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HUMANITARIAN CONDITIONS IN THE
PALESTINIAN TERRITORIES:
SHORT- AND LONG-TERM PERSPECTIVES ON A DEVELOPING CRISIS

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Humanitarian Conditions in the Palestinian Territories

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Abstract

This paper attempts to shed some light on the underlying causes and the potential consequences of the ongoing developing humanitarian crisis in the Palestinian territories, and reflects on both short- and long-term policy measures needed to confront it. The paper argues that (1) the rapid deterioration in the Palestinian living conditions in West Bank and Gaza is not solely the product of the surprise ascent of Hamas to power, and that an already precarious humanitarian situation existed long before the sudden change in the Palestinian political landscape in January 2006; (2) that the abrupt cut off of the much needed financial resources to the post-election Palestinian Authority (PA) has led to a crippling financial crisis with potential grave adverse consequences on all fronts; (3) that the attempt by Western donors to "bypass" the Hamas-led government by channeling aid directly to the Palestinian people through other agencies, UN or NGOs, may not be as easy as thought due to real-life limitations; (4) that all parties share moral responsibility in the short term to take urgent measures to alleviate Palestinian mounting human suffering; and (5) building on the experience of the past decade, and given the political and territorial realities that exist today in the West Bank and Gaza, foreign aid, at best, may help mitigate Palestinian hardship, but it will not end it; nor will it enable the Palestinian people to build a self sustained economy without first altering the conditions that underpin their current misfortune. Only a fair, negotiated political settlement will.

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I. Introduction

The startling victory of the Islamic Resistance Movement - Hamas – in the Palestinian parliamentary elections January 25th, 2006, and Hamas' subsequent formation of the Palestinian Authority (PA) government, has brought to risk two vital sources of PA finance: an aid package by Western donor countries of about \$1 billion a year in humanitarian, developmental, and direct budgetary support; and a monthly transfer by Israel of about \$50-60 million in Palestinian customs and tax revenues that Israel collects on behalf of the PA under the 1994 economic protocol.

Israel suspended the remittance of funds soon after the Hamas-dominated Palestinian Legislative Council (PLC) convened its first session in mid-February, tightened its grip over border crossings separating Israel from the Palestinian territories, further restricted the movement of Palestinian people and goods, and boycotted the new Hamas-led PA government. On the other end, a statement by the Middle East Quartet (United States, European Union, United Nations, and Russia) five days after the elections, on January 30th in a meeting in London, warned of Western donors' intention to drastically review their aid policy to the PA unless Hamas agrees to meet three basic political principles or conditions: forswear violence, abide by previous PA-Israel agreements, and recognize Israel's right to exist. Hamas did not budge, and on April 7th, a week after the Hamas-led government was officially sworn into office, both the European Union and the United States responded by curtailing all direct financial aid to the PA— a position that was more recently reiterated by the Quartet members in a meeting on May 9th in New York.¹

Given the almost total dependence of the PA government on these two financial resources, i.e., foreign aid and customs revenue transfers, for running PA institutions, delivering essential public services to the nearly 4 million Palestinians under PA jurisdiction, financing development plans and infrastructure projects in the West Bank and Gaza, and providing humanitarian assistance to

¹ In the meeting, however, the Quartet endorsed the establishment of "a temporary international mechanism that is limited in scope and duration, and operates with full transparency and accountability," and only for a limited three-month trial period, to send international humanitarian aid directly to the Palestinian people bypassing the Hamas-led PA government. At this point, however, it is not yet known how much aid will be given, how money will be allocated, through what agencies, and how it will be vetted. The Quartet statement also noted the "willingness [of Western donors] to work toward the restoration of international assistance to the Palestinian Authority government once it has committed to these [three] principles." Quartet Statement, May 9, 2006, New York.

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the most vulnerable segment of the Palestinian population, the new Hamas-led PA government is currently facing an unprecedented cash squeeze in its first months in office. With domestic revenues constituting no more than 20 percent of the PA's total financial needs, and no readily-available alternative sources of funds to fill in the gap, this abrupt shortage of cash, if it persists, could very well lead to the virtual institutional collapse of the PA government, and potentially turn the already precarious economic and social conditions in the West Bank and Gaza into an unprecedented humanitarian crisis of major proportions.

A quantitative assessment of what could be expected as a result of a sudden cash crunch in the PA territories has been recently produced by the World Bank. This assessment has gauged the impact of the reduction of Western financial assistance and the suspension by Israel of Palestinian customs and tax transfers along with tightening of restrictions on Palestinian labor and trade movement, on, among other things, GDP per capita income, unemployment, and poverty levels in the West Bank and Gaza over a three-year period, between 2006 and 2008.²

According to the report's analysis, a freeze of customs and tax transfers to the Palestinian coffers, accompanied by further Israeli restrictions on movement, and assuming no change in the level of foreign aid, could, by 2008, lead to a 30 percent fall in Palestinian GDP personal income. Unemployment is projected to reach 45 percent from its pre-election level of 23 percent (an increase of 22 percentage points), and a projected poverty rate could engulf 70 percent of the Palestinian population, compared to its 2005 level of 44 percent (a dangerous rise of 26 percentage points). If these Israeli measures are coupled with a gradual reduction of international aid to PA territories, to about \$900 million in 2008, from its 2005 level of \$1.3 billion, further deterioration in all economic and social aggregates is likely to occur: GDP per capita income could decline by 36 percent in real terms, and both unemployment and poverty rates in West Bank and Gaza could jump to 47 and 74 percent, respectively, from their 2005 levels.³

² The World Bank, "*West Bank and Gaza: Economic Update and Potential Outlook*," March 15, 2006 (www.worldbank.org/ps)

³ It is important to note here that the available figures for unemployment and poverty in the Palestinian territories are mere "averages" that do not reflect the true scale of the problem facing the most vulnerable segment of the Palestinian population. For example, while the 2005 data for unemployment in the West Bank and Gaza show a jobless rate of about 23 percent of the workforce, unemployment among the younger-age group (i.e., those aged between 20 and 25 years old) stands at some 35 percent. Similarly, while the poverty rate (largely defined as the

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The analysis of the World Bank has been confirmed, less than a month later, by a United Nations report that further exposed the potential grave consequences if the PA financial crisis persists and Israeli restrictions on Palestinian movement continue. Under these conditions, the UN report projects, by the end of 2006, a 30 percent drop in Palestinian personal real income, with unemployment increasing from beginning of the year figure of 23 percent to 40 percent of the Palestinian labor force, and poverty among West Bank and Gaza population to dangerously jump from the 2005 rate of 44 percent to 67 percent.⁴

The potential gravity of PA conditions, as the joint forces of the deep financial squeeze and the extended repetitive Israeli closures of border crossings work their destructive way in the Palestinian economy faster than previously anticipated, has led the World Bank in a report published May 7th, just six weeks after the publication of its first report, to warn Western donors that its original estimates of the severity of the PA economic crisis were underestimated. According to the Bank's new analysis, the decline in PA economic indicators "would make 2006, by a margin, the worst year in the West Bank and Gaza's dismal recent economic history," and could cause an institutional decay that will have a negative impact on security, making it difficult for government, the private sector, and providers of humanitarian assistance to operate properly. The Bank concluded that the ensuing institutional damage may be irreversible, and could lead to a situation in which the West Bank and Gaza in effect become ungovernable.⁵

The Palestinian humanitarian predicament and the continued worsening of the living conditions in the West Bank and Gaza – precipitated largely by the recent abrupt shortage of the much needed financial resources and the continued crippling restrictions by Israel on the Palestinian movement of people and goods – have generated serious discussion among development

percentage of those who subsist on less than \$ 2 a day) among the Palestinian population in 2005 hovered around 40 percent, almost 20 percent of the residents of the West Bank and Gaza are living in absolute deep poverty (subsisting on less than \$1 a day), unable to secure their basic subsistence needs. For more detailed analysis of the overall economic conditions in the Palestinian territories, see World Bank, *"The Palestinian Economy and the Prospects for its Recovery – Economic Monitoring Report to the Ad Hoc Liaison Committee Number 1,"* December 2005.

⁴ The United Nations, *"Assessment of the Future Humanitarian Risks in the Occupied Palestinian Territory,"* April 11, 2006.

⁵ The World Bank, *"The Impending Palestinian Fiscal Crisis, Potential Remedies,"* May 7, 2006

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professionals of various international organizations operating in the Palestinian territories, and among policymakers in Western donors' capitals. To a large extent, the debate has centered around three major related issues: (1) the nature and depth of the current PA financial crisis, (2) the possible humanitarian and economic consequences of the PA financial quandary, and (3) the possible role that various UN agencies and international NGOs can play to mitigate the Palestinian humanitarian plight.

This paper will not attempt to provide answers to the many sticking questions generated by the current precarious conditions in the Palestinian territories, nor will it suggest solutions to the emerging crisis situation there. Rather, the aim here is to conduct an objective analysis of all the crucial nonpolitical humanitarian and economic issues raised by the sudden change in the Palestinian political landscape, and to contribute positively to the ongoing debate in order to better understand what is at stake for all concerned parties.

