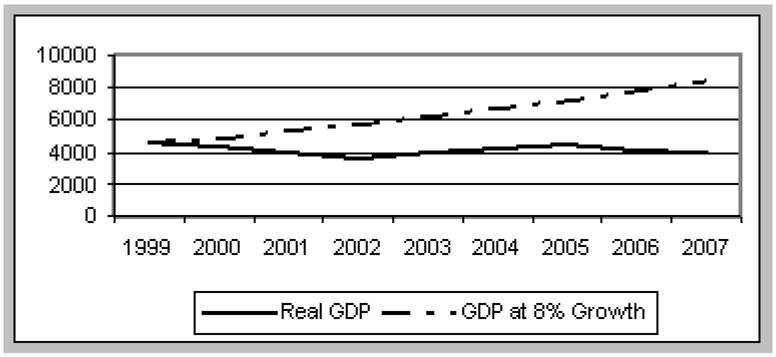
West Bank and Gaza: Economic Developments and Prospects - March 2008

1. Following the Oslo accords in the early nineties, it was expected that the Palestinian economy would enter a period of sustained and rapid growth. While performance was not as strong as hoped, there was steady growth and by 1999 real GDP had grown to $4,512 million. However, since the Intifada in 2000, when Israel instituted a strict closure regime, the Palestinian Economy has been on a downward trend (Figure 1). GDP fell to $3,557 million at the height of the violence and Israeli incursions in 2002 and then recovered slightly in 2004 and 2005. But, with the continuing growth in settlements, continuing closures, and the cut off in direct aid after the election of a Hamas government, GDP fell again in 2006.

2. Real GDP in 2007 is expected to be about $3,901 million, some 14 percent lower than its peak in 1999. Because of the rapid population growth during the same period, per capita GDP is off nearly 40% from its peak. The contributing effects of the closures and movement restrictions can not be overestimated. Between, 1995 and 2000, the Palestinian economy was growing at an average rate of 8% per year. Had that trend continued through 2007 in the absence of restrictions, real GDP may have been more than double its current value (Figure 1).

Figure 1: Estimated Real GDP: Actual and With 8% Real Growth (USD million)



Source: PCBS and World Bank staff calculations

3. A combination of borrowing, remittances and increased aid that flowed around the PA has propped up GDP in the past two years and has allowed both public and private consumption to remain strong. A recent Palestinian Central Bureau of Statistics (PCBS) survey estimates that despite the economic crisis, household consumption dropped by only 0.6% between 2005 and 2006. But while consumption may have remained robust, investment has fallen to precariously low levels resulting in a hollowing out of the Palestinian productive sectors. Public investment has nearly ceased and in the last two years almost all government funds have been used to pay salaries and cover operating costs. Private investment is also low. The IMF estimates that it fell by over 15% between 2005 and 2006 and there is no evidence that it has significantly increased in 2007. A recent World Bank Investment Climate Assessment, which found that less than a quarter of private sector firms made any investments in 2005/2006 and that the equipment in manufacturing enterprises was on average over 12 years old. The lack of investment in public infrastructure and private enterprises is hollowing out the the Palestinian productive base, leading to increased aid dependency and pointing to bleak future prospects unless the trend is reversed.

4. Despite large inflows of aid, the shrinking economy has led to increasing poverty. Unemployment in WB&G stands at nearly 22 percent up from only 10 percent before the beginning of the Intifadah in 2000. Unemployment is highest in Gaza at 29 percent of the active work force. Under the current closure regime and the restrictions on imports and exports for commercial activity, this is likely to become much higher as the layoffs in the industrial sector become permanent. The unemployment rate in the West Bank is approximately 19 percent. The percentage of Gazans who live in Deep Poverty has been steadily increasing, rising from 21.6% in 1998 to nearly 35% in 2006. With the continued economic decline in 2007 and the implementation of even more strict closures on Gaza, the current Deep Poverty rate is certainly higher.

