theory, the Palestinian economy is highly unlikely to opt for anything close to a Hong Kong-like course, for three reasons. First, until it develops a much more effective revenue raising capacity, the Palestinian economy will continue to rely on tariff revenue and other border duties for an important part of its revenue, as do many other lower-middle-income economies. Second, given the importance of agriculture as a source of livelihood in the Palestinian economy, and the extent to which the sector is protected and subsidized among its trading partners, the Palestinian economy would likely continue to protect its agriculture to a significant extent, as is also the norm across lower-middle-income economies (and most high- and middle-income economies as well). Though in theory adopting a completely liberal trade stance in agriculture could make sense for the Palestinian economy, its farmers, who operate small-scale operations (90 percent of Palestinian farms are less than 40 dunams/4 hectares) would be large losers, and the resources to compensate them are simply not available. Third, the Palestinian Authority would want to retain some negotiating chips as it negotiates trade agreements with third parties, including with Israel.

4%, less than half of its MFN rate and only 2% higher than that of the CU between Israel and the Palestinian economy. Also, Jordan's AHS rate has been on a sharp downward path: it was much lower in 2014 than in 2004, the result of implementing trade agreements with its main trading partners. Thus, assuming that the Palestinian Authority does not withdraw from its existing FTAs (and we believe there is no good reasons for it do so) the Palestinian economy's trade regime will be liberal from day one. Even if the Palestinian economy adopts a high MFN tariff rate (which is unlikely as it has to negotiate its entry into the WTO) its AHS rate will be much lower than its MFN rate.

The assumption that the Palestinian economy's trade regime will be liberal from the outset is important for three reasons: first, because—as many analysts have argued (Dessus 2004; Schiff 2003)—the Palestinian economy's trade regime might be prone to capture by special interests, and a protectionist trade regime could turn out to be inferior to the customs union; second, because the Palestinian economy's FTAs will enable the Palestinian economy to quickly scale up its trade with other trading partners when and if the CU is dissolved; and third, a liberal trade regime implies that, should the Palestinian Authority conclude an FTA with Israel, the implied trade diversion will be less.

We believe that an FTA between Israel and the Palestinian Authority could be viewed favorably by Israel. The Palestinian economy represents a significant export market for Israel and is especially important for a number of sectors which export relatively little outside of Israel. Assuming that the Palestinian economy's new trade regime looks much like Jordan's—implying an MFN tariff of close to 10 percent, many tariff peaks, especially in agriculture, and extensive FTAs with major trading partners—Israel would naturally be keen to avoid tariffs and not suffer preference erosion relative to the European Union, United States, and Arab countries with which the Palestinian economy has FTAs.

However, viewed from a Palestinian perspective, the economic argument for an FTA with Israel, with whom it runs a very large trade deficit, is less compelling.⁵⁵

In the Palestinian economy, as in many developing countries with weak tax-raising capacity, tariff revenue considerations play an important role, and the revenue strapped Palestinian Authority will be inclined to continue to levy tariffs on Israel. Assuming, for example, that around half of Israel's official exports to the Palestinian economy (BOI 2014) originates in

55. It is worth noting that, whichever trade regime is chosen—either an MFN regime under the WTO, or an FTA—the issue of certified origin of goods or components, and added value in processed goods, would solve the leakage of Palestinian Authority revenue that now occurs when Israeli companies act as an entrepôt channel to or from the Palestinian economy. This would ensure that Palestinian Authority revenues would more closely match the amounts for which the Palestinian Authority is entitled. There would be complexities and difficulties in implementing certificates of origin in what has previously been a single customs area, but the return on effort would be considerable.

Israel,⁵⁶ and that the Palestinian economy applies an MFN tariff of 10 percent, the loss of fiscal revenue from according duty-free treatment to Israel could amount to around 2 percent of GDP.⁵⁷ If the Palestinian economy were to adopt a more restrictive trade regime than Jordan's, such as like Egypt's, the revenue loss would be greater still.⁵⁸ Moreover, since, as discussed above, Israel's comparative advantage lies in only a narrow set of products, the losses of Palestinian consumers from the imposition of an MFN tariff on Israeli products would be contained insofar as more products could be sourced less expensively from Arab neighbors or in Europe and the United States with whom the Palestinian economy already has FTAs. And, while Israel is a large market relative to the Palestinian economy, it is a tiny part of the world market, and Palestinian exporters could find new outlets for their exports in the large Arab markets and elsewhere. Obviously, the new tariffs the Palestinian economy would face in Israel's markets would not be welcome, but the Palestinian economy exports relatively little to Israel, and Israel's trade regime is already quite liberal anyway. Similar conclusions were reached by Schiff (2003). Eschewing an FTA with Israel would also avoid Palestinian businesses having to comply with cumbersome and restrictive rules-of-origin requirements (Panagariya and Diwan 1997; Krueger 1997), which are especially costly for small economies, such as the Palestinian economy, which have to rely on imported inputs (Krueger 1997; Panagariya and Diwan 1997; Dessus 2004).⁵⁹

The political economy of an FTA with Israel would also be problematic in the Palestinian economy. Negotiating such an agreement entails relying on the interest of exporters to offset the influence of the import competing sectors. Since the Palestinian economy runs a very large trade deficit with Israel, and the Palestinian export sector is tiny, its ability to act as a counterweight to the much larger import competing sector—which includes directly competing products in agriculture, processed food, stone quarrying, shoes, clothing, and generic pharmaceuticals, as well as in many types of services—would be limited. Indeed, following half a century where Israeli products enjoyed the artificial advantage already discussed, the Palestinian Authority might be keen to encourage a rapid diversification of its imports.⁶⁰ For both economic and political economy reasons, then, the prospects for a narrowly defined FTA between Israel and the Palestinian economy appear inauspicious.

56. UNCTAD (Elkhafif, Misyef and Elagraa 2014) refers to a BoI estimate that the share is 61 percent.

57. Israel's exports to the Palestinian economy were US\$2.9 billion in 2014, accounting for about 22 percent of the Palestinian economy's GDP.

58. If the Palestinian economy adopts a very restrictive trade regime, it could end up worse off than under the present customs union (see next section).

59. See Dessus (2004) and Missaglia and Valensisi (2010) for a modeling approach that allows for unemployment.

60. To be sure, this rather discouraging assessment of the prospects for an FTA between Israel and the Palestinian economy today could look quite different in the future, should the Palestinian economy succeed in improving its investment climate and diversify the product and geographic composition of its trade. If the Palestinian economy develops rapidly, overcomes its fiscal crisis, becomes more competitive, and shows itself able to attract foreign investment, including from Israel, its trade deficit with Israel might narrow significantly, and the prospects for increasing Palestinian exports to Israel could be much greater, changing the Palestinian

However, evaluating a possible FTA between the Palestinian and Israeli economies by focusing only on trade is too limiting, as there are many other areas of possible collaboration, and broadening the negotiating agenda increases the likelihood that win-win outcomes are found. The assessment of the opportunity to pursue an FTA changes considerably if the economic negotiating agenda is broadened to encompass other areas where Israel can reciprocate. These areas are very important and the gains from the Palestinian economy would probably turn out to be much larger than any possible disadvantages associated with a narrow FTA. They include: increased and better compensated and regulated labor movement;⁶¹ promotion of foreign direct investment; investment; and technical and business collaboration in such crucial areas as energy, water utilities, and infrastructure. Though significant trade opportunities exist, and exploiting them could be a central part of the deal,⁶² there are also vital nontrade areas where the Palestinian economy's and Israel's needs coincide closely today. International donors whose preoccupation is the development of the Palestinian economy, peace and stability would favor collaboration across a broad front. This means that they may be more inclined to provide the Palestinian Authority with the needed budget support as it undergoes a major transition, builds institutional capacity, invests in trade and transport infrastructure, and undertakes regulatory reforms to establish a more conducive business environment.

An important quid pro quo for continued preferential access to the Palestinian market is for Israel to allow a large number of Palestinian workers to continue to commute to Israel, to increase the range of sectors and level of worker skills Israel will accept, to take steps to formalize their employment, and to transfer a larger share of the income tax and social contributions revenue to the Palestinian Authority. The gains for Palestinian workers and their families would represent by far the greatest welfare impact of such an arrangement, and the indirect effects of increased incomes on Palestinian businesses would also be large. But the direct fiscal impact could

economy's benefits in favor of an FTA.

61. While around 90,000 Palestinians now work legally in Israel (and perhaps another 30,000 illegally), setting quotas and all other decisions are made unilaterally by the Government of Israel.

62. Despite all the problems, a lot of new mutually beneficial trade has clearly been created between the Palestinian and Israeli economies—not just the diversion of trade from more efficient third parties. For example, in the five relatively peaceful and restriction free years immediately following the June 1967 war, when people and goods moved freely, (1) Israeli exports to the Palestinian economy soared from close to zero to exceed US\$1 billion, while the Palestinian economy's exports to Israel are estimated to have reached US\$500 million (representing a very large share of GDP at the time); (2) over a short period, some 75,000 Palestinian unskilled and semi-skilled workers found work in Israel; and (3) both the Palestinian and the Israeli economies enjoyed a period of rapid growth. The point here is that under a scenario of more typical economic relations and appropriate trading arrangements, the Palestinian economy would benefit from trading with Israel, a much larger high-income, high-tech economy contiguous to it, that could also be the source of large foreign direct investment in the Palestinian economy. Intense trade and cross-border investment involving wealthier neighbors is the reality in countries as diverse as Morocco, Egypt, and Turkey with the European Union; Mexico and Costa Rica with the United States; and Poland and Slovakia (well before they became EU members) with Germany.

TABLE 8: Key Trade-offs of Alternative Trade Regimes

Customs Union		Autonomous Customs Territory		
Customs Union between Palestinian and Israeli Economies		FTA between the Palestinian and Israeli Economies	Broad Economic Partnership between the Palestinian and Israeli Economies (including FTA)	Liberal MFN Regime for the Palestinian Economy
+	<p>Low external tariff</p> <p>Administrative ease</p> <p>No ROO requirement on exports to Israel</p>	<p>Continued access to Israeli market at preferential rate</p>	<p>Continued access to Israeli market at preferential rate</p> <p>Labor agreement</p> <p>Agreement on foreign investment</p> <p>Collaboration on energy, water and infrastructure</p>	<p>Control of economic border</p> <p>WTO membership</p> <p>Low MFN tariff negotiated at WTO</p> <p>Trade-supportive regulations and institutions</p> <p>Implementation of existing FTAs with EU, US, GAFTA, Egypt, and Jordan</p>
-	<p>Large transfers to Israel = imports from Israel × (preference margin + differential trade costs with rest of world). Included in these transfers is lost tariff revenue on imports from Israel (relaxation of security restrictions and control of economic border can reduce the transfers to Israel)</p> <p>Cost of defraying customs operation by Israel (3% of trade)</p> <p>No control over: external tariff, negotiation of new FTAs, collection of customs revenue (fiscal leakage)</p> <p>In the long term, the asymmetry of the two parties carries a high risk that any adjustments/ negotiation will be tilted in the interest of the stronger party</p>	<p>Net transfers to Israel (insofar as the Palestinian economy's MFN rate is higher than the common external tariff)</p> <p>Included in these transfers is lost tariff revenue on imports from Israel</p> <p>Administration of ROOs on exports to Israel and other costs related to sovereignty of borders, etc.</p>	<p>Net transfers to Israel (as above but higher insofar as the Palestinian economy's MFN rate is higher than the common external tariff)</p> <p>Included in these transfers is lost tariff revenue on imports from Israel</p> <p>Administration of ROOs on exports to Israel and other costs related to sovereignty of borders, etc.</p>	<p>Costs related to sovereignty of borders</p>

Note: ROO = rule of origin

also be significant. Under a worker mobility agreement, Israel would commit to numbers of workers but would also commit to formalize their employment, and to transfer a large part of income tax, social security, and health care contributions to the Palestinian Authority, since commuting workers would draw on the public services in the Palestinian economy. Currently, even though the Paris Protocol provides for 75 percent of the income and other taxes paid by Palestinian workers to be transferred to the Palestinian Authority, the amount of taxes actually transferred to the Palestinian Authority under this protocol is minuscule (Elkhafif, Misyef and Elagraa 2014). According to the IMF, Palestinian manual workers in Israel generate income equal to about 10 percent of Palestinian GDP (IMF report to the AHLC, September 2013 and September 2015). Assuming that numbers stay at current levels, the Palestinian labor force in Israel (which is largely unskilled, low paid, and frequently employed informally) pays taxes equal to 10 percent of its income, and 75 percent of that revenue is transferred to the Palestinian Authority—equal to 0.75 percent of GDP. A recent World Bank report has estimated that the Government of Israel retains US\$669 million—equal to 5.3 percent of Palestinian GDP—owed to Palestinians and to the Palestinian Authority, consisting mainly of pension and health care contributions by Palestinian workers withheld at the source (World Bank 2016a).

