



Summary of the Palestinian Economic Initiative

**Ad-Hoc Liaison Committee Meeting – New York
September 25, 2013**

(1) INTRODUCTION

In May, 2013 at the Dead Sea World Economic Forum in Jordan, US Secretary of State John Kerry emphasized the critical importance of a robust and growing Palestinian economy for the Middle East Peace Process. ‘As long as prospects for economic advancement remain weak, so do the prospects for peace and stability,’ stated Secretary Kerry. He also stressed that economic progress alone could not serve as a substitute for political progress in Palestinian-Israeli peacemaking.

There is an immense need for political negotiations on final status, but also for the credibility of these negotiations to be boosted by a robust, visible and practical set of changes to the lives of Palestinians. The Palestinian people need the dignity of statehood but also require stability, opportunity and prosperity. Properly done, these two elements – the political and economic tracks – positively reinforce each other. Without a political process, there is an absolute limit to the possibilities of economic advancement, but without economic empowerment, any negotiations are likely to seem too remote from reality to be credible. The purpose of a new and bolder economic track is to support the Palestinian Authority in engendering transformative change in the West Bank and Gaza Strip, strengthening the link between Palestinian statehood and greater life-changing opportunities on the ground.

In support of renewed Palestinian-Israeli political negotiations, a team of policy advisors, external economic analysts and international domain experts under the leadership of Quartet Representative Tony Blair recently prepared an ambitious three year plan, entitled the ‘Palestinian Economic Initiative’, designed to effect rapid and positive change in the Palestinian economy. The initiative focuses on catalyzing private sector-led growth in the West Bank and the Gaza Strip, and covers eight key economic sectors: agriculture, construction, tourism, information and communication technology (ICT), light manufacturing, building materials, energy and water. The success of the initiative relies heavily on the inflow of new financing into the Palestinian economy, particular from the private sector, continued and expanded Israeli easing measures, and boosted institutional capacity within the Palestinian Authority (PA)

This report to the AHLC provides an overview of the strategic direction and content of the ‘Palestinian Economic Initiative’. The initiative was submitted in draft form to the Palestinian Authority (PA) in August, 2013 and is currently undergoing internal review. The initiative was also shared with the Government of Israel and a

preliminary set of enabling measures for its implementation was enacted by the Israeli Government prior to the AHLC meeting. These measures included approval for the importation of greater quantities of construction material and water into Gaza. After the PA concludes its internal review process, outreach efforts to donors and investors for financing support are expected to commence in partnership with key stakeholders.

(2) CONTEXT

The inability of the Oslo process to conclude final status negotiations over a twenty-year period has hindered the development of a vibrant and sustainable Palestinian economy. Since the mid-1990s, the PA and the Palestinian economy have remained both vulnerable to changing events of the ground and reliant on external donor assistance flows. Over the last twenty years, donors have granted over USD 10 billion to the PA and external budget support still averages around USD 1 billion per year (comprising about a third of the PA budget). Notwithstanding this substantial financial support, Palestinian economic prospects are still impeded by the current environment controlling and affecting economic life in the West Bank and Gaza Strip.

Despite the surrounding constraints, Palestinian economic growth from 2009-2011 was relatively high, underpinned by a mixture of PA reforms, donor assistance and the removal of Israeli restrictions. During the same period, the Office of the Quartet Representative (OQR) pursued a development agenda in coordination with the PA and donors focused on consolidating the PA fiscal situation and spurring on economic growth. OQR was actively engaged in supporting the PA budgetary position by mobilizing direct budget support, unblocking the flow of PA clearance revenues from Israel (when required, as in November 2011) and providing technical assistance during the recent revenue enhancement discussions between the PA and the Government of Israel (GOI).

On fostering Palestinian economic growth, OQR worked with other partners on easing movement and access restrictions and facilitating Palestinian trade. The Jalameh crossing linking the northern West Bank to Israel was opened in 2009 – facilitating the entry of Arab Israelis and leading to the economic revitalization of the Jenin and Nablus areas. Crossings around Bethlehem were made more accessible for international tourists. Tens of thousands of permits were secured for Palestinians to work in Israel. In June, 2010, OQR negotiated a significant change in the Israeli closure regime affecting Gaza – by moving away from a positive list system to a

negative one – which expanded the volume and range of products entering the Gaza Strip.