The discussion in this paper is organized around seven sections. This introduction will serve as Section one. Section two introduces two preliminary remarks that aim to set the stage for the discussion in the paper. Section three sheds further light on the PA current financial predicament, the crucial role of international aid in maintaining the operation of the PA activities, the possible alternative sources of funds that the PA might tap to bridge the cash shortfall, along with the difficulties facing Hamas-led PA government in tapping these resources. Section four will examine in detail the various potential humanitarian and economic consequences of PA financial crisis, and the hardship it is causing to the population of the West Bank and Gaza. Section five will discuss the various factors that could limit the ability of UN agencies and international NGOs to further extend their present role in helping the Palestinians cope with the ramifications of the current crisis. Section six reflects on some short-term measures and policies needed by all parties to mitigate the current conditions. The paper concludes, in Section seven, with some long-term thoughts on the whole foreign aid question to the Palestinian territories.

II. Setting the Stage: Two Preliminary Remarks

Before discussing the paper's main topic in detail, it is necessary, to both fully understand the current conditions in the Palestinian territories and the discussion that will follow, to make two preliminary, related points.

First, to a large extent, the current humanitarian and economic critical situation in the Palestinian territories is not an entirely new phenomenon, or solely the product of the surprise outcome of the Palestinian parliamentary elections that were held on January 25, 2006; rather, an already precarious humanitarian and economic situation existed in the West Bank and Gaza long before the elections were held. Tough living conditions were a daily reality for the overwhelming majority of the Palestinian population for a number of years now. The ongoing developing crisis, in other words, precedes the recent sudden change of the Palestinian political landscape, but it was only made worse due to the reaction of the Western donor community and Israel to the elections results, which led to the curtailment of PA financial access to direct foreign aid and to the PA's own tariffs and tax money, and to stiffening of the already crippling restrictions on Palestinian movement and access to internal and outside markets.

To be more specific, over the past five-and-a-half years, and since the start of the Palestinian second Intifada in September 28, 2000 and the eruption of confrontation and violence, the economic, social, and humanitarian conditions in the West Bank and Gaza have been increasingly worsening to a scale never seen before. All indicators have persistently shown serious deterioration in living conditions in the Palestinian territories. The statistics on Palestinian economic and social decline over this time period are all well known, and one can only refer to the writings of local, regional and international organizations operating in the field which have constantly been monitoring and reporting on this issue.⁶

The striking fact about the past five years, though, should not escape any student of the Palestinian economy; a fact that is probably more apt - than anything else - to the current

⁶ For a comprehensive discussion on this subject, see The World Bank, *Four Years – Intifada, Closure, and Palestinian Economic Crisis: An Assessment*, (October 2004); The World Bank "The Palestinian Economy and the Prospects for its Recovery – Economic Monitoring Report to the Ad Hoc Liaison Committee Number 1," December 2005; and Bennett, A, et. al. *West Bank and Gaza: Economic Performance and Reform under Conflict Conditions* (IMF, Washington, DC, September 15, 2003).

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discussion of the emerging financial and humanitarian crisis in the Palestinian territories: that while the international donor community has doubled its level of financial assistance to the Palestinians since 2001, from an average of \$500 million a year to about \$1 billion a year, both poverty and unemployment levels among the Palestinian population and workforce were – at the beginning of 2006 – three times higher than their pre 2001 level. The last section of the paper will comment and reflect on this point and its policy implications in detail.

Second, since the eruption of violence and confrontation in September 2000, increasing Israeli restrictions on the free movements of Palestinian trade and people have greatly complicated the functioning of all aspects of life in the Palestinian territories. What is commonly known as closure policy – a comprehensive system of permit and checkpoint restrictions imposed by Israel on the Palestinian people and goods, both within the Palestinian territories and across borders with Israel – has fragmented Palestinian economic space, raised the cost of doing business in the West Bank and Gaza, eliminated predictability needed for normal economic activities, and is largely acknowledged by the international donor community as the main detrimental factor causing the current Palestinian economic crisis.

These Israeli restrictions on Palestinian movement and trade have been in place since March 1993 and have continued in various degrees and scope throughout the 1990s, a period of relative peace and calm between Israel and the Palestinians. Over time, these restrictions intensified, both in numbers and complexities, after the Palestinian uprising broke out in September 2000, along with the Israeli government's use of its military power in an attempt to quell the violence and restore calm in the West Bank and Gaza. Statistics about the number of days border crossings were closed, the number of military checkpoints, the type of movement barriers (road blocks, road gates, earth mounds, earth walls, trenches, fences, etc...), the size of Palestinian land confiscated for building and expanding Israeli settlements and bypass settlers-only roads, and later, for the construction of the separation barrier inside the West Bank, etc... are all documented by international organizations.⁷

⁷ For complete updated account on these restrictions, check continued monthly reporting and updates by the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) in the Occupied Palestinian Territory. (www.ochaopt.org)

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This complex network of Israeli restrictions and checkpoints, along with repeated and extended closures of border crossings by Israel on security grounds, has severely complicated daily lives of the Palestinians and worsened their economic and social conditions. These actions have also made the work of many international humanitarian agencies operating in the West Bank and Gaza much more difficult in their efforts to mitigate the suffering and hardship of the Palestinian population, and they have largely reduced the effectiveness of donors' development assistance to help rebuild the Palestinian economy.

Furthermore, these restrictions, contrary to previous expectations, have been intensified following the evacuation of the Israeli settlers and troops from Gaza on September 12, 2005 after 38 years of prolonged military occupation.⁸ The Agreement on Movement and Access (AMA) reached on November 15th, 2005 with the active intervention by the U.S. Secretary of State Condoleezza Rice and the Quartet Special Envoy for Disengagement, James Wolfensohn, has largely failed to produce its intended output; i.e., making the Palestinian people's daily lives and the Palestinian trade a bit easier, with the possible exception of the continued operation of Rafah terminal at the southern tip of Gaza border with Egypt.⁹

Long meetings over extended months during most of 2005 that included technical teams, both Palestinians and Israelis, with experts from the World Bank, the European Union, the United States and James Wolfensohn and his team, have resulted in a large volume of technical proposals aimed at easing restrictions on Palestinian movement by the gradual implementation of

⁸ According to latest OCHA report, the number of Israeli obstacles in the West Bank increased from 376 in August 2005, to 471 in January 2006, to 507 in April 2006; i.e., a 25% increase over the period. For a full detailed account on Israeli imposed restrictions on Palestinian movements in the West Bank, see OCHA, *Territorial Fragmentation of the West Bank* (May 2006).

⁹ In his final report before his resignation, Mr. Wolfensohn reported that "The prolonged and repetitive closure of Karni [the main commercial crossing between Gaza and Israel], attributed to IDF [Israel Defense Forces] warnings of security threats, has been extremely damaging. Since the beginning of the year [2006], Karni has been closed on 50% of the days it was scheduled to operate. [Gaza] export volumes during this period averaged just 23 truckloads per day, compared to the target level of 150 truckloads per day by 31 December [2005] as set out by the AMA (not including agricultural exports)." Furthermore, "Neither bus nor truck convoys began by their respective deadlines of 15 December 2005 and 15 January 2006 and discussions on a permanent territorial link ceased after violence erupted in the Gaza Strip at the end of 2005 and beginning of the New Year". In addition, "Discussions on the airport and seaport have not taken place. A draft letter regarding Israeli guarantees concerning the sea port was passed via U.S. intermediaries to GoI [the Government of Israel] in December 2005, and is still pending." For a complete account of the fate of AMA, see the office of the Special Envoy for Disengagement, *Periodic Report* (April 2006).

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a set of regulations and procedures to upgrade border crossings infrastructure, introduce new scanning technology, and improve border crossing management; all without compromising Israel's security concerns. These meetings, which constitute the basis of the November 15th AMA agreement, failed to produce tangible improvement; if anything, the restrictions got even worse.¹⁰

The main point here is that humanitarian conditions in the West Bank and Gaza had been very difficult even before the recent sudden change on the Palestinian political stage. The difference now, and the major concern, is that this already precarious humanitarian and economic situation is now turning worse because of the following combined set of circumstance: the arrival of Hamas at the helm in the Palestinian territories; the position Western donors and Israel have both taken to cut off financial resources that could be available to Hamas to conduct its normal government operations; the tightening of Israeli restrictions on the Palestinians; and the impact this policy has had on the overall humanitarian conditions in the PA territories— a subject discussed below in detail.

III. The PA'S Current Financial Predicament

The decision by Western donor countries and the Israeli government to tighten the financial squeeze on the Palestinians has confronted the new Hamas-led PA government with a financial crisis that further complicates the already feeble fiscal situation which predates Hamas' takeover of power. It is now drastically limiting its ability to govern and implement its election-program of "Reform and Change."

