



## **A costly divide | February 2015**

Economic repercussions of separating  
Gaza and the West Bank



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## 1. Introduction

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Work on this report began in the spring of 2014. The idea was to gather, process and analyze current data from Gaza's business sector in order to gain an understanding of the economic impact of access restrictions between Gaza and the West Bank. Another goal was to illustrate the potential that remains unrealized because of Israel's separation policy,<sup>1</sup> which splits the two parts of the Palestinian territory. To do this, Gisha's field researcher in Gaza, along with the heads of local professional organizations and business people, gathered a group of subjects representing Gaza's manufacturing sectors, who we planned to survey with comprehensive questionnaires. Then, the terrible violence of July and August came and changed everything. The devastating toll on the lives of children, women and men, was compounded by damage to Gaza's already deficient and failing infrastructure, homes, and hundreds of factories, businesses, workshops and warehouses, along with their contents. Gaza's already stifled economy suffered a series of painful blows, and answering questionnaires about business potential understandably became less of a priority for people who found themselves counting so many losses.

The region's cycle of life and death has bred a habit: after every massive escalation in violence, Israel eases the Gaza closure slightly: an obstacle is removed, a procedure is changed, and all are reminded how Israel's control over the most significant aspects of the lives of Gaza residents is also there to serve a policy concept. The essence of this concept, though not exclusively, is expressed in the phrase "the separation policy", namely, a series of decisions intended to institutionalize a split between the two parts of the Palestinian territory - the Gaza Strip and the West Bank.

**The Palestinian economy has no hope of realizing its potential without a connection between its two major territorial parts, making any reconstruction talk that leaves out this connection unrealistic**

The "separation policy" is open to interpretation, mostly because it has never properly been explained and did not arise from an open debate or decision-making process. The reasons cited for it have fluctuated between (Israel's) security interests and (Israel's) political goals. Minor changes made to the

policy over time have been reversible, and were rolled back as punitive measures when the Israeli Ministry of Defense saw fit to do so.<sup>2</sup> The essence, however, has not changed and the prevention of movement between the West Bank and the Gaza Strip remains. During the first seven years of the closure, many of the decisions the security establishment made regarding the Gaza closure were informed by the concept of the "separation policy".

Since the cease-fire reached on August 26, 2014, the discourse has once again shifted. Israel's top security officials have cooperated with the broad international mobilization, collaborating with the United Nations' coordination mechanisms and the Palestinian consensus government, and everyone is talking about the need to reconstruct Gaza and build an economic future for its residents.<sup>3</sup> There is a broad consensus on the need to create commercial, professional and employment opportunities, rebuild, fill the gaps in terms of infrastructure (the supply of electricity has been partial for years and running water is largely un-potable), and reduce the housing demand. For this purpose, Israel announced, for the first time since the closure was imposed in June 2007 that it would allow the sale of Gaza-grown and manufactured goods in the





Photo: Eman Mohammed

At the edge of the Gaza market, a vendor hauls empty crates

West Bank. In addition, a mechanism has been put in place for the purpose of allowing entry of construction materials through Gaza's only commercial crossing, Kerem Shalom.

At first glance, this looks like a dramatic shift. People involved in efforts to bring stability to the region have considered economic discourse to be a practical option for some time, and current rhetoric seems to suggest that this pragmatic approach is being adopted. However, five months after the ceasefire agreement, the effects the changes have had on the ground are still minute. It appears that it is too early to know if Israel is actually retreating from the concept of closure, to the point of eliminating the split between the West Bank and the Gaza Strip or if this is just a softer version of the same closure. A real change would require reversing the system of prohibitions that has stifled the Palestinian economy, particularly in the Gaza Strip. It is not too early to emphasize that residents of the Palestinian territory require reliable, free access between the territory's two parts, Gaza and the West Bank. Without it, a fabric of life that includes family,

social, economic and cultural ties is not possible, and more particularly, without the link to the West Bank, Gaza cannot have a functioning economy.

It is precisely because tentative steps toward reviving aspects of the connection between the Gaza Strip and the West Bank are currently underway that the following pages seem to gain more importance. In this paper, we attempt to do more than just show the potential that such a connection has for Palestinian economic recovery, but to demonstrate how critical it is for the feasibility of such a recovery. In other words: the Palestinian economy has no hope of realizing its potential without a connection between its two major territorial parts, making any reconstruction talk that leaves out this connection unrealistic. The separation policy cannot make the facts disappear – a third of Gaza's residents have relatives in the West Bank and in Israel; cultural, language and business connections between the two areas have a long history, and the areas are internationally recognized as together forming the Palestinian territory, a recognition that has been incorporated into international agreements.

This report is intended for those involved in efforts to resolve the conflict that has afflicted the Middle East for decades through diplomatic channels. The report's conclusions provide tools for those who come into contact with decision-makers, helping to demonstrate how the advancement of Palestinian human rights can be productively incorporated into the process of laying the groundwork for a future peace agreement.

At the present time, when dozens of countries have pledged to help Gaza's residents recover from the violence of the summer of 2014 and truly rehabilitate its fabric of life, not just bring it back to the dire state it was in before the fighting, the economy, addressed in this report, is of paramount importance. The possibility of economic development will bring hope and relief. Freedom of movement will create education and business opportunities, bring a technological boom and enable sustainable planning. These are not just the needs of Palestinian residents. International observers and Israel's top security and political figures agree that true stability in this part of the world is not possible without them.

Following a brief historical overview, which provides the basis for a discussion on Gaza, we clarify the current state of affairs with four chapters reviewing the conditions required now for Gaza's reconstruction and development, and offer an analysis that helps explain the Palestinian territory's unique economy, profiling its various sectors. We follow with a model that allows to assess what this type of economy needs in order to flourish, and which illustrates exactly why the connection between the West Bank and the Gaza Strip is a fundamental condition for the existence of an economy of this size.

We give a short overview of some of the sectors that were hardest hit by the separation of Gaza from the West Bank. In the absence of quantitative data, the overview includes a qualitative evaluation of the major issues.

As this report is finalized, we are working on an analysis of field research that will serve as a follow-up and supplement to this report. It contains an in-



A supermarket in Gaza

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depth examination of the most important elements of Gaza's manufacturing sector. The focus groups we gathered in the Gaza Strip, with the help of local research institutions, will help us individually assess the particular needs of each sector and its potential if the remaining access restrictions between the West Bank and the Gaza Strip are lifted.

Later, we present a model that enables a rough estimate of the impact of the fragmentation of the Palestinian economy, based on a comparative calculation. The model is based on conservative economic theory focused on economies in peacetime. It does not take into account many social aspects of the separation policy, and therefore provides only a partial estimate of the damage caused by the severing of connections between Gaza and the West Bank.

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## 2. The beginning

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The policy aimed at separating the Gaza Strip from the West Bank was born before the turn of the millennium. Most residents of the Gaza Strip are considered refugees, members of families who, until 1948-1951, lived in areas that are now inside the international borders of Israel. Of Gaza's 1.8 million residents, close to 1.25 million are registered with the United Nations' Relief and Works Agency (UNRWA)<sup>4</sup> According to the UN 1947 Partition Plan, the Gaza Strip was to be included in the Arab state, but in the 1949 Armistice agreement, it was put under Egyptian military rule. Short of a few months in 1956 (in which the Israeli military occupied Gaza), the Gaza Strip remained under Egyptian control until June 1967, when it was occupied by Israel. The occupied territory was placed under military rule, which was replaced with the civil administration in 1981.<sup>5</sup>

After the occupation began, Israel was faced with the question of which economic policy to apply in the occupied Palestinian territory. Moshe Dayan, minister of defense at the time, believed in economic integration, while Finance Minister Pinchas Sapir favored separation. Dayan's approach prevailed and the interrelationship between the two economies grew deeper with time.<sup>6</sup> Israel collected taxes and provided basic services to the occupied Palestinian territory (oPt) through the civil administration, but its investment in infrastructure remained low.

**In Gaza, the closure has been enforced with particular efficacy since an electric fence was installed around its perimeter in 1995. Passage was periodically denied to permit holders as well, when Gaza was put under a “full closure”**

The first years of the occupation were marked by free movement throughout the geographic space ruled by Israel. Tens of thousands of Palestinians worked inside the Green Line, mainly in construction. However, trade freedom was incomplete. Pressure from various Israeli sectors resulted in a policy aimed at protecting Israeli goods from Palestinian competition.<sup>7</sup>

The lack of restrictions on the workforce had a positive impact on the Palestinian economy, mostly because Palestinian laborers returned from their work

in Israel with cash in hand. For various reasons, this income was mostly put into building homes. Over the years, the Palestinian economy grew more dependent on Israel and became vulnerable to economic shifts inside Israel and to the restrictions Israel imposed on it.