During 2007-2012, OQR also worked with the international community to unblock major infrastructure projects in the West Bank and the Gaza Strip. In the energy sector, OQR negotiated an agreement to commence Israeli-Palestinian negotiations on the development of the Palestinian Gaza Marine Gas field in the Mediterranean Sea and helped facilitate the commencement of the project to construct four electrical sub-stations in the West Bank. In the waste water sector, OQR cooperated with others to facilitate the implementation of the large Northern Gaza Emergency Sewage Treatment Project (NGEST) and Sheikh Ajleen Projects in Gaza. The successful operation of NGEST is now contingent upon an adequate supply of electricity into the Gaza Strip.

In spite of important progress on the ground, economic growth during the 2012-2013 period experienced a general slowdown. The reasons for this economic deceleration stemmed from a number of factors including regional instability, political deadlock between the Israelis and the Palestinians, donor fatigue, and the absence of continued and broad-based Israeli measures to ease restrictions on Palestinian economic life. With the resumption of peace talks between the parties, it is expected that the Palestinian Economic Initiative, alongside the positive effect engendered by the political track itself, will help reverse this general economic easing and provide a constructive climate for the political negotiation between the Palestinians and the Israelis.

(3) OBJECTIVES

The overriding objective of the ‘Palestinian Economic Initiative’ is to catalyze transformative and accelerated change in the Palestinian economy. The initiative aspires to rapidly grow the Palestinian economy spanning the entirety of the West Bank including Area C and the Gaza Strip over a three-year period from 2014-2016. It also aims to achieve a significant reduction in joblessness, a substantial increase in average Palestinian household income, a large surge in investment flows - both domestic and foreign - and a significant decline in PA reliance on direct budgetary assistance.

The initiative also aims to engender, over the medium-term, a substantial shift in the Palestinian economy toward private sector-led development. By focusing on

the growth of key private industries, assisted by a mix of enabling factors, the initiative aims to shift the Palestinian economy towards a model of private sector-led development and economic sustainability ahead of eventual Palestinian statehood.

The Gaza Strip and Area C are important parts of the Palestinian Economic Initiative. The initiative focuses on the development of critical infrastructure in the water and energy sectors in Gaza and in Area C (completing and operating the large sanitation projects in northern and central Gaza, initiating the large impact desalination project, establishing new power plants in the West Bank). It also addresses the expansion of housing, agriculture, and light-manufacturing activity in Gaza and Area C through a combination of easing measures, private investment, and donor financing including the provision of technical assistance (more details are provided below in the section on sector strategies).

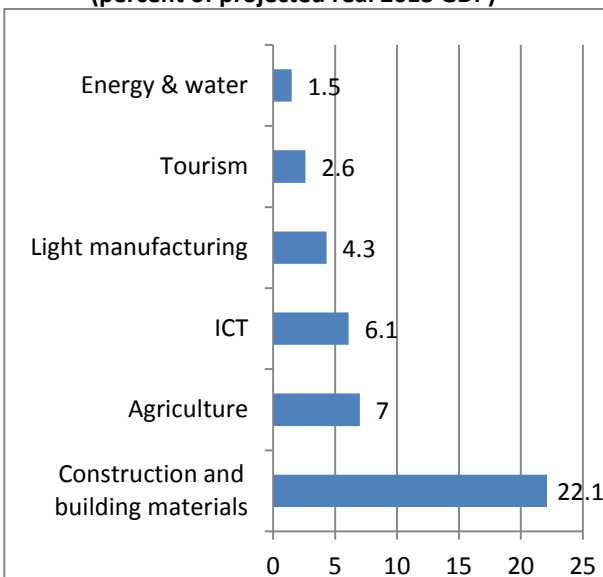
(4) PROPOSED SECTOR STRATEGIES

Overview

The initiative aims to unlock the economic potential of the Palestinian private sector through a mixture of private sector investments, donor development assistance, Israeli measures necessary for implementation, and expanded PA capacity. It is expected that donor assistance will be used to leverage greater private sector investment in key Palestinian economic sectors and will continue funding critical Palestinian infrastructure in the water and energy sectors. Donor assistance could be provided in different forms including grant financing, concessional loans, political risk insurance and bank guarantees.