Virtually bankrupt, the PA needs \$120 million per month to pay its staff, and an additional \$60 million monthly to continue basic services to its constituency. With Israel suspending the transfer of \$60 million in monthly customs receipts on goods that transit through its borders en route to the West Bank and Gaza, the \$35 million the PA collects each month in domestic revenues – which is less than 20% of total PA monthly financial needs and highly doubtful to be sustained under current conditions - is not enough to keep it afloat. If financial pressure persists, it could

¹⁰ Complete listing of all reports and technical studies on improving Palestinian trade transactions across borders with Israel are posted on the World Bank website (www.worldbank.org/ps)

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lead to the PA's institutional collapse and trigger an unprecedented humanitarian crisis in the Palestinian territories.

In 2005, the PA had a budget of \$2.1 billion and a financing gap of about \$900 million. The gap was mostly financed through a combination of sources: donors' direct budget support (\$350 million), short-term borrowing from local commercial banks (\$250 million), credit from local private businesses (\$140 million), and profits from the PA-controlled Palestinian Investment Fund (\$175 million). These sources of finance now, to a large extent, along with the customs transfers by Israel, are no longer available to the new PA government.

Western donor countries have halted all direct budget support to the PA, along with their funding for development projects which amounted to about \$450 million in 2005. Israel, as mentioned, has, since March, withheld the transfers of Palestinian customs receipts (although it continues to deduct at source about \$25 million a month for payments against water, electricity, and health services charges, all provided by Israeli utilities companies and Israeli hospitals to the Palestinians). The PA, to a large extent, has also exhausted all other possible domestic means of obtaining funds to finance expanding recurrent deficit (caused mainly by a policy of Keynesian-style fiscal stimulus that has led to an increase in public sector hiring and a rise in the public wage bill, along with expanding social transfer schemes). With close to \$1.3 billion in outstanding debt to both local commercial banks (\$640 million) and accumulated arrears to local suppliers (\$660 million), these domestic sources of funds are greatly off limit now, and can no longer, under the current conditions, constitute resources that can be tapped.¹¹

The Palestinian Investment Fund (PIF), the commercially-run investment arm of the PA with current total holdings of about \$850-\$900 million, could potentially provide a source of temporary relief to ease the PA's current financial distress. But with \$550 million already used as

¹¹ The PA ministry of finance has officially requested from the Palestinian Monetary Authority (PMA) a \$100 million loan to ease the current financial crisis. According to the law, PMA could provide a short-term interest-free loan to the PA provided two conditions: first, that the loan does not exceed 10% of PA annual domestic revenues, and, second, that the PA be able to repay the loan within one year. Given the current circumstances, PA is not likely to meet these two conditions. Annual domestic revenues, estimated in 2005 at about \$1.23 billion (\$476 million from domestic taxes and \$757 million from customs and VAT transfers), although slightly exceeds the first requirement, but current conditions make a similar revenue performance in 2006 highly doubtful. This would make it difficult for the PA to repay the loan within a year as stipulated by the second condition. The PMA is currently studying the PA loan request.

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collateral for domestic bank loans the PA obtained in past months to pay salaries for its workers, and another \$200-\$250 million earmarked for other investments, the PIF now has \$250 million in liquid assets that can be tapped by the new government, but at the risk of draining up whatever strategic funds it has left.¹²

The new Hamas-led government has reached out to Arab countries, mainly the oil-rich states, along with other Muslim countries to fill in the gap created by the abrupt shortage of traditional sources of financing. Other wealthy individuals and businesses (Palestinians, Arabs, and Muslims) were also called upon to step in and help. Two potential problems exist with respect to these alternative sources of financial assistance.

The first has to do with the existing less-than-favorable record of not delivering on promises made by Arab countries to provide direct budget support to PA. In other words, the issue of the gap between commitments and actual disbursement of funds is very much fresh in the memory of the Palestinians. Actual data on financial assistance have consistently showed a gradual decline in the level of disbursement over time.¹³

Second, even if intentions are to be closely matched with deeds, as was the case in the past three months where some Arab and non-Arab countries have rushed to pledge financial assistance to the cash-strapped Hamas-led government (e.g., Saudi Arabia provided \$90 million; Iran, Qatar and the Arab Monetary Fund, each promising \$50 million; while Russia provided \$10 million), the question of how aid money could be transferred to the Palestinian territories is currently, as expected, the real challenge facing both the PA government and Arab/Moslem donors. So far, the Hamas-led PA has not been able to transfer a single dollar of the assistance funds donated by

¹² Press interview with Mohammed Mustafa, PIF General Manager and PA President economic adviser. (Al-quds newspaper, April 16, 2006, and in Ha'aretz newspaper, April 17, 2006)

¹³ At the Arab summit which was held in the Sudanese capital, Khartoum, on March 28-29, 2006, Arab countries have reiterated their commitment made at the Beirut Summit in March 2002 to provide a payment of \$55 million per month to the PA. Past experience, however, has shown that actual disbursements of funds from all Arab countries, with the exception of Saudi Arabia, have constantly fallen short of that target. "Actual payments fell to an average of \$42 million per month in 2002, declining further in 2003 to \$24 million per month, and to only \$9 million per month in 2004." See, The World Bank, *Stagnation or Revival? Israeli Disengagement and the Palestinian Economic Prospects* (December 2004). In 2005, Arab countries contributed only \$240 million to the PA budget, i.e., a little more than one-third of the financial commitment made in 2002.

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Arab and Moslem countries through the banking system.¹⁴ Banks have also refused to cooperate in a plan aimed at using these funds to pay PA workers salaries by directly depositing the money to their bank accounts. Fears of being subjected to legal retribution and sanctions by international financial centers – driven mainly by the U.S. administration – international, regional, and local banks are refusing to be part of any deal that transfer the money to Hamas-led PA.¹⁵

Deprived from essential financial resources to keep it running, and faced with increasing tightening of Israeli-imposed restrictions on movements of its people and trade, both within its own territories and across its borders with Israel, the Palestinian Authority could very well be on the verge of institutional collapse. Furthermore, the Palestinian territories are currently witnessing rapid worsening of an already difficult economic and humanitarian situation; if allowed to persist, this could have potentially adverse security and political consequences. Following is a discussion in further detail of the nature and the implications of the emerging crisis in the West Bank and Gaza.

IV. Potential Humanitarian and Economic Consequences

Given a rapidly growing population, increasing at a rate of 4 percent annually, coupled with debilitated economic conditions, the PA, on the eve of the parliamentary elections January 25th, 2006, was facing a daunting responsibility to provide adequate basic public services, maintain social stability, and secure acceptable living conditions to its constituency. The task became ever more challenging over the past five-and-a-half years when sudden eruption of violence and armed confrontation between the PA and Israel in September 2000 led to loss of political stability and to an increase in stringent restrictions on movement of Palestinian people and products— an environment that resulted in more hardship and suffering to the Palestinian

¹⁴ On May 11, it was reported that the Arab League Secretary General called PA president and informed him that "the League is not in a position to transfer [some of] the money offered by Arab countries [about \$70 million] due to the refusal of the banks to transfer the money as a result of American and international pressure." Reported by Agence France Press, AFP, May 11, 2006.

¹⁵ On April 12, 2006, the office of Foreign Assets Control in the U.S. Department of the Treasury issued an act prohibiting any financial dealings or any engagement in any transactions with the Hamas-led PA government. Under U.S. law, any foreign bank that refuses to comply with this act risk having its U.S. assets frozen and its access to U.S. financial markets denied. Banks in the Palestinian territories are citing the case of once-successful *Al-Aqsa Islamic Bank* until the U.S. government in 2001 labeled it to be "the financial arm of Hamas" and blocked it out from the U.S. financial market; an act that led to the bank's isolation from international financial centers.

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population, and to a more than 30 percent loss of domestic output, and subsequent erosion of the domestic tax base.¹⁶

These adverse developments on the political and economic fronts have led to more reliance on foreign aid and external financial resources to help the PA meet its obligations in four crucial public areas: (1) meeting an ever increasing wage bill for PA civil and police employees, (2) financing of social sector expenditures, mainly on health and education, and funding of social programs geared toward easing the suffering of the most vulnerable segment of the Palestinian population, (3) covering running costs of essential service-oriented public institutions, and (4) the financing of basic infrastructure and essential development projects.

In 2005, according to the World Bank available figures, Western donor countries have disbursed a very high-level aid package in the West Bank and Gaza amounting to about \$1.3 billion in three areas: direct budgetary support (\$350 million), development project financing (\$450 million), and humanitarian assistance (\$500 million). Palestinian customs and tax receipts transferred to the PA coffers by Israel at the same time period, in 2005, were estimated at \$757 million.¹⁷ With the decision of Western countries to halt all direct aid to the Hamas-led PA government, and Israel freezing the transfer of funds, a good deal of this money is now totally out of PA reach. Continued pressure on public services, and lack of financial resources to provide them, coupled with tightening of Israeli constraints on the Palestinian economy, the situation in the PA territories is quickly reaching a crisis point.

(1) Consequences of Failure to Pay Salaries

The PA currently has about 165,000 employees in its payroll roster. Approximately half of the public servants are civil workers while the rest are serving in PA security forces. Women, on the other hand, make up close to one-third of the PA staff.

