

Chapter 4

**THE POLITICAL ECONOMY
OF TAMING THE PALESTINIAN AUTHORITY**

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ABSTRACT

International donors have invested more than USD 34 billion in Palestine to support the Palestinian Authority's (PA) state-building process and promote peace between 1993 and 2016. Foreign aid was distributed based on World Bank-designed internationally-led state-building programs, which focused on economic stability and separated state-building from the larger political context. International state-building efforts resulted in the fiscal and economic integration of the Palestinian economy and the PA with the Israeli economy. The World Bank concocted economic programs that intertwined economic activity between Palestinian and Israeli institutions. It further encouraged the PA to rely on local revenue sources to finance its operations. However, the Authority's lack of territorial control, including borders, meant that Israel was responsible for the collection and distribution of most of the PA's

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fiscal resources. Consequently, more than 80 percent of the PA's fiscal resources originated from clearance revenue or foreign aid and, as such, were controlled by Israel or international donors respectively. This chapter discusses the evolution of the PA's dependence on external sources of income. It investigates the role of the World Bank in shaping the current fiscal structure of the PA and the economic interconnectedness of the Palestinian and Israeli economies. The chapter also explains how Israel's control over the majority of PA's fiscal resources has undermined its fiscal sustainability and independent decision making. It finally argues that internationally-led state-building efforts created PA institutions that were designed to operate only within the political context of Israel's occupation.

Keywords: Palestinian Authority, state-building, political rents, clearance revenue, fiscal sociology

INTRODUCTION

International donors have invested more than USD 34 billion in Palestine to support the Palestinians Authority's (PA) state-building process in East Jerusalem, the West Bank, and Gaza, and promote peace between 1993 and 2016. The World Bank and a handful of donors steered the distribution of these funds and implemented several transformational initiatives as part of an externally driven and complex international state-building process. This process started in 1993 with the Oslo Accords, but continued after the collapse of talks between the PA and Israel in 2000. The process undertook various themes that satisfied the conditionalities and vision of the World Bank and other donors. At the receiving end of this investment, the PA underwent a case of perpetual state-building that manifested in two clear waves of internationally-led institution and capacity building; neither wave, however, succeeded in granting the PA local legitimacy, achieved economic development, or built a financially sustainable government. These waves were necessary for the PA's political survival in the short term, but this chapter's main argument is that these waves created institutions that were designed to thrive in a context where a sovereign state was absent and nascent Palestinian institutions

economically integrated into Israel. More importantly, the PA's revenues were designed in a manner that accentuated its dependence on external income and ensured the PA's continued reliance on Israel.

First, the chapter will provide a short discussion on the theoretical understandings of internationally-led state-building and the resultant "state" in the Palestinian case. It will also demonstrate the importance of studying the fiscal compositions of states in order to understand their socio-political and economic development. Second, the chapter will display the evolution of the PA's fiscal composition and hypothesise foreign aid and clearance revenue as two sources of external income for the PA. Third, the chapter will attempt to investigate the role of the World Bank in designing and implementing the international "state-building" objectives that gave rise to the PA's economic and fiscal dependence on Israel. The fourth section discusses the PA's ability to entice economic development within a framework of World Bank-led international state-building. It will explore whether this process has reaped tangible economic benefits for everyday Palestinians. The final part of this section will examine the outcomes of the fiscal reforms advocated by the World Bank and the impact that these have had on the PA's financial revenues. It will interrogate whether Israeli influence over PA finances has driven a wedge between the PA and Palestinian national interests.

The State, International State-Building, and External Income in Palestine

Defining the state in Palestine (East Jerusalem, the West Bank, and Gaza) can be addressed from two perspectives: the first analyses the internationally-led state-building efforts in establishing, designing, and financing the PA since 1993, whereas the second explores scholarly literature on the classification of the PA. Deborah Brautigam (2008, 2) defines state-building as "the process of increasing the administrative, fiscal and institutional capacity of governments to interact constructively with their societies and to pursue public goals more effectively." Mark

Berger (2006, 6) defines international state-building, however, as “an externally driven, or facilitated, attempt to form or consolidate a stable, and sometimes democratic, government.” Berger (2006) delineates international state-building to encompass peacebuilding, conflict resolution, national construction, and international aid under the auspices of major international donors, such as the United States (US) and European countries, or international or regional organisations, such as the World Bank and the International Monetary Fund (IMF). Accordingly, the international state-building process in Palestine has been fostered primarily by the World Bank and international donors, predominantly the US and European countries, to create and sustain the PA.

Andres Persson (2018, 435) argues that internationally-led state-building efforts are composed of three broad objectives: a security objective where security sector reform and the monopolisation of violence by the state are the main components; a political objective with democracy promotion and state legitimacy as the main goals; and an economic objective which focuses on economic development through good governance, fiscal conservatism, and economic liberalisation. In the Palestinian case, the security objective has received excessive attention in the literature and from development practitioners alike. It must be highlighted, however, that most of the state-building literature emphasises the importance of prioritising security settings for its arguably positive role in providing conducive conditions for achieving any sort of positive political or economic development (Persson 2018, 435). This premise has formed the basis for the internationally-led state-building approach towards the PA from the start of the Oslo process. As Persson (2018, 426) further illustrates: “The belief in the U.S. and Europe has traditionally been that only when the Palestinians were able to guarantee their own security and the security of Israel would Israel be ready for a major withdrawal from the West Bank.” Thus, more than 30 percent of the total foreign aid disbursed to Palestinians between 2007 and 2017 was devoted to the security sector (Taghdisi-Rad 2010; UNCTAD 2010). Many scholars, including Dimitris Bouris (2012), Brynjar Lia (2007), Jeffrey Monaghan (2016), Yezid Sayigh (2011), and Alaa Tartir (2017) have provided a detailed review of

the development and evolution of the Palestinian security sector and the outcomes of aid securitisation in the Palestinian context. There seems to be a consensus regarding the detrimental implications of this approach vis-à-vis human rights, political pluralism, and Palestinian independence. Above all, the fixation of internationally-led state-building efforts on security has resulted in little development on both political and economic fronts, as will be discussed later in the chapter.