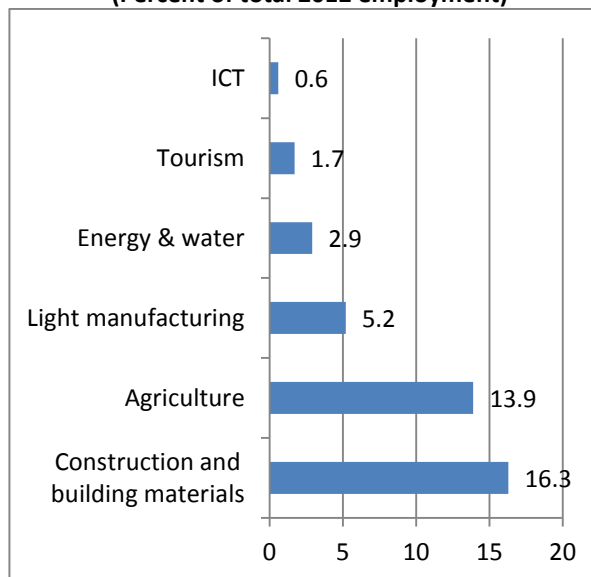
The eight sectors included in the ‘Palestinian Economic Initiative’ were chosen based on their private sector orientation, relative contribution to GDP and employment figures, and their potential for economic growth. Graphs 1 and 2 below point to the relative economic significance of these eight sectors. Water and energy are combined and represented as one sector, as are construction and building materials. Current sector contributions indicate the relative significance of the construction and agricultural sectors and it is expected that these sectors will offer the greatest potential for growth and job creation over the medium-term. Other sectors, such as tourism, currently contribute less to overall economic activity and employment, but have vast potential to grow particularly under conditions of greater peace and stability within the region.

**Graph 1: Sector Contributions to Palestinian GDP
(percent of projected real 2013 GDP)**



Sources: PCBS, PalTrade, IMF

**Graph 2: Sector Contributions to Employment
(Percent of total 2012 employment)**



Sources: PCBS, PalTrade, IMF

Sector Strategies

1. Agriculture

Agriculture already makes a relatively large contribution to GDP, but it could deliver significantly more to the Palestinian economy. Agricultural land currently used for low-input, low-yield, rain-fed crops can be converted to high yield crops within a single season, in some cases leading to a twenty-fold increase in financial return. Enabling the expanded development of the Palestinian agricultural sector requires: greater volumes of water for Palestinian farmers, fertilizer in standard concentrations, advanced seed types, improved farming knowledge, and access to financing mechanisms (e.g. seasonal credit and crop insurance).

Fragmentation of land holdings also needs to be overcome, by establishing farmer cooperatives or single farmers leasing land in particular areas. These broader-based initiatives could help facilitate the aggregation of extension services by the Ministry of Agriculture and other technical organizations as well as the transfer of advanced skills to individual farmers in the field. These types of changes could also provide farmers with sufficient economies of scale -- enabling them to negotiate

better supply contracts and access higher value markets. There are also large areas of marginal land that could be brought into agricultural production by the provision of road access and the rehabilitation of land for cropping.

In Gaza, farmers use land under cultivation relatively well, producing high-value, high-yield crops on small farm holdings. Land can now be accessed up to 300 meters from the fence. The initiative envisions bringing back into cultivation land that was abandoned due to the 'extended buffer zone' of around 1 km from the Gaza border fence. There are also abandoned tracts of agricultural land within Gaza that could be cultivated again. Geo-spatial analysis suggests that around 50 percent of cultivable land in the Gaza Strip is currently cultivated, and that a further 34 percent could be brought into production. The water required for the additional irrigation can be supplied, at least in part by treated waste water (some treatment plants are already under construction), although additional supplies may be needed. Such changes will require access to standard concentration fertilizers, advanced seed types and farming knowledge. The initiative also envisions the sale of Gazan produce, particularly vegetables, in West Bank and Israeli markets. These markets should be made accessible to Gazan produce using improved bureaucratic and logistic procedures.