¹⁶ A concise assessment of the overall PA economic and fiscal situation can be found in the most recent IMF report "*Macroeconomic Developments and Outlook in the West Bank and Gaza*," presented at the Ad Hoc Liaison Committee (AHLIC) meeting, London, December 14, 2005. The full report is available at the Funs website (www.imf.org).

¹⁷ The World Bank, "*The Impending Palestinian Fiscal Crisis, Potential Remedies*," May 7, 2006.

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Failure to pay PA salaries – which are already three months late at the time of writing this report – is leaving PA workers and a million other Palestinians, or close to 25 percent of the West Bank and Gaza population who survive on public-sector salaries, with no means to subsist.¹⁸ And when the economy is in state of constant decline and alternative domestic jobs are virtually non-existent or very hard to find, and over one-third of the Palestinian workforce is already jobless, the nonpayment of PA salaries could take its severe toll on the most vulnerable and poverty-stricken segment of the Palestinian population which has already exhausted all possible coping mechanisms due to continued deterioration of its living conditions over the past five-and-a-half years.^{19, 20} The poverty rate in the West Bank and Gaza, as projected by the World Bank and the UN, is expected to skyrocket as a result of continued salary nonpayment, reaching a dangerous level of 74 percent of the Palestinian population. The situation is expected to be especially acute in Gaza where over 40 percent of the working adults are PA employees according to latest UN figures.

Worse yet, in today's increasingly lawless PA, where maintaining law and order comes in a close tie with the need for jobs as the population top priority, leaving 80,000 armed security men penniless is proving to be catastrophic.^{21, 22}

¹⁸ An illustrative case of how some people are coping is found in a recent media report covering the story of a 52-year-old PA school principal who, unpaid for two months in a row, was forced "to break bits of wood for a fire she is using to cook and bake bread in a makeshift clay oven in her [village home] back yard ... because she cannot afford to make food in any other way." "Every time I bake bread", she said "my face turns as red as a tomato, not to mention being tired from inhaling the smoke... to which I am allergic." See "*Palestinians Resort to Primitive Means to Survive*" Reuters, May 12, 2006.

¹⁹ These coping mechanisms constituted of some or all of the following: (1) non payment of public utility bills (mainly water and electricity), (2) drawing on past personal savings, (3) buying on credit, (4) reducing consumption of expensive nonessential food items, (5) selling off house assets, mainly furniture and appliances, (6) cashing off personal gold jewelry; a traditional form of savings in the Palestinian society, and (7) receiving handouts, both in cash and kind, from relatively well-off extended family members.

²⁰ UNRWA, the United Nations Relief and Work Agency operating in the Palestinian territories to serve the refugee population, has been lately reporting of an increasing numbers of Palestinian families approaching its offices in the West Bank and Gaza asking for food and cash assistance.

²¹ In the recent months, it has increasingly become a familiar common occurrences for Palestinian armed men, either already part of the PA security structure or belonging to different armed factions, to demonstrate in the street as a show of force, or to occupy, for a number of hours, government buildings or storm Palestinian Legislative Council, demanding payments of their salaries, asking for pay raise, or for jobs in PA security forces.

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Downsizing of PA staff to reduce recurrent budgetary burden may not be a feasible policy at a time where alternative job opportunities, at home or abroad, are not available and could, if hastily implemented without carefully thinking of its potential adverse repercussions, lead to more chaos in the increasingly lawless Palestinian territories.²³ Equally threatening to the Palestinian social fabric would be any attempt to reduce PA salaries from their already very low levels, especially if this policy targets PA staff at the lower pay ladder where average monthly salary is slightly above the \$415 benchmark commonly defined by development professionals as the minimum income necessary for a family of six members to survive above the poverty line.²⁴

Palestinian social stability could be another potential victim of the continued PA salary crisis, and, unlike the previous hardship endured by the Palestinian population during the 2001-2002 economic crisis, this time around social stability may not be able to survive the severity of the current situation. Several factors account for this highly likely possibility, where, at present, the severity of the crisis is more pronounced, the Palestinian street is more militant than ever before, law and order is largely absent, coping mechanisms are virtually depleted, Israeli restrictions on movement and access on people and goods (both in West Bank and Gaza) are more stringent, foreign aid may not be at levels previously disbursed, and, finally, the current developing financial and economic crisis is more acute; all this is bound to have a serious threat to the once celebrated Palestinian ability to preserve social stability and cohesion under adverse conditions.²⁵

²² The UN warns that nonpayment of PA security forces' salaries "could lead to a highly volatile security situation and in turn to a possible rise in the criminality. [and] if past patterns are any indication, the violence may also spill over and be directed at Israel, including the targeting of Israel civilians." UN report, April 11, 2006.

²³ In his testimony to the Foreign Relations Committee of the US Senate on March 15, 2006, James D. Wolfensohn, the Quartet Special Envoy for Gaza Disengagement, stated that "the PA must shed at least 30,000 of its security sector employees in order to return to a path of fiscal sustainability." (The full text of testimony is available at the Committee page of the US Senate website www.foreign.senate.gov). This demand was echoed more recently by the World Bank. "The new [Hamas-led-PA] government cannot escape the need to address serious [fiscal] imbalances through a major retrenchment of public servants, a significant reduction in public sector salaries, or a combination of both." *The Impending Palestinian Fiscal Crisis, Potential Remedies*, World Bank, May 7, 2006.

²⁴ The poverty line is defined as per capita consumption of \$2.3 per day for a benchmark household of two adults and four children.

²⁵ In their comment on the Palestinian social ability to stand resilient in the face of the harshly adverse economic conditions of 2001-2002, donors noted that "What is quite remarkable is the continued cohesion of Palestinian society. Despite violence, economic hardship, and the daily frustration of living under curfews and closure, lending and sharing are widespread and families for the most part remain functional. Donors were saying even prior to Operation Defensive Shield that Palestinian society was absorbing levels of unemployment that could well have fractured the social contract in industrial societies." See *Twenty-Seven Months – Intifada, Closures and Palestinian*

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(2) Implications for Education and Health Services

Most educational and health facilities in the West Bank and Gaza are government run, with expenditures on their services are the largest expenditure item in the PA running budget. These facilities, already operating on a low budget even before the current financial crisis hit, are quickly running short of cash at the present time. Lack of vital finances or sharp cuts in the budget allocated to its operation, may very well cause a breakdown of the whole Palestinian health and educational system, and could prove very costly, both in the short and long terms.²⁶

Today, 62 percent of primary healthcare clinics, all major general hospitals, and 75 percent of grade schools (primary, preparatory, and secondary) in the Palestinian territories are operated by the PA. The rest of the health and education services are provided by UNRWA, NGOs, and the private sector. In 2005, over 60 percent of the non-security public expenditure went to operate and maintain activities in these two fields; while over 65 percent of the PA 80,000 *civil* servants, or close to 51,000 employees, are engaged in social sector related activities in one way or another.²⁷

In the short term, failure to secure orderly education services could be disastrous. Today, tens of thousands of young Palestinians are schooled in PA run educational facilities, and the repercussions of letting teenaged school kids in the street because their teachers are not paid or their classrooms are no longer open, could have grave social and security ramifications. Funds shortages at a time where PA education facilities are wrapping up their school-year long teaching activities could seriously disrupt ongoing preparations for final exams, especially for senior

Economic Crisis, World Bank, May 2003. This was quoted again in the Bank's recent Report of May 7, 2006. Given the changing realities in today's West Bank and Gaza, it would be very surprising indeed if one could continue to state a similar opinion.

²⁶ In the immediate term, and compared to other crisis-hit countries, "the likely decline in services in the Palestinian occupied territories will be more acutely felt because it affects an urbanized, former middle income society with a highly developed system of service provision on which the population have come to heavily rely." UN report, April 11, 2005.

²⁷ At the present time, there are 12,000 employees in the education sector providing grade education to about 700,000 students in the West Bank and Gaza, and close to 39,000 employees in the health sector operating 22 general hospitals. The role of the PA in providing health services is crucial since not all of the Palestinian areas, nor are all types of health services covered by NGOs (which run 12 smaller hospitals) or UNRWA. PA run hospitals, for instance, are the main providers of all vaccinations. See UN report, April 11, 2006.

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students ending their high school education. It could also make it very difficult for the PA to adequately plan for the new school year next fall.

The situation is much graver in the health sector where a combination of abrupt cuts of Western denoted financial resources and Israeli prolonged closure of border crossings are quickly having their devastating impact on the already destitute Palestinian population and causing unnecessary suffering and even losses in human lives.²⁸ A series of recent reports both by professional health organizations and world media are now warning of rapidly deteriorating conditions in PA healthcare facilities in the Palestinian territories, mainly in Gaza, where hospitals are running short on the totally-donor-funded basic medical supplies, doctors and nurses are not paid, and patients are not receiving treatments for preventable diseases; a situation that, if continued, could eventually cause the collapse of the PA health system, and, according to the Physicians for Human Rights – Israel, "lead to the death of thousands of people in the short term, and extensive morbidity in the long term."²⁹

In the long run, the overall mental and physical health of the nearly 4 million Palestinian population of the West Bank and Gaza could also be at risk. In a place where natural resources are relatively scarce, the quality of human resources becomes a crucial factor in determining future Palestinian economic growth potential. Compromising the quality of the Palestinian social capital caused by foreign aid cuts will only undermine the viability of the future Palestinian state; a long term stated goal of the international community as part of the two-state solution to the Israeli-Palestinian conflict.

