The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

The RAND Corporation presented a report aimed at estimating the costs of the Israeli-Palestinian conflict. The comprehensive study builds on detailed analysis to calculate the net costs and benefits to Palestinians and Israelis of five alternative trajectories, ranging from a two-state solution to a situation of violent uprising

Recent analysis by the IMF focuses on Palestine's fiscal situation, issuing recommendations to enhance tax collection and deriving GDP growth projections based on alternative fiscal scenarios

As trade deficit remained sizeable in Q1 2015, PALTRADE, in partnership with the PNA Ministry of National Economy and international organisations, launched a new National Export Strategy for 2014-2018

The first edition of the "International Green Environment & Energy Expo & Forum" took place in Ramallah between 2-4 June

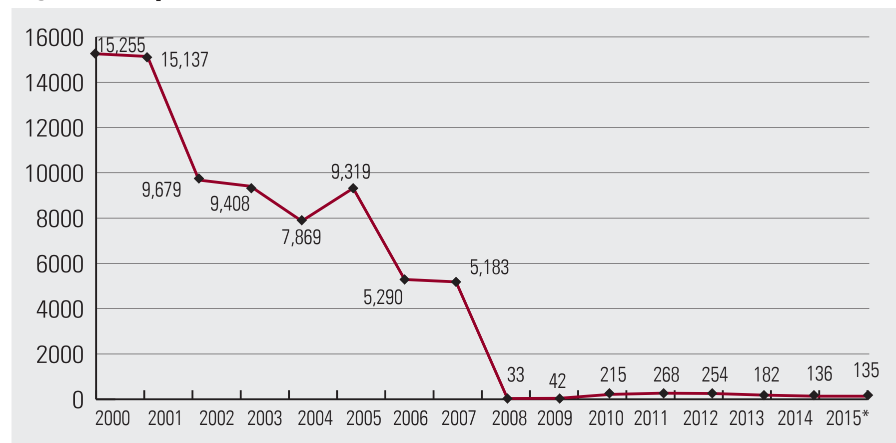
Exports from Gaza

In May 2015, 118 truckloads of goods left Gaza, marking the highest monthly trade level on record since the beginning of the blockade imposed by Israel in 2007. Of the total traded from Gaza in May, 61 truckloads were exports to Israel (39) and other international markets (22), while the rest was marketed in the West Bank.[1] The increase comes as a result of some relaxation on restrictions to the exit of goods from Gaza by the Government of Israel (GoI), which since November 2014 has allowed the sale of certain Gaza-made products in the West Bank. More recently, from March 2015, the GoI has allowed the entry of agricultural products from Gaza into Israel, following a complete ban since 2007. Between 8 March and 11 June (latest available data), 102 truckloads of tomatoes and eggplants (equalling almost 1,400 tons) were exported from Gaza to Israel.[2]

While increased trade from Gaza is undoubtedly a positive development, recent figures must be put in context to stress that the number of truckloads recently allowed out of Gaza is only a negligible portion of the trade level observed prior to the blockade.

Data from UNOCHA (Figure 1) shows that exports from Gaza dropped from 15,255 truckloads in 2000 to as little as 136 truckloads in 2014.[3] A sharp decrease was immediately observed after the beginning of the blockade, with merely 33 truckloads of goods leaving Gaza in 2008. Average monthly exports in 2014 (11.3 truckloads) amounted to just 0.9% of the monthly average in 2000. Even if the upward trend observed over the last few months is sustained during the rest of 2015, the average number of monthly truckloads is unlikely to exceed 3% of the 2000 level.