Both Palestinians and Israelis may be reluctant to see much larger numbers of Palestinians working in Israel. Over and beyond political and security considerations, as already discussed, durably raising the Palestinian economy’s long-term growth rate is probably best achieved by providing jobs at home, not abroad. Israel’s income inequality is already very high by the standards of high-income countries, and—absent a big jump in the skill level of the lowest paid Israelis—that cautions against allowing ever larger numbers of unskilled workers in Israel (notwithstanding the demands of Israeli construction and agricultural interests). However, there are important other areas where Israel could favor the Palestinian economy as part of a quid pro quo for continued free access to the Palestinian market and that could also have fiscal implications, as well as large welfare gains for the Palestinian population—such as job creating and technology enhancing foreign direct investment by Israeli companies in the Palestinian economy. Another important area is preferential access to natural gas, which Israel is likely to find in excess supply in coming years; electricity; and technical assistance and investment in water and wastewater management. These issues and opportunities have been extensively analyzed elsewhere.⁶³

Even though the Israeli economy is much larger than the Palestinian economy, Israel would have a strong interest in this kind of comprehensive economic partnership. Not only is the Palestinian economy a significant market for Israeli exports, but Israel, given its solid growth rate and low unemployment, needs workers, and the Palestinian

63. For an overview of critical infrastructure investments and related issues, see Office of the Quartet (2015, 2016b).

workers are the least administratively complex for Israel. Israel also needs markets for its new natural gas finds. And, surely, for security and for other reasons, Israel would prefer not to have a failed community as its closest neighbor.

4.3 TEN FEATURES OF THE PALESTINIAN ECONOMY'S NEW TRADE REGIME

This section presents the underpinnings and defining elements of a new trade regime for the Palestinian economy—to be established within a reformed framework of economic relations with Israel. This entails deepening some of the arguments in the previous section, but also highlighting other features that we consider essential to a successful trade reform.

4.3.1 OBJECTIVES AND UNDERPINNINGS

The objectives of a new trade regime in the Palestinian economy are ambitious:

(1) facilitating a shift in the Palestinian economy—becoming less an import economy, establishing a vibrant export sector (see Box 6: Palestinian National Export Strategy); (2) reducing its trade costs; (3) reorienting its trade, drawing on the cheapest sources worldwide, improving its access to Arab markets, as well as to markets beyond the region; (4) reducing its dependence on Israel for control of most of its fiscal revenue and to help establish a larger and more durable tax base; and (5) leveraging its deep economic ties with Israel.

Box 6: Palestinian National Export Strategy

In September 2014, the Palestinian Authority endorsed the National Export Strategy (NES), a central element of its agenda to sustainably boost Palestinian exports, tap into new markets, and develop the Palestinian economy. Developed with the support of the national community, the NES identifies priority goods (olive oil; stones and marble; fresh fruits, vegetables, and herbs; agro-processed meat; textiles and garments; footwear and leather; as well as furniture) and services (tourism and information and communication technology), which are selected based on their capacity to contribute to export growth, trade deficit reduction, and employment generation. The NES also plans for a Palestinian Export Council to be established and spearhead the strategy's implementation. The target metrics for the NES include (1) increasing the value of Palestinian exports over the next five years by approximately US\$722 million; (2) generating US\$483 million in exports of products from priority NES sectors; (3) growing exports of services from priority NES sectors by US\$239 million; (4) developing the export sector (products) at an average of 13 percent per year; and (5) generating an overall growth of the export sector (products) of 67 percent. Achieving these targets will require significantly improving the Palestinian economy's supply-side competitiveness, enhancing its institutional capacity and business environment, addressing constraints to trade facilitation and logistics, and boosting access to finance and market information.

Sources: Palestinian Authority 2014; Office of the Quartet 2015.

As mentioned from the outset, it would be naive to believe and misleading to suggest that reform of the trade regime can, by itself, address all these issues. For example, it is difficult to imagine a sizable increase of investment in manufacturing in the Palestinian economy without it being preceded by a period of stability that reassured investors, reliability in the movement of people and goods, or an opening of access to the potential to build and to exploit the natural resources of Area C. It is also difficult to imagine that, in the presence of so many restrictions, Palestinian productivity can greatly accelerate to the efficient movement of people and of goods. However, it would be equally naive—and even dangerous—to believe that the current situation can endure. It would also be wrong to assume that one cannot make progress toward a more viable Palestinian trade regime until all the other conditions are fulfilled. And, to begin the journey, one needs to know the destination, or at least its general direction.

The Oslo Accords and the ensuing Paris Protocol on Economic Relations were written as a transitional format to take the Palestinian economy from where it had been during 1967–94 as a fully integrated and dependent element of the Israeli economy toward greater economic sovereignty in the context of increased stability and peaceful relations. **In the spirit of these agreements, the key underpinning for a reformed long-term trade vision is that the Palestinian Authority would be able to control its customs territory, including, among other things, exercising the effective control of its borders, setting and collecting VAT and import tariffs, and setting and enforcing industry standards.**

4.3.2 KEY ELEMENTS AND RATIONALE

We propose that the destination should be a comprehensive set of trade reforms in the Palestinian economy that also profoundly alters the framework of economic relations between the Palestinian and Israeli economies. The reforms are comprised of the following ten elements:

1. Control over a separate customs territory
2. WTO membership
3. Continuation of liberal trade
4. Time-bound and performance-based international aid to assist in the transition
5. FTA with Israel
6. Labor movement agreement with Israel
7. Technical and business collaboration with Israel in critical areas (energy, water utilities, infrastructure, natural resources)
8. FTAs with major trading partners
9. Capacity building in the operation of customs and tax collection
10. Domestic competitiveness enhancing reforms

Following is a brief discussion of the rationale for each of these elements. (Implementation and sequencing are discussed in Section 5.)

- » **Effective control over its customs territory would enable the Palestinian Authority to exercise an independent trade policy more appropriate to the Palestinian economy’s level of development and comparative advantage.** It would also help facilitate Palestinian trade with the rest of the world, especially with the Arab countries. Control of the customs territory, entailing Palestinian customs officers at the relevant crossing points through which Palestinian imports and exports flow, would enable the Palestinian Authority to raise customs taxes, excise taxes, purchase taxes, and VAT directly.
- » **The Palestinian Authority should seek full membership into the WTO.** This effort would require negotiations with several interested WTO members, including Israel. The Palestinian Authority would be asked and encouraged to establish a liberal trade regime, and required to adopt regulatory and legal reforms that facilitate trade and safeguard the interest of trading partners and in some limited areas of foreign investment. In exchange, WTO membership would secure predictable access to 98 percent of the world market. For example, it would limit Israel’s ability to raise tariffs against the exports of the Palestinian economy, even in the absence of an FTA with Israel, and, conversely, would limit the Palestinian economy’s ability to raise its tariffs vis-à-vis Israel beyond the tariff it applies to other WTO members (the MFN principle). Most important, the run-up to WTO membership would provide a roadmap for a broad range of trade and investment supportive reforms, would significantly strengthen the hand of Palestinian reformers politically, and would help make the Palestinian economy more competitive and attractive as an investment destination. WTO membership has historically proven above all to be a vital instrument to achieve open and predictable trade and a binding mechanism to enact trade supportive domestic reforms.
- » **In any event, the Palestinian economy’s new trade regime *should be liberal, consisting of a moderate MFN applied tariff, limited tariff peaks, and steady expansion of its bilateral trade agreements that lowers its effectively applied tariffs (AHS).*** This is the trajectory adopted by the likes of Jordan, Morocco, and Tunisia. While, as already argued, a case can be made for higher tariffs in the Palestinian economy on various grounds—for example, to raise tax revenue, to countervail agricultural subsidies, and to retain negotiating chips—there are usually better ways in the long run to achieve these objectives than embarking on a protectionist course. Indeed, should the Palestinian economy adopt a highly restrictive trade regime, it could end up being worse off than under the current customs union regime. A far less distortive way to raise government revenue is to make the Palestinian Authority’s collection of VAT and progressive income tax more efficient and comprehensive. The best way to reduce the high cost of doing business

in the Palestinian economy is not to raise tariffs, which penalizes consumers and raises the cost of imported inputs, but to adopt measures that improve the investment climate, make product and labor markets more flexible, reduce trade costs, and augment competition among service suppliers. In contrast to the likes of India or Brazil, which heavily protect domestic industry, the domestic market of the Palestinian economy is tiny, so the incubation of “infant industries” is unlikely to make a material difference in the vast majority of sectors. Tariffs in agriculture may be justified, but only in selected commodities, and also should be mindful of the cost to consumers, especially low-income households, for whom food is a principal expenditure. Thinking more positively, maintaining a low rate of tariff protection is good for consumers, reduces rent seeking, and facilitates the imports of inputs and raw materials, thus enabling investors.

- » **As an integral part of its new trade regime, the Palestinian Authority should also negotiate an FTA with Israel, which is likely to remain its most important trading partner in the foreseeable future.** Such a course is not inconsistent with widening and deepening the Palestinian economy’s trade ties with the rest of the world. The Palestinian economy should aim to increase its exports to fast-growing markets in Asia, to the rich markets of the Gulf, and to the large markets of Europe and the United States, reducing its dependence on Israel. The Palestinian economy should also aim to buy from the world’s cheapest source of supply wherever it may be found. While some trade diversion in favor of Israel is inevitable, as in any FTA, insofar as the Palestinian economy maintains a relatively liberal free trade regime and it has control over its own economic borders, the trade diversion can be minimized. There are many ways that the Palestinian economy can achieve the objective of penetrating world markets independently of Israel—for example, by working with investors and trading partners from Arab countries and other Muslim majority states. But the Palestinian economy can also penetrate world markets by working with Israel—for example, in such sectors as high technology, back-office support, food processing, tourism, pharmaceuticals, and stone quarrying and transformation. Under the proposed scenario, foreign direct investment from Israel could be instrumental to creating jobs in the Palestinian economy in higher value-added sectors that export throughout the world. In any agreement, security exceptions should be strictly disciplined, in line with international practice, to avoid unnecessary obstacles to trade, applied arbitrarily or in a draconian fashion. **More generally, an FTA with Israel must include a reliable dispute settlement mechanism that is consistent with international standards.**
- » **As already discussed, for the Palestinians, the economics and the political economy of a narrow FTA are not propitious, unless the agenda under negotiations is broadened.** Specifically, the Palestinian Authority should aim to negotiate a comprehensive labor movement agreement with Israel as part of the

overall deal. The Palestinian long-term objective should be to create good jobs for its workers in the Palestinian economy. However, this does not mean discouraging workers who want to work in Israel or want to emigrate elsewhere. Under a revised economic relationship and if domestic competitiveness enhancing reforms are successful, investment incentives mean that part of the remittances of expatriates and of workers in Israel will be directed at job-creating investments in the Palestinian economy. In any event, given the dire economic situation in the Palestinian economy at present, there is no choice but to enhance the movement of labor. Important questions to be addressed in framing the labor movement agreement with Israel include how the flow of workers should be regulated; the qualifications and vocational training of these workers; and the conditions under which they will work in Israel, including medical coverage, pensions, and work accident insurance. Since Palestinian workers in Israel reside in the Palestinian economy, the Palestinian Authority must provide them with many services—from hospitals to schools for their children—and appropriate revenue transfers from Israel to the Palestinian Authority should be implemented. Appropriate taxation of Palestinian workers in Israel is also a way to efficiently regulate the flow, without necessarily continuing to resort to quotas, which are heavily distorting (Schiff 2004).

- » **The Palestinian Authority should continue to work to enhance its technical and business collaboration with Israel in critical areas (energy, water utilities, infrastructure, natural resources).**⁶⁴ This partnership should be guided by the objective of fostering Palestinian sustainable development of its natural resources, water and infrastructure and ensuring its long-term economic growth potential.
- » **To diversify its trade, the Palestinian economy should engage broadly in “open regionalism,” by negotiating new trade agreements or operationalizing and deepening existing agreements with its main trading partners, beginning with the Arab countries, the European Union, and the United States.** Israel should recognize Palestinian agreements on trade already signed with European and Arab partners. The Palestinian economy should aim to establish liberal rules of origin in these agreements, as well as in the agreement with Israel, facilitating the creation of global value chains involving as many of its trading partners as possible. Qualifying industrial zones, such as those promoted by the United States and that establish preferential treatment for products of value chains that span Jordan and Israel, and Egypt and Israel, could also be developed to include the Palestinian economy.
- » **Capacity building is needed in such areas as customs management and tax administration.** Establishing the capacity to manage customs, devise and execute

64. For an overview of critical infrastructure needs and related issues, see Office of the Quartet (2015, 2016b).

a trade policy, negotiate trade agreements, and implement WTO rules and regulations would be a costly and complex endeavor. The Palestinian Authority should seek donor support for these activities under a time bound and performance linked program entailing reform targets and investment.

- » **Last, but not least, is the need for complementary measures that must accompany the reform of the trade regime.** These measures are not just critical to success—they are at the core of the effort needed. Even the best designed and managed trade regime will fail to deliver results if the basic conditions for a sound investment climate are absent. Indeed, given the high cost of doing business in the Palestinian economy (related to its large remittances, and so forth), other aspects of the investment climate must be better than just “sound” for the Palestinian economy to become internationally competitive. Internal trade costs must be reduced, as discussed elsewhere in this note. Industrial policy measures in selected sectors may be appropriate.

Having proposed broad outlines of a new trade regime in the Palestinian economy, in the next section we turn to proposing next steps and sequencing of the proposed trade reform agenda. Our focus will be on immediate measures that can be taken to remove existing impediments to Palestinian trade under the current operation of the Paris Protocol, and steps to facilitate the transition toward an autonomous trade regime in the long run. Short-term measures are essential and, in our view, can and should be undertaken, regardless of whether the parties agree to move forward on the 10-point program outlined above. However, removing these trade impediments can also help set the stage for more fundamental changes.