²⁸ The general director of the main Shifa hospital in Gaza sums it all up "there are shortages of medication and disposables in all departments, from disposable needles and adhesive tape to vital drugs. The hospital can no longer provide chemotherapy for many forms of cancer, has only few days' supply of key surgical drugs like atropine, adrenaline, heparin and lidocaine, and has used up its strategic three-month cache normally kept for a health crisis. We're trying to limit the operating list and people are suffering, even dying, because of these shortages." In an interview with the New York times (see reference below).

²⁹ Examples of these reports include: WHO, "possible consequences on the health sector due to the reduction of support to the public services," April 7, 2006; Physicians for Human Rights - Israel, "Collapse of the Palestinian Health System," May 10, 2006 (www.phr.org.il); and the Palestinian Health Policy Forum, "Recommendations on the implications of the imposed financial and economic sanctions on the Palestinian people," Ramallah, West Bank, May 8, 2006. Media reports include: "*PA health care teeters on total collapse*" Jerusalem Post, May 7, 2006; "*Cuts make Palestinian lives even worse*," The New York Times, May 7, 2006; and "*The Palestinian tipping point*," The Guardian, May 15, 2006.

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(3) The Fallout on the Palestinian Economy

The fallout on the battered Palestinian economy, which has already lost one third of its output since the eruption of violence in September 2000, and continues to operate under an increasingly stiffening restrictions by Israel, is no less damaging and could equally be destructive.

Curtailed Western development aid not only deprives the Palestinian population of vital infrastructure services in water, roads, sewage and the like, but is almost certain to hit hard the construction sector and all business activities linked to it.³⁰ Traditionally, donors spend about one third of their annual aid money and technical assistance on rehabilitating and upgrading existing infrastructure network and adding new projects in the process in order to provide the rapidly growing Palestinian population and their nascent economy with the needed physical capital base for their future growth and development. In 2005, \$450 million of foreign aid had been disbursed on developmental infrastructure projects in the West Bank and Gaza. Most of these projects have been labor intensive, providing badly needed job opportunities to thousands of Palestinian workers that otherwise could stay unemployed under the current economic decline in the Palestinian territories.

In the Palestinian context, developmental projects also have a humanitarian dimension to them through the money income they generate and make available to the Palestinian working class, and through their positive impact in improving the quality of living conditions in Palestinian towns and localities (e.g., water projects that supply fresh and clean water to Palestinian villages; sewage networks that reduce environmental hazards, new schools to accommodate expanding enrollment, clinics for growing population, roads, etc...). So, a shortfall of funds to these projects can have an adverse impact and worsen the humanitarian condition in the Palestinian territories.³¹

³⁰ Example of development aid cuts to PA includes the cancellation or suspension of \$130 million of US funded infrastructure projects (roads, water infrastructure, and construction). See: US State Department, office of the spokesman, Washington, DC., April 7, 2006

³¹ More than \$320 million of donors funds previously allocated for sewage infrastructure in the West Bank are now frozen, along with investments of \$15.5 million by the World Bank, the European Union. Without these projects in sewage and waste treatment facilities, many of local water sources in the West Bank will continue to be contaminated, and the contamination will spread to additional areas and deeper into the aquifer. The U.S. administration has frozen \$50 million in funding for a sewage treatment facility in Hebron, raising concerns of continued contamination of the mountain aquifer and the Hebron River with the attendant health and environment-related problems. See "*Even sewage is not free from politics*" Haaretz, May 9, 2006.

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The Palestinian private sector, which at the end of the third quarter of 2005 provided jobs to 75 percent of the Palestinian workforce and contributed over 65 percent of the GDP last year, could also be another victim of the ongoing financial crisis.³²

Small businesses in the West Bank and Gaza, which account for over 90 percent of the private sector activities, are already feeling the heat and could, if the crisis continues, soon start to crumple due to sharp potential drop in domestic demand and customers likely to default on outstanding debts, both precipitated by the PA's deep financial crunch. With the recent escalation of Israeli restrictions on Palestinian trade and continued extended and unpredictable closure of border crossings, local business became heavily dependent on domestic demand for sales. With the PA facing a crisis in securing the salaries of its workers, and the Palestinian population expecting tough times ahead and consequently reducing their spending on life basic necessities, Palestinian local businesses are fighting for survival.³³

And finally, the Palestinian banking sector which has survived adverse conditions in the recent past and showed a surprisingly steady increase in both deposits and credit facilities over the past two years, between 2003 and 2005, could face serious trouble if the PA and other local private businesses fail to honor debt their obligations, leading banks to tighten credit policy, thus further straining the economy.³⁴ Furthermore, Palestinian commercial banks in the West Bank and Gaza are currently under mounting pressure not to carry any financial transactions that belong to the Hamas-led PA government or face boycott by Israeli banks and isolation from international

³² Palestine Economic Policy Research Institute (MAS), et.al. *Quarterly Economic and Social Monitor*, Volume 4 (Ramallah, April 2006).

³³ Local shops in West Bank and Gaza are lately reporting sharp drops in sales as high as 80%. With continued uncertainty and risks about the future, local businesses are no longer providing credit for their customers, finding it increasingly difficult to get repaid, or repay their own debts to other businesses and local commercial banks. If this sudden distraction to normal business practices continues, soon business may start to close, private investment may plunge, and private sector workers as a result, be laid off; further aggravating the ongoing crisis.

³⁴ Latest available figures on commercial banks activities in the Palestinian territories (with a total of 21 banks and 140 branches) by the end of the third quarter of 2005 showed total bank deposits of \$4,606 million, and total credit of about \$1,798 million, implying a 39% credit/deposit ratio. \$1,160 million of banks credit went to the Palestinian private sector while the rest, \$638 million was borrowed by PA government. See MAS, op.cit. Page 23-26.

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financial centers. Moves in this direction have actually started, threatening with grave repercussions the whole financial intermediation industry in the Palestinian areas.³⁵

V. UN and NGO'S: "Bypassing" Role and Limitations

The preceding section outlined in detail the potential adverse humanitarian, social, and economic consequences emanating from Western donors' decision to effectively halt all direct financial aid to Hamas-run PA institutions, the suspension by Israel of the transfers of Palestinian tax and customs receipts, and the continued tightening of Israeli restrictions on Palestinian movement and trade. In an attempt to deal with the emerging crisis while circumventing Hamas-led government, Western countries have contemplated the use of the UN agencies along with international NGOs that are currently operating in the Palestinian territories as alternative channels in delivering humanitarian aid and providing basic services directly to the Palestinian population.³⁶ This issue raises a whole host of related questions as to the potential role these institutions could possibly play in the post-election Palestinian context.

³⁵ Three major Israeli banks have already announced their intention to sever relations with the Palestinian banking sector. The latest blow came on May 17, 2006 when the Israeli Discount Bank decided to cut ties with the Palestinian banks within the next three to six months, citing fears of being subjected to anti-terrorism laws by doing business with any entity even slightly connected to Hamas. See Haaretz, "Discount Bank to sever ties with Palestinian banks in the territories" May 17, 2006. This move by Discount Bank was preceded earlier, on April 4, 2006 by a similar announcement by two other Israeli banks, Hapoalim and Leumi, to terminate all banking transactions with Palestinian banks. Given the strong ties between the Palestinian private businesses with their Israeli counterparts, and the continued dependence of the PA government on purchasing basic utilities (water, electricity, and fuel) from the Israeli suppliers, this severing of banking contacts is pound to further complicate economic activities in the West Bank and Gaza Strip.

