

LABOUR  
FRIENDS  
*of* ISRAEL

LFI: *Policy Report*

# Aiding Peace

**Funding to the  
Palestinians in  
support of the  
Peace Process**

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This policy report is published by Labour Friends of Israel (LFI). LFI promotes a strong bilateral relationship between the UK and Israel, working with Government, Labour MPs and MEPs, advisers and think-tanks who share a similar vision for future peace in the Middle East. We hold a clear commitment to both an Israel recognised and safe within its borders and the establishment of a viable, democratic Palestinian state.

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## Foreword

On 25th January 2006, the Palestinian people participated in democratic parliamentary elections to the Palestinian Legislative Council (PLC) and elected Hamas to form their next government. Hamas' victory ends Fatah's forty-year monopoly over Palestinian politics and brings Israelis, Palestinians and international policy-makers to a major crossroads.

There is consensus about the underlying need for large-scale external aid and assistance to the Palestinian people to support the Palestinian economy in order to facilitate long term peace and security<sup>1</sup>. But there is also broad agreement about the possible dangers of providing funds to a Palestinian Authority controlled by Hamas, a proscribed terrorist organisation. This paper focuses on how to manage that dilemma and what steps the EU and G8 can take to mitigate the risks involved. In particular it tackles the question of how the EU and G8 can best leverage their funding resources to promote stability and help make progress towards peaceful conflict resolution.

The analysis is based upon personal interviews with senior representatives of the key players in the region, including the EU and US representatives to the Quartet's Office of the Special Envoy, James Wolfensohn, Israel's Ministry of Industry & Trade, the Palestinian Ministry of National Economy, the Palestine-Israel Business Forum (established by the Swedish Economic Council for Manufacturers and the Swedish Ministry of Foreign Affairs to act as an informal Chamber of Commerce), the EU Technical Assistance Office, the Aix Group of academics, experts and members of Israeli, Palestinian and international official institutions, Bir Zeit University, the Peres Centre for Peace, the Portland Trust, the International Crisis Group and the Israel Export Institute. It is also based on analysis of published reports and statements by international and local agencies and experts including the Ad Hoc Liaison Committee, the EU, G8, IMF, World Bank and Paltrade.

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<sup>1</sup> See for example UK Treasury Interim Progress Report (20 January 2006): 'Economic Aspects of Peace in the Middle East'; Milken Institute (July 2005), 'The Economic Roadmap: Beyond the Israeli-Palestinian Conflict'.

## 1. Executive Summary

### Key Points:

- The election of Hamas fundamentally changes the international community's relationship with the PA.
- Hamas' victory is a result of social, economic and political failure.
- Future financing of the PA must be linked to benchmarks for reform.
- Alternative avenues to develop the Palestinian economy through NGOs and the private sector need to be developed.

The election of Hamas fundamentally changes the dynamics of the Israeli-Palestinian conflict and has a great impact on the options available to the international community. Hamas, a nationalist movement established in 1988, with an Islamic world-view inspired by the extremist Muslim Brotherhood, is clear in its covenant about its aim to destroy Israel and impose Islamic rule in Palestine.<sup>2</sup> The UN backed Quartet responded to the result by saying: "it was inevitable that future assistance to any new Government would be reviewed by donors against that Government's commitment to the principles of non-violence, recognition of Israel, and acceptance of previous agreements and obligations, including the Road Map."<sup>3</sup>

Hamas' electoral success can be attributed largely to five main factors:

- The widespread corruption of the PA under the control of Fatah and the belief that there are few prospects for economic advancement outside the PA's elite position-holders
- Divisions within the Fatah party and the resulting mismanagement of their election campaign
- Dissatisfaction with the slow pace of the peace process and a lack of progress towards permanent status

<sup>2</sup> The Hamas Covenant can be viewed at <http://www.yale.edu/lawweb/avalon/mideast/hamas.htm>

<sup>3</sup> <http://www.un.org/News/Press/docs/2006/sg2104.doc.htm>

- Credit on the Palestinian street for the role of Hamas' terror campaign in bringing Israel to carry out its unilateral disengagement from the Gaza Strip
- Hamas' social and economic agenda, which in effect, acts as a parallel welfare state in parts of the Palestinian territories

Financial support to the Palestinian Authority is an integral part of the Palestinian economy. Total aid from the major donors, the EU and the US, amounts to approximately \$1 billion a year - \$300 of aid per capita - the highest per capita rate in the world. However, since the election results were announced, donor country foreign ministries and aid agencies have mostly reaffirmed their position with regard to the prohibition on funding Hamas and any Hamas-led government directly.

Complete international isolation of the PA would have enormous economic as well as political implications. If EU and G8 aid is cut off entirely the PA will not be able to function nor pay salaries without matching funds obtained from other sources. A significant source of Palestinian GDP would be removed and the private sector would also be severely hit. The economy would rapidly deteriorate and the risk of violence both internally as well as violence aimed at Israel would increase.

## Summary of Recommendations

### 1. Political stability and a permanent settlement

#### 1.1 Conditionality

**1.1.1** The EU and G8 need to make the continuation of aid conditional on the PA's progress towards the standards outlined by the international community: recognising Israel, renouncing violence, dismantling terrorist infrastructure and accepting the obligations of previous agreements.

**1.1.2** Donors should develop a benchmark programme of progress towards good governance, respect for human rights, reorganisation of the security forces and the decommissioning of terrorist weaponry.

