

## **Hypothesis for applying a Social Market Economy in Palestine**

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# **Hypothesis for applying a Social Market Economy in Palestine<sup>1</sup> (Working paper)**

**By: Karam Omar**

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<sup>1</sup> Reference to Palestine, or Occupied Palestinian territories in this paper refers to the West Bank unless indicated otherwise.

## Outline

This paper serves as a hypothesis for the “Social Market Economy in Palestine” project initiated by the Institute of Law at Birzeit University. The points covered in this paper are outlined in the questions below:

- 1) Is it possible to apply the principles of the social market economy in Palestine in light of:
  - a) The absence of a strong Palestinian economy
  - b) In the presence of a Palestinian economy which is dependent on the Israeli economy
  - c) In the presence of a Palestinian economy which is dependent on foreign aid
  - d) In the absence of control and sovereignty over the 1967 borders (including control over natural resources)
- 2) Do the PA’s agreements with the Israeli Government create obstacles for:
  - a) The improvement of the Palestinian economy; and
  - b) the application of a social market economy model in Palestine?
- 3) What must be changed in order to apply a social market economy model in Palestine?

In analysing and answering the above inquiries, this paper will first examine the political and economic reality in Palestine; secondly, it will examine the distortions in the economy, the lack of sovereignty in Palestine and its effects on the economy; thirdly, an in-depth analysis into the state of the Palestinian economy will be undertaken. This section will define the current state of the economy from external (eg the Palestinian Authority’s agreements with Israel) and internal factors (eg Palestinian economic policy); lastly, the fourth section will examine the key changes required for the adoption of a social market economy system in Palestine.

## ***I. The Palestinian economic and political reality***<sup>2</sup>

The current environment which has shaped the modern Palestinian economy was born out of the Oslo Accords, and its annex, the Paris Protocols which created the Palestinian Authority (PA). Pursuant to the Oslo Accords (i.e Oslo II), the West Bank was divided into Areas A, B and C.<sup>3</sup> Areas A and B, mainly composed of urban areas, were placed under full civilian Palestinian control. On the other hand, Area C (approximately 61% of the West Bank<sup>4</sup>), where the vast majority of natural resources are located, would remain under full Israeli civilian and military control to be gradually transferred in the future. Therefore, the PA was granted autonomy in managing the affairs of Palestinians and economic resources in Areas A and B. However, the PA was deprived of control over its borders and the majority of West Bank's land including natural resources<sup>5</sup> (i.e Area C).

Furthermore, by granting the PA the provisional and limited powers as stipulated in the interim agreements,<sup>6</sup> the PA was given the responsibility in meeting the basic needs for all the Palestinians under their jurisdiction. As a result, the PA had to work under harsh conditions since it was founded. The harsh conditions created by the Oslo Accords and Paris Protocol created an authority which depended on donor aid to continue its survival. Furthermore,

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<sup>2</sup> This paper was prepared based on the unpublished paper prepared by Dr. Nasser Abdul Kareem (infra n.9) and the research conducted by the author.

<sup>3</sup> See the Israeli-Palestinian Interim Agreement (Oslo II), 1995 (Link: <http://www.acpr.org.il/publications/books/44-Zero-isr-pal-interim-agreement.pdf>) accessed on: 20/10/2018

<sup>4</sup> United Nations Conference on Trade and Development (UNCTAD)- *Report on UNCTAD assistance to the Palestinian people: Developments in the economy of the Occupied Palestinian Territory*, 2016 (Link:

[https://unctad.org/en/PublicationsLibrary/app2016d1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/app2016d1_en.pdf)) accessed on: 20/10/2018

<sup>5</sup> Natural resources refer to those resources which are vital to the Palestinian economy and people such as water, agricultural lands, stone quarries and mines and Dead Sea minerals; see below for more detail

<sup>6</sup> The Oslo Accords and their annexes were temporary agreements for a provisional period pending the entering of final status negotiations between Israel and the Palestinian Liberation Organisation (PLO). It was stipulated that the newly formed PA would thereafter be granted full autonomy over the West Bank (including East Jerusalem) and the Gaza Strip.

as the peace process remained stagnant for nearly two decades, the PA's interim agreements with Israel remained in force. As a result, ***the transitional body (i.e PA), pending final status negotiations, which would have transformed into a government with a newly established and sovereign State of Palestine remained unchanged.***

As for the Paris Protocol, it was born out of the political and security framework laid down by the Oslo Accords. The Paris Protocol regulates the economic relationship between the PA and Israel in relation to trade, fiscal and monetary policies. The main distinguishing promising features of the Paris Protocol were:<sup>7</sup>

- 1) Implicitly recognising the need to rectify the Palestinian economy's skewed relationship with Israel;
- 2) an intention to equip the PA with the legal, institutional and procedural means to manage and develop Palestinian external trade within a Palestinian development vision; and
- 3) a recognition in the Preamble of each party's distinct economic interest.

