Accord to Discord: A Political Economy Approach to the Oslo Process

JAMIE LEVIN MARCH 12, 2004

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Economic Cooperation and the Paris Protocol

The Paris Protocol, signed in April 1994 as part of the Oslo Accords, set out the economic relations between Israel and the Palestinian Authority (PA). Unlike the "unilaterally imposed customs union" (CU) that followed the 1967 Six Day War, the Paris Protocol specified almost every form of daily (non-security) interactions, covering cooperation in water, electricity, energy, finance, transport, communications, trade, industry, labor relations and social welfare issues. The Protocol was predicated on cooperation with the aim of "strengthening the economic base of the Palestinian side and for exercising its right of economic decision-making in accordance with its own development plan and priorities." It specifically granted the PA autonomy over "the exchange of goods, fiscal policy, currency arrangements, and labor services."

The Oslo Trade Regime

Under the Protocol, trade relations between Israel and the PA continued to be governed by a CU, granting free and preferential access to each other's markets. Tariffs, purchase taxes, value-added taxes (VAT), import procedures, price valuations, product classifications, technical and health requirements and standards were harmonized to the Israeli customs regime and import policy; the PA was limited in setting its own trade policy. Most importantly, tariffs could not be lower than the prevailing Israeli rate. Although the PA was allowed to set its own tariffs on certain goods from Arab League countries, the lists were such that in 1998 the value of these goods amounted to only "US$35 million, just 1.1% of total [Palestinian] imports" (World Bank, 2002: 19). In other words, the PA was granted only the trappings of autonomy.

This arrangement was intended to confer advantages upon both parties. Israel was to continue to have preferential access to the Palestinian market and generally reap the dividends of peace. The Palestinians were to gain access to highly competitive foreign markets through Israel's free trade partners, as well as preferential access to the Israeli market. Greater integration should have provided the Palestinians with technological, administrative, managerial and organizational spillovers from the Israeli economy.

Aside from limited economic liberalization, few benefits accrued to the PA, due to inefficiencies in the CU as well as poor implementation of the Protocol. Goods were to move freely through the construction of a deep water harbor, an international airport in Gaza, and a safe passage between the Gaza Strip and the West Bank. However, the port was never constructed, the safe passage was often closed owing to Israel's security concerns, and the airport in Gaza is unoperational. As Palestinians had to rely on complex and expensive procedures to move their goods from the West Bank to Gaza or abroad, their import and export costs are estimated to be 30% higher than Israeli companies', and goods take 20-80% longer to reach their destinations.

Labor Flows and Employment

Access to the Israeli job market should have ameliorated some of the costs associated with the CU. The Protocol promised free labor movement between the Palestinian territories and Israel, where Palestinians earned 91% more than in the territories. Closures, however, negated these benefits. The Israeli government's immediate response to terror was to impose wholesale closures on the territories. Conversely, closures were lifted when the security situation improved. This created an environment of "general uncertainty… which in turn depresse[d] private investment" (Alonso et al, 2000: 13).
As then-PA Minister of Finance Salam Fayyad noted: "Although there are many countries around the world with similarly high or even higher rates of unemployment, I know of none where the rate of unemployment can go up by 10-20 percentage points overnight." This instability caused Israeli employers to seek laborers elsewhere; immigration policies were changed to grant easier access to foreign rather than Palestinian workers. The impact on the Palestinian economy was drastic: In 1992 more than a third of the Palestinian workforce was employed in Israel, contributing about 25% of the GNP, but in 1996 only 7% was similarly employed, contributing no more than 6%.

The Oslo Fiscal and Monetary Regime

As with the trade regime, the PA's fiscal and monetary policies were subordinate to Israel as part of the Protocol. A Palestinian Monetary Authority (PMA) was established to oversee the local banking system and manage official foreign currency reserves, but its scope of authority is limited; banks must operate according to "Basel Core Principles" and reserves must be "in line with those in Israel" (Bennett et al, 2003: 52). The PMA was not granted the authority to issue its own currency, which denied the PA the use of monetary policy. VAT and import tariffs were harmonized to the prevailing Israeli rate, denying the PA much of fiscal policy.