The second perspective on defining the state in Palestine addresses the view of scholarly literature on the classification of the PA. On the one hand, Shibley Telhami (2001), Nu'man Kanafani (2011), Nathan Brown (2003), and Brynjar Lia (2006) question the contextual setting of the internationally-led state-building of the PA and argue that this process contradicts the foundational premises of state-building since the PA lacks sovereignty over territory. On the other hand, Rex Brynen (1997), Alaa Tartir and Sam Bahour (2013), Ali Jarbawi (2007), and Jeff Halper (2006) criticise the internal course of the process citing fragmentation, authoritarianism, neopatrimonialism, and aid dependence as its only outcomes in lieu of a state. Other scholars, such as Ammar Ad-Duweik (2013) and Assem Khalil (2013), view the PA as part of a larger political system with partial sovereignty, but one that exercises powers within limited existing legal and constitutional frameworks. Finally, Ghada Al-Madbouh (2017) classifies the PA as a 'quasi-political system' to bypass the fact that the foundations of the political system in Palestine are troubled by a unique set of internal mechanisms, such as factional competition between Fatah and Hamas, and external influence, such as the Israeli occupation and aid dependency.

These arguments examining international state-building efforts and the nature of the resultant "state" in Palestine are largely based on a mixture of two main conceptions of modern understandings of "the state". The first is a Weberian conceptualisation, where the state is viewed as a "corporate group" that successfully monopolises the legitimate use of force over a territory (Weber 1964). The second conception focuses on juridical statehood in accordance with the 1993 Montevideo Convention, where a state has "a permanent population", "a defined territory", "an effective

government”, and the “capacity to enter into formal relations with other states” (Grant 1999, Einsiedel 2005). Although both conceptions largely shape ideas about the modern state, their approach emphasise the state’s means instead of its ends (Bizhan 2017, 3). Both views stress the importance of the state’s organisational means rather than the functions it performs or the motives that drive the state’s governing-elites (Moore 2001, 399). Both perspectives, however, understate the importance of the state’s revenues in driving policy and building legitimacy. Joseph Schumpeter and Rudolf Goldschmidt were, perhaps, the first to identify this gap and to argue for the central role a state’s revenues and taxation play in “driving socio-economic changes” (Moore 2001, 399). Schumpeter claims that the extraction of tax revenue has a consequential influence on the economic organisation and social structures of states. He argues that “the study of the social processes behind taxation and public finances, that is, fiscal sociology, is one of the best starting points for an investigation of society, and particularly its political life” (Campbell 1993, 163).

The literature on fiscal sociology asserts that different sources of revenue produce different implications on the evolution, development, and behaviour of states. This claim is supported by a wealth of scholars including Hussein Mahdavy (1997), Mick Moore (2004), Hazem Beblawi (1987), Giacomo Luciani (1987), Odd-Helge Fjeldstad (2008), Deborah Brautigam (2008), and Margaret Levi (1988), who also identify that contemporary states can rely on two major sources of revenues: taxes and external income (rents). A state that derives the majority of its revenue from taxation is generally referred to as a “tax state”. On the other hand, a state that derives the majority of its revenue from external income is generally described as a “rentier state”. Moore (2004, 305) defines the state’s external income as “surplus that can accrue to governments or to other organizations exercising effective territorial jurisdiction by virtue of either them as legitimate territorial authorities, even if the reality on the ground does not quite correspond.”

External income has been shown to affect receiving states in two ways. The first suggests that external income hinders economic development by altering the economic structure of the state. External income negatively

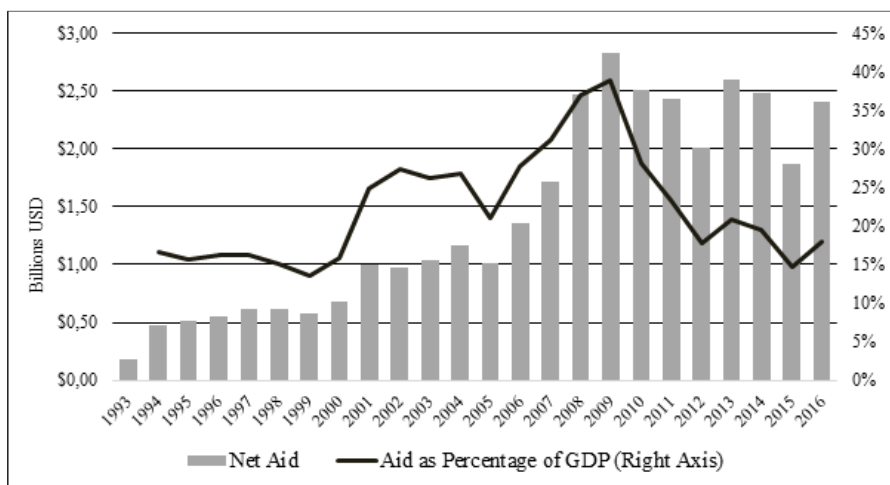
affects economic diversification and economic growth and promotes short-term expenditure policies in lieu of sustainable development. The second way external income affects receiving states is through facilitating the rise of a number of “political pathologies” as coined by Moore (Moore 2004, 306). These include hindering the political evolution of the state to a representative form of governance, state autonomy from its citizens, authoritarianism, susceptibility to external intervention, non-transparency in public expenditure, and ineffective public bureaucracy.