5. CONCLUSION: SEQUENCING OF REFORMS⁶⁵

This policy note analyzed the features and outcomes of the Palestinian economy's current trade arrangements, identified critical reform measures to immediately address trade constraints, and examined the elements of an alternative trade regime in the long term. The analysis and recommendations are intended to support consultations with public and private Palestinian and Israeli stakeholders. Such consultations will be required to confirm the nature and desirability of the reform agenda, and to identify in greater detail the steps, means, and responsible institutions required to implement the reforms. (See Table 9 on the proposed staging of reforms.) Some of the recommended measures are solely under Palestinian control, some require cooperation between the Palestinian Authority and the Government of Israel, while others entail unilateral Israeli decisions. In all cases, success will hinge on a renewed partnership with Israel and the support of the international community.

Under the present CU arrangement, as a result of Israel's unilateral decisions, the Palestinian trade regime is already very liberal compared with that of other developing regions. As the Palestinian economy adopts a new trade arrangement, it is unlikely that Palestinian firms will face a significant shock from further trade liberalization. Unlike many developing countries embarking on a major program of trade reforms, the implementation challenge in the Palestinian case does not lie in preparing the private sector to deal with a flood of cheap imports. Instead, the Palestinian implementation challenges are threefold:

- a. Embarking on the difficult job of building a large and dynamic export sector;
- b. Equipping the Palestinian Authority with the capacity to manage customs, standards, and other trade-related regulatory responsibilities; and
- c. Equipping the Palestinian Authority with negotiation and analytical capacity to run a trade policy and conclude (or revise) agreements with major trading partners.

65. This section will require further elaboration and adaptation following stakeholder consultations.

The reforms of the Palestinian trade regime suggested in this note represent just one part—though an absolutely necessary part—of a broader reform of the Palestinian economy. Taken in their entirety, these reforms are intended to transform the investment climate in the Palestinian economy, to generate jobs so workers stay in the Palestinian economy, and to create the conditions for viable public services built on a solid domestic tax base. They are also intended to make the Palestinian economy less dependent on Israel, not by cutting its links with its most important trading partner, but by fostering the growth of its links with the rest of the world. Achieving this vision would enable the Palestinian Authority to regain its capacity to conduct economic policy and escape from its stunted development path; provide a more propitious setting for mutually beneficial economic relations with Israel; enhance the prospects for improved stability and security for both sides; and improve political relations, whatever shape it might take. Clearly, given the existing close integration between the Israeli and Palestinian economies, Israelis and Palestinians will need to collaborate to effect these reforms, and a move toward conventional or normal economic relations is a sine qua non of their success.

Transitioning to a renewed trade framework—building on immediate steps to remove existing trade restrictions, strengthening institutional capacity, and increasing mutual trust and cooperation between the Palestinians and Israelis—would be consistent with the aspirations of the Oslo Accords (and minor adjustments in Oslo II) and of the ensuing Paris Protocol on Economic Relations. This framework was originally written as a transitional format to take the Palestinian economy from where it had been during 1967–94 as a fully integrated and dependent element of the Israeli economy toward greater economic sovereignty in the context of increased stability and peaceful relations. This would include Palestinian ability over time to control its custom territory and, among other things, autonomously exercise effective control of its borders, set and collect VAT and import tariffs, and set and enforce industry standards.

TABLE 9: Proposed Staging of Reforms

Item	Lead Authorities Involved
Immediate Steps (up to 3 years)	
Set up negotiations to update the special goods lists (A1, A2 and B) in the Paris Protocol, expand their scope, remove quotas, and expand the list of import countries thereunder and recognition of Palestinian trade agreements.	Government of Israel (COGAT, Ministry of Foreign Affairs) Palestinian Authority (Ministry of National Economy, Ministry of Foreign Affairs) Government of Jordan (Ministry of National Economy, Ministry of Foreign Affairs) Government of Egypt (Ministry of National Economy, Ministry of Foreign Affairs)

(continued)

TABLE 9: Continued

Item	Lead Authorities Involved
Immediate Steps (up to 3 years)	
Revise the dual-use goods lists and establish transparent and predictable implementation processes.	Government of Israel (COGAT)
Strengthen the capacity, procedures and activities of Palestinian institutions in the area of customs and tax, standards, and border management in coordination with Israeli counterparts. Revise the 3% administrative fee arrangement related to tax revenue collection.	Palestinian Authority Government of Israel
Consider the establishment of pilot bonded warehouses under Palestinian control for customs clearance and other functions like standards enforcement.	Palestinian Authority Government of Israel
Join relevant mutual recognition agreements with key trading partners, such as the agreement of conformity assessment and acceptance of industrial products with the EU. Consider the unilateral recognition of conformity assessment from advanced markets.	Palestinian Authority (Ministry of National Economy, Palestinian Standards Institute)
Ensure transparent and efficient application of standards regulations and adopt mutual recognition of Palestinian and Israeli industrial and food safety standards. Establish a password accessible website to show progress on each standards application.	Government of Israel (COGAT) Palestinian Authority (Ministry of National Economy, Palestinian Standards Institute)
Significantly reduce or remove existing restrictions to Palestinian infrastructure and natural resource development and the movement of goods and people within Palestinian economy, as well as with Israel. This would include reopening Gaza crossings and ensuring the economic integration and link between West Bank and Gaza.	Palestinian Authority Government of Israel
Introduce door-to-door arrangements and expedite containerization at crossings where it does not yet exist (Jalameh, Allenby/King Hussein Bridge, Kerem Shalom/Kerm abu Salem).	Government of Israel (COGAT, Israeli Airports Authority) Palestinian Authority (Ministry of Civil Affairs, Ministry of National Economy) Government of Jordan (Public Security Directorate)

Item	Lead Authorities Involved
Immediate Steps (up to 3 years)	
Institute 24-hour goods operations at Allenby/ King Hussein Bridge.	Government of Israel (COGAT, Israeli Airports Authority) Palestinian Authority (Ministry of Civil Affairs, Ministry of National Economy) Government of Jordan (Public Security Directorate)
Plan for the reopening of Damya Bridge in the short term.	Government of Israel (COGAT) Palestinian Authority (Prime Minister's Office, Ministry of Foreign Affairs, Ministry of National Economy)
Achieve observer status to the WTO General Council and start accession negotiations to the WTO. Publish a technical development plan for changes required to fulfill WTO responsibilities.	Palestinian Authority (Ministry of Foreign Affairs, Ministry of National Economy)
Establish a Trade Policy Unit.	Palestinian Authority (Ministry of National Economy)
Publish trade and crossing information in Arabic and Hebrew.	Palestinian Authority (Ministry of National Economy)
Continue development of Palestinian national standards tailored to the needs of the Palestinian market and compatible with relevant standards of major trading partners.	Palestinian Authority (Palestinian Standards Institute, Ministry of National Economy, Ministry of Health, Ministry of Agriculture)
Accelerate the reform program to improve the Palestinian investment climate.	Palestinian Authority (Ministry of National Economy)
Complete the negotiations to update the special goods lists (A1, A2 and B) in the Paris Protocol, expand their scope, remove quotas, and expand the list of import countries thereunder and recognition of Palestinian trade agreements.	Government of Israel (COGAT, Ministry of Foreign Affairs) Palestinian Authority (Ministry of National Economy, Ministry of Foreign Affairs) Government of Jordan (Ministry of National Economy, Ministry of Foreign Affairs) Government of Egypt (Ministry of National Economy, Ministry of Foreign Affairs)
Initiate discussion with trading partners on the full implementation of existing trade agreements and development of further agreements with trading partners.	Palestinian Authority (Ministry of National Economy) EU GAFTA
Begin negotiations for an EPA with Israel.	Government of Israel (Prime Minister's Office, Ministry of Foreign Affairs) Palestinian Authority (Prime Minister's Office, Ministry of Foreign Affairs, Ministry of National Economy)

(continued)

TABLE 9: Continued

Item	Lead Authorities Involved
Immediate Steps (up to 3 years)	
Implement changes in practice and policy to widen the tax base and improve tax collection.	Palestinian Authority (Ministry of National Economy, Ministry of Finance)
Conclude a Labor Movement Agreement.	Government of Israel (COGAT) Palestinian Authority (Ministry of Civil Affairs, Ministry of National Economy)
Medium-Term Steps	
Advance the WTO accession process and relevant structural reforms to meet WTO responsibilities.	Palestinian Authority (Ministry of National Economy) WTO Secretariat
Conclude and implement an EPA with Israel. Palestinian officials take control of revenue collection.	Government of Israel (Prime Minister's Office, Ministry of Foreign Affairs) Palestinian Authority (Prime Minister's Office, Ministry of Foreign Affairs, Ministry of National Economy, Ministry of Finance (Customs))

Note: COGAT = Coordination of Government Activities in the Territories; EPA = economic partnership agreement; EU = European Union; GAFTA = Greater Arab Free Trade Agreement; GRM = Gaza Reconstruction Mechanism; WTO = World Trade Organization.

APPENDIX 1

LISTS A1, A2, AND B

TABLE 1.1: List A1—Goods Imported Must Be Locally Produced in Jordan and Egypt

Description of Goods	Quantities (tons)	
	Annual	3 Months
Cane or beet sugar and chemically pure sucrose, in solid form	25,000	6,300
Cane sugar		
Beet sugar		
Other, containing added flavoring or coloring matter		
Rice	20,000	5,000
Rice in the husk		
Husked brown rice		
Semi-milled or wholly milled rice, whether or not polished or glazed		
Broken rice		
Dried leguminous vegetables, shelled, whether or not skinned or split	2,000	500
Beans (<i>Vigna</i> spp., <i>Phaseolus</i> spp.)		
Beans of the species <i>Vigna mungo</i> (L.) Hepper or <i>Vigna radiata</i> (L.) Wilczek		
Small red (adzuki) beans (<i>Phaseolus</i> or <i>Vigna angularis</i>)		
Kidney beans, including white pea beans (<i>Phaseolus vulgaris</i>)		
Lentils		

(continued)

TABLE 1.1: Continued

Description of Goods	Quantities (tons)	
	Annual	3 Months
Broad beans and horse beans	4,500	1,100
Cotton, not carded or combed	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Maize (corn)	1,200	300
Dried yogurt	500	125
Live sheep	5,000 head	300 head
Silica sands and quartz sands	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Rye	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Barley	36,000	9,000
Unwrought aluminum		
Aluminum not alloyed		
Aluminum alloys		
Aluminum waste and scrap	4,000	1,000
Aluminum powders and flakes		
Powders of nonlamellae structure		
Powders of lamellae structure; flakes		
Cocoa beans, whole or broken, raw or roasted	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Cement (c)	150,000	50,000
Cement clinker, not white		
Portland cement, not white		
Bars and rods of iron or nonalloy steel:	24,000	8,000
Containing indentations, ribs, groves or other deformations produced during the rolling process		
Mineral or chemical fertilizers, phosphatic		

Description of Goods	Quantities (tons)	
	Annual	3 Months
Super phosphates		
Basic slag		
<i>Mineral or chemical fertilizer, potassic</i>		
Carnallite, sylvite and other crude natural potassium salts	6,000	2,000
Potassium chloride		
Potassium sulfate		

Source: Khalil 2012.

Note: Items in bold and italics may be imported only from Jordan and Egypt.

TABLE 1.2: List A2—Goods May Be Imported from Arab, Islamic, or Other Countries

Description of Goods	Quantities (tons)	
	Annual	3 Months
Cane or beet sugar and chemically pure sucrose, in solid form	25,000	6,300
Cane sugar		
Beet sugar		
Other, containing added flavoring or coloring matter		
Rice	20,000	5,000
Rice in the husk (paddy or rough)		
Husked (brown) rice		
Semi-milled or wholly milled rice, whether or not polished or glazed		
Broken rice		
Dried leguminous vegetables, shelled, whether or not skinned or split	2,000	500
Beans (<i>Vigna</i> spp., <i>Phaseolus</i> spp.)		
Beans of the species <i>Vigna mungo</i> (L.) Hepper or <i>Vigna radiata</i> (L.) Wilczek		
Small red (adzuki) beans (<i>Phaseolus</i> or <i>Vigna angularis</i>)		
Kidney beans, including white pea beans (<i>Phaseolus vulgaris</i>)		
Lentils		

(continued)

TABLE 1.2: Continued

Description of Goods	Quantities (tons)	
	Annual	3 Months
Broad beans and horse beans	4,500	1,100
Cotton, not carded or combed	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Wheat and meslin		
Wheat and meslin flour		
Maize (corn)	1,200	300
Dried yogurt	500	125
Live sheep	5,000 head	3,000 head
Silica sands and quartz sands	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Rye	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Barley	36,000	9,000
Coffee not roasted	2,200	550
Not decaffeinated, not ground		
Decaffeinated not ground		
Tea, in packages exceeding 3 kilograms	400	100
Cocoa beans, whole or broken, raw or roasted	Quantity will be approved according to Palestinian proved needs	Quantity will be approved according to Palestinian proved needs
Palm kernel oil or babassu oil and their fractions	5,600	1,500
Crude edible oil		
Hardened or solidified edible oil		
Other edible oil		
Meat of bovine animals, fresh or chilled	5,000	1,500
Meat of bovine animals, frozen		
Sesame seeds	2,000	1,000

TABLE 1.3: List B—Goods Imported Subject to Israeli Standards

Description of Goods
Equipment for building and sand work
Equipment for the textile industry
Commercial refrigerator
Farm machinery
Electrical equipment
Equipment for the stone industry
Conveyance equipment
Pharmaceutical products
Other equipment

APPENDIX 2

LIST OF CONTROLLED DUAL-USE ITEMS

TABLE 2.1: Section 1 (Applies to West Bank and Gaza)

