**Chapter 2**

**2.1. Geopolitical and Economic History**

Geopolitical events and changing political arrangements in the Israeli-Palestinian case have played a significant role over the past 100 years, with key events leading to changes in the control and governance over the region, as shown in Figure 1:

**Figure 1: Key Geopolitical Events**

This chapter reviews these geopolitical events and aspects of economic integration in the region over the past century and examines how they have shaped economic relations between Israel and the WBG leaderships as they stand today. Reviewing this history is essential for understanding the current situation. In each period under study, we describe the economic activity in the region and the impact of geopolitical events on it. The chapter does not seek to present a comprehensive history of the Palestinian and Israeli economies, but focuses on the economic interaction between Israel and the WBG to provide essential background for our analysis.

* 1. **British Mandate for Palestine (1922–1947)**

From about 1517 to 1917, the Ottoman Empire ruled much of the region of the Middle East but, as a result of its collapse after World War I, Great Britain took effective control of what came to be called Palestine and Transjordan in 1918. For the first time in many centuries, borders within the region were defined, as under the Ottomans, such putative boundaries had been subsumed into larger regions. The territory of what was to become the British Mandate included land on both sides of the Jordan River, encompassing the present-day countries of Israel and Jordan. In 1921, Great Britain created a separate administrative entity to the east of the Jordan River called Transjordan, which it later recognized as a separate “government.” In July 1922, the League of Nations entrusted Great Britain with the Mandate for Palestine.[[1]](#footnote-2)

**Figure 2: Division of the British Mandate for Palestine**



*Source: IDF Mapping Unit and Israel MFA*

According to Metzer (1998), the mandatory administration provided an official “state” identity, citizenship, and a unified civil administration including a legal structure enforced by police and courts; a centrally designed and administered fiscal system; an integrated monetary regime; and a modern transportation and communication infrastructure. These measures offered a common framework for all residents of the region toe conduct civil affairs, internal economic activity, and external trade. The mandatory administration provided a strong *de facto* institutional and operational foundation for the development of a single economy, but the Mandate also included an explicit, written British commitment to the promotion of a Jewish national home within this region in which lived Jews, Moslems and Christians, among others.[[2]](#footnote-3)

The area of Palestine was an integral part of the Ottoman Empire until 1918 and therefore used its currency. In 1921, the British administration ordered that only the Egyptian currency and the British gold sovereign would be legal tender in the area. In 1926, the British Secretary of State for the Colonies appointed a Palestine Currency Board to establish a local currency.[[3]](#footnote-4) The board decided that the new currency would be called the Palestine pound and would be pegged in value to sterling. It became legal tender in November 1927.[[4]](#footnote-5)

Shoukair argues that one should speak of there being two rather than one Palestinian economies at that time:

[W]hile the Arab economy was based primarily on agriculture and commerce, the Jewish economy was more broad-based. Seeking to create a European lifestyle in Palestine to attract and consolidate Jewish immigration, the Jewish community erected urban centers and established capital-intensive industries. Given the social, demographic, organizational and political differences between the Jewish and Arab populations, economic integration in Mandatory Palestine was limited. Political ideologies and events exacerbated socio-economic segregation (2013, 52).

Metzer and Kaplan (1985) discuss the Arab-Jewish duality and economic growth during the Mandate and argue that under the relatively stable conditions of the British Mandate, a Jewish community developed alongside the Arab community. Consequently, Palestine became a binational, dualistic entity administratively united by the Mandate. Palestine’s dualism was reflected in two distinct economies: the low-income and relatively backward Arab economy and the relatively modern, high-income, urban Jewish economy. As Metzer and Kaplan note:

Besides the typical dualistic trade in agricultural products, Arab transport and trade services were used intensively by Jews. Arab building materials — primarily quarry products — fed the expanding Jewish construction industry, and dwelling services sold by Arab landlords housed part of the rapidly increasing Jewish population of the mixed towns. On the other hand, the proportion of Arab labor services bought by the Jewish economy, while rising, was still relatively small in 1935.

In addition, a special role in intersectoral trade was played by the land sold by Arabs to Jews:

[T]here has been substantial rise in the product share of Arab exports to the Jewish economy, growing from 9.3 percent of Arab net product in 1921 to 14.0 percent in 1935 (including land sales, it rose from 13.9 to 24.5 percent of Arab product between the two years) while Jewish exports to the Arab economy were negligible in 1921 and reach to 7.8 percent of Jewish product (1985, 339–341).

Metzer and Kaplan’s findings indicate that in view of the efforts made to limit intersectoral relations at that period, the political conflict between the two communities played only a minor role in shaping their economic interrelationship and respective performances.

According to the United Nations Conference on Trade and Development (UNCTAD), both the West Bank and Gaza Strip were highly integrated into the economic network of Mandatory Palestine (UNCTAD 1995). The economy of the WBG was for the most part based on agriculture. The West Bank, mostly a semi-arid farming area, sold much of its output to the coastal urban centers. The Gaza Strip was primarily a citrus-producing area. For both, the central coastal area also served as an outlet for their surplus labor. It is estimated that up to 1948, at least 80,000 persons from the West Bank worked, both seasonally and for extended periods, in the coastal urban centers. The Gaza Strip was also economically integrated into the coastal region to the north and it is estimated that around 80 per cent of the Gaza population depended on contacts with the rest of Palestine for their livelihoods.

