



The Palestinian Economy: A Historical View

Brian J. Friedman, CFA

September 30, 2014

Among the thousands of articles written about the Israeli-Palestinian conflict, very few study the impact of the conflict on the Palestinian economy. According to the CIA approximately 2.2 million Palestinians live in the West Bank (along with 350,000 Jewish settlers) and 1.8 million in the Gaza Strip. Total Gross Domestic Product (GDP) for the Palestinian Authority is \$6.6 billion or \$1,650 per capita. By way of comparison, Israeli GDP is \$273 billion or \$35,000 per capita. Israel's 1.5 million Arab citizens suffer from a significantly lower standard of living than Jewish Israelis. Nonetheless, Israeli Arab GDP per capita is estimated to be \$12,000 (Israel Bureau of Statistics). Even without a formal peace agreement, a cessation of Palestinian terrorism and violence could produce a significant peace dividend for the nearly 12 million people living between the Jordan River and the Mediterranean Sea.

Unfortunately the Palestinians only started developing a working economy in 2007 with the appointment of Salam Fayyad as Finance Minister, and then again just in the West Bank. While Israel certainly shares some of the blame for the Palestinians economic malaise, economic development was also a low priority for the Palestinian leadership. Until Mahmoud Abbas became President of the Palestinian Authority in 2005, Palestinian factions pursued armed struggle and terrorism against Israel rather than build institutions required for economic prosperity such as banks, courts, capital markets, factories or corporations.

The Palestinian Economy Prior to 1967

In June of 1967 the combined militaries of Egypt, Jordan and Syria mobilized against Israel. After six days of intense warfare, Israel once again repulsed Arab enemies bent on its annihilation. Not only did Israel win the war, but it captured the West Bank from Jordan, the Gaza Strip and the Sinai Desert from Egypt and the Golan Heights from Syria. The Arab countries suffered a humiliating defeat and Israel retained strategically important territory that improved its defensive position.

The 600,000 Arabs in the West Bank and 350,000 in the Gaza Strip lived in a pre-industrial economy. The 1967 Census figures show that 35% of the population were farmers or fisherman and another 25%

worked as craftsman, artisans or construction labor. Unemployment was quite high, particularly in Gaza (www.levyinstitute.org, The 1967 Census). While Jordan allowed the PLO to launch terrorist raids from the West Bank prior to the war, it also incorporated many West Bank residents into the Jordanian economy (the West Bank accounted for half of the Kingdom's population at the time). Egypt, on the other hand, sponsored terrorist Fedayeen raids from the Gaza Strip and let its residents languish in poverty.

Israel did not develop the Palestinian economy in the early years, hoping to trade most of the newly acquired territory for a lasting peace. The Arab League, however, adopted the Khartoum Resolution which articulated their three famous no's: 1) No peace with Israel. 2) No recognition of Israel; and 3) No negotiations with Israel. Egypt backed up its hostile intent by shelling Israeli positions in the Sinai desert during the 1969-1970 War of Attrition and by launching a devastating joint surprise attack with Syria against Israel on Yom Kippur 1973.

Following Israel's victory in the Yom Kippur War, Israel and Egypt finally engaged in negotiations that ultimately lead to their peace treaty in 1979. Anwar Sadat - President of Egypt – tried to bring the Palestinians to the negotiating table, but their leaders in the Palestine Liberation Organization (PLO) refused. Jordan would not join the peace process unless the Palestinians also joined. As a result, Israel returned the Sinai desert to the Egyptians, but the West Bank and Gaza Strip remained under Israeli control. The PLO preferred to perpetuate armed conflict rather than liberate Palestinian territory peacefully.

Israel pursued ad hoc economic policies toward its occupied territories. On the one hand, every Israeli government encouraged Jewish settlement in areas critical to Israel's security, and later in other areas important to the settler movement. Meanwhile, Israel never developed a coherent economic strategy for the Palestinian population other than allowing them to work inside Israel. Palestinian laborers worked in construction, restaurants and other unskilled or moderately skilled jobs. At peak, approximately 40% of the Palestinian labor force was employed in Israel (Arie Arnon, "Israeli Policy Toward the Palestinian Territories: The Economic Dimension 1967-2007"). Wage income from Israeli jobs transformed the West Bank and Gaza Strip into urbanized societies with smaller agricultural sectors and a growing range of service occupations. The standard of living rose, but Palestinian entrepreneurship was limited and Jewish settlements developed the overwhelming majority of industrial enterprises inside the territories.