Table of Chemicals

	Common Name	Emphasis/Other Names	Chemical Formula
1	Chlorate salts	Emphasis on: potassium chlorate, sodium chlorate	NaClO ₃ KClO ₃
2	Perchlorate salts	Emphasis on: potassium perchlorate, sodium perchlorate	NaClO ₄ KClO ₄
2A	Perchloric acid		HClO ₄
3	Hydrogen peroxide (concentration of over 18%)		H ₂ O ₂
4	Nitric acid		HNO ₃
5	Musk xylene		C ₁₂ H ₁₀ N ₃ O ₆
6	Mercury (including mercury for medical purposes)		Hg
7	Hexamine	Methenamine, HMTA (hexamethylenetetramine)	C ₆ H ₁₂ N ₄
8	Potassium permanganate	Potassium salt	KMnO ₄
9	Sulfuric acid, excluding sulfuric acid found in finished car batteries	Battery acid oleum	H ₂ SO ₄
10	Potassium cyanide		KCN
11	Sodium cyanide		NaCN
12	Sulfur		S

Table of Chemicals

	Common Name	Emphasis/Other Names	Chemical Formula
13	Phosphorus	White phosphorus, red phosphorus	P
14	Aluminum powder	Aluminum	Al
15	Magnesium powder		Mg
16	Naphthalene		C ₁₀ H ₈
17	Fertilizers and chemicals		
	(a) Ammonium nitrate (solid and liquid)		NH ₄ NO ₃
	(b) Potassium nitrate (solid and liquid)	13-0-46 fertilizer, saltpeter, niter	KNO ₃
	(c) Urea (solid and liquid)	Carbamide	CH ₄ N ₂ O
	(d) Urea nitrate (solid and liquid)		CH ₄ N ₂ O-NO ₃
	(e) 17-10-27 fertilizer		
	(f) 20-20-20 fertilizer		
	(g) Any solid fertilizer containing one of the chemicals listed in bullets (a)–(c)		
18	Nitrate salts of other metals		
	(a) Sodium nitrate (solid)	Chile saltpeter, soda niter	NaNO ₃
	(b) Calcium nitrate (solid), including with extra chalk	Kalk amon	Ca(NO ₃) ₂
19	Pesticide materials		
	(a) Lannate	Methomyl	
	(b) Endosulfan		
20	Nitrate salt		
21	Methyl bromide		CH ₃ Br
22	Potassium chloride		KCl
23	Formaline	Formaldehyde	CH ₂ O
24	Ethylene glycol		C ₂ H ₆ O ₂
25	Glycerine		C ₃ H ₈ O ₃
26.	Platinum boards, titanium boards, and graphite boards under 10-cm thick;		
27.	Communications equipment, communication support equipment, or equipment with communication functions;		
28.	Equipment that can, while activated, interfere with communications networks;		
29.	Infrastructure equipment for communications networks;		
30.	Lathes for removal of metal;		
31.	Spare parts for lathes and accompanying equipment for lathes;		
32.	Machinery used for one or more of the following functions: milling, screwing, iron rolling;		

(continued)

TABLE 2.1: Continued

Table of Chemicals

-
33. Casting furnace with heating capacity exceeding 600 degrees Celsius;
 34. Aluminum rods, circumference between 50 and 150 mm;
 35. Metal pipes, with or without seams, whose circumference is under 333 mm;
 36. Metal balls whose circumference is above 6 mm and metal-bearing holding metal balls with above 6 mm circumference;
 37. Optical binoculars;
 38. Telescopes, including telescopic sights (including marks);
 39. Laser range finders;
 40. Laser markers;
 41. Night-vision equipment;
 42. Underwater cameras and sealed lens;
 43. Compasses and navigation equipment, including GPS;
 44. Diving equipment, including diving compressors and underwater compasses;
 45. Water skis;
 46. External sea propulsion engines above 25 HP, and parts whose primary use is for said engines;
 47. Parachutes, windsurfers, and model airplanes;
 48. Hot-air balloons, dirigible airships; hand gliders, model airplanes, and other flying vessels not powered by engines;
 49. Equipment and measurement tools to measure gamma rays and x-rays;
 50. Equipment and tools of physical and chemical analysis;
 51. Telemetric measurement equipment;
 52. Motorized all-terrain vehicles (ATVs); weapons and ammunition aimed for civilian use, such as hunting, scuba diving, fishing and sport, daggers, swords and folding knives over 10 cm;
 53. An item or a set of items that spew fire or detonate, including fireworks;
 54. The items on the list as defined in the Defense Export Control Law (Controlled Dual-Use Equipment)—2007;
 55. Uniforms, symbols, and badges.
-

Source: GISHA (2008). Unofficial translation from official COGAT document in Hebrew.

Note: cm = centimeter; GPS = global positioning system; HP = horsepower; mm = millimeter.

TABLE 2.2: Section 2 (Applies to Gaza)

1. Fertilizers or any mixture containing choleric potassium with concentrations greater than 5%.
2. Fibers or textiles containing carbon (carbon fibers or graphite fibers), including the following:
 - a. Chopped carbon fibers;
 - b. Carbon roving;
 - c. Carbon strand;
 - d. Carbon fabric tape.
3. Glass fiber-based raw materials, excluding plain glass wool used for insulation during construction, and including the following:
 - a. Chopped glass fibers;
 - b. Glass roving;
 - c. Glass strand;
 - d. Glass fabric tape;
 - e. S-Glass;
 - f. E-Glass.
4. Sailing vessels.
5. Fibers or fabrics featuring polyethylene fibers, also known as Dyneema, excluding insulation polyethylene boards as a finished product.
6. Retro detection devices.
7. Gas tanks.
8. Drilling equipment.
9. Equipment for the production of water from drilling, excluding water pumps designated only to the Water Authority.
10. Vinyl ester resins.
11. Epoxy resins.
12. Hardeners for epoxy resins containing amide or amine chemical groups, including the following materials, but excluding SIKA filler + curing agent:
 - a. DETA—diethylenetriamine;
 - b. TETA—triethylenetriamine;
 - c. AEP—aminoethylpiperazine;
 - d. E-11—Ethyleneamine;
 - e. T-403—jeffamine;
 - f. Catalyst 4, 5, 6, 22, 23, 105, 140, 145, 150, 179, 190, 240;
 - g. D.E.H. 20, 24, 25, 26, 29, 52, 58, 80, 81, 82, 83, 84, 85, 87;
 - h. XZ 92740.00.
13. Vinyl ester accelerants, including the following:
 - a. DMA—Dimethylaniline;
 - b. Cobalt octoate;
 - c. Mckp—Methylethyl ketone peroxide;
 - d. AAP—Acetyl acetone peroxide;
 - e. Cuhp—Cumene hydroperoxide.
14. M or H type HTPB (hydroxyl-terminated polybutadiene).

(continued)

TABLE 2.2: Continued

15. Water disinfection materials—solutions with a concentration of over 11%, including hypochloride (HTH) and bleach with a disinfectant concentration of over 11% concentration, excluding sand glass for disinfection and filtering.
16. TDI—Toluene diisocyanate.
17. Portland cement (bulk or bags or drums).
18. Natural aggregates, quarry aggregates and all foundation materials.
19. Prepared concrete.
20. Concrete elements and/or precast and/or tensed concrete.
21. Steel elements and/or construction products.
22. Iron for foundations and pillars of any circumference, including welded steel mesh.
23. Steel cables of any thickness.
24. Forms for construction elements of plastic or galvanized steel.
25. Industrialized forms for concrete pouring.
26. Beams from composite materials or plastic with a panel thickness of 4 mm and thicker.
27. Thermal insulation materials and/or products, excluding roof tiles, plaster/mortar glue, mosaic tiles, building stone/coating stone/exterior stone, plaster roofing panels, polyethylene insulation panels, glass wool, and moisture insulation fabric.
28. Concrete blocks, silicate, Ytong or equivalent of any thickness.
29. Building sealing materials or products which include epoxy or polyurethane components, excluding acrylic silicone, acrylic filler for ceramics, plasticine, BOND BD sealing solution.
30. Asphalt and its components (bitumen, emulsion) in bulk or in packages of any sort.
31. Steel elements and/or steel working products for construction, excluding galvanized steel up to 0.4-cm thick.
32. Elements and/or products for channeling and drainage from precast concrete with diameters of over 1 meter.
33. Trailers and/or shipping containers.
34. Vehicles, except for private vehicles, but including 4X4 vehicles, two-wheeled vehicles, and construction vehicles.
35. Optic equipment, infrared cameras, thermal cameras, and night-vision cameras.
36. Gas-operated pumps.
37. Electric air blowers.
38. Copper, stainless steel, and aluminum panels, including mesh, pipes, and rods from copper, stainless steel, and aluminum.
39. Electrodes, including pH meters, graphite electrodes, platinum-covered electrodes, mixed metal oxide (MMO) electrodes, excluding blood-testing electrodes.
40. Scanners, including x-ray machines.
41. Dirty water pumps, with a pumping capacity of 10 liters per hour and above.
42. Vacuum pumps.
43. Various materials for the plastics industry, including polyester, polyurethane, and epoxy resin.
44. Walk-through metal detectors.
45. Welding machines, including welding electrodes.
46. Metal detection equipment (ground-penetrating radar (GPR)).
47. Metal pipes, with or without seams, with diameters of under 350 mm.

48. Equipment and tools for physical or chemical analysis, excluding blood analysis.
49. Wood planks that are 1-cm thick and 5-cm wide.
50. Uninterrupted power supply (UPS) parts.
51. Fiber-reinforced plastic panels of any thickness; nonfiber-reinforced plastic panels over 1-cm thick.
52. Smoke detectors with radioactive material.
53. Dichromate salt.
54. Barium chloride.
55. Ammonium chloride.
56. Castor oil.
57. Iron oxide.
58. Softeners (D.O.A., D.O.P.).
59. Asbestos insulation.
60. Winches and lifting equipment.
61. Graphite powder.

Source: GISHA (2008).

Note: Unofficial translation from official COGAT document in Hebrew.

TABLE 2.3: Dual-Use Items
for Construction Projects in Gaza

1. Portland cement (bulk or bags or drums).
2. Natural aggregates, quarry aggregates, and all foundation materials.
3. Prepared concrete.
4. Concrete elements and/or precast and/or tensed concrete.
5. Steel elements and/construction products.
6. Concrete for foundations and pillars of any diameter (including welded steel mesh).
7. Steel cables of any thickness.
8. Forms for construction elements of plastic or galvanized steel.
9. Industrial forms for concrete pouring.
10. Beams from composite materials or plastic with a panel thickness of 4 mm and thicker.
11. Thermal insulation materials and/or products excluding roof tiles, plaster/mortar glue, mosaic tiles, building stone/coating stone/exterior stone.
12. Concrete blocks, silicate, Ytong or equivalent (of any thickness).
13. Building sealing materials or products that include epoxy or polyurethane.
14. Asphalt and its components (bitumen, emulsion) in bulk or in packages of any sort.
15. Steel elements and/or steel working products for construction.
16. Elements and/or products for channeling and drainage from precast concrete with diameters of over 1 meter.
17. Trailers and/or shipping containers.
18. Vehicles, except for personal vehicles (not including 4X4 vehicles), including construction vehicles.

Source: Israel Ministry of Foreign Affairs 2016.

Note: List refers to projects authorized by the Palestinian Authority and implemented and monitored by the International Community.

APPENDIX 3

TRADE FLOWS ANALYSIS

Israel is the Palestinian economy's top trading partner, for both exports and imports. At the same time, the Palestinian economy is Israel's second most important export partner (merchandise), whereas it is not a significant import partner. Israel's merchandise exports to the Palestinian economy account for, on average, 1.3 percent of Israel's GDP. The tables and figures in this appendix are based on the authors' calculations, derived from World Bank (2016b) and UNCTAD (2016). The data are presented as reported by the Palestinian Authority. Mirror data for Israel are not available.

