Policy Brief

Still Digging Out

The Economics of a Palestinian Future
Acknowledgments

We gratefully acknowledge James Prince and the Milken Institute Review for their willingness to allow us to update and use parts of the 2005 research. Thanks to Steve Zecher, Mimi Kaplan, Jacob Udell, and Glenn Yago for their work on this report.

About the Milken Innovation Center

The Milken Innovation Center at the Jerusalem Institute focuses on developing market-based solutions to Israel’s greatest challenges as it transitions from a startup nation to a global nation. Through the Milken Institute Fellows program, we train some of Israel’s best and brightest young professionals in creating pragmatic financing and economic policy solutions, and then deploy them as resources to government ministries, nonprofits, and other key organizations. Our applied research and Financial Innovations Labs serve as a launching pad for transformative change, using innovative financing mechanisms, programs, and policies to bridge social, regional, economic, and technological and productivity gaps within Israel and between Israel and the world. Our goal is to accelerate economic growth, build human capital, and cement Israel’s role as a pioneer in addressing global challenges in water, food, education, health, and energy with solutions that others can replicate.
This policy brief updates a previous research report, “The Economic Roadmap: Beyond the Israeli Palestinian Conflict,” June 2005, published at the time of Gazan Disengagement by Glenn Yago and James Prince. That article described the dire situation at the tail end of the Second Intifada, the “uprising” in the West Bank and Gaza, which left the Palestinian economy in shambles and Israel reeling. A shorter version appeared as, “Digging Out: The economics of Palestinian independence,” *Milken Institute Review* Third Quarter, 2005 and was summarized in an op-ed entitled, “Privatizing the Peace Process,” *Wall Street Journal*, August 5, 2005. Given the current impasse, this update was indicated by the hope that the force of empirical observation might inspire a change of unsustainable economic trends and circumstances.
The failed 2014 Palestinian-Israeli negotiations and subsequent conflict illustrated once again that what is happening on the ground below the diplomats’ radar may have more to do with eventual economic outcomes than the vagaries of Palestinian and Israeli internal politics and international efforts. Economic development through market building is central and causative for new states, and the missing variable in this equation. Job creation and growth buttress diplomatic policy initiatives and provide the foundation and incentives for political solutions. Previous talks have focused almost exclusively on processes related to elections, sanctions and negotiations, delegating pressing economic, environmental, trade, and infrastructure programs that could improve daily life to matters of secondary importance until “final status.” Under the mantra that “nothing is agreed until everything is agreed,” important economic development work is left behind, and succeeds only in ensuring that negotiations never conclude.

The 2005 Israeli disengagement from Gaza and subsequent cycles of negotiation promised to lessen political friction during the move toward eventual Palestinian statehood. Now, after yet another decade of diplomatic frustration, “final status discussions” have become an ominous signal for locals to brace themselves for the next outbreak of violence. Even in an economy based upon international donor transfer payments or the militarization of the conflict, diplomatic welfare and the perpetuation of refugee status for many Palestinians in the West Bank and Gaza is no substitute for job creation to support market and nation building. More than ever, an economic roadmap defined by common Palestinian and Israeli interests could, as a practical matter, make a bigger difference in building transactional trust than another toss of the political dice. Ultimately, the past two decades proved that only by structuring shared economic interests will a political solution become feasible.

The empirical evidence on the adverse relationship between economic growth and conflict is definitive. Security is dependent upon economic development. Lower levels of GDP per capita are always more correlated with higher risk of armed conflict. Diving deeper into this association, we find that lower recruitment costs in low-income countries make conflict resumption increasingly likely. By stimulating job creation, growth reduces grievances and makes armed conflict less attractive. Where there is a large proportion of youth in the demographic composition of the population (35% or more), the risks of instability and violence increases by 150%. It is not the absolute number of youth alone, but the lack of economic opportunities that raises the risk of violence. Lack of social recognition, low employment opportunities, and frustration with educational achievement returns to income compound conflicts and increase the likelihood of violence. The combination of low per capita income, weak growth and horizontal inequalities (inequality among groups) in socio-economic and political dimensions provoke violent group mobilization.

