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The Day After: paper # 1



Economic Repercussions for the Dissolution or Collapse of the PA

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Economic Repercussions for the Dissolution or Collapse of the PA

This paper is one amongst ten such papers prepared within the Palestinian center for policy and survey research's initiative titled, "The day after". The initiative aims to study the circumstances that would face Palestinian politics and society in a situation in which the PA becomes unable to carry out its role. These papers examine the consequences of the dissolution or collapse of the PA on a number of central issues that concern the Palestinians, which include: security, economy, education, health, judiciary, telecommunications, basic services such as water and power, local government, political and civil conditions, as well as the future of the two-state solution.

These papers examine the significance and implications of PA's absence as well as possible options that could be adopted to mitigate the negative effects of such an absence and develop specific recommendations for the sector in question. Two experts have commented on each of these prepared papers. Each paper was presented and discussed in a workshop attended by policy makers, parliamentarians, experts, and academics.

This initiative has been organized in cooperation with the U.S./Middle East Project and the Norwegian Peacebuilding Resource Centre.

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Summary:

After examining the general environment and buildup of the Palestinian economy, following the establishment of the PA, the collapse of the PA and the dismantling of its institutions would have a strong effect on the general indexes of the Palestinian economy.

With regards to the buildup of the Palestinian economy, the contribution and role of the service sector would be diminished due to the collapse of civil and military institutions, thus ending the need for those who work there (with the exception of some public servants in education, health and civil affairs), and the disappearance of the effects of 3 billion dollars in public spending on the economy as a whole. It is expected that the share of the service sector of GDP would recede to pre-PA levels (approximately 25%). It is expected that such a decrease would be in favor of the other sectors, such as the agricultural sector, which would constitute a major refuge for families who have lost their main source of income. These families would surge towards the agricultural and household production sectors, increasing the share of these sectors in employment. The dissolution of the PA could lead to many industrialists returning to traditional local crafts to overcome the loss of total consumption and demand on imported goods.

The public finance sector would be one of the most affected by the dissolution of the PA. It is expected that there would be a total halt in all sources of finance, whether domestic or foreign. Direct tax income, especially the income tax, would be immediately frozen due to the absence of tax collection departments. Palestinian companies and persons, would refrain from paying their indirect taxes, especially the VAT. Israel would halt its transfer of tax returns to the Palestinian side, which is currently worth 1.5 billion USD per year. There is a strong possibility that the dissolution of the PA would result in the cessation of international aid.

When it comes to the jobs sector, more than 100,000 public servants would be under risk of termination from their jobs as a result of the PA's dissolution, and the lack of need for the services provided by the ministries and institutions in which they work. This would have catastrophic repercussions on Palestinian economic, security and social reality. Unemployment rates would reach unprecedented levels (Over 40%), and the poverty rates would increase noticeably, to include segments which were previously over the poverty line, it could reach record levels of more than 60%.

Public servant borrowers' ability to repay their debts would be affected, which would in turn affect the banking sector which would have to carry the burden of unpaid debts.

The Palestinian workers within Israel sector would be one of the most affected, it is probable that the total number of Palestinian workers inside Israel would increase noticeably, whereas the Israeli authorities would need to open up its job market so that the economic collapse within the Palestinian territories would not be mirrored by a security collapse.

As for the financial sector, as of 2012, the PA has a total debt of 1.115 million USD owed to banks operating within the Palestinian territories. The dissolution of the PA, and the inability to pay back these debts, along with the lack of any guarantees from the international community, would put these

banks at major risk, and threaten their ability to function and provide services.

With regards to the Gaza Strip, the Gazan economy would lose its share of official public spending from the government in Ramallah, which totals 1.2 billion USD, which is split between public servants salaries, social aid, the energy bill, as well as some development projects. This would constitute a major blow against the Gazan economy, and would increase both poverty and unemployment rates, and would lead to a dramatic decline in GDP and disruptions in the majority of public services, as well as confusion in the efforts to rebuild infrastructure. The dissolution of the PA would increase the chance of reintegrating the Gazan economy with its Arab and Islamic surroundings, through Egypt.

It is unlikely that the dissolution of the PA would affect the political or legal situation in Jerusalem, which is maintained by Israel. Therefore, the effects of such a dissolution on the economy of this city would be limited.

In order to face these repercussions, this paper recommends searching for a new financial policy, which includes increasing local revenues, austerity in public expenditure, attracting emergency Arab and International aid, repairing distortions in the labor market, reducing the dependency of the Palestinian economy on the Israeli economy, generating interest and support for local products, as well as support service institutions and social welfare.

I. Introduction:

Each time the possibility of PA dissolution is discussed, it is associated with a dialogue about the repercussions of this option, most important of which are the financial/economic-related ones. Before addressing the economic impacts, it is important to consider the role played by the PA in economic respects, in addition to the indirect impact brought by the existence of PA institutions. There have been differing opinions defending the sustainability of the PA as a response to the calls for dissolving it, since the PA is a national project leading the transitional phase in order to retrieve Palestinians' rights, which include –above all else- an independent state that enjoys complete sovereignty and which is geographically contiguous. The economic considerations, alongside the political ones, were a fundamental basis for defending the PA, due to the great damage that dissolution might cause at the Macro (economy) and Micro (individuals and establishments) levels.

II. General picture of the Palestinian economy

The Paris Economic Protocol, which was signed between Palestinians and Israelis in 1994, regulates everything that has to do with economic relations between both sides, including commercial, financial, monetary and labor issues. These Protocols have remained in action for 18 years, and they are the framework that governs Palestinian-Israeli economic relations, despite frequent violations by Israel, and the numerous comments recorded against it, and the damage sustained to the Palestinian economy because of its continuous implementation.

Thus, dissolving the PA –according to facts above- would lead to the termination of these Protocols, and it is expected that the areas it regulates would also be affected, whether directly or indirectly, especially trade arrangements, clearance transfers, financial/banking matters and labor issues.

III. Composition of the Palestinian economy

The enforcement of political agreements signed in 1994 between the Palestine Liberation Organization and Israel brought many radical political, economic and social changes. These agreements allowed the PA to undertake administrative, regulatory and legal authorities within the main populated areas, as well as manage economic resources in a way which complements Palestinian objectives and priorities. With time, the political and economic arrangements set in the first half of the 1990s reshuffled the composition of the Palestinian economy. Before the advent of the PA, the production sectors dominated the Palestinian economy as they contributed the most to Gross Domestic Product (GDP) and employment. Whereas the agricultural sector contributed 13% of employment and GDP. Industry was an important source of production and employment at the time (%22 and %30 respectively¹). In contrast, the share of the services sector was %25 of employment and GDP. This sector was confined to public services (education, health, civil affairs).

With the establishment of the PA, a considerable change occurred to the composition of the Palestinian

¹ The Palestinian Economy in the Transitional Phase, PECDAR, second issue, 2003.

economy; construction and economic performance were immensely improved. GDP increased by more than %23 in the first three years of the PA's lifespan to reach roughly \$ 3744 million in 1997. The Palestinian economy leaned towards favoring the services sector even more, naturally at the expense of the production sectors shares in GDP and employment. Establishment of civil and military bodies meant that a larger number of public servants was needed to undertake tasks and responsibilities which the PA was now in charge of in the service sectors, governance and in defense. Domestic and foreign trade, services, transportation and storage were also improved in tandem with the PA's advent, all of which contributed to increasing the share of the service sector in GDP and employment. Data indicates that the share of services in GDP went up from %25 in 1994 to about %40 in late 2012, and employment witnessed an increase (%25 to %36) within the same period. However, the share of other production sectors such as agriculture declined to less than %5 only, taking into account that it used to be %13.

The collapse of PA establishments would greatly impact the general indexes of the Palestinian economy. Prediction results made by the Palestinian Central Bureau of Statistics (PCBS) in 2013 – based on the most pessimistic scenarios- were used to deduce the scope of that impact². It should be mentioned that these predictions did not take into account the dissolution of the PA, but assumed that political/security conditions would deteriorate, tax collection would decline sharply and restrictions on the freedom of transportation of individuals and goods would be increased. However, these factors were not as bad as the possibility of PA dissolution, which would have a much more severe impact on economic performance. According to these estimations, it is anticipated that GDP would be reduced by %14.5 during 2013, and that GDP per capita would be reduced by %16.8. Total consumption would drop by %3.9, which means that consumption per capita would also decrease by %6.5, so poverty in the Palestinian territories would grow. This scenario also anticipates that total investments would drop by %6.5.

Regarding the composition of the Palestinian economy, it is expected that the share of the services sector and its role in the economy would decline due to the collapse of civil and military establishments, resulting in most of their staff not being needed anymore (except for part of the staff in education, health and civil affairs), and the impacts of public spending (\$ 3 billion) on different components of the economy would disappear. Share of the services sector in GDP would also decrease to pre-PA levels (approximately %25). The decrease would be in favor of other sectors such as agriculture and household production, which would be the main resort for families which would lose their main source of income. This would also increase the share of these sectors in employment. On the other hand, the upcoming stage –in light of the possibility of PA dissolution- might witness the return of many industrialists and workers to domestic handicrafts to fill the gap in total demand and consumption of imported goods.