Following the First Intifada, which broke out in 1987, Israel began restricting the movement of Palestinians and Palestinian goods. In 1991, the “General Exit Permit” was cancelled and Israel began requiring Palestinian residents of Gaza to obtain individual permits to exit the Strip,<sup>8</sup> severely limiting travel between Gaza and the West Bank. The terms of the Oslo Accords, signed in 1994, stipulated a gradual transfer of powers to the Palestinian Authority (PA), including powers pertaining to creating economic policy for the occupied territory. In addition, an expanse of 20 nautical miles off the Gaza coast was slated to remain open for fishing, recreation and economic activity. Since the parties to the agreement decided to leave the issue of borders between Israel and the Palestinian Authority to permanent status negotiations, it was agreed that Israel and the occupied territory would remain under a single customs envelope, with Israel collecting customs and Value Added Tax (VAT) on imports into the PA on the PA's behalf. Until then, these monies remained in Israel's coffers. According to Professor Efrayim Kleinman, a member of the Oslo negotiating team, the agreement was signed with both parties' interest in economic development of the oPt in mind. However, a wave of



terrorist attacks soon washed over country, and the occupied territory was put under closure. In Gaza, the closure has been enforced with particular efficacy since an electric fence was installed around its perimeter in 1995. Passage was periodically denied to permit holders as well, when Gaza was put under a “full closure”. The policy whereby everyone, barring exception, was free to travel was replaced with a policy whereby no one, barring exception, was free to travel.

The “Oslo Era” access restrictions were shaped by two opposing trends in Israel: on the one hand, the peace process was aimed at dividing the space politically, while keeping it as open as possible for the flow of workers and goods. On the other hand, due to security instability, the freedom of movement of Palestinians in general, and Gaza residents in particular, was increasingly restricted as a defense, deterrence and punitive measure.

In 2000, with the failure of the Camp David summit and the outbreak of the Second Intifada, the peace process reached an impasse and the economic discourse of the 1990s gave way to a security discourse. Palestinians’ exit permits were cancelled. New ones were issued only to workers, merchants and patients receiving medical care in Israeli hospitals. The restrictions on the transfer of goods into and out of the Gaza Strip were also tightened.

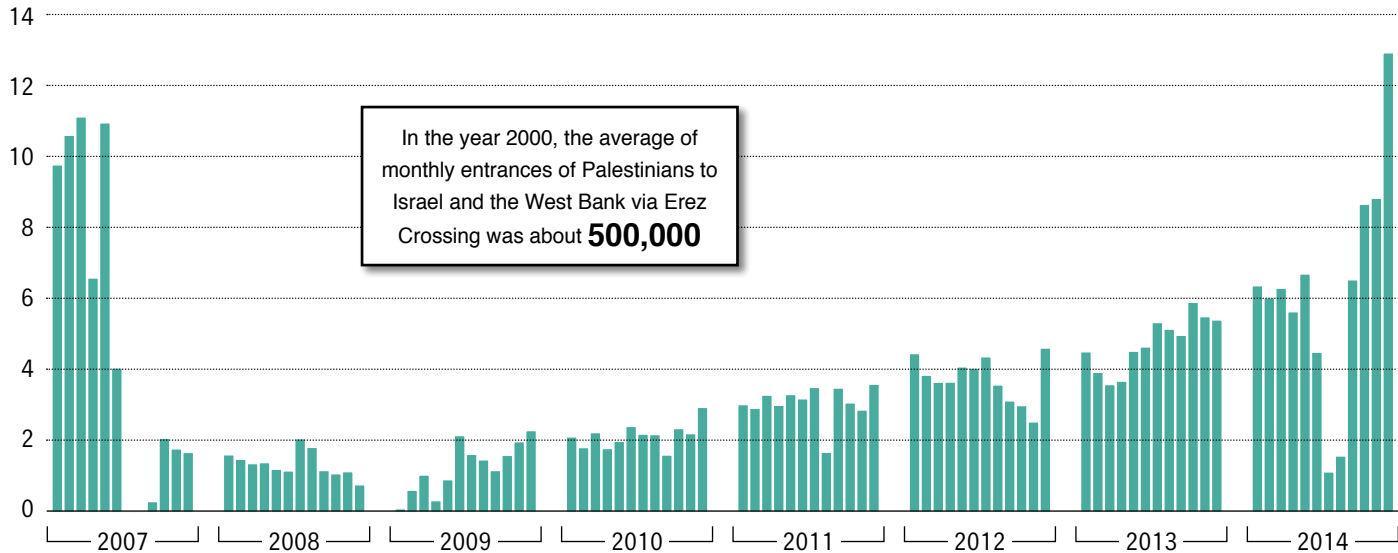


Photo: Karl Schembri

Some, who previously worked in the construction industry and are now unemployed, acquired cargo bikes in order to make a living

Access restrictions were not confined to land crossings. In 2001, Israel bombed Gaza’s only airport, the Arafat Airport, which began operations only in 1998, closed in 2000 and has not reopened since. Israel also prevented sea access to and from Gaza. No sea vessel, with the exception of fishing boats, was allowed to sail Gaza’s seas, and fishing boats themselves were restricted to a distance of up to 12 nautical miles off the coast. In 2001, the daily average number of laborers exiting Gaza to work in Israel dropped to about a quarter of what it was before the intifada. The number of trucks entering and exiting Gaza declined significantly after 2000 as well.<sup>9</sup>

Entrances of Palestinians from Gaza to Israel via Erez Crossing, by the thousands



Source: Palestinian Civil Affairs Committee

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### 3. Disengagement

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In September 2005, Israel implemented its plan for unilateral disengagement from Gaza, but even after the Gush Katif settlements were dismantled and the military left the Strip, Israel retained its exclusive control over Gaza's air and sea space. Israel also maintained control over the crossings between Gaza and the West Bank, the population registry, the taxation system, the electromagnetic space (cellular phone systems, broadcasting, internet connection), most of the electricity supply and more.<sup>10</sup>

After Hamas won the elections held in the Palestinian Authority in January 2006, Gaza - Israel relations, which had deteriorated since disengagement, took a turn for the worse. The situation continued to worsen when rocket attacks on Israeli communities (which began in 2001) intensified and Israeli soldier Gilad Shalit was taken captive. Israel launched a military operation which lasted five months. Late that year, clashes erupted between Hamas and Fatah, which provided the backdrop for the establishment of a Palestinian unity government in March 2007. It lasted about three months.

**The closure all but paralyzed Gaza's trade with Israel and the West Bank, where 85% of Gaza goods had been sold previously. Israel allowed a few dozen items into the Gaza Strip, mostly for humanitarian needs, causing a 95% drop in the average number of trucks entering**

In June 2007, Hamas forcibly seized control of Gaza's governing apparatus. PA president, Mahmoud Abbas, dismantled the unity government and Hamas declared an independent government in the Gaza Strip. These events enabled Israel to change the intensity with which it applied its policy of separation between the Gaza Strip and the West Bank with significant international support. The concept of separation is based on a distinction drawn between the two Palestinian governments, the one in the West Bank which had rejected violence and opted for negotiations, and the one in the Gaza Strip, which refused to

recognize Israel and the agreements signed with it and remained committed to armed resistance.

Israel gave the concept of separation between the Gaza Strip and the West Bank a very broad interpretation, aiming to isolate Gaza from the rest of the world. In the West Bank, separation was expressed in the adoption of a discourse centered on economic development. In early 2008, Binyamin Netanyahu, then leader of the opposition, began talking about a need for "economic peace" with the West Bank, and economic development there. Netanyahu took office in 2009. The West Bank economy did grow, and Netanyahu was quick to take credit, but studies showed that this growth was short-lived and was mainly the result of aid rather than private sector activity and investment.<sup>11</sup>

As mentioned, in terms of Gaza, Israel and the international community had an entirely different policy. International donors removed much of their support for Gaza's development and scaled down to humanitarian aid only. In June 2007, immediately after Hamas took over the Gaza Strip, the Gaza closure was tightened and the Agreement on Movement and Access,<sup>12</sup> which was signed in 2005 and essentially left Israel in control of Rafah Crossing, saw its final demise. The closure included a prohibition on fishing activity farther than three to six nautical miles off Gaza's coast (imposed intermittently and to varying degrees since 2000), severe restrictions on the transfer of goods to and from Gaza and further restrictions on entry by Gaza residents into either Israel or the West Bank, which had already been



reduced to “exceptional humanitarian cases” in March 2006.