³⁶ There are four potential alternative disbursement channels that could, in theory, be identified, and their services and expertise be tapped. First, there is the World Bank which has been operating in the Palestinian territories since 1994. Its staff, both in the field and in Washington, is familiar with the prevailing conditions and problems facing the Palestinian economy, and has relatively long working relation with most public, private and civil society institutions. The Bank has assisted in the past in administrating the disbursement of donor funds for budget support (through the *Holst Fund* in the early 1990s), and in various areas of technical and financial assistance (e.g., through the *Emergency Services Support Program*, and the *Public Financial Management Reform Trust Fund*), helping the cash-strapped PA and other Palestinian public institutions overcome their financial and institutional difficulties. Second, there is UNRWA, the United Nations Relief and Work Agency for Palestinian Refugees, with over half a century of uninterrupted relief activities to the refugee population in the West Bank and Gaza. UNRWA currently has a staff of close to 13,000 in the Palestinian territories providing food aid and emergency cash assistance to about 70 percent of the population in Gaza, and about 28 percent in the West Bank. Third, other UN agencies of various capacities and experiences have been similarly operating in the Palestinian areas providing basic services and assisting the most vulnerable segment of the Palestinian population meet essential human needs. Examples include *United Nations Development Program* (UNDP), *United Nations Children's Fund* (UNICEF), *World Health Organization* (WHO), *World Food Program* (WFP), and *United Nation Educational, Scientific and Culture Organization* (UNESCO), to name just a few. Finally, the Palestinian territories have a multitude of international

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For instance, which UN agencies and international NGOs could likely be potential candidates for such a role? Could they, in practice, deliver the *extra* and *different* output that is expected from them? Can they *replace* or *duplicate* the existing PA institutions in delivering essential public services to the overwhelming majority of the Palestinian population in West Bank and Gaza? And in both cases, do they have a mandate for the job? Will the new PA government allow such a *substitute* or *parallel* activity that could undermine its own mandate? Do the potential candidates have the adequate resources, both human and financial, required to enable them to do the envisaged extra work? How soon can these resources be secured? And to what extent does the new involvement by UN agencies and foreign NGOs affect their existing work with the Palestinian communities they are now serving? What factors, if any, may limit the potential candidates ability to function under the new Palestinian political landscape?

These questions, and other similar ones, need to be seriously addressed by the donor community in order to objectively assess the effectiveness of the proposed alternative approach to humanitarian aid delivery, and to identify the potential cost – measured in human suffering and hardship – of an alternate strategy aimed at bypassing the Hamas-led PA government.

Generally speaking, UN agencies and international NGOs working in the Palestinian territories are pretty much familiar with the Palestinians' problems and needs; all have the staff, both local and international, the experience, and a record of distinguished achievement. They have helped the Palestinian people in the past, and most certainly can do more to assist in the future, each agency in its own line of work, if provided with adequate financial resources to continue providing services to the Palestinian population and communities.

Playing a different role beyond their traditional line of work to replace or duplicate the work of existing PA institutions, could, in reality, and for a variety of reasons – mostly related to capacity, funding, mandate and access – prove both costly and problematic, if not impossible

NGOs covering almost all walks of life (e.g., health, education, women, children, human rights, relief work, business support, etc.). Examples include names like: Save the Children, Oxfam, Care International, and other members of AIDA, the *Association of International Development Agencies* which consist of 36 non-governmental aid organizations working in the West Bank and Gaza. Some of these organizations are well known to the Palestinian public and to donor countries, with established records of excellent service delivery. They have very professional and experienced staff, and have proven very effective both in planning interventions in times of crisis and in delivering services to local Palestinian populations.

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altogether, especially in the short run. In this regard, five complications come to mind which, individually or collectively, will act to greatly limit the ability of UN agencies and international NGOs to serve as potential bypassing alternative delivery channels for Western aid to the Palestinian public.

- (1) By attempting to divert direct aid, both monetary and technical, from the new Hamas-led PA government in favor of other potential contenders for aid delivery, Western donor countries could in the process seriously undermine the Palestinian public institutions they themselves helped to set up, and later got involved in their reform. Over the past 12 years, and since the establishment of the PA in 1994, donor countries have disbursed an average of 15 percent of all aid disbursed throughout the period (1994-2005) on public institutions capacity building. Careful attention should be given to this potential adverse impact of not dealing with PA public institutions.³⁷
- (2) Bypassing the PA government may also prove to be a tough exercise. In practice, it is not always possible to distinguish between what is governmental and what is not since all aspects of the aid cycle, at one stage or another, has to go through official bureaucracy. The dividing line here is very thin and could at times be very blurry. International NGOs and UN agencies, for example, that deal directly with the Palestinian population in delivering their assistance, all have to deal along the way with the government agencies and PA officials of various ranks and stature in order to facilitate their work in the Palestinian territories. Setting the criteria of what is permissible and what not could be a tedious exercise that may needlessly complicate aid delivery at times where the need for such aid could be immense.
- (3) Almost all development aid to fund infrastructure projects in the Palestinian territories has to go through governmental institutions at one stage or another. Even when projects are directly implemented by donors, coordination with the government and its final

³⁷ Reflecting on this point, the World Bank report of May 7th (cited earlier in this paper) noted that "A protracted period in which the PA is disabled might result in the unraveling of a dozen years of donor efforts to build the responsible, accountable institutions needed for a future Palestinian state – or for continued governance *ad interim*. It is also hard to envisage how the PA could meet the Quartet's conditions if it is not operative."

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approval at the early stage of the process is needed to make sure that the intended projects are consistent with government development plans. At times foreign-funded projects have to be supervised, and sometimes jointly implemented, by the government. Furthermore, even in the case where Western donors intend to curtail all development assistance to Hamas-run institutions, and restrict their contribution to humanitarian aid, it is very hard sometime to distinguish between what is a developmental project and what is not since almost all projects, including humanitarian ones, have a developmental aspect. All those who have been involved in development planning in the Palestinian territories, be it national or international experts, can attest to this fact.

- (4) Even if Western countries decide to seek delivering humanitarian aid through some alternative channels, avoiding cooperation with the Hamas-led government at time of actual crisis may prove to be a difficult task for securing smooth running operations. In crisis circumstances, governments usually see as their first job to help the population cope with the situation, both by initiating relief measures and by coordinating various efforts where outsiders are involved. Hamas, with its well-known history and experience in this field will tend to lead and not to leave the task to others.
- (5) It is not at all clear at this point if the UN agencies and international NGOs working in the Palestinian territories have the extra capacity, or the mandate, needed to provide services in areas traditionally covered – with effectiveness and quality one should add – by the PA government. Their ability to function could become even more complicated if worsening humanitarian conditions on the ground lead to spread of internal chaos, rise in lawlessness, and, consequently, more tightening of Israeli restrictions on access and movement; a situation which may force internationals to leave the Palestinian territories or not to have easy access to it.

It is worth noting here that both the UN agencies and international NGOs realize the above potential constraints, and both have made statements to this effect. In its recent report on the unfolding humanitarian situation in the West Bank and Gaza, the UN clearly stated that "The UN is on no position – in terms of mandate or capacity – to duplicate or replace the role of the PA, or

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the quality and extent of its services. In any case, any step in this direction would require the concurrence by the PA."³⁸

In a more recent jointly-signed statement, the community of the 36 members of non-governmental organizations operating in the Palestinian territories has clearly emphasized their position on the issue: "With the PA providing services to 80% of the Palestinian population, these factors [i.e., continued and increased Israeli restrictions on movement, the withholding by the Israeli government of Palestinian tax money, and the suspension of Western direct aid to the PA government] will seriously undermine the PA's ability to provide these services. The UN and international and local NGOs cannot fulfill the core public sector responsibilities by setting up parallel mechanisms. More practically, the UN and NGOs do not have the capacity to coordinate, manage and administer the wide range of essential social services in the West Bank and Gaza, only to complement and support existing public sector structures as in the case of a humanitarian crisis."³⁹

VI. What Can Be Done? Short-Term Measures

The preceding analysis attempted to shed some light on the rapidly worsening living conditions in the Palestinian territories. Four months after the Palestinian elections of January 2006, there is currently a growing realization among all concerned parties regarding the potential adverse consequences of what could at some point become a major humanitarian crisis. There are, at the same time, different assessments among the parties themselves about the severity of the present situation, and diverse views on how to move forward; each reflecting different understanding and interpretation of what brought the whole situation to this point. This, it seems, makes it all the more difficult for all involved players to find minimum common ground to reach some kind of consensus on a workable strategy translated into a set of practical procedures to defuse the developing predicament.

³⁸ UN report, April 11, 2006. To emphasize this point even further, David Shearer, the head of United Nations office for Humanitarian Affairs in the Palestinian territories, OCHA, was quoted recently saying "all the international aid agencies put together will not be able to replace the services that the Palestinian authority provides to the population in the Gaza Strip." See "*PA health care teeter son total collapse*" Jerusalem Post, May 7, 2006.

³⁹ This statement was made at the outset of a joint report by the 36 NGOs on the humanitarian conditions in the Gaza Strip six months after disengagement. See AIDA, *Humanitarian Situation in Gaza Six Months after Redeployment*, May 4 2006. (www.aida-jer.org)

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But the luxury of waiting may not be attainable here. As the PA financial crisis continues to bite harshly, manifesting itself openly every day in mounting Palestinian suffering, rapid deterioration of the economy, and rising of lawlessness and anarchy in the streets, the unmistakable disaster-in-the-making signs are becoming increasingly clear for all to see. International organizations and world media have been documenting the disaster course, and projecting and updating its future severity. No one seems to have an easy answer on how to avoid it. This is, after all, a politically originated crisis, and may take some time to solve itself. In the short term, however, all parties share responsibility to, at least, mitigate its direct impact, and its potential adverse consequences.

(1) The Palestinian Side

On the Palestinian side, there are recently three encouraging developments that may help find a way out of the current political and financial impasse.