2. Construction

Expanding construction in housing is a central part of the Palestinian Economic Initiative. Meeting the huge demand for affordable housing would help improve living standards, provide quality homes for people who cannot afford to buy and create tens of thousands of new jobs. Housing construction is limited by a mismatch in supply and demand. Lack of access to land stemming from problems with ownership, land registration (only about thirty-five percent of the West Bank is registered), titling and general Area C land restrictions drives up the cost of land. This high cost of land renders the average price for a housing unit higher than the available housing budget for 50-80 percent of the population, mostly the low and middle-income segments of Palestinian society. Other challenges include tight mortgage lending standards which limit the mortgage market and home ownership financing (the Palestinian mortgage market is less than 5 percent of GDP), lengthy permit processes for new construction in East Jerusalem and Area C; and restrictions on imports to Gaza.

The Palestinian Economic Initiative envisions the construction of different types of housing to address the various demographic and geographic segments across the

West Bank and Gaza - including on available land in city centers, around the urban periphery, and in new locations. By building affordably, leveraging scale and infrastructure, identifying suitable land, using modern building techniques and materials, and developing effective partnership between the public and private sectors, reasonably priced housing should be made accessible to broad segments of the population.

In Gaza, the focus of the construction effort is on affordable housing, tailored to fit the local income segments. The aspiration is to build 10,000 to 16,000 housing units every year in Gaza, as part of the overall range of 25,000-40,000 housing units in the West Bank and Gaza. These units would be priced at USD 35,000-50,000 (depending on the availability of land subsidies) and would address a large segment of the Palestinian population. For those individuals who cannot afford home ownership, developing a larger, more well-functioning rental market would be another option. This development requires the further lifting of restrictions on importing building materials, ensuring access to land (potentially through use of government lands), and securing financing for developers and potential homeowners.

3. Tourism

Boosting tourism is vital to long-term Palestinian economic growth. The West Bank, Gaza and East Jerusalem are immensely rich in the full range of historical and ecological attractions, from the historic city of Nablus to the Old City in East Jerusalem and the coastline of Gaza, including fourteen approved or nominated world heritage sites. Despite these opportunities, Palestinian tourism remains underdeveloped due to regional instability, low awareness of existing tourism destination sites and offerings, restrictions on access to land and archaeological sites located in the West Bank, and on the entry of Arab tourists from the region.

The tourism sector strategy focuses on two tracks – a short-term track concentrating on strategic marketing of the Holy Land in certain target markets and a medium-term track aimed at the development of five tourism hubs within the West Bank and Gaza. The hubs would provide a range of new hotel offerings and would be underpinned by aggressive marketing and improved access for visitors from the region. Critical to the success of the initiative will be the establishment of a Palestinian public-private partnership (i.e. a Palestinian Tourism Board) to coordinate site development and an integrated approach to the marketing of the Holy Land.

Gaza, in particular, underperforms on key tourism metrics. The Gaza Strip has significant potential as a tourism hub with its Mediterranean coastline and cultural offering. This potential can be realized with improvements in the overall political-security situation, expanded access and movement for individuals, the provision of necessary energy and water to the service tourism infrastructure, and required investment and financing for the tourism sector.

4. Information and Communication Technology (ICT)

ICT is a critically-important and growing service sector in the Palestinian economy. It represents an estimated six percent of Palestinian GDP. By allowing the telecommunication sector to expand through greater access to mobile and fixed broadband technology, such as 3G and 4G services, it would experience even further growth and boost economic activity across other sectors of the Palestinian economy.

Within the area of information technology, the economic initiative seeks to attract both domestic and international investments in specific IT services. These investments will leverage the quality and relative wage competitiveness of the Palestinian labour force. The initiative also aims to create opportunities for multinational corporations to employ mid-skilled developers in software programming and generate specialized business process outsourcing opportunities. Investment in IT incubators and trade promotion agencies is also important as it creates a platform around which start-ups can grow and attract more funds.

The development of the ICT sector in Gaza is dependent on the entry of telecommunication equipment and the upgrading of existing infrastructure. The growth of the telecommunication sector also requires greater access to the electromagnetic spectrum and to particular geographic markets for rolling-out infrastructure. Developing the IT sector would require the establishment of a full 'eco-system' including accelerators for IT start-ups, specialized training for the local workforce, and early-stage financing.