In 1936, a nationalist uprising by Palestinian Arabs against the British administration demanded Arab independence and the end of the policy of open-ended Jewish immigration and land purchases explicitly aimed at establishing a “Jewish national home.” The revolt included a general strike and economic boycott of the Jewish sector, but did not achieve its goals. In fact, the hostilities contributed to greater disengagement between the Jewish and Arab economies in Palestine, which had hitherto been somewhat intertwined. The Jewish sector was not materially harmed; indeed its economic activity intensified. Development of the Jewish economy and infrastructure were accelerated: for example, a separate, Jewish-run seaport in Tel Aviv was constructed, metalworks to produce armored plating for vehicles were established, and a rudimentary arms industry was founded. Transportation capabilities were enhanced, and Jewish unemployment declined, as a consequence of Jewish workers now replacing striking Arab laborers, employees, craftsman and farmers, and Jews being employed as police officers by the British following the revolt.

In contrast, in the Palestinian community, houses were destroyed, massive financial costs were incurred because of the general strike, and fields, crops, and orchards were devastated. The economic boycott further damaged the fragile Palestinian Arab economy through the loss of sales, reduced available goods, and increased unemployment.[[5]](#footnote-6) Goren (2017) maintains that one of the consequences of the Arab uprising was serious economic damage to the Arab sector, particularly evident in those places where extensive trade relations between Arabs and Jews had existed in the past, such as in the coastal cities of Haifa and Jaffa.

The Arab uprising over, the start of World War II saw the Palestinians still suffering from the economic impact of the uprising. In addition, they now faced another difficult period confronting them with new problems, such as an even greater economic slowdown and higher unemployment. In view of the dismal situation, the Arabs naturally sought to establish conditions that would enable them to repair the damage from the uprising and alleviate their daily subsistence challenges due to the war. They now turned their focus to day-to-day economic issues. With the Jewish community also preoccupied with the problems of the proper management of daily economic life during the war, Jewish-Arab cooperation increased during this period. This mutually beneficial cooperation was most evident in areas where Jewish and Arab interest were intertwined, primarily in the economic field. However, from 1943 onward, when it became clear that Britain and its allies would win the war, an Arab political resurgence emerged that constricted the scope for intercommunal ties. Overall, however, the period of World War II, unlike that preceding the war, was characterized by a significant improvement in relations between Arabs and Jews, both within the mixed cities and between Arab and Jewish localities.

Stein (1987) identifies and delves into the factors that influenced the rural economy’s evolution, including how Palestine’s rural population fared during the emerging Arab-Zionist struggle over the country’s political future. This struggle, coupled with the attraction of British and Jewish capital enjoyed from sales of rural land and/or funneled through public works projects ultimately undermined the Palestinians’ rural economy by alienating the peasant from the land in.

Metzer (1998) finds that between 1922 and 1947, the Palestine economy’s Jewish sector maintained an annual growth rate of 13.2 percent (4.8 percent in per capita terms), accounting for 54 percent of the net domestic product of the Jewish and Arab economies combined in 1947.[[6]](#footnote-7) However, the Arab sector grew 6.5 percent annually on average at (3.2 percent in per capita terms), less than half that of the Jewish sector over the same period.

On November 29, 1947, the UN General Assembly voted for the Partition Plan for Palestine into two states, Arab and Jewish, that would maintain an “economic union,” although it also stated “that the present situation in Palestine is one which is likely to impair the general welfare and friendly relations among nations.”[[7]](#footnote-8)

**Figure 3: UN Partition Plan Map for Two States**



*Source: Israeli Ministry of Foreign Affairs*

What immediately followed was the successful Israeli War of Independence, or “*Al-Nakba*” (‘the disaster”) as it has come to be referred to among Arabs. On May14, 1948, the proclamation of the State of Israel was made and Britain announced the effective end of its mandate the following day.

* 1. **Between the Wars (1948–1967)**

However, the November 1947 UN Resolution to establish Arab and Jewish states was never implemented, and the War of Independence continued off and on until July 1949. By the end of the war, Israel had taken control of some 5,000 km² beyond the areas putatively allocated to it by the UN. The War of Independence led to a complete halt in economic ties between Israel and the WBG. It also left the Arab population divided into two geographical-political regions: the West Bank under Jordanian jurisdiction and the Gaza Strip was that of Egypt. This had far-reaching implications for both territories. Their economies became geographically and functionally discontinuous and their populations, both indigenous and refugee, were alienated from each other. There was little, if any, interaction between the West Bank and the Gaza Strip, geographically separated as they were by Israeli territory.

