

OFFICE OF THE UNITED NATIONS SPECIAL COORDINATOR
FOR THE MIDDLE EAST PEACE PROCESS

Report to the Ad-Hoc Liaison Committee
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Disclaimer

This report of the Office of the United Nations Special Coordinator for the Middle East Peace Process (UNSCO) assesses the uneven progress toward sustainable development and institution building in the Occupied Palestinian Territory (OPT).

The report draws on a variety of sources, including original research; inputs from United Nations (UN) Agencies, Funds, and Programmes; and publicly available sources. Before the paper was released, it was circulated to the parties for comment.

The reporting period is from May 2022 through September 2022, unless otherwise noted. Many references fall outside this period to illustrate relevant trends.

The UN Special Coordinator for the Middle East Peace Process provides monthly briefings to the United Nations Security Council on the situation in the Middle East. These briefings provide greater detail on the UN's positions related to the changing political, development, and humanitarian situation. Previous UNSCO reports to the AHLC and briefings to the Security Council can be found at <https://unSCO.unmissions.org/resources>.

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Executive summary

Much has changed since the signing of the Oslo II Accords 29 years ago this month. As outlined in our last report to the AHLC, settlement activity, the demolition and seizure of Palestinian-owned structures in the West Bank, including East Jerusalem, and Israeli restrictions on Palestinian access to land and resources, alongside Palestinian population growth, have heightened the spatial limitations on Palestinian socioeconomic development. At the same time, increasing integration between the Israeli and Palestinian economies has shifted dynamics significantly and generated opportunities in areas such as trade, the labor markets, and the financial sector. Militant build-up and recurrent conflict in the West Bank and Gaza Strip continue to damage many socioeconomic gains.¹ All of these changes have taken place against the backdrop of declining direct budget support to the PA and multi-year declines in overall aid inflows to the Palestinians. Moving forward, these new realities must be addressed.

There are strategic initiatives which the parties can take, together as well as independently, and with support from international partners, to strengthen the PA, create the necessary space for a viable Palestinian economy, and improve the humanitarian, development, fiscal, and governance situation of Palestinians. These initiatives together would help rebalance Palestinian engagement with Israeli state institutions and reinvigorate the two-State solution.

First, the drivers of conflict must be addressed. This requires the parties to significantly reduce tensions and violence across the OPT. The militant build-up and militant activity in the Gaza Strip and West Bank must stop. Unilateral steps that undermine peace should also stop—in particular, settlement approval, expansion, and construction, including outposts, demolitions, and displacement.

Second, efforts to strengthen Palestinian institutions and address the challenge of Palestinian governance are needed. This requires strengthening the fiscal health of the PA in line with World Bank and IMF recommendations, focused on reducing the wage bill, along with parallel efforts by all parties to implement the macro-fiscal framework and enhance growth in the OPT, including increased financing from development partners. It also requires strengthening the PA's political legitimacy and accountability through free and fair elections across the OPT, democratic reforms and opening civic space, as well as restoring the effectiveness and credibility of Palestinian security forces. These efforts would be reinforced by accelerating legal and administrative reforms that are currently underway.

Third, improving access, movement, and trade would create space for the Palestinian economy to grow. Steps should be taken to increase access for Palestinians and Palestinian businesses to land and resources in Area C in the West Bank, including reducing restrictions and barriers, while increasing permits for Palestinian residential construction, and implementing infrastructure projects that benefit Palestinians and long-term economic growth. In Gaza, while the increase in the number of worker permits to the highest level since 2007 is positive, a more comprehensive approach to easing restrictions on the movement of people and goods should be developed with a view to lifting the closure regime altogether, in line with SCR 1860 (2009). Increasing the volume of goods permitted to exit Gaza and allowing in more goods, raw materials, and spare parts, including dual-use items, is vital. Re-linking the economies of the West Bank and Gaza Strip should be a related objective, particularly resolving Palestinian administrative barriers to West Bank–Gaza Strip commercial activities and

¹ See, for example, the Gaza Rapid Damage and Needs Assessment published by the World Bank, European Union, and United Nations in 2021.

implementing the “Safe Passage” project and funding other infrastructure projects to reduce travel time and logistics barriers.

Fourth, the parties should engage each other to re-envision their economic and administrative relationship. Progress in this area could attract much-needed investments and promote growth in both economies. Given the expansion of permits for Palestinian workers in Israel, finalizing reforms to the permit regime, including electronic salary payments and ending the broker system, should be a priority. Resolving the longstanding fiscal files, including Area C taxation, and the fragile correspondent banking system relations, are also high priorities. Enhancing cooperation between the parties’ Ministries of Finance and monetary authorities will be important in this regard.

This ambitious reform agenda must be met with robust support from international partners—political, technical, and financial—to meet the urgency of the moment.

Introduction

In 2011, the two reports of the Office of the United Nations Special Coordinator for the Middle East Peace Process (UNSCO) to the Ad Hoc Liaison Committee (AHLC) assessed that the Palestinian Authority's "governmental functions are now sufficient for a functioning government of a state,"² but warned that the absence of a political horizon put at risk the achievements of the Palestinian state-building agenda, constraining them from realizing their full potential. Eleven years later, a comprehensive political solution to the conflict remains elusive, while political, security, and socioeconomic trends are threatening to erode the very institutions and development gains that underpinned the 2011 assessment. There is a widening gap between, on the one hand, the stalled political track and the negative trajectory on the ground and, on the other hand, the progress achieved since the PA's founding in 1994. This widening gap is reaching the point of unsustainability, putting at great risk the historic accomplishments in the OPT.