5. Light Manufacturing

Light manufacturing is an important growth sector for the Palestinian economy. Over the past two decades, countries in the region succeeded in expanding their light manufacturing sectors and export activities. Palestinian light manufacturing, by contrast, registered negligible improvements and was hindered by poor infrastructure, movement and access restrictions, and a low level of investment. The predominance

of small scale family businesses has also limited the scalability of Palestinian manufacturing rendering it unable to compete with regional and international competitors.

The potential for growth in light manufacturing hinges on the competitive wages of a young and educated Palestinian workforce, low operating costs and a positive investment climate. Geographical proximity to Israel and Arab markets, as well as attractive bilateral trade agreements with major global markets, could provide unique incentives for multinational companies to set up competitive production plants in new Palestinian special economic zones.

The Palestinian Economic Initiative foresees the scaling up of investment in several sub-sectors with high growth potential (e.g. domestic appliances, motor vehicle parts, pharmaceuticals). An important element of the strategy would be to attract multi-national companies (MNCs) and target important export markets in the region. The initiative also focuses on enhancing existing local small and medium enterprises (SMEs) to supply complementary products to MNCs and to expand export (and transfers) in certain sub-sectors.

In Gaza, exports and transfers in this sector have fallen substantially since 2005, but local players retain key advantages and could contribute significantly to Palestinian GDP and employment. If Gazan manufacturers were granted access to Israeli and West Bank markets, Gazan manufacturers would likely retain specific “niche” advantages over competitors in Turkey and China, e.g. for high-end designers in Israeli clothing markets requiring relatively small, customized orders not handled well by bulk-order manufacturers, as well as quick delivery of specific inputs (e.g., zippers, buttons) for production.

6. Building Materials

Although building materials are not in themselves a high impact contributor to Palestinian GDP or employment growth, expanding this sector will help unlock the economic potential of other sectors. The economic initiative aims to ensure that necessary building materials are available to meet the planned increase in the construction, tourism, water and energy sectors. Stone and marble has also been identified as a source of increased export revenue. Currently, the Palestinian economy relies heavily on imports, specifically cement, steel and sand. The main issues facing the industry in the present are the lack of modern machinery, deficiency in international market knowledge, and limited access to new quarry land.

This initiative focuses on increasing domestic production capacity, diversifying import sources and improving capabilities. These improvements are achievable through a combination of steps and measures including: conducting a geological survey to determine potential stone and aggregate reserves, the construction of a cement mill for local Palestinian production, setting up a dedicated cement export terminal for Palestinian use, access to the controlled use of explosives in gravel quarries to boost production, and access to advanced machinery in the stone and marble industry.

7. Energy

Reliable energy and electricity supplies are critical for all sectors of the Palestinian economy. A larger volume of electricity should be made available in both the West Bank and in Gaza to adequately address current and future demand for electricity as the Palestinian economy and population continue to grow.

The Palestinian Economic Initiative aspires to increase, over the short-term, the supply of electricity from the Israel Electricity Corporation (IEC) and from independent power producers. At the same time, capacity for local electricity generation needs to expand through conventional power plants and the development of a robust renewable energy sector. These new sites will need to be fueled by natural gas, which requires finalizing long-term gas supply contracts with either Israeli or Palestinian gas companies. The development of the Palestinian Gaza Marine gas field will play an important part in this latter effort to expand the energy sector.

In Gaza, households, businesses and infrastructure struggle under conditions of uncertain electricity supply. This initiative aspires to enhance power supply by importing more electricity from Israel through new and improved high-voltage transmission lines, upgrading the distribution network, expanding electricity generation in Gaza using renewables such as small to medium scale solar installations, and the scaling up of the current Gaza power plant capacity. Below is a list of proposed infrastructure projects included in the Palestinian Economic Initiative.

8. Water

To match the ever growing need for water by Palestinian households and business, major efforts in infrastructure are required to generate new sources of water. This economic initiative aims to secure the volume and quality of water necessary for rapid Palestinian economic growth, particularly in agriculture and industry, as well as for growing household consumption. The focus will be on facilitating the implementation of large infrastructure projects (e.g. a large desalination project in Gaza and sanitation projects in Gaza and the West Bank). The initiative also aims to ensure that aquifer sources remain sustainable and Palestinian water rights are protected.