However, GDP would generally tend to decrease as a reflection to all economic activities. Extent of the decrease would exceed %50, the same rate as was in 2002 when the economy collapsed in the wake of Israeli invasions and attacks that reached their peaks at that point.

² It has been assumed that political/economic conditions would greatly deteriorate as a result of political and economic factors the region would witness. It was also assumed that tax evasion would increase, collection of income and VAT taxes would be reduced, government investing would be diminished, government transfers would drop, transfer of tax returns (clearance) to PA would be stopped by Israel (only %30 would be transferred) and restrictions against movement of individuals and goods inside the Palestinian territories, or to and fro nearby countries, would be intensified.

IV. Sectoral repercussions

Naturally, the total impact to the Palestinian economy is brought on by different sources linked to activities of different sectors, which would be affected by PA dissolution or collapse to varying degrees. The following is an Analysis of the repercussions of PA dissolution to key Palestinian economy sectors:

1. Public finance

This term means everything that has to do with items mentioned in the PA budget (returns, spending, domestic and foreign debt). PA finance has improved since its establishment, and what is of interest for us here is public spending, which is financed by many sources, most important of which are domestic revenues, foreign assistance and borrowing from banks and foreign debts. Studies and reports on PA financial performance have concluded that:

- PA revenues have undergone many quantitative and structural changes since the PA's advent. Since its inception up to 2000, the PA depended on tax and clearance returns to finance its ongoing spending, in addition to foreign assistance to cover developmental spending. Following the outbreak of the second Intifada and the accompanying Israeli measures that undermined the PA's ability to finance ongoing spending, the structure of its budget underwent some changes, where the bulk of foreign assistance was now directed to the ongoing budget, especially payrolls and wages that which witnessed an increase in size in the wake of the PA absorbing the labor surplus caused as a result of Israel denying access to Palestinian workers who worked within the green line.
- PA spending is the main stimulator of the Palestinian economy since 2001 in particular, whether through ongoing spending on wages or through spending on other operational costs (purchase of goods and services from or through local producers). Data indicates that the volume of public servants' wages (115,000 employees) reached \$ 524 million by 2000, added to that is another \$420 million as part of operational and capital costs. Generally, the share of government spending varied from %18-%25 of Palestine's GDP from 1994-2000. On the other hand, the PA has spent about \$300 million of its own resources and foreign assistance for infrastructure projects in various Palestinian communities.
- After the year 2000, the structure of the general budget changed, where a considerable part of expenses was directed to urgent relief programs in view of the decrease in the standard of living, prevalence of unemployment and poverty among Palestinians and the growth of Palestinian households in need of aid. The scope of government spending has continuously increased since then until it reached \$3.5 billion in late 2012, %90 of which takes the form of ongoing spending. Payrolls were two thirds of ongoing spending from 2001-2012.
- PA finances expenses through various sources, of which the tax and non-tax returns constituted %35 of self finance resources during 2012. Share of clearance transfers (\$500 million a month) supported the remaining percentage next to the other financing resources such as foreign assistance (\$800 million annually) and borrowing from banks (\$400 million)³.

The public finance sector could be affected the most as a result of PA dissolution. It is anticipated that all domestic/foreign resources of financing would be completely terminated, as direct tax returns

³ Balance of government debt to banks reached \$ 1115 million, which constitute about one third of credit facilitations provided by banks in the Palestinian economy.

(income tax in particular) would immediately stop due to absence of collection authorities, and Palestinian taxpayers (individuals, corporate) would refrain from paying indirect taxes, especially VAT. Israel would stop clearance transfers to Palestinians (one billion and a half USD annually, %70 of total general returns). Given that clearance funds would in turn drop due to a decrease of domestic demand for goods imported from Israel and rest of the world, which constitutes the main source of clearance funds⁴.

One of the possible scenarios is the takeover of direct and indirect tax returns as well as clearance funds by the Israeli treasury, which would force the Palestinians to pay them to finance operation of the 'civil administration'. Past experience proved that this administration used to spend at minimum, whether for current expenses or infrastructure.

There is a good chance that PA dissolution would lead to the cessation of international assistance or at least part of them, which go to the PA treasury (\$1,132 million). Part of which (\$900 million) is used to support the budget and the other part (\$256 million) was for developmental spending in 2012. However, there is a possibility that this assistance –or part of it- would be channeled through NGOs and UN organizations.

The Palestinian private sector -service and goods providers in particular- would lose an important outlet for its products; the governmental institutions. Annual government procurement is estimated at \$ 1 billion, great deal of which is provided by local contractors and producers. On the other hand, the Palestinian economy would be unable to provide salaries for the majority of public servants (except for a part of the employees in education, health and civil affairs). Salaries help regular economic circulation. We are talking here about more than \$500 million a month, where consequences of which include severe economic recession, closing of many private enterprises and the laying off of a large number of staff (estimated at %10 of the existing workforce). Many indebted private sector enterprises to the government in the past years would be affected. Estimates indicate that the government owes the private sector an aggregate amount of \$500 million, and indirect impacts would be greater and include a decline in rates of consumption, saving and investment in the majority of production and service sectors in the Palestinian territories.

The PA currently provides more than \$100 million as part of social support projects to about 100,000 disadvantaged households through the Ministry of Social Affairs. Direct and indirect financial support (\$200 million) is also provided to families of martyrs, the wounded and prisoners, besides covering medical treatment costs in local, Israeli and Arab hospitals for Palestinian patients from the West Bank and the Gaza Strip. Cost of medical treatment abroad in 2012 alone is estimated at \$40 million, and it is likely that many households and beneficiary groups would be affected by the dissolution of the PA and the termination of assistance programs. Consequently, the range of poverty would expand to include families which previously benefited from assistance and relief programs, poverty rates could reach up to 60%.

2. Public employment

Since its inception, the PA established government institutions as the executive arm that makes the undertaking of operations possible. The PA inherited a great deal of executive and administrative tasks from the Israeli authorities, which controlled the occupied Palestinian territories (oPt) until 1994.

⁴ Clearance returns are specifically important to the Palestinian economy because they contribute to %65-%70 of total domestic returns in the PA budget. If foreign assistance is added, share of clearance funds would drop to %35-%40.

Estimates indicate that the number of Palestinian employees who worked at the civil administration were approximately 22,000 staff members, and were the basis of the Palestinian public sector. The PA introduced departments and offices for different ministries throughout the Palestinian provinces for easy access by the public, and this meant that more than 75,000 staff members were needed; nearly half of them are security personnel. The number of public servants kept climbing at an annual rate of %12.4 (115,000 in 2000, 62,000 civil and 53,000 military), and they sustain 700,000 people on average. During the first years of PA (1994-2000), public servants constituted %19 of the total workforce in the Palestinian territories, while their salaries took %38 of general budget within that period.

Following the outbreak of the second Intifada, the number of workers inside Israel dropped to less than half due to Israeli authorities' ban, and the other sectors (private, CSOs) became unable to employ further. The PA had to absorb a large part of the workforce to mitigate unemployment and to stop the collapse of the economic and social circumstances. Furthermore, great numbers of resistance activists were recruited in the Palestinian security agencies, so the number reached 160,000 civil and security employees.

Since the establishment of the Palestinian public sector and the stability of economic conditions and cash flows for public servants, banks operating in the Palestinian territories offered credit facilitations to those servants, where the volume of facilitations expanded since 2007 (after formation of Dr. Salam Fayyad's government in the West Bank and the restoration of relative stability needed to keep assistance flowing). Estimates of the Palestine Monetary Authority denote that the value of loans and other credit facilitations offered to public servants until the end of 2012 are worth \$690 million⁵. However, this amount does not include the value of loans given to those who do not serve in the government, who received loans based on the necessary guarantees which were presented by public servants.

The reasons why the effects of a possible dissolution of the PA on public servants must be researched are many. The relation of their work to provision of social and economic services to the public is the key motive for studying this sector and the repercussions of the PA dissolution on it, not to mention the direct impact of laying off the majority of public servants at the individual and collective levels. Key possible consequences in this regard could be outlined as follows:

- Public servants are present in all civil and military bodies. With the exclusion of military personnel, civil staff is distributed to ministries and other state bodies that serve a large number of people in different areas. 40,000 public servants work in the education and health sectors; the biggest part of which could be maintained in service as long as the occupation authorities take on their responsibilities in the occupied territories and provide basic services in the main sectors. Civil/social affairs, and probably justice, staff might be added.
- The remaining number (more than 100,000 staff members) might be forced to leave as a result of dissolution, which would render ministries and institutions at which they work unnecessary. This would have catastrophic repercussions against the Palestinian economic, social and security conditions. It is expected that the main source of income for servants and their families would be severed, as the direct impact would hit more than 600,000 Palestinians. In case the Israeli, Arab Gulf or European labor markets do not absorb them, this would cause political and security conditions to deteriorate and impact nearby countries, including Israel, in addition to direct effects inside Palestinian society. In light of

⁵ According to estimates of the public servants union, %75 of them had loans from banks operating in the Palestinian territories.

those who would lose their jobs, unemployment rates would reach record levels (more than %40), and the reach of poverty would significantly expand to huge groups that used to be outside that reach, which could rise to exceptional rates (more than %60).