Ensuring the readiness of the Palestinian Authority (PA) for statehood is, therefore, an urgent priority. Much has changed since the signing of the Oslo II Accords 29 years ago this month. As outlined in our last report to the AHLC, issued in May 2022, settlement activity, the demolition and seizure of Palestinian-owned structures in the West Bank, including East Jerusalem, and Israeli restrictions on Palestinian access to land and resources, alongside Palestinian population growth, have heightened the spatial limitations on Palestinian socioeconomic development. At the same time, increasing integration between the Israeli and Palestinian economies has shifted dynamics significantly and generated opportunities in areas such as trade, the labor markets, and the financial sector. Militant build-up and recurrent conflict in the West Bank and Gaza Strip continue to damage many socioeconomic gains.³ All of these developments have taken place against the backdrop of declining direct budget support to the PA and multi-year declines in overall aid inflows to the Palestinians, fundamentally shifting the revenue base for the PA and the sources of development financing (see Annex). Moving forward, these new realities must be addressed. Both PA institutions and the framework governing the Israeli-Palestinian economic relationship require adaptation to face these shifting dynamics.

There are strategic initiatives which the parties can take, together as well as independently, and with support from international partners, to meaningfully strengthen the PA, create the necessary space for a viable Palestinian economy, and dramatically improve the humanitarian, development, fiscal, and governance situation of Palestinians. These initiatives would lay crucial foundations for a more balanced engagement with Israeli state institutions and reinvigorate efforts toward the two-State solution. Some promising measures have been taken over the past year, particularly easing restrictions on the movement of people and goods into and out of the Gaza Strip. Israel has granted significant, emergency loans to the PA and has worked with the PA and international partners to initiate pilot projects related to container shipping at Allenby Crossing and electronic VAT payments. However, more needs to be done and the link between such economic steps and a two-State horizon needs to be articulated more clearly and consistently.

At the last meeting of the AHLC on 10 May 2022, many participants expressed their view that economic steps are not a substitute for a legitimate political process that will resolve the core issues driving the Israeli-Palestinian conflict; rather, economic steps must be anchored within a broader

² [UNSCO report to the AHLC 13 April 2011](#) and [UNSCO report to the AHLC 18 September 2011](#)

³ See, for example, the Gaza Rapid Damage and Needs Assessment published by the World Bank, European Union, and United Nations in 2021.

political horizon and approach. The Chair's Summary called on partners to "work with the Parties to prepare a policy package of incremental, durable, and meaningful steps with commitments for their implementation." In this report, UNSCO considers four strategic elements of such a package as: (i) addressing the continuing drivers of conflict and instability; (ii) strengthening Palestinian institutions and addressing the challenge of Palestinian governance; (iii) improving access, movement, and trade and thereby creating space for the Palestinian economy to grow; and (iv) better aligning the framework of economic and administrative relationships with the economic transformations of the past decades.

If implemented, these elements would help reverse the current negative trajectory, strengthen the Palestinian economy and Palestinian institutions, and maintain the viability of the two-State solution until such time that formal negotiations can recommence. Ultimately, there is no substitute for a legitimate political process that will open the path towards meaningful negotiations and credibly address the core issues driving the conflict. Only an end to the occupation and the achievement of two States in line with relevant Security Council resolutions, international law, and bilateral agreements will lead to Palestinians achieving their full socioeconomic development potential and their legitimate national aspirations.

[Addressing the continuing drivers of conflict and instability](#)

Persisting drivers of conflict—including heightened violence, settlement advancement and settler-related violence, demolitions, military operations, attacks, militant activity, and incitement—damage socioeconomic progress, breed a climate of mistrust and tension between Palestinians and Israelis, and undermine political solutions. These drivers have contributed to a pervasive sense of pessimism regarding the prospects for meaningful negotiations to resolve the conflict, and they undermine the realization of the core objectives outlined below: strengthening the PA, preserving the space needed for the Palestinian economy to grow, and consolidating mutually-beneficial economic ties between Israelis and Palestinians.

Trends across a number of these conflict drivers show a negative trajectory. Violence, including settler-related violence, increased in the first half of 2022, particularly in the West Bank, with 61 Palestinians, including 14 children, killed by Israeli security forces, some in the context of Palestinian attacks or armed clashes. This represents a 52 per cent increase compared with the same period last year, alongside a marked increase in Israeli security forces search operations in the West Bank and related clashes with armed Palestinians.⁴ The first half of the year also witnessed the most serious terrorist attacks perpetrated by Palestinians and Arab Israelis inside Israel in years, killing 11 Israelis and three foreign nationals. Militant activity in the Hamas-controlled Gaza Strip continued, including the indiscriminate firing of rockets towards Israel, a number of which fell short inside the Gaza Strip, during the most recent escalation between Israel and Palestinian armed groups in August 2022. This latest escalation resulted in 49 Palestinians killed, of whom at least 26 were civilians, including 17 children and 4 women. In addition, a number of Israelis were injured, and residential and other civilian structures were damaged.

As highlighted in various other United Nations reports, the expansion of Israeli settlements continues, in contravention of international law, including continued consideration of advancing plans in politically sensitive locations in and around Jerusalem, such as E1 and Givat Hamatos. This expansion

⁴ West Figures in this paragraph are taken from OCHA. 2022. "Occupied Palestinian Territory: Mid-Year Humanitarian Response Dashboard (January to June 2022)."

has led to a significant increase in points of friction between Israelis and Palestinians and a related uptick in violence in the West Bank. Thus far in 2022, the United Nations has recorded the highest monthly average of incidents of settler-related violence since 2005, which also represents a 46 percent increase compared with 2021.⁵

Demolitions and seizures of Palestinian-owned property, including in East Jerusalem, remain another persistent flashpoint. In 2021, the OPT saw the highest number of demolitions ever recorded.⁶ While the first six months of 2022 saw a slight reduction in demolitions compared to the same period in 2021, the practice continued, with Israeli authorities demolishing 378 structures, including 68 donor-funded structures, because they lacked Israeli-issued building permits that are nearly impossible for Palestinians to obtain. As a result, 479 people, including 230 children, have been displaced. Meanwhile, little progress has been made on advancing plans to address the housing and development needs of Palestinian residents.