However, in reality, the Paris Protocol made the Palestinian economy more depended on and subordinate to the Israeli economy due to several factors. The most important aspect is that the agreement created a one-sided customs union between both economies that primarily served the interests of the Israeli economy. Indeed, as stipulated in the Protocol, the VAT and customs rate applicable by the PA for most goods and services could not be 2% higher or lower than the rate applicable by Israel. As a result, the prices for goods in both markets would be relatively similar despite the considerable difference in the average income between both. To illustrate this unjust disparity further, the average income of Jewish Israelis is \$40,000 compared to \$3,700 for Palestinians living in the West Bank.<sup>8</sup>

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<sup>7</sup> UNCTAD, *The Palestinian economy: Macroeconomic and trade policymaking under occupation*, 2012 (Link: [https://unctad.org/en/PublicationsLibrary/gdsapp2011d1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/gdsapp2011d1_en.pdf)) accessed on: 17/10/2018

<sup>8</sup> Professor Robert Wade, *Living where you don't make the rules: Development in Palestine – one of the world's last colonies*, London School of Economics International Development, 2017, (Link: <http://eprints.lse.ac.uk/77123/1/LSE%20International%20Development%20%E2%80%93%20Living%20where%20you%20don%E2%80%99t%20make%20the%20rules%20Development%20in%20Palestine%20%E2%80%93%20one%20of%20the%20world%E2%80%99s%20last%20colonies.pdf>) accessed on: 23/10/2018

Moreover, as per the Protocol, the collection of customs and VAT on imported goods would remain under the jurisdiction of the Israelis. The transfer of these funds by the Israelis to the PA has proven on many occasions to be contingent on the fulfilment of the Israeli Government's demands, and thus used as a pressure tool. Furthermore, the lack of a Palestinian currency, which can only be issued with the agreement of the Israeli side, deprives the Palestinian Monetary Authority from the most important monetary policies that aim to develop the Palestinian economy. It follows, and as Dr. Nasser Abdulkareem aptly argues, that the Paris Protocol kept all the keys to the Palestinian economy in the hands of Israel.<sup>9</sup>

Even though Israel has clearly breached the Protocol and have caused detriment to the Palestinian economy over the past two decades,<sup>10</sup> the Paris Protocol has remained the key tool regulating the economic relationship between both sides. It is also worth noting that the lack of an effective dispute resolution clause<sup>11</sup> in the Protocol assisted in maintaining the grave breaches by the Israeli side. The Protocol provides for a Joint Economic Committee (JEC) responsible for, *inter alia*, settling a dispute in connection with the Protocol or to amend its terms. The JEC however, must consist of equal representation by both sides and can only reach decisions by agreement by both sides.<sup>12</sup> Therefore, in the case of a dispute arising from a breach by the Israeli side, this clause merely provides for a negotiation dispute resolution method as opposed to an adjudicatory one reached by an independent third party. As such, in terms of ensuring compliance with the Protocol by the Israeli side or amending its terms justly, the lack of independence of the JEC and the unequal bargaining power by both sides renders the JEC merely symbolic.

Accordingly, the above-mentioned factors have contributed to, if not aggravated, the issues inherent in the Palestinian economy. The PA's efforts to

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<sup>9</sup> الدكتور نصر عبد الكريم، الوضع الاقتصادي والمالي في فلسطين: تقييم للسياسات والأداء، ورقة مرجعية (غير منشورة)، ٢٠١٨

<sup>10</sup> The World Bank, *Economic Monitoring Report to the Ad Hoc Liaison Committee*, 2016 (Link: <http://documents.worldbank.org/curated/en/474311473682340785/pdf/108205-V2-WP-PUBLIC-SEPT-14-2PM-September-2016-AHLC-World-Bank-Report.pdf>) accessed on: 20/10/2018

<sup>11</sup> Most international commercial agreements contain a dispute resolution clause which gives either party the right to apply for an independent arbitration panel, such as the ICSID or the ICC, for adjudication over any breaches of the agreement/s.

<sup>12</sup> Article 2 of the Protocol on Economic Relations between the Government of the State of Israel and the P.L.O. (Paris Protocol), 1994

rebuild the Palestinian economy have been conducive in enacting laws regulating economic activity, rebuilding the institutional foundations for the Palestinian economy and taking measures to encourage trade and investment. However, as many contend,<sup>13</sup> these achievements came at a heavy price and were severely limited by the restrictions imposed by the occupation. Additionally, the absence of a clear Palestinian development plan which aims to rebuild the economy, coupled with the deficiencies in the economy inherited from the occupation have negatively affected the management of the PA's public budget. These factors have also revealed the PA's substantial dependence on international donor aid and on customs revenues collected by Israel. The heavy reliance on funding from customs revenues by the PA was further influenced from the reduction in revenue from local production tax. Indeed, the Palestinian economy (see below), has switched from having a productive base which relied on manufacture and agriculture production and export, to a service and trade (mainly import) sector. As such, the Palestinian economy became heavily exposed and affected by external shocks.

However, the weaknesses in the Palestinian economy do not only stem from the Paris Protocol's Articles or implementation, it also stems from the Oslo Accords. Indeed, it is not possible to disconnect the economic relations with Israel from the political discourse. It would be rather naïve for one to assume that an equal and equitable economic partnership could exist between two entities, one of which occupies the other. The economy, from an Israeli perspective, as some believe,<sup>14</sup> is on the forefront of the Palestinian-Israeli conflict. As such, it would also be naïve for one to assume that Israel would allow the Palestinian economy to develop and grow and thus free from dependence on Israeli pressure.