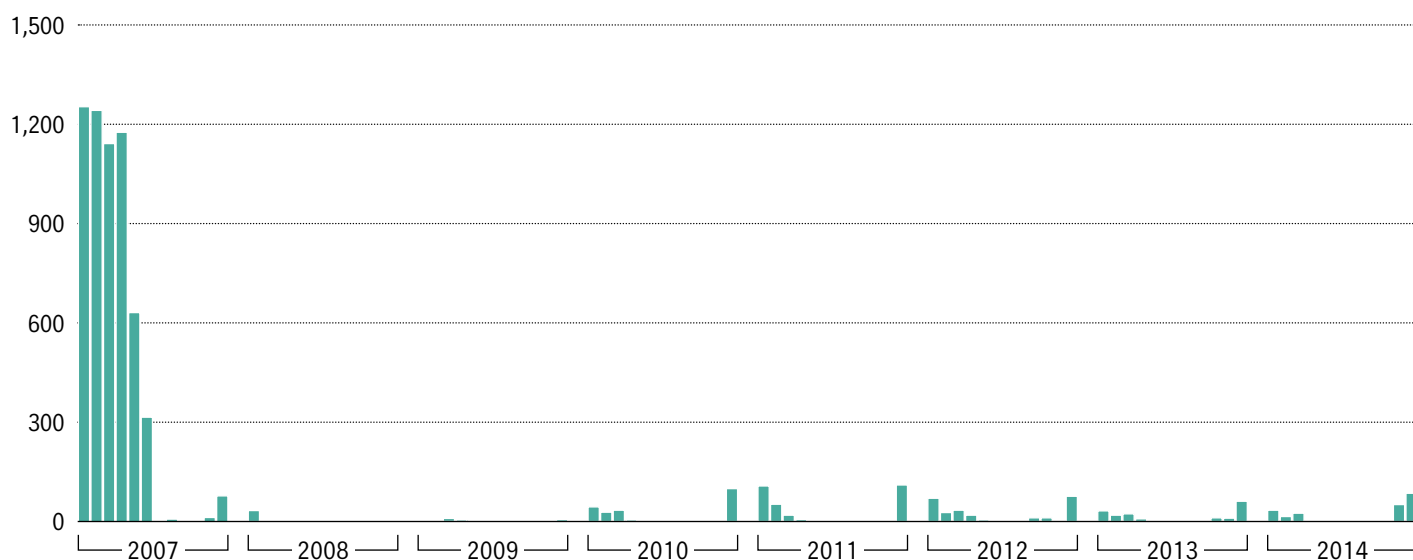
The closure all but paralyzed Gaza's trade with Israel and the West Bank,<sup>13</sup> where 85% of Gaza goods had been sold previously. Israel allowed a few dozen items into the Gaza Strip, mostly for humanitarian needs, causing a 95% drop in the average number of trucks entering Gaza between the first half of 2007 and the second half of that year. Ninety percent of the factories and workshops in the Gaza Strip closed down. A general ban on export from Gaza was also put in place, with the exception of negligible quantities of agricultural export to Europe, though the West Bank and Israel are the natural destinations for marketing Gaza produce.

The artificial disconnect between the two major blocks of the Palestinian territory fractured Palestinian society and the Palestinian economy and gave rise to a flourishing tunnel trade along the Gaza-Egypt border, which evolved even further when Israel changed its closure policy in 2010, allowing most goods into the Gaza Strip. The competition from Israel brought down the prices of goods entering through the tunnels and provided reasonably priced raw materials and wholesale goods to Gaza residents, along with a fairly substantial income for the Hamas

government from taxation levied on tunnel activity, which it regulated.

The closure did not just fail to achieve political ends through economic means, it also failed as a security measure. Since the end of the Second Intifada in 2004, Israel has launched several large-scale military operations, in 2006 (“Operation Summer Rains”), in 2008 (“Operation Warm Winter”), in 2008-2009 (“Operation Cast Lead”), in 2012 (“Operation Pillar of Defense”) and in 2014 (“Operation Protective Edge”). Each of these operations exacted a heavy price from Gaza's civilian population, causing many deaths and extensive damage to energy, water and sewage infrastructure, tens of thousands of housing units and other buildings, as well as roads, education and health infrastructure. Trade and industry were also hard hit. Yet, if these military operations improved security for Israeli civilians, this improvement is hard to detect. Indiscriminate firing of rockets and other projectiles at civilian targets inside Israel by various groups had become the norm, the military had to invest significant resources into policing, monitoring, attack and response, but the “calm” that Israel always claimed it was pursuing never came, certainly not for residents of communities located near the Gaza border.

### Total goods exiting the Gaza Strip via Israeli controlled crossings, in hundreds of truckloads



Sources: United Nations Special Coordinator Office (UNSCO), Palestinian Ministry of Agriculture

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## 4. The current situation

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Israel's closure of Gaza completely prohibits sea or air access, either to or from Gaza, making its residents completely dependent on the three remaining land crossings (after the Nahal Oz, Karni and Sufa were shut down) – two with Israel (Kerem Shalom and Erez) and the Rafah crossing into Egypt. With Egypt's regime change in the summer of 2013 came comprehensive military operations designed to eradicate tunnel activity between the Sinai desert and the Gaza Strip, and severe travel restrictions at Rafah Crossing.<sup>14</sup> Kerem Shalom is the sole commercial crossing Gaza has with the rest of the world.<sup>15</sup>

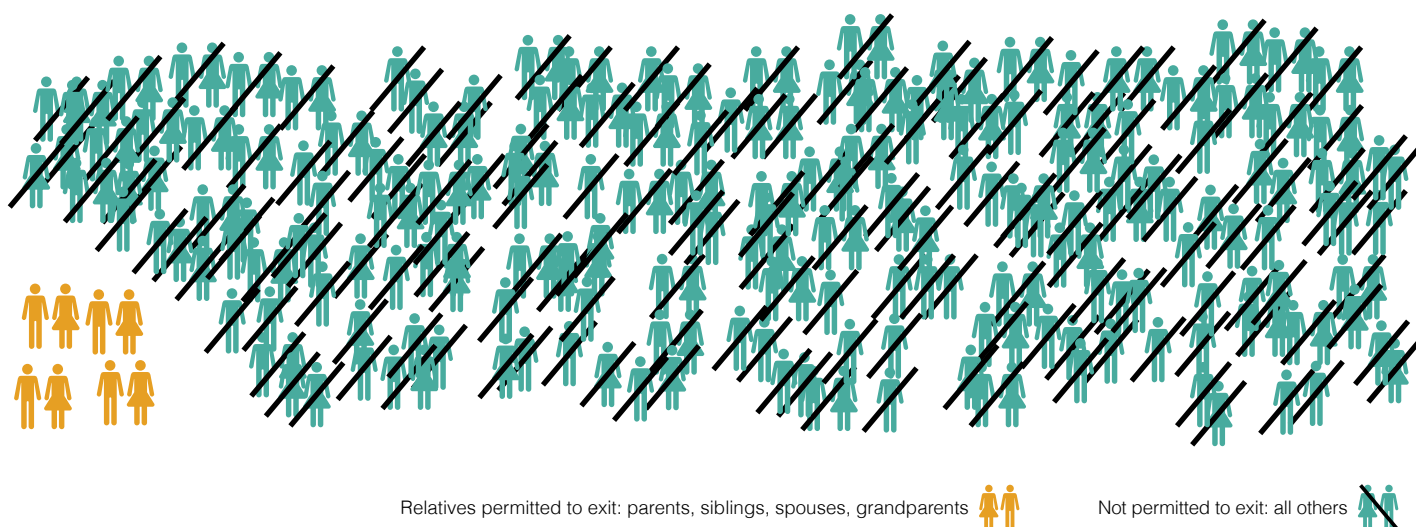
Goods exiting Gaza, even if destined for a third country, must be shipped through Israel, leaving abroad via Israel's Ashdod seaport, Ben Gurion Airport or the Allenby Bridge border crossing into Jordan. The cost of double transport – by Palestinians to the sterile zone at Kerem Shalom and by Israelis from the crossing, coupled with the need for extra storage at times, and naturally, the distance and the costs it involves greatly reduce the profitability of exporting from Gaza. Therefore, most of the goods exported from Gaza during the first years of the closure were part of subsidized projects officially intended to support Gaza's floundering economy (export is almost non-

viable in any case, given low demand for unreliable delivery of goods and the high cost of shipping).