- The economic composition, as explained earlier, would also be affected, where the service sector's share of GDP would decrease, to the benefit of other production sectors. It should be mentioned that production levels would witness a great plummet due to salaries cut, which means that 100,000 staff member would stop being a major sources of economic circulation/growth and purchasing power in local markets. Loss of 500 million NIS each month would bring about severe recession, closing of many private enterprises and laying off of a great number of employees. Rates of consumption, saving and investment in most of the production and service sectors would also be affected.

- Public sector Borrowers would be unable to pay their debts, which would impact the banking sector if it has to face risks of insolvency alone. Borrowers might take part of the risks through the confiscation of some assets as collateral such as lands, real estates, vehicles, etc.

- It is expected that the average salaries for workers within the Palestinian economy would drop due to the increase in job demand brought by the surge of thousands of public servants into the labor market. According to economic theories, an increase in workers, assuming demand by employers is stable, would lead to reduced wages. The drop would be greater (which is more than likely) if the economic conditions caused by the PA dissolution made the demand for workers drop, which is associated with the demand for goods and services. Conversely, absorbing part of workforce by labor markets in Israel and the Arab Gulf might help limit the drop in the general level of wages.

- The Palestinian social fabric might be immensely affected by lay offs, where it is anticipated that levels of crime, law violation, divorce and marriage aversion would rise. Quality of education might also be compromised because of growing rates of school dropout and decreasing rates of enrollment.

3. Labor in Israel

The Palestinian workforce in Israel has received a great deal of attention in studies on the Palestinian economy. The number of Palestinians working in Israel has shown different developments. There were about 153,000 workers in 1999 (%23 of the Palestinian workforce in general), but this number has dramatically dropped to 90,000 in 2001 due to the Israeli blockade. The number of workers from the West Bank now reaches 78,000 (Israeli settlements included), and they are divided into 46,000 Palestinians in the West Bank proper, 30,700 of which with special permissions and 15,300 without permissions. Numbers also indicate that nearly 32,200 Palestinians who hold Israeli identity card work in Israel. Today, Palestinian workers in Israel form about %10 of the total workforce of the West Bank and Gaza Strip⁶. Money transfers of the Palestinian workforce around the world –according to data of the Palestinian balance of payments- were \$1,051 million in 2012. The biggest part of these transfers comes mainly from Palestinians working in Israel, along with indirect transfers (income tax, insurance deducted from wages) to the PA and clearance transfers as well.

If we went further with the possibility of dissolution, the Palestinian workforce in Israel would be impacted the most. Political and social motives would be the main drive for changes occurring in this sector, and it is likely that the number of workers in Israel would increase considerably or possibly return to the levels of 1999 (before the outbreak of the second Intifada), or even exceeding them since workforce within the Palestinian territories has significantly grown since that date. The main cause behind this growth in the number of workers would be due to the Israeli authorities opening their labor market to offer further employment for Palestinians from the West Bank and even the Gaza Strip, so

⁶ According to PCBS, the current average annual wages received by Palestinians working in Israel is something between 3527-4338 NIS.

that the economic conditions would not completely collapse due to the loss of jobs following the dissolution of the PA. Israel fears that economic deterioration in the Palestinian territories would affect the security conditions severely.

It is true that the workforce in Israel would greatly increase, which would lead to an increase in financial transfers which would stimulate the economy of the Palestinian territories. However, we must not ignore the distortion that might afflict the Palestinian economy, which was previously diagnosed by studies and research that addressed the influence and effects of the Palestinian workforce working inside Israel. They could be outlined by the deformation of the educational system and massive school dropout in favor of paid work inside Israel, in addition to the decline which might impact the Palestinian production sector. What's more, Israel would use the relatively cheap Palestinian workforce and their presence within Israel to extort the Palestinians for political reasons.

4. Trade sector

This sector is divided into two main parts; domestic trade and foreign trade. We clarified the impacts that might hit domestic trade in a previous chapter, especially in terms of recession of commercial activities due to public servants' low purchasing power and the great decline in public procurement. This part will address the foreign trade and related impacts to imports and exports.

First of all, we have to point out the great impact of the PA on foreign trade. The advent of the PA noticeably helped the development of foreign trade. The factors that contributed in the development of this sector are:

- a. Signing many bilateral and multilateral trade agreements.
- b. Stabilization of economic conditions and providing relative security.
- c. Increasing the options for imports and exports which were prohibited prior to the establishment of the PA.
- d. Establishing many supporting institutions that provided logistic services to the sector over the past years.

The following are the major developments seen by foreign trade indicators:

- Trade between Palestine and the outside world suffers chronic structural distortions, as Israel maintains control of Palestinian border crossings. Moreover, Palestinian foreign trade is concentrated with Israel in view of the continuous deficit, so development of foreign trade indicators usually face Israeli obstacles and policies, which aim to restrict any attempt to open up to the outside world and benefit from the advantages of trade.

- The volume of exports in 1996 was \$340 million and kept climbing until it reached about \$400 million in 2000. PCBS data show that exports in 2012 were \$1000 million or so, and some attribute this increase to the trend of making use and the better utilization of commercial agreements signed by the PA, and to improve the performance of institutions which support foreign trade. %70 of these exports are national products, whereas the remaining percentage is re-exported products. Data indicates that the biggest share of exports (%85) is directed towards Israel whereas about %12 towards Arab countries, and what is left goes to rest of the world. Palestinian exports go through three border crossings:

- * Crossings with Israel, through which %86 of products are being exported.
- * Karamah Crossing (%13 of exports).
- * Muntar Crossing (%1 of exports).

Stone and marble are the main Palestinian exports (%18), followed by foodstuffs.

- Palestinian imports are associated with many factors which influence their value and composition.

They include the purchasing power of Palestinian consumers, cost of imported goods against local goods, legal/institutional framework of the import country and logistics provided. Palestinian imports have been qualitatively and quantitatively improved, which is manifested by the huge increase of total imports (reached record levels in 1999, \$3 billion). However, they severely dropped in 2002 by %50 compared to 1999. The decline is caused by bad economic, security and political conditions, as well as the reduced total demand by Palestinians, and Israeli impediments that restricted movement of individuals and goods within the Palestinian territories and with the outside world. Imports resumed rising throughout subsequent years due to relative calm, where they exceeded pre-Intifada levels to hit \$3,284 million in 2007. The increase continued alongside economic improvement and the rise seen by government spending and relatively constant payment of salaries. Imports recorded unprecedented levels in late 2012 (\$4,050), the greatest share (%73) is the Israeli products, half of which is oil derivatives, water and electricity, which are essential and irreplaceable products. On the other hand, Palestinians import %10 of total products from Turkey and China, and the same proportion from European countries. Imports include foodstuffs (a quarter of total imports), machinery, electric appliances (%8) and chemical products (%7).

- Data shows that the Palestinian economy suffered from a chronic trade deficit even before the establishment of the PA. This deficit grows with the change of imports, exports or both.

PCBS published predictions on foreign trade for 2013 and set a number of scenarios, including the most pessimistic one. They said that total exports would drop by %7.6 (\$947 million). It is likely that these forecasts were quite conservative because they were not based on the PA dissolution scenario. It is likely that the value of exports would drop by less than %15 at minimum, which is the share of exports to the outside world, excluding Israel. Israel might impose severe restrictions against exporting to the outside world, which would go on without any sort of follow up by Palestinian official authorities to observe the Israeli violations.

Regarding imports, PCBS predicts that they would grow by %12.4 (\$ 4,551 million), **we disagree completely with these predictions**. Importing is the main sector which would be affected by the dissolution of the PA and subsequent repercussions on Palestinians' purchasing power and level of aggregate demand. Therefore, imports are likely to witness severe decline (%30), which would cause the value of the trade deficit of the Palestinian economy to drop off. The decrease would hit imported consumer and investment goods, which would reflect the decrease of investment in the Palestinian territories.

5. Financial sector

This sector is divided into two main sections:

- The banking sector: which includes banks, money exchange firms and micro-lending firms. This sector is supervised by the Palestine Monetary Authority.

- The non-banking financial sector: includes insurance, stock exchange and respective brokerage firms, finance lease firms and mortgage firms. This sector is supervised by the Capital Market Authority.