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2 The principle of “nothing is agreed until everything is agreed” emerged from international trade negotiation and is often referred to as the “single undertaking” approach denoting a consensus-based, all-or-nothing approach for multilateral trade agreements. Though sometimes, but not always, successful for general agreement on tariffs and trade, it is unclear why this has become accepted wisdom for Israeli-Palestinian negotiations. There is increasing evidence from other fields to rethink the “nothing is agreed until everything is agreed” principle since it has proved overly rigid. See Philip I. Levy, “Do we need an undertaker for Single Undertaking?” Considering the angles of variable geometry” in S. J. Evenett and B.M. Hoekman (eds.), Economic Development and Multilateral Trade Cooperation, Palgrave-MacMillan, (2006).


Addressing the dire need for economic growth is long overdue for the Palestinian economy, which has experienced a lost decade, as depicted in Table 1. Since 2005, real average wages have decreased by some 10%, unemployment remains structurally high at an around one-quarter of the labor force, and mean GDP per capita growth lags behind population growth at 2.6% per year. Over the last two decades, despite massive aid, remittances, and a wealthy Diaspora, Palestinians have the world’s poorest relative performance in per capita GDP growth. The PA’s performance is at the bottom of the Arab world and less than average growth performance among what the World Bank defines as heavily indebted poor countries. Time is of the essence to make an economic roadmap the priority in order to save the two-state solution—the solution to which the official policy of Israel and the Palestinian Authority (and the Quartet) are committed.

Donor and public sector expenditures – at the top of the agenda of ways to buffer the political pain of compromise for the Palestinians – are currently not structured to support the enduring economic expansion most needed by the Palestinian economy. Robust economic development requires investment, leveraged and strengthened by aid. If donor grants simply replace market discipline, they do little to help private investors to build a knowledge base, management expertise, or to bring about sustainable job creation.

Additionally, the amount of international aid and donations can shift rapidly from year to year, leading to uncertainty and inefficient allocation of funds. Following the Gaza Disengagement in 2005, the rise in donor aid, which reached almost 32% of GDP in 2008 (equal to 45% of total net revenues), initially fueled rapid economic growth. However, the decline of aid to the level of 6% of GDP by 2015, without systematic efforts to replace it with market investment, has exposed the fundamental vulnerabilities of the Palestinian economy.8

Donor aid that is pledged to the Palestinian Authority often does not materialize. For instance, only 35% of the $3.5 billion in Cairo Conference funds pledged to the Palestinian Authority for Gazan reconstruction have been delivered. Overall, despite the shifts and shocks, foreign aid in 2015 continued to make up more than 30% of the PA’s $4.3 billion budget.9 This aid model (as opposed to an investment model leveraged by aid) continuously distorts Palestinian economic development and hampers growth. The key issue for Palestinians remains, as it was in 2005, how to use the available aid to help its people on a day-to-day basis, while at the same time leveraging market discipline for job creation and capital formation.

Engaging the private sector in shaping regional economic development is the key to overcoming the limits of dependence. While political negotiations are often viewed as zero-sum games – what we win, you lose – economic cooperation can benefit both sides and enhance transactional trust necessary for both market and nation building.

Table 1: The Palestinian Lost Decade – Key Development Statistics in the West Bank and Gaza10