Levi (1988, 1) notes that “the history of state revenue production is the history of the evolution of the state.” Based on this assumption, this chapter argues that existing literature on the PA and its state-building trajectories under-address a basic tenet for the evolution of any political entity. That is, current literature bypasses the importance of studying how the PA’s reliance on external income influences its decision making processes and the outcome of its efforts at state-building. The subsequent sections argue that internationally-led state-building efforts since 2007, mainly as propagated by the World Bank and elucidated throughout this chapter, resulted in the creation of an authority that is mostly dependent on two main external sources of income: foreign aid and clearance revenue. It is common for the literature on Palestinian state-building to cite the PA’s dependence on foreign aid as a major source for its fragmentation, ineffectiveness, and authoritarianism. However, the literature overlooks the role of the World Bank and foreign aid in constructing the PA’s overall revenues to perpetually depend on the Israeli government and Israel’s economy. Consequently, the impact of the PA’s reliance on Israeli controlled clearance revenue is rarely investigated.

IDENTIFYING EXTERNAL INCOME FOR THE PA: FOREIGN AID AND CLEARANCE REVENUE

Foreign aid played a central role in the creation of the PA. Taking into account the small geographic area and low population of Palestine, foreign

aid to the Palestinians could easily be described as one of the largest multilateral funded projects since the Second World War. For example, international state-building efforts from 1993 to 2000 made Palestinians the highest per capita foreign aid recipients in the world (Brynen 2000, 78). Annual disbursements increased from USD 180 million in 1993 to more than USD 680 million in 2000. Foreign aid levels continued to climb between 2000 and 2006, but their value reached unprecedented levels after 2007. As Figure 1 illustrates, foreign aid jumped by around 200 percent between 2005 and 2009 to reach USD 2.8 billion and amount to a whopping 40 percent of Palestinian GDP.



Source: Author's calculations from data available by World Bank (December 2018).

Figure 1. Total Foreign Aid Disbursed in Palestine 1993-2016.

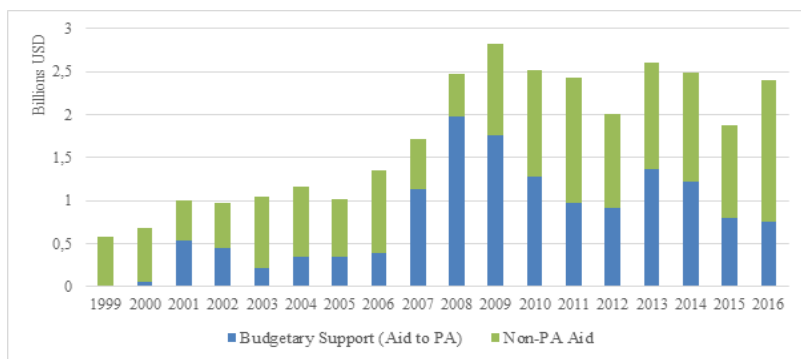
Between 1993 and 2016, Palestinians received more than USD 34 billion in foreign aid. During this period, Palestinians continued to be one of the largest aid recipients per capita in the world.

Palestinians, for example, were the highest foreign aid recipients per capita in the world in 2014; at USD 587 per capita, this was significantly higher than the average per capita foreign aid received in the Middle East and North Africa region at USD 92, fragile and post-conflict areas at USD 70, or the world average at USD 22 (World Bank 2018). It is imperative to

mention that most of foreign aid disbursed in Palestine after 2007 was expended in the West Bank. After the political, economic, and administrative fragmentation of the West Bank and Gaza in 2007, the international donors and the PA have been strict about channelling foreign aid into the Gaza Strip (Dunning 2016, Baconi 2018).

Aid delivery in Palestine is divided into two segments: the first is direct budgetary support where donors transfer funds to finance the PA’s budget; the second is represented by development and humanitarian assistance that is channelled independently of the PA and through the Palestinian civil society sector. When the PA was established in 1993, donors envisioned that their funds would finance developmental and humanitarian projects independent of the PA.

In particular, the World Bank worked on reducing the PA’s budgetary reliance on foreign aid by encouraging the PA to minimise expenditure and to rely on local sources of revenue. As a result, the PA’s budget in 1999 was financed entirely from local revenue sources as illustrated in Figure 2. However, as Figure 2 also highlights, the PA’s budget has since been a major destination of foreign aid disbursements. For example, over 80 percent of foreign aid received in 2008 was destined to the PA’s budget (Iqtait 2017).



Source: Author’s calculations from data available by World Bank and IMF (December 2018).

Figure 2. Foreign Aid Disbursements in Palestine 1999-2016.

