



Commissioned research paper:

***ANALYSING ISRAEL'S
ECONOMIC POLICY
TOWARDS PALESTINE
AND THE PRACTICAL
IMPLICATIONS OF
NETANYAHU'S ECONOMIC
PEACE***



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PREFACE

Economic peace is a word that is often used by Israeli prime-minister Netanyahu as a way forward in the Israeli Palestinian conflict. Economic peace is an instrument of conflict transformation that can be helpful in peace processes especially, but not only, when economic differences between parties form one of the conflict issues or fuel the conflict. In the name of economic peace prime-minister Netanyahu supported the ambitious development plans of the Palestinian Fayad government by lifting checkpoints in the 'B- areas' of the Westbank. B-areas are the areas that in the Oslo agreement are under civil Palestinian administration while the security is under Israeli control. This area counts for 21% of the Westbank. The others areas, areas A, 18% of the Westbank, is under full Palestinian control, while area C, 61% of the Westbank, is under full Israeli control. Although the lifting of checkpoints in area B did support economic development, the overall restrictions posed by Israel in the end hampers real development.

In Istanbul, in February 2012, IKV Pax Christi together with his Israeli and Palestinian partners gathered peace activist, political advisors, diplomats and businessmen from different countries in the Middle East, including Israel, to discuss the meaning of the Arab Peace Initiative in the light of the many changes taking place in the Middle East. During the meeting many Israeli businessmen showed interest and belief in the possibilities of economic relations as a peace building tool. From the side of the Palestinian activists the positions of the Israeli businessmen were rejected as 'economic peace' while on the Israeli side this framing was denied. This report is written to clarify the meaning of economic peace, both as an instrument of peace building and in it's specific meaning in the Israeli Palestinian conflict. It will be made available to the IKV Pax Christi partners and the participants in the Arab Peace Initiative program.

IKV Pax Christi

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ACRONYMS

PA	Palestinian Authority
PLO	Palestinian Liberation Organization
OPT	Occupied Palestinian Territories
US	United States
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNSCO	Office of the United Nations Special Coordinator for the Middle East peace process



EXECUTIVE SUMMARY

This paper analyzes the theoretical framework of economic peace, and provides an assessment of the economic peace theory that influences Netanyahu's economic policy towards Palestine and the extent to which the theory is applicable to the Israeli-Palestinian conflict. In addition, the role of economics in peace building is assessed, and the extent to which Israel's policies and practice can be considered as conducive to peace.

In the current political climate that is hardly conducive to renewed peace talks, the Netanyahu government has taken up a policy of 'economic peace' in its relations towards Palestine. The economic peace theory asserts that economic integration contributes to peace. Numerous studies indeed show a significant correlation between economic interdependence and peace. However, there are several features to the Israel-Palestinian conflict that seriously hamper the applicability of the economic peace theory to this particular conflict. First, the theory asserts that economic integration reduces the probability of states to start a violent conflict, but does not necessarily apply to protracted conflicts. Second, the theory considers economic interdependence between states, and not a situation of asymmetric relations and dependence of one party on the other, such as exists in the Israeli-Palestinian conflict.

The fact that the economic peace theory does not apply to the Israeli-Palestinian conflict does not mean that economy is not important. It is widely recognized that economic elements are essential in the process of peace building, especially when economic deprivation or inequality is a factor hampering the peace process. While economic deprivation in the OPT is certainly a problem, it is not a source of the conflict. Important to note is that economic elements in peace building can only be successful when considered in the context of the political situation and applied accordingly. The question is thus to what extent economic peace policies of Netanyahu's and previous governments are considered in the broader picture of the political situation and are meant to positively contribute to it, or are meant to distort from the political process and engage in a process of normalization aimed to strengthen the occupation. Various developments in the relations between Israel and the OPT since Netanyahu's return to power in 2009, such as the settlements expansions, continuing border controls, conditions on trade, continuing control over the C areas and the effect of the Palestinian economy, and withholding of tax revenues, suggest that rather than trying to make economics an integral part of the political process, Netanyahu's 'economic peace' is considered in isolation of political (peace) processes and in fact opposing it.



MAP ISRAEL AND PALESTINE



C SECURITY AREAS IN WEST BANK



INTRODUCTION

Since the 1967 Six Day War the Palestinian Gaza Strip and the West Bank, including East Jerusalem, are under Israeli occupation.¹ Over forty years later, during which the parties witnessed two intifadas and the establishment of the Palestinian Authority in between, the conflict is still ongoing. Major stakes of the conflict include border demarcations, the right of refugees to return to their homes, the status of East Jerusalem, and the dismantling of the Israeli settlements in the West Bank.² Numerous peace initiatives, including the 1993 Oslo Accords, the Quartet's Roadmap to Peace, and the Arab Peace Initiative, have so far not proven to be effective. When the newly installed Netanyahu government in 2009 accepted a settlement freeze it inspired new hopes for a peaceful solution to the conflict. But only a year later, at the end of 2010, another low point was reached when the moratorium was not extended, construction plans reactivated, and the peace talks frozen. Since then, no peace negotiations have taken place.