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<tbody>
<tr>
<td>GDP Constant $ US</td>
<td>4,197</td>
<td>4,161</td>
<td>4,233</td>
<td>4,524</td>
<td>4,664</td>
<td>4,744</td>
<td>4,825</td>
<td>4,913</td>
<td>5,012</td>
<td>5,112</td>
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<tr>
<td>(Millions)*</td>
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<tr>
<td>GDP Per Capita Constant $ US*</td>
<td>1,459</td>
<td>1,360</td>
<td>1,406</td>
<td>1,449</td>
<td>1,530</td>
<td>1,606</td>
<td>1,753</td>
<td>1,808</td>
<td>1,793</td>
<td>1,735</td>
</tr>
<tr>
<td>Population Growth</td>
<td>2.96%</td>
<td>2.96%</td>
<td>2.97%</td>
<td>2.86%</td>
<td>2.87%</td>
<td>2.88%</td>
<td>2.98%</td>
<td>2.99%</td>
<td>2.96%</td>
<td>2.94%</td>
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<tr>
<td>GDP Per Capita Annual</td>
<td>7.5%</td>
<td>-6.8%</td>
<td>3.4%</td>
<td>3.1%</td>
<td>5.6%</td>
<td>5.0%</td>
<td>9.1%</td>
<td>3.1%</td>
<td>-0.8%</td>
<td>-3.3%</td>
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<td>Growth</td>
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<tr>
<td>Poverty Rate</td>
<td>29.5%</td>
<td>30.8%</td>
<td>31.2%</td>
<td>26.2%</td>
<td>25.7%</td>
<td>25.8%</td>
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<tr>
<td>Unemployment Rate</td>
<td>26.0%</td>
<td>23.6%</td>
<td>21.6%</td>
<td>26.0%</td>
<td>24.5%</td>
<td>23.7%</td>
<td>21.0%</td>
<td>23.0%</td>
<td>23.4%</td>
<td>26.2%</td>
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<tr>
<td>Real Wage (NIS)**</td>
<td>66.8</td>
<td>66.1</td>
<td>68.2</td>
<td>66.5</td>
<td>63.1</td>
<td>64.1</td>
<td>60.4</td>
<td>58.6</td>
<td>58.5</td>
<td>58.0</td>
</tr>
</tbody>
</table>

Source: Palestinian Monetary Authority & World Bank

10 *Assumes a base year of 2004; ^Uses PMA’s Consumer Price Index
The Second Intifada, three wars, and diplomatic failures have undermined Palestinian state building. In the absence of political breakthrough, political, environmental and security conditions can and must be improved through the reconstruction and implementation of major regional infrastructure projects – housing, urban revitalization, transportation and communications, renewable energy, and environmental projects, including wastewater and solid waste treatment. These sorts of capital investments propel aggregate demand forward, and provide the base for economic development led by the private sector. Aligned interests on such projects also build positive flows of labor and capital that can help bring about desired political outcomes. The needs of the Palestinian economy are urgent, and the time to grapple with them is now.

Job Creation and Private Sector Finance in the West Bank and Gaza

The Palestinian recession that began in 2000, the result of a fresh round of open conflict, still has reverberations in the economy today. During the height of the economic crisis of the Second Intifada, most estimated that nearly one in two residents of the West Bank and Gaza lived below the poverty line, and while that crisis has since subsided, today the number remains structurally high at above one quarter of the population. Meanwhile, the population has grown at almost 3% yearly since 2000, adding new dependents at a consistent rate and an ever growing demand for jobs.

While the poverty rate does seem to be falling over the last decade, it is largely a result of public transfer payments, not private sector job creation. Indeed, the West Bank and Gaza are also highly reliant on the cash remittances from workers in Israel and abroad, as opposed to local employment and production to drive economic growth. Simultaneously, by some measures, the Palestinian Authority is also the highest per capita GDP recipient of foreign assistance. Since 1993 until 2013, remittance inflows have oscillated from 16% to 34% of the GDP, making it the country with the second largest reliance on cash remittances (as a percentage of GDP) in the world. The disaggregated remittance data, seen in Table 2, show that remittance inflows for investment total only about 13%, whereas household transfers – money sent back home by family and friends for expenses – constitutes 30% of remittance inflows, and worker’s compensations – paychecks from Israel or abroad used for domestic consumption – totals over 50% of remittance inflows. These data illustrate the extreme dependence of residents of the West Bank and Gaza on work in Israel and financial support from family members abroad for their basic consumption and survival needs.

No attempt has been made to create remittance-based financial products and mechanisms such as insurance products, savings accounts, business loans, children’s education loans, and other financial services.

Table 2: Components of Personal Remittances, Mean 1995-2013

![Pie chart showing components of personal remittances]


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Disaggregating labor statistics by age reveals a number of additional troubling trends. Since 2001, for instance, unemployment among males aged 15-24, which as discussed is a leading indicator of conflict, has moved between 35% and 40%, and in 2014 reached 43%. Over those years, the Palestinian Authority has also become the employer of last resort, with 23 percent of the work force on its rolls. Yet the Authority’s cash crunch limits the ability to pension off excess employment.