Palestinians are very rarely able to make the short trip between the two parts of the Palestinian territory, other than in exceptional humanitarian cases (mostly medical patients and the people accompanying them), a handful of "senior" merchants and a small group of athletes who are members of national teams. At the time of writing, ordinary Palestinians who are interested in studying, enrolling in professional courses or networking for their businesses are not permitted to travel between the West Bank and the Gaza Strip. This is also true of those wishing

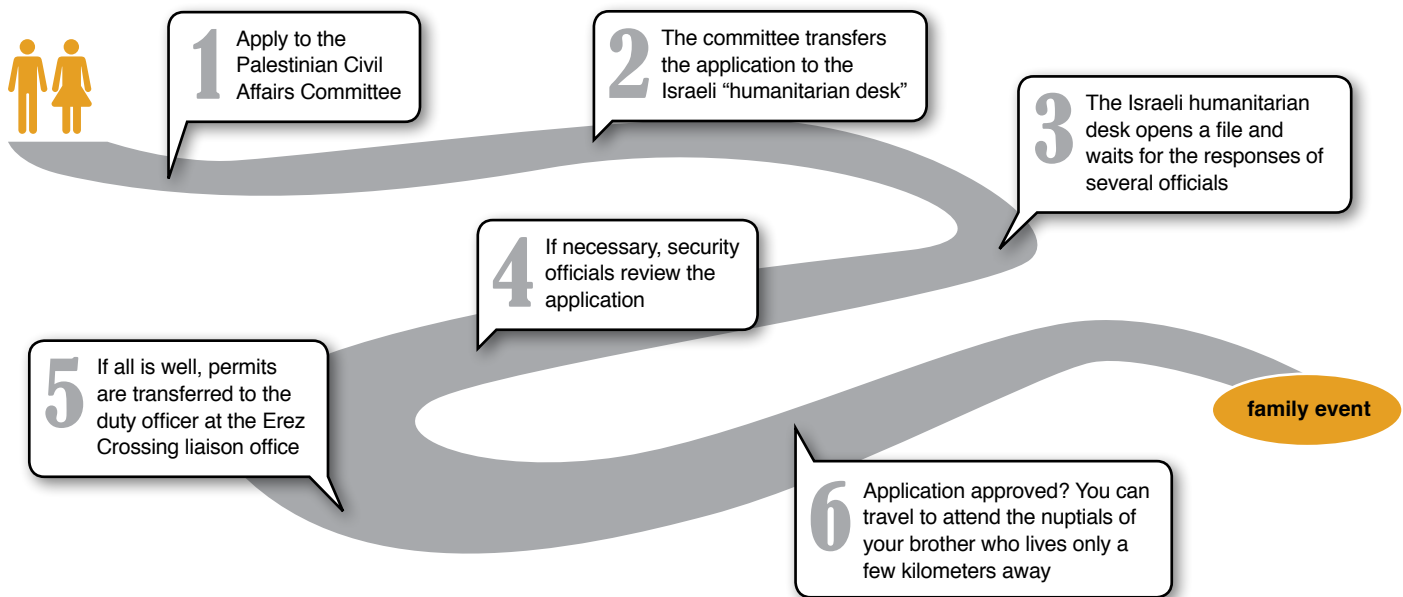
### Exiting from Gaza for weddings and funerals in Israel and the West Bank

Exit from Gaza is not possible other than in exceptional cases\*. One such exception: exit by first-degree relatives and their children\*\* to attend a wedding or funeral



\*Preference is currently being given to medical patients and individuals injured during Operation Protective Edge, so that even those who meet the criteria for exit do not always receive an exit permit. \*\*The protocol allows accompanying children up to the age of six to exit as well. The Closure Permission Status document states that children up to age 15 are allowed to exit. It is not yet clear which of these provisions is in force.

## What it takes to exit Gaza for a family event:



to move to live in the other part of the oPt or mark family occasions other than marriage or death, those interested in traveling as tourists, or those wishing to any other human desire, which should be a basic right for anyone. Following cease-fire negotiations late in the summer of 2014, Israel expanded some of the travel criteria (relating to the age of accompanying children and the inclusion of grandparents in the definition of first-degree relatives, for example), but the principles restricting most Palestinian travel remained as they were.

At the time of writing, there is some tentative movement of goods from Gaza to the West Bank for the first time since the closure was imposed in 2007. This will perhaps give some hope to a job market that even before the destructive fighting that took place in the summer of 2014 had an unemployment rate of about 45% (63% among young people under age 29).<sup>16</sup> As stated, before the closure, 85% of all goods shipped out of Gaza were destined for Israel and the West Bank. Whereas before the closure (until 2007), an average of 1,064 trucks loaded with goods departed Gaza every month, through most of 2014, the monthly average was less than ten trucks, that is, less than

one percent of the volume pre-closure. A World Bank report about the future of the Palestinian economy published in October 2013 showed that restrictions on freedom of movement along with political instability are the main reasons why the Palestinian economy is grounded.<sup>17</sup> That is why more than 70% of the population relied on humanitarian aid and 57% experienced food insecurity even before the fighting of July-August 2014.

Israel has banned the sale of Gaza goods in the West Bank for seven years. Along with Israel, the West Bank is the most natural and most accessible market for Gaza's manufacturing sector – a short trip by truck. At the time of writing, the future of sales to Israel is not known, nor is the scale to which Israel will allow sales to the West Bank. It also appears that Israel still conceptualizes the issue in terms of "easing restrictions" and "making gestures" – small scale, reversible actions,<sup>18</sup> rather than the necessary paradigm shift that seems to be implied in the declarations that have been made by key Israeli officials about the extent of needs in Gaza and the political advantage for Israel in rallying for the restoration of the Palestinian economy.



Increasing unemployment rates among Gaza's rather small workforce reduces the population's purchasing power even further, weakening its ability to strengthen economic sectors and increasing internal pressures. Gaza once supplied affordable, quality labor for Israel's textile sector (See Chapter 6), and laborers from Gaza worked in Israel's agricultural sector. In the new line of thinking that has seemingly emerged

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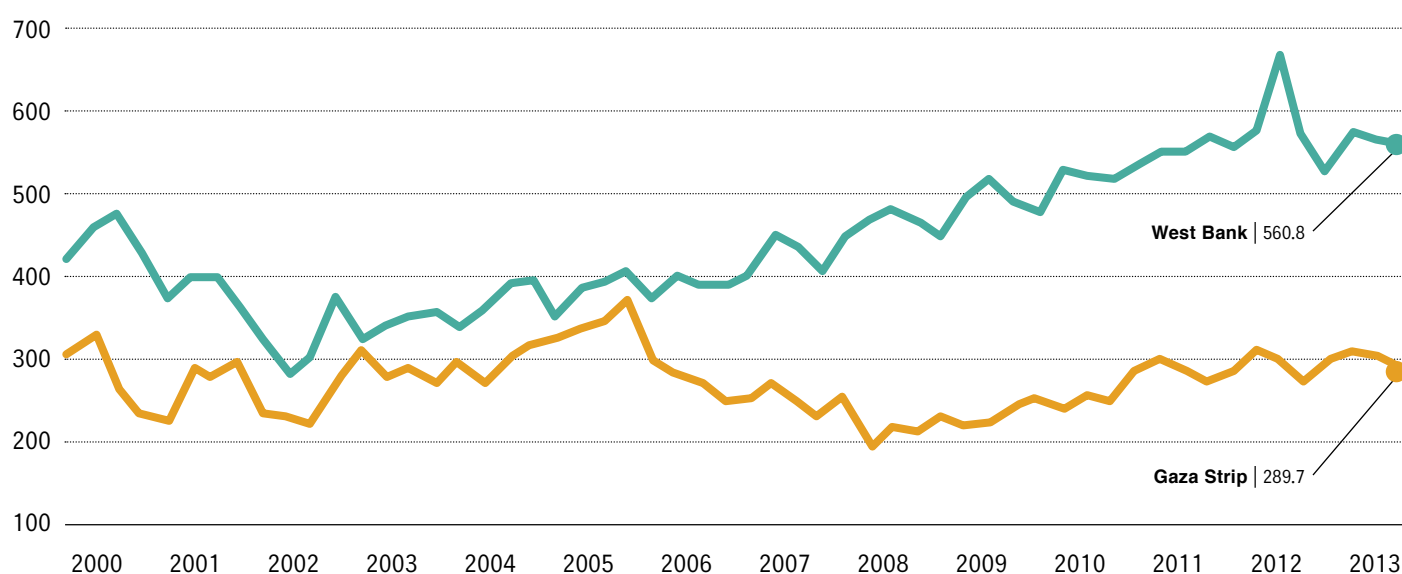
from an understanding reached by the security establishment that the closure failed to provide the results Israel wanted, even in the short term, there is now talk of having Gaza residents work as day laborers inside Israel, in fields located near the Gaza Strip. Longer stays may be permitted in the future, but at the moment, the best case scenario concerns just a few thousand laborers. Open crossings would restore

Israeli companies' ability to take advantage of Gaza's available, skilled labor force.