First, there is the "*Private Sector Initiative*" by a group of prominent Palestinian business leaders. The initiative calls for the formation of a Palestinian coalition government and for the adoption of a Palestinian peace initiative based on the Arab Peace Initiative of 2002. The private sector initiative is increasingly gaining ground in the Palestinian territories and other local businesses and civil society organizations are signing in.

Second, there is the proposed initiative titled "*the National Conciliation Document*" that has been drafted by top Palestinian leaders jailed in Israeli prisons. The document calls for the establishment of a Palestinian state in the West Bank and Gaza and for resisting the Israeli occupation by peaceful means on the land occupied in June 1967. The initiative was welcomed by top officials in Hamas-led government, including the prime minister and the minister of foreign affairs. The two main signatories to the "prisoners' document" were Marwan Barghouti, Fatah leader in the West Bank, and by Abdel-Khaleq Natche, a well-known figure in Hamas. This document was viewed as a significant development and could, if adopted, lead to a major shift in Hamas position vis-à-vis the issues that have precipitated the PA current financial crisis.

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Finally, there is the initiative by the Hamas-dominated Palestinian Legislative Council and its speaker for all Palestinian political parties to hold an "*Open National Dialogue*" to debate the current state of Palestinian political affairs and to search for a common vision to lead the Palestinian people out of the internal political deadlock. The national dialogue conference convened on May 25-26, 2006 in Gaza and Ramallah, and decided at the conclusion of its two-day meeting to form a "national dialogue committee" headed by the PA president and includes in its membership representatives from all Palestinian political factions, private sector, and civil society organizations. The committee is mandated to come up with a "unified national action program". In his opening speech, the PA president declared that agreement among participants should be reached within 10 days; otherwise, he intends to take the issue to a national referendum.

(2) *The Israeli Side*

On the Israeli side, there is an urgent need for positive actions on three fronts: (1) the release of the Palestinian customs and tax money, (2) the easing up of restrictions that are suffocating Palestinian trade and Palestinians daily lives, and (3) the easing of access to humanitarian international organizations operating in the Palestinian territories.

On the first issue, and for both moral and practical reasons, a decision by the Israeli government to release the Palestinian revenues withheld since March would go along way to mitigate the current PA financial predicament, enable PA workers to receive at least part of their already three-month-overdue salary, and to inject badly needed cash in the moribund Palestinian economy to restore activities in dormant local businesses. Once the principle is accepted, the modalities can be worked out. Absent that action, largely recognized by international organizations and some members of the Quartet itself, the crisis will just continue to escalate.⁴⁰

Secondly, there is an urgent need for the gradual easing of Israeli-imposed restrictions on the movements of Palestinian people and goods, especially where Israeli security is not at risk. The Palestinian mobility question here is no less urgent than the issue of the release of Palestinian

⁴⁰ The Israeli cabinet decision on May 11, 2006 to release \$11 million (of the \$220 million in Palestinian tax money estimated to date to be withheld by Israel) for purchasing medicines and medical equipment "to ease the Palestinian humanitarian strain" falls way short of what is needed to help ease the crisis.

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frozen funds, and it is widely considered by all international organizations and development experts to be a vital measure to stop continued downward pressure on the Palestinian economy; as continued impediments to trade have devastated local business, led to high transaction costs, and discouraged private investment.⁴¹ A good place to start here would be to begin implementing the "Agreement on Movement and Access" reached between the PA and Israel on November 15, 2005.⁴²

Thirdly, international humanitarian organizations need to have direct unfettered access to the crisis-stricken communities in the West Bank and Gaza. It has always been a constant complaint by international staff that their ability to move freely in and out of the Palestinian territories has been hindered by unnecessary Israeli regulations related to access and operation. This has been a complicating issue in the past, and if it remains unresolved, could continue to cause unnecessary waste of much needed resources, increase human suffering, or even lead to losses of human lives at times of crisis.⁴³

⁴¹ According to latest OCHA report, and as of April 30th, the Erez border crossing, the main access point to both Palestinian workers and business people with valid permits to enter Israel, has been closed 73 days since the beginning of 2006 (i.e., 68% of the year); Karni crossing, Gaza's main commercial border crossing with Israel, to and, through it, to the West Bank and the rest of the world has been closed 58 days in 2006 (i.e., 53% of the year) with the average number of truckloads destined for exports are less than 4.5 daily; and the Sofa crossing, the main entrance point for construction materials to Gaza has been closed 48 days in 2006 (i.e., 44% of the year). See the United Nations Office for the Coordination of Humanitarian Affairs (OCHA) in the Occupied Palestinian Territory *"The Gaza Strip: Access Report, April 2006"*. The impact of this extended closure of Gaza commercial and business crossings with Israel has been specially devastating to the Palestinian private sector. According to the PA official in charge of Gaza border crossings "Textile factories have thrown 75,000 people out of work because they can no longer get their garments out. The rest of the economy was destroyed as a result of the closure of borders. A third of Palestinian industrialists have left for abroad. Twenty-two of the big Palestinian factories have sought a permit to move to Egypt or Sudan. Nineteen garment factories have closed in the past two months." The Guardian, *"How can people live, I wonder?"* (May 25, 2006).

⁴² This agreement, as stated before, was never fully implemented. For an assessment of the difficulties that faced its implementation, see, World Bank *"An Interim Assessment of Passages and Trade Facilitation"*, February 28, 2006, and the periodic biweekly reports by the office of the Special Envoy for Disengagement titled *"Report on the Implementation of the Agreement on Movement and Access"*.

⁴³ In its latest report, OCHA noted "At a time when humanitarian needs are greater than ever, access by humanitarian agencies in the past six months has become increasingly difficult. United Nations staff can no longer be guaranteed to get to their places of work. Checkpoints within the West Bank ... have become increasingly unpredictable ... Israeli Border Police enforce different and increasingly variable regulations ... [and] employ new restrictions and regulations that delay passage. UN staff are regularly being asked to adhere to different checking procedures despite previous agreements with the Israeli authorities. During period of closure, the movement of Palestinian staff [working with international agencies] is further restricted." See OCHA, *Territorial Fragmentation of the West Bank* (May 2006). These restrictions are not usually cost free, both in monetary and human terms. According to OCHA, for example, UNICEF was not able in April 2006 to get in essential medical and

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Continued inaction by Israel on these three vital short-term questions will exacerbate the Palestinian crisis, cause far more damage to the PA than the curtailment of direct foreign aid, and may, at the end, lead to the total institutional collapse of the PA government; a situation which will eventually, under the Fourth Geneva Convention, face Israel, as the occupying power, with its responsibility for the welfare of the Palestinian population.⁴⁴

(3) *The International Community*

As for the international donor community, probably the most vital issue that is of direct impact on the ongoing Palestinian financial crisis and how it will evolve in the immediate future in terms of its potential humanitarian consequences, is the question of "bypassing the PA" and the agreement on a limited resumption of essential humanitarian aid to be channeled directly to the Palestinian people through a "temporary international mechanism" endorsed by the Quartet in their recent meeting at the UN in New York.

On the bypassing issue, this paper has outlined the immense potential limitations of this approach when it is put into test in real life, and there is currently an almost unanimous consensus among those working in UN agencies and international NGOs of the near impossibility of avoiding the PA institutions when providing basic services to the Palestinian population. If left unresolved, the devastating consequences of continued lack of much needed financial resources to meet the Palestinian urgent human needs could reach levels unimaginable, probably far beyond what this paper and other recent reports have described.

It will be quite unfortunate if the current critical situation in the Palestinian territories is allowed to reach that level, threatening in the process long term vested interests of the donor community.

educational supplies, including refrigerators for vaccines, laboratory and office equipment for use in the Gaza Strip. UNRWA is paying \$78,000 a month in surcharge payments just because it can't send empty truck containers out through the Gaza Karni crossing. See OCHA, *The Gaza Strip: Access report, April 2006*. "This is a ridiculous waste of badly needed money", Gaza UNRWA director was quoted saying, "we'd rather use the money for food." New York Times "*Cuts make Palestinian lives even worse*" May 7, 2006.

⁴⁴ The Israeli general Ilan Paz was quoted as saying "if the Palestinian Authority collapses, we will not be able simply to stand there and look on. Approximately 3 million people are already on the brink of starvation, with anarchy and violence all around". In his estimates, it will cost the Israeli government more than \$2.5 billion a year to administer the Palestinian territories. See, Israeli Policy Forum, IPF Focus, "*Picking up Congress's Slack*," volume 4.18 (May 17, 2006).

