

# PALESTINIAN ECONOMIC PROSPERITY IS ESSENTIAL TO PEACE IN THE MIDDLE EAST

If we are ever to see the emergence of a peaceful and prosperous Middle East 'common market', it must first be shown that mutual benefits from free trade and co-operation are attainable on the narrower level between Palestine and Israel. That is the central message of research by Professor **Nu'man Kanafani**, published in the latest issue of the *Economic Journal*. In that sense, trade relations between Israel and the West Bank and Gaza Strip (WBGS) have even wider implications than the immediate issue of improving Palestinian living standards. It is therefore essential that future agreements move on from the design of the Economic Protocol (EP) of 1994 between Israel and the Palestinian Authority (PA).

Kanafani argues that many of the economic problems of the WBGS in the past few years can be traced back to the EP trade regime and not only to political turbulence and the harsh Israeli policy of economic siege. In particular, he blames the unfortunate and shortsighted design of the EP, which subordinates economics and makes Palestinian living conditions a pressure tool for political gains. This state of affairs created uncertainty of a nature and extent that would make it impossible for any economic system to function properly.

The experience of the past years have clearly demonstrated four major weaknesses that should be avoided in future economic agreements between Israel and the WBGS:

- *First*, it is the time to realise that the success of any political settlement is conditioned by providing minimum conditions under which the Palestinian economy can survive and prosper. Interim, unfinished and half-hearted economic arrangements have had catastrophic economic consequences, if only because they are synonymous with uncertainty about the future. Uncertainty is probably the most important single factor in explaining the dismal economic performance of the WBGS especially in terms of productive investment. The Israeli policy of closure is particularly harmful because it is totally unpredictable. It is time to realise that any political settlement that does not ensure economic viability and improvements in standards of living undermines its own foundation.
- *Second*, the absence of a real enforcement mechanism and of effective arbitration between the parties is one of the major defects in the EP's trade arrangements. The Joint Economic Committee between the two parties should have full competence to deal with all trade disputes no matter what their origins (security or mere customs valuation problems), and to do so with an undisputed enforcement mechanism. Both Israel's notorious record of creative use of non-tariff barriers and the PA's short history in trade matters promise endless trade disputes in the future. Along with the vast discrepancy in the bargaining power of the two parties, this implies the need for an effective arbitration mechanism and a permanent arbitration body. Special arrangements can probably be made to assign this role

to the World Trade Organisation (WTO).

- *Third*, the trade regime envisaged in the EP is complex in structure, impractical and costly. The hybrid trade regime envisaged in the EP was an unfortunate novelty. It was basically a political creature that allowed the parties to continue their political battle by economic means. It established a costly regime of double bureaucratic layers, double trade policy and customs books, and countless overlapping preferential trade agreements with third parties. At the same time, the Palestinians lost the potential gains from a properly designed customs union without benefiting much from free-trade area concessions. Given the special circumstances of the region, the parties would have been better off with as simple and straightforward a trade regime as possible.
- *Fourth*, with regard to future arrangements, if a customs union is chosen, then some formula for revenue sharing should be seriously considered. It is well established, both in theory and from specific applications, that potential benefits from customs unions are not necessarily equally distributed between the participants. A future customs union between Israel and the WBGS should incorporate a mechanism for compensating the poorer and weaker members of the union. If a free-trade area is chosen, there will be an even stronger need for an enforcement mechanism and arbitration to solve the problems related to rules of origins and to smooth the flow of trade on the customs borders. Special non-reciprocal trade concessions should then be carefully negotiated to give the WBGS economy a chance to restructure itself and develop its productive base.

**Note for Editors:** 'Trade: A Catalyst for Peace?' by Nu'man Kanafani is published in the June 2001 issue of the *Economic Journal*. Professor Kanafani is at the Royal Veterinary and Agricultural University, Denmark.

**For Further Information:** contact Nu'man Kanafani on 00-45-35-28-22-69 (email: [Kanafani@flec.kvl.dk](mailto:Kanafani@flec.kvl.dk)); or RES Media Assistant Niall Flynn on 020-7878-2919 (email: [nflynn@cepr.org](mailto:nflynn@cepr.org)).