Another factor weakening the Palestinian economy is the logistical complexities imposed on transporting goods over the few dozen kilometers separating the two parts of the Palestinian territory. These restrictions push Palestinian traders to purchase goods from Israeli companies that are able to supply them faster and more cheaply compared to Palestinian companies based in the West Bank, partly because shipping from Israel is simpler, quicker and cheaper. The cycle of business Gaza does with Israel, including fuel, water and electricity, reached NIS 1.3 billion in 2012. Gaza's supermarkets sell fruit, vegetables, household cleaning products and processed foods made in Israel and the goods are paid for with New Israeli Shekels, the legal tender in the Palestinian territory.

One of the first trucks to leave Gaza when the ban on marketing goods in the West Bank was lifted carried 670 kilograms of fish and shellfish.<sup>19</sup> The fishing industry, which considering Gaza's geographic location, has a long and rich tradition, suffered throughout the years of closure from the loss of the Israeli and West Bank markets (in the first half of 2007, before the closure was imposed, a monthly average of 24 tons of fresh and frozen fish from Gaza were

## Gross domestic product per capita in the West Bank and Gaza, average over quarter, US dollars



Sources: UNSCO, Palestinian Ministry of Agriculture



Photo: Eman Mohammed

Sewage flowing in an open area in the Strip

sold in Israel and abroad). It also suffered from severe restrictions on the permitted fishing zone. At various times over the years, sea access was limited to three to six nautical miles off the Gaza coast, which has resulted in reduced catch. As an example, in 2012, the catch was less than half (47%) of what it was in 1999. According to a report published by the UN Office for the Coordination of Humanitarian Affairs (OCHA), overfishing in the restricted zone has depleted fish breeding grounds, shrinking the fish population and with it the entire sector, which went from providing livelihoods to some 10,000 fishermen in 2000 down to about 3,000 fishermen in 2011.<sup>20</sup>

One final example is the construction sector. The closure of the tunnels running from Gaza to the Sinai desert, coupled with the prohibition on bringing in construction materials for the private sector through the Kerem Shalom crossing has led to the collapse of a sector that managed to flourish even under closure. According to the Palestinian Central Bureau

of Statistics, in mid-2013, 24,200 people worked in the construction sector. Just before the fighting in the summer of 2014, only 6,800 people were employed in the sector. In other words, more than 17,000 people lost their jobs within less than a year. They are joined by an additional layer of traders, wholesalers and retail sellers whose income has suffered as a result of this collapse. Some of the construction materials that might have been brought into Gaza are manufactured in the West Bank (stone for building facades for example), making the damage to the Palestinian economy more extensive still.

The result of all this is an attendant sharp decline in the GDP (Gross Domestic Product) per capita in the Gaza Strip. While the West Bank has shown a slow increase in the GDP, from USD 1,494.20 in 1994 to USD 2,251.30 in 2010, a 50.6% growth rate, in the Gaza Strip, over the same 18 years, the GDP shrank from USD 1,346.80 to USD 1,159, a negative growth rate of 14%.<sup>21</sup>

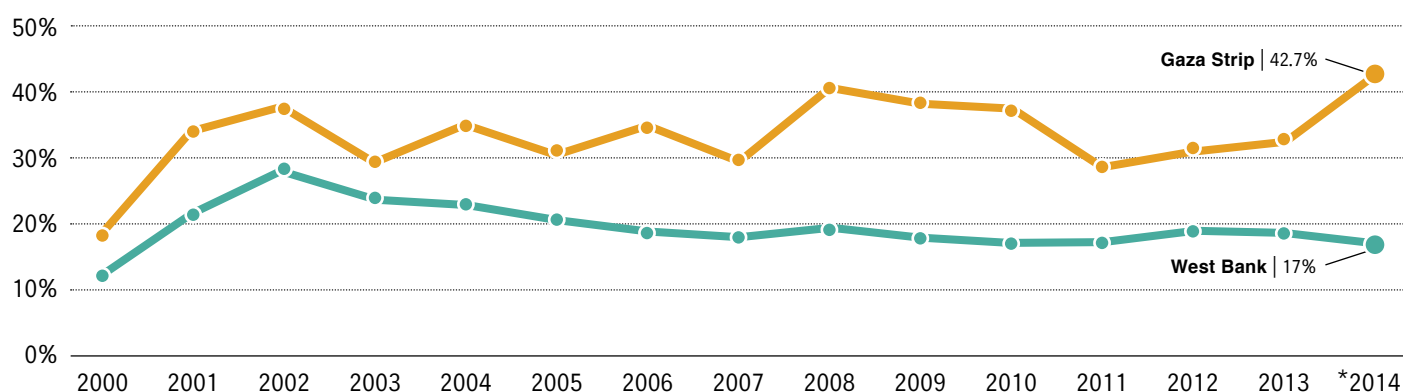
## 5. Beyond reconstruction

The heavy fighting of July-August 2014 caused massive damage and drew much international attention. Throughout the summer, international media outlets reported extensively from the ground, documenting the human disaster and the massive damage to infrastructure and homes: Close to 1,500 civilians dead, a third of them children, and more than 11,000 wounded (3,374 of them children). The damage that affected the entire population of the Gaza Strip has left more than 100,000 of its residents homeless; 20,000 housing units were destroyed or severely damaged; the power station and its fuel reserves were hit; water and sewage infrastructure were badly damaged, as were 174 schools and 67 clinics and hospitals. A total of 360 factories, workshops and businesses were damaged, 126 of them completely destroyed.<sup>22</sup> In an area where running water is not potable to begin with, and where electricity is not consistently supplied for more than eight consecutive hours in the best of times, this is particularly bad news.

The urgency of the situation has mobilized the international community. In an October 2014 conference in Cairo, attended by about 50 countries including the USA, ten European Union member states, Saudi Arabia, the United Arab Emirates, Jordan, Bahrain, Kuwait, Qatar and Oman, more than 5 billion dollars were pledged for Gaza's reconstruction. Israel's Chief of Staff also declared that Israel was committed to reconstruction,<sup>23</sup> while Foreign Minister, Avigdor Lieberman clarified: "You can't reconstruct Gaza without Israeli participation and without Israeli cooperation",<sup>24</sup> meaning, Gaza's reconstruction will always depend on Israeli approvals – to bring in construction materials, to name one. Israel itself does not contribute resources to the reconstruction.

More than 100,000 housing units must be built in Gaza. This figure includes new damage caused during the summer of 2014, about 5,000 housing units destroyed in previous military operations that have yet to be rebuilt, and an ongoing shortage of at least 75,000 housing units that results from the gap between construction capacity and population growth. This figure does not include the reconstruction of factories, hospitals, clinics, sewage treatment and desalination facilities, and public buildings. Transferring the required quantities of construction materials necessitates a coordination mechanism that is efficient and expeditious. The mechanism in place now is complex and years of shortage seem to be assured. Immediate construction needs can provide employment for

### Unemployment rate in Gaza, average over quarter



Source: PCBS

\*Listed here is the semi-annual average unemployment rate for 2014, as the annual rate has not yet been published





Photo: Eman Mohammed

Construction site in Gaza City, from the period where construction materials came in through tunnels from Sinai

## **What must be understood is that Gaza's reconstruction cannot be separated from its reconnection to the West Bank, and that reconstruction means more than restoring the number of buildings in Gaza to what it was before**

Palestinian owned quarries in the West Bank (in 2009, the Gaza Strip accounted for 3% of the market for West Bank manufactured construction materials, and 0% of the market for stone and granite – among the most valuable commodities produced in the West Bank).<sup>25</sup> It can also provide work for professionals and experts who will be able to travel between the two areas and help markets and peripheral industries recuperate.