**Figure 4: The Territorial Results of the War 1949–1967**



*Source: Jewish Virtual Library*

Both the West Bank and the Gaza Strip lost access to their primary markets, now in Israeli territory, and to ports and shipping routes, their supply line for a wide range of products. Their transportation networks and communication systems were disrupted and even rendered redundant. Many of their inhabitants found that access to jobs was severely curtailed and many border villages lost much of their agricultural land. Both the West Bank and the Gaza Strip also faced the difficulties of reorienting their economies to Jordan and Egypt respectively. Both Jordan and Egypt were more concerned with the political stability than the economic development of these areas (UNCTAD (1995, 11).

According to Mansour (1988) and Shoukair (2013), the 1948 war caused the displacement of more than 276,000 Palestinians to refugee camps set up in the West Bank, increasing its population by approximately 60 percent by 1952. This resulted in extremely high levels of unemployment — 50 percent by 1954 — which led many to seek livelihoods in other Arab countries, particularly Jordan and the Arab Gulf states.

Cohen reports that the West Bank in the early 1950s was more highly developed than Jordan in almost every respect (1986, 92). However, this was to change under Jordanian rule. In the years following Jordan’s 1950 annexation of the West Bank, several factors were responsible for the economic development of the West Bank lagging behind that of the rest of Jordan. First, many professionals left the West Bank in search of work elsewhere. In addition, now separated from its traditional ports located in the Israeli cities of Haifa and Jaffa, the West Bank was in need of new transportation outlets. However, Jordanian infrastructure investments were allocated primarily to the Jordan proper, and its capital Amman emerged as a key center for trade and commerce. According to Hilal (1976), the eighteen years (1948–1967) of Jordanian rule left the West Bank severely underdeveloped. The West Bank economy suffered not only from the general crisis of the Jordanian economy, but also from the Hashemite regime’s policy of economic discrimination against the area that undermined the development of its productive forces. Deprived of any significant industrial or agricultural investment, West Bank unemployment remained extremely high during these eighteen years.

Shoukair (2013) argues that the new geopolitical realities after the 1948 war affected the West Bank’s foreign trade patterns. While most imports, which were predominantly industrial, came from abroad, almost 50 percent of West Bank exports, which were predominantly agricultural, went to Jordan. The West Bank’s trade deficit did not disappear with the end of the British Mandate and separation from the Jewish community. By the time Jordanian governance of the area ended in 1967, the West Bank’s deficit exceeded 82 percent of the total value of trade, and its economy remained largely underdeveloped.

Unlike the West Bank, the Gaza Strip was never annexed to Egypt and Cairo did not grant its residents Egyptian citizenship. Egypt treated Gaza as a territory controlled and administered by a military governor.[[8]](#footnote-9) The economy of the Gaza Strip after 1948 was on the verge of collapse:

Having lost most of its cultivable land and many of its domestic trade links, the Strip’s rural, agrarian sector could not absorb its massive population… Agriculture was clearly the primary economic activity; industrial activity remained virtually undeveloped…Trade and commerce became important income-producing sectors, focused strongly on the development of an entrepot and smuggling trade since custom duties inside Gaza were relatively lower than those prevailing in Egypt…The infrastructure of the Gaza Strip remained rudimentary and, in the absence of an integrated market and skilled manpower base, the economy as a whole stagnated (Roy 1987, 58–59).

Further dividing the region economically was the currency, as the Israeli pound became the currency of the State of Israel from June 1952, the Palestinians in Gaza used the Egyptian pound, and those in the West Bank the Jordanian dinar. This period ended with the outbreak of the 5–10 June 1967 “Six-Day War” between Israel on one side and Egypt, Syria and Jordan on the other.

* 1. **The WBG under Israeli Control (1967–1993)**

In the wake of the Six-Day War, Israel took control of the WBG, the Sinai Peninsula, and the Golan Heights, tripling in size and gaining sovereignty over approximately a further one million Arabs in addition to 300,000 Arabs living in Israel at the time.[[9]](#footnote-10)

**Figure 5: After the Six Day War**



*Source: IDF Mapping Unit and Israeli Ministry of Foreign Affairs*

Arnon (2007) relates that the external borders under Israel’s control were closed within a few days of the war ending, while the internal borders between Israel’s 1948 original borders and those of the conquered territories disappeared for all practical purposes within a short time, allowing economic transactions to take place. Israel implemented its own trade protocol in relation to the new external borders and created a customs “envelope” compromising Israel and the WBG. Israel arranged the terms of the customs union according to its own needs and there was no agreement on sharing revenues from import taxes. The public sector of the Palestinian economy — dealing with taxation, service provision, infrastructure investment, and so on — was under Israeli control.

Neither a macroeconomic policy aimed at serving the needs of the Palestinian economy nor any monetary policy—since local currency did not exist—was ever implemented. The local Palestinian banking system had been ordered closed in 1967 and was not reopened until the 1980s and, even then, only to a very limited extent. During the first decades of the occupation, a few Israeli banks operated in a very limited way in the WBG. Very few financial institutions existed, with minimal financial transactions available through a relatively well-developed network of money changers linked to the Jordanian banking system.