The above analysis thus leads us to two conclusions (although see below):

- 1) Changing the course of the Palestinian economy from a dependent and weak economy to an independent productive economy requires fundamental changes in the political relationship with Israel. In the case of Palestine, the state of the economy depends on the political situation and not the opposite.
- 2) Any efforts to develop the Palestinian economy in light of the present situation will not allow the economy to reach its full potential in light of

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<sup>13</sup> supra at n.7 & n.9

<sup>14</sup> supra at n.9

the present political situation and 'security' restrictions imposed by the Israeli government.

## ***II. A distorted economy governed by an authority with no actual sovereignty***

### ***a) Pre-Oslo Accords***

*The Palestinian economy's infrastructure and institutions have been severely affected by the Israeli occupation and its policies over two phases. The **first phase** started with the occupation of the West Bank (including East Jerusalem) and the Gaza Strip in 1967. During this phase, the Occupied Palestinian Territories (OPT) became a prime destination for Israeli products and a source of cheap labour for Israel. Furthermore, the Occupation authorities exploited Palestinian economic activity by arbitrarily imposing a taxation policy on individuals and commercial establishments. This resulted in weakening Palestinian economic growth and development; thus, making the economy unable to absorb a fast-growing Palestinian labour force. As such, Israel benefited from exploiting this labour force in accordance with its own economic needs and placed them in low-skilled jobs. The effect of absorbing this labour force in low-skilled jobs also reflected negatively on the Palestinians. Indeed, the nature of these jobs meant that the Palestinian labourer was not able to develop their skills from working in a more advanced economy (i.e Israel) in order to transfer such skills to the OPT.*

Furthermore, the inability of the Palestinian economy to grow with its growing labour force resulted in an inability to meet the Palestinian's market's demand of goods and services. As a result, a new reality was created on the ground whereby a relationship of dependence on the Israeli economy by importing goods from Israel to fulfil the Palestinian market's needs. Another devastating effect on the Palestinian economy, which resulted from the 1967 occupation has been the termination of pre-1967 trade relations/agreements that the OPT had with Arab and Muslim countries. As a result, the Palestinian trade sector was prevented from exporting and importing (including raw materials) from those countries.

## ***b) Post-Oslo Accords***

The inherent deficiencies in the Palestinian economy became graver in the **second phase** (i.e Post-Oslo). The deficiencies in the Palestinian economy within this phase become more complex due to the various actors and policies involved. The main components are the Oslo Accords and its annex the Paris Protocol, the Israeli Occupation and its policies, the PA's mismanagement of the economy and international donor influence which affects the sphere and direction of policy in the OPT. Although each of these factors contributed differently to the weakening of the Palestinian economy, the root cause however, is the Oslo Accords and Paris Protocol which created a weak PA with limited to no control over its fiscal and monetary policy, its borders and natural resources. Indeed, although the Palestinian economy was weak in the Pre-Oslo era, reports estimate that the Palestinian growth domestic product (GDP) per capita would have been 80% higher by 2010 had the Oslo era never come to light.<sup>15</sup>

Therefore, the birth of the PA signalled the formation of a weak authority limited by the Oslo Accords and the Paris Protocol. To illustrate, a UNCTAD study in 2009 reported that if the PA was empowered with policy instruments relating to fiscal, exchange rate, trade and labour policies, the GDP could increase by 23% and unemployment<sup>16</sup> could drop by 19%.<sup>17</sup> However, *“donors’ involvement in Palestinian reform and in the institution-building process, together with their aid conditionality and the existing policy framework of the Paris Protocol, have resulted in a shrinking Palestinian policy space, whereby Palestinian Authority policies are on the one hand made within a framework offered and approved by donors, and on the other hand, are mere responses to the numerous and sometimes contradictory donor aid conditionalities. **These limitations have not only reduced the capacity of Palestinian institutions to respond to the needs of the Palestinian economy, but have also created fragmentations within Palestinian institutions and ministries**”*.<sup>18</sup>

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<sup>15</sup> International Monetary Fund, *Macroeconomic and fiscal framework for the West Bank and Gaza: Seventh review of progress*, Report to the Ad Hoc Liaison Committee meeting, 2011 (Link: <https://www.imf.org/~media/external/country/WBG/RR/2011/041311.ashx>) accessed on: 20/10/2018

<sup>16</sup> Although not explicitly mentioned in the report, it is assumed here that the unemployment rate refers to the West Bank and Gaza.

<sup>17</sup> UNCTAD, *Policy Alternatives for Sustained Palestinian Development and State Formation*, 2009 (Link: [https://unctad.org/en/Docs/gdsapp20081\\_en.pdf](https://unctad.org/en/Docs/gdsapp20081_en.pdf)) accessed on: 26/10/2018

<sup>18</sup> supra n.7

Others, however, view that the main issue lies with the development model implemented by the PA and international donors and which aims to keep the Oslo peace process alive as much as possible.<sup>19</sup> This argument, though, presupposes that the Israeli occupation is either an external factor, or an uncontrollable one. Therefore, one must accept the existence of the occupation and seek a development strategy within the limits imposed by the occupation. However, for this reason, many experts<sup>20</sup> believe that sustainable development under the occupation is not possible. ***As such, there should be an alternative development strategy capable of achieving self-reliance, removing the occupation and achieving social justice in the aim of liberation as opposed to accepting the presence of the occupation.***<sup>21</sup>

