1. The Context: The Palestinian Territory

The nature of poverty in the West Bank and Gaza is intrinsically tied to and must be understood within the historical and political context of this region. Over the last five decades, political developments in the West Bank and Gaza have had a significant impact on the social and economic wellbeing of Palestinians. Changes in domestic, Israeli and international policies have affected the Palestinian economy throughout this period, both in terms of growth trends and the volatility of growth. This has a natural consequence on indicators of wellbeing at the household and individual level. Following the Second Intifada of 2000, the Palestinian economy began to resemble no other in the world. Limited say over economic policies and trade, the extent of dependence on Israel and international aid and a regime of internal and external closures has created an economy characterized by extreme fluctuations in growth and employment and an increasing divergence between the two territories: the West Bank a fragmented archipelago; and Gaza an increasingly isolated island.\(^7\) Despite stringent Israeli restrictions, the West Bank and Gaza outperforms countries with similar per capita incomes on many dimensions of development, and is in fact on par with much richer countries such as Turkey and Jordan. This suggests that within its limited ambit of influence, the Palestinian Authority has implemented effective policies and ensured service delivery, which bodes well for the formation of a future Palestinian state.

1. The First Intifada to the Second

1.1 With the conclusion of the 1967 war between Israel and the neighboring Arab states, the West Bank and the Gaza Strip came under the control of the Israeli army. A subordinate of the Israeli Ministry of Defense called the “Civil Administration” managed day-to-day affairs of Palestinians living in the West Bank and Gaza. The Civil Administration functioned in close collaboration with the Israeli Defense Forces who managed security and political matters in the territory. Thus, many aspects of Palestinian daily life such as mobility, employment, and business development were determined by the Israeli Army and the Civil Administration, frequently resulting in intermittent rounds of politically driven confrontations, ranging from unarmed civil resistance to the use of lethal force.

1.2 Most prominent of these confrontations was the First Intifada, a term which means “public uprising”. Starting in the Gaza Strip during 1987, the uprising rapidly spread to the West Bank. The violence associated with the Intifada persisted until direct peace talks were held between the Palestinians and the Government of Israel (GoI) in Oslo in 1993. This extended period of conflict subsided by 1994. The successful resolution of the conflict and the establishment of the Palestinian Authority as a prospective sovereign entity to govern a future Palestinian State created a sense of optimism. Despite the fact that the complete transfer of power from the Government of Israel to the Palestinian Authority never materialized, the prospects of peace initiated a short-lived period of political stability and economic revival in the years following the Oslo Accord.

1.3 As part of the piecemeal plan for the establishment of a Palestinian State, localities in the West Bank and Gaza were divided into 3 areas: A, B, and C (see Map 3). The Palestinian Authority

possessed semi-complete autonomy in area A (composed of heavily populated Palestinian cities and towns); civil autonomy but no security control in area B, and no control whatsoever in area C – the largest of the three, encompassing more than half of the West Bank and Gaza. As a part of civil control over areas A and B, a publicly elected parliament\(^8\) was established and ministries were created to regulate education, health, labor, and finance in the territory, creating a vehicle for domestic policy

\(^8\) Palestinian Legislative Council (PLC)
formulation and implementation. Despite original plans of progressively increasing Palestinian sovereignty over areas B and C through negotiated withdrawals, little progress took place in subsequent years, leading up to a second round of violence.

1.4 Seven years after the Oslo peace talks, the Palestinian Authority remained far from achieving sovereignty in the West Bank and the Gaza Strip. With no control over the territory’s borders, it had little say over its economic policies with other counties. Additionally, border closures by Israel reduced Palestinian employment opportunities in Israel considerably. With limited trade options, and fewer employment opportunities, as discussed in more detail in Chapter 3, the Palestinian Authority dramatically increased public employment as a means of social assistance.

1.5 On the political front, continued Israeli settlement expansion in the West Bank and Gaza created further strain. In late 2000, a clash between Palestinians and Israeli security forces erupted in Jerusalem and rapidly spread to the rest of the Palestinian territory. This became the Second Intifada. In an attempt to contain and dampen the escalation of violence, the Israeli government rescinded the Palestinian Authority’s limited autonomy in areas A and B, imposing restrictions on the movement of people and goods in, out, and within the West Bank and Gaza. Over the next 10 years, the level of violence and closures varied, as did their impact on social and economic welfare. In particular, the West Bank and Gaza experienced different forms of violence, mobility restrictions and political changes. This created a divergence between the two territories, which had important implications for growth, employment, and poverty.