Naqib (2015) analyzes the dynamics of the evolving relationship between the Israeli and Palestinian economies after 1967 as subject to two contrary trends: one positive, tending to help the Palestinian economy expand through new employment trade, and technology transfer opportunities that opened up with Israel; and one negative, tending to impede economic progress and to reinforce underdevelopment through restrictions on resource use, business activity, domestic and international trade, and resource transfer to Israel, as well as the neglect of the public sector. The Palestinian economy benefited significantly from its relationship with Israel in the first decade, when Palestinian GDP per capita grew from nine to 15 percent of that of Israel, but thereafter it continually declined. In the first decade following the Six-Day War, the two economies underwent a process of convergence and the poorer economy grew at a faster rate than the richer economy. After this, however, the richer economy grew at a faster rate than the poorer, exacerbating the economic disparities between them.

Arnon and Gottlieb (1993) identify the defining feature of the economic processes after 1967 war as the interaction between two very different economies meeting in the market. The rapid rise in standards of living until 1987 was driven by high employment in Israel (much in the large public sector), with significantly lower growth in output and productivity. In an economic environment free of controls, it is not obvious that income disparities between such different economies should have narrowed as much as they did. In fact, any reductions in the economic gaps between the two economic sectors could be attributed mainly to relatively cheap labor flowing from the WBG to Israel proper, reflecting an unbalanced and dependent economic relationship of the WBG with Israel. Despite increasing standards of living and high saving rates, only a small share of those savings was productively invested and, as a result, industry contributed little to economic growth.

Arnon and Spivak (1996) find that Israel and the WBG became closely integrated, whereas economic integration between the WBG and Jordan was much weaker. They computed the shocks involved to the economies and the correlation between the transitory shocks and the permanent shocks. Given past circumstances, the imposed monetary union between Israel and the Palestinian economy was warranted.

According to Shikaki (2019), the Palestinian economy had become completely dependent on the Israeli labor and goods market by the end of the 1967–1993 period. The contribution of its own productive sectors diminished and economic activity revolved around work in Israel. Half of the labor force worked in or for the economy of Israel, which had become an unrivalled trade partner for the WBG.

As a result, the number of Palestinians employed more than doubled, but employment within the WBG grew by less than 33 percent. Jobs in Israel kept unemployment in the WBG below seven percent between 1970 and 1993, sustaining a population that had grown more than 2.2 percent a year on average since 1970 (Farkash 2005, 26).

**Figure 6: Palestinians Employed in Israel and WBG Unemployment Rate (1970-1993)**



*Source: Farkash (2005), Appendix*

According to Farkash, the Palestinian economy of the WBG underwent a process of structural change between 1967 and 1993 that made it dependent on Israel:

This dependency was a result of an Israeli policy of economic integration that dealt with the Palestinian demographic challenge by allowing an improvement in individual economic welfare while diminishing the capacity of the WBGS’s economy to stand on its own feet. Growth of the Palestinian economy became dependent on Israeli regulations and demand, rather than on domestic growth and linkages between domestic sectors. It became dependent on access to Israeli labor and product markets, rather than on domestic or international markets. While the economy shifted from being a predominantly agricultural economy to a service-oriented one, its employment-generation and productive capacities remained limited. Palestinian labor flows to Israel, meanwhile, played three key roles: they fostered the integration of the WBG into Israel, they shaped the nature of Palestinian development, and they provided an important source of income at both the individual and the national level. Meanwhile, as the economy became further integrated into that of Israel, the boundaries of the WBG’s economy became more difficult to delineate (2005, 41).

In late 1987, the First Intifada began in the Jabalia refugee camp and spread to Gaza, the West Bank, and East Jerusalem, beginning a series of Palestinian protests and rioting against the Israeli military occupation of the WBG. Arnon (2007) reports that it caused a severe economic crisis in its first year, but one limited to particular areas. Over the following years the ties to Israel continued in the areas of employment, especially in the West Bank, and in trade. There were no strict limitations on the movement of workers and goods, so there was a rapid return to the conditions that had prevailed over the previous 20 years. Arnon and Gottlieb describe the key economic effects of the First Intifada on the West Bank as follows:

The level of GDP fell short of its potential in the first year of the Intifada (1988) by about 15 percent of actual GDP. Thereafter the potential output loss was considerably reduced to 8 and 2 percent in 1989 and 1990. By the year 1991 the level of output returned to its normal level. Over the four years the cumulative output loss is estimated at about 1/4 of current GDP. The calculation also implies a cumulative loss of about 30,000 jobs in the domestic economy. The shortfall in private consumption was much larger (in relative terms) than in output, mainly due to the negative effect of employment in Israel (1993, 24–25).

The First Intifada lasted until the beginning of a peace process at the 1991 Madrid Conference, which eventually led to the “Oslo Accords.”