### ***III. Defining the Palestinian economy (the larger picture)***

#### ***a) A rentier state with a rentier economy***<sup>22</sup>

According to the legal expert Yasser Salah, the Palestinian economy could be properly termed as a rentier economy. A rentier economy is one in which there is income to the economy which stems from an exploitation of the economic, social and political environment without having any real active and productive

<sup>19</sup> supra n.9

<sup>20</sup> *ibid*; سمير أبو مدالله، الاقتصاد الفلسطيني في ضوء اتفاق أوسلو وملحقه الاقتصادي، فلسطين اليوم ٢٠١٣

(Link:

<https://paltoday.ps/ar/post/180928/%D8%A7%D9%84%D8%A7%D9%82%D8%AA%D8%B5%D8%A7%D8%AF-%D8%A7%D9%84%D9%81%D9%84%D8%B3%D8%B7%D9%8A%D9%86%D9%8A-%D9%81%D9%8A-%D8%B6%D9%88%D8%A1-%D8%A7%D8%AA%D9%81%D8%A7%D9%82-%D8%A3%D9%88%D8%B3%D9%84%D9%88-%D9%88%D9%85%D9%84%D8%AD%D9%82%D9%87-%D8%A7%D9%84%D8%A7%D9%82%D8%AA%D8%B5%D8%A7%D8%AF%D9%8A-%D8%B3%D9%85%D9%8A%D8%B1-%D8%A3%D8%A8%D9%88-%D9%85>

accessed on: 28/10/2018

<sup>21</sup> *ibid*

<sup>22</sup> see ياسر صلاح، بين تعبئة الإحتلال الاقتصاد الفلسطيني في ظل السلطة الفلسطينية، وتعبئة التمويل الأجنبي

**الاقتصاد الريعي الفلسطيني في ظل السلطة الفلسطينية**

(Link: بين تعبئة الإحتلال وتعبئة التمويل الأجنبي، ٢٠١٤)

<https://hogog.wordpress.com/2014/06/04/142/> accessed on: 25/10/2018

market activity.<sup>23</sup> Therefore, a rentier state is a state which relies on income that is not derived from national production. Most commonly, rentier states are those states with natural resources such as oil (eg Gulf states). However, in the Palestinian case, the economy is termed as a rentier economy due to the fact that it relies on foreign aid and funding to ensure its survival. The dangers of this economic model, Salah argues, are grave as it incrementally transforms the society in which it operates into a consumption driven society, which directs its investments towards the service sector as opposed to a productive one (eg such as manufacture).

Another feature of this model is the absence of long-term development projects and the presence of short-term projects to combat unemployment. Even then, the employment opportunities which usually exist under this model are non-productive jobs (i.e service industry or the public sector). **Furthermore, rentier states rely on exported products to satisfy domestic demand and its own needs to make short-term profit.<sup>24</sup> As a result, the value of national products decreases leading to a deterioration in national industries.** In the PA's case, one may deduce that this is the case. Indeed, it has been reported that the revenues received from customs and VAT on imported goods in 2012 amounted to 69% of local revenues and contributed to 52% of public expenditure.<sup>25</sup> Recent figures also reveal that the trade deficit (i.e when a country imports more than it exports) is substantial in the OPT. In 2018, monthly imports (70% of which are from Israel) amounted to \$493 million whereas monthly exports only amounted to \$89 million.<sup>26</sup> Indeed, **Palestinians import more than three times what they manage to export; a trade structure which resembles failed states such as Somalia.<sup>27</sup>**

Furthermore, some of the reasons which create and assist in the maintenance of a rentier economy include the lack of capital investments in the national economy, the lack of a productive economy, the lack of equitable distribution of national wealth and the increasing presence of poverty and unemployment.<sup>28</sup> Most importantly, sustainable development of a rentier

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<sup>23</sup> ibid

<sup>24</sup> ibid

<sup>25</sup> supra n.20

<sup>26</sup> Trading Economics, *Palestine Balance of Trade 2018*, (Link: <https://tradingeconomics.com/palestine/balance-of-trade>) accessed on: 29/10/2018

<sup>27</sup> David Wainer, *New in the West Bank: A Credit Boom Waiting for a Real Economy*, Bloomberg Businessweek 2018, (Link: <https://www.bloomberg.com/businessweek>) accessed: 28/10/2018

<sup>28</sup> supra n.21

economy is not possible when the rentier state's policies are determined by international donors. In this regard, Salah points to the 2006 parliament elections in the OPT as a prime example.<sup>29</sup> Upon Hamas securing a majority of seats in the Palestinian Parliament, the PA faced an international boycott which led to the suspension of aid in the OPT. According to Palestine Monitor, this has resulted in the number of people living in deep poverty (less than 50 cents a day) to double from 500,000 to over 1 million.<sup>30</sup> **First, this demonstrates the current fragility of the Palestinian economy and reinforces its rentier classification. Secondly, and as Salah argues, this demonstrates that the PA's policies are restricted by the desired policies of donors, which may suspend aid should the PA take independent policy decisions.** The latter view is also shared by the UNCTAD (see above).