Figure 1: Exports from Gaza, 2000-2015* (Truckloads)



Source: OCHA OPT
(*) Data for 2015 only covers January-May (latest available)

1 www.gisha.org/graph/2401?datares=monthly
2 www.bit.ly/1TEpnTX // Sales were enabled by the GoI during the current Jewish "shmita" year only (a special period in a seven-year cycle during which land owned by religious Jews in Israel cannot be exploited)
3 www.bit.ly/1IVVAA3 // Exports data only includes truckloads leaving Gaza with destination Israel or other international markets (i.e. does not include Gaza-produced goods marketed in the West Bank)

A comprehensive, sustainable lift of trade restrictions (both on exports and imports) is a crucial pre-condition to enable meaningful economic development in Gaza. Gaza's economy has historically relied on export-oriented sectors, including manufacturing, agriculture, textile and furniture. According to the World Bank, the virtual elimination of export activities as a result of severe restrictions from both Israel and Egypt since 2007 was one of the main drivers behind the reduction in gross domestic output in Gaza by a third between 2005 and 2008.[4] Conversely, the only period of positive growth in Gaza since 2007 was fuelled by increased trade with Egypt through illegal trade tunnels. The closure of tunnels by the Egyptian authorities in 2013 following increased security concerns, resulted in sizeable economic losses for Gaza, including the loss of thousands of jobs.

Unlocking Gaza's trade potential will also necessarily need a reinforcement of its relationships with the West Bank. Recent reports by Gisha, an Israeli not-for-profit organisation advocating the freedom of movement of Palestinians, discuss the grave economic repercussions of separating Gaza from the Palestinian hinterland. Gisha points out that "the reality of the closure imposed by Israel on the Gaza Strip is a reality of separation and isolation, in which contact between Gaza and the West Bank is severely restricted", due to which "…entire sectors are reduced to a fraction of their potential size."[5] Interviews with leaders of Gaza's manufacturing industries indicate that the textile sector, historically of great importance to Gaza's economy, employed 25,000 workers (mostly women) in 2005-2007 and as many as 37,000 in 2000. Following the separation, the share of Gaza-made textiles in the West Bank collapsed and the number of employees in the sector declined by 85%.[6] Textile companies are estimated to be currently operating at no more than 25% of their capacity. Gisha's analysis also highlights that in 2005 there were 100 food processing companies in the Gaza Strip, employing 2,500 persons. About 155 truckloads of processed food products left Gaza every month, the majority of which went to the West Bank. Following the blockade, it is estimated that companies are operating at 20-40% of their full capacity, since the Gaza market cannot absorb more than 25-30% of their pre-closure output.

The Costs of the Israeli-Palestinian Conflict

On 8 June the RAND Corporation presented in Ramallah a report aimed at estimating the cost of the Israeli-Palestinian conflict. The comprehensive study builds on detailed analysis to calculate the net costs and benefits to Palestinians and Israelis of five alternative trajectories, ranging from a two-state solution to a situation of violent uprising.[7]

RAND's work uses a counterfactual approach, by building a baseline scenario based on the continuation of recent trends (e.g. economic and security outcomes continue along their current trajectories, the main issues defined in the Oslo Accords remain unresolved). The study then evaluates how a specific set of outcomes might have departed from the baseline if conditions had been different. The assumptions constituting each of the five alternatives scenarios are based on historical precedent. Results are naturally driven by and are sensitive to these assumptions. Other methodological limitations stem from the fact that the analysis assumes that changes across the different dimensions are independent from each other.

The paper acknowledges these and other limitations. The report's core finding is that a two-state solution produces by far the best economic outcome for both Israel and Palestine compared to any other scenario, including a unilateral withdrawal by Israel (coordinated or uncoordinated), and nonviolent resistance or a violent uprising by Palestinians. The latter yields the worst outcomes for both parties.

The study concludes that aggregate results for the two-state solution scenario over a 10-year period would yield benefits to Israel of $123bn (around half of Israel's GDP in 2014) and to Palestine of $50bn (roughly three times its GDP in 2014).[8] In turn, a violent uprising would cost Israel $250bn and Palestine $46bn. Absolute gains are naturally higher for Israel given the disproportionally larger size of its economy. However, relative gains would be higher for Palestinians, who would see their average GDP per capita increasing by 36% above the baseline in 2024. This is much higher than the average 5% increase estimated for Israelis under the two-state solution scenario. Again, higher relative returns for Palestinians should not come as a surprise given the fundamentally different stages of development in Israel, an industrialised economy, and Palestine, which lags well behind its developmental potential.