* 1. **From Peace Process to Entangled Reality (1994–2004)**

On September 13, 1993, Israel and the Palestine Liberation Organization (PLO) signed a Declaration of Principles On Interim Self-Government Arrangements, also known as “the Oslo 1 Accord.” The Accord’s stated aim was an eventual end the Israeli-Palestinian conflict based on a comprehensive peace agreement. During a five-year interim period, negotiations would be held on the main issues of a permanent peace agreement: the political status of Jerusalem, refugees, settlements, security arrangements, borders, relations, and cooperation, along with other issues, such as water provision. It also provided for the withdrawal of Israeli forces from parts of the WBG and the creation of a Palestinian interim government, the Palestinian Authority (PA), the first instance of Arab self-government in the territory of the mandate in Israel’s history.

The Oslo 1 Accord was concluded following secret talks held in Norway between Israeli and Palestinian delegations and signed officially in Washington DC. It served as the basis for a series of subsequent agreements, the most significant of which was the Interim Agreement on the West Bank and the Gaza Strip — known as “Oslo 2” — that was signed in September 1995. This Interim Agreement expanded Palestinian self-government to the rest of the Palestinian towns and to many of the villages in the WBG.[[10]](#footnote-11) It divided the West Bank and the Gaza Strip into three zones — A, B, and C — which served as the basis for the redeployment of Israeli forces. As a result of all the Oslo accords, almost all Palestinians in the WBG came under the control of the PA.[[11]](#footnote-12)

**Figure 7: The Oslo Accords**



*Source: IDF Mapping Unit and Israeli Ministry of Foreign Affairs*

In April 1994, the Protocol on Economic Relations between the Government of the State of Israel and the PLO, representing the Palestinian People, also called the “Paris Protocol” (PP),[[12]](#footnote-13) was signed. It stated that:

The two parties view the economic domain as one of the corner stone in their mutual relations with a view to enhance their interest in the achievement of a just, lasting and comprehensive peace. Both parties shall cooperate in this field in order to establish a sound economic base for these relations, which will be governed in various economic spheres by the principles of mutual respect of each other’s economic interests, reciprocity, equity and fairness.[[13]](#footnote-15)

The PP regulates the following main areas: customs, taxes, labor, monetary and financial issues, agriculture, industry, and tourism. Originally, the PP was to remain in force for an interim period of five years. As of 2022, however, the PP was still in effect.

A major element of the agreement was the establishment by the PA of a Palestinian Monetary Authority (PMA) to regulate and supervise banks, foreign currency reserves, and transactions. Under it, the Palestinians levy income tax on individuals and corporations, property and municipal taxes, and have similar import policies to Israel. Palestinians can import mutually agreed upon goods at customs rates different than those prevailing in Israel. The Israeli shekel remains legal tender in these areas until an agreement is reached on a Palestinian currency. The PA can also impose a value added tax resembling Israel’s.

The PP integrates the Palestinian into the Israeli economy. According to Article III, the Israeli and Palestinian economies are to be part of a unified customs “envelope” that Israel manages. Israel transfers tax revenues it collects on Palestinian economic activity to the PA, including customs on goods directly entering the Palestinian economy, VAT on the net purchases made by Palestinians in the Israeli economy, fuel excise taxes, and purchase taxes.[[14]](#footnote-16)

**Figure 8: Clearance Revenues**

*Source: PMA and PCBS*

Article VII of the PP states: “Both sides will attempt to maintain the normality of movement of labor between them, subject to each side’s right to determine from time to time the extent and conditions of the labor movement into its area.”

**Figure 9: Palestinian Employment in Israel (1968–2019)**

*Source: ICBS and PCBS and author calculations*

 According to Arnon, those who signed the PP anticipated increased economic integration between the two economies, but the reality was a unilaterally imposed and growing separation (2007, 17). After the agreement was signed, Israel introduced many more restrictions on the flows of both goods and labor, even on free movement of labor within the WBG. Many political and security reasons were given for the restrictions created and enforced by Israel. Hostilities between Israelis and Palestinians overshadowed the ongoing bargaining between the sides and contributed to fading hopes of economic prosperity.

More than 80 percent of reported Palestinian exports are exported to or through Israel, including plastics, furniture, and footwear. About 60 percent of Palestinian imports come from Israel or through Israeli importers, consisting mostly of fuel, grain, fodder, construction materials, and machinery.

**Figure 10: Palestinian Exports to and Imports from Israel 1968–2018**

*Source: ICBS, PCBS, and author calculations*

The number of Palestinian workers in Israel dropped drastically. Arnon relates that before the 1994 interim agreements, 30 percent of the Palestinian labor force in the West Bank and more than 40 percent of that in Gaza worked in Israel. During 1995–1996, the percentage of West Bank workers in Israel dropped to 18 percent and those from Gaza to only six percent. Thus, salaries paid to workers from the territories declined. Remittances from work in Israel dropped from more than 30 percent of the West Bank’s GDP to about 20 percent and from 50 percent in Gaza in the 1980s to less than 10 percent. At the same time, the rate of unemployment in the territories, which had been relatively low until 1993, rose to very high levels: around 20 percent in the West Bank and more than 30 percent in Gaza in 1996. These figures improved a little after some restrictions on [the] movement of workers into Israel ended in 1996 (Arnon 2007, 18).