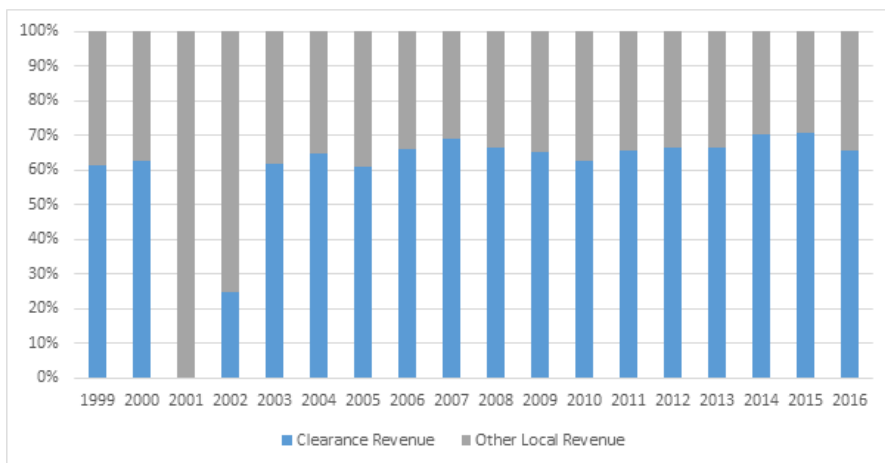
Although the PA's budget was a major destination for donor aid, large sums were disbursed independent of the PA. Non-PA aid in Figure 2 refers to aid that was disbursed through international organisations, such as the World Bank; international NGOs, such as Save the Children; and the developmental agencies of donors and their subsidiaries, such as USAID. But, perhaps, the largest recipient of aid after the PA was the Palestinian civil society sector.

CLEARANCE REVENUE

Besides foreign aid, the PA's other major source of external income is clearance revenue. The revenue is a direct outcome of the Oslo Accords, which instilled a legal-framework for Palestinian economic activity and economic relations with Israel and the rest of the world (Roy 1999, 68). The Paris Protocol, formally known as the 'Protocol on Economic Relations between the Government of the State of Israel and the P.L.O.', was signed in 1994 as an annex of the Oslo Accords and addressed, in detail, various topics regulating future Palestinian–Israeli economic relations (The Oslo Accords 1994). Most notable areas covered by the Paris Protocol include import taxes, import policy, direct taxation, labour, and industry.

The Paris Protocol was originally envisioned to serve the purpose of regulating economic relations between the PA and Israel for an interim period of five years; it, therefore, fundamentally inhibited the PA from exercising sovereignty over economic policy. It formally liberalised trade between the two entities, unified Value Added Taxes (VAT) rates, and generally imposed a shared external tariff on imports. While these measures have largely been in place since 1967, the Protocol additionally introduced the clearance revenue mechanism by which Israel and the PA collect various taxes in areas under their respective control. The most prominent component of clearance revenue has evolved to be custom duties and VAT collected by Israel from Palestinian traders, whereby Israel remits these taxes to the PA on a monthly basis after extracting a three

percent administrative fee (Iqtait 2018). Clearance revenue represents the vast majority of available local revenue to the PA. As illustrated in Figure 3, about 70 percent of the PA’s total local revenue is accrued from clearance revenue.



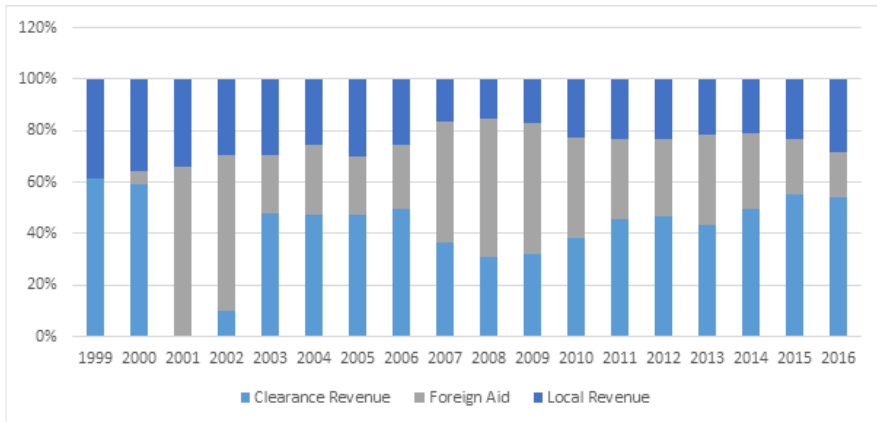
Source: Author’s calculations from data available by World Bank and IMF (December 2018).

Figure 3. Palestinian Authority’s Local Revenue 1999-2016.

Clearance revenue is classified as external income for two reasons. The first is Israel’s complete control over the collection, processing, and transfer of this revenue. The second being the PA’s lack of institutional capacity and sovereignty to independently collect this revenue. Although this revenue is collected from Palestinian traders and the Paris Protocol unambiguously grants it to the PA, Israel has repeatedly obstructed its flow to the PA’s coffers. Israel has withheld the transfer of clearance revenue to the PA for a cumulative period of more than four years since 1997 (Iqtait 2017). The most notable incidents were in response to the Second Intifada in 2000, following Hamas’ win in the 2006 legislative elections, and in retaliation for the PA’s bid for international diplomatic recognition after 2011. Each time the revenue was suspended, the Palestinian economy suffered damaging consequences, and undercut the PA’s ability to pay its employees and meet its financial commitments (Iqtait 2018).