TABLE 3.1: The Palestinian Economy's
Top 10 Export Partners 2010–14

	2010		2011		2012		2013		2014	
1	Israel	79.0%	Israel	79.3%	Israel	74.8%	Israel	82.3%	Israel	78.8%
2	Jordan	7.2%	Jordan	7.7%	Jordan	9.9%	Jordan	8.4%	Jordan	8.6%
3	United Arab Emirates	2.9%	Saudi Arabia	1.8%	United Arab Emirates	2.6%	United States	1.2%	United Arab Emirates	2.1%
4	United States	1.8%	United Arab Emirates	1.8%	United States	2.5%	Saudi Arabia	1.6%	United States	1.8%
5	Algeria	0.7%	United States	1.0%	Saudi Arabia	0.4%	United Arab Emirates	0.5%	Netherlands	1.7%
6	Saudi Arabia	1.4%	Algeria	2.0%	Qatar	2.0%	Qatar	1.3%	Saudi Arabia	1.6%
7	Egypt, Arab Rep.	0.7%	Kuwait	1.2%	Algeria	1.2%	Kuwait	0.6%	Kuwait	1.3%
8	Netherlands	0.3%	Netherlands	0.6%	Kuwait	1.3%	Netherlands	0.8%	Qatar	1.2%
9	Kuwait	0.3%	Qatar	0.4%	Canada	0.5%	Turkey	0.5%	Unspecified	0.5%
10	Germany	0.1%	United Kingdom	0.1%	United Kingdom	0.2%	United Kingdom	0.5%	United Kingdom	0.4%
	In Tot Exp	94.4%		95.8%		95.3%		97.6%		98.0%

TABLE 3.2: The Palestinian Economy's
Top 10 Import Partners 2010–14

	2010		2011		2012		2013		2014	
1	Israel	67.3%	Israel	64.9%	Israel	65.5%	Israel	65.8%	Israel	63.2%
2	China	5.4%	Turkey	5.7%	Turkey	5.9%	Turkey	6.7%	Turkey	6.9%
3	Turkey	5.4%	China	5.3%	China	5.1%	China	5.5%	China	6.0%
4	Germany	2.6%	Germany	2.8%	Germany	3.0%	Germany	2.9%	Germany	3.0%
5	Jordan	2.1%	Jordan	2.5%	Jordan	2.6%	Jordan	2.2%	Jordan	2.2%
6	Italy	0.3%	Italy	0.6%	Italy	0.9%	Italy	1.1%	Saudi Arabia	1.4%
7	France	1.5%	Spain	1.8%	France	1.7%	Spain	1.5%	Italy	1.4%
8	United States	1.2%	France	1.5%	Spain	1.4%	France	1.4%	Spain	1.3%
9	Spain	1.2%	Korea, Rep.	1.0%	United States	0.9%	Saudi Arabia	1.0%	Egypt, Arab Rep.	1.2%
10	Egypt, Arab Rep.	1.3%	Switzerland	1.3%	Korea, Rep.	1.6%	Egypt, Arab Rep.	1.2%	France	1.2%
	In Tot Imp	88.3%		87.5%		88.5%		89.4%		87.8%

TABLE 3.3: Israel's Top 10 Export Partners 2010–14

	2010		2011		2012		2013		2014	
1	United States	36.2%	United States	34.4%	United States	33.7%	United States	33.5%	United States	34.7%
2	Palestine	4.9%	United Kingdom	5.3%	United Kingdom	5.5%	Palestine	5.4%	Palestine	5.9%
3	China	4.4%	Palestine	4.9%	Palestine	5.1%	China	4.7%	Hong Kong, China	4.9%
4	Belgium	4.3%	China	4.5%	China	4.5%	Hong Kong, China	4.3%	China	4.7%
5	United Kingdom	4.2%	Hong Kong, China	4.4%	Hong Kong, China	4.1%	United Kingdom	4.1%	Turkey	4.3%
6	Germany	3.8%	Belgium	4.4%	Netherlands	4.1%	Netherlands	3.8%	India	3.4%
7	Hong Kong, China	3.6%	Germany	3.8%	India	3.6%	Belgium	3.6%	Belgium	3.3%
8	Netherlands	3.5%	India	3.8%	Belgium	3.3%	Turkey	3.6%	Germany	3.2%
9	India	3.5%	Netherlands	3.5%	Germany	3.2%	India	3.4%	Netherlands	3.0%
10	Turkey	2.3%	Turkey	3.0%	Turkey	2.6%	Germany	3.2%	United Kingdom	2.6%
	In Tot Exp	70.8%		72.0%		69.8%		69.5%		69.9%

Note: In the Israel's import partners list, the Palestinian economy ranks between 29th and 31st during 2010–14.

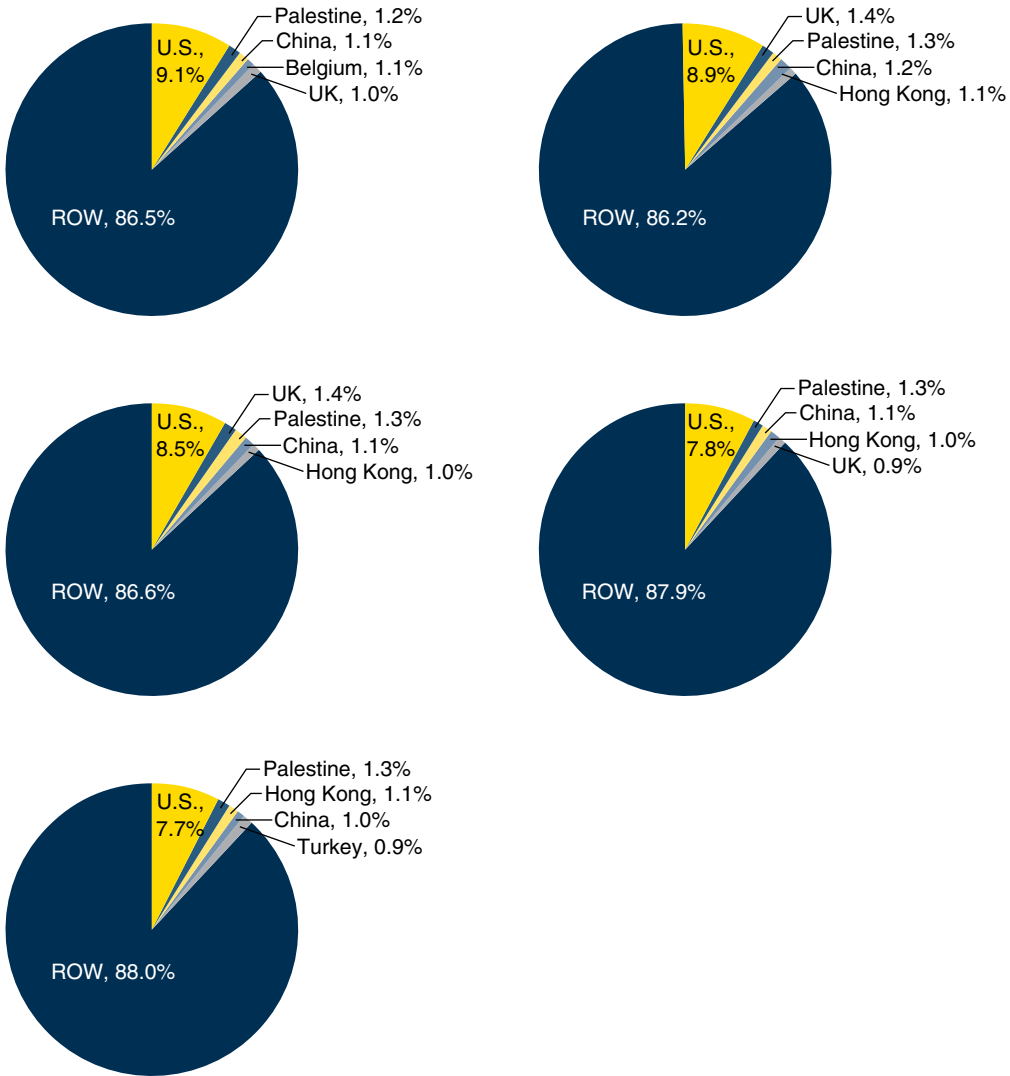


Figure 3.1: Israel's Exports as a Share of GDP

Note: ROW = rest of the world

Energy represents the bulk of Palestinian imports from Israel (or Israel's exports to the Palestinian economy). If this "product" is replaced by third-party providers, this would mean a significant loss to Israel. Moreover, cement is among the top five products Israel exports to the Palestinian economy (production capabilities that are hampered by Israel for security reasons/concerns). Also, worked marble is more likely produced by Palestinian labor and then sold to Palestinian markets. Israel can benefit from Palestinian **low-cost labor**, thus minimizing production costs. Albeit nonsubstantial, Palestinian exports to Israel concentrate mainly on primary products and labor and resource-based manufacturing.

TABLE 3.4: The Palestinian Economy's Top 25 Merchandise Imports from Israel 2010–14 (SITC 3–6 digit-level data)

	2010		2011		2012		2013		2014	
1	Electrical energy	15.5%	Electrical energy	17.9%	Electrical energy	18.0%	Electrical energy	0.0%	Electrical energy	20.9%
2	Natural gas, liquified	10.2%	Natural gas, liquified	8.6%	Portland cement	6.3%	Natural gas, liquified	0.0%	Natural gas, liquified	7.5%
3	Portland cement	5.2%	Portland cement	5.0%	Natural gas, liquified	6.3%	Portland cement	0.0%	Animal feeds n.e.s.	5.6%
4	Animal feeds n.e.s.	3.2%	Animal feeds n.e.s.	3.2%	Animal feeds n.e.s.	3.5%	Animal feeds n.e.s.	0.0%	Portland cement	5.0%
5	Marble etc., worked	3.1%	Marble etc., worked	3.0%	Marble etc., worked	2.7%	Marble etc., worked	0.0%	Bovine animals, other	2.1%
6	Flavored waters non-alc	1.8%	Mineral water/ice/snow	2.0%	Bovine animals, other	2.4%	Bovine animals, other	0.0%	Cigarettes (tobacco)	2.0%
7	Mineral water/ice/snow	1.8%	Medicam nes retail packs	1.7%	Cigarettes (tobacco)	2.0%	Cigarettes (tobacco)	0.0%	Mineral water/ice/snow	1.8%
8	Bovine animals, other	1.8%	Flavored waters non-alc	1.7%	Durum wheat	1.8%	Mineral water/ice/snow	0.0%	Medicam nes retail packs	1.8%
9	Medicam nes retail packs	1.6%	Flour of wheat or meslin	1.7%	Medicam nes retail packs	1.7%	Medicam nes retail packs	0.0%	Cereals grains nes	1.6%
10	Flour of wheat or meslin	1.4%	Bovine animals, other	1.6%	Mineral water/ice/snow	1.7%	Durum wheat	0.0%	Paper nes 40–150g non-me	1.5%
11	Paper nes 40–150g non-me	1.4%	Paper nes 40–150g non-me	1.4%	Flour of wheat or meslin	1.5%	Cereals grains nes	0.0%	Durum wheat	1.5%
12	Rice husked (brown)	1.4%	Rice husked (brown)	1.3%	Flavored waters non-alc	1.5%	Paper nes 40–150g non-me	0.0%	Flavored waters non-alc	1.3%
13	Cigarettes (tobacco)	1.3%	Yogurt	1.1%	Cereals grains nes	1.5%	Flavored waters non-alc	0.0%	Rice husked (brown)	1.2%
14	Other motor vehcl parts	1.1%	Bovine animals, breeding	1.1%	Paper nes 40–150g non-me	1.4%	Rice husked (brown)	0.0%	Flour of wheat or meslin	1.2%
15	Yogurt	1.1%	Durum wheat	1.0%	Rice husked (brown)	1.3%	Flour of wheat or meslin	0.0%	Yogurt	0.8%

(continued)

TABLE 3.4: Continued

		2010		2011		2012		2013		2014
16	Pass motor veh exc buses	1.0%	Other motor vehcl parts	1.0%	Poultry cuts, frozen	1.0%	Poultry cuts, frozen	0.0%	Plstc packg contnrns/lids	0.8%
17	Cereals grains nes	1.0%	Detergent nes non-retail	1.0%	Yogurt	1.0%	Yogurt	0.0%	Other motor vehcl parts	0.8%
18	Bovine animals, breeding	1.0%	Cigarettes (tobacco)	0.9%	Other motor vehcl parts	0.8%	Petroleum bitumen/resids	0.0%	Detergent nes non-retail	0.8%
19	Detergent nes non-retail	0.9%	Barley grain	0.8%	Barley grain	0.8%	Apples fresh	0.0%	Poultry cuts, frozen	0.8%
20	Durum wheat	0.9%	Petroleum bitumen/resids	0.8%	Sugar, coloured/flavoured	0.7%	Oth domstc elec appl nes	0.0%	Oth domstc elec appl nes	0.7%
21	Sugar confectionery nes	0.9%	Primary polyesters nes	0.7%	Air-cond window/wall typ	0.7%	Other motor vehcl parts	0.0%	Primary polyesters nes	0.7%
22	Oth domstc elec appl nes	0.9%	Cereals grains nes	0.7%	Primary polyesters nes	0.7%	Detergent nes non-retail	0.0%	Goods transp vehicle nes	0.7%
23	Barley grain	0.8%	Copper waste and scrap	0.7%	Apples fresh	0.7%	Barley grain	0.0%	Maize ex sweet corn nes	0.7%
24	Apples fresh	0.7%	Domestic refrigerators	0.7%	Colour tv receivers	0.7%	Primary polyesters nes	0.0%	Apples fresh	0.7%
25	Goods transp vehicle nes	0.7%	Sugar confectionery nes	0.6%	Bovine animals, breeding	0.7%	Plstc packg contnrns/lids	0.0%	Sugar, coloured/flavoured	0.6%

TABLE 3.5: The Palestinian Economy's Top 25
Merchandise Exports to Israel 2010–14