More than 60 percent of the PA’s revenues, excluding international aid, were transferred from Israel in the years 1995–2000 (“clearance revenues”). Thus, dependency remained although it changed from simple dependency on Israel’s labor and goods markets to include financial support to the Palestinian public sector (Arnon, 2007, 19).

Al-Botmeh and Kanafani (2006) argue that there were three key reasons that the PP failed: the 1994 PP was flawed from the outset since it did not build on political or economic sovereignty for the Palestinians; the true problem lay in the political and security environment, rendering the implementation of the PP ineffective; and it had design faults that were further exposed by the lack of a supportive political environment. They argue instead for a trade regime that granting the Palestinians a reasonable degree of sovereignty over their trade policy and economy while maximizing the economic benefits of proximity and privileged access to its neighbor Israel’s advanced economy.

In July 2000, the Camp David Summit failed to reach a permanent agreement to end the Israeli-Palestinian conflict. In September 2000, the Second Intifada erupted and terminated the Oslo Accords process. This Second Intifada was a period of intensified Israeli-Palestinian violence with thousands of casualties. On the March 29, 2002, Israel launched “Operation Defensive Shield,” the main objective of which was to strike at the Palestinian terrorist infrastructure and end the wave of terrorist attacks against Israeli citizens. One of the main triggers for the operation was the March 27, 2002 attack at the Park Hotel in Netanya on Passover Eve resulting in numerous fatalities and casualties, and considered especially heinous in Israel. Operation Defensive Shield concentrated on cities in Judea and Samaria, in particular Nablus, Ramallah, Jenin, and Bethlehem, which hosted most of the terrorist infrastructure. Once the Israel military controlled the main cities, it used other mitigation tools, including commencing the construction of a the separation barrier between Israel and the West Bank (“the Israeli West Bank Wall”) to further reduce the number of terrorist attacks.

These hostilities dramatically affected both economies. Successive border closures led to *de facto* separation, which dramatically reduced commerce, employment, and investment across the board. Israel suffered a three-year recession and its GNP fell by about eight percent. The Palestinians suffered an economic catastrophe on an even greater scale. In the first three years of the Second Intifada, their living standards dropped by about 30 percent, while GDP contracted by 8.7 percent in 2000, an additional 8.6 percent in 2001, and a further 13.3 percent in 2002. The unemployment rate rose to historically extreme heights: about 30 percent in the West Bank and nearly 40 percent in Gaza. Approximately 180,000 Palestinians—of whom 100,000 had been employed in Israel—lost their jobs in the second half of 2000. Wages from abroad in 2001 had plunged to 40 percent of what they had been in 1999.

International aid rose to the unprecedented level of over one billion dollars a year, about one-third of GDP, but this assistance, rather than helping to build the Palestinian economy, became an emergency safety net (Arnon 2007; Shoukair 2013).

Many consider the Sharm el-Sheikh Summit on February 8, 2005 as marking the end of the Second Intifada. The PA and the Israeli Government agreed that all Palestinians factions would stop all acts of violence against all Israelis, while Israel would cease all its military activity against all Palestinians. The two parties also reaffirmed their commitment to the peace process roadmap.

* 1. **Israel’s Gaza Strip Disengagement and Hamas’s Electoral Victory (2005–2021)**

Israel disengaged from the Gaza Strip in 2005, dismantling the 21 Israeli settlements within it and evacuating the settlers and Israeli military. Israel has continued to maintain direct external and indirect internal control over life within Gaza, however: it controls Gaza’s air and maritime space, as well as its land crossings and Gaza remains dependent on Israel for its water, electricity, telecommunications, and other utilities.[[15]](#footnote-18) Gaza residents require permits to enter Israel, as do Israelis and foreigners into Gaza. Gaza residents’ ability to transit to Israel through the Erez Crossing has been gradually limited over the years. Since 1991, residents have been required to obtain exit permits and the number issued has gradually declined.

**Figure 11: Israeli Disengagement from the Gaza Strip**



*Source: Israeli Ministry of Foreign Affairs*

Israel’s disengagement hastened the establishment of Hamas control over the Gaza Strip. On January 25, 2006, Hamas won a landslide victory in the Palestinian Legislative Council elections. The Hamas victory sent shockwaves through both the Palestinian and the wider international community. For the first time in Middle Eastern history, an overtly terrorist organization with a radical Islamic ideology acceded to government by democratic election. The results of the election reflected the feelings of many Palestinians exasperated by the PA’s rampant corruption and ineffectiveness who sought change with Hamas and its worldview. During 2006, Hamas built up its military strength in the Gaza Strip, rapidly establishing itself as both the central military and political power.[[16]](#footnote-19) In June 2007, conflict between Fatah and Hamas reached a peak and Hamas took control over the Strip. In September 2007, the Israeli Security Cabinet designated the Gaza Strip a “hostile territory” due to repeated terrorist attacks emanating from it that targeted Israeli civilians. While Israel remains committed to averting any humanitarian crisis, it does not feel obligated to provide any supplies which go beyond this level.[[17]](#footnote-20)

Gaza’s economic relations with both Israel and the West Bank have deteriorated since Hamas took control over the Gaza Strip: Figures 12 and 13 show this in terms of Gross National Income (GNI) per capita and respective unemployment rates for the West Bank and Gaza Strip.