What must be understood is that Gaza's reconstruction cannot be separated from its reconnection to the West Bank, and that reconstruction means more than restoring the number of buildings in Gaza to what it was before the most recent round of fighting, or to the one that came before. If Gaza residents are to live in dignity, they must have access to opportunities. The critical importance of rebuilding damaged industries cannot be overstated, nor can the need for offices and labs in the ICT sector, a booming sector that is already acting as a powerful engine for

growth in the Palestinian economy. These sectors are simply waiting for opportunities to develop and reach out beyond Gaza's impenetrable borders.

Normal family connections are highly significant for social development within a society. Practical and moral support, entrepreneurship and help with professional and personal tasks help build capacities for education and professional development and afford greater freedom to travel - for example, in order to make business connections. An independent survey commissioned by Gisha in 2013 showed that about a quarter of Gaza's residents have relatives in the West Bank.<sup>26</sup> Opening the crossings for travel will not just release tensions that have been built up over the years of closure and restrictions, but will also give the productive sector of Palestinian society more flexibility and lead to options that have so far been left out of any calculation of the immense potential Gaza's very young society.

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## 6. Review by sector

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Gaza's economic sectors have not been equally impacted by its isolation from the West Bank. While certain sectors in the Gaza Strip are more independent, or more focused on export or import with other countries, other sectors have developed close working relations with West Bank businesses, which they are unable to pursue due to the Israeli-imposed closure. This review by sector is intended to illustrate, using examples, how the fragmentation of the Palestinian economy hinders growth, disrupts potential and causes direct and indirect losses to Palestinian businesses. The focus here is on the disconnection between the Gaza Strip and the West Bank, although the isolation of the Palestinian economy is influenced by many other factors as well.

The discussion here revolves around a general, qualitative assessment, as we are unable at the present time to conduct a quantitative assessment. A quantitative assessment would have served as a basis for an additive calculation of the damage inflicted by the separation (see Methodological Issues, below). Assessing the potential for recovery in these sectors is a much more difficult task, given that changes have occurred in the world outside Gaza during its seven-year isolation. Demand in the Israeli and West Bank markets was met using other sources and habits have changed. It is not possible to press play on a reality that was paused seven years ago and expect the same manufacturing, sales and consumption patterns to resume.

### **Without the ability of ICT managers to conduct business meetings, show their offices to potential investors from the West Bank and send employees to receive training and gain experience in the West Bank, the development of the Gaza ICT sector remains stunted**

Each of the sectors reviewed below not only offers added value for the GDP and contributes to the standard of living, but also creates employment, an extremely important issue in the Gaza Strip, given its young population and very large workforce in proportion to the population. Our follow-up research

is expected to produce a list of challenges specific to each sector.

**Agricultural sector:** According to PalTrade, Palestinians in the oPt prefer locally produced foods, especially vegetables, fresh and dried fruits, and legumes. PalTrade estimates a high potential for internal consumption of tomatoes grown using dryland farming and of herbs.<sup>27</sup> The renewed but still tentative connection between Gaza growers and West Bank markets will likely bring changes, but it is too early to estimate how.

Water allocation is extremely important for the agricultural sector. A joint water policy for the entire oPt, which determines water allocation with a view to maximizing food production for local consumption, thereby reducing dependency on food imports and supporting highest yield crops for export, is especially important in light of severe water shortages. However, the fragmentation of the oPt prevents the implementation of a joint water policy, and the allocation of water between different parts of the oPt.<sup>28</sup> The agricultural sector in Gaza also stands to benefit from joint research and development (R&D) projects with the West Bank. Currently, the only agricultural R&D station in the oPt is located in the West Bank.<sup>29</sup>

**Education sector:** The high population density of the oPt, and especially of Gaza, makes education an important asset. In order to provide enough employment for Gaza's population, businesses must develop vertically, by maximizing value-added per





Photo: Eman Mohammed

Greenhouse with seedlings. Subsidized spices and flowers have been exported

worker, as well as relying on skilled labor, technology, longer supply chains, and large investments of capital per worker. Horizontal business development, in which many unskilled workers are employed in similar jobs and with low value-added per worker, would not create the long-term employment Gaza needs. However, highly developed businesses require a highly-trained and well-educated workforce. Gaza's young population also illustrates the importance of this sector, given that compared with other areas where the age-pyramid is narrower, a large proportion of the population attends school. The education sector is diverse by nature, and requires experts in many different fields. Currently, Palestinian students from Gaza are prevented from studying topics that are only available for study in the West Bank, such as physiotherapy, human rights and gender.

The isolation of the Gaza Strip causes excessive homogeneity in training and education. This increases the risk to the economy whenever certain skills fail to keep up with technological advancements, or when certain economic opportunities cannot be seized because of a lack of appropriately trained

professionals. The education sector is largely dominated by public institutions, and in the case of the Gaza Strip, by international aid organizations (primarily UNRWA). Therefore, it is not often measured using the same tools as private businesses (in terms of profit, value-added, etc.). Nevertheless, one cannot ignore the direct and indirect benefits this sector provides in all countries, and its specific benefits for Gaza's economy (SEC, 2013).

**Energy sector:** the Palestinian energy sector is highly dependent on supply from Israel. Due to decades in which the local production of electricity was neglected, sometimes because of Israeli decisions (the power station was bombed in 2006), Palestinians are highly dependent on Israel for the provision of electricity.<sup>30</sup> At the same time, natural gas reserves off the Gaza coast remain unused. Even if they are eventually developed, the Palestinians will have to find a market for the natural gas. Since Israel has also discovered natural gas and is already in the process of securing markets for it, Palestinians will be left with a smaller export potential, and with lower prices, despite the fact that natural gas was discovered in Gaza's territorial waters before it was





Photo: Karl Schembri

Making of cinderblocks in Gaza, likely using materials smuggled through tunnels from Sinai

discovered off the coast of Israel.<sup>31</sup> On the other hand, demand for energy in the West Bank could help resolve these issues. Using natural gas to supply electricity to the domestic market would resolve the energy dependency of the oPt, while at the same time, ensuring a market for the natural gas.<sup>32</sup>

**Food processing sector:** Food processing plants purchase lower quality agricultural goods and use them for manufacturing. Because it is based on local produce, this branch offers a double benefit - increasing the revenue of local farmers while reducing its own production costs. In this sector, the advantage of a large agricultural base that can increase both the variety and the quantity of produce (and, accordingly, the quantity of lower-quality produce) demonstrates the particular importance of the connection between the two parts of the oPt.<sup>33</sup> The food processing sector in Gaza is also in competition with Palestinian food processing plants in the West Bank, which reduces this sector's potential for growth even if

access restrictions are lifted. In other words, public welfare and living costs are also negatively impacted by the reduction in competition as a result of access restrictions.<sup>34</sup> Economists agree that competition is usually a desirable element in most sectors. In the food processing sector, the fragmentation of the Palestinian economy along geographic lines has been especially harmful to competition.

**Furniture sector:** The furniture sector is one of Gaza's trademark industries. It provides employment for thousands of skilled laborers. The furniture industry manufactures goods for export, but due to high transportation costs, its main markets have been the West Bank and Israel (Ibid, pp. 60-65). In 2005, 600 workshops, with more than 5,500 employees, were involved in the furniture industry. Annual sales amounted to 55 USD million that year. About 33% of the furniture manufactured in Gaza was sold in Israel or exported abroad through Israel, and about 15% was marketed in the West Bank. Every month, an average of

170 truckloads of furniture left the Karni crossing. Most of the furniture businesses focused on manufacturing furniture for homes and some produced office furniture. Before the closure, on average, 40% of the furniture made in Gaza was sold in the West Bank and Israel, and the rest was sold in the local market.<sup>35</sup>