The RAND report identifies a sizeable dividend for both parties in the event of a two state solution. For Israel, the primary direct costs of the conflict are linked to high military spending and opportunity costs including perceived instability. Under a two-state solution, gains for Israel would derive from increased trade with both Palestine and the broader Arab World, increased tourism and access to cheap Palestinian labour. Gains for Palestinians are directly related to increased opportunities following the lifting of Israeli constraints on movement and access,

4 www.bit.ly/1CifNLp
5 www.gisha.org/updates/3998
6 www.gisha.org/UserFiles/File/publications/made_in_gaza/made_in_gaza_en.pdf

7 www.rand.org/international/cmepp/costs-of-conflict.html
8 All values are expressed in constant 2014 dollars

including re-gaining control of land, ports and natural resources.

RAND acknowledges that the path towards a two-state solution will require much more than proper recognition of the peace dividend by all parties. This will necessarily need to go hand in hand with major progress in relation to other crucial non-economic factors, including security, political leadership, regional developments and historical and religious issues.

Fiscal and Growth Outlook

Recent analysis by the IMF warns that in Q1 2015 the Palestinian National Authority (PNA) fiscal deficit increased dramatically due to a severe shortage of revenues, mainly caused by Israel's withholding of clearance revenues during the first months of the year.[9] At the same time, domestic revenue collection dropped by 15% in Q1 2015 from the corresponding quarter in 2014. As a result, the PNA was forced to borrow an extra $200m from local banks, in addition to accumulating further wage and nonwage arrears. In the absence of front-loaded donor aid, the government had to apply strict cash rationing, paying only 60% of the wage bill in January and February.

In the light of recent performance, greater fiscal discipline will be needed over the coming years. With the aim of helping eliminate persistent financing gaps without drastic changes in expenditure (which would in turn have negative effects on the economy), the IMF issued a series of recommendations to enhance revenue collection, in the belief that this should be the key driver in reducing the fiscal deficit. According to the IMF, maximum revenue collection should be achieved at minimum cost through voluntary tax compliance and effective tax administration.

Domestic revenues (excluding clearance revenues) currently are merely 22% of total net revenues (or 4.6% of GDP), indicating little fiscal autonomy and great aid dependency. The IMF estimates that domestic revenues could be increased to 7% of GDP if the PNA implements effective policies to raise the tax base by eliminating exemptions, increasing the number of registered taxpayers and enhancing compliance. It is estimated that the government currently taps into just 30% of the potential tax base, as tax avoidance is widespread.

In addition, the IMF also considers that there exists great potential to increase nontax revenue (coming from fees for government services and income from public property and investments). At 2% of GDP, nontax revenue in Palestine is the lowest in the MENA region, due in part to the fact that government fees have not been adjusted for the past 20 years. At the same time, the IMF stresses the importance of boosting clearance revenues as the current most significant source of income for the PNA. Efforts in this sense will require close cooperation with the GoI, which collects custom duties and other trade-related taxes on behalf of the PNA. Finally, the IMF stresses the need for the PNA to be able to collect revenues in Gaza, which has been interrupted since 2006. A significant part of the PNA's budget is spent on salaries of its Gaza employees (around 40% of the public wage bill).

Based on expected performance of the main fiscal indicators and other variables, the IMF prepared GDP growth projections through to 2020 (table 1).

Table 1: IMF Estimates and Projections for Key Fiscal and Economic Indicators, 2012-2020

	2012 (prel.)	2013 (prel.)	2014 (est.)	2015 (proj.)	2016 (proj.)	2017 (proj.)	2018 (proj.)	2019 (proj.)	2020 (proj.)
Real GDP (annual growth; %)									
Palestine	6.3	2.8	-0.4	2.5	4.2	4.0	3.7	3.5	3.2
West Bank	6.0	1.0	5.1	1.1	3.1	2.8	2.8	2.6	2.6
Gaza	7.0	5.6	-15.2	7.0	7.5	7.5	6.5	6.2	5.0
Fiscal indicators (% of GDP)									
Revenues	18.4	18.6	20.6	21.1	21.5	21.7	21.7	21.7	21.6
Recurrent Expenditures and Net Lending	31.4	29.7	30.6	30.4	29.9	29.0	28.2	27.4	26.7
Financing Gap	n/a	n/a	n/a	3.7	2.4	1.8	1.3	1.1	0.7

Source: IMF

Under a baseline scenario which assumes no major changes from the current political conditions and donor aid levels, real GDP growth prospects in Palestine are dim. Relatively higher growth in Gaza is projected as a result of the expected rebound following the major contraction in 2014 after the war. However, Gaza growth projected from 2015 is clearly insufficient to result in any meaningful recovery in the mid-term.

