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Past, Present and Future

Focus

Back to Negotiating the Final Status – The Economic Dimension

An independent trade regime would lead to a competitive Palestinian environment.

by [Arie Arnon](#) and by [Saeb Bamyia](#)

The collapse of the second Camp David talks and the disastrous start of the second intifada changed the approach of many Israelis and Palestinians to the peace process. On the one hand, many Israelis adopted the “there is no Palestinian partner” approach and became supporters of the government’s strategy to stop the intifada by force, arguing that there should be “no negotiations under fire.” On the other hand, many Palestinians felt that negotiations were leading nowhere. Many of the illusions on the Israeli side as to the possibility of minimal territorial concessions and no compromise in Jerusalem disappeared. The Israeli public now knows that significant concessions are inevitable and that there will be no agreement without Jerusalem; a clear majority supports the evacuation of 85–90% of the West Bank, whether unilaterally or under an agreement.

The issue that became the most worrying for many Israelis and Palestinians, an issue that was not openly discussed before 2000, is that of the Palestinian refugees. The hegemonic “no partner” approach in Israel has been strengthened by the view that the Palestinian side is in fact asking for an agreement that would not only stipulate a state in the West Bank and Gaza, including a capital in al-Quds, but would also leave the right of return on the table. Such an interpretation of the collapse of the 2000 negotiations tends to underestimate the role played by the Jerusalem issue in the painful failure of Camp David II. But the real question now is whether a new round of negotiations on permanent status issues is doomed to fail, or might have a good chance of culminating in an agreement. We would like to argue for the latter.

The basic trade-off between the two sides is clear: In order to achieve an end to the conflict, the two sides will compromise on a “package” including borders, Jerusalem and refugees. For the Israelis, the first two, and in particular Jerusalem, will be hard; for the Palestinians the compromise on a practical solution for the refugees will be hard.

The fact that a majority of Israelis support evacuating 85% of the West Bank means that we have to convince them that there is a clear advantage in agreeing to withdraw from close to 100%, including in Jerusalem: the end of conflict and an agreed resolution to the refugee problem that does not threaten them. The fact that a majority of Palestinians accept the two-state solution and yet many still hold on to the right of return means that we have to convince them that a compromise on the implementation of the right of return — a compromise many agree to already — is the only path to statehood, freedom and independence.



A Palestinian farmer works in a field adjacent to the separation wall in Qalqilia.
(Photo: Mahfouz Abu Turk)

One of the obstacles to the realistic application of the two-state solution envisioned in the past, including in the Road Map, is Israel's continued "preemption" strategy; i.e., the process of creating facts on the ground that make the realization of two states less probable. Israel's continued settlement activity and construction of the separation wall on its present route create facts on the ground that contradict the continuity and contiguity of the West Bank, as well as separate the West Bank from East Jerusalem — contradicting the foundations of the "two states" concept economically. An agreement for two states will have to keep open the economic links between the two sides concerning trade, labor and other economic flows.

Based on these considerations, we thus submit, again, that the trade-offs both necessary and possible include the following package:

1) The borders between the two states will be drawn so that the two states will have continuity. The land will be divided 78% to 22%, allowing for swaps of land along the "Green Line." The arrangements satisfying contiguity between Gaza and the West Bank will guarantee the free flow of people and goods within both Israel and Palestine, so that it will not entail crossing a border.

2) Jerusalem will be the capital of both Israel and Palestine. There are two options for Jerusalem's borders:

Option A: An "open" Jerusalem, necessitating the creation of borders around Jerusalem, or the part of the city that remains "open."

Option B: The border bisecting Jerusalem, separating Jewish and Arab neighborhoods.

3) An agreed and fair solution to the refugee problem will address both the individual claims and the collective considerations of the two sides. On the one hand, the Palestinian refugees will be able to choose a permanent place of residency while, on the other hand, the implementation of these decisions will be subject to the sovereignty of all the countries that will be affected, including Israel and Palestine. A compensation scheme for the refugees will be agreed upon. The process will change the status of these refugees to that of citizens. The parties will agree that the compensation scheme will include, as a collective receiver, the State of Palestine. The scheme will address all the claims concerning the past but will be forward-looking.

If the two peoples want self-determination, normalcy and prosperity, they should move forward towards a historical compromise. The international community, by supporting such a "package," can contribute to the beginning of a new path in this troubled region.

Towards an Economic Final Status Framework Agreement

A clear distinction should be made between an agreement on the principles of permanent status arrangements and its gradual implementation. The difference between a gradual process where the two sides disagree and fight about the endgame (like in Oslo), and a gradual implementation process where the endgame is agreed upon, at least in principle — must not be underestimated. At the same time, the delicate balance between the clarity of the principles and the detailed endgame contract which is, naturally, yet to be determined, will make a framework agreement on the final status a critically sensitive document.

The status of such a document and the guarantees behind it are crucial. If the international community, represented by the Quartet and supported by the G8, stands behind it, together with the majority of moderate Arab regimes, the document can help create a historical turning point. There is no question that without such a change, we are doomed to live on in this never-ending vicious cycle.