### **b) The infrastructure of the Palestinian economy (Post-Oslo)**

As intimated above, since the PA was founded in 1993, international donor aid became an important tool in 'supporting' the Oslo peace process and the Palestinian economy. However, donor aid soon thereafter shifted to fund different segments from the Palestinian economy such as the economic infrastructure, public and civil society institutions, and to pay the public sector's wage bill. Although the Palestinian consumption driven economy resulted in a weak GDP growth, such growth is *unsustainable* as it is fuelled by an expansion in bank credit to the PA, its employees and the private sector.<sup>31</sup> Moreover, the weakening of the private sector resulted in a substantial shift of employment to the public sector.<sup>32</sup> Indeed, it is estimated that approximately 33% (a high percentage) of the Palestinian workforce are employees in the public sector.<sup>33</sup> Furthermore, it was estimated in 2015 that nearly 12% of the Palestinian workforce is employed in Israel (including illegal Israeli settlements).<sup>34</sup> With unemployment rates in the OPT reaching 18%,<sup>35</sup> the private sector is left with merely 37% of the workforce.

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<sup>29</sup> *ibid*

<sup>30</sup> as reported in *supra* n.7

<sup>31</sup> UNCTAD, *Report on UNCTAD assistance to the Palestinian people: Developments in the economy of the Occupied Palestinian Territory*, 2016 (Link:

[https://unctad.org/en/PublicationsLibrary/app2016d1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/app2016d1_en.pdf)) accessed on 16/10/2018

<sup>32</sup> *ibid*

<sup>33</sup> *ibid*

<sup>34</sup> *ibid*



**with other countries and adopts a tariff regime that suits its own needs and requirements.<sup>42</sup>**

Besides the industrial sector, the deprivation of access to natural resources has been another major impediment to a productive economy. As mentioned above, most of the natural resources in the West Bank are located in Area C, which is under Israeli civil and military control. ***The expansion of Israeli settlements and lack of permit issuance to Palestinians by the Israeli authorities have prevented the development and emergence of existing and new industries. This has severely affected the Palestinian labour market, GDP growth and poverty levels.***

Historically, agriculture has been a major contributor to the Palestinian GDP and a source of employment. Since the early 1990s, its contribution to Palestinian GDP has almost halved to 4-6% of GDP in recent years.<sup>43</sup> Indeed, according to the World Bank data, only 35% of irrigable Palestinian land is actually irrigated, which costs the economy 110,000 jobs and 10% of GDP.<sup>44</sup> The reason for this decline is primarily the deprivation of water resources in the West Bank and lack of access to lands, many of which lie in Area C. The lack of access to water stems from the Israeli confiscation of 82% of ground water in the West Bank for its own use,<sup>45</sup> which is above the determined level in the Oslo Accords.<sup>46</sup> Palestinians are then forced to import over 50% of their water from Israel.<sup>47</sup> ***As a result, agricultural activities have become less viable forcing many farmers to abandon cultivation.<sup>48</sup> Additionally, employment in the agricultural sector has been severely affected due to lack of access to***

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<sup>42</sup> ibid

<sup>43</sup> ibid

<sup>44</sup> The World Bank, *West Bank and Gaza - Assessment of restrictions on Palestinian water sector development*, Report no. 47657, 2009 (Link:

<http://documents.worldbank.org/curated/en/775491468139782240/pdf/476570SR0P11511nsReport18Apr2009111.pdf>) accessed on: 24/10/2018

<sup>45</sup> UNCTAD, *The Besieged Palestinian Agricultural Sector*, 2015 (Link:

[https://unctad.org/en/PublicationsLibrary/gdsapp2015d1\\_en.pdf](https://unctad.org/en/PublicationsLibrary/gdsapp2015d1_en.pdf)) accessed on: 24/10/2018

<sup>46</sup> Article 40 of appendix I of the Oslo II Accord, signed on 28 September 1995 (see

<http://www.mfa.gov.il/mfa/foreignpolicy/peace/guide/pages/the%20israeli-palestinian%20interim%20agreement%20-%20annex%20iii.aspx>) accessed on: 24/10/2018

<sup>47</sup> supra n.45

<sup>48</sup> supra n.31

**inputs and the costly and complex system of exports.<sup>49</sup> This resulted in high transaction costs and destruction of large quantities of agricultural exports.<sup>50</sup>**

Furthermore, a World Bank study<sup>51</sup> provided partial estimates of possible lost revenue to the OPT from the inaccessibility to natural resources due to the occupation in Area C. The study assumed that there are no physical, legal or regulatory impediments on the ability of Palestinians to invest, produce and sell in Area C. The specific sectors included in the study included agriculture, Dead Sea minerals exploitation, stone mining and quarrying, construction, tourism, telecommunications and cosmetics. It was estimated that those sectors' output could be 23% of GDP (\$2.9 billion) in direct costs plus 12% of GDP (\$1.5 billion) in indirect costs. Therefore, if the occupation in Area C would end, the Palestinian employment could rise by 35%.

***c) Insider view: The Palestinian economic policy (working answer)***

The Palestinian Amended Basic Law of 2003 classifies the Palestinian economy in Article 21 and takes a neoliberal approach by basing the economy on the free market economy principles.

**Article 21**

1. The economic system in Palestine shall be based on the principles of a free market economy. The executive branch may establish public companies that shall be regulated by a law.
2. Freedom of economic activity is guaranteed. The law shall define the rules governing its supervision and their limits.
3. Private property, both real estate and movable assets, shall be protected and may not be expropriated except in the public interest and for fair compensation in accordance with the law or pursuant to a judicial ruling.
4. Confiscation shall be in accordance with a judicial ruling.

