

THE PERFORMANCE OF THE PALESTINIAN ECONOMY SINCE 1994

A new report by **Stan Fischer** and colleagues at the International Monetary Fund (IMF) examines developments in the Palestinian economy in the period 1994-2000, prior to the outbreak of the recent conflict. The report, which is published in the latest issue of the *Economic Journal*, indicates that economic performance during these years was uneven. Aggregate income rose by about 12% over the seven-year period. But per capita income declined despite the mobilisation of substantial amounts of foreign aid and progress in establishing a basic institutional framework and improving physical infrastructure. Per capita income rose sharply in the period from 1997 until September 2000, when violence intensified.

The overall decline in per capita income over the period is clearly disappointing. On the basis of the variables typically thought to be important for long-term economic growth - such as the initial income level (convergence effect), the level of education, trade openness, financial development, inflation, infrastructure - the Palestinian economy could have been expected to record fairly high growth in per capita GDP. But economic growth and private investment in the WBS in recent years were adversely affected by a combination of factors, most significantly closures, excessive transportation and transaction costs related to the permit system and other restrictions, and major uncertainties about political developments and the direction of policies. There have also been concerns over governance.

Since 1993, the Palestinian economy has been subject to a permit system and an intensification of controls, including periods of closure that Israel has imposed often in response to security incidents or at times when the risk of security incidents was perceived to be high. During closures, the WBS are sealed off from the rest of the world and from each other. The movement of goods and people is disrupted or completely blocked. There is a permanent loss of income for the Palestinians who work in Israel (in June 2000, there were 130,000 such workers, or roughly 20% of the Palestinian labour force) and closures have a severe effect on household income and consumption. The cumbersome system of restrictions has led to high transportation and transaction costs, and closures have also added volatility and unpredictability in production and trade. The resulting increases in risk and loss of competitiveness have adversely affected exports, investment, and growth.

As for policies, a major achievement is the establishment of a Palestinian institutional framework, essentially from scratch. Key policy institutions, such as the Ministries of Finance and Economy and Trade, and the Palestine Monetary Authority, have been created and many new laws have been approved.

But progress in economic policy reforms has been episodic and in many areas it has been slower than desirable:

- One concern relates to the PA's involvement in the economy. Its large equity holdings in private enterprises raise concerns about fair competition and the best use of scarce fiscal resources.
- There are also concerns about how the PA operates, including about decentralisation, transparency, and the management of public finances.
- Another area of concern is the weak capacity and independence of the judiciary and the status of the legal and regulatory framework more generally.

Concerns in all of these areas are likely to have deterred private investment. At the same time, the PA has come a long way under difficult circumstances, and important improvements in governance were made in the spring of 2000.

While it is difficult to say how much income and production have fallen in the last nine months, there can be no doubt that the current conflict that began in late September 2000 and the associated closures represent a massive setback to the development of the Palestinian economy.

Notes for Editors: 'Economic Developments in the West Bank and Gaza since Oslo' by Stanley Fischer, Patricia Alonso-Gamo and Ulric Erickson von Allmen is published in the June 2001 issue of the *Economic Journal*. The authors are at the IMF. The views expressed here are those of the authors and not necessarily of the IMF.

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