Ironically, though the labor force participation rate is currently at its highest since 2000, at 45.8%, it has been accompanied by an overall spike in unemployment. Though the female rate remains low, the positive net entry of new job seekers into the market exceeds the ability of the economy to create new employment. As we anticipated over a decade ago, the relative cohort size of youth in the Palestinian age structure continues to make job creation imperative. The tsunami of youth entering the labor market over the last 10 years, coupled with the frictional and structural unemployment of the adult population and the almost non-existent job growth since, has left youth unemployment at alarming rates.

Job creation is the most pressing diplomatic imperative to make up for the missed opportunities of the past decades. As the IMF recently pointed out, the combination of maintaining the political status quo, unpredictable donor aid, and limited policy innovation is creating a situation where growth at around 3% remains insufficient to absorb the rising labor force. The resulting rise in unemployment and fall of living standards will undermine any diplomatic initiatives. Even without diplomatic accomplishments, improvements in Israeli-Palestinian economic cooperation would be beneficial.

As it currently stands, the Palestinian economy is driven mostly by consumption, which stood at over 90% of total Palestinian GDP in 2014. This suggests that a swift structural change in both capital and labor markets in the Palestinian economy is needed. Loans create deposits only when they support production. Production, not consumption is the true source of the wealth of nations, especially new ones. For Palestinians to have a healthy economy, it must create conditions where producers (businesses) can accelerate wealth creation for others to consume and finance future production, not the government alone. Consumption spending alone cannot be the engine of economic growth.

The Palestinian financial sector, while continuing to develop, still does not provide enough credit to the private sector; total private sector lending is 24% of total credit in the West Bank and Gaza, as opposed to 95% in Israel and 74% in Jordan.

<table>
<thead>
<tr>
<th>Table 3: Labor Force Participation Rate in West Bank and Gaza, 2015</th>
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<tbody>
<tr>
<td>Age Groups</td>
</tr>
<tr>
<td>15-24</td>
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<tr>
<td>25-34</td>
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<tr>
<td>34-44</td>
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<tr>
<td>45-54</td>
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<td>55-64</td>
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<td>65+</td>
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<td>Males</td>
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<table>
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<th>Table 4: Unemployment Rate in West Bank and Gaza, 2015</th>
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<tbody>
<tr>
<td>Age Groups</td>
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<tr>
<td>15-24</td>
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<td>25-34</td>
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<td>34-44</td>
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<tr>
<td>45-54</td>
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<td>55-64</td>
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<tr>
<td>65+</td>
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<tr>
<td>Males</td>
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</table>

unsustainable trend. Financial inclusion is also falling quickly behind in the Palestinian Territories. Among residents of the West Bank and Gaza, only 24% hold a bank account and only 4% borrowed from a financial institution in 2014. These numbers reveal that, relative to neighboring countries, basic financial services upon which a thriving economy relies – including payments clearing, credit products for consumption and investment needs, and more – are lacking in the Palestinian Territories (see Table 5). Credit is a pre-condition for production to take place. While the credit to deposit ratio of Palestinian banks has improved dramatically – from approximately 30% in 2008 to 56% in 2012 – there is still some ways to go in creating an adequate deposit base from which banks can extend new credit to producers and consumers in the private sector.

Separation versus Integration

With the collapse of the Oslo process in 2000 and the many diplomatic setbacks since, we are left still with the pressing question of how to promote adequate security and sovereignty, and yes, ultimately peace, built on mutual economic self-interest.

Almost all Oslo-driven visions of a Palestinian state as a viable economic entity were premised on the eventual integration of the Palestinian and Israeli economies. A political settlement, it was assumed, would lead to a free flow of goods, labor and capital between Israel and the Palestinian state. But the Second Intifada, as well as the subsequent ill-will built up over the last decade, has led to a reconsideration of the united we-stand-divided-we-fall assumption that was really driven by the long occupation of the West Bank and Gaza. And it would serve neither Israelis nor Palestinians to cling single-mindedly to the integration idea. Indeed, the normalization of economic relations and individuation between two independent states will depend on an agreement that facilitates trade and capital flows, but does not rely solely on integrating labor or capital markets.