We propose an agreement on new economic arrangements, consistent with the “two states” concept, which will promote: independence in defining economic objectives and strategies, growth in both economies, the pursuit of policies that acknowledge economic interdependencies, and the prospective convergence of Palestinian living standards with those of Israel. We acknowledge that cooperation can only grow on the basis of common interest, which exists in many spheres.

In exploring future policy options, we compared a post-conflict “status quo” — i.e., a customs union between Israel and the Palestinian state and unregulated labor flows to Israel — with an independent trade regime (either a free trade area or a Most Favored Nation regime) embodying regulated labor flows. The results indicated that in the short run, overall employment levels and incomes would be higher under the “status quo” scenario. However, under an independent regime, an initial decline in domestic wages should bring about a more competitive Palestinian environment and higher levels of productive investment opportunities, leading to increased exports of goods and services and higher growth rates in GDP over time. Accordingly, in fostering per capita income growth and income convergence, we emphasize policies that promote domestic income growth rather than policies aimed at encouraging workers’ remittances from abroad.

We propose a radical change in the economic regime that has determined the economic relations between the two sides since 1967. Instead of the customs envelope that characterized trade relations between the Israeli and Palestinian economies, both before the Economic Agreement of 1994 (the Paris Protocol) and after, we should reach an agreement based on two separate customs areas.

Thus, we suggest that the economic part of the framework agreement include clear key principles that both parties agree to. First, it is imperative that they agree that the sovereign authority of each party, within internationally recognized borders, means the right to conduct internal and external economic affairs, including the operation and administration of their economic borders, autonomously but in cooperation with each other. Hence, the parties must reciprocally recognize each other as independent customs territories, and make it the foundation for their economic and trade relations. Second, economic and trade relations shall be guided by the following concepts, which both parties will agree to:

- 1) Economic and trade relations must be based on, and compatible with, established rules and principles of the global trading system, particularly those of the World Trade Organization and other bilateral and multilateral agreements.
- 2) Cease introduction of any new barriers to trade in goods, services, labor and investment.
- 3) Establish joint committees and adopt mechanisms in the field of economic regulation in order to use scarce human and financial resources in an optimal manner and ensure the facilitation of trade.
- 4) Establish institutions, rules and procedures for both mandatory consultations and binding and effective dispute settlement, including the

involvement of a third party in these institutions.

5) Base their relations on technical, health, safety and environmental requirements on the relevant WTO agreements. They shall operate under a principle of mutual recognition of the results of trade-related conformity assessment procedures. They shall seek to harmonize such requirements and procedures where appropriate and shall cooperate in their implementation.

6) Adopt a comprehensive agreement on transit, securing access of goods to their respective territories from land routes and from air- and seaports, in accordance with pertinent international standards and agreements.

7) Seek to gradually liberalize market access in the field of services, taking into account the diverging levels of economic and social development of the parties. They shall work towards mutual recognition and harmonization of professional qualifications and standards.

8) Agree that trade between the two parties as well as any transit trade is built on the principle of normal commercial traffic, that is, door-to-door movement of goods by through-traffic of trucks and other means of transportation.

9) Establish incentives for investment, including rules prohibiting discrimination, double taxation and the expropriation of real or intellectual property rights. The parties shall remain free to regulate ownership of real estate in accordance with their own needs.

10) Only apply restrictive economic measures to protect legitimate and essential interests in national security, in accordance with principles and practices well established in international law, including international trade regulation. In particular, the parties shall define in detail the relevant factors and criteria under which such measures may be applied, including the requirements of necessity and proportionality. Security measures must be demonstrably necessary to protect legitimate and essential security interests, and among measures of equivalent security effect, the one least harmful to trade, labor relations and investment shall be applied.

Politics and economics cannot be separated. The failure to negotiate an agreement over the last 15 years and the economic crisis in the Palestinian economy should be well understood. The failure is closely related to the "gradual approach": The belief that not defining the end result would help the peace process was wrong. It is now time to start on a different path that we have termed "Reverse Engineering": First define the ends clearly, and then structure the means towards those ends. The Aix Group, a forum where Israeli, Palestinian and international economists, policymakers and private sector entrepreneurs have been exchanging ideas since 2002, presented both the economics of a two-state agreement and the "Reverse Engineering" approach in its Economic Road Map, 2004 (see <http://www.aixgroup.org/index.html>). The Group has continued its work on various economic aspects of a two-state agreement, in particular concerning cooperation between the two states, the future of Jerusalem and the Palestinian refugees; it will present shortly detailed proposals on these issues. It is time to negotiate a permanent political and economic agreement between Israel and Palestine.

¹ We would like to thank all our friends in the Aix Group for many discussions and deliberations over the years. Thanks to our colleagues in the Steering Committee of the Aix Group, Gilbert Benhayoun, Samir Hazboun and Ron Pundak for their continuing efforts to try and shape our lives together in a human manner. However, we alone are responsible for the views herein.

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