**Economic Consequences of a Volatile Political Situation**

1.6 While the pre-Intifada years were generally characterized by high GDP growth, there was a significant slowdown in growth in 1995 and 1996, as a result of the frequent border closures imposed by the GoI during that time. As the restrictions were gradually eased in 1997 and 1998, the economy was able to recover and resume growing at a
fairly high rate through 1999 and the first half of 2000. Beginning with the outbreak of violence in September 2000, economic activity fell dramatically (Figure 12).

1.7 It is difficult to underestimate the dependency of the Palestinian economy on Israel at the time of the Second Intifada for various reasons. First, the Israeli labor market had been a very important source of employment and income for many Palestinians. Second, Israel was the most important trading partner for the West Bank and Gaza. Prior to the second Intifada, Israel accounted for more than 90 percent of Palestinian exports. While some imports into the West Bank and Gaza originated from outside Israel, virtually all imports came through or from Israel. Third, Israel collects taxes on behalf of the Palestinian Authority, which at the time of the Second Intifada normally made up about two-thirds of total government revenues. By affecting these channels, the conflict had an economic impact on the West Bank and Gaza far beyond the physical destruction of infrastructure. As a result of the dependency of the West Bank and Gaza on the Israeli economy, the fluctuations in economic activity over the past twenty years have been closely related to the varying levels of restrictions imposed by the Government of Israel (GoI). The most important of these restrictions have been the periodic border closures, but since the Intifada began in late 2000, the internal blockades and curfews have also played an increasingly important role.

1.8 The regime of closures is especially harsh given the high dependence of the Palestinian economy on imports. Total domestic expenditure surpassed domestic production by a large margin throughout 1994–2000, ranging between 150 to 165 percent of GDP. With exports typically equal to only 20 percent of GDP during this period, imports ran between 70–85 percent of GDP. The high levels of imports were partially explained by the high levels of private consumption and investment. Private consumption remained close to 100 percent of GDP throughout the 1994–2000 periods, fueled by worker’s remittances and transfers from abroad. Public consumption also increased over these years, reflecting the growth of the Palestinian Authority (PA). Fixed investment was over 30 percent of GDP in every year during 1994–2000, mostly undertaken by the private sector, with a large proportion of this investment being directed to residential housing, rather than productive investment.

1.9 The dependency on imports led to a large deficit in the Palestinian trade balance, which ranged from 50 to 65 percent of GDP during 1994–2000; this trade deficit was offset to a considerable degree by net factor income and net current transfers, which include aid and remittances. As noted earlier, employment in Israel and the settlements played a very important role as a source of income. Net factor income from abroad rose fairly steadily during 1996–99, after the dip that followed the closures of 1995–96, reaching 21 percent of GDP before subsiding in 2000. That source of income was complemented by large current transfers, in form of aid flows as well as private remittances from the large Palestinian expatriate population.

1.10 Despite this high level of factor income and current transfers from abroad, the Palestinian economy ran current account deficits in the order of 20 to 35 percent of GDP from 1994 to 2000.

CHAPITRE 1

Donor assistance for capital projects to the West Bank and Gaza was very high on a per capita basis and has played a crucial role toward financing the large current account deficits.\textsuperscript{10}

1.11 On the fiscal front, the PA succeeded in steadily increasing revenue from about 8 percent of GDP in 1994 to around 21 percent by 1999, bringing the share of revenue to GDP in the West Bank and Gaza substantially above the average for other Arab countries in the region. This was largely the result of the PA’s efforts in strengthening its tax administration capabilities, the establishment of the revenue clearance system with Israel\textsuperscript{11} and the setting up of mechanisms to mobilize domestic tax revenue. It had more difficulties in managing and controlling public expenditure, especially with regard to the wage bill. The high and increasing wage bill began to crowd out other expenditures, and the PA had to rely on donors and NGOs to provide some public services and finance public investment. The PA nevertheless achieved an impressive turnaround in the current budget balance from a deficit of 4 percent of GDP in 1996 to a surplus of 1 percent in 1999.\textsuperscript{12}

1.12 The renewed violence, closures, and blockades at the end of September 2000 put an end to these favorable trends, and since then, the budget of the PA was challenged by a collapse of revenues while expenditure needs continued to grow due to the growing population, rising poverty and the destruction of essential infrastructure.