Look closely at the years before the Second Intifada, and it becomes clear that Palestinians’ economic dependence on Israel was a mixed blessing. During the Oslo period (1993-2000), real GDP of the Palestinian economy grew by 20 percent – a seemingly reasonable number until one remembers that explosive population growth actually led to a reduction in output per person of 8 percent.\(^18\) By the same token, the higher wages paid to Palestinians by Israelis certainly pleased the recipients. But it also put pressure on wages and prices within the territories, making it more difficult for homegrown Palestinian enterprises to take root or for Palestinian businesses to compete in foreign markets other than Israel. In fact, gross capital formation has remained dangerously low since 2006 – between 20%-25% of GDP (see Table 6).

The negative trade balance is a product of dependence and lack of diversification of trade partners; Israel’s market is the major destination for Palestinian goods, totaling some 85% of Palestinian exports, and also its major supplier, at 60% of total imports.\(^19\) The Palestinian economy remains a consumption driven economy financed largely by donor aid and debt. The key to economic growth for any developing economy, that is, traded sectors, is conspicuously absent.


\(^{19}\) Sebastian Welisiejko, “The Palestinian Economy,” Portland Trust Presentation at the Milken Innovation Center (August 2015).

### Table 5: Financial Inclusion, West Bank & Gaza and Neighbors (as % of population)

<table>
<thead>
<tr>
<th></th>
<th>Held an Account at a Financial Institution</th>
<th>Borrowed from a Financial Institution in the Past Year</th>
<th>Saved at a Financial Institution in the Past Year</th>
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<tbody>
<tr>
<td>Egypt</td>
<td>14.3%</td>
<td>6.3%</td>
<td>4.1%</td>
</tr>
<tr>
<td>Israel</td>
<td>90.0%</td>
<td>40.5%</td>
<td>53.5%</td>
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<tr>
<td>Jordan</td>
<td>24.6%</td>
<td>13.6%</td>
<td>3.8%</td>
</tr>
<tr>
<td>Lebanon</td>
<td>46.9%</td>
<td>15.6%</td>
<td>17.5%</td>
</tr>
<tr>
<td>West Bank and Gaza</td>
<td>24.2%</td>
<td>4.2%</td>
<td>5.1%</td>
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Trends pointing towards local economic development built upon sound institutions in the West Bank and Gaza do exist. For instance, the Palestinian Investment Fund (PIF), a sovereign wealth fund with close to $800m in assets, has become more transparent than ten years ago when it was still in the midst of a major corruption controversy. The Fund has recently engaged in a renewable energy investment process with the goal of investing $150 million in ten solar plants throughout the West Bank and Gaza.

Nevertheless, investment figures remain discouraging and, despite remittances, there are no diaspora bonds or measures to enable the Palestinian Diaspora (whose wealth estimates by the World Bank varied from $40-80 billion) to invest in the PA. In 2015, the international investment position abroad was a net $1.3 billion. Palestinian investment abroad was $5.9 billion, a figure higher than foreign investment in Palestine at $4.6 billion (slightly over half of the foreign investments were foreign direct investment). This trend has continued through 2016. The Palestinian economy’s investment outside the PA continues to significantly outweigh investment in the PA from abroad. Shifting this paradigm by the promotion of continued investments by the Palestinian Investment Fund and others in local infrastructure and economic development projects is crucial.

Looking Out: Sources of Competitive Advantage

A future Palestine could find advantage in its weaknesses – as Israel has long done. Like Israel, Palestine lacks natural resources, but has a wealthy diaspora, a cultural commitment to education and strong entrepreneurial and trading traditions vital to a modern, skills-based economy. Palestine could also capitalize on the good will and proximity of the Arab world; if it built efficient capital markets, Palestine could become a financial and commercial services hub for the Arab East.