Readers seeking greater detail on the various political, human rights, protection, and humanitarian developments during the reporting period are directed to other recurring publications and briefings by the United Nations. The most up-to-date information on political, human rights, and protection issues can be found in the monthly briefings to the UN Security Council ([found here](#)). The most recent humanitarian updates are made available by the Office for the Coordination of Humanitarian Affairs (OCHA) ([found here](#)).

Necessary steps

As noted in the 2016 Report of the Middle East Quartet, “violence, terrorist attacks against civilians, and incitement to violence are greatly exacerbating mistrust and are fundamentally incompatible with a peaceful resolution” to the conflict.⁷ The Quartet also emphasized that “the continuing policy of settlement construction and expansion, designation of land for exclusive Israeli use, and denial of Palestinian development is steadily eroding the viability of the two-State solution,” and that “the illicit arms build-up and militant activity, continuing absence of Palestinian unity, and dire humanitarian situation in Gaza feed instability and ultimately impede efforts to achieve a negotiated solution.” The fate of two Israeli civilians held by Hamas and the bodies of two IDF soldiers missing in Gaza also remains an important humanitarian concern.

These conflict drivers undermine Palestinian institutions, contribute to the fragmentation of the OPT, and create a climate of insecurity in which social and economic activity cannot flourish. UNSCO calls on the parties to take the following necessary and urgent steps:

- Significantly reduce tensions and violence across the OPT, including by investigating and holding perpetrators accountable for attacks and addressing excessive use of force.
- End militant build-up and militant activity by Hamas, PIJ, and other groups in the Gaza Strip and West Bank.
- Halt settlement expansion, in line with Israel’s obligations under international law.
- Halt demolitions and displacement, in line with Israel’s obligations under international law.

⁵ Figures in this paragraph are taken from OCHA. 2022. “Occupied Palestinian Territory: Mid-Year Humanitarian Response Dashboard (January to June 2022).”

⁶ Figures in this paragraph are taken from OCHA. 2022. “Occupied Palestinian Territory: Mid-Year Humanitarian Response Dashboard (January to June 2022).”

⁷ Report of the Middle East Quartet. 2016. Found [here](#).

Strengthening Palestinian institutions and addressing the challenge of Palestinian governance

The drivers of conflict outlined above directly undermine the progress on socioeconomic development and institution building achieved since 1994, by eroding the PA's exercise of authority and credibility with the Palestinian population. The current negative trajectory of the security situation in the West Bank described above is of serious concern, particularly as it undermines the functioning and credibility of the Palestinian Security Forces. The unresolved political divide between the Gaza Strip and the West Bank and the inability of the PA to operate in Gaza is another central factor challenging Palestinian institutions. In addition, the absence of elections, overly centralized decision-making, and limited civic space have significantly exacerbated these governance challenges.

Strengthening the legitimacy and capacity of Palestinian institutions and their ability to deliver necessary services to their people requires a bold and comprehensive package of governance and institutional reforms, and it requires addressing the internal Palestinian divide. These efforts should be accompanied by measures from Israel and by political, technical, and financial support from the international community.

In the near-term, the fiscal sustainability of the PA must be strengthened in a manner that ensures its ability to operate more independently, with less and less reliance on international aid over time. The internal reforms proposed by the International Monetary Fund and the World Bank offer the best path to that end. The “fiscal leakages” files should be closed and competencies for customs collections extended to the PA. Palestinians and their institutions urgently need to embark on governance reforms, entrench the rule of law, and create an inclusive and dynamic business environment, while protecting the most vulnerable. In addition, the efficiency and effectiveness of Palestinian service delivery should be enhanced in key sectors such as telecommunications, social protection, education, and health. In parallel, Israel should undertake meaningful steps to provide the PA with the space and means to pursue more independent control over economic and fiscal policy and to increase its revenues.

Palestinian governance reforms should include—but are not limited to—improvements to democratic legitimacy and accountability, respect for political and human rights and civil liberties, addressing administrative and capacity gaps, resolving discriminatory and inconsistent laws and practices, and improving transparency. UN treaty bodies have continuously called on Palestinians to re-convene their legislature due to its crucial role in the implementation of UN conventions.

The 2030 Agenda sets out an ambition to “provide access to justice for all and build effective, accountable and inclusive institutions at all levels.”⁸ In the OPT, all duty bearers have responsibilities for improving the human rights of Palestinians and the providing security and justice in an environment of accountability. Greater progress should be made by both the Israeli authorities and the relevant Palestinian authorities in the West Bank and Gaza Strip to investigate and prosecute the perpetrators of attacks, violations linked to incidents of possible excessive use of force, and allegations of torture and ill-treatment. Greater accountability will lead to improved justice and governance.

Necessary steps

A future Palestinian State requires institutions with the legitimacy and capacity to deliver quality services to its people. The PA must move swiftly towards implementing its own institutional reform agenda across political, social, economic, and fiscal dimensions. Reforms identified by the World Bank

⁸ Sustainable Development Goal 16.

and International Monetary Fund in their recent reports to the AHLC should also be implemented. Given the current framework governing the Israeli-Palestinian fiscal and economic relationship, Israel should take critical steps, in tandem with Palestinian reforms, to strengthen the fiscal sustainability of the PA and allow it to operate more independently.