The water sector in Gaza remains in deep crisis due to the deterioration of the underground coastal aquifer. The over-pumping of groundwater resources in Gaza has led to salt-water infiltration and a significant decline in the quality of drinking water. The construction of Palestinian desalination facilities in the Gaza Strip (with small scale plants in the short-term and a large plant in the longer term) and increased purchases of water from Israel are important in redressing this worsening situation. Donor financing of the larger desalination plant is contingent upon the successful operation of other critical infrastructure in the water sector particularly the North Gaza Emergency Sewage Treatment Plant (NGEST).

The development of waste water treatment facilities in the West Bank and in Gaza are important not only for health and sanitation - but also to enable the re-use of treated water for agricultural irrigation. The initiative also envisions access to additional water from aquifers by developing springs and wells in locations in the West Bank, including the rehabilitation of existing wells for both domestic and agricultural water purposes, and highlights the potential for developing dam infrastructure to capture rainwater for use in agriculture. These plans require improved coordination on water infrastructure projects between Palestinians and Israelis, as well as improved Palestinian institutional capacity in the water sector.

Proposed Infrastructure Projects in the West Bank and Gaza

Energy Sector
Development of the Palestinian Gaza Marine off-shore gas field and infrastructure to tie-in and transfer the gas
Building up power generation facilities in the West Bank and Gaza through gas-fired power stations including the necessary gas transmission infrastructure to the power plants
Creating a strong renewable energy sector in the West Bank and Gaza with roof-top solar applications and medium to large scale solar power plants
Water Sector
Constructing small scale seawater desalination facilities to address acute water crisis in Gaza
Developing large scale regional seawater desalination plant in Gaza
Investing in water network rehabilitation all over Gaza and West Bank to reduce water losses
Developing and implementation of around fifteen Palestinian waste water treatment plants in West Bank and Gaza to treat effluents of all major population centers (including a treatment plant at Wadi Nar/Kidron Valley in Area C subject to agreement between the PA and Israel)
Building dams and other rain water catchment facilities in the West Bank
Construction of new wells and the rehabilitation of existing wells for Palestinians domestic and agricultural use in the West Bank
Development of brackish springs in Al-Feshkha area in the West Bank and constructing a desalination facility (subject to conclusions of a technical feasibility study)

(5) CRITICAL ENABLERS

Implementing the ‘Palestinian Economic Initiative’ requires significant cooperation and support from the Government of Israel and from the Palestinian Authority. This initiative identifies a large set of immediate and medium-term factors necessary for the implementation of each sector strategy, and for the creation of a secure environment to enable accelerated Palestinian economic growth.

On the Israeli side, there are broad-based measures necessary for the implementation of this economic initiative. Some of these large-scale measures, for example, involve: facilitating greater Palestinian investment in the agriculture, tourism, manufacturing, and housing sectors in the West Bank including Area C and East Jerusalem; expediting the implementation of critical infrastructure in the water and energy sectors in the West Bank and the Gaza Strip; allowing the Palestinian telecommunications sector greater access to electromagnetic spectrum and new

technologies (3G and 4G); and restoring two-way commercial relations between the West Bank and the Gaza Strip.

On the Palestinian side, there is an important set of enablers associated with the PA legislative and institution-building agenda. These enabling factors include, for example: finalizing and enacting a Palestinian Land Law; developing and enacting new mortgage and foreclosure laws; establishing a new 'Planning and Zoning Committee' for national infrastructure projects; finalizing discussions of the planned Telecommunication Regulatory Commission; and developing and enacting a new Public Private Partnership (PPP) Law.

Next Steps

There are several important next steps for moving ahead with the Palestinian Economic Initiative. These steps include: (i) concluding the technical consultations on the details of the initiative with the PA and operationalizing its specific proposals; (ii) discussing and agreeing with the Government of Israel the next steps necessary for the implementation of the initiative; (iii) working with the PA on outreach to donors on the public financing aspects of the plan; (iv) supporting the PA in attracting private sector investments, both domestic and overseas, through the organization of investment promotion activities, and (v) engaging with the PA and the GOI on ensuring high-level implementation and monitoring arrangements for the economic initiative.

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