With stability (and external funding), the construction and construction-materials industries could be jump-started through massive investment in roads, buildings, and infrastructure, including desalination plants, sewage works and water transport. During a period of historically low interest rates internationally and the ability to leverage bi-lateral and multi-lateral guarantees, the opportunity to create massive projects in water, alternative energy, environmental, and tourism and transportation and communications infrastructure is unprecedented. These initiatives would link the Palestinian economy to ecosystems throughout the Arabic language internet, trade and commerce through the region and globally. The country also has favorable conditions for high-value agriculture

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and agricultural technologies – fruits, vegetables, animals, and high-value growing practices. Technology transfers from Israel, a country that has figured out how to grow food and fiber in unlikely places (in climates similar to those found in Palestinian areas), could dramatically improve Palestinian agricultural productivity. Currently, the average agricultural yield per dunam in the Palestinian Authority is half of that in Jordan and only 43% of the yield in Israel.23 The ICT sector, which has grown by leaps and bounds in Palestinian businesses, over the past decade, can continue to develop as a key driver of economic growth.

It’s important here to emphasize that developing strong economic ties between a new Palestinian state and Arab countries would serve the interests of the Israelis as well as the Palestinians. Linking a trade and aid commitment that would leverage their trade for growth and poverty reduction from other Arab nations would lessen the dependence on Israel. Arab states, along with the United States and Europe, could also institute preferential trade and tariff agreements through qualified trade zones to spur employment and production, as they have done in Jordan and Egypt over the last decade.

Arms-length tourism agreements between Israel and Palestine, which made it convenient to visit both Israel and Arab sites in single trips, could also play an important role in driving economic development and job creation. Tourism, especially with the growing global trend for high value-added tourism, is, after all, a labor-intensive industry with great potential for absorbing the large and rapidly growing numbers of unemployed Palestinians.

Finally, industrial development inside Palestinian areas, including state-of-the-art industrial parks, incubators for new technology businesses, and accelerators supported by international businesses would facilitate technology transfers. These economic developments might well focus on intermediate and finished products with export potential for global and regional trade and employment generation.

Looking In: Local Investment in Economic Development

Over a decade ago, at the 2005 Milken Institute Global Conference in Los Angeles, we asked a spectrum of business and political leaders from the

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23 The Besieged Palestinian Agricultural Sector, UN. Conference on Trade and Development, 2015.
today. One of the key approaches hearkens back to the investment leveraged by aid model mentioned above – to employ donor funds more effectively by using them to shelter private projects from the systemic risks found in the region. Through the employment of capital structure tools such as limited liability, subordinated risk, and others, those financing a given project are partially insulated from the potentially riskier activities occurring elsewhere in the market, thereby facilitating productive activities that otherwise may not have occurred. Specifically, donors could provide credit enhancement and risk insurance, as well as underwriting the planning for private investment in a variety of important economic developments:

Water Infrastructure. A handful of specific river basin projects would have an immediate impact on living standards in Palestinian cities and villages, as well as provide water for agricultural and industrial needs.

Infrastructure. Natural gas production, electricity co-generation and alternative fuels production (solar, biomass renewables) would all decrease Palestine’s energy costs and reduce the need to spend scarce foreign exchange on imports. These projects would also generate stable, predictable revenues that could be used to finance capital costs through private borrowing. The Palestinian Authority Energy Ministry recently provided a license for the first solar park of a 5.7 MW installation near Hebron. Future projects in renewable energy would be beneficial for lower water treatment costs as well.

Trade, Tourism and Transportation. Here, we would include regional interurban rail, port, and, eventually, air facilities, as well as destination tourism at religious, archeological and recreational sites. It could be time to revisit the RAND Corporation’s attempt in The Arc Project to provide a formal physical structure for a Palestinian State to link urban centers to new population growth cities and neighborhoods (like Rawabi) via linear transportation arteries to support commercial and residential development. This plan could include urban revitalization of Palestinian cities, affordable housing, and compelling alternatives to refugee camps.24

Housing Construction and Finance. The expansion of markets for primary and secondary mortgages would stimulate homeownership and urban revitalization, as well as invigorate the contractor and construction and craft workers to focus on green buildings and sustainable housing.