5. Poverty levels starkly illustrate the level of aid dependency in WB&G. The previously cited rates reflect actual consumption. If remittances and food aid are excluded and poverty is based only on household income, the poverty rate in Gaza rockets to almost 67%. The increase in poverty in the West Bank has been lower but is still significant.

6. The situation in Gaza has widened the gap in economic well-being with the West Bank. The current closure policy due to the illegal takeover of Gaza has eroded its economic backbone in a manner that is difficult to reverse. According to the Palestinian Federation of Industries, the restrictions have led to the suspension of 95% of Gaza's industrial operations (Table 1). They can access neither the inputs for production nor the crossings to export what they produce, transforming Gaza into a consumer economy driven by public sector salaries and humanitarian assistance only. The agriculture sector has also been badly hit. Nearly 40,000 workers depend on the agriculture sector in Gaza.

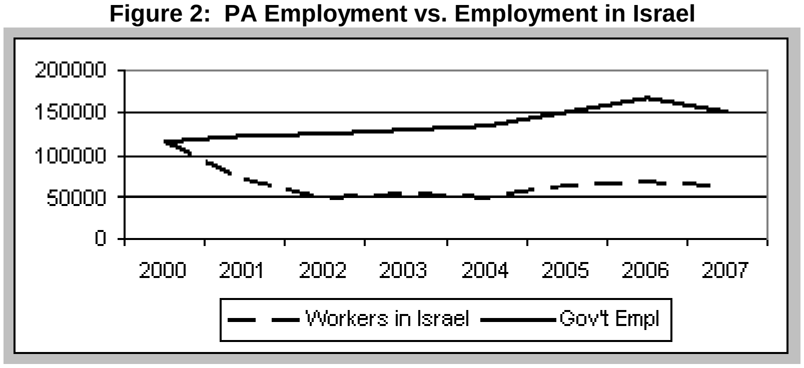
Table 1: Industrial Decline in Gaza

	June 2005 Pre-disengagement	Week 1, July 2007	End-2007[2]
Working Establishments[1]	3,900	780	195
Working Employees[1]	35,000	4,200	1,750
Exports from Gaza (truckloads)[2]	748	0	34 (recent shipments of strawberries and carnations)

Source: PalTrade Presentation to PSCC, July 2007 and recent World Bank interviews with PFI.
1 Source: original data from Industrial associations in Gaza reported to PalTrade
2. Source: Recent World Bank interviews with the Palestinian Federation of Industries

7. With one of the highest population growth rates in the world- nearly 4 percent per annum- there is a persistent need to accommodate new workers in the labor force. To compensate for the shrinking private sector and the loss of employment opportunities in Israel, the PA has attempted to provide for the rapidly growing population by increasing social transfers and becoming the employer of last resort. The number of Palestinians working in Israel or its settlements fell from 116,000 in 2000 to less than 64,000 in the first half of 2007. To compensate for this, PA employment increased from 114,940 to 150,290, not including contractors and part-time workers (Figure 2). This, along with various increases in salaries, raised the wages by 80% between 1999 and 2007. Thus, government efforts to alleviate the effects of the economic crisis have led to an unsustainable fiscal situation.

Figure 2: PA Employment vs. Employment in Israel



Source: PCBS and World Bank staff calculations

8. The government budget, which was in surplus in 1999 when the economy was growing, is expected to have a fiscal gap for recurrent and capital expenditures of around $1.8 billion in 2008. The PA has announced a Palestinian Reform and Development Plan (PRDP) to increase revenues, reduce expenditures, and introduce sector reforms to enhance efficiency. But even with these measures and assuming resumed economic growth, the fiscal gap for recurrent expenditures alone is projected to remain high, at around $1.25 billion.

