

Palestinian Economic Dependence on Israel

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Brief Analysis

As the international donor community struggles to determine its stance on aid to the Palestinians under the Hamas government, it is important to remember the extent to which the Palestinian economy is dependent upon Israeli decisions. Last year the international community gave the Palestinians \$1.4 billion in aid; Israel has the potential to affect at least that sum through its policies on trade, Palestinian workers in Israel, and the tax revenue it collects.

Trade

Under current procedures, all Palestinian exports and imports must pass through Israeli control. In Gaza, only two points of entry have been open, and then only with strict limits and frequent closures. On March 22, the Palestinian Authority (PA) agreed to an Israeli proposal that humanitarian goods from Egypt be allowed to pass through Kerem Shalom on the Israel-Egypt-Gaza border. Previously, the Karni crossing to Israel was the sole functioning passage for goods into or out of Gaza, and Israel has closed it for extended periods in 2006. Though Israel and the PA agreed in principle in the November 15, 2005 Agreement on Movement and Access that the Rafah crossing will ultimately enable goods to pass from Gaza to Egypt, any Palestinian trucks leaving Rafah for Egypt are not allowed to return. Israel prefers that goods go through Kerem Shalom so that it can ensure no arms are smuggled from Egypt into Gaza. The PA had previously refused to use Kerem Shalom, fearing that such an arrangement might be permanent and that Karni, over which it has some supervision and has a greater trade capacity, would never reopen.

Israel most recently closed Karni from January 15 to February 4, February 22 to March 4, and again from March 14 to 20, citing concerns about explosions and smuggling tunnels. Karni was the target of a suicide bomb attack in January 2005. Israeli defense minister Shaul Mofaz has announced that Karni's status will be decided on a day-to-day basis. Karni was partially opened for humanitarian imports on March 9-13 and has again been open since March 21.

The closures have cost at least \$17 million in lost exports, equivalent to approximately 3 percent of all Palestinian exports in 2005. Of this amount, approximately 40 percent is in irrecoverable agricultural products (strawberries, flowers, tomatoes, and so forth) that spoiled in trucks while waiting for the crossing to reopen. Many of these crops were grown in the greenhouses of former Israeli settlements that Quartet special envoy James Wolfensohn and other American philanthropists purchased for \$14 million. Israel's closures have also affected imports into Gaza. These imports include not only consumer goods, but also humanitarian aid. For weeks the United Nations Relief and Works Agency (UNRWA) and World Food Programme were unable to import medication and the humanitarian supplies they use to provide food assistance to 63 percent of Gaza's population. Shortages have driven up the prices of basic commodities; in early March, the price of flour rose by 25 percent in a single week.

Workers in Israel

Prior to the outbreak of the second intifada in 2000, 22 percent of employed Palestinians worked in Israel or in Israeli settlements. While these numbers dwindled during the intifada, the World Bank estimated that in 2005 a

daily average of 44,800 Palestinians, primarily from the West Bank, worked in Israel: 7,400 held Israeli papers or foreign passports, 18,800 were legal workers, and 18,600 worked illegally. These numbers do not include East Jerusalem ID holders whose number has remained steady over the last five years. Taken together, these West Bank, Gaza, and East Jerusalem workers constituted 10 percent of all employed Palestinians and earned 12 percent of Palestinian incomes.

According to the World Bank, in 2000 the Palestinian economy was one of the most remittance-dependent economies in the world, with income outside the territories comprising 21 percent of Palestinian Gross National Income (GNI). While the World Bank has noted that it is important that Palestinians move "away from a dependency on labor exports to Israel to a growth-path based on the export of goods and services to Israel and other countries," it also acknowledges that in the interim period "a priority must be given to preserving employment." It estimates that every additional 10,000 Palestinians allowed to work in Israel would generate \$120 million for the Palestinian economy and increase the GNI by 2.5 percent. This would have significant effects on the Palestinian economy, where unemployment stands at 22 percent, poverty remains at 43 percent, and 15 percent of the population lives in "deep poverty" such that they cannot meet subsistence needs.

Israel has announced plans to decrease the overall number of foreign workers and to phase out all Palestinian work permits by the end of 2007. Present regulations require all workers to be older than thirty-five and married with children. The current political situation may accelerate this process. Due to heightened concerns of a terror attack during the Jewish holiday of Purim and the Israeli elections, no Palestinian workers have been allowed into Israel since March 11, and Mofaz indicates that this will continue until further notice.

Tax Revenue

As part of the complicated economic relationship between Israel and the PA outlined in the 1994 Paris Protocol -- a portion of the Oslo interim agreement -- Israel, the West Bank, and Gaza are in a customs union administered by the Israeli government. Israel collects a duty on any foreign imports destined for the West Bank and Gaza and additionally collects a value added tax (VAT) on goods and services from Israel destined for the Palestinian territories. The Israeli Ministry of Finance estimates gross revenue from both of these levies to have been \$75 million per month in 2005. From this sum Israel, withholds money to pay Palestinian electricity and water bills that many Palestinians have refused to pay for years to protest Israeli occupation. The Finance Ministry deducts an average of \$15 million each month: \$6.5 million for electricity, \$2.2 million for water, \$3.2 million for West Bank utilities, and the remaining approximately \$3.1 million for additional expenses including items such as hospital fees and sewage treatment. That leaves about \$60 million per month that Israel passes to the PA, compared to the \$34 million a month the PA raises from taxes and other charges and the \$30 million or more the PA receives in direct budgetary aid from the international community.

Since mid-February, the Israeli government has withheld the revenue it collected on the PA's behalf. Concerned about the impact of this decision, Wolfensohn proposed in a February letter to the Quartet that Israel could use the withheld clearances to pay for the fuel the PA buys, which comes from the private Israeli company Dor Alon. The bills, which PA deputy finance minister Jihad al-Wazir estimates at about \$66 million per month, are roughly equal to the clearance revenue Israel is now withholding. There has already been a preview of the possible standoff that may occur between Dor Alon, Israel, and the PA. At the end of February the PA's check to Dor Alon bounced and Dor Alon immediately suspended fuel shipments. Despite Dor Alon's effort to involve the Israeli government in the dispute, the prime minister's office refused, arguing it is a private commercial dispute. While Israel's response indicates a desire not to assume fuel payments, it remains unclear what would happen if there were to be a humanitarian crisis should Dor Alon once again suspend fuel shipments due to the PA's failure to make payments.

Conclusion

The future of the Israeli-Palestinian economic relationship remains in flux. Israel is unlikely to resume revenue transfers as long as the Hamas government refuses to renounce terror and recognize Israel. Given Israel's security concerns, more restrictions on movement can be expected. Israeli decisions about these matters are likely to matter to the Palestinian economy at least as much as any decisions made by donors about international aid.

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