The Paris Protocol has a chapter that regulates matters that have to do with monetary and banking affairs. They stipulate that NIS is one of the recognized and accepted currencies as payment, including official deals. It should be brought up that the Israeli authorities allowed a very small number of Arab banks to operate in the Palestinian territories before 1994, where they played a very limited role in the economic arena.

Political agreements signed between PLO and Israel, as well as the advent of PA, left a great impact on the development of the financial sector's two sections. It has witnessed considerable growth since 1994;

there were only three banks operating before that date, but the number went up to 18 banks and 233 branches by late 2012. This growth of the number of banks and branches affected the growth of banking indexes, where the value of deposits reached \$ 7200 million and the value of credit facilitations provided was \$ 3756 million. Performance of the PA has greatly improved in the past few years and managed to maintain the stability of the banking system and safeguard it against risks and domestic/foreign traumas.

Given the composition of credit facilitations, we see that the Palestinian public sector has taken %30 of total facilitations (\$ 1115 million) as a tool which the Palestinian government resorted to to mitigate the financial crisis. Banking services are provided to wide groups of the Palestinian people, where facilitations offered to the Palestinian private sector constitute %70 of total facilitations (\$ 2,641.5 million). In contrast, data indicates that facilitations offered to public servants until late 2012 reached \$ 700 million.

Currencies traded in Palestinian territories are NIS, USD and JD. The traded money supply is determined by demand deposit account and cheques traded in the currencies mentioned above. According to calculations, the money supply is estimated between \$ 6-8 billion in the three currencies, with NIS taking up about half the amount of money traded in the Palestinian territories, or \$ 3-4 billion until late 2012.

The non-financial sector, for which insurance companies are the cornerstone, has developed remarkably since the PA's inception. The scope of the insurance portfolio in the Palestinian territories reached \$ 113 million provided by 10 companies at the end of third quarter of 2011. These companies offer services to individuals and economic enterprises in different insurance fields, which aim to improve the investment scene and provide insurance coverage against risks and fluctuations that might face economic businesses. There are a limited amount of mortgagee and finance lease firms operating in the Palestinian territories, while there are 48 capital market companies, which hold a market value of shares at \$ 2.7 billion as of late 2012. The stock exchange has 8 brokerage companies at which hundreds of employees work, added to other institutions that undertake operations other than financial brokerage.

The financial sector is the most prone to being influenced by political changes, and it is collectively affected by **what is known as the domino theory, or devolvement of regulatory risks to all pieces of this system very quickly**. Thus, components of this sector would be exposed to repercussions of PA dissolution, and the following are key consequences to banking and non-banking sections of the financial sector based on this dissolution:

- PA indebtedness to banks operating in the Palestinian territories reached \$ 1,115 billion by the end of 2012, where it is clearly seen that if there is a PA dissolution, and thus failure to pay banks, and international organizations' refrain from offering any banking guarantees, it would expose banks to major risks that impact their ability to maintain action and provide banking services.
- This dissolution would lead to the laying off of most public servants and, consequently, compromise their ability to pay back banks for their debts estimated at \$ 700 million. In case of insolvency, banks could resort to confiscation of real estate and assets (guarantees), which would allow banks to recover part of debts. However the social ramifications and refusal to this step might impede implementation.
- Salary cutoff would affect other private sector activities, which, in turn, would lead to insolvency of some private sector businesses due to inability to pay.
- It is unlikely that Israeli authorities would facilitate wide trading of other currencies other than NIS in

the Palestinian territories, whether for deposits or cheques, which would leave effects on trade activities and hamper trading of assets and real estate mostly done in USD and JD. The Israeli authorities would bridge the gap left by absence of the PA in this regard and supervise the banking system, which is likely to resume action the same way as before 1994. This would marginalize the role played by banks in financing consumer and investment actions for individuals and economic businesses.

- The private sector depends on banks in financing part of its investments, and absence of the PA (purchasing power and state spending) would cause aggregate demand to drop, and withdrawal of investments and the need to finance them by banks. This would eventually lead to a decline in demand for banking services and impact investment decisions made by banks to continue work or expand their offered services.

- Banks would face serious problems regarding bounced cheques. It is anticipated that, in light of absence of a judicial system and law enforcement agencies, the number of bounced cheques would increase (whether intentionally or unintentionally). This would undermine the credibility of cheques in commercial transactions as a payment tool, and the size of transactions as a result.

- The insurance sector would be affected significantly, and insurance companies might move their main operations outside the Palestinian territories in light of absence of a law protecting their operations. It is also expected that the Palestinian economy would lose an important source of finance for investment actions; the Palestinian stock exchange. Companies listed in the stock exchange would incur heavy losses due to damage to market value of shares (growth of risk), which makes a great number of investors (individual, corporate) flee the stock exchange. This would leave an impact on share prices and the total market value of shares listed would be downsized (%50 or more).

6. The Investment scene

The investment scene depends on an attractive and safe legal environment, stable political arena and an improved infrastructure. Investment volume has considerably grown following the advent of PA, and growth of investment business could be observed through the large increase lately in new companies registered by the company registrar, as well as projects benefiting from the investment promotion law. Number of companies registered from 2008-2011 reached 5438.

The PA has improved the investment scene through procedures taken such as enacting laws that regulate economic matters, financing infrastructure projects and providing security and judicial systems and making commercial agreements.

The Possibility of PA dissolution would undermine the efforts made to create a proper investment scene that would encourage investments, which would be badly reflected in the severe decline of investment actions. It is expected that investors' decisions would favor the withdrawal of many existing investments in the Palestinian territories.

Absence of supervisory bodies such as PMA and CMA would compromise investors' trust in the national economy, many of them would be extremely cautious and conservative upon making any investment decisions. This would affect the ability of the national economy to employ workers and remarkably increase poverty and unemployment amongst Palestinians.

7. Public services & social affairs

The PA serves the Palestinians through ministries and other public bodies. In addition to facilitation of daily transactions, sectors of education, health and social affairs receive the biggest share of government spending and support. The volume of spending directed at the health sector at the end of 2010 was more than \$ 360 million (%36 of total spending for health services in the Palestinian territories), and PA dedicated \$ 600 million from the state budget for the education sector, bearing in mind that the biggest proportion (%80) goes to payrolls for that sector. Additionally, PA spending for

social affairs in 2012 was estimated at more than \$ 310 million to support households and families of martyrs and the injured. Generally speaking, some sources indicate that the total cost of only civilian daily life matters is about 10 billion NIS each year (\$ 2.8 billion).

In the case where the PA is dissolved, it is expected that the PA would empty all the civil and security bodies of their employees, except for a small number of departments that keep records of citizens such as personal documents, lands, corporate, education and health. In case Israel agrees to take responsibility as an occupying force, it would have to manage the occupied territories and bear the costs of service provision to the Palestinians. However, past experience dictates that the occupation force was a negligent service provider, and it would take measures that guarantee a financial surplus from management of the occupied territories. This policy could be understood through the focus of service departments in specific locations, unlike the decentralized pattern adopted by PA, whereas occupation authorities aim to control costs. On the other hand, the occupation authorities would drain the Palestinian financial resources through arbitrary collection of taxes and custom duties, with no services provided, so they, in addition to VAT, would end in the Israeli treasury.

V. Special Considerations in focus

The potential economic repercussions resulting from the dissolution of the PA have been discussed and analyzed in the previous parts, apart from a number of considerations that might have an impact on severity of these repercussions. Yet, at the same time we expect that these considerations, when incorporated within the substantially accredited analytical model, would not affect the trend of these repercussions or any of their general features. In this regard, we point out the following three main considerations:

First: the division between the West Bank and Gaza Strip

Since the establishment of the PA and up until the year 2006, four common factors between the West Bank and the Gaza Strip have controlled the orientation of the Palestinian economic performance:

1. Agreements signed with Israel during the Transitional Phase.
2. *De facto* Influence of the Israeli occupation on the Palestinian territories, which has influenced all aspects of life of all of its citizens, in violation of most of the provisions of the agreements signed with Israel.
3. Level and nature of international assistance.
4. The methods and policies adopted in running the national economy by successive governments.

In 2006, a new factor began influencing the Gaza Strip's economy, which is perhaps relatively the most important one, that factor was the direct and severe Israeli siege on Gaza. It almost completely managed to isolate the Gaza Strip from the West Bank, Israel and the rest of the world. According to all indicators, the siege and the division deepened Gaza's crisis and economic distortion, and intensified the "**Economic Deviation**" between Gaza and the West Bank. As time passed, this situation, unfortunately, began to slip into a state of "**Complete Separation**".