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Foreign aid and clearance revenue make up on average 80 percent of the PA's annual expenditure. Figure 4 displays the evolution of this dependence since 1999, and highlights the PA's increasing reliance on external income. In 2016, 54 percent of the PA's budget was composed of clearance revenue, 18 percent of foreign aid, and 28 percent of local, PA collected tax revenue. The PA's dependence on clearance revenue and foreign aid reflects its limited ability to raise taxes or other sources of revenue from the local population, particularly in the West Bank where the PA has control over the majority of the population. According to the PA's Ministry of Finance, only 30 percent of the tax base in the West Bank and Gaza is covered. The subsequent sections will highlight how the World Bank helped create this structure, and how Israel exploits it against the PA.



Source: Author's calculations from data available by World Bank and IMF (December 2018).

Figure 4. Palestinian Authority's Fiscal Composition 1999-2016.

THE WORLD BANK'S ROLE

The PA has experienced two major waves of internationally-led state-building. The first wave laid the institutional foundations for the PA's government during the Oslo Accords era from 1994 to 2000. The second was synonymous with PA Prime Minister Salam Fayyad's reforms and

state-building agenda from 2007 to 2013. Both waves were orchestrated by the World Bank and emphasised the importance of security and economic achievements, through security coordination with Israel and economic integration with the Israeli market. At the epicentre of each wave was the PA's financial viability as a self-sustaining governing body capable of performing externally prescribed security and economic duties.

The first wave of international state-building began after the Oslo Accords and the creation of the PA in East Jerusalem, the West Bank, and Gaza. Immediately after the Accords were signed, the international community, represented by major international donors, and the Oslo Accords sponsors such as the US and European countries, delegated to the World Bank the responsibility to lay the technical blueprints for establishing the PA's governing institutions. This resulted in a series of reports between 1993 and 1994 that proposed comprehensive institution-building programs for creating a functioning government in the West Bank and Gaza and to "provide tangible benefits to the Palestinian population quickly, equitably, and efficiently, while laying the foundation for sustainable development over the long-term" (World Bank 1994). In April 1994, the World Bank issued the Emergency Assistance Program for the Occupied Territories (EAP) to serve as a procedural framework for establishing the PA. The World Bank specified two objectives for the PA: the first was to continue the negotiation process with Israel as postulated in the Oslo Accords; the second was to provide emergency economic assistance to the Palestinian population.

The World Bank's vision was not to create a "state" but to introduce "self-rule" or "self-government", as defined by the World Bank, over a portion of the Palestinian population residing in the West Bank and Gaza (World Bank 1994). At the time, Israeli-Palestinian negotiations were viewed as the primary goal, and the by-product of the process was the establishment of the PA as a tool for achieving the World Bank's prescribed economic and security objectives. Accordingly, the World Bank's essential role in forming the PA did not translate to the creation of political institutions necessary for sustaining self-government, nor the creation of a state. Guiding this approach was an ideological belief among

World Bank staff that economic wellbeing induced political stability and, as such, economic prosperity was more important than building the capacity and structure of a central authority (Frisch and Hofnung 1997). These ideals could have been informed by the largely discredited modernisation theory of the 1950s and 1960s, whereby economic growth was suggested to be both a cause and effect of the institution of democracy (Tippis 1973). This approach was also influenced by institutional neoliberalism, whereby neo-colonial relations of production and exchange buttress liberal economic models that proselytise individualism and state minimalism (Khalidi and Samour 2011). Not surprisingly, Abdallah Bouhabib (1994), the Middle East Advisor to the World Bank, summarised his organisation's approach thus: "this particular program has a political element insofar as it is particularly important in this case for the people to see very early that their [economic] situation will improve because of peace."

By 1999, PA institutions were largely built according to World Bank design with donor financing. However, when the Second Intifada erupted in 2000, the PA became an open target for Israeli military operations in the West Bank and Gaza. In the years following, PA institutions were systematically dismantled by Israel leading to the financial and administrative collapse of the Authority. Subsequently, the World Bank viewed the PA's collapse as an opportunity for a second wave of "state-building". Between 2002 and 2007, several rounds of reforms were suggested but resulted in little success. Nonetheless, after Salam Fayyad was appointed Prime Minister in 2007, the World Bank glimpsed an opening to implement their economic programs independent of the political process with Israel or the needs and aspirations of ordinary Palestinians.

Salam Fayyad, a former IMF and World Bank economist, first entered the PA when former PA President, Yasser Arafat, appointed him as Finance Minister in 2002. Fayyad who was an international community favourite for his putative political independence, demanded autonomy to restructure Palestinian financial records and integrity. He presented an alternative to the shadowy administrative practices that were rampant

during the early years of the PA. During his first year as Finance Minister, Fayyad disclosed the diversion of USD 900 million of funds by the PA to personal accounts (Bennett and Nashashibi 2003). He started to centralise the PA's financial public records, convinced Arafat to disclose personal secretive accounts of the PA, and spearheaded the financial and fiscal reformation of the PA. Following the 2007 factional division between Fatah and Hamas - and the consequent geographical, administrative, and political split of the West Bank and Gaza – PA President Mahmoud Abbas appointed Fayyad as both Prime Minister and Finance Minister of the PA. Fayyad's appointment was received feverishly by western donors, which soon pledged USD 7.4 billion in foreign aid to Palestinians, largely to the PA and the West Bank, between 2008 and 2011 (Mohammed and Murphy 2007).