- **Strengthen the fiscal health of the Palestinian Authority:** Implement the macro-fiscal reforms identified by IMF and World Bank, including on the wage bill, pensions, medical referrals, and net lending. Develop a sustainable, medium-term macro-fiscal framework with the IMF. Close the “fiscal leakages” files. Transfer some customs authorities to the PA. Resolve the impasse over the so-called “prisoners’ payments.” Improve the transparency of net lending and other clearance revenue deductions. Improve the transparency of the fiscal relationship between the West Bank and Gaza Strip.
- **Strengthen the political legitimacy and accountability of the Palestinian Authority:** The PA should move deliberately toward comprehensive Palestinian elections, including in occupied East Jerusalem; Hamas should allow free and fair elections to proceed in Gaza; and Israel and international partners should create conditions conducive to successful Palestinian elections. Reforms are also needed to improve democratic norms and procedures, entrench the rule of law, and open civic space. Israeli and Palestinian efforts to strengthen the PA are needed, particularly by reversing negative security trends in the West Bank, including in Area A, which is undermining the effectiveness and credibility of Palestinian security forces.
- **Accelerate legal and administrative reforms:** Build on the recently enacted telecommunications and business laws and continue improving the Palestinian business climate. Resolve risks to correspondent banking relationship. Build on progress in reforming the utilities sector, in both the West Bank and Gaza Strip, to improve collections and sectoral sustainability.

Improving access, movement, and trade; creating space for the Palestinian economy to grow
As outlined in UNSCO’s May 2022 report to the AHLC, the OPT is fragmented by the longstanding division between the West Bank and Gaza Strip; the further division of the West Bank into East Jerusalem and Areas A, B, and C; by multiple barriers, fences, checkpoints, and other infrastructure; and by accelerated Israeli settlement expansion and continued restrictions on Palestinian access by Israel.

Repeated military conflicts between Palestinian armed groups in Gaza and Israel—amidst the unresolved internal Palestinian divide, continued Hamas-rule in the Strip, and Israeli closures—have profoundly set back economic growth in Gaza and turned international donor attention toward urgent humanitarian needs, away from longer-term investment in sustainable development. These dynamics have led to significant divergence between the economies of the West Bank and Gaza.

While the OPT has become more spatially fragmented over time, Palestinian society has undergone rapid demographic growth and urbanization, trends that will continue for the foreseeable future. Together, fragmentation, demographic growth, and urbanization drastically shrink the space for economic growth, undermine the contiguity and viability of a future Palestinian State, and drive conflict and humanitarian crisis.

This fragmentation should be addressed in a comprehensive way through more ambitious and meaningful efforts to increase Palestinian access to land and resources in Area C and East Jerusalem,

further ease restrictions on the movement of people and goods into and out of Gaza, better connect Gaza and the West Bank economically and socially, and undertake infrastructure projects that lead to long-term economic growth.

Access for Palestinians to land and resources in Area C and East Jerusalem

In the West Bank, Israeli restrictions on land use by Palestinians, alongside continued settlement activity, undermine Palestinian economic potential. Area C, under Israeli control, covers more than 60 percent of the West Bank, including East Jerusalem. Settlement municipal boundaries cover approximately 10 percent of the West Bank, while a further 18 percent of the West Bank has been designated as a closed military zone, to which Palestinian access is restricted.⁹ Areas designated by Israel as “state land” and nature reserves in Area C also prevent access for Palestinians. Israeli-built “herding outposts” in Area C are exacerbating tension and further limiting Palestinian access to land and resources. Although less than 2 percent of the settler population resides in so-called agricultural settlements, these settlements and far-flung outposts together impede Palestinian access to vast swathes of land especially in the fertile Jordan Valley, an area representing around 28 percent of the West Bank. Settlements and settlement outposts are illegal under international law; settlement outposts are also illegal under Israeli law.

Israeli restrictions on Palestinian access to the productive assets in Area C similarly limit Palestinian economic potential across key sectors. A 2013 World Bank report,¹⁰ for example, estimated that if businesses and farms were permitted to develop in Area C, Palestinian GDP would increase by as much as 35 percent, or USD 4.15 billion.¹¹ In its May 2022 report to the AHLC, the IMF noted that improved access to land and water in Area C, elimination of physical, legal, regulatory, and bureaucratic constraints to Palestinian investment in the area, and lower transportation costs, with less checkpoints and use of all roads, raises both capital and total factor productivity. If combined with structural reforms, such efforts could boost the potential growth rate of the Palestinian economy to about 6 percent, up from its current estimated long-term potential growth of around 2 percent.

Such analyses provide a clear picture of the potential for Palestinian economic growth if access and investment for Palestinians in Area C can be improved. As noted by the IMF, there are also fiscal implications from lack of access to Area C, because the PA is unable to collect revenues on economic activity in Area C, in addition to the Gaza Strip and occupied East Jerusalem, despite having significant expenditures in each location.

In the past two years, Israel has made tentative steps toward allowing limited Palestinian development in Area C. For example, in July 2022, the Office of the Coordinator of Government Activities in the Territories (COGAT) advanced six zoning plans for Palestinians in the West Bank: Hizma, Harmala, Fukeikis, Hares, Kisan, and Battir. Plans have been advanced for a farm in Khirbet Abu-Falah, for drilling near Mount Hebron, and to establish a connection line to the Tulkarm wastewater treatment plant. While advancing plans is welcome, such steps are not at the scale needed to unlock the Palestinian growth potential of Area C, particularly given that Area C is one of the only areas in which Palestinians can build critical infrastructure to scale quickly, such as for solar power, water, and wastewater treatment.