Several studies and reports have indicated that the policy of the siege and repeated attacks against the Gaza Strip, which had escalated after the internal division, has obliterated any chances or possibilities

for development. It also has led to a significant deterioration in the level and quality of infrastructure facilities and public services, and to an acute decline in the functionality of all economic facilities. The siege manifested itself in the recurrent closure of Israeli main crossing points and in the prevention of the free flow of Gaza imports and exports (consumer goods, raw materials and semi-manufactured goods for production purpose). This siege had also influenced the banking sector, impeding the role it plays to revitalize the economy and preventing it from providing the necessary cash flow for daily business transactions. This resulted in the private sector's exposure to severe damage, mainly because it employed around 100,000 workers who represented 53% of Gaza's workforce, of whom about 40,000 were working in agriculture and respective exports. All of which have led to an increased dependence on foreign assistance as well as a relative increase in influence of the black market within the economy of the Gaza Strip.

As a result, there has been wide deterioration in the economic, macro social and sectorial indicators. Despite the relatively high growth rates in the GDP (with an average of %25) over the past three years, the GDP per capita in Gaza Strip remains lower by about 40% from that of the West Bank. Consequently, unemployment and poverty rates in the Gaza Strip have increased. In 2008, unemployment rates were at their peak, reaching 44.8%. According to PCBS, the number of unemployed Palestinians (as defined by the International Labor Organization 'ILO') during the third quarter of 2012 reached approximately 120,000 (equivalent to 31.9%), while unemployment rates during the second quarter of the same year were only 28.4%, an increase of %3.5 more than the second quarter of 2012. The rates are expected to rise in the fourth quarter of 2012 due to the consequences of the recent war on Gaza. In addition, unemployment rates have also risen up to 57.5% among college graduates who hold bachelors and diploma degrees in all specialties.

The siege also boosted the unending daily blackouts for more than six years due to inadequate amounts of diesel inflows needed to run the only power plant in the Strip, added to the prohibition of the admission of necessary spare parts for maintaining the plant. This resulted in the increase of economic, social and psychological suffering of Gazan citizens; wherein the electricity is cut off for 8 to 12 hours daily depending on the load on the power grid.

As the financial strangling policy continues, Israel still imposes restrictions on currency inflow into the Gaza Strip, leading to a crisis in cash flow that disrupted the banking system and caused many problems among banks, citizens and employees.

The financial crisis that the PA has been going through over the past two years has cast its shadow on the economic and living conditions in the Gaza Strip. The year 2012 witnessed an unprecedented escalation in the crisis, which came to a deadlock following the United Nations' recognition of Palestine as a non-member state. As a response, the Israeli government seized the Palestinian tax and customs funds collected by Israel for the PA. The crisis was reflected through delayed salary payments to public servants, brining about a state of commercial and economic recession due to poor purchasing power and the accumulation of obligations. **Part of the worsening deficit in the PA budget could be traced back to the decline of revenues generated from the Gaza Strip, which is transferred to the PA treasury in Ramallah, whereas Gaza's share in government revenues decreased to 2% in the year 2011, although its contribution in the year 2006 was 28%, through which the PA continued to pay salaries and expenses of the public sector in Gaza Strip. They accounted for approximately 39% of the total public expenditure.**

According to the United Nations Development Program (UNDP) report for 2011, more than 70% of

families in the Gaza Strip and 56% in the West Bank have been living under the poverty line since mid-2007. The humanitarian conditions in Gaza Strip are still very severe. Main crossing points allow nothing but the essential imports and impede the export of goods. This has led to a boom in the tunnel trade, which has reached approximately \$1 billion in worth. The report noted the deteriorating situation in the Gaza Strip following the reduction of fuel supplies from Israel at the start of 2008, causing a curb in the production wheel in most sectors as well as the fleeing of most private investments, some to the West Bank and others to Egypt and other neighboring countries. The disruption of water supplies and sanitation is another side of the problem.

With regards to the siege's impact on the key economic sectors on which the Gazan economy depends, this report indicates that agricultural activities in the Gaza Strip constitute a significant part of it, due to its key role in the export of goods, as it also provides many raw materials to various economic sectors. Farmed acreage in the Gaza Strip constituted around 9.9% of the total 1.835 million farmed acres in both the West Bank and the Gaza Strip in 2009. Approximately 45,000 people work in the agricultural sector, in addition to another 25,000 who work on a seasonal (temporary) basis in the period from October-May (known as the cultivation season). These workers work on a daily pay basis and do not own agricultural lands or any other sources of income. The importance of agricultural activities is also highlighted by the fact that they provide food for 25% of Gaza's population.

The constant closure of the main crossing points has caused aggravated damage to the Palestinian agricultural sector famous for its high quality and compliance to health codes and International agricultural production standards. The Israeli siege and the constant closure of the crossing points have led to the loss of thousands of employment opportunities in the Gaza Strip. Restrictions imposed against fishing activities and the deterioration of sea life, caused mainly by the dumping of wastewater into the sea, have affected the fishing sector massively. Restrictions imposed on exporting and importing goods have consequently pushed large sections of the agricultural sector into a state of paralysis.

The Israeli authorities' decision to expand the buffer zone (which extends for 300 m) alongside the borders of the Gaza Strip has resulted in further deterioration in the agricultural sector. This decision denied residents' access to almost 25,000 acres of the finest agricultural lands. Moreover, the recurring incursions and the outbreak of the last war in 2009 have also destroyed lands, crops and equipment, in addition to the death of livestock and poultry.

Almost 90% of enterprises operating in the industrial sector in the Gaza Strip have declined due to closure and destruction, while the remaining enterprises have been operating with a very limited capacity and depend on old stocked material at very high costs. The same report clarified that the closure of enterprises has contributed to increasing unemployment rates, whereas most workers in this sector (around 35,000) lost their jobs. The most affected industries include furniture, clothing and textile enterprises. The number of operating enterprises in the furniture sector went down from 600 in 2005 to 120 in July 2007, only to reach less than 50 in July 2009. The General Union of Palestinian Industries has estimated a monthly loss of \$15 million for the industrial sector in Gaza since 2007, which amounts to a total of \$277 million in losses until the end of 2008, apart from losses caused by the last war (estimated at \$35 million).

Would this state of division and the ongoing Israeli siege cause discrepancies in the nature of the economic fallout resulting from the PA dissolution on the situation in the West Bank in comparison with that of the Gaza Strip? If so, what is the size and direction of these discrepancies?

The answer to these two questions depend on the assumptions regarding the future of the existing political and legal *status quo* in Gaza, which would probably remain unchanged as a result of the PA dissolution. Moreover, it is not likely that Israel would pull a broad military action against Gaza

resulting in the re-occupation of the strip and the termination of Hamas's authority. It might resort to tightening the siege on the Gaza Strip and isolating it completely from the West Bank, while maintaining the currently existing limited trade ties with the West Bank in order to avoid collapse or a state of chaos that might threaten the stability of the entire region. Israeli actions may help in turning the Strip into the new fulcrum of the Palestinian National Project; these actions would attract the much needed attention and provide an impetus of financial and political support from the Arab and Islamic worlds. However, this is where the political risk resulting from the PA dissolution in the light of the division rises. Concrete developments are evident through Gaza's ongoing economic relations with the outside world via Egypt.

Economic repercussions on Gaza upon PA dissolution

Assuming that the existing political and legal entities in the Gaza Strip would remain as is, then the direct repercussion of PA dissolution can be summarized as follows:

1. The economy in the Gaza Strip would completely lose its share of the government expenditure in Ramallah, which amounts to \$1.2 billion, allocated for public servants' salaries, social aid, the energy bill and some developmental projects. This would impair Gaza's economy, raise poverty and unemployment rates, lead to a severe decline in GDP, disrupt a large part of public services, and it would also lead to confusion for the infrastructure reconstruction efforts.
2. The loss of financial resources allocated for the Gaza Strip would put the *de facto* governments' budget under great pressure; through which the budget deficit would reach more than \$1.5 billion. In the light of limited, or even absent, options from the *de facto* government in the way of financing the deficit, addressing financial sustainability becomes impossible.
3. On the other hand, dissolution of the PA may hold many opportunities that would help reintegrate Gaza's economy into the Arab and Islamic worlds through Egypt. This option may open wider horizons for this economy in terms of attracting foreign assistance, even if not directly through the *de facto* government. New prospects of employment for workers of the Gaza Strip may be realized through travel and work in the Arab Gulf States.
4. In conclusion, the dissolution of the PA would have serious negative economic impacts on the Gaza Strip, especially in the immediate short-term. Nonetheless, these impacts may begin to recede with time; however, it would depend on the ability of the Gazan economy to utilize its available opportunities.

Second: The Isolation of Jerusalem

Jerusalem is now under semi-complete isolation from the rest of the Palestinian territories occupied in 1967, where the Israeli government system is enforced, whose goal is to Judaize and vacate Jerusalem of its indigenous Palestinian residents. At the same time, Jerusalem remains isolated from the rest of Israel, where its economy remains unintegrated. This isolation exacerbates the economic, social and institutional crisis, and dangerously and worryingly lowers the living conditions and level of public services in the city. The UN's World Trade Organization report issued recently indicates that poverty and unemployment have reached unprecedented record levels; these rates are double those prevailing in the West Bank and five times higher than those in Israel.