The absence of a Palestinian currency deprived the PMA of the ability to set interest and exchange rates. There was no possibility to devalue, meaning that a devaluation of the NIS inevitably increases the Palestinian trade deficit. Further, $50 million in seigniorage revenue accrues to Israel rather than the PA each year. Nonetheless, the absence of a currency means that there is little risk of currency crisis and the circulating currencies' low inflation rate has benefited those living in the territories.

The PA does have some scope for fiscal policy through direct taxes, tariffs for imports destined for the Palestinian territories and VAT. In 1995 and 1996 the VAT was the "largest single source of revenue for the PA," amounting to $223 million in 1996 (Brynen, 1999: 38). But Palestinian autonomy in this sphere is limited; "VAT cannot be more than 2 percentage points lower than in Israel" (Banister, 2001: 107). In addition, there is considerable leakage in tariff collection. Taxes and tariffs are collected by Israel and are transferred to the PA if the goods are declared destined for the territories, less a 3% service charge. These leakages are estimated at $133-174 million per year, far exceeding the "estimated US$48 million" saved annually by the PA in not setting up a customs authority.

A more autonomous fiscal policy would require a different type of trade relationship with Israel, something that Israel was not willing to consider during the Oslo years. Banister et al charge that the limited fiscal policy and absence of monetary policy impedes the PA's ability to achieve long-term growth and prosperity (2001).

From Honeymoon to Discord: The Oslo Years

The Oslo Accords began as an experiment - an academic exercise apart from the bilateral talks taking place in Washington. The negotiators were neither beholden to domestic constituents (due to the secretive nature of the negotiations); nor were there meaningful constraints from their governments. Thus, the Declaration of Principles (DOP) was highly optimistic, based on compromise, cooperation and confidence-building measures (CBMs), and was ultimately destined to fail.

Despite their differences the two sides came together with a similar vision. According to David Brodet, the former director general of the Israeli Ministry of Finance and negotiator during the Oslo years, "these were the issues that at that time both sides saw as win-win" (2004, 4). This was to be the "New Middle East" often described by then-Israeli Foreign Minister Shimon Peres, in which "men, goods and services can move freely without the need for customs clearance or police licenses" (1994). Similarly, "Abu Ala [Ahmed Qurei] spoke of a free trade area between Ashdod and Gaza" (Beilin, 1999: 66).

The concrete expression of CBMs came in multiple forms. The Protocol offered a promise of free labor and trade movements in a CU, as Ron Pundak, one of the lead Israeli negotiators during the secret negotiations phase, notes: "Israel has a role to play in strengthening the Palestinian economy, assisting in its development, and leading the effort to create a donor conference" (2004: 4).

Yet the Oslo track moved away from CBMs and cooperation, towards concerns for security and autonomy. Pundak explains:

The Oslo spirit… was brushed aside by the implementers… security is beyond everything, at the expense of everything… From the Palestinian side there was a tendency to try and score national points at the expense of the generic issues by trying to attain some fast achievements… [these are] the roots of the deterioration. (2004: 4)

Israel, habitually fearing for its survival, quickly shunted economic cooperation aside, focusing instead on security matters and terror prevention. A slogan used by the Barak campaign during the 1999 Israeli elections stated simply: "Anakhnu Kan, Hem Sham," or "Us Here, Them There." The so-called "border-fence option" gave Israel a veto over "the transit of goods, capital and labor… [transforming the] relationship between Israel and the Palestinians from one of partnership, as stated in the Paris Protocol, to one of Palestinian subordination" (Usher, 1996: 36).

Many of the side payments promised to the Palestinians were lost because of Israeli security concerns and, according to Pundak, "the economic situation on the ground for the Palestinians became worse than they were before [Oslo]" (2004: 5). As Allier et al note, "in the absence of a developed system of social assistance, poverty is closely linked to unemployment" (2000: 12). When closures increased, production fell and unemployment and poverty increased.