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<sup>49</sup> supra n.7

<sup>50</sup> ibid

<sup>51</sup> The World Bank, *West Bank and Gaza - Area C and the future of the Palestinian economy*, Report no. AUS2922, 2013 (Link: <http://documents.worldbank.org/curated/en/137111468329419171/pdf/AUS29220REPLAC0EVISION0January02014.pdf>) accessed on: 23/10/2018

development plans began with the principles of the liberal economy, which are stipulated in the Amended Basic Law:

1. Dependence on the market system and the prosperity of the private sector as an engine of sustainable growth and national prosperity.
2. The limited role of government in the economy. Such role is limited to providing the appropriate, stimulating and encouraging environment for the private sector.
3. Openness to the outside world and increasing export in order to achieve the desired economic growth.<sup>52</sup>

The experience of developed countries has consistently shown the need for government to protect and newly developed industries, at least in the early stages of independence.<sup>53</sup> However, in the Palestinian context, where there is lack of independence, open markets and export led growth are adopted even before neither a significant productive basis to the economy nor control of borders exist.<sup>54</sup> Additionally, it is important to note that the notion that the Palestinian private sector is an engine of sustainable economic growth and national prosperity, provides no explanation as to why the private sector must act as an engine of growth, nor does it adequately define what amounts to national prosperity.<sup>55</sup> This policy implicitly equates between “private sector growth” and “national prosperity” which conflates private benefit with public good.<sup>56</sup> It can then be argued that this approach ***is evidently “class effacing”, as it fails to acknowledge that profit and growth can be unequally and unjustly distributed under unregulated economic development, with the weakest and most disadvantaged segments failing to prosper in the same manner as those with power, education and capital do.***<sup>57</sup>

Adopting a free market economy has exposed an already suffering Palestinian industry to unfair competition from exported goods, especially Chinese goods.

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<sup>52</sup> see for example the Palestinian Development Plan 2008-2010

<sup>53</sup> Centre for Development Studies, *Critical Readings of Development Under Colonialism*, Birzeit University 2015 (Link: [http://home.birzeit.edu/cds/new-cds/sites/default/files/sites/default/files/publications/CRITICAL-READINGS1%20%25281%2529%20\(1\).pdf](http://home.birzeit.edu/cds/new-cds/sites/default/files/sites/default/files/publications/CRITICAL-READINGS1%20%25281%2529%20(1).pdf)) accessed on: 22/10/2018

<sup>54</sup> *ibid*

<sup>55</sup> *ibid*

<sup>56</sup> *ibid*

<sup>57</sup> *ibid*

**As a result, this has led to a decrease in the industrial sector's contribution to the Palestinian economy thereby limiting its ability to absorb the growing labour force.** As mentioned above, the private capital sector is dominated by small firms and lacks large public stock firms. In this instance, government assistance is vital to assist firms to develop, expand the market and increase their ability to compete in the market. It is therefore unlikely that a free market economy (i.e no government intervention) is able to achieve sustainable economic development and social balance in the Palestinian context.

Critiquing this policy further, Dr. Abdulkareem,<sup>58</sup> an economist expert, makes a few pertinent points about adopting a neoliberal approach to the economy in the OPT context. Firstly, there is a state of fragmentation in the West Bank due to the occupation which has separated Palestinian cities by settlements, checkpoints, the separation wall and the lack of sovereignty over Area C. As a result, separate markets have developed in different geographical areas in the OPT, which means that the power of supply and demand works differently in each market. Production inputs and investments (i.e goods, work and capital) are therefore prevented from moving between those different markets in response to market power. **One can then conclude that the current state of the Palestinian economy does not and cannot, correspond with the free market economy principles.**

Another feature of this neoliberal approach is the recent expansion of credit in the OPT.<sup>59</sup> Even though there is still economic stagnation in the OPT, this expansion has allowed many of the middle-class Palestinians to increase their quality of life. The danger in this expansion is that it could lead to an asset bubble and widen inequalities between various segments of the Palestinian society. According to Chris Harker, a researcher in Palestinian debt, this is leading to higher prices, thus making life unaffordable for many.<sup>60</sup> By way of example, as credit expansion has mainly focused on construction and services' activities as opposed to productive ones in the economy,<sup>61</sup> the lack of building

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<sup>58</sup> supra n.9

<sup>59</sup> David Wainer, *New in the West Bank: A Credit Boom Waiting for a Real Economy*, Bloomberg Businessweek 2018, (Link: <https://www.bloomberg.com/news/articles/2018-01-03/new-in-the-west-bank-a-credit-boom-waiting-for-a-real-economy>) accessed on:22/10/2018

<sup>60</sup> ibid

<sup>61</sup> supra n.31

space led to housing prices to skyrocket in Ramallah.<sup>62</sup> As a result, housing, a right guaranteed by the Basic law,<sup>63</sup> has become unaffordable to many.