9. In addition to PA reforms, the defining factors for the WB&G economy remain settlement growth and movement and access restrictions related to Israeli security concerns, which have fragmented the economy into disconnected cantons. In the West Bank, the number of checkpoints increased from 376 in August 2005 to 580 in early 2008. There are currently 149 settlements in the West Bank, including East Jerusalem, and roughly 100 outposts that lack Israeli government approval. The Settlement population has risen to approximately 450,000, 63% more than during the Oslo Accord period in 1993. Some 38% of the West Bank has been confiscated for current or future settlements, outposts, closed military areas, municipal boundaries, and settlement regional jurisdiction. Palestinians without special permits are restricted from important agricultural areas in the Jordan valley, and producers are cutoff from the East Jerusalem market. Recently, the GoI has established five crossing points along the Separation Barrier to transfer commercial goods between Israel and the West Bank. The crossing points use a back-to-back cargo transfer system similar to the one for crossing into Gaza. With over

95% of Palestinian trade being through or destined to Israel, these crossings are unlikely to accommodate the current volume of traffic between Israel and the West Bank without creating additional delays and costs. Given this difficult environment, the chances of WB&G to achieve most of the Millennium Development Goals (MDGs) by 2015 have become a major challenge (Box 1).

Box 1: WB&G's Status vis-à-vis the Millennium Development Goals

Eradicate extreme poverty and hunger. The percentage of Gazans who live in Deep Poverty has been steadily increasing, rising from 21.6% in 1998 to nearly 35% in 2006. About 80% of the population relies on some form of UN humanitarian assistance. With the continued economic decline in 2007 and the strict closures on Gaza, the current Deep Poverty rate is certainly higher. The previously cited rates reflect actual consumption. If remittances and UN food aid are excluded and poverty is based only on household income, the poverty rate in Gaza rockets to almost 67%. The increase in poverty in the West Bank has been lower but is still significant.

Achieve universal primary education. Access to education is equitable with respect to gender, location (rural and urban) and refugee status. Government schools account for 70% of enrolments, while UNRWA has 24% and private schools 6.1%. Although access to schools is primarily constrained by physical conditions and movement restrictions, insufficient investment in upgrading has led to crowding and a deterioration in the learning environment. As schools have lost their revenue base from fees, they have also faced difficulties in securing basic school supplies and materials. With more children facing psychological trauma, the limited services for students with special needs has also become more evident. The inequity in resource allocation between the West Bank and the Gaza Strip has also become acute.

Promote gender equality and empower women. The WB&G has achieved gender parity in primary, secondary and tertiary education, in contrast to much of MENA. Women's participation in the tertiary education sector, at 107.6, exceeds the MDG target, although these figures do not account for the large numbers of male students who seek education abroad. However, at 12.7%, women's labor force participation is among the lowest in the world. Similarly, women's decision making role in the public domain is limited. In 2005, women held 10% of the Director General positions and 5% of the Parliamentary seats. However, there appears to be improvement at the local government level (19% were elected to office in WB and 17% in Gaza).

Reduce child mortality. The infant mortality rate decreased from 34 deaths per 1,000 live births in 1990 to 21 in 2005 and the under-five mortality rate decreased from 40 deaths per 1,000 live births in 1990 to 23 in 2005. This general reduction in infant and child mortality over a 15 year period reflects, inter alia, the resiliency of the Palestinian health sector in the face of continuous financial pressures and service delivery difficulties. By contrast, the average infant mortality rate for the MENA region as a whole was 43 deaths per 1,000 live births.

Reduce maternal mortality. There were an estimated 70 maternal deaths per 100,000 live births in 1995. This ratio, in contrast to the declining trend in infant and child mortality rates, increased to 100 by 2005. The maternal mortality ratio in Jordan, by comparison, in 2005, was 41 maternal deaths per 100,000 live births.

Combat HIV/AIDS, malaria, and other diseases. There are no reliable data on the prevalence and incidence levels of HIV/AIDS in the WB&G. A recent report indicated that 23 cases were reported in Gaza from 1990-2002. Tuberculosis is still an important public health concern. In 2005, the estimated prevalence rate of tuberculosis was 36 cases per 100,000 individuals. In Egypt the prevalence level was 32 cases per 100,000 individuals in the same year.

Ensure environmental sustainability. The conflict has led to environmental degradation due to scarcity of water, rapid population growth, the refugee situation, desertification and land degradation, and land confiscation. Green lands, forests, and biodiversity have dropped from 4.3% in 1998 to below 1.5% in 2004.