It is not likely that PA dissolution would affect Jerusalem's political, institutional and legal status that has been constituted by Israel as an occupation force. Impacts of PA dissolution on the city's economy would be limited, and this option would possibly lead to a gradual mitigation of the siege,

which would reopen Jerusalem, albeit partially, to Palestinians from the West Bank. This would no doubt stimulate, although partially, trade circulation in the city. On the other hand, the city would lose financial resources allocated by the Palestinian government's budget necessary for some of the facilities and service projects. The Jerusalemite public servants loss of income would negatively impact their consumption. The city of Jerusalem might be among the least affected economically as a result of the PA dissolution.

Third: Palestinian Diaspora

Since its inception, the PA has replaced the Palestinian National Fund of the PLO by undertaking the responsibility for spending on social services for Palestinians in the Diaspora, especially those living in refugee camps. There are thousands of staff working in the Organization's embassies, representative offices and institutions whose headquarters are stationed abroad to this day. Hence, PA dissolution would lead to a massive loss of resources for these institutions, which depend upon such resources for all their needs. As a consequence, the PLO would face severe economic difficulties if it is to regain its previous role and undertake financial responsibility for the Palestinians in Diaspora.

Concluding remarks

It is clear that the direct and immediate economic repercussions for PA dissolution would be significant and would no doubt affect all aspects of Palestinian life. The severity of these repercussions would not differ much if this dissolution was voluntary (a Palestinian decision) or if it was compulsory (a deliberate act by Israel). The pace of continuance of these repercussions (on the medium or long-term) would mainly depend on the Israeli position and on the resilience of the Palestinian people and their leadership organizations in coping with this new reality, and on their ability to renew the national labor system at all levels. It also depends on the Arab and International reaction towards this strategic development. In any case, the Palestinian leadership and respective organizations must do their best to avert this option, or in the worst case, to take all necessary precautions to ensure the minimization of the size of damages that may hit individuals and organizations. This means that all steps necessary to reform the PA action mechanisms and policies must be taken in order to empower the Palestinian economy and benefit from opportunities and the limited available resources. With regards to this, it is possible to immediately begin designing and implementing a reform and development plan which takes into account the lessons learned from previous experience in running the national macro and sectorial economy.

Possible economic options in the meantime

These options will remain limited and regulatory in nature for markets and the internal economic relations. They do not affect the core strategic path of the Palestinian economy. The most likely field in which these options can be implemented is the public funds management which is also the most likely to re-set some sectorial policies in order to regain internal economical balance, and to realize more social justice.

First: In terms of the General Fiscal Policy

First, it must be emphasized that international assistance may not go on forever, at least at the current pace. Therefore, it should not remain a fixed and constant element in the strategic development. It should be viewed as temporary and not guaranteed. Palestinians must exercise high levels of prudence and efficiency in employing this aid whenever available, while continuously searching for alternatives that would progressively free them of their dependency. The PA's dependency on International aid has begun to truly recede over the past two years. This governmental approach may be accepted and justified both politically and economically, yet it has not gained national consensus. Many believe that International aid is necessary for the purposes of compensating the Palestinians for the damage and suffering inflicted upon them by the Israeli occupation. Consequently, the inflow of this aid should continue as long as the Israeli occupation exists. The government has set an ambitious, yet unrealistic, goal for itself; to do without this aid by the end of the year 2013. This International aid, however, is expected to remain an essential component in financing the overall budget deficit in the next three years.

Why search for a new Fiscal Policy now?

- The gradual decline in the size and frequency of aid since the end of 2010 has triggered a severe financial crisis for the PA, for which aspects and dimensions were very clear.
- Most importantly, this crisis has brought back to the table the question of the PA's financial sustainability. It also re-set the direction of this debate towards finding other alternatives or available possible options in order to adopt a national financial policy for upcoming periods, where such aid may cease partially or completely.
- The attempt to restructure fiscal policy has gained a lot of attention in the process of establishing a Palestinian State, through which an increase in the likelihood of conflict with Israel and perhaps with some major donors is possible.
- There are fears among Palestinians that donor countries could use their 'aid card', while Israel could use the 'tax transfers' card, in this open conflict.

Possible features of the fiscal policy!!

Presumed options that should help any country solve financial crisis:

- ✓ Increase local revenues (tax and non-tax) either through expanding the local economy's capacity, or through improving tax collection by expanding the taxes' horizontal base and/or reducing tax evasion.
- ✓ Austerity in public expenditure, through rescheduling on the basis of 'prioritization'. Improving spending efficiency and putting an end to the waste of public funds. It should be noted that there is a difference between 'austerity' and 'rationalization'.
- ✓ Additional borrowing as permitted by applicable laws and regulations, either through the banking or financial markets.
- ✓ Procure urgent Arab and International aid.

But the fundamental question is: Which of these options is available and can possibly benefit the PA in accordance with the *status quo*?

- ✓ Increasing revenues is a possible option, but should be done within reason, as tax burden in PA territories cannot exceed %75 of GDP to finance current expenses. Most importantly, justice and economic stimulus must be observed when doing so. Recent modifications to income tax

laws have been applied within the government's endeavor to increase local taxation. Even though, these modifications would not lead to a significant increase in revenue due to fundamental disruptions in the Palestinian tax system, which depends mainly on indirect forms of taxation, particularly VAT and custom fees (on consumption). This comes at the expense of direct taxation on income and wealth.

- ✓ Austerity is a needed and urgent option that has two values; one of them is economic and the other is moral. However, this option is generally not popular and is often strongly opposed. In the case of Palestine, this option is also restricted with the current spending.
- ✓ Additional borrowing is currently an unavailable option for many reasons:
 1. The General Debt Law stipulates in article (5) the general debt limitation of 40% of the GDP.
 2. An expansion in domestic borrowing has negative economic effects caused by the public sector's competing with the private sector on the available financial resources.
 3. An expansion in local bank borrowing would increase what is known as "credit concentration risks".
- ✓ Getting loans through issuing bonds in private or public subscription might be possible and appealing, especially among the wealthy Palestinian Diaspora. These bonds can be based on fundamental economic and financial returns. However, this requires either an amendment to the Debt Law or sufficient economic growth to that end.
- ✓ Attracting additional international aid (regular and urgent) may be an available option both Arab and Islamic-wise, but limited on an international level in light of the negotiations impasse, and the higher likelihood of conflict with Israel as a result.
- ✓ It may be useful at this stage to negotiate Israel's compliance guarantee mechanism in transferring monthly dues to the PA's treasury without equivocation or political employment with the Quartet and other international parties. One of these mechanisms may be granting the PA a sponsor or an international guarantor (state or organization) for these transfers as an additional motive to return to direct and final negotiations with Israel.

Thus, if all of these options are necessary for a sustainable and efficient National Fiscal Policy, any of these options alone would not be sufficient in achieving this.

Second: The macro economical and sectorial levels

- Address distortions in the labor market through absorbing the bulk of the Palestinian labor force within the Palestinian economy, particularly within the private sector. This requires the activation of the role of the employment fund and adopting policies which would increase the productivity of the Palestinian workforce by focusing on the export of Palestinian goods and services of global added-value instead of exporting Palestinian workers. This can be accomplished through showing interest in humanitarian development and the improvement of labor productivity, in addition to showing interest in rehabilitation, vocational and technical training programs, and developing college education systems, in line with the needs of the labor market.

- Reduce the dependency of the Palestinian economy on that of Israel, and develop economic and trade relations with the Arab and Islamic world. In this regard, the question revolving around the fate of the Paris Economic Protocol surfaces: should this Protocol be amended through negotiations with Israel? Should enforcement of this Protocol be ceased until reaching a new agreement? Should full commitment to this Protocol be demanded first through the Quartet or other international parties until reaching the final arrangements for political and security relations with Israel, within the framework of the final, just and comprehensive solution? The researcher supports the latter because amending the provisions of these Protocols with Israel requires direct negotiations that incorporate political damage and undermines the Palestinian leadership's continuous opposition to these negotiations without achieving just Palestinian conditions. However, the main problem does not lie within the Paris Protocol, but within their political and security terms of reference that were mentioned in the Oslo Accords. Amending provisions of the Protocol, even if in accordance with the Palestinian vision, would not have any economic returns as long as Israel remains in control of the land, borders and resources, and as long as it continues to impose restrictions on the movement of individuals and goods within the Palestinian territories for security purposes. Separating the development of economic relations with Israel from the development of the course of the political settlement is not the correct framework. Assumptions of collaboration and the possibility of development in economic relations, regardless of progress in the course of the political settlement process have proved inaccurate, especially in the face of crisis, in addition to the inaccuracy of the assumption of Israel's bona fide, which proved incorrect in all stages.
- Supporting service and social welfare institutions which support the marginalized and the poor: the social safety and social aid networks intended for poor families are considered of immediate priority and are necessary for maintaining, at minimum, the cohesion of the social fabric, especially in the light of the growing numbers of the poor due to deteriorating economic conditions. The increase in the funds of the Ministry of Social Affairs is considered an urgent issue which would increase the ministry's ability to raise the efficiency and level of aid coverage provided in the form of urgent and humanitarian aid for poor families, especially families directly affected by the Israeli occupation.