	2010	2011	2012	2013	2014
1 Building stone unworked	19.3%	Building stone unworked 18.0%	Building stone unworked 17.7%	Building stone unworked 17.1%	Building stone unworked 18.5%
2 Marble etc., worked	6.8%	Remelt iron/steel ingots 6.2%	Waste tinned iron/steel 7.4%	Plastic sacks/bags/cones 7.3%	Plastic sacks/bags/cones 7.4%
3 Remelt iron/steel ingots	0.5%	Marble etc., worked 0.8%	Marble etc., worked 1.2%	Pharmacy plants nes 1.2%	Footw text up,ru/pl sole 6.7%
4 Plastic sacks/bags/cones	7.6%	Plastic sacks/bags/cones 8.3%	Plastic sacks/bags/cones 7.7%	Waste tinned iron/steel 5.7%	Marble etc., worked 5.7%
5 Rub/plast footw nes weld	2.8%	Rub/plast footw nes weld 3.6%	Rub/plast footw nes weld 3.2%	Marble etc., worked 3.0%	Mattresses other mater. 4.9%
6 Wood pallets etc.	2.7%	Copper waste and scrap 0.3%	Wood pallets etc. 8.5%	Rub/plast footw nes weld 5.8%	Waste tinned iron/steel 4.9%
7 Wood bedroom furniture	0.2%	Mattresses other mater. 0.6%	Wood bedroom furniture 0.1%	Wood bedroom furniture 0.0%	Cucumber/gherkin frsh/ch 4.1%
8 Copper waste and scrap	3.7%	Wood pallets etc. 2.9%	Mattresses other mater. 3.5%	Mattresses other mater. 3.8%	Wood bedroom furniture 3.9%
9 Mattresses other mater.	1.8%	Wood bedroom furniture 2.2%	Primary ethylene pol nes 2.5%	Seats nes, wood frames 2.9%	Seats nes, wood frames 3.8%
10 Waste tinned iron/steel	3.9%	Primary ethylene pol nes 3.0%	Seats nes, wood frames 3.5%	Wood pallets etc. 2.6%	Wood pallets etc. 2.5%
11 Primary ethylene pol nes	0.3%	Seats nes, wood frames 0.4%	Vegetables prov preservd 1.3%	Primary ethylene pol nes 1.3%	Gravel/crushed stone/etc 2.1%
12 Aluminium wste and scrap	0.3%	Misc food preprtions nes 0.6%	Copper waste and scrap 1.0%	Vegetables prov preservd 1.1%	Wood kitchen furniture 2.0%
13 Seats nes, wood frames	1.4%	Aluminium bars/rod/prof. 1.7%	Misc food preprtions nes 1.6%	Misc food preprtions nes 1.8%	Misc food preprtions nes 2.0%
14 Cigarettes (tobacco)	3.2%	Office type adjust seats 3.8%	Cigarettes (tobacco) 1.7%	Vegetables nes, frsh/chld 0.7%	Copper waste and scrap 1.9%
15 Misc food preprtions nes	0.0%	Metal office furniture 0.0%	Gravel/crushed stone/etc. 0.0%	Cigarettes (tobacco) 1.6%	Vegetables nes, frsh/chld 1.5%

(continued)

TABLE 3.5: Continued

	2010	2011	2012	2013	2014
16 Office type adjust seats	1.0%	Aluminium wste and scrap 1.3%	Metal office furniture 1.3%	Metal office furniture 1.4%	Metal office furniture 1.3%
17 Yogurt	2.7%	Toilet paper cut to size 2.8%	Office type adjust seats 2.5%	Gravel/ crushed stone/etc. 2.2%	Primary ethylene pol nes 1.1%
18 Concrete blocks/tiles	1.4%	Cereal nes rolled/flaked 0.1%	Footw text up,ru/pl sole 1.4%	Footw text up, ru/pl sole 1.5%	Cigarettes (tobacco) 1.0%
19 Aluminium bars/rod/ prof.	2.0%	Paper tissues, towels etc. 1.2%	Toilet paper cut to size 0.4%	Office type adjust seats 0.2%	Aluminium wste and scrap 0.9%
20 Metal office furniture	0.8%	Plastic furniture 0.3%	Wood kitchen furniture 0.4%	Wood kitchen furniture 0.4%	Prepd bov/ equine leather 0.9%
21 Cereal nes rolled/flaked	0.0%	Footw text up, ru/pl sole 0.8%	Aluminium bars/rod/ prof. 0.8%	Toilet paper cut to size 0.7%	Plastic furniture 0.9%
22 Footwear nes leathr sole	0.2%	Iron/steel sheet piling 1.2%	Paper tissues, towels etc. 1.0%	Root vegetables, frsh/chd 1.0%	Toilet paper cut to size 0.8%
23 Iron/ st doors/ windows	0.2%	Rigid plastic pipes etc. 0.9%	Cereal nes rolled/flaked 0.8%	Paper tissues, towels etc. 0.9%	Paper tissues, towels etc. 0.8%
24 Mattress rubber/ plastic	0.9%	Yogurt 0.9%	Plastic furniture 0.8%	Aluminium bars/rod/ prof. 0.7%	Cereal nes rolled/flaked 0.7%
25 Sugar confectionery nes	0.6%	Cucumber/ gherkin frsh/ch 0.8%	Iron/st doors/ windows 0.6%	Copper waste and scrap 0.5%	Iron/steel sheet piling 0.7%
Tot Exp to Israel	64.7%	62.7%	70.7%	65.4%	80.8%

Agricultural and **food** products, such as fruits, olive oil, and meat, are among Palestinian top exports and imports. These products are very sensitive to both sunlight and heat exposure. Back-to-back checks and open-air controls (and long, time-consuming procedures) at the border crossings may represent a major cause of their deterioration. This could be avoided through containerization.

TABLE 3.6: Palestinian Top 30 Merchandise Exports

	2010	2011	2012	2013	2014
1 Medicam nes retail packs	34.9%	Ferrous waste/scrap nes 14.2%	Ferrous waste/scrap nes 11.7%	Building stone unworked 11.3%	Building stone unworked 12.0%
2 Building stone worked	14.6%	Building stone worked 10.6%	Virgin olive oil 8.5%	Virgin olive oil 10.5%	Ferrous waste/scrap nes 9.8%
3 Virgin olive oil	5.1%	Medicam nes retail packs 8.9%	Medicam nes retail packs 7.2%	Dates, fresh/dried 6.3%	Virgin olive oil 7.7%
4 Building stone unworked	5.1%	Virgin olive oil 7.8%	Building stone unworked 6.7%	Ferrous waste/scrap nes 6.2%	Building stone worked 6.7%
5 Medicaments nes non-ret.	4.1%	Pharmacy plants nes 5.0%	Beef prepared/presvd nes 5.5%	Building stone worked 5.6%	Dates, fresh/dried 6.6%
6 Other cargo ships/boats	3.1%	Berries fresh 4.7%	Building stone worked 5.3%	Beef prepared/presvd nes 4.8%	Beef prepared/presvd nes 4.7%
7 Sausages etc. (meat)	3.0%	Beef prepared/presvd nes 4.3%	Dates, fresh/dried 4.9%	Pharmacy plants nes 3.3%	Spices nes, mixtures 4.6%
8 Pharmacy plants nes	2.9%	Building stone unworked 3.6%	Flagstones etc., nat stone 4.6%	Waste/scrap cast iron 3.1%	Pharmacy plants nes 3.1%
9 Men/boy trouser/etc. wovn	2.9%	Men/b trouser/etc kni/cr 3.3%	Prim form iron/steel nes 3.6%	Spices nes, mixtures 3.1%	Other olive oil 2.9%
10 Spices nes, mixtures	2.2%	Spices nes, mixtures 2.9%	Pharmacy plants nes 3.2%	Prim form iron/steel nes 2.8%	Medicaments nes non-ret. 2.3%
11 Granite/sandstone/etc.	1.4%	Dates, fresh/dried 2.3%	Cut flowers 2.7%	Medicaments nes non-ret. 2.5%	Flagstones etc., nat stone 2.1%
12 Other soap in bars etc.	1.2%	Other soap in bars etc. 2.1%	Spices nes, mixtures 2.6%	Flagstones etc., nat stone 2.2%	Semi-trailer tractors 2.0%
13 Dates, fresh/dried	1.1%	Garlic/leek/etc. frsh/chld 1.6%	Vegetables nes, frsh/chld 2.1%	Vegetables nes, frsh/chld 2.2%	Medicam nes retail packs 2.0%
14 Ferrous waste/scrap nes	1.1%	Marble etc. finished 1.6%	Marble etc., worked 1.9%	Medicam nes retail packs 1.7%	Avocado/mango/guava frsh 1.8%
15 Vegetables nes,frsh/chld	1.0%	Marble/etc. slabs 1.6%	Berries fresh 1.8%	N-hetero atom cmpds nes 1.5%	Vegetables nes,frsh/chld 1.8%
16 Marble/etc. slabs	0.9%	Vegetables nes, frsh/chld 1.5%	Medicaments nes non-ret. 1.7%	Avocado/mango/guava frsh 1.4%	Potatoes frsh excl sweet 1.7%

(continued)

TABLE 3.6: Continued

	2010	2011	2012	2013	2014					
17	Mattresses supports	0.7%	Veg fat/oil/ fractions	1.3%	Other soap in bars etc.	1.5%	Garlic/leek/ etc. frsh/chd	1.4%	Lemons/ limes, fresh/ dried	1.6%
18	Machnry nes, indiv functn	0.7%	Granite/ sandstone/ etc.	1.3%	Mattresses supports	1.4%	Marble/etc. slabs	1.4%	Flavored waters non-alc	1.3%
19	Veg fat/oil/ fractions	0.6%	Mattresses supports	1.2%	Garlic/leek/ etc. frsh/chd	1.3%	Other soap in bars etc.	1.3%	Other soap in bars etc.	1.2%
20	Garlic/leek/ etc. frsh/chd	0.5%	Flavored waters non-alc	1.2%	Marble/etc. slabs	1.2%	Flavored waters non-alc	1.3%	Garlic/leek/ etc. frsh/chd	1.2%
21	Grindstones	0.5%	Cut flowers	0.9%	Veg fat/oil/ fractions	1.1%	Mattresses supports	1.2%	Marble/etc. slabs	1.2%
22	Marble etc. finished	0.5%	Woven cottn unbl > 200g/m ²	0.8%	Flavored waters non-alc	1.1%	Lemons/ limes, fresh/ dried	1.1%	Veg fat/oil/ fractions	1.1%
23	Plstc packg contnrs/lids	0.5%	Tomatoes fresh/chilled	0.8%	Avocado/ mango/ guava frsh	1.0%	Veg fat/oil/ fractions	1.1%	Non-co wood pulp semi-bl	1.0%
24	Ice cream, edible ice	0.4%	Marble etc., worked	0.8%	Tomatoes fresh/chilled	0.8%	Polymer paints aqu solut	1.0%	Waste/scrap cast iron	0.9%
25	Footwear nes leathr sole	0.4%	Grindstones	0.8%	Plstc packg contnrs/lids	0.8%	Marble etc., worked	1.0%	Mattresses supports	0.8%
26	Cut flowers	0.4%	Sausages etc. (meat)	0.7%	Military firearms nes	0.7%	Cut flowers	1.0%	Onions/ shallot, frsh/ chld	0.8%
27	Berries fresh	0.4%	Paper etc. diapers etc.	0.6%	Footwear nes leathr sole	0.5%	Berries fresh	0.9%	Grindstones	0.7%
28	Tomatoes fresh/ chilled	0.4%	Wood bedroom furniture	0.5%	Grindstones	0.5%	Potatoes frsh excl sweet	0.8%	Almonds, fresh/ dried	0.7%
29	Onions/ shallot, frsh/ chld	0.4%	Onions/ shallot, frsh/chld	0.5%	Olive oil blends	0.5%	Footw text up, ru/pl sole	0.7%	Footw text up, ru/pl sole	0.6%
30	Flavored waters non-alc	0.4%	Ice cream, edible ice	0.5%	Granite/ sandstone/ etc.	0.5%	Oth veg presvd, prepd nes	0.7%	Polymer paints aqu solut	0.6%

TABLE 3.7: Palestinian Top 30 Merchandise Imports

	2010	2011	2012	2013	2014
1 Pass motor veh exc buses	10.5%	Pass motor veh exc buses 11.5%	Pass motor veh exc buses 16.2%	Pass motor veh exc buses 17.4%	Pass motor veh exc buses 17.7%
2 Medicam nes retail packs	4.1%	Medicam nes retail packs 4.3%	Beef, frozen, boneless 5.2%	Beef, frozen, boneless 4.3%	Beef, frozen, boneless 3.2%
3 Cigarettes (tobacco)	3.2%	Beef, frozen, boneless 3.9%	Flour of wheat or meslin 4.0%	Flour of wheat or meslin 3.2%	Medicam nes retail packs 3.0%
4 Bakers wares nes	2.8%	Flour of wheat or meslin 2.9%	Medicam nes retail packs 3.5%	Medicam nes retail packs 3.1%	Sweet biscuits etc. 3.0%
5 Sweet biscuits etc.	2.4%	Cigarettes (tobacco) 2.9%	Electrical energy 2.5%	Sweet biscuits etc. 2.5%	Flour of wheat or meslin 2.3%
6 Aluminium bars/rod/prof.	1.8%	Sweet biscuits etc. 2.6%	Water filters/purifiers 2.5%	Antisera/bld fra/vaccine 2.1%	Raw solid sugar nes 2.2%
7 Misc food preprtions nes	1.8%	Flavored waters non-alc 2.3%	Cigarettes (tobacco) 2.4%	Bakers wares nes 1.6%	Refractory cement/mortar 2.1%
8 Goods transp vehicle nes	1.8%	Bakers wares nes 2.2%	Sweet biscuits etc. 2.1%	Aluminium bars/rod/prof. 1.5%	Bakers wares nes 1.8%
9 Antisera/bld fra/vaccine	1.7%	Misc food preprtions nes 1.9%	Bakers wares nes 2.0%	Misc food preprtions nes 1.4%	Refined safflower oil 1.8%
10 Flavored waters non-alc	1.7%	Air-cond window/wall typ 1.6%	Flavored waters non-alc 2.0%	Flavored waters non-alc 1.4%	Cigarettes (tobacco) 1.8%
11 Sugar confectionery nes	1.7%	Aluminium bars/rod/prof. 1.5%	Misc food preprtions nes 1.7%	Cigarettes (tobacco) 1.4%	Flavored waters non-alc 1.5%
12 Polyethers nes	1.6%	Electrical energy 1.4%	Antisera/bld fra/vaccine 1.6%	Refined safflower oil 1.4%	Chocolate bars nes 1.4%
13 Juice,one fruit/veg nes	1.6%	Telephone line equip nes 1.3%	Sands nes non-metallic 1.6%	Goods transp vehicle nes 1.3%	Misc food preprtions nes 1.4%
14 Flour of wheat or meslin	1.6%	Antisera/bld fra/vaccine 1.3%	Aluminium bars/rod/prof. 1.5%	Alu tanks < 300l exc gas 1.3%	Polymer paints non-aques 1.3%
15 Refined safflower oil	1.6%	Polyethers nes 1.2%	Cocoa foods nes 1.1%	Refractory cement/mortar 1.2%	Aluminium bars/rod/prof. 1.2%
16 Electrical energy	1.4%	Mixtures of diff juices 1.2%	Air-cond window/wall typ 1.0%	Cocoa foods nes 1.1%	Cocoa foods nes 1.2%