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What is needed now more than anything else is a delicate balance between political and humanitarian consideration. This approach, if adopted, should lead to some adjustment to the newly established three-month humanitarian aid fund, by, for example, addressing the critical six issues raised about its purpose and structure by the World Bank in its report of May 7th in order to make the new temporary trust fund more responsive to deal with the humanitarian challenges posed by the current PA crisis without much costly delay.⁴⁵

Add to this concern, is the extent to which ongoing international efforts vis-à-vis the Palestinian humanitarian conditions might be closely coordinated to avoid any potential conflicting and contradictory policy measures to deal with the emerging crisis in the West Bank and Gaza.⁴⁶

VII. Concluding Thoughts: Long-Term View

The preceding section reflected on some of the short term measures that could be taken by the parties (Palestinians, Israelis, and the international donor community) in order to at least alleviate the deepening impact of the continued worsening living conditions in the Palestinian territories till a way can be found to deal with its political causes. But a discussion of this subject cannot be completed without reflecting on what is really at stake in the long run, since the current PA financial and humanitarian crisis has brought to the fore, like never before, the question of the almost total dependence of the Palestinian economy on foreign aid.

It was argued earlier in this paper that economic, financial and humanitarian conditions in the Palestinian territories were all showing unhealthy alarming signs even before the sudden arrival of Hamas to power, and that the situation in the West Bank and Gaza was only made worse as a

⁴⁵ At the time of writing this report, little is still publicly known on who will administer or oversee the trust fund— the World Bank, the IMF, or the UN? It is also not known how the money will be channeled— through international NGOs or through the PA president office. According to recent news reports, however, the new temporary international trust fund, based on a proposed plan by the European Commission, would disburse about \$30 million a month to three different channels: \$6 million to pay Palestinians' utility bill; \$7 million to meet non-salary expenses "essential health, education and social services"; and a third channel to directly pay salaries PA workers in selected sectors, pensions and other transfers. See "*Healthcare at top of EU plan to aid Palestinians*," Financial Times (May 21, 2006).

⁴⁶ Of immediate concern here is the passage on May 22, 2006 by the U.S. House of Representatives with a large majority (361-37) of the "Palestinian Anti-Terrorism Act of 2006 – HR 4681." As it stands, the bill, among other things, restricts U.S. humanitarian aid to the Palestinian Authority, including aid that goes to NGOs, and withholds U.S. dues to the UN by the amount that goes to UN departments working on Palestinian human rights. Although the bill still has to go through further deliberations and steps before it becomes a law, the potential adverse impact of such policy measures on the ongoing humanitarian crisis in the West Bank and Gaza cannot be underestimated.

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result of the way the elections outcome – and the subsequent unexpected change in the Palestinian political landscape – was received by Western donors and Israel.

Would a resolution of the current political impasse and a moderation of Hamas-led government position toward the Quartet three conditions bring an end to the developing crisis in the Palestinian territories? One would be very much tempted to answer affirmatively if one is to focus only on the immediate humanitarian aspects of the current financial crisis. But beyond that, a much careful consideration is needed.

According to "scenario one" of the World Bank reports of March 15 and May 7, 2006 quoted earlier in this paper, preserving the status quo, where Western aid, customs and tax revenues, and restrictions by Israel on Palestinian labor and trade movement are maintained at their 2005 levels, would not prevent Palestinian economic conditions from deteriorating. By 2008, the World Bank projects GDP per capita income - which has already declined by 30 percent during the past five years - to decrease by 5 percent in real terms; unemployment and poverty will increase by 11 and 7 percentage points respectively, reaching 34 percent of the workforce and 51 percent of the population.

This outcome should not come as a surprise. Since September 2000, as mentioned in section two of this paper, Western donors have doubled their annual financial assistance to the PA, from \$500 million to about \$1 billion a year, yet both unemployment and poverty rates in the West Bank and Gaza were at the end of 2005 three times higher than their pre-2000 levels.

The question that should be asked immediately here is: what has caused this apparent ineffectiveness of international aid to the Palestinian territories? And, more importantly, why does a PA that receives a hefty \$1 billion of aid package per year - unprecedented by international standards on per capita basis – continue to face trouble in paying the salaries of its 165,000 employees?

Under normal conditions, international aid of this magnitude to a relatively small economy with a population of approximately 4 million should have been enough to transform it over time to a

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self sustained economy. But since 1994, and in particular over the past five-and-a-half years, conditions in the Palestinian territories have been anything but normal.

Since 1994, a set of draconian measures imposed by Israel on security grounds have restricted Palestinian labor and trade movements and made the Palestinian economy to operate below its potential. Consequently, the PA was barely able on the eve of the second Intifada in September 2000 to finance its recurrent expenditure leaving the bulk of development activities for donor community financing.⁴⁷

In the turbulent years that followed, as violence and confrontation, high political instability, and a tightening of Israeli restrictions dominated the scene, Palestinian economic conditions rapidly worsened. Private investment plunged, Palestinian jobs in Israel fell to record lows, and poverty and unemployment in the West Bank and Gaza reached precarious levels. PA revenues dwindled as a result of the continued erosion of the domestic tax base and falling customs transfers, while pressure to provide basic services continued to rise, setting off recurrent budget deficits. International aid was subsequently deviated from development projects to fill the growing financing gap and to meet the humanitarian needs of an increasingly vulnerable segment of the Palestinian population.

At its core, then, the current Palestinian financial predicament is the product of a suffocating economic crisis that is deeply rooted in an extremely unfavorable political environment. Viewed as such, and in the absence of any real prospects for a political breakthrough, international aid can only help Palestinians to survive, without having a tangible impact on their economy.⁴⁸

⁴⁷ For a complete account of the Palestinian economic performance during the interim period (1994-1999), see the following five studies: Diwan, I., and Shaban, R., (eds.) *Development under Adversity: The Palestinian Economy in Transition* (World Bank and Palestine Economic Policy Research Institute, 1999); Alonso-Gamo, P., et. al, *West Bank and Gaza: Economic Developments in the Five years since Oslo*, (Middle Eastern Department, IMF, Washington, DC, 1999); Valdivieso, Rosa A., et. al, *West Bank and Gaza: Economic Performance, prospects, and Policies* (Middle Eastern Department, IMF, Washington, DC, 2001); UNCTAD, *The Palestinian Economy: Achievements of the Interim Period and Tasks for the Future* (Geneva, 2001); UNSCO, Report on Economic and Social Conditions in the West Bank and Gaza Strip, (quarterly publication during the 1995-2000 period).

⁴⁸ On the question of international aid effectiveness in the Palestinian context, an UNCTAD study in 2003 has shown how skewed Palestinian trade structure with Israel has caused a big chunk of foreign aid to the PA to "leak out" of the Palestinian domestic economy to Israel. According to the study analysis, large Palestinian trade deficit with Israel in 2002, both as a percentage of total trade deficit (70%), and as a percentage of GDP (45%), has, respectively, caused "some 70 per cent of donor funds to pay for Israeli imports", and "some 45 cents of every dollar

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Under these circumstances, and from a purely economic standpoint, it really matters little whether money – be it international aid or customs and tax revenues - continues to be delivered directly to a Hamas-led government or through some other means. In both cases, and if nothing else changes, the Palestinian economy will just continue to operate under stringent conditions and will continue its dangerous downward spiral as predicted by the World Bank analysis.

To their credit, Western donors have tried over the past two years to mitigate the Palestinian economic crisis by way of proposing technical measures. Examples include work by the World Bank, and, since June 2005, similar efforts by James Wolfensohn, the Quartet Special Envoy for Disengagement.⁴⁹ Unfortunately, these endeavors did not succeed to produce their expected output, largely because they were merely technical fixes, and not part of a wider comprehensive package designed to deal with the underlying root causes of the Palestinian economic quandary.

For international aid to make a lasting difference, donors discussion on the subject should transcend the color of the PA governing body, and actively address whether political and territorial realities as they exist today in the PA allow external aid to be used in a way that enables the Palestinians to transform their economy from one which is totally dependent on foreign assistance for survival, as is the case today, to a different economy capable of generating sustained growth rates to provide decent living standards for a rapidly expanding population.

Failing to address this fundamental question, the Palestinian fiscal crisis will just continue to worsen, in an endless vicious cycle: continued political conflict will lead to further instability and more restrictions, leading to further deterioration in the Palestinians' economic conditions, making it increasingly difficult for the PA government – led by Hamas or anyone else - to meet

produced domestically to be channeled to the Israeli economy.” Under these circumstances, it is difficult to see how donor funds injected in the Palestinian economy would have a noticeable domestic multiplier effect. “On the contrary,” the UNCTAD study concluded, “a positive income multiplier effect of these funds would be felt in the Israeli economy.” See UNCTAD, *International Support to the Palestinian People 1999-2000/2002-2003* (Geneva, July 2003)

⁴⁹ In addition to the set of technical reports on trade facilitation which the World Bank produced in 2005, the Bank has also produced three other technical studies related to the Palestinian economy : (1) Borders and trade logistics; (2) Industrial estates; and (3) Trade and exports. For more information see, the World Bank, *Stagnation or Revival? Israeli Disengagement and Palestinian Economic prospects* (December 2005.)

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the essential needs of the population, thus increasing Palestinian dependence on international handouts.

Clearly, this unsustainable situation with mounting human and economic toll cannot go on forever. International aid can help mitigate Palestinian suffering, but it will not end it; nor will it enable the Palestinian people to build a self sustained economy without first altering the conditions that underpin their current misfortune. Only a fair, negotiated political settlement will.