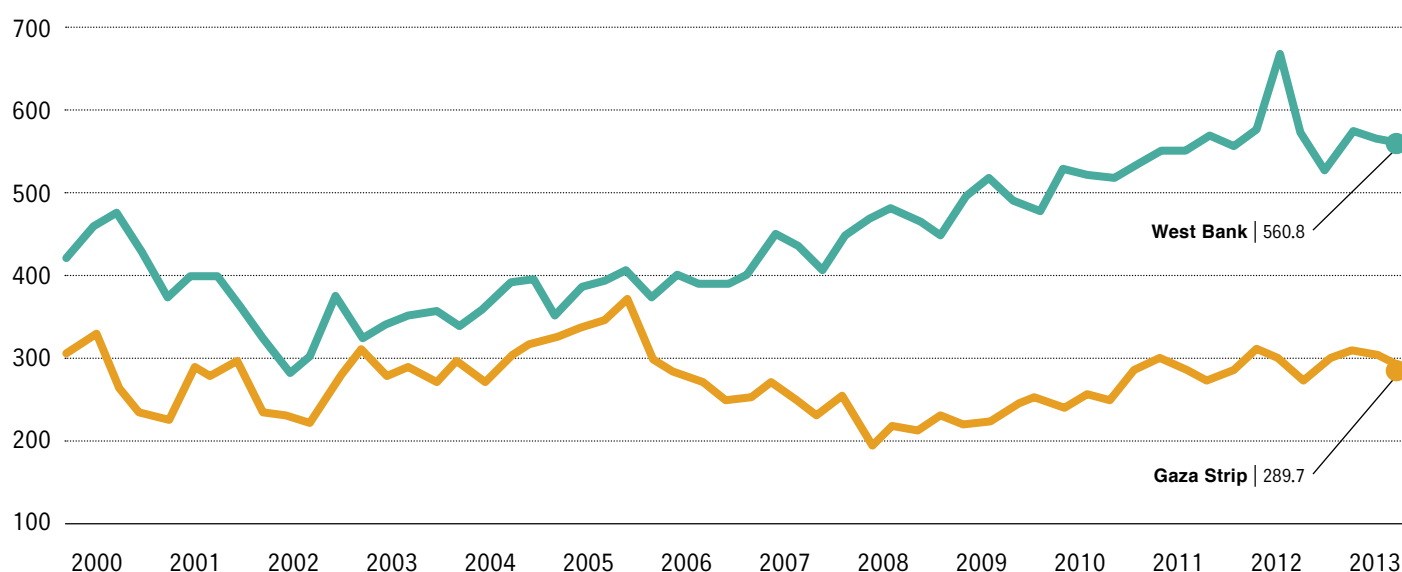
**ICT sector:** Information and communication technology (ICT) is a fast-growing global sector, which has more importance for the global economy than ever before. This sector relies heavily on education and on the skills of its workers. West Bank businesses are already developing exportable services and technologies. BPO (Business Process Outsourcing) is a central component of the growing ICT sector.<sup>36</sup> Access for Gaza residents to the West Bank can allow Palestinians from Gaza to integrate into this already growing sector, securing high-return employment opportunities. The ICT sector in the Gaza Strip is less developed, but through access to West Bank employees, its growth could be accelerated. The ICT sector is considered less dependent on mobility of goods and people, because of the mobility of information. However, without the ability of ICT managers to conduct business meetings, show their offices to potential investors from the West Bank and send

employees to receive training and gain experience in the West Bank, the development of the Gaza ICT sector remains stunted.<sup>37</sup> Potential investors would be aware of these limitations, and as the ICT sector requires large investments, its ability to attract investment is negatively impacted by the separation policy.

**Textile sector:** The textile sector in the Gaza Strip is historically of great importance. Until the closure was tightened in 2007, the sector employed 25,000 workers, mostly women. According to interviews with textile manufacturers in Gaza, there is high demand for Gaza-made textile products in the West Bank. However, after the closure was tightened the market share for Gaza-produced textiles in the West Bank collapsed. Due to increased competition from manufacturers in East Asia, the West Bank market has become increasingly important for Gaza manufacturers, as consumers in the West Bank are more likely to appreciate the brand value of Gaza Strip factories (Ibid, pp. 55-60).

The list of sectors reviewed here is not exhaustive. While the discussion here focused on a few examples, illustrating the economic impact of disconnecting Gaza from the West Bank, the separation policy has, in all likelihood, had an adverse effect on other sectors of the economy as well.

## Gross domestic product per capita in the West Bank and Gaza, average over quarter, US dollars



Source: PCBS

## The methodological challenge

Several reports published over the years have examined various elements of the negative impact of the occupation on the Palestinian economy. Perhaps the most well-known of these is the report of the Palestinian Authority and the Applied Research Institute – Jerusalem (ARIJ), titled “The Economic Costs of the Israeli Occupation for the Occupied Palestinian Territory,” which focused on a number of case studies in the West Bank.<sup>38</sup>

Our goal here is to evaluate one aspect of the impact of the occupation that was not analyzed in the report of the PA and ARIJ. Namely, the impact of access restrictions between Gaza and the West Bank, imposed by Israel as part of the “separation policy”, and the resulting disconnect between these two parts of the Palestinian territory.

Of course, other factors also affect the Palestinian economy. The closure Israel imposes on Gaza entails additional restrictions on movement that cut off Gaza, not only from the West Bank, but also from the rest of the world and have isolated it economically. Another major disruptive element is the destruction caused during rounds of hostilities.

Two possible methodologies could be used in order to assess the damage caused specifically by the restrictions imposed as part of the separation policy.

The first is additive measurement, in which the researcher makes a list of all of the negative economic implications of the separation policy, calculates each of these and adds up the numbers. This method often results in an underestimation of harmful effects, because it is difficult to assemble a comprehensive list and account for the cumulative outcomes and cross-cutting effects of the interplay between different types of harmful influences.

The second methodology is comparative. The researcher finds a comparable case study in which the cause of the damage did not exist, and compares the differences between the case study, which serves as a control group, and the subject of the research. The comparative methodology is prone to distortions as no two cases are truly identical in all but one differentiating aspect. For example, comparing the Gaza Strip with the West Bank may overlook the fact that the West Bank is also under military occupation and prevented from fulfilling its own economic potential. Each additional differentiating aspect may skew the comparison.

In the case of the Gaza Strip, the additive methodology would require compiling a list of all forms of economic value that have been denied or impaired because of the restrictions on movement between the Gaza Strip and the West Bank. The longer such isolation persists, however, the more hidden these items become. As merchants, manufacturers and service providers in the Gaza Strip and the West Bank continue to operate without access to the rest of the oPt, and continue to develop their efforts to locate alternative places to conduct business, they spend less and less time planning business ventures with the restricted area, and become less aware of missed opportunities. The additive methodology is therefore a limited tool for measuring damage inflicted over long periods of time.

The comparative methodology in the Gaza Strip would require us to find a comparable case of a densely populated area which is subject to access restrictions, but still has a connection to a nearby area with similar cultural, economic and social characteristics. In other words, the comparable case study should be a peninsula-like enclave, with a single exit towards a friendly territory but with all other directions blocked by a hostile force. A possible example would be West Berlin under the Soviet blockade, during which it was still able to maintain its connection with West Germany through airlifts. However, the blockade on West Berlin lasted only eleven months.

The methodological difficulty is further complicated by the difficulty to access accurate and current information on the Gaza Strip. The collection of statistical information about a region requires resources and a qualified staff of surveyors who can move freely and interact with the population. Under conditions of closure and frequent hostilities, these requirements are not available in Gaza as they are elsewhere.<sup>39</sup> Currently, due to the hostilities of July and August 2014, obtaining primary data is even more difficult. Many of the business figures and other individuals who would be surveyed for the purpose of this report were displaced; lost their property (such as the businesses in question); or were otherwise impacted by the recent military operation. Because of these special circumstances, this report is based on studies and articles conducted previously, with the aim of achieving a deeper level of analysis of data that is already available.



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## 7. Benefit of size

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The review by section presented above offers a qualitative approach for the additive calculation of the harmful effects of the of separation policy. Since there is no comparable area against which the unique conditions of the isolation of the Gaza Strip and the fragmentation of the oPt can be highlighted, we will apply the comparative approach (see Methodological Issues, above) on the basis of an abstract economic model which was constructed by analyzing data on the benefits of size.

Even if the oPt were a unified territory with free access between its parts, it would be a small economic unit, in terms of territory, population and GDP. Small size is an economic disadvantage, leading to stronger dependency on trade.<sup>40</sup> Some small countries such as Singapore and Oman have achieved high levels of economic development despite their size, and they are often mentioned when discussing the potential of the Palestinian economy. However, in all such discussions, the Palestinian economy is referred to in terms of the unified economy of the West Bank and the Gaza Strip, rather than two separate economies. The forced

### **Small size is an economic disadvantage, leading to stronger dependency on trade. The forced separation between the West Bank and the Gaza Strip compounds the problem caused by the small size**

separation between the West Bank and the Gaza Strip compounds the problem caused by the small size.<sup>41</sup> This perspective puts the isolation of the Gaza Strip within the broader context of the fragmentation of the Palestinian economy. While Gaza bears more of the harm caused by this fragmentation, both parts of the oPt suffer from the lack of free access between them.