⁹ [Humanitarian Needs Overview](#), OCHA, December 2021.

¹⁰ World Bank. 2013. [Area C and the Future of the Palestinian Economy](#). Report No. AUS2922.

¹¹ Here converted to 2022 US dollars.

Restrictions on the movement of people and goods into and out of Gaza and the internal divide

Restrictions on the movement of people and goods into and out of Gaza by Israel, significantly tightened in the context of the escalation in 2006 and largely maintained amidst continued militant activity and Hamas's control of the Strip, has effectively closed Gaza and severely weakened economic ties with the West Bank. The combined impact of Hamas-rule and Israeli closures on Gaza's economy has been catastrophic. Before the takeover and closure, Gaza's economic output accounted for approximately one-third of the overall Palestinian GDP.¹² Fifteen years after Hamas' violent takeover and the imposition of the Israeli closure regime, Gaza's contribution has dropped to less than 18 percent of overall GDP and accounts for only 1 to 2 percent of the value of all Palestinian exports.¹³

Since the May 2021 escalation, and to some extent since the 2018 ceasefire, the Israeli approach points towards a broader policy of gradually easing some restrictions on the Gaza Strip, including with a view to boosting economic activity. When it comes to the movement of goods, some notable progress has also been recorded since May 2021. In August 2021, exports to Egypt started for the first time, boosting the monthly average of exports to 787 truckloads in the first five months of 2022. There has been a significant easing of restrictions on the entry of essential construction materials and some telecommunications equipment. Initiatives are being developed that would allow entry of dual-use materials required for the maintenance and repair of fishing boats and other large infrastructure projects such as desalination plants. The coastal fishing zone was extended up to 15 nautical miles in some areas, which alongside the easing of restrictions on materials such as epoxy and fiberglass to repair boats, would allow for more development in the fishing sector. In addition, Israel increased the water supply provided to Gaza by five million cubic meters, for a total of 20 million cubic meters.

Perhaps most importantly, in March 2022, the Government of Israel announced a goal of 20,000 worker permits for Palestinians to exit Gaza to access markets in Israel. As of mid-September 2022, around 15,500 permits had been issued for Gaza-based workers, traders, and businessmen to commute to Israel.¹⁴ This new flow of remittances has helped many households in Gaza pay off debts, make essential purchases, buy more food, and obtain medical treatments. Over the longer term, with greater numbers of permits, Gaza should begin to see significant macroeconomic impacts, including on the unemployment and poverty rates.

Further easing of restrictions and addressing continued impediments to the timely and routine entry of goods, materials, and equipment into Gaza is still required. Israeli permitting and other access procedures remain cumbersome and slow, resulting in delays and high costs. Specific restrictions on materials and equipment classified by Israel as "dual-use" remain an obstacle and Israel's definition of what is "dual-use" is opaque and stringent compared to prevailing international practices. The limited availability of raw materials, production inputs, equipment, and spare parts, coupled with exports restrictions and high transportation costs, present significant impediments for the private sector, hamper job creation, and stunt economic growth.

Necessary steps

The fragmentation of the OPT shrinks the space for growth of the Palestinian economy, fuels humanitarian needs and conflict, and undermines the viability of a future Palestinian State. Steps are required to further ease Israeli movement and access restrictions across the OPT, improve Palestinian

¹² Excluding East Jerusalem.

¹³ Palestinian Central Bureau of Statistics. National Accounts Data, various years.

¹⁴ Of the 14,110 issued permits, 11,279 are for workers, 2,372 are for traders and 459 are for businessmen.

access to land and resources, better link the economies of the West Bank and Gaza Strip, and address the internal Palestinian divide.

- **Unlock the economic potential of Area C**: Increase access for Palestinians to land and natural resources in Area C and implement infrastructure projects that benefit Palestinians and long-term economic growth. Significantly increase permits for Palestinian residential construction, investment, and development in Area C; convert some parts of Area C to Area A and B; inspect and legalize Palestinian-built structures in Area C; and promptly remove and prevent the establishment of new settlement outposts. Taking into account the legitimate Israeli security concerns, reduce, remove, or close Israeli checkpoints and other barriers in the West Bank. Implement infrastructure projects, such as solar energy and water, that improve services to Palestinians and address the net lending problem.
- **Unlock the economic potential of Gaza**: While taking consideration of Israel's legitimate security concerns, for tangible economic dividends to materialize in Gaza and further relapses into conflict to be avoided, a more comprehensive approach to easing restrictions on the movement of people and goods should be developed with a view to lifting the closure regime altogether, in line with SCR 1860 (2009). This will also require calm to be maintained and assurances that materials intended for humanitarian, development and commercial uses are not misused and diverted, so that the steps taken to ease restrictions can be sustained and expanded.¹⁵
- **Address the political and social fragmentation of the OPT**: Reinvigorate mediation to address the divide between the West Bank and Gaza Strip and ultimately bring the PA back to Gaza. Increase the movement of people, including from the private sector and civil society groups, between Gaza and the West Bank, including East Jerusalem. Increase the space for civil society.
- **Re-link the economies of the West Bank and Gaza Strip**: Resolve Palestinian administrative barriers to West Bank–Gaza Strip commercial activities, such as double taxation and fees, company registration, and Palestinian export permits. Implement the “Safe Passage” project and fund other infrastructure projects to reduce travel time and logistics barriers within West Bank and between the West Bank and Gaza Strip. Enhance capacities at Gaza crossings on both sides, open additional commercial crossing(s) with adequate staffing capacity and simplified procedures, and upgrade the Gaza Industrial Estate.