**Figure 12: GNI Per Capita at Current Prices by Area**

*Source: Palestinian Central Bureau of Statistics*

**Figure 13: Unemployment Rates by Area**

*Source: Palestine Monetary Authority*

Over the years, the levels of violence, mainly in the Gaza Strip, have continued to reflect the fraught situation in the region. In December 2008, Israel launched “Operation Cast Lead”[[18]](#footnote-21) due to the ongoing rocket fire from the Gaza Strip on Israel’s south and endeavored to destroy terrorist infrastructures in Gaza, especially rocket launching capabilities. In November 2012, the IDF launched “Operation Pillar of Defense[[19]](#footnote-22) against terrorist organizations in the Gaza Strip, with the objective of reducing the number of rocket attacks directed at Israeli civilians. While temporarily effective, the rocket attacks resumed, and in July 2014, Israel launched “Operation Protective Edge”[[20]](#footnote-23) in response to increasing rocket and mortar fire on Israel from the Gaza Strip. Furthermore, ground forces entered the Strip to identify and neutralize the cross-border assault tunnels that originated in the Strip’s urban outskirts.

A wave of violence called the “Intifada of the Individuals” took place during 2015–2016 prompted by the suspicion spreading among Palestinians that Israel was attempting to change the status quo of Jerusalem’s Temple Mount by imposing age and gender restrictions on Muslim access while allowing entry to larger groups of Jewish activists. During these events, Palestinians from the West Bank and East Jerusalem carried out assaults against Israeli soldiers and police officers as well as civilians. Between March 2018 and December 2019, Hamas orchestrated a campaign billed as peaceful civilian protest that was, in fact, an excuse for violent rioting on the Gaza-Israel border. In addition, kites and helium balloons with incendiary material were launched from the Strip into Israel, the resulting fires destroying thousands of acres of forest and agricultural land exacting a huge cost to farmers and to the entire ecosystem of the western Negev​. During this same period, the number of rockets launched from the Gaza Strip also increased.

In May 2021, “Operation Guardian of the Walls”[[21]](#footnote-24) was launched after rockets were fired toward Jerusalem by terrorist organizations in the Gaza Strip. Later, Israel was attacked by thousands more rockets. In response, the IDF struck at Hamas terrorist placements in Gaza, including many kilometers of Hamas’s extensive tunnel system.

* 1. **Recent Years**

Given the lack of progress in the political peace process in recent years, the PA has begun seeking ways to reduce its significant dependence on Israel. In February 2018, the PA decided to establish a committee to formulate action plans for separation from Israel on all levels, including the economic agreements and the PP. The PA statement said that the committee would examine, among other things, ending the use of the Israeli shekel in favor of an independent Palestinian or other currency. The Palestinians resented the PP’s practical implications and the need to obtain Israeli approval for any significant economic move, something which restricted the growth of the Palestinian economy. The PA later announced that it would end its commitment to agreements signed with Israel and withdraw its recognition of Israel until it recognized a Palestinian state. Subsequently, the PA established another committee to formulate its definitive view on relations with Israel, the United States, and Hamas. In 2019, Israel agreed to re-examine economic agreements with the PA and to update the PP.[[22]](#footnote-25)

The PA refused to receive clearance revenues from Israel in 2019–2020 in protest against Israel enacting a law to deduct and withhold from them a sum equal to the amount paid by the PA to Palestinians detained in Israel (including prisoners convicted of bombings and murder), as well as to their families and to released prisoners. This continued in 2020, as part of the PA’s suspension of coordination with Israel in protest of Israel’s declared intent to annex large areas of the West Bank. Although these issues were eventually resolved, they had a negative impact on the Palestinian economy and impaired the PA’s ability to function, since it lost a significant percentage of its revenues over a long period, triggering a reduction in the its activity, salary cuts, and additional funding from banks at the expense of the private sector.

A trade war between Israel and PA also began in 2019 when the PA decided to stop the import of calves from Israel (accounting for about 60 percent of meat consumption in the PA territories) in an attempt to reduce its economic dependence on Israel. Israel reacted with sanctions against the PA, including revoking Palestinian businessmen’s trade credentials, barring Palestinians from importing calves from any other source, and blocking all West Bank agricultural goods.

However, Israel approved in November 2021, for the first time, a quota of technology work permits for West Bank Palestinians[[23]](#footnote-26) and granted the Israeli Standards Mark, also for the first time, to four Palestinian factories in the West Bank, enabling them to sell their products in Israel and Europe.[[24]](#footnote-27)

The political situation created by Hamas makes it difficult to establish a process for economic rehabilitation and development in the Gaza Strip. Although long-term projects are hard to pursue, Israel approved the marketing of processed foods from the Gaza Strip in the West Bank in November 2020.[[25]](#footnote-28) Israel also approved the entry of 10,000 Gazan workers into Israel after a long period of disengagement.[[26]](#footnote-29)

At the time of writing, Israel was planning to ease a number of restrictions currently in place on the Gaza Strip, aiming to alleviate some of the territory’s economic woes, improve the standard of living of the population, and prompt popular pressure on Hamas’s leadership to keep the peace.