Other necessary procedures include:

- ✓ Providing health insurance programs for citizens with limited means for trivial fees, and providing medication at subsidized prices.
- ✓ Establishing a fund to protect against unemployment through the contribution of stakeholders (the government, employers and workers).
- ✓ Continuing development of special programs for emergency employment.
- ✓ Contributing to the provision of training programs for the rehabilitation of non-skilled workers.

- ✓ Fighting inflation and supporting basic goods and services of common consumption among citizens.
 - ✓ Reconsidering the decision regarding minimum wage before putting it into action, for the purpose of making it more just and responsive to the expectations of the working class.
- Showing interest in and supporting national products, and providing the requirements of survival and resilience for individuals and businesses through:
 - ✓ Providing and supporting agriculture.
 - ✓ Concentrating on production according to the needs of the local market rather than that of the foreign market, i.e. to adopt the policy of imports substitution rather than exports increase.
 - ✓ Encouraging and supporting the role played by agriculture cooperatives which help Palestinian farmers to survive and grow.
 - ✓ Provide temporary protection to the new national industry.
 - ✓ Monitoring imported goods and ensuring their conformity to national standards and specifications.
 - ✓ Prioritizing local products in government procurements provided that they meet Palestinian standards and specifications.
 - ✓ Reconsidering the amendments which took place recently to the Investment Promotion Law through which the capital of projects that benefit from exemption is raised from \$100,000 to \$250,000. This is completely contrary to all recommendations of previous studies and reports that see the need to provide tax incentives not only for big businesses but also for small and medium businesses.
 - Intensifying reform efforts at all judicial, administrative and institutional levels and exerting maximum efforts in fighting corruption and ceasing the waste of public funds.
 - ✓ Reconsider custom duties imposed on imported goods; reduce fees on basic and necessary goods and raise fees on goods that are suffering from intense competition from Israeli and Chinese products. This also applies to VAT rates.
 - ✓ Intensify campaigns in the Palestinian territories to get rid of settlement products, encourage community-based initiatives to boycott Israeli products and to support National products.
 - ✓ Adopt technical support programs and in coordination with the private sector, which represents Palestinian industrial enterprises to enable them to improve the quality of their products, and to reduce their cost in order to increase internal and external competitiveness.

If we want to talk about the repercussions of the PA's dissolution, I do not see that this would leave a direct impact on the Gaza Strip due to its regional and international political situation, in the wake of the Israeli unilateral disengagement in September 2005.

In the case where the PA was dissolved, this would have no effect on the economic condition of Jerusalem, as a UNCTAD report indicates the weak and frail economic situation there.

After clarifying these accounts, we reiterate –like everyone else- that the economic conditions, especially after the PA's dissolution, would definitely be associated with politics. We are convinced that there is no Palestinian, Israeli, Arab or international motivation to dismantle the PA. Even in the case of such a dissolution, independent from local and regional desires, the geographical division, basically caused by the Israeli occupation, would render the Gaza Strip an independent economic entity, including its own foreign trade system in terms of exports and imports, whether through Turkish and Cypriot harbors or through border crossings with Egypt. This brings us back to the case of Jerusalem, as PA dissolution would not have any direct impact because it has been unilaterally annexed to Israel a long time ago.

Here, we remain confined to the economic impact on the West Bank, specifically territories under the control of the PA (A and B areas), which only constitute approximately %40 of the West Bank. If the PA actually collapses, economic matters would be administered by old Israeli military rule, albeit with an economy bigger than what used to be twenty years ago, and somewhat more complicated in terms of entanglements and programs within this economy, which were internally achieved with all stakeholders, whether through the legislative structure on one hand or through public/private sector partnerships on the other hand. The latter relationship is very hard to realize between a nationally-motivated private sector and military rule representing the new public sector. Not to mention the financial partners-related matters. However, the private sector, which managed to build up a returns portfolio worth of 2.5 billion USD every year, would no doubt be an easy catch for the new military rule that would control Palestinian society, driven by military/security considerations to maintain its colonial policies and border control, which would benefit greatly from increasing cheap Palestinian labor, and attracting them to a comprehensive development program that serves the expansionist plans of the Israeli rightist cabinet, which would eventually lead to the utilization of what is left of the Palestinian economy's relative features.

Workshop Discussion:

Dr.Nassr Abd Alkareem:

The economic situation in Palestine is connected with the political and security one. This has been noticed since 1994; the economic performance has followed the political and security scene in terms of rising and falling.

Thus, the option of dissolving or the collapse of the Palestinian National Authority(PNA) means cancelling Oslo Agreement and Paris Economic Agreement that is governing the economic relations between the PNA and Israel.

In fact, the economic environment in Palestine is ruled by group of legislations and laws that were agreed by the PNA and the terms of Paris Agreement and its applications on the ground.

Characteristics of the Palestinian economy:

1. The domination of commerce and service sectors on other productive ones.
2. The domination of public expenses on the account of private investments.

3. Gap is huge between wages and prices.

Possible changes may take place in the structure of the Palestinian economy after the collapse or the dissolve of the PNA. For instance, both agriculture and industry sectors may dominate other sectors again.

On the other hand, it is obvious that the growth of Gross National Product (GNP) will severely decrease. It is probable that the GNP growth will fall (15% or 20%). This is because the collapse of the PNA will confuse the economical scene. As a result, poverty and unemployment rates will increase in West Bank and Gaza strip as well. The reason for this is that the majority of the employees of the public sector (roughly 100,000 employees) will lose their jobs. This situation will continue for a while until the Palestinian economy has adapted with the new situation and benefitted from the situation of the Israeli economy, but it takes more time. Service sector will extremely drop, too.

However, the most affected and declined sector will be the public financial sector as it spends about \$3.5 billion out of 9.5 billion of the total amount of the Palestinian economy (roughly 40%). This means the public sector will stop financing which leads to dismiss large numbers of employees. Therefore, the influence of public financial sector is double-aged that includes the purchasing and commercial movement on one hand, and the ability to provide jobs, services, interior security and the projects of infra structure, on the other hand.

Moreover, the effect of the public finance on the banking sector is huge, since the latter provides the Palestinian government with loans of approximately \$1.2 billion. In addition, it also provides the employees of the public sector and their guarantors' loans which reach \$700 millions. So, if the PNA collapse happens, the employees of the public sector will not be able to pay back their debts.

In order to face the dangers that may affect the banking sector in the next phase, the monetary authority should increase reserves accumulation and rise the percentage yearly whether it is compulsory or voluntary. It should also try to liquidate the credit that is given to public sector and its employees. Furthermore, it should seek for international guarantees for debt payment.

Another consequence of this collapse is working in 'Israel'. It is clear that approximately 100,000 employees will be out of work, but West Bank's labor market will not absorb them, so they resort to other places including Israel. In this case, it is widely expected that Israel facilitates the return of the Palestinian workers to the Israeli economy because they cost Israel less socially and economically and by this Israel saves itself partially from chaos (political turmoil) since the Israeli occupation is interested in controlling the territories that are occupied.

With respect to commercial sector, it is expected that the imports will decline as the ability of people's consumption drops, and so people will go back to the traditional methods of agriculture. As for exports, they will not expose to harm as imports because Israel will facilitate the arrival of the Palestinian exports to its markets and continue to let the Palestinian exports go out Palestine.

Regarding Palestine stock market, which has a value of about \$2.7 millions. If the PNA is dissolved it will not be under control, so it may drop 5% per day for a whole month. There will be no contributors in the stock market except those who have trust and confidence that it has the ability to regain its power. As a result, it is expected that the loss of the stock market be more than 50%.

Concerning social affairs, the PNA spends roughly \$300 millions. If the PNA collapses, this sum of money will vanish.

As for the consequences of this collapse on Palestine Liberation Organization (PLO) and Palestine diaspora, it will be enormous since the PLO's budget follows the PNA's.

Finally, the consequences of this dissolve or collapse on Gaza strip will relatively be less because there is a political entity there. Moreover, there will be a chance to Gaza strip to play a larger role after the collapse of the PNA and weakening of the PLO. So, Gaza will become a spotlight to the world, a place of greater openness and trade of tunnels will turn into official trade all over the Arab world. Consequently, if the collapse takes place during the political partition, then the danger will be

enormous on the political level. The same can be said on the economical level, Gaza strip will also be affected especially that 40% of the PNA's budget is spent on Gaza.

Dr. Samir Abdullah:

First of all, the ruling circles in Israel wishes that the PNA would collapse, but it doesn't want this collapse come through official channels.

Secondly, if the PNA dissolves itself, the Palestinian economy will completely collapse.