Better aligning the economic and administrative relationships going forward

The Israeli-Palestinian economic relationship has transformed over the years, leading to greater economic integration, though with significant disparities between the West Bank and Gaza Strip in terms of the level of this economic integration. Despite this growing integration, Israeli and Palestinian incomes have not converged over time, suggesting a better policy framework is needed.

One significant transformation of the Israeli-Palestinian economic relationship has been the dramatic increase in the number of Palestinian workers crossing into Israel. As of Q2 2022, around 210,500 Palestinians worked in Israel and in Israeli settlements in the West Bank, most with official permits, but also including tens of thousands of workers who cross daily without official permits.¹⁶ This

¹⁵ Priority areas within the industrial sector in terms of productivity and employment generation are examined in detail in the May 2022 Office of the Quartet report on “the Condition of Gaza’s industry: Reality, Challenges and Required Interventions”.

¹⁶ PCBS. Q2 2022. Labor Force Survey.

represents a 50 percent increase in the number of commuters since 2019. Around two-thirds of these workers are men working in construction, agriculture, manufacturing, and related work.¹⁷ Calculations using the PCBS Labor Force Survey data suggests the inflow of wages to the Palestinian economy may be approximately USD 4 billion dollars per year; our outreach with the Palestinian financial sector suggests the inflow may be as high as USD 7 billion per year, should the current commute patterns continue. As of Q2 2022, roughly a quarter of the West Bank labor force worked in Israel or the settlements; in comparison, 15 percent of the West Bank labor force works in the public sector. In Gaza, despite the increase in permits this year, just less than 1 percent of the Gaza labor force commuted regularly into Israel in Q2—suggesting significant room to grow. Nevertheless, the economic impact of these workers in Gaza is significant, as daily wages for Palestinian workers in Israel are perhaps five times the average wage in Gaza.

The Israeli Government has taken steps to regularize the conditions for Palestinian workers. In past practice, workers paid intermediaries for permits that enabled them to work legally in Israel. A Bank of Israel working paper conservatively estimated profits of NIS 122 million by these intermediaries in 2019.¹⁸ The ILO calculated the estimated annual profits at NIS 427 million.¹⁹ Despite an Israeli Government decision in 2016 to undertake an imminent reform of the work permit regime, some first steps toward implementation were only taken in December 2020 in the construction sector. These reforms aimed at de-linking the permit quotas from employers and hence opening the possibility for Palestinian workers to change jobs and employers. This reform continues. In addition, the Israeli Government is rolling out electronic payments for Palestinian workers to bring their wages back to the West Bank and Gaza Strip electronically, rather than in cash.²⁰ Finally, Israel is converting permits for Gaza commuters to proper worker permits, which grant important labor protections compared with so-called “financial needs” permits. These are all important steps toward improving working conditions, and Israel should move rapidly to implement them fully.

The growing interdependence of the Israeli and Palestinian economies can be seen by trends in the Palestinian current account. The current account measures imports and exports of goods and services, payments to foreign investors, payments received from investments abroad, and transfers such as foreign aid and remittances. The Palestinian Monetary Authority publishes quarterly figures of current account income from the compensation of workers in Israel. From the first quarter of 2011 to the first quarter of 2022, the size of these flows measured as a percent of GDP have almost quadrupled, from 5.3 percent to 19.4 percent of GDP (Figure 1). In other words, this income source has grown faster than overall Palestinian GDP over the same period and is an increasingly important element of the Palestinian economy, particularly in the West Bank.

¹⁷ PCBS. Q2 2022. Labor Force Survey.

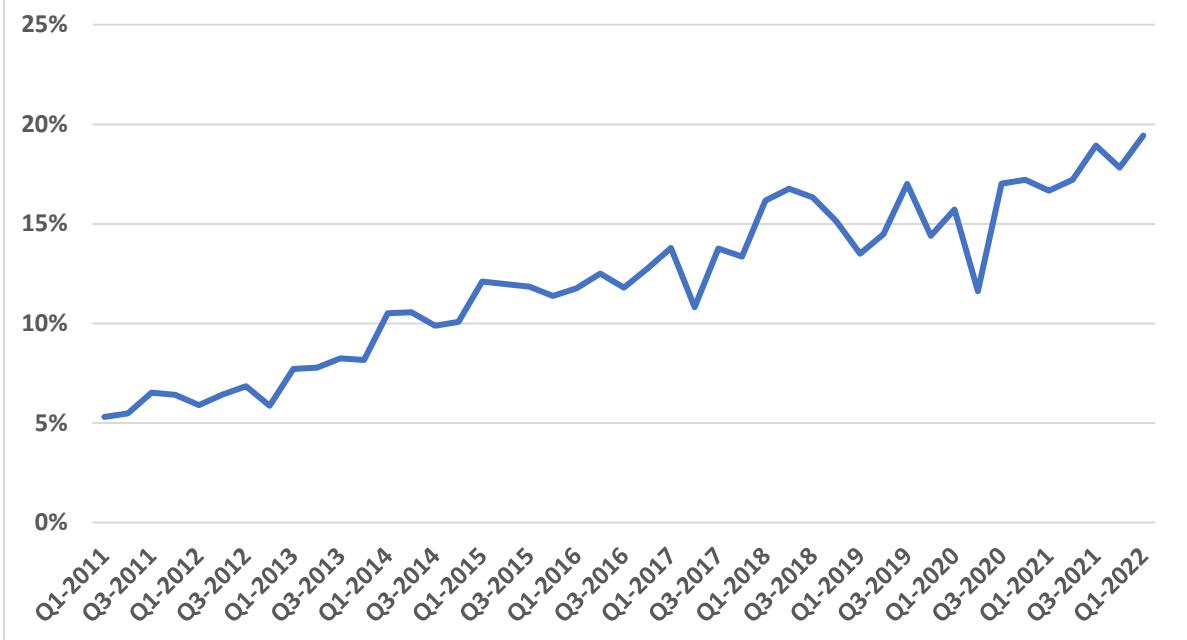
¹⁸ Bank of Israel. 2019. Illegal trade in work permits for Palestinian workers in Israel.