While the political climate is anything but conducive to renewed peace talks, the Netanyahu government has taken up the discourse of 'economic peace' in its relations towards Palestine. In 2008 Netanyahu already noted that the economic reality of Palestine 'is liable to lead people to think that they have nothing to lose, and the road from here to terrorism is short'.³ In 2009 he stated: 'We must weave an economic peace alongside a political process. That means that we have to strengthen the moderate parts of the Palestinian economy by handing rapid growth in those areas, rapid economic growth that gives a stake for peace for the ordinary Palestinians'.⁴ Furthermore, at the Likud faction meeting in May 2010 Netanyahu declared that: 'We have removed checkpoints, eased the lives of Palestinian and are working all the time to advance the Palestinian economy. Despite this, the Palestinians are opposing economic peace and are taking steps that in the end hurt themselves'.⁵

¹ As a result of the Six Day War, the West Bank (including east Jerusalem) became an occupied territory within the meaning of international law, more specifically article 42 of the 1907 Hague Convention and the Fourth Geneva Convention.

² These settlements are illegal under international law, which was confirmed by the 2004 advisory opinion of the International Court of Justice: 'Israeli settlements in the Occupied Palestinian Territory, including East Jerusalem, are illegal and an obstacle to peace and to economic and social development [...] and] have been established in breach of international law'. See also Schuit, A. (2011). EU Import of Products Originating from the Israeli Settlements on the West Bank. YPRI Publications. Available at: <http://www.ypri.org/research/34-eu-import-of-products-originating-from-the-israeli-settlements-on-the-west-bank>.

³ Feldman, N. (2009). Economic Peace: Theory versus Reality. Strategic Assessment, vol. 12 (3), pp. 22, 21.

⁴ Ahren, R. (2008). Netanyahu: Economics, not politics, is the key to peace. In: Haaretz, 21 November 2008. Available at <http://www.haaretz.com/hasen/spages/1038970.html>. Last visited at 5 May 2012.

⁵ Mualem, M. (2010). Netanyahu to PA: Israel boycott is only hurting yourselves. In: Haaretz, 24 May 2010. Available at: <http://www.haaretz.com/news/national/netanyahu-to-pa-israel-boycott-is-only-hurting-yourselfes-1.291977>. Last visited at 5 May 2012.



The notion of economic peace is not new in the Israeli policy discourse towards the Occupied Palestinian Territories (OPT).⁶ Aba Lerner, an important Israeli economist in the fifties and sixties who greatly influenced Israel's economic thinking, was one of the first to note that the occupation of the (OPT) had created possibilities of economic unification.⁷ Around that same time, Defense Minister Moshe Dayan refused to withdraw or disengage from the occupied territories because 'Dayan believed that economic development and better living conditions would replace the Palestinian desire for political rights'.⁸ In the thirty years that passed, economic integration continued to be an important topic. It formed a key component of the Oslo Accord, with the 1994 Paris Protocol laying the foundations of the current economic relations between Israel and the OPT, combining economic development with a peace process. Amongst other regulations, it aimed for Palestinian products not to be subjected to any export restrictions, trade to and from the OPT to have full access and equal treatment in Israeli ports, and for Israeli regulations on customs, purchase tax and standards to apply to Palestinian imports (with a few exceptions). While the Protocol strived to achieve economic integration, the reality was a growing separation with more restrictions on free movements, including the flows of goods and labor between Israel and the OPT and within the OPT itself.⁹ Nevertheless, in 1998, when Netanyahu was also Prime Minister, Israel again expressed its commitment to economic peace, and stated that: 'The government of Israel considers Palestinian economic prosperity an important Israeli interest. This concept derives from the understanding that the peace process needs to be backed by economic arrangements that will result in improving the socio-economic situation of the region'.¹⁰

Netanyahu's declarations on the potential stimulus that economic peace can give to negotiations have been received with mixed reactions. Critics claim that Israel's focus on the economic dimension is motivated by a desire to avoid discussing the essential stakes of the conflict. However, 'few have attempted to examine if there are theoretical foundations or relevant empirical data to support the rationale presented by the prime minister'.¹¹ This paper aims to do just that. It starts by analyzing the academic literature on economic peace in general, providing a clear assessment of what the theory is about. It then specifies the economic peace theory to the Israeli-Palestinian conflict, assessing the extent to which the theory is applicable to this conflict and with that if Netanyahu's economic peace is actually supported by evidence. The second part of the paper focuses on the role of economics in peace building, as specifies the conditions for its success.

⁶ In addition, the idea that the Israeli and Palestinian economies should be united was already suggested by Resolution 181 of the United Nations in 1947. Furthermore, stipulations on economic cooperation are also found in various peace agreements, such as the 1993 Oslo Accords, 1994 Paris Protocol, September 1995 Israeli-Palestinian Interim Agreement on the West Bank and the