Thirdly, the Palestinian economy has mainly become economy of service since 1980s.

Finally, it is difficult to open the Israeli labor market if the security situation is very bad. Therefore, Israel will do its best to facilitate travel and immigration outside Palestine for work.

Mazin Sinnokrot:

First of all, between 1967 and 1993(signing Oslo agreement), the Palestinian economy was run by the Israeli Civil Administration, nevertheless, the Palestinian private sector was able to work on a limited scale.

Secondly, after Oslo agreement up to 2007, many huge investments and economical projects was brought to Palestine (West Bank and Gaza strip) and organizing economic relations became better.

Thirdly, since 2007, the trade between West Bank and Gaza strip has decreased as a result of the political partition.

Fourthly, Jerusalem is excluded whether the PNA remains or collapses.

Fifthly, if the collapse takes place, its effect on Gaza will be less than West Bank, and new arrangements may be done to Gaza strip.

Finally, if the PNA collapses, Israel will collect taxes and spend them on building settlements; it will also use the Palestinian workers in building them.

Main issues for discussion:

Is there a scenario in the economy field that gives a new role for the PNA without affecting the Palestinian political goal (that is an independent state)?

Israel has the option of keeping this institution (the PNA) and handing it over to 'Palestinians' as it did in the past with so called 'Rawabit alqura' (spies),or keeping the PNA but to be run by Israeli occupation officers.

The Palestinians should step out of this deadlock they are living; the national movement should put its strategy for the next phase.

Day After - Workshops' Participants

#	Name	Organization
1	Mr. Abd Alnaser Masoud	National Sec. Forces - NSF
2	Dr. Abd Alrahman Altamimi	Head of Palestinian Hydrology Group
3	Dr. Abdelnaser Makky	JICA/Birzeit University
4	Ms. Abeer Albatma	PENGON
5	Mr. Abulmajeed Melhem	PALTEL
6	Mr. Ahmad Hindi	PWA
7	Mr. Ahmad Qurei "Abu Alaa"	Adisory Board/Fatah
8	Mr. Ahmad Surghally	PALTEL
9	Mr. Alaa Lahlouh	PSR
10	Mr. Alaa Yaghi	PLC
11	Mr. Ali Hamoudeh	JDECO
12	Dr. Ali Jarbawi	Minister of Higher Education
13	Mr. Ali Nazzal	President office
14	Mr. Ali Omar	National Sec. Forces - NSF
15	Mr. Amin Maqboul	Sec. General, Fateh Revol. Council
16	Mr. Ammar Dwaik	Birzeit University
17	Mr. Anwar Abu Ammash	Welfare Association
18	Dr. Ayman Daraghme	PLC
19	Mr. Aziz Kayed	PSR
20	Dr. Azmi Shuaibi	AMAN
21	Mr. Basem Tamimi	Popular Committes
22	Mr. Basri Saleh	Ministry of Education
23	Mr. Bassam Alaqtash	National Sec. Forces - NSF
24	Ms. Buthaina Hamdan	Ministry of TLC
25	Ms. Covadonga Bertrand	UNDP
26	Mr. Daoud Darawi	Adala law
27	Mr. Eyad Zeitawi	PMA
28	Mr. Fadel Hamdan	PLC Member
29	Mr. Fadi Qura'an	Alhaq
30	Ms. Fadwa Barghouthi	Revolutaionary Council/Fatah
31	Dr. Faisal Awartani	Researcher
32	Mr. Fajr Harb	Carter Center
33	Mr. Faris Sabaneh	Supreme Judicial Council
34	Dr. Fathi Abumoghli	former minister of Health
35	Ms. Florence Mandelik	NOREF
36	Mr. Florid Zurba	Ministry of TLC
37	Dr. Ghassan Khatib	Birzeit University
38	Dr. Hanan Ashrawi	PLO
39	Dr. Hanna Abdalnour	Alquds University
40	Mr. Hasan Abushalbak	Ramallah Municipality
41	Mr. Hazem Gheith	Egyptian Embassy

42	Mr. Henry Siegman	US/ MIDDLE EAST PROJECT
43	Mr. Ibrahim Barghouthi	head of MUSAWA
44	Mr. Ihab Shihadeh	Ministry of Justice
45	Mr. Jacob Hoigilt	NOREF
46	Mr. Jamal Zakout	FIDA
47	Mr. Jamil Rabah	Negotiations Support Unit - NSU
48	Dr. Jehad Albadawi	MOH
49	Mr. Jehad Alwazer	PMA Governor
50	Mr. Jehad Harb	PSR
51	Dr. Jehad Mashal	Expert
52	Mr. Jihad Shomali	UNDP
53	Mr. Khaled Alosaily	Business man
54	Mr. Khaled Shtayeh	UNDP
55	Mr. Khalil Rifai	Deputy Ministry of Justice
56	Dr. Khalil Shikaki	PSR
57	Mr. Mahmoud Haroun	Military Intelligence
58	Mr. Mariano Aguirre	NOREF
59	Dr. Mashhour Abu Daka	Former Minister of Communication
60	Mr. Mazen Sinokrot	Private Sector
61	Mr. Mohammad Alfaqih	PNC
62	Mr. Mohammad Aref	PMA
63	Mr. Mohammad Attoun	Wassel co.
64	Mr. Mohammad Daraghme	Journalist
65	Mr. Mohammad Hadieh	Ministry of Justice
66	Dr. Mohammad Odeh	MOH
67	Dr. Muatasem Alhmod	MOH
68	Mr. Munib Masri	Private Sector
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79	Mr. Natasha Carmi	Negotiation Aff. Dep.
80	Mr. Nayef Swetat	Revolutaionary Council/Fatah
81	Mr. Omar Assaf	Return right committee
82	Mr. Peter Krause	Boston University
83	Mr. Qaddora Fares	Prisoner's Affairs
84	Mr. Qais Abdelkarim	PLC

85	Mr. Radi Jarai	Alquds University
86	Mr. Reda Awadallah	PPP
87	Mr. Roland Friedrich	DCAF
88	Dr. Sabri Saidam	President consultant
89	Mr. Sadam Omar	National Security Forces
90	Dr. Safa Nseraldin	Minister of TLC
91	Mr. Said Alhmouz	PMC
92	Mr. Said Zaid	PLC
93	Mr. Salam Zagha	NEDCO
94	Mr. Saleh Ra'afat	Former Head of FIDA
95	Mr. Samer Farah	Welfare Association
96	Mr. Sami Alsaedi	AI Bank
97	Mr. Samir Abdallah	MAS
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107	Mr. Tayseer Zabre	HURRAT Center
108	Dr. Ummaya Khammash	UNRWA
109	Dr. Wael Qa'adan	PRCS
110	Mr. Waleedd Ladadweh	PSR
111	Dr. Walid Aburas	HWC
112	Mr. Walid Hodali	JWU
113	Mr. Wisam Atwan	National Security Forces
114	Mr. Yousef Adwan	UNDP
115	Mr. Zafer Milhem	PERC

The Day After: How Palestinians Can Cope if the PA Ceases to Function

January-October 2013

PSR, in cooperation with the USMEP and NOREF, has initiated in January 2013 a policy research project that aims at exploring Palestinian conditions and options in the day after the PA ceases to function. The initiative seeks to produce a series of expert papers focusing on 10 main challenging areas of “the day after” in Palestinian political, social, financial, economic, and security life.

The initiative’s point of departure is that the PA may collapse or may decide to dissolve itself in the near future under the heavy weight of various financial and political pressures. Three scenarios are conceivable: (1) Israel and the US may impose on the PA severe or crippling financial and political sanctions; (2) the PLO leadership may conclude that the two-state solution is no longer practical and may begin to search for other means to gain Palestinian rights leading it to dissolve the PA; and (3) a series of economic, financial and political crises may lead to popular demands for change expressed in mass demonstrations against the PA and a widespread demand for regime change leading to chaos and eventual collapse.

The initiative goals are three: (1) explore the implications of such a development on various critical dimensions of Palestinian life and government, elaborating on the magnitude of the problems and challenges that might arise as a result of PA demise; (2) debate various policy options to respond to such a development, to contain the damage, and to capitalize on potential benefits, if any; and, (3) recommend a course of action for Palestinians to pursue in response to the expected complications.

PSR has gathered a team of 30 experts in the areas of finance and economics, internal security and law enforcement, health, education, communication, justice system, local government, water and electricity, civil and domestic political affairs, and the future of the two-state solution. Experts have been asked to write 10 papers in their various areas of expertise examining the implications, policy options, and recommendations. Each paper has been reviewed and critiqued by two experts. Drafts of the expert papers have been discussed in small specialized workshops attended by policy makers, parliamentarians, experts, and academics.

A final report will be prepared based on the expert papers, workshops/focus groups, interviews, and background research. The report will summarize the main findings, examine the overall policy implications for the PA and the international community, and provide policy recommendations for the various relevant parties.

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