Economic literature discusses the economic advantages larger states have over smaller ones.<sup>42</sup> The term “benefits of size” has been developed in economic theory to explain how larger states (in terms of population, territory and economic volume) enjoy a

better growth rate in the long-term. The reasons for this are (1) the advantage of size in producing public goods (single state-wide education, health, transportation and energy systems are more efficient than isolated localized services); (2) relative safety from military conflicts; (3) the ability to internalize cross-regional externalities by central provision of public goods (for example, by formulating policy to deal with industry that is located in one area and creates pollution in another)<sup>43</sup>; (4) the larger state can provide economic insurance for regions, and assistance in case of natural disaster or other types of localized crisis; (5) the capacity for building a larger redistributive social system to restrict social inequality, thereby encouraging citizens to remain in the country rather than emigrate for economic reasons; and (6) the advantage of a larger market, which encourages variety and competition, restricts monopolies and ensures an abundance of needed skills and resources.

Of these six reasons, all but reason (2) are relevant to the oPt. For example: (1) resources could be saved by allowing hospitals and universities to specialize, thereby avoiding duplicate services in the West Bank and the Gaza Strip; (3) a water-allocation policy for the entire oPt would be more efficient than several separate policies for different regions; (4) a guarantee against unexpected disasters would improve the incentive for investment; (5) disparity in the standard of living between different areas of the oPt serves as a serious threat to social cohesion in Palestinian society, a gap which could be bridged with a social welfare system; and (6) the previous chapter listed how

various sectors of the Palestinian economy are better geared towards reaching across regional boundaries and how inter-regional trade could improve each of these sectors.

A large state (both in terms of territory and of population) gains from the fact that a greater percentage of business interaction takes place within the state, rather than across borders. A larger state tends to have a more varied array of natural resources, geographical terrains and labor force qualifications. It is assumed that in every cross-border transaction (such as export, import, currency conversion, investment, resolution of legal disputes, etc.), there are additional costs involved when compared to such transactions conducted domestically, even across great distances. Domestic transactions are conducted using the local currency, the local legal code and without paying customs and other fees. These advantages remain valid whether one compares long-distance transactions within a large state or between distant states, or short-range transactions inside a state or between nearby states. Economist Paul Krugman suggests that workers in smaller countries tend to have lower wages to compensate for the disadvantages of their country's size.<sup>44</sup>

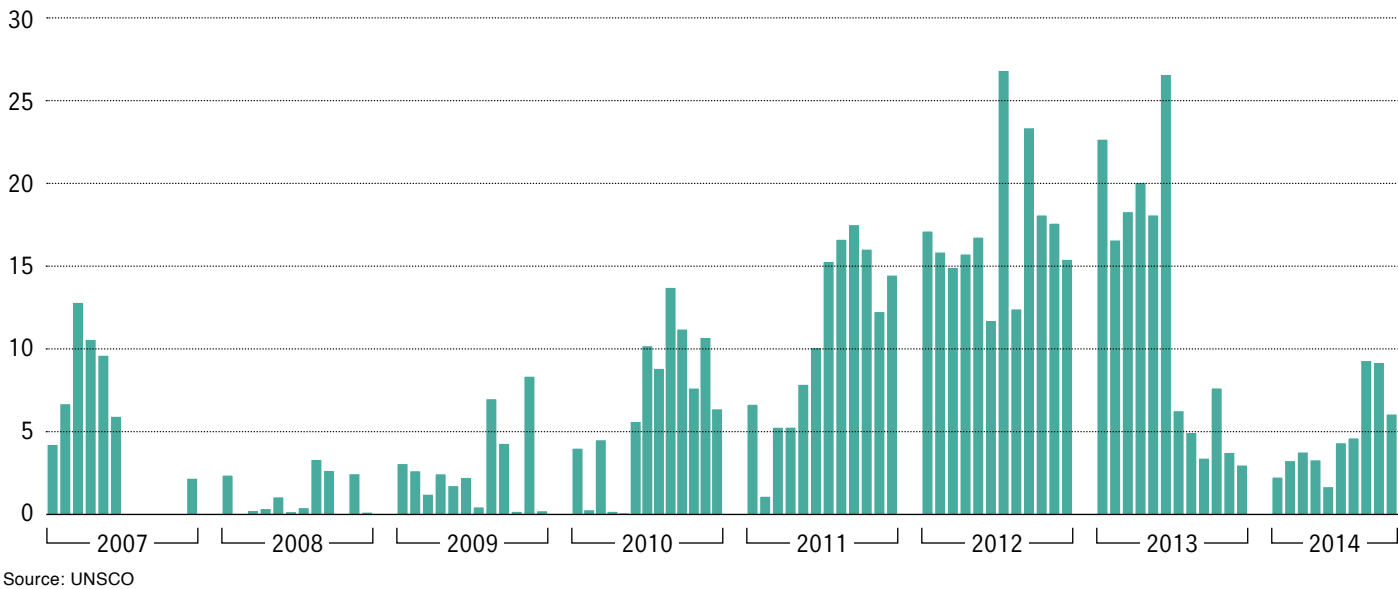
The case of the Gaza Strip and the West Bank is a clear example of this potential advantage. The Gaza



November 6, 2014. The first sale of cucumbers to the West Bank since 2007

Strip has access to different natural resources (fish, natural gas, sand for construction) than the West Bank (stone and marble, fertile land in the Jordan Valley, olive trees, etc.). There are also differences in the qualifications of the labor force.<sup>45</sup> Coupled with the short distance between the two areas, it is possible to conclude that trade between businesses in the Gaza Strip and in the West Bank would be a natural and important component of the Palestinian economy. This conclusion is further strengthened when taking into account the shared history and culture of the two areas, and the fact that the same language is spoken in them.

**Entrances of from Gaza to Egypt via Rafah Crossing, by the thousands**



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## 8. Conclusion

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In almost every survey of the prospects of the economy of the Gaza Strip, the issue of an open connection with the West Bank (including the free movement of goods and people) is a central point. The World Bank has determined that the integrity of the oPt, including free access between the Gaza Strip and the West Bank, is a necessary condition for the viability of the Palestinian economy as a whole.<sup>46</sup> Yet the reality of the closure imposed by Israel on the Gaza Strip is a reality of separation and isolation, in which contact between Gaza and the West Bank is severely restricted.

In almost every survey of the prospects of the economy of the Gaza Strip, the issue of an open connection with the West Bank (including the free movement of goods and people) is a central point. The World Bank has determined that the integrity of the oPt, including free access between the Gaza Strip and the West Bank, is a necessary condition for the viability of the Palestinian economy as a whole. Yet the reality of the closure imposed by Israel on the Gaza Strip is a reality of separation and isolation, in which contact between Gaza and the West Bank is severely restricted.

This separation has many, unavoidable, effects. Being both smaller in size and more acutely affected by the separation policy, the population of the Gaza Strip bears the brunt of these negative effects. Separation has an immediate impact on income, employment, investment and the standard of living in both areas. Factories are unable to procure raw materials defined as “dual-use” materials by Israel, and lose access to a key market. Entire sectors are reduced to a fraction of their potential size. Lack of access to education facilities restricts the acquisition of proficiencies and slows the technological development of industries (especially in the ICT sector).

Beyond the short-term harm caused by the separation, the long-term impact of the disconnection is devastating for both areas, and especially for the Gaza Strip. The increase in unemployment causes social damage that carries over to the next generations. Lack of educational possibilities means that Gaza youth may not have the chance to learn about fields of study in which they could potentially excel. Even if the areas were to be re-

connected, these young people would already be at a disadvantage and would need to spend time and effort to bridge the gaps that have already formed.

While it is difficult to determine exactly how much the Palestinian economy has lost as a result of the separation policy imposed by Israel, it is clear beyond a doubt that these losses have been extensive and that the Gaza economy has been particularly hard hit. In addition to its immediate harmful implications, the policy has a stifling effect – the longer it lasts the more it undermines Gaza’s future prospects for economic recovery, growth and development. In view of this, and in light of Israel’s obligation to do everything in its power to ensure normal life in the Palestinian territory and to enable its residents to live in dignity, Israel must immediately cancel the separation policy. Rather than restricting movement between Gaza and the West Bank to the minimum necessary, it must allow the maximum movement possible subject only to restrictions that are necessary for security and which satisfy the requirements of proportionality.<sup>47</sup>

Dozens of countries, major international organizations, the Palestinian consensus government and Israel’s top political and security officials all recognized the urgent need to help Gaza residents rebuild and recover. In this report we explored what recovery means in terms of economic potential, leading to the realization that recovery cannot begin without opening access routes between the two parts of the Palestinian territory. The future of millions of people depends on it.

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