After securing international financial support, Fayyad launched his government's program: 'Palestine – Ending the Occupation, Establishing the State' (Palestinian Authority 2009). The 13th Government Plan, as it became locally known, presented practical, measurable, and transparent institution-building objectives. The plan was considered a breakthrough for two reasons. The first was related to the PA's routine administrative policies. Since 1994, the PA was directed by Presidents Yasser Arafat (1994-2004) and Mahmoud Abbas (2005 – present), both strong men who favoured patrimonial, cliente list, and personalised relations to effective governance (Amundsen and Ezbidi 2002, Høigilt 2016). Fayyad's proposed program was to fundamentally change the PA's governance in favour of effective bureaucracy and minimal personalisation. Second, Fayyad's plan marked an ideological shift in that it unambiguously proposed 'state-building' before liberation (Bouris 2013; Khalidi and Samour 2011). Previously, the PA's objective was to provide economic sustenance to Palestinians in East Jerusalem, the West Bank, and Gaza while negotiating with Israel to establish a Palestinian state. Fayyad's proposal, however, altered the discourse of Palestinians' right of statehood from historical claims towards Palestinian institutional readiness to establish a state (Broning 2011, 99-102).

Although Fayyad was driven by strong convictions vis-à-vis state-building and Palestinian statehood, the World Bank's supervisory role in shaping his government's outcomes were nothing short of full international trusteeship (Khalidi and Samour 2011). The PA was put under strict measures to satisfy Israel's security objectives (Pugh 2012). Foreign aid disbursements aimed at building PA institutions were contingent on the PA's collaboration with Israel in security and economic fields. The World Bank's new mandate, therefore, separated this wave of state-building from the larger political context. This meant that Israeli-Palestinian negotiations, or lack thereof, had little relevance to the internationally-led state-building process of the PA. This approach created PA institutions that were designed to operate only within the political context of Israel's occupation. Paradoxically, Fayyad's state-building agenda created institutions that thrived in a context where a sovereign state was absent.

ECONOMIC AND FISCAL INTEGRATION

The World Bank and other donors played a key role in concocting the economic relationship between the PA and Israel after the Oslo Accords. The Paris Protocol technically established a de facto customs union area, resembling partial elements of free trade agreements and a single common market (Hamed and Shaban 1993, Arnon 2007). As mentioned earlier, the agreement was originally envisioned to serve the purpose of regulating economic relations between the PA and Israel for an interim period of five years. However, the Protocol has superseded its intended timeframe and continues to dictate economic interactions between Palestinians and Israelis.

There is a general agreement amongst policy makers and academics regarding the negative impacts of the Paris Protocol on the Palestinian economy (Roy 2007, Koldas 2007, Samhoury 2016). Most prominent arguments tackle the asymmetrical economic structure shaping the relationship between the PA and Israel. The Paris Protocol adopted a liberal 'peace-time' economic framework among economies of similar

economic development levels, and each possessing individual sovereignty (Alonso Terme and Kattan 2010). However, the Palestinian economy was characterised by under-development, dependence, and fragmentation. In this regard, the Palestinian economy's dependence on the Israeli economy was a by-product of Israeli economic policies since 1967. This can be best described by a multi-structural sectoral dependence of international trade, means of production, labour flows, productivity, fiscal revenues, and energy supplies. A concrete example of this dependence is the fact that Israel is the biggest trade partner of the Palestinian economy – at least 83 percent of Palestinian exports were destined for, and 58 percent of imports originated from, Israel in 2016 (PCBS 2016). This dependence extends to electricity and energy supplies, healthcare provision, international travel, raw materials, and Palestinian labour. Israeli markets, for example, absorbed at least 16 percent of the Palestinian labour force in 2016 (ICBS 1996).

Internationally-led state-building did little to address these multi-structural sectoral imbalances that characterised Palestinian-Israeli economic relations. On the contrary, the Palestinian economic situation deteriorated after each round of international intervention and injections of foreign aid. Even though the World Bank has monitored the disbursement of at least USD 34 billion in aid since 1994, there is a general agreement among researchers that aid has failed to achieve sustainable economic development in Palestine (Barghouti 2011, Hanieh 2016, Khalidi and Samour 2011, Le More 2008, Roy 1999). Major macroeconomic indicators do not demonstrate any linear relationship between sustainable economic performance and the billions of dollars in foreign aid received. Growth rates have been volatile, and unemployment is consistently estimated at 25%. Palestine is one of the worst places in the world to work; public and private debts have reached unprecedented levels; 25% of Palestinians live in poverty; 80% of Gaza's population is aid dependent; and 50% of Palestinians are food insecure (ITUC 2014, WFP 2010, World Bank 2015). The only economic growth achieved has been in the West Bank and this has largely been a jobless growth coming off a low base after the devastating effects of the Second Intifada of 2000, driven by private

consumption, and fuelled by bank borrowing and one-off public expenditure projects. Furthermore, the Palestinian economy is aid driven, suffering from aid-induced inflation, with deteriorating living conditions, and just surviving under the Israeli occupation.

The policies of the World Bank and other donors, moreover, have led to an unsustainable economic structure consisting of 33 percent of GDP originating from services, public administration, and security sectors, and employing more than 50 percent of the Palestinian workforce. Public sector growth has accounted for most of the growth in domestic employment since 1994, and this mostly occurred in the security sector (RAND 2007). In this context, the core functions of Palestinian governmental institutions are to provide civil and legal administration to the Palestinian inhabitants of the West Bank and Gaza - and largely the West Bank only after 2007 - while ensuring the security of Israelis (Khan 2004). Accordingly, Palestinian governmental institutions established through foreign aid have facilitated the expansionary policies of the Israeli occupation and transferred the cost of the occupation to the international community.