2. The Second Intifada and its Ramifications

\textbf{2000 – 2006}

1.13 The first few years of the second Intifada were particularly violent, resulting in significant collateral damage and the targeting of civilians on both sides. In an attempt to contain the escalation of violence, the Israeli army frequently relied on curfews, limiting the movement of hundreds of thousands of people for weeks. Curfews, along with the system of closure, resulted in limited internal mobility within the West Bank and Gaza, coupled with complete isolation of movement between the two areas.

1.14 These curfews limited economic activities and restricted the income-generating potential of entire communities in the West Bank and Gaza. Consequently, the demand for daily wage workers diminished and regular wage workers were unable to reach their place of business. This was particularly true of low skilled laborers working in Israel. The result of the post-2000 closure system was critical to the Palestinian economy leading to huge employment losses for Palestinians previously working in Israel.

1.15 The West Bank, in particular, experienced a sharp rise in unemployment during this period, as a greater proportion of its labor force worked for Israeli employers relative to Gaza. In areas heavily dependent on Israeli employment in the West Bank, such as Hebron and Bethlehem, the

\textsuperscript{10} \textit{Ibid.}
\textsuperscript{11} From the first year of operation, the Government of Israel and the PA jointly operated a unified invoice system and closely collaborated to ensure the smooth operation of the revenue clearance system. This system provided a significant and stable source of revenue to the PA, equivalent to about 60 percent of the PA’s total budgetary revenue, remitted on a monthly basis.
effects were particularly severe. Once tensions eased, the economy rebounded strongly between 2003 and 2005.

1.16 In 2005, the Israeli government unilaterally withdrew from the Gaza Strip. By reallocating its military presence, and some Israeli settlers away from Gaza, there was no need to maintain a network of roadblocks within the Strip. While the withdrawal resulted in greater internal mobility for the residents of Gaza, the Israeli government imposed a more stringent policy of external closure. This development is critical to understanding the divergence in economic outcomes between the West Bank and Gaza.

1.17 This new policy of external closure of the Gaza Strip transformed daily life in Gaza. Border crossings with Egypt were closed for goods and people, as well as movement of Gazans to the West Bank. The only functional crossing (the Karni border crossing) was controlled by Israel, and it only allowed the passage of goods.

1.18 Meanwhile, the Palestinian Authority (with a Fatah party majority) was losing popularity in Gaza and when parliamentary elections were held in 2006, its rival party, Hamas, came to power in Gaza. Since presidential elections had taken place only a one year earlier, the executive branch of the Palestinian Authority remained under the control of Fatah. As a result of the consequent international boycott of the Palestinian Authority, and Israel’s freeze on clearance revenues, the PA was put under severe fiscal stress. The situation was exacerbated by the destruction of physical infrastructure during the Israeli incursion into Gaza and increased uncertainty about the Palestinian territories’ prospects. GDP fell by 5.2 percent in real terms in 2006, leaving average real GDP per capita 22 percent below its 1999 level.

2007 – Present

1.19 After a failed attempt at forming a unity government, Hamas took over control of Government and security positions in the Gaza Strip. Meanwhile the President of the Palestinian Authority assigned a temporary caretaker government to manage public institutions in the West Bank. Israel and the international community endorsed the Caretaker Government and began to reinstate financial and technical assistance. By the end of 2007, two de facto governments existed concurrently, both claiming legitimacy in their respective territories. These developments were fundamental changes in institutional structure, with important ramifications for the scope of policy making, flow of international assistance, delivery of public services and social assistance in the two territories.