In response, the PA placed disproportionate emphasis on achieving the trappings of national sovereignty and independence from Israel, often more for their symbolic value than for their economic, developmental or collaborative value. Despite the economic risks, the Palestinians unsuccessfully demanded their own national currency because a currency is "one of the basic symbols of national sovereignty" (Schiff, 2002: 33). Achieving little to satisfy their narrative in the economic realm, the PA set out to gain national symbols elsewhere. As Yasser Abed Rabbo, one of the lead Palestinian negotiators during Oslo and later a PA minister, explains: "The most defining factor at Oslo was the political factor so these [economic] matters did not play a major role in confidence-building" (2004: 1).

Rafael Benvenisti, director of projects of the Israeli Ministry of Finance during the Oslo years, concurs:

Economic and social issues were not the priorities on the agenda of the parties. They were easily sacrificed for the political and security interests of both parties. Resources, human life and well being of the population were not the main considerations of the parties. The main objectives are land, state, right of return… not the people and the economy (2004: 1).

The Interim Agreement spelled out "the terms for postage stamps, radio and television stations, drivers licenses, licence plates, identity cards, [and] passports/travel documents." Only when the DOP was nearly hammered out were government constraints introduced. Later negotiations such as

Paris, while based on the optimism of the DOP, were negotiated in full view of the public, thus the concerns of domestic constituents factored in.

While the Palestinians claimed that Israel was not doing enough to implement the agreements, the Israelis complained that the Palestinians did not do enough to curb terrorism. My research suggests that the Oslo process was frustrated because the legacy of the conflict predisposed the parties to treat the economic realm in a manner not conducive to CBMs.

It is no coincidence that disillusionment with the peace process was most prevalent where unemployment was highest. Poor economic conditions contribute to a population that is unsupportive of its government and negotiators. The Palestinian population was unwilling to accept or ratify a compromise agreement, thus tying the hands of their negotiators. The PA's reliance on fees, especially for social services, also helped fuel the popularity of anti-Oslo groups offering social welfare and educational services, such as Hamas. Public opinion polls conducted by the Palestinian Center for Policy and Survey Research (PCPSR) are telling: "[Palestinian] respondents ranked job availability and standards of living ahead of repression, violence, and corruption as the greatest concern in the transition to self-government" (October 5-10, 1993). In Israel the popularity of Oslo-resistant groups such as the Likud party rose.

Conclusion

In the optimistic spirit that prevailed at the time, the Oslo Accords were built on the premise of CBMs. However, when dominant Israeli and Palestinian narratives were introduced, the emphasis shifted to security and sovereignty, thus helping to unravel the process. The parties' win-sets narrowed considerably and cooperation became a liability.

As the Palestinian economy went into decline, so too did hopes for a negotiated solution. In the words of Moty Cristal, CBMs became "catastrophe building measures" (2004: 4).

The best way to solve the Palestinian-Israeli conflict is to enlarge the win-sets of both parties within the context of their national narratives. As Jerome Slater argues:

No settlement of this long and bitter conflict can be based on trust… Any peace plan that seeks to meet legitimate Israeli security concerns must start from the premise that the Palestinians might continue to harbor the desire to regain all of Palestine and might later seek to renege on its commitments. The task is to ensure that a Palestinian state will never have the capability of threatening Israel. (1991: 416)

Israel and the PA must respect the narratives that destroyed the Oslo process in order to satisfy their domestic constituents. Cooperation and CBMs must be traded in for political and economic separation. This would ensure the Palestinians the state they so desire, and would deliver a political victory to the PA large enough to pursue domestic reforms. Israel would benefit from clear and defensible borders and increased international legitimacy. Yet, with all proposed solutions, there remain problems associated with separation. Over time these may be overcome when Israel achieves security and the Palestinians obtain statehood - gains that allow for cooperation to begin in earnest.

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