Although the general economic conditions have not improved for everyday Palestinians, the World Bank and donors cemented the integration of the Palestinian economy into the Israeli one. A prime example of this accelerated integration is best showcased by joint Israeli-Palestinian industrial zones in the West Bank. These zones are: Bethlehem Multidisciplinary Industrial Estate, Jenin Industrial Free Zone, Tarqumia Industrial Estate, and Jericho Agro-Industrial Park. Each industrial zone received special sponsorship from donors such as France, Germany, Japan, Turkey, and the World Bank (Dana 2015). The zones also received Israeli approval, promotion, and supervision in the fields of import exemptions, industrial standardisation, site development, construction, and management. According to the World Bank, these zones would provide Israelis with the opportunity to invest in the West Bank, access cheaper Palestinian labour, and provide Israeli goods with free access to Arab markets under the label of 'Made in Palestine' (World Bank 2012). At the receiving end, the PA has also played an active role in implementing and

promoting these projects citing their economic development potential as justification (Palestine National Authority 2019).

Another example of the PA's economic integration with Israel is the economic and infrastructural projects funded by donors and planned, implemented, and inaugurated jointly between the PA and Israel. One such project was the Allenby Bridge crossing between the West Bank and Jordan. The crossing underwent an extensive upgrade between 2012 and 2017, facilitated by Israel, Jordan, and the PA. Germany, the Netherlands, and the United States provided the required funding and technical support to aid the project including the construction of new passenger facilities and the installation of cargo scanner equipment (Quartet 2012). Other examples of heightened PA economic integration with Israel involve agreements regarding electricity supply, as well as water and sewage treatment infrastructure. Senior Palestinian Authority officials (including the Prime Minister, Economic Minister, and Finance Minister) and Israeli officials (including the Finance Minister and Israeli military commanders) regularly presided over the inauguration of these projects in joint ceremonies.

In addition to institutionalising the asymmetrical economic structures between the Palestinians in the West Bank and Gaza and Israel, the policies of the World Bank and other donors, coupled with the PA's cooperation, resulted in the creation of a fiscally dependent PA structure. The PA's dependence on clearance revenue grew significantly under the tenure of Salam Fayyad. His World Bank sponsored reforms pushed the PA to rely less on international aid and more on local sources of revenue. Thus, clearance revenue's share of the total PA budget grew from 31 percent in 2008 to 54 percent in 2016, and its total value increased by 120 percent during the same period (Iqtait 2018). Although empowering the PA to rely on local sources of revenue is sound economic policy, Israel's total control over the processing and distribution of clearance revenue, as discussed earlier, undermined the PA's fiscal sustainability and independent decision making.

Table 1. History of Suspension Transfer of Clearance Revenue by Israel

Suspension Period	Declared Reason	Estimated amounts withheld (In US dollar millions)	Total period (In months)
August to September 1997	Deterioration in security and political conditions, and bombings in Jerusalem.	78	2
December 2000 to December 2002	The outbreak of the Second Intifada in September 2000.	500	24
March 2006 to July 2007	Hamas's electoral victory in Palestinian Legislative Council, and formation of government.	1100	16
May 2011	PA and Hamas national reconciliation agreement.	100	1
November 2011	PA's application at UN to upgrade Palestine to a member state; and UNESCO admission of Palestine.	100	1
December 2012 to March 2013	PA's successful bid at UNGA to upgrade Palestine status to non-member observer state.	400	4
December 2014 to April 2015	Palestine accession to the Rome Statute of the International Criminal Court.	500	5

Source: Author's Analysis, and Kock and Qassis (2012).

Table 1 illustrates Israel's utilisation of clearance revenue since 1997. The most recent example of suspending the revenue occurred after the PA decided to join the jurisdiction of the International Criminal Court (ICC) in 2014. Israel retaliated against the PA's decision by withholding the transfer of clearance revenue for a total period of five months. During this suspension, the PA paid its public servants 60 percent of their monthly salaries; failed to fund its operational expenses; accumulated a large amount in arrears to the Palestinian private sector; and was unable to secure funding from local banks (New York Times 2015, Reuters 2015).

The PA's accession to the ICC is a prominent example of how Israel's control over clearance revenue has altered PA policy and decision making. Joining the ICC was a core tenet of the PA's internationalisation strategy, which was launched by PA President Mahmoud Abbas in 2011 to obtain international recognition with the aim of declaring a Palestinian state. Israeli threats to suspend clearance revenue transfers, however, forestalled the PA's accession to the ICC. Israeli tactics also limited the PA's ability to effectively utilise the ICC to investigate potential violations of international law in Palestine.

In 2009, the PA's Minister of Justice, Ali Khashan, lodged a declaration recognising the jurisdiction of the ICC "for the purpose of identifying, prosecuting and judging the authors and accomplices of acts committed on the territory of Palestine since 1 July 2002" (United Nations 2009). The ICC prosecutor responded to the PA's request in April 2012. It concluded that Palestine did not meet the preconditions for the ICC to exercise jurisdiction, because Palestine's status at the United Nations had only been recognised as a *non-state observer entity*, and not as a *non-member observer state* (ICC 2012). Therefore, PA officials and Palestine observers expected Abbas to immediately join the ICC after Palestine's status at the UN was upgraded in November 2012. These figures included senior members of Abbas' own government, such as Foreign Minister Riyad al-Maliki, who stated in 2012 that the PA was moving towards pursuing litigation against Israel at the ICC (Reuters 2012). However, Abbas shelved the idea, and decided to postpone lodging the necessary paperwork to join the ICC in 2012.