At the same time, with overall growth not expected to exceed 4.2% in the coming years, the labour market will be seriously hit, with total unemployment likely increasing beyond the high 27% observed at the end of 2014.

Foreign Trade in Goods

During Q1 2015 exports reached $211.3m, an increase of 0.3% compared to Q1 2014. At the same time, imports decreased by 9.9% from the previous year (to reach $1123.9m), which prompted the trade deficit ($912.6m) to decrease by 11.9% from Q1 2014.[10]

With the top two destinations for Palestinian exports, Israel and Jordan, accounting for more than 90% of all Palestinian exports in 2014, there is an urgent need to improve export capabilities and diversify destination markets. To this effect, PALTRADE, in partnership with the PNA Ministry of National Economy and international organisations, recently launched a new National Export Strategy (NES) for 2014-2018. The strategy for export

9 www.imf.org/external/country/WBG/RR/2015/051815.pdf

10 www.bit.ly/1eFAUT9

growth identifies nine priority sectors based on their capacity to contribute to export growth, trade deficit reduction and employment generation. Priority sectors include stone and marble; olive oil; textiles and garments; furniture; tourism; fresh fruits, vegetables and herbs; agro-processed meat; footwear and leather; and ICT services. The NES sets a series of objectives to improve export performance, including promoting a dynamic business environment, helping capacity building and improving international perceptions of Palestinian products and services.

According to PALTRADE, successful implementation of the strategy could increase the value of Palestinian exports over the next five years by over $700m, resulting in a 67% overall growth in total exports.

Green Energy Forum

The first edition of the "International Green Environment & Energy Expo & Forum" took place in Ramallah between 2-4 June.[11] The private sector-led event brought together numerous local businesses as well as regional and international organisations active in the sector with the intention of showcasing opportunities for investment and development. More than 20 exhibitors raised awareness around the importance of preserving the environment, promoting greater energy independence in Palestine, and enhancing energy efficiency by increasing savings and rationalizing consumption. Dr. Omar Kitaneh, chairman of the PNA Energy and Natural Resources Authority, addressed the conference, stressing the strategic importance of renewable energy for Palestine's development and the government's commitment to enabling investment in the sector.

With over 60 companies working on renewable energy, 40 of which are organised under the Palestinian Federation of Renewable Energy Industries, the sector is gaining momentum. Following long-standing blocks to the development of projects due to regulatory gaps, it is expected that the Cabinet approval of a draft Renewable Energy Law in May 2015 will unlock investment and job creation opportunities.

Kito de Boer, Head of Mission of the Office of the Quartet, praised private sector and governmental efforts, adding that while "…it is true that the challenging fiscal position of the PA is measurably different to rich countries which can afford to pay subsidies and invest heavily in the sector, … renewable technologies are getting cheaper, more cost-efficient, and therefore less subsidy-dependent." Mr. De Boer added that "Entrepreneurs can and are playing a pioneering role the development of the Palestinian renewable energy sector. Across the globe, the growth and success of the renewable energy sector has largely been a result of private sector leadership and innovation and I would like to commend the individuals and businesses who are doing this work (in Palestine)."

May Trading

In May, the Al-Quds index decreased by 1.07% from April, reaching 478.85 points on the last day of trading. A total of 9.0m shares worth $15m were traded. This marked a decrease of 37% in the volume and 29% in the value of traded shares from the previous month. Market capitalisation decreased over the month by 1%, reaching $3bn.

In related news, PEX announced that the amount of cash and stock dividends distributed in 2014 by listed companies reached $170.9m, a decline of 0.3% from 2013.

11 www.facebook.com/IGEE.Expo?fref=photo

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The Palestinian Economic Bulletin is prepared by the Palestine Economic Policy Research Institute (MAS) and edited by The Portland Trust. Please send any comments, suggestions, or complaints to feedback@portlandtrust.org

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