1.20 The Israeli government’s response to Hamas’s takeover was instituting a complete embargo on the Gaza Strip. With very few exceptions, movement of people and goods was severed by the summer of 2007. A fuel and electricity shortage paralyzed the basic necessities of life in Gaza. For example, a 60 percent - 70 percent shortage in fuel needed to generate electricity resulted in hospital power outages exceeding 8 hours per day. Throughout the Intifada, the Israeli Army only occasionally issued permits allowing individuals to cross checkpoints for urgent medical needs. This was even further reduced in this period: according to the World Health Organization, the proportion of critical patients given permits to cross the border decreased from 89 percent to 64 percent between January and December of 2007.
1.21 While the Palestinian economy fared better beginning in mid-2007 with the reengagement of the international community, it remained constrained by Israeli restrictions on movement and access. The end of financial sanctions and improved private sector confidence following the advent of Prime Minister Fayyad’s government led to some rebound in growth beginning in June 2007. However, the recovery was confined to the West Bank, as Gaza’s borders were virtually sealed following continued civil strife. As a result, Gaza’s economic and humanitarian situation deteriorated markedly due to the war and its increased isolation. The decline in economic activity in Gaza amounted to a 20 percent contraction in economic activity in 2006 followed by an 8 percent contraction in 2007 and a further 9.8 percent contraction in 2008 (see Figure 13). At end-2008, real per capita consumption in Gaza was 40 percent below its 1999 level.

1.22 These continued contractions in Gaza’s GDP are almost without precedent. For example, the Asian crisis led to contractions of 6.9 percent in South Korea and 10.5 percent in Thailand in 1998 with subsequent sharp increases in growth the following year. Similarly, the Russian crisis led to a contraction of 5.3 percent in 1998; the Argentine crisis led to a contraction of 10.9 percent in 2002 with sharp increases in growth the following years. More recently, the financial crisis led to an 18 percent contraction in Latvia, the hardest hit country in 2009, with growth expected to have resumed in the second semester of 2010. These cases of extreme economic distress pale in comparison to the recurring high negative growth rates in Gaza.

1.23 More generally, the volatility in GDP observed over the past two decades has been unparalleled; only a few countries have had higher volatility in their GDP growth than the West Bank and Gaza (Figure 14). Excluding small island nations, the volatility of the economy’s GDP growth between 1995 and 2009 is only comparable to that of Qatar and Chad (which had episodes of double digit growth due to oil wealth) and those of Rwanda, Guinea Bissau and Sierra Leone (which had double digit recessions as a result of internal conflicts). The outbreak of the second “Intifada” in 2000, combined with the violence and the regime of closures and curfews that followed marked a turning point.

Figure 13: GDP Growth in the West Bank and Gaza by Region
(Annual Percentage Change)

Source: Palestinian Central Bureau of Statistics
Beyond the physical and economic ramifications of Gaza’s embargo, the last three years were damaging on a psychological level, especially for women. Media and humanitarian organizations report a rise in domestic violence, driven by a sense of frustration due to rampant unemployment and very limited access to running water or electricity.

The West Bank and Gaza’s exports to Israel have been heavily constrained by Gaza’s blockade as well as the steady tightening of the Separation Barrier between the West Bank and Israel. Trade restrictions have adversely affected the private sector in general and in particular the sectors producing tradable goods. While the majority of Gaza’s industries remain stifled by the closure policy, one business branded the “tunnel industry” is thriving. With basic household and construction supplies barred from entering Gaza, several hundred tunnels have been constructed underneath the 7 mile border with Egypt to smuggle goods at a premium to Gaza’s markets. Though goods smuggled through the tunnels do not meet the needs of Gaza’s 1.5 million people, and are more expensive than locally or Israeli produced goods, the “tunnel industry” may represent an important source of both goods and jobs in an otherwise closed economy.

On the other hand, in the West Bank, Israel somewhat eased movement restrictions and closures, replacing the majority of over 400 roadblocks with many permanent checkpoints. However, Israel’s presence in the West Bank continues to be manifested in areas labeled “Security Zones”,

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with very different ramifications compared to the external closure of Gaza. Security zones are composed of checkpoints, military compounds, settlement blocks, and a separation barrier, in total encompassing approximately 40 percent of the West Bank.\textsuperscript{14} Over the span of the second intifada, security zones in the West Bank expanded at the expense of several Palestinian population centers. The construction of the separation wall, which cuts through several Palestinian rural and urban communities, resulted in a seam-zone east of the green line\textsuperscript{15} and west of the wall, forcing most of its inhabitants to relocate.

1.27 In the meantime, the international community resumed its financial assistance to the West Bank government, which invested heavily in developing effective public institutions. Towards the end of 2007, stability and easing of movement in the West Bank began to have a positive effect on the economy. By 2009, the combined annual growth rate of the two territories reached 6.8 percent, though most of this growth was driven by the West Bank (8.5 percent) while Gaza remained sluggish under Israel’s strict closure (1 percent growth).\textsuperscript{16} This dichotomy of the macroeconomic performance reflects the disparities in the determinants of poverty and vulnerability across the West Bank and Gaza at the microeconomic level. While the two territories are part of the same political entity and are often studied at the aggregate level, several inherent and recently developed differences exist between the two. This brief account of the conflict in these territories and the recent divergence between the two territories provides the context as well as the lens through which the insights presented in this report should be interpreted.