**1.1.3** Contact should be sustained with political interlocutors including President Abbas, independent MPs and international mediators, to keep channels of communication open and foster the development of pragmatic leaders.

1.1.4 Aid should be given in a far more transparent and specific manner according to project, with each recipient held accountable for funds received and with greater involvement and oversight by individual governments.

1.1.5 Emphasis should be placed on lower-profile capacity and institution-building projects rather than grand infrastructure projects, even if they do less to satisfy donor governments' need for public recognition.

1.1.6 Donor coordination should be upgraded to avoid donor institutions competing to manage funds. Donor offices in Jerusalem, including the EU office, need to be upgraded in terms of their ability to focus on implementation.

1.1.7 There should be continued focus on public sector reform including ensuring anti-corruption and fiscal discipline measures are put in place.

1.1.8 EU and G8 conditionality should also include assurances over the acquisition and use of funds from other sources such as Iran.

## 1.2 Alternative funding destinations

1.2.1 The EU and G8 should develop alternative, non-PA, destinations for their financial support in both the NGO and private sectors, whilst ensuring recipients are fully accountable.

1.2.2 More aid should be pushed towards specific private sector development projects in order to build the foundations of a Palestinian economy which is not dependent on outside assistance.

1.2.3 NGOs should be used to administer aid and establish strong financial power centres that are removed from PA institutions. This would help rebalance the relationship between the PA and civil society.

## 2. Improving access to markets and suppliers

2.1 Support should be given to the full implementation of the November 2005 Agreement on Movement and Access. The US mediation and EU engagement was important in reaching this agreement. The EU could also take the lead in the future.

- 2.2 Support for further third-party involvement in border crossings, such as the EU monitors at Rafah, should be given.
- 2.3 Support should be given to outside investors doing business in border industrial zones such as the role of Turkey's Union of Chambers and Commodity Exchanges in rehabilitating the Erez–Palestine Industrial Free Zone on the Gaza-Israel border.
- 2.4 Support with caution should be given to the proposal for a Gaza sea-port. A direct link by sea to international markets is important when overland access is limited but it is a far more politically sensitive topic in terms of Israeli security concerns, and may also be a target for over-spending due to considerations of national prestige.
- 2.5 The recovery of Israeli-Palestinian trade and joint ventures to regain pre-Intifada levels should be encouraged. This will aid grassroots peace-building by widening the base of stakeholders in a stable political environment and an open access regime.
- 2.6 Support should be given to plans for an Israeli-Palestinian Chamber of Commerce, drawing on the durability of trade relations even in times of heightened tension.

### 3. Stimulating employment

- 3.1 Support should be provided for quick-impact programmes as a means to relieve the economic pressure in the Palestinian Territories.
- 3.2 As well as funding building costs, longer term commitments for maintenance should be ensured.
- 3.3 Higher-profile aid should be balanced with money for mundane, ongoing but essential low-profile projects such as school maintenance, rubbish collection and municipal level projects.
- 3.4 Money should be directed to areas of highest need and greatest socio-political threat such as southern Gaza.
- 3.5 Investment programs should be combined with training workshops aimed at updating and upgrading skills in the sectors that are involved.

## 4. Building the Palestinian private sector

4.1 International support for the small and medium sized enterprise (SME) sector should be strengthened, particularly to support infant businesses.

4.2 Support should be given to existing business-to-business organisations and bilateral industry sector associations that encourage the development of business opportunities in the PA and joint ventures by and with leading companies from EU/G8 countries.

4.3 New incentive schemes for foreign companies to embark on such ventures should be considered.

4.4 Professional forums should be established for service industries that the private sector will increasingly need, but for which they have little practical experience – such as market research, public relations, business and strategic consultancy.

4.5 The PA should be encouraged to integrate international business norms into Palestinian legislation, especially if a Hamas-led government seeks to make Islamic 'sharia' law, a source of law in the Gaza Strip and West Bank.

## 5. Strengthening the business environment

5.1 Support should be given to existing EU, World Bank and US teams involved in reform programmes in the PA, which push for international business and regulation norms to be integrated into legislation.

5.2 Support should be provided for the establishment and development of private sector institutions such as business associations, chambers of commerce and industry federations.

5.3 Judicial infrastructure projects such as the EU's €7m (\$8m) Judicial Training Centre should be nurtured and their scope widened to assistance to law schools and the Palestinian Bar Association along with mechanisms for the enforcement of judicial decisions.

5.4 Support should be given to financial infrastructure and instruments projects being developed by the EU, USAID and NGOs such as the Portland Trust, in areas such as micro-finance, leasing, developing a national credit rating bureau, loan guarantees and banking regulations.

## 6. Improving economic competitiveness

6.1 Education and training in technology skills, research, problem-solving, team-building, business management and corporate governance should be initiated from within the school system, continuing into new degree programmes and adult-education courses.

6.2 Assistance should be given to private sector and PA-affiliated organisations tasked with developing the PA's competitive potential including Minister of National Economy Mazen Sinokrot's efforts to improve competitiveness and establish a National Competitiveness Council.

6.3 There should be focus on building the Palestinian business environment's 'advanced factor conditions'<sup>4</sup> which develop a nation's competitive advantages and that enable development and prosperity. These should include advanced educational and training centres for professions and skills and R&D institutions close to Palestinian universities.

6.4 Support should be given to training programs in corporate governance, which barely exists in the modern sense in the PA.

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<sup>4</sup> See Professor Michael Porter's 'The Competitive Advantage of Nations', 1990