1. The name “Palestine” chosen for this Mandate was based on “Palestina,” a name the Roman Empire gave it in the second century CE. [↑](#footnote-ref-2)
2. The Mandate for Palestine July 24, 1922, Article 2: “The Mandatory shall be responsible for placing the country under such political, administrative and economic conditions as will secure the establishment of the Jewish national home, as laid down in the preamble, and the development of self-governing institutions, and also for safeguarding the civil and religious rights of all the inhabitants of Palestine, irrespective of race and religion.” [↑](#footnote-ref-3)
3. The Currency Board was dissolved in May 1948, with the end of the British Mandate, but the Palestinian pound continued in circulation for a transitional period. [↑](#footnote-ref-4)
4. “Report of the Palestine Currency Board for the period ended 31st March 1928,” *The Palestine Bulletin*, December 10, 1928: https://www.nli.org.il/en/newspapers/plb/1928/12/10/01/article/4/?e=-------en-20--1--img-txINpercent7ctxTI--------------1. Accessed May 13, 2022. [↑](#footnote-ref-5)
5. For further details, see Segev (2000), Kramer (2008), and Kelly (2017). [↑](#footnote-ref-6)
6. The main factors in fostering rapid economic growth of the Jewish sector were Jewish population increases, mainly through immigration, and capital inflows and investment. [↑](#footnote-ref-7)
7. https://web.archive.org/web/20120524094913/http://domino.un.org/unispal.nsf/0/7f0af2bd897689b785256c330061d253

 [↑](#footnote-ref-8)
8. During the 1956 Sinai Campaign, fought to put an end to the terrorist incursions into Israel and to remove the Egyptian blockade of Eilat, the Gaza Strip was temporarily occupied by Israel. [↑](#footnote-ref-9)
9. Israeli Ministry of Foreign Affairs. [↑](#footnote-ref-10)
10. The last agreement, signed on 23 October 1998, is known as the “Wye River Memorandum.” [↑](#footnote-ref-11)
11. Israel Ministry of Foreign Affairs. [↑](#footnote-ref-12)
12. It was incorporated, with minor amendments, into the Oslo II Accord of September 1995 [↑](#footnote-ref-13)
13. https://mfa.gov.il/MFA/ForeignPolicy/MFADocuments/Yearbook9/Pages/181percent20Israel-PLOpercent20Economicpercent20Agreement-percent20Paris-percent2029percent20April.aspx**.** [↑](#footnote-ref-15)
14. The clearance mechanism was specified as follows: at the end of each month a reconciliation session is held for the revenues of the previous month which will be received in cash at the beginning of the month following the session. [↑](#footnote-ref-16)
15. https://www.mfa.gov.il/mfa/foreignpolicy/peace/guide/pages/israelspercent20disengagementpercent20plan-percent20renewingpercent20thepercent20peacepercent20processpercent20aprpercent202005.aspx [↑](#footnote-ref-18)
16. https://mfa.gov.il/mfa/foreignpolicy/terrorism/palestinian/pages/thepercent20hamaspercent20terrorpercent20organizationpercent20-percent20percent202006percent20updatepercent2015-mar-2007.aspx [↑](#footnote-ref-19)
17. https://mfa.gov.il/MFA/ForeignPolicy/Issues/Pages/Gazapercent20designatedpercent20apercent20percentE2percent80percent9CHostilepercent20TerritorypercentE2percent80percent9Dpercent2024-Sep-2007.aspx#:~:text=Duepercent20topercent20continuedpercent20terroristpercent20attacks,suppliespercent20whichpercent20gopercent20beyondpercent20that. [↑](#footnote-ref-20)
18. https://mfa.gov.il/MFA/AboutIsrael/Maps/Pages/Operation-Cast-Lead.aspx [↑](#footnote-ref-21)
19. https://www.idf.il/en/minisites/wars-and-operations/operation-pillar-of-defence/operation-pillar-of-defense/ [↑](#footnote-ref-22)
20. https://www.gov.il/en/Departments/General/operation-protective-edge-full-report [↑](#footnote-ref-23)
21. https://www.idf.il/en/minisites/wars-and-operations/operation-guardian-of-the-walls/operation-guardian-of-the-walls-1/ [↑](#footnote-ref-24)
22. https://www.globes.co.il/news/article.aspx?did=1001272325 [↑](#footnote-ref-25)
23. https://www.timesofisrael.com/in-first-government-approves-small-quota-of-tech-work-permits-for-palestinians/ [↑](#footnote-ref-26)
24. https://www.gov.il/en/departments/news/1standards [↑](#footnote-ref-27)
25. https://www.gov.il/en/departments/news/exportingfoodmanufacturedfromthegazastripheb [↑](#footnote-ref-28)
26. https://www.timesofisrael.com/israel-authorizes-3000-additional-entry-permits-for-gaza-workers/ [↑](#footnote-ref-29)