<https://www.boi.org.il/en/NewsAndPublications/PressReleases/Pages/25-9-2019.aspx>

¹⁹ ILO. 2020. The situation of workers of the occupied Arab territories. ILC.109/DG/APP/2020.

²⁰ This reform will also help relieve the excess cash problem in the Palestinian banking system. Electronic transfers are easier to monitor and would hence help strengthen the anti-money laundering/countering the financing of terrorism regime. Lastly, electronic payments may reduce the scope for abuse by employers of their employees.

Figure 1: Current account income from workers in Israel as % of GDP



Source: Palestinian Monetary Authority; UNSCO calculations.

While the trade volume between the Palestinian and Israeli economies more than doubled between 1996 and 2022 (not shown), over the same period, the Palestinians have been addressing their trade dependence on Israel, reorienting both imports and exports toward other partners in the region and the global economy (Figures 2 and 3). Figures 2 and 3 show the percentage of total imports coming from Israel and the share of total exports going to Israel have steadily declined over the past 25 years.

Figure 2: Percentage of Palestinian Imports Coming from Israel

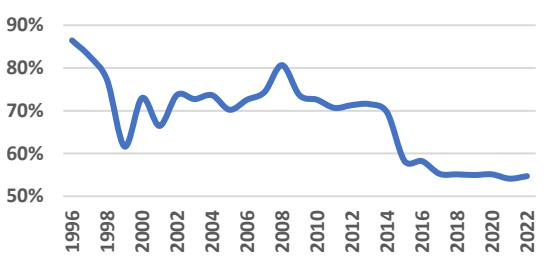
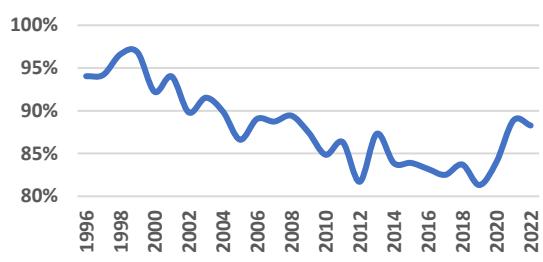


Figure 3: Percentage of Palestinian Exports Going to Israel



Source: Palestinian Central Bureau of Statistics. UNSCO calculations.

Despite this evolving pattern of interdependence—growing in some sectors—the framework that governs the economic and administrative relationships between the parties is outdated in some respects or, in other respects, not fully implemented. This situation creates an economic imbalance between the economies and does not maximize long-term economic benefits for either side, particularly the Palestinians. In addition to providing space for the PA to pursue more independent economic and fiscal policies, policy-level dialogue and concrete measures are required to address gaps in the regulatory framework between the economies, maximize economic and fiscal benefits for the

Palestinians and their government, and, ultimately, strengthen the conditions for achieving stronger economic growth in an independent Palestinian state.

Over 25 years have passed since the signing of the Paris Protocol, which was intended to be five-year arrangement in preparation for the conclusion of final status negotiations. The Protocol remains the general framework²¹ that governs and predominately shapes and constrains Palestinian trade relations, trade policy, macroeconomic policies, and fiscal policies—and the economic and fiscal relations between the PA and the Government of Israel. In principle, the Paris Protocol was supposed to encourage economic cooperation, grow the economy, and strengthen the PA by delegating the authority to design economic policies and programs. In practice, the Protocol has provided the PA with a narrow space to pursue an economic policy independent of Israel.

The Paris Protocol established a customs union between Israel and the OPT, while Palestinian external trade remains under the full control of Israel. Israel also effectively regulates large parts of the Palestinian economy, both indirectly and directly, including by restrictions on the movement of people and goods. This results in an asymmetric interdependency of the Palestinian economy on the Israeli economy, as shown above. Over the years, a key challenge has been in the procedures for Israeli collection of clearance revenues on behalf of the PA and the subsequent transfer of these revenues each month from Israel to the PA, particularly the “fiscal leakages” that this system engenders.

However, the economic challenges associated with the application of the Paris Protocol go far beyond just the clearance revenue issue. Some, but not all, of these challenges stem from the fact that certain elements of the Paris Protocol are outdated given the changes in the global, regional, and local economies in the past decades. Other challenges reflect the uneven or incomplete application of some of its basic conditions. For example, the free-trading relationship envisioned in the Oslo process remains unimplemented. Notably, after fifteen years of Hamas-rule and the unresolved Palestinian divide, Gaza sits outside the Protocol’s basic framework. For example, the fiscal arrangement between Israel and the PA often breaks down with respect to Gaza, with Gaza firms that are owed VAT refunds sometimes not receiving them from the Ministry of Finance in Ramallah. In addition, none of the foreign trade passing through Rafah or Salah ad-Din crossings are taxed by the PA, unlike trade passing through Ashdod Port or via Jordan. The rates of domestic taxes collected by the PA in the West Bank are not necessarily harmonized with the rates of domestic taxes collected by the *de facto* authorities in the Gaza Strip. Altogether, these realities create significant market distortions for firms in Gaza. A better economic and administrative framework is possible.

Necessary steps

The Israeli and Palestinian economies are different in size and nature. Yet, since the Oslo II Accords, the two economies have been in a customs union and are increasingly integrated in many respects. The agreements governing the relationship between the two economies are considered outdated or are only partially implemented. Since the 2000s, Israel has made most changes to the overall framework unilaterally. To strengthen the PA and the Palestinian economy, as outlined in sections above, adjustments to some elements of current framework are needed, while for other elements the agreement should be fully implemented.