3. **Coping with Conflict?**

1.28 The prevailing reality in the West Bank and Gaza is unique in the world. The economy is profoundly influenced by its dependence on international aid and on Israel, the regime of man-made internal and external barriers to mobility and its limited say over economic policies and trade. With this in mind, this report provides a detailed assessment of poverty and inclusion in the two territories. Its overarching purpose is to examine poverty, labor market and human development outcomes and trends at the individual and household levels in the context of the ongoing conflict.

1.29 Analytical studies on the West Bank and Gaza have focused largely at the level of the macro economy. The World Bank last conducted a poverty assessment of the West Bank and Gaza in 2001, relying on data from years prior to the second Intifada. Given the fundamental developments since then, this poverty assessment is an attempt to present a cohesive picture of the economic and social well being of the people of the West Bank and Gaza. The analysis is based on a long series of household and labor force survey data and is the result of a close collaboration with the Palestinian Central Bureau of Statistics.

1.30 The report will demonstrate that poverty in the West Bank and Gaza, unlike in many other countries, is not correlated with poor human development outcomes. In fact, the West Bank and Gaza is a stellar performer on many dimensions of human development, especially in terms of measured indicators of early childhood nutrition. The Palestinian territories outperform other

\textsuperscript{14} http://www.ochaopt.org/documents/TheHumanitarianImpactOfIsraeliInfrastructureTheWestBank_full.pdf

\textsuperscript{15} The border separating Israel from the West Bank. Currently, both sides of the green line are controlled by Israel.

countries with similar GNI per capita (US$, Atlas method) as well as its neighbors in the Middle East and North Africa region in terms of health and education outcomes.

1.31 Life expectancy and literacy rates in the West Bank and Gaza are much higher than in countries with similar per capita incomes such as India, Egypt, Nigeria, Cameroon and Ghana (Figure 15). In fact, Palestinian measures are on par with its much richer neighbors in the region, Turkey and Jordan, which have seven and three times the per capita income of the West Bank and Gaza.

1.32 Even more striking is the remarkable performance of the Palestinian territories on measures of early childhood development. Countries with similar per capita GNIs perform far worse in terms of measures of stunting and wasting (Figure 16). India, Pakistan and Nigeria have stunting rates more than three and a half times that of the West Bank and Gaza. The comparison is even starker in wasting incidence, with rates more than seven times higher than in the Palestinian territories. Again, the performance of the West Bank and Gaza on these measures of long term investments in human capital dimensions is in line with middle income countries such as Jordan and Turkey rather than countries with similar per capita incomes.
This preliminary evidence suggests that poverty in the West Bank and Gaza is not driven by deprivations in human capital, as one might find in India, Nigeria and Yemen for instance. It also suggests that the Palestinian Authority has invested in human capital in a sustained and effective manner. Rather, as this report will demonstrate, poverty in the West Bank and Gaza is strongly linked to labor market outcomes. This is evident in the high rates of unemployment in the West Bank and Gaza, which are the highest not only compared to countries with similar per capita incomes, but also in comparison to other countries in the MNA region, where unemployment rates are much higher than in the rest of the world (Figure 17).

Within its limited ambit of influence in sectors such as health and education, it appears that the Palestinian Authority has implemented effective policies and ensured service delivery, which bodes well for the formation of a future Palestinian state. However, labor market outcomes, which depend far more on the ability to trade freely within and outside the Palestinian territories, the free mobility of labor, and the competitiveness and dynamism of the private sector, reflect the limitations under which the Palestinian Authority continues to operate. Ultimately, sustainable economic growth and job creation, essential for poverty reduction, will require a significant easing of the numerous restrictions that currently distort the Palestinian economy. Nevertheless, the human development record of the Palestinian Authority bodes well for the creation of a future Palestinian state.

Figure 17: Unemployment in the West Bank and Gaza compared to other selected countries

Source: World Bank central database, latest available years and Nigeria Bureau of Statistics