Abbas' decision was met with fierce criticism and wide condemnation by Palestinians, even among senior PA officials. One such critic was PA chief negotiator Saeb Erekat. In 2014, Erekat accused Abbas of backpedalling on his internationalisation foreign policy and succumbing to Israeli and American pressure (Arab Forty Eight 2014). Other senior members of the PA expressed similar concerns, doubting "the merits of self-limitation". However, Abbas's reluctance to join the ICC immediately after the UN upgrade could have been motivated by the PA's reliance on clearance revenue.

To this end, Israel demonstrated its disapproval of the PA's internationalisation policy when it suspended clearance revenue transfers for four months, starting from December 2012 after Palestine's status was upgraded at the UN (UNCTAD 2015). Israel's suspension of clearance revenue in 2012 sent a strong signal to Abbas that would shape his future decisions. It is clear that PA officials have a sober understanding of the limitations of their international relations policy given current economic considerations, whereby the Palestinian economy is dependent on Israel. In this case, the PA's strategy vis-à-vis the ICC was adjusted to accommodate or minimise any Israeli retaliation, i.e., in the form of suspending clearance revenue.

When Abbas decided to lodge the necessary paperwork to submit Palestine to ICC jurisdiction in December 2014, a decision that was probably inspired by Israel's fierce war with the Gaza Strip in 2014, Israel, as expected, suspended clearance revenue transfers for four months. In a clear example of Israel's influence over PA policy, clearance revenue transfers only resumed after the PA agreed to abandon legal action against Israel at the ICC. Such legal actions included investigating alleged Israeli war crimes in Gaza during the 2014 Gaza-Israel conflict, and Israeli settlement construction in the West Bank (Jerusalem Post 2015). The PA also agreed to continue its security cooperation with Israel in exchange for Israel's transfer of clearance revenue. It took the PA three years to refer the issue of international law violations in East Jerusalem, Gaza, and the West Bank to the ICC in May 2018 (ICC 2018).

The ICC case demonstrates the undermining of the PA's ability to represent Palestinian national interests or lead an independent government. Nonetheless, clearance revenue plays a vital role in sustaining the PA's operations in the West Bank and Gaza and meeting basic economic necessities. The revenue, for example, covered the salaries of most of the PA's 180,000 public servants of USD 2.5 billion in 2017 (Iqtait 2018). Furthermore, the PA's governmental expenditure is the largest economic driver in the Palestinian economy, and clearance revenue fuels nearly 60 percent of such expenditure. In this regard, the fiscal reforms imposed on the PA during the second wave of institution-building enhanced the PA's

ability to sustain the Palestinian economy, but undermined its ability to lead an independent policy by entangling PA finances with Israel.

CONCLUSION

The arguments presented in this chapter showcase how the PA was created to operate functionally only under an environment dominated by Israel. The World Bank and international donors orchestrated two distinct waves of international state-building with the PA at the epicentre of each wave. The outcome of this process was an authority that is dependent on external income and lacking control over nearly 80 percent of its revenue. The theoretical section argued that scholars of the Palestinian economy have overlooked the impact and evolution of the composition of PA's revenues. External income was shown to have detrimental economic and political consequences on the receiving political entity. The subsequent sections established the PA's two main sources of external income: foreign aid and clearance revenue. In particular, clearance revenue increased in importance for the PA after the 2007 World Bank-inspired reform policies of Fayyad.

The international state-building process, however, had little effect on improving the economic conditions of everyday Palestinians and affected the Palestinian economy in two ways. First, it failed to provide tangible economic development to ordinary Palestinians. Economic conditions stagnated or worsened after each wave of aid injections. Second, the process entrenched the asymmetrical economic structures between the Israeli and Palestinian economies. Policies of forced economic integration between the PA and Israel prevented the PA from forming an independent economy capable of serving a Palestinian state. Donor-funded and World Bank-designed Israeli-Palestinian joint economic zones, border crossings, and unified infrastructural projects serve as examples of entangling the two economies.

The fiscal reforms imposed on the PA during the second wave of internationally-led state-building fostered an economic model where the

central government is continuously concerned with maximising revenues, minimising spending, and controlling fiscal deficits. These ideals are reflected in the PA's revenue structure, which was designed to be reliant on Israel. Clearance revenue, which is collected and processed by Israel, grew in importance to the PA to cover about 60 percent of its total expenditure. This reliance impeded the PA's ability to represent Palestinians in international settings or pursue Palestinian strategic interests. The example of joining and utilising the ICC highlighted Israel's strategic use of clearance revenue to undermine the PA.

These arguments explain how the international state-building agenda built and undermined the PA's ability to govern or adequately represent Palestinians. Nonetheless, World Bank and other donors have been successful at establishing government-like institutions that operated well under Israel's hegemonic control of economic and political conditions. In fact, the PA's institutions and economic policies were designed to operate within the limitations, and not independent, of Israel's occupation. While the long-term viability of any future settlement between Israel and Palestinians is best projected in a two-state solution, this chapter has shown that the policies of the World Bank and other international donors have tamed the PA's ability to work towards the establishment of an independent, sovereign, Palestine.

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