(continued)

TABLE 3.7: Continued

	2010		2011		2012		2013		2014	
17	Vegetables n.e.s. frozen	1.2%	Sugar confectionery nes	1.2%	Preprd pigment/ glaze/etc.	1.0%	Potatoes presvd ex vineg	1.1%	Potatoes presvd ex vineg	1.2%
18	Preprd pigment/ glaze/etc.	1.2%	Preprd pigment/ glaze/etc.	1.2%	Chocolate bars nes	0.9%	Air-cond window/wall typ	1.1%	Goods transp vehicle nes	1.2%
19	Electro-diag equip nes	1.2%	Water filters/ purifiers	1.1%	Polyethylene terephthlat	0.9%	Glazed ceramic paving et	1.0%	Hair care preparations	0.9%
20	Sodium hydroxide, solutn	1.1%	Juice, one fruit/veg nes	1.1%	Antibiotics nes retail	0.8%	Chocolate bars nes	1.0%	Sugar confectionery nes	0.9%
21	Potato flaked	1.1%	Cocoa foods nes	1.0%	Goods transp vehicle nes	0.8%	Electrical energy	0.9%	Baby foods (cereal)	0.9%
22	Refined soya bean oil	1.0%	Chocolate bars nes	1.0%	X-ray apparatus	0.7%	Raw solid sugar nes	0.8%	Alu tanks < 300l exc gas	0.9%
23	Pipe tobacco etc.	1.0%	Potatoes presvd ex vineg	0.9%	Portland cement	0.7%	Preprd pigment/ glaze/etc.	0.8%	Beef prepared/ presvd nes	0.8%
24	Rice milled unbroken	1.0%	Pipe tobacco etc.	0.8%	Glazed ceramic paving et	0.7%	Polymer paints non-aques	0.7%	Packing/ wrapping mac nes	0.8%
25	Cocoa foods nes	0.9%	Raw solid sugar nes	0.8%	Toilet paper cut to size	0.7%	Water filters/ purifiers	0.7%	Diesel buses	0.7%
26	Portland cement	0.9%	Goods transp vehicle nes	0.8%	Polyethylene sg > 0.94	0.7%	Electro-diag equip nes	0.7%	Electrical energy	0.7%
27	Wheat nes/ meslin	0.9%	Glazed ceramic paving et	0.7%	Juice, one fruit/veg nes	0.6%	Sugar confectionery nes	0.7%	Cheese, processed n.e.s.	0.7%
28	X-ray apparatus	0.8%	Toilet paper cut to size	0.6%	Sugar confectionery nes	0.6%	Sands nes non-metallic	0.6%	Cheese, unfermented, n.e.s	0.6%
29	Mixtures of diff juices	0.8%	Refined soya bean oil	0.6%	Oth medical instruments	0.6%	Antibiotics nes retail	0.6%	Preprd pigment/ glaze/etc.	0.6%
30	Chocolate bars nes	0.8%	Crude safflower oil	0.6%	Lifts and skip hoists	0.6%	Toilet paper cut to size	0.6%	Electro-diag equip nes	0.6%

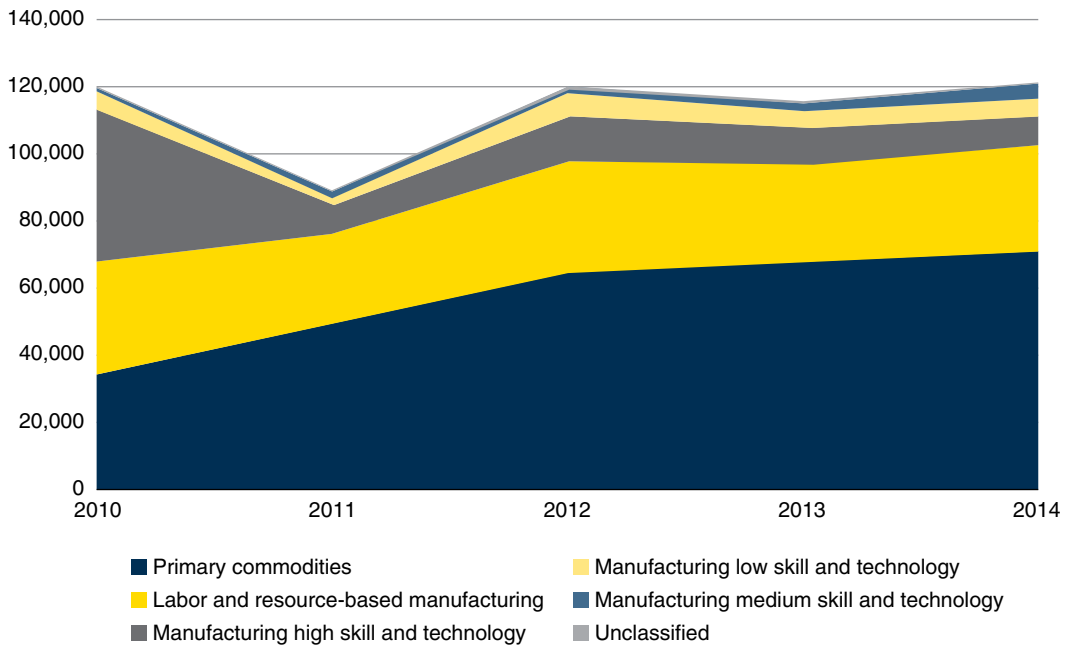


Figure 3.2: Palestinian Merchandise Exports by Skill and Technology Intensity (current US\$1,000)

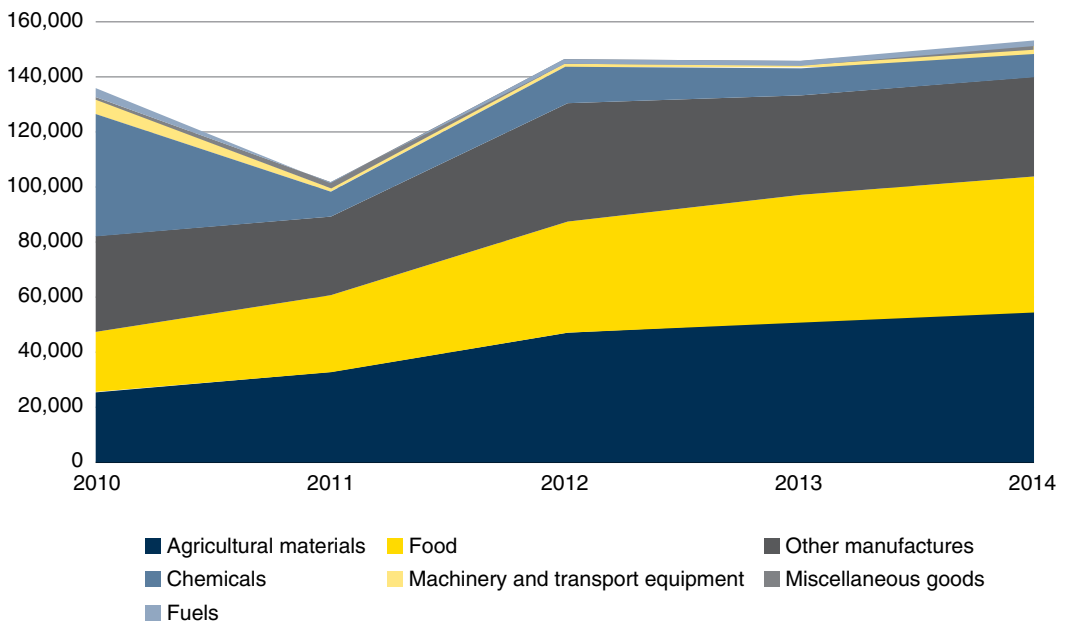


Figure 3.3: The Palestinian Economy's Composition of Merchandise Exports (current US\$1,000)

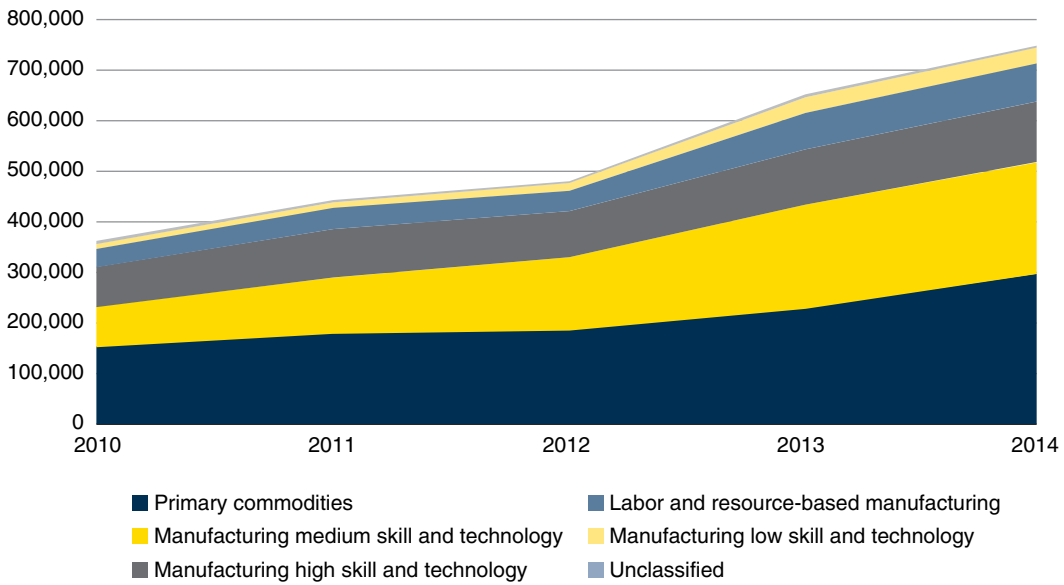


Figure 3.4: Palestinian Merchandise Imports by Skill and Technology Intensity (current US\$1,000)

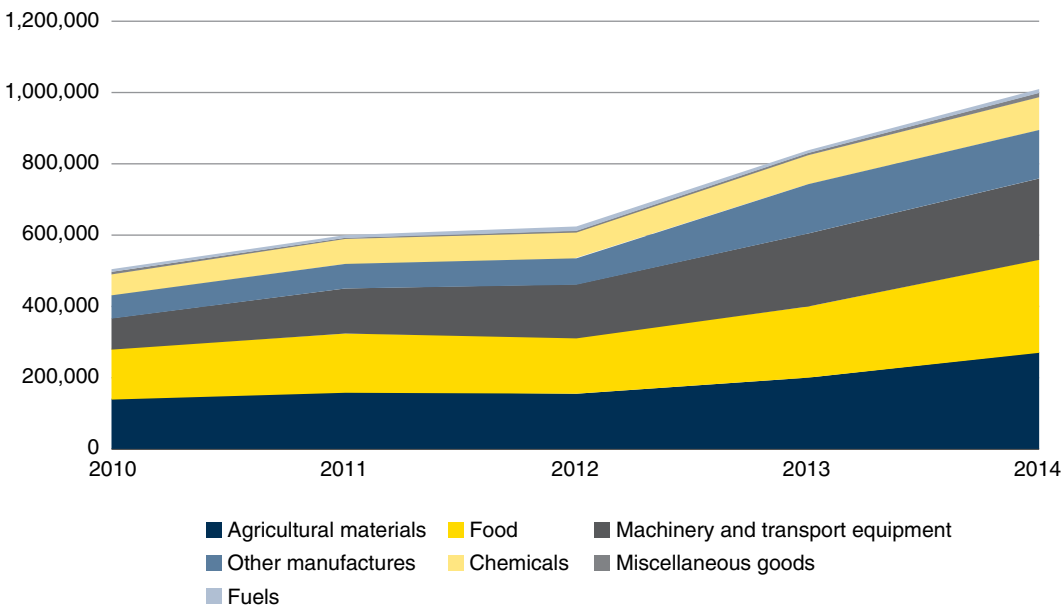


Figure 3.5: The Palestinian Economy's Composition of Merchandise Imports (current US\$1,000)

APPENDIX 4

GRAVITY MODELING OF THE PALESTINIAN ECONOMY'S TRADE POTENTIAL⁶⁶

INTRODUCTION AND PRIMARY RESULTS

This memo tries to provide estimates of the potential of merchandise trade of the Palestinian economy, based on a simple gravity model.⁶⁷ The method used to obtain these estimates is the gravity model, a well-established tool in the empirical trade literature. The model can be used to estimate what the “normal” trade pattern of a country would be, based on its size, geography, and other variables such as language and history that can affect economic distance between countries.