Kidron River/ Wadi El Nar Revitalization

In 2010, the Kidron Basin Working Group – of which the Milken Innovation Center was a part – was convened in order to propose an integrated redevelopment plan for the Kidron Basin, which runs from the Old City to the Dead Sea and crosses Israeli and Palestinian territory. The central element of the 2013 plan was the implementation of a special purpose vehicle (SPV) that utilized a combination of financial instruments to provide sewage collection and treatment services on a contract basis with the Israeli and Palestinian water authorities. A $100 million wastewater treatment facility that would become self-financing and provide treated effluent for Palestinian agriculture and environment for economic development projects in cultural tourism, recreation, and other private sector businesses was demonstrated to have enormous economic development impact.

Looking Up: Capital Ideas

Even carefully refined projects designed to harvest the low-hanging fruit first will not get off the ground unless the current lack of private-sector credit in the Palestinian territories is ended. This can be done by giving banks both the tools for coping with risk and the profit incentives to expand lending and financial inclusion. At the moment,

though Palestinian banks have become more sophisticated in terms of coordination, post-loan monitoring, underwriting standards, still lacking is the institutional support needed to reach the scale of private sector credit available in other developing countries in the region.

By the same token, there has been little effort to date to employ the many successful models for raising investment funds in high-risk environments. Among the possibilities: partnerships with international companies for private concessionaires to run public facilities, privatization of public utilities ranging from power generation and distribution to border-logistics management and venture capital funds for targeted growth sectors like pharmaceuticals and food processing.

### Housing and Mortgage Finance

In 2013, Palestinian President Mahmoud Abbas launched a $500 million mortgage finance facility called AMAL (The Affordable Mortgage and Loan Corporation). The initiative was established jointly by a number of bodies who had pledged to provide funds, including: OPIC (approx. $300 million), Palestine Investment Fund ($72m), International Finance Corporation ($72m), the Bank of Palestine, and more.

The initiative has been stalled largely because the creation of new Palestinian residential developments has likewise been delayed. Chief among them is the first Palestinian planned city in the West Bank, Rawabi. Built by the developer Basher Masri northwest of Ramallah, Rawabi was designed for 40,000 residents and construction began in 2010, and the first 350 families have moved in during the summer of 2016.

As Rawabi and other smaller scale developments around Ramallah and Nablus do come to fruition, there is the urgent need to restart the AMAL program, as residential mortgage are almost non-existent in the West Bank. As Palestinian banks continue to mature, it is imperative that international bodies and philanthropists leverage the opportunity that cities like Rawabi represent.

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**Water and Food**

The water and agricultural sectors in the West Bank and Gaza constitute both important challenges and sustainable growth opportunities for the Palestinian economy. The dire state of Gaza’s water sector can be summarized by the constantly diminishing amount of potable water. Currently, only an estimated 3 percent of Gaza’s water is suitable for drinking. By the end of the year, all water in Gaza will be contaminated due to infiltration of untreated sewage accompanied by large chloride concentrations, over-extraction and salination.

The Palestinian agricultural sector is currently in a similar state of decline, as illustrated by trends in the labor market and production. The number of low value-added agricultural workers in the Palestinian Territories has more than doubled in twenty years, from less than 40,000 workers in 1995 to over 100,000 in 2013, while productivity per worker in the sector declined almost 80%. Simultaneously, food insecurity rose to over 34% in 2012, according to the World Food Programme.

Establishing a strong legal and regulatory infrastructure for the Palestinian Authority’s financial markets is, of course, a prerequisite for leveraging donor funds for project finance. And there is much to be done – for example, less than 50 companies are listed on the Palestinian Securities Exchange. Creating diverse securities that could be traded at low cost, possibly with enhanced credit via donor funding, would increase the total pool of cash for development projects. Note, moreover, that investors in Israel, Palestine and Jordan have generally responded favorably when uninterrupted commerce rises.

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The Window of Opportunity

Despite good intentions, donor-driven development programs in the context of constant tension offer little evidence of past progress. But, as we argued a decade ago, identifying and supporting specific development projects for the Palestinian economy provides a way to take concrete steps towards cooperation and stability. Success lies in the pragmatic use of the economists’ toolbox to facilitate growth, plus an understanding that the Palestinian economy must be able to stay afloat without tethers to Israel. When the history of this long, grinding phase of the Israeli-Palestinian conflict is written, the accounts could emphasize how economic strategy, financial leverage, and the creation of jobs and income overcame short-term political concerns as the path forward to the formation of a new state.