## ***IV. The way forward (Working answer)***

### ***a) Foundations of development (working answer)***

According to Palestine Economic Policy Research Institute (MAS),<sup>64</sup> international development experience during the last three decades has shown that success in attaining development objectives is not primarily related to natural resources, geographical location or population. On the contrary, achieving those objectives should depend on a suitable development vision, good and transparent governance, and sound development management. States which failed to attain those factors, such as several countries in the Middle East, did not succeed in achieving their development objectives, irrespective of their resource endowment. By contrast, *“states which managed to secure efficient development management and good governance, based on a development vision formulated in consultation with private-sector and civil-society partners and derived from a scientific analysis of opportunities and strengths in their development environment, managed to face up to development challenges and set their economies on a course of sustainable development. Some examples of countries belonging to the latter group are the newly-industrialised Asian economies or ‘tigers’ (Hong Kong, Malaysia, Singapore, South Korea, Taiwan and Thailand) and Ireland, which has also been labelled the ‘Celtic tiger’ owing to its recent economic performance.”*<sup>65</sup>

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<sup>62</sup> supra n.59

<sup>63</sup> Article 23 of the Basic Law

<sup>64</sup> MAS, *Towards a Palestinian Development Vision*, 2005 (Link: <http://www.mas.ps/files/server/20141811144317-1.pdf>) accessed on: 29/10/2018

<sup>65</sup> *ibid* at p.1

The Palestinian development vision, as reflected in Article 21 of the Basic Law, has failed to connect between the principles of the free market economy and the principles of social justice and equal opportunity. Alternatively, it has been suggested that adopting a social market economy is more suitable in the Palestinian context.<sup>66</sup> By doing so, it is possible to create a competitive market and guarantee social protection for citizens. Furthermore, this also corresponds with the development plan which was developed by a team of Palestinian experts led by Dr. Yousef Al Sayegh in 1993 and adopted at that time by the PLO at the time.<sup>67</sup>

### ***b) A productive Palestinian economy (working answer)***

To rebuild an independent Palestinian economy, the Palestinian Ministry of Economy recommends the following:<sup>68</sup>

- 1) Control of Palestine's borders with its neighbours, including Israel. This includes independent control over the flow of people, goods and services.
- 2) Controlling all natural resources in Palestine. *Some of the potential these natural resources in generating revenue and employment have been outlined above.*
- 3) The creation of an independent Palestinian customs system with the ability to control Palestine's trade relations with the world.

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<sup>66</sup> Professor Dr. Naser Abdelkarim, *Reforming the Economic Policies in Palestine: Towards Equitable and Sustainable Growth*, Palestine General Federation of Trade Union, 2014 (Link: [http://www.global-labour-university.org/fileadmin/GLU\\_conference\\_2014/papers/Abdelkarim.pdf](http://www.global-labour-university.org/fileadmin/GLU_conference_2014/papers/Abdelkarim.pdf)) accessed on: 20/10/2018

<sup>67</sup> *ibid*

<sup>68</sup> وزارة الاقتصاد الوطني، البدائل الاقتصادية لاتفاقية باريس

(Link: <http://www.mne.ps/mne/download/economystudies/27.html>) accessed on: 22/10/2018

- 4) The ability and freedom to set an independent monetary and taxation policy, which includes the issuance of a Palestinian currency.

It should be noted that the Ministry's last two recommendations would involve the termination of the Paris Protocol. In light of the present situation, a unilateral move to terminate the Protocol is not possible. Indeed, Israel controls, *inter alia*, the borders, OPT trade and collects customs and tax revenues on behalf of the PA. Such tools, as have been demonstrated in the past are likely to be used by Israel to pressure the PA to reverse such a decision. As for the first two, it would not be possible either to achieve them without an agreement with Israel. ***As such, it is of vital importance to distinguish between those policies available within the present circumstances, in the absence of any political solutions between Israel and Palestine, and those policies which allude to the presence of an independent Palestinian state and therefore not realistic in the present situation.***

In order to create a productive Palestinian economy within the current circumstances, the following recommendations have been brought forward by several economic and legal experts:

- 1) **Sovereignty over the trade sector and of policy space** for any future Palestinian trade strategy. From a trade perspective, this necessitates the diversification of trading partners with efforts and legal incentives to expand the volume of local production and exports.<sup>69</sup> Arab and regional partners are key avenues.
- 2) **Economic policy.** The PA should in consultation of civil society and the private sector, develop as a matter of priority a new economic policy which aims at creating a productive economic sector in sectors such as agriculture, manufacture and IT.<sup>70</sup>
- 3) **Land registration.** Most land in the West Bank remains unregistered making it difficult for businesses to purchase land and expand operations. An UNCTAD report recommends funding a project to improve land policy and officially register all land which would give a major boost to private-sector activity.<sup>71</sup>

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<sup>69</sup> supra n.7

<sup>70</sup> supra n.22

<sup>71</sup> supra n.7

- 4) **Legislative reforms** are necessary, as many of the existing laws affecting private-sector activity are contradictory. The most essential laws required for a stable legal environment are the Commercial Law, Companies Law and the Competition Law. *“The procedures for drafting, passing, and enforcing legislation should be improved to allow for easier entry of private businesses into contracts and an expansion of their operations”*.<sup>72</sup>
- 5) **Competition policy.** The Palestinian economy is becoming less competitive with monopolies and large businesses exploiting the current crisis to expand their market power. In this regard, UNCTAD<sup>73</sup> recommends that the PA should renew efforts to develop a competition policy and establish regulatory bodies in areas such as telecommunications. The author recommends that the PA should consider in the future establishing an antitrust authority such as the one in Israel.<sup>74</sup> This would in turn ensure public confidence in the economy by developing competition rules in a way that responds to the needs of the Palestinian market. The enforcement of such rules would also be ensured by this body.
- 6) **Public expenditure.** The PA must include within its public budget, a priority of expenditure towards improving essential services, subsidising and providing incentives for the local agriculture and manufacture industries.<sup>75</sup>