The estimated merchandise exports of the Palestinian economy in “normal and ideal” circumstances could be as high as \$2.8 billion, compared to about \$130 million in actual exports in 2015.⁶⁸ This estimate includes \$1.5 billion of exports to Israel and \$1.3 billion of exports to the rest of the world. The estimated Palestinian–Israeli trade is very large because of their immediate geographic proximity and the size of Israel’s economy. Other than Israel, the primary estimated export destinations include the rest of MENA, Eastern Europe and Central Asia (ECA), and North America. This should be considered as an upper-bound estimate and a lot of caution should be made in using these estimates. Many factors affect the trade potential of the Palestinian economy, and these estimates are meant

66. This note was prepared by Michael Ferrantino and Gabriela Schmidt from the global Trade unit of the World Bank’s Trade and Competitiveness Global Practice, under the supervision of Jose Guillermo Reis, Trade Practice Manager. It was prepared as an input to the World Bank report *Unlocking the Trade Potential of the Palestinian Economy* (2017).

67. Defined for statistical purposes as “West Bank and Gaza.” Nothing in this memo is meant to imply a position of the World Bank Group regarding geographical definitions and boundaries.

68. Actual exports and imports for the Palestinian economy are based on mirror import data of partner countries.

to propose an order of magnitude of what the trade volume of the Palestinian economy could look like at its fullest potential, free of all the restrictions it currently faces and in a partial equilibrium set-up. This estimate is an approximation and is certainly not a projection of the future trade potential of the Palestinian economy.

The estimated merchandise imports of the Palestinian economy in “normal or ideal” circumstances could be as high as \$10.0 billion, compared to \$860 million in 2015. The estimate included \$5.6 billion of imports from Israel and \$4.4 billion of imports from the rest of the world. This estimate is less reliable than the estimate on exports, as it implies a large expansion of the already existing trade deficit. While countries that are economically similar to the Palestinian economy also frequently run large trade deficits, the methods of financing them vary greatly from country to country, and the gravity model is not specifically designed to analyze the current account.

ESTIMATING THE PALESTINIAN ECONOMY TRADE POTENTIAL—THE METHOD

The gravity model is a well-established tool for analyzing trade flows on a bilateral basis. It is named from an analogy to Newton’s theory of gravitation, under which gravitational force increases between pairs of massive objects and falls between pairs of distant objects. Similarly, the gravity model estimates the extent to which trade is large between large economies (as measured by GNI or GDP), and decreases between countries which are economically distant from each other, as measured by linear distance, common language, common history, or other variables which may influence economic distance. While subject to many refinements, the basic gravity model has been in use since the 1960s.

The Palestinian economy’s trade potential was calculated through a gravity model using 2014 data for all available country pairs in the world [N = 16,211].⁶⁹ The best fitting model has the following specification:

$$\ln(X) = \beta_0 + \beta_1 \ln(dist) + \beta_2 contig + \beta_3 comlang_{off} + \beta_4 colony + \beta_5 comcol + \beta_6 \ln(gdp_o) + \beta_7 \ln(gdp_d) + \beta_8 \ln(gdp_o)^2 + \beta_9 \ln(gdp_d)^2 + \epsilon_y$$

where X represents potential exports from origin country o to destination country d ; $dist$ is the great circle distance between the largest city in each of the two countries; gdp_o and gdp_d

69. This model was originally estimated as part of World Bank work on Cyprus reunification. Estimating the “missing trade” between the Republic of Cyprus and Turkey, and between the Turkish Cypriot community and the world, is a problem similar in nature to the problem of estimating trade potential of the Palestinian economy. In both cases, historical circumstances have caused trade flows to be much smaller than what would be expected in a “normal” situation.

are the GDPs of the exporting and importing countries, respectively, expressed in current USD; *contig* is a dummy variable equaling 1 if the two countries are contiguous and zero otherwise; *comlang_{off}* is a dummy equaling 1 if the two countries share the same official language and zero otherwise; *comcol* is a dummy equaling 1 if the country pair was ever in a colonial relationship and zero otherwise; and ϵ_y and is a zero-mean stochastic disturbance.⁷⁰ The estimation results, not presented here, indicate that all variables are statistically significant at the highest confidence level and have the *a priori* expected signs, given that a flexible functional form is used.⁷¹

TRADE POTENTIAL BETWEEN THE PALESTINIAN ECONOMY AND THE WORLD

The model yields a total of 2.8 billion USD potential exports by the Palestinian economy to the world (compared to 129.8 million USD actual exports by the country in 2015), of which 73 percent (2 billion USD) would have Middle East and North Africa as a destination, with Israel absorbing three-quarters of such regional total (1.5 billion USD). This estimate is broadly in line with a simple estimate based on comparator countries.⁷² The simple average of merchandise exports of the Palestinian economy's closest 10 comparators in terms of GNI and GNI per capital is \$3.7 billion.

After Israel and the rest of MENA, Europe and Central Asia, as well as North America, are the next most important destinations, both according to potential and actual export values, whereas East Asia and the Pacific, South Asia and Sub-Saharan Africa have only marginal importance, as can be seen in Table 4.1. It is worth noting that even though exports are expected to increase substantially in the counterfactual scenario (more than twentyfold), the estimated regional percentages in total that the Palestinian economy exports to the world arising from the model are close to those reflected in actual export data, with the exception of the Palestinian economy exports to Israel, which are expected to raise spectacularly from their actual negligible value. It should be noted that trade statistics between the Palestinian and Israeli economies suffer from major measurement error, and actual trade is most likely much higher than what is recorded by official statistics.

70. Potential imports are estimated through the same equation, inverting origin and destination countries' GDPs.

71. The introduction of quadratic terms for GDP create a flexible functional form. Though these are not commonly used in the literature, they do not conflict with the theory of gravity modeling. They were introduced in order to improve the fit of the model for trade between country pairs including a very small country and a very large country, and thus to improve out-of-sample prediction.

72. Comparators were selected based on similarity of economic indicators such as GNI and per capita GNI. The Palestinian economy closest ten comparators according to such criteria are the Democratic Republic of Congo, Armenia, Mongolia, Albania, Georgia, Jamaica, Namibia, Nicaragua, Honduras and Lao PDR.

TABLE 4.1: The Palestinian Economy Actual and Potential Exports to World Regions

Country	World Region	Actual Exports (current USD)	% of Actual Exports (current USD)	Potential Exports (current USD)	% of Potential Exports (current USD)
West Bank and Gaza	East Asia & Pacific (all income levels)	2,069,228	2%	95,460,307	3%
West Bank and Gaza	Europe & Central Asia (all income levels)	24,556,480	19%	343,588,900	12%
West Bank and Gaza	Latin America & Caribbean (all income levels)	204,334	0%	7,849,422	0%
West Bank and Gaza	Middle East & North Africa (all income levels)	97,200,465	75%	2,022,047,739	73%
	of which accounted for by Israel:	1,000	0.001%	1,516,821,760	54%
West Bank and Gaza	North America	5,817,686	4%	185,779,162	7%
West Bank and Gaza	South Asia	2,464	0%	97,309,487	3%
West Bank and Gaza	Sub-Saharan Africa (all income levels)	4,538	0%	32,034,096	1%
West Bank and Gaza	WORLD	129,855,195	100%	2,784,069,112	100%

Source: Data used to calculate trade potential estimates was sourced from CEPII databases and WDI, with the Palestinian economy including both the West Bank and the Gaza Strip, year 2015. Data on the actual Palestinian economy trade with World regions was sourced from UN Comtrade, mirror data, year 2015, and does not include Gaza Strip since trade data for such territory was missing overall (every year since 2007). Data on actual exports from the Palestinian economy to Israel corresponds to 2016 (the only year for which this disaggregate number is available since 2007).

Notes: Estimates of potential exports from the Palestinian economy to each World region were obtained by aggregating over individual countries' estimates according to standard World Bank regions, after calculating the potential exports of the Palestinian economy to each individual country using distance of each country to Israel as a proxy of the distance between the same country and the Palestinian economy (the same policy was applied to the remaining relevant gravity variables). The values of the Palestinian economy exports to Middle East and North Africa include the Palestinian economy exports to Israel (noted separately underneath), both in the cases of actual as well as potential exports.

Imports by the Palestinian economy are also estimated to increase substantially, from an actual 855.1 million USD in year 2015 to an estimated 10 billion USD in the counterfactual scenario (almost twelvefold), which is equivalent to 79 percent of the Palestinian economy's GDP in 2015 (12.7 billion USD). Even though this number appears high, it is within-range relative to actual exports of close comparators of the Palestinian economy.⁷³ Indeed, the simple average of actual 2015 import value by the ten closest comparators of the Palestinian economy is 6.4 billion USD, with individual countries' actual import values reaching as high as 11.2 billion USD (Honduras), 7.7 billion USD (the Democratic Republic of Congo and Georgia) and 7.4 billion USD (Namibia).

The estimate for imports is unlikely to be as reliable as the export number, since potential exports and potential imports are modeled separately (that is, the gravity model does not specifically model the current account). Like the Palestinian economy, most countries within the comparators' group run trade deficits of variable magnitudes,⁷⁴ which are financed in a variety of ways including debt, remittances, and underreported services exports. Taking the import and export estimates together implies an increase in the trade deficit of \$6.4 billion, or about half of the Palestinian economy's GDP in 2015. It would be speculative to imagine what combination of remittances, official development assistance, FDI inflows, or other balance of payments financing could account for such a large amount in a "normal" scenario.

POTENTIAL TRADE BETWEEN THE PALESTINIAN AND ISRAELI ECONOMIES

As Table 4.2 shows, in the context of Israel's trade with selected export destinations, the Palestinian economy–Israel trade potential appears relatively high in terms of the Palestinian economy's relatively low GDP; however the two countries are very close and contiguous, which would tend to intensify the expected commercial flows between the two countries. Israel's exports to the Palestinian economy are expected to become the largest within the selected destinations shown in Table 4.2 at 5.6 billion USD, whereas Israel's imports from the Palestinian economy are also expected to be relatively large (1.5 billion USD), only coming behind those sourced from Turkey.^{75,76}

73. See footnote 66.

74. The only exception is found in the case of Mongolia.

75. For the purposes of this analysis, the variable "comcol" for common colonial history has been set equal to 0. In principle this could have been set to 1, since both Israel and the Palestinian economy share a common history with respect to both the Ottoman Empire and Britain (*cf.* the example of Israel–Jordan in Table 4.2). It was decided to ignore this history; otherwise, the estimated Israel–Palestinian economy trade would be even larger than that presented here.

76. It is quite possible that the trade potential of some of the countries in Table 4.3 with Israel also exceeds the current actual trade by a significant amount.

TABLE 4.2: Israel Potential Trade
with the Palestinian Economy and Actual Trade
with Selected Peers

Country	Trade Partner	Actual Exports (current USD)	Actual Imports (current USD)	contig	comlang_off	colony	comcol	dist	GDP Israel (current USD)	GDP Partners (current USD)
Israel	Cyprus	418,394,000	349,328,000	0	0	0	1	365.69	299,415,699,456	19,559,942,144
Israel	Egypt, Arab Rep.	111,920,000	54,805,000	1	0	0	0	404.45	299,415,699,456	330,778,542,080
Israel	Jordan	98,723,000	410,538,000	1	0	0	1	111.09	299,415,699,456	37,517,410,304
Israel	Turkey	1,701,205,000	2,446,072,000	0	0	0	0	1,123.01	299,415,699,456	717,879,771,136
Israel	West Bank and Gaza	5,568,850,432	1,516,821,760	1	0	0	0	66.22	299,415,699,456	12,677,399,995

Source: All trade values come from UN Comtrade data (reported data, year 2015), except for the Israel-Palestinian economy trade, whose values are estimates from the Gravity Model. All GDP values come from CEPII database (whose indirect source is WDI), except Palestinian GDP which is sourced directly from WDI.

TABLE 4.3: The Palestinian Economy Actual and Potential Imports from World Regions

Country	World Region	Actual Imports (current USD)	% of Actual Imports (current USD)	Potential Imports (current USD)	% of Potential Imports (current USD)
West Bank and Gaza	East Asia & Pacific (all income levels)	185,008,024	22%	400,742,449	4%
West Bank and Gaza	Europe & Central Asia (all income levels)	340,670,620	40%	1,485,861,181	15%
West Bank and Gaza	Latin America & Caribbean (all income levels)	59,925,313	7%	30,230,227	0%
West Bank and Gaza	Middle East & North Africa (all income levels)	268,406,618	31%	6,834,696,571	68%
	of which accounted for by Israel:	n/a	n/a	5,568,850,432	56%
West Bank and Gaza	North America	878,788	0%	716,605,136	7%
West Bank and Gaza	South Asia	1,924	0%	442,157,496	4%
West Bank and Gaza	Sub-Saharan Africa (all income levels)	210,027	0%	93,539,572	1%
West Bank and Gaza	WORLD	855,101,315	100%	10,003,832,634	100%

Source: Data used to calculate trade potential estimates were sourced from CEPII databases and WDI, with the Palestinian economy including both the West Bank and the Gaza Strip, year 2015. Data on the actual Palestinian economy trade with World regions were sourced from UN Comtrade, mirror data, year 2015, and do not include Gaza Strip since trade data for such territory were missing overall (every year since 2007). Data on actual imports of the Palestinian economy from Israel is not available in COMTRADE.

Notes: Estimates of potential imports of the Palestinian economy from each world region were obtained by aggregating over individual countries' estimates according to standard World Bank regions, after calculating potential imports of the Palestinian economy from each individual country using distance of each country to Israel as a proxy of the distance between the same country and the Palestinian economy (the same policy was applied to the remaining relevant gravity variables). The values of the Palestinian economy imports from Middle East and North Africa include the Palestinian economy imports from Israel (noted separately underneath), both in the cases of actual as well as potential imports.

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