It is for the parties to decide the best vehicle for substantive discussions on their economic and administrative relationships: whether by convening the Joint Economic Committee, by holding

²¹ The Protocol consists of 11 articles on many aspects relevant to economic, trade and taxation policies, as well as policies that regulate importing, banking, insurance, standards, specifications, agriculture, water, energy, and petroleum.

meetings between the Ministers of Finance or between the line ministries, by forming technical working groups patterned on the Joint Water Committee, or through another format. In support of these discussions on the economic and administrative framework, the international community can outline the priority reforms in advance of the next AHLC meeting. In addition to some of the reforms discussed above, the ambition of these discussions should aim for at least the following outcomes:

- Attract investments and create strong market conditions in West Bank and Gaza Strip, including in the labor market so workers can bring back skills and resources to invest in their own economy; modernize quotas on goods and promote trade integration; align product safety and health standards to improve the competitiveness of Palestinian exports to Israel and the wider region.
- Finalize rolling out the reforms to labor regulations for Palestinian workers in Israel, such as electronic salary payments and ending the broker system.
- Strengthen economic linkages between Israelis and Palestinians, and thereby promote growth in both economies.

Conclusion

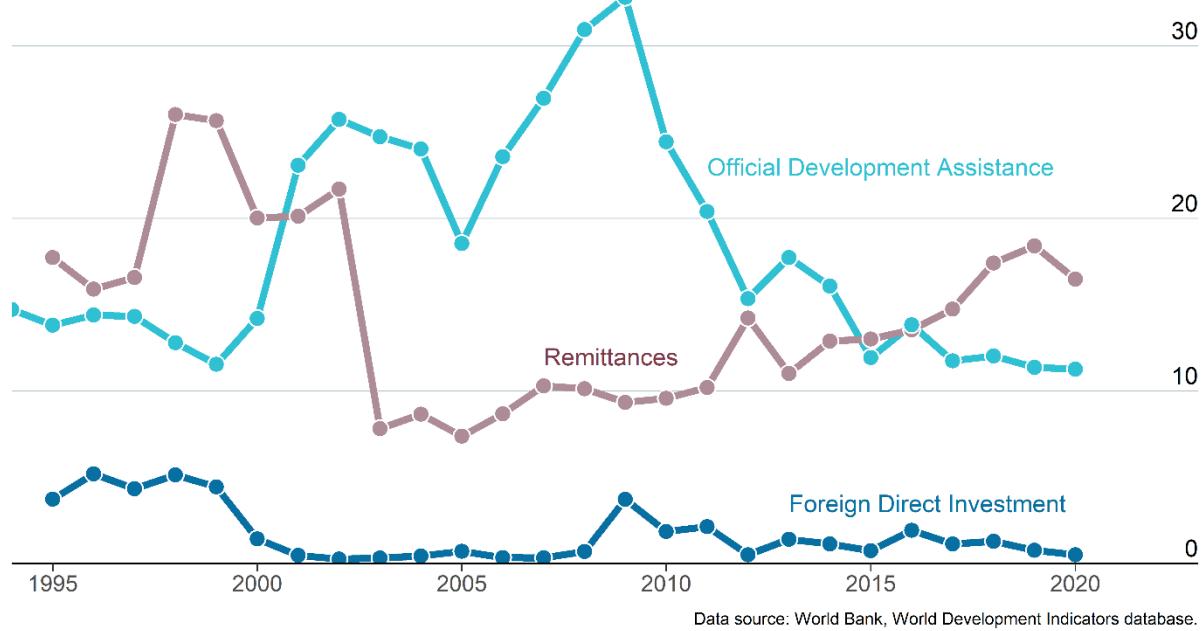
In this report, UNSCO has identified four strategic elements of a “comprehensive package of incremental, durable, and meaningful steps” that the parties and their partners should take to address the current situation. UNSCO believes that these four strategic elements, if implemented, would maintain the viability of the two-State solution until such time that formal negotiations can recommence. Amongst them, serious efforts by all parties to address the drivers of conflict outlined in this report are essential. Only by reversing the negative trends on the ground, particularly growing insecurity in the West Bank, can real progress across all elements be made. Ultimately, there is no substitute for a legitimate political process that will return the parties to meaningful negotiations and resolve the core issues driving the conflict. Only an end to the occupation and the achievement of two States—living side-by-side in peace and security, with secure and recognized borders, based on the 1967 lines, with Jerusalem as the capital of both States, and in line with UN resolutions, international law, and previous agreements—will lead to Palestinians achieving their full socioeconomic development potential and their legitimate national aspirations.

The last quarter-century of engagement by the members of the AHLC was never intended to support the Palestinians and the PA in perpetuity and in the absence of political negotiations. Rather, the engagement of the AHLC was meant to create the socioeconomic and institutional conditions necessary for Palestinian statehood *in parallel* to a peace process that was heading toward a final status agreement.

Instead, the efforts of the members of the AHLC in the past few years have been channeled to halting erosion of Palestinian institutions, to avoiding a sharp reversal in socioeconomic development outcomes, to reducing violent conflict and humanitarian crisis, and to preventing the Israeli-Palestinian relationship from unravelling fully. While the worst has perhaps been avoided due to vigorous international support, the recurrent rounds of conflict and instability make plainly visible the unsustainability of the current trajectory.

Annex: Trends in development financing in the OPT

External sources of development financing, % of GDP (Remittances and FDI) or GNI (ODA)



Key PA revenues and budget support, constant 2010 USD, millions