<sup>72</sup> ibid

<sup>73</sup> ibid

<sup>74</sup> The Israeli Antitrust Authority defines itself as an independent professional authority working to protect the public from harms to competition and to promote competition, for the good of the public through its economics legal intelligence and investigations & administration departments; see <http://www.antitrust.gov.il/eng/about/about1.aspx> accessed on 28/10/2018

<sup>75</sup> سمير أبو مدالله، الاقتصاد الفلسطيني في ضوء اتفاق أوسلو وملحقه الاقتصادي ، فلسطين اليوم ٢٠١٣

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accessed on: 28/10/2018

- 7) **Foreign aid.** Directing a greater portion of foreign aid to invest in, subsidise or assist Palestinian production (including agriculture). Such long-term investments are vital for creating a more self-reliant and productive economy. In this regard, it is recommended that conditions are placed on foreign funding of projects and only accepted if they contribute to building productive sectors within the Palestinian national interests as opposed to foreign sponsors' interests.<sup>76</sup>

### c) *Social Policy (working answer)*

It is of vital importance that any future plans to adopt a social market economy in the OPT should include a social policy and a welfare state. By interpreting the welfare state provisions in the German Basic Law, Zacher contends that social laws made in pursuance of social policy should aim to:<sup>77</sup>

- 1) Ensuring an existence of human dignity for all: the guarantee of a minimum standard of living for everyone (e.g. by means of public assistance), and elementary personal services (education, the provision of care and nursing);
- 2) A greater degree of equality: the evening-out of inequalities of wealth (re-distribution, combatting of discrimination), the procuring of equality of opportunity (e.g. through the education system, and income payments to facilitate the utilisation of it by all members of society), as well as the elimination, mitigation and control of situations of dependency (e.g. in labour law);
- 3) More narrowly, social security: protection against a basic deterioration of the economic conditions of life, experienced by the individual as outside [their] own control (e.g. by means of social insurance). This

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<sup>76</sup> supra n.22

<sup>77</sup> Hans F. Zacher, *Social Market Economy, Social Policy, and the Law*, *Zeitschrift Für Die Gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics*, vol. 138, no. 3, 1982 at p.377 (Link: [www.jstor.org/stable/40750541](http://www.jstor.org/stable/40750541)) accessed on: 29/10/2018

aspect is given a particularly characteristic expression in the protection of the living standards which the individual has previously achieved. The benefits paid by the public assistance system in replacement of the income lost (e.g. sickness benefits, invalid and old age pensions) serve this end. This latter aim, to afford protection against inroads into the "social biography" of the individual, is of special importance in a developed social policy.

One may now inquire as to how do the concepts of the social market economy, and social policy and law interact. Altogether, their function is the provision of society with goods.<sup>78</sup> Where the market economy primarily aims at an unhindered distribution of goods, social policy primarily focuses on equal distribution.<sup>79</sup> Thus, where the market economy distributes by means of price, social policy distributes by means of state allocation; as such, one can classify them as means of distribution (i.e by the market economy) and redistribution (i.e by the state).<sup>80</sup> This then leads to the principle of social balance; where in market economies, the freedom of the weaker is at risk of being devoured, social policies aim to curtail the power of the stronger members of society in favour of the weaker ones.<sup>81</sup>

It can then be derived from the above that the level of prosperity determines the extent of social policy. Where prosperity levels in society are low, social policy should aim at combating poverty, in order to guarantee a minimum standard of living. By contrast, where prosperity levels are acceptable or high, social policy aims at ensuring "prosperity for all";<sup>82</sup> meaning, social policy would be restricted to a role of mediating participation in prosperity (i.e between businesses and citizens).<sup>83</sup> To illustrate by an example, if housing in Palestine is unaffordable leading many Palestinians to be unable to afford to buy or rent a house, the PA would have to interfere by formulating a suitable social policy. This exact issue became prevalent in England at different periods when there was either a shortage in housing or the inability of many low-income households to rent or buy a house. As a result, the UK government,

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<sup>78</sup> This does not imply that social policy is only concerned with the provision of goods. However, the provision of goods is the sphere in which it comes into contact with economy and economic policy; *ibid*

<sup>79</sup> *ibid*

<sup>80</sup> *ibid*

<sup>81</sup> *ibid*

<sup>82</sup> *ibid*

<sup>83</sup> *ibid*

through policies and legislation, created what is known as “council housing”.<sup>84</sup> Built by the government and managed by the local council, council housing provided good-quality affordable housing (by renting or selling) to low-income members of society. Such a policy may encroach on the economic freedoms of landlords (i.e the powerful) by either leading to a reduction of rent as a result of lower demand, or denying them of potential tenants. However, social policy intervenes in this instance to protect low-income households’ (i.e the weaker) right to an adequate minimum of living.

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<sup>84</sup> see University of the West of England, The History of Council Housing (Link: [https://fet.uwe.ac.uk/conweb/house\\_ages/council\\_housing/print.htm](https://fet.uwe.ac.uk/conweb/house_ages/council_housing/print.htm)) accessed on 29/10/2018

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