Israel did not encourage an indigenous industrial base in the West Bank or Gaza Strip nor a Palestinian financial system. At the time, Israel was a largely Socialist economy dominated by government or quasi-governmental enterprises. Israelis worried that a similar system in the territories could ultimately prove threatening to Israel, economically, politically and militarily. The PLO devoted its resources to its terrorist campaign and did not advocate for alternative economic arrangements.

Oslo, Closures and the Second Intifada

In 1993, Israel and the PLO reached a historic accord whereby the Palestinians were supposed to recognize Israel in exchange for autonomy within the newly established Palestinian Authority (PA). Israel ultimately withdrew from all of the major Palestinian population centers, and agreed to negotiate the final status of the territories within five years if security could be maintained. Instead Israel suffered increased terrorism emanating from the territories, often from groups linked to the PLO or the jihadist groups Hamas and Islamic Jihad. In response, Israel imposed numerous and sometimes extended “closures”, preventing Palestinians from reaching their jobs in Israel. Israeli employers increasingly replaced Palestinians with other foreign workers.

In July 2000, President Bill Clinton invited Yasser Arafat, President of the PA and Ehud Barak, the Prime Minister of Israel to Camp David to hammer out a final peace agreement. Despite a very generous territorial offer from the Israelis the Palestinians demanded a “right of return” for millions of Palestinians to live inside Israel’s borders. This demand was tantamount to a denial of Israel’s right to exist as a state with a majority Jewish population, a principal Israel believed the Palestinians had accepted in the 1993 Oslo Accords. Yasser Arafat left the unsuccessful summit and unleashed a massive terror campaign known as the “Second Intifada.”

Over the next five years 1,000 Israelis lost their lives in waves of Palestinian suicide bombings and other terrorist attacks. Israeli reprisals killed an estimated 3,000 Palestinians, but another casualty was the economic linkages between Israel and the PA. Almost all Palestinians working in Israel were replaced during this period. Average income in the territories fell by 30% during the Intifada, while unemployment exceeded 30% in the West Bank and 40% in Gaza. The poverty rate in the West Bank rose from 13% prior to the Intifada to 40% and from 32% to 65% in the Gaza Strip. (Arnon)

Israeli Disengagement from Gaza

In 2005, Israel withdrew its forces from the Gaza Strip thereby handing governmental authority to the PA. Shortly thereafter, Hamas won a surprise majority in the 2006 elections to the Palestinian Legislative Council. A Palestinian civil war left Hamas in control of the Gaza Strip and the PA in charge of the West Bank. Hamas rejects Israel’s right to exist and turned Gaza into its base for terrorist operations, primarily rocket fire into Israel’s Southern communities. In response, Israel imposed a blockade on the Gaza Strip starting in 2007. Israel, in partnership with Egypt, prevented the importation of weapons or militarily useful materials (although Hamas became adept at smuggling operations through underground tunnels).

Despite these hardships, the Hamas regime continued to prioritize terrorist activities against Israel over economic development in Gaza. In the seven years since Hamas assumed control over the Gaza Strip average Palestinian incomes declined by an estimated 40% (UNCTAD, Report on UNCTAD assistance to the Palestinian people, July 15, 2011). The economic damage from this summer’s conflict has yet to be calculated, but it is most likely quite severe.

The West Bank: A New Direction

Meanwhile, the West Bank under President Mahmoud Abbas and his former Prime Minister Salam Fayyad embarked on a new economic direction. Rather than focus on violence toward Israel or peace negotiations, Fayyad believed a Palestinian state would eventually evolve if the Palestinians created solid institutions, such as a judicial system, financial system and effective police authority. Since Abbas became PA President in 2005 average income in the West Bank increased 36%. (UNCTAD)

Palestinians in the West Bank and the Gaza Strip are now embarked upon two radically divergent paths with regard to governance and economic policy. Hamas pursues a policy of violent confrontation with Israel ensuring continued poverty and periodic destruction of Palestinian lives and property. Meanwhile, the current Palestinian leadership in the West Bank rejects violence and terrorism and is attempting to create domestic Palestinian economic institutions.

Palestinian rejection of Israel as a Jewish State and continued violence against the Jewish people has reduced the Palestinian population to poverty, unemployment and dependence on the generosity of foreign donors. Only in recent years has the Palestinian leadership in the West Bank adopted a policy of peaceful development, albeit in an atmosphere of political intrigue, corruption and haphazard implementation. Nonetheless, the policies of Mahmoud Abbas and Salam Fayyad offer a glimpse into a more peaceful Palestinian society. Israelis and Palestinians may never agree on basic principles, but peaceful relations must begin with the Palestinians at peace with themselves. By working toward a prosperous society with secure governmental institutions the Palestinians will build the state they demand. Violence and terrorism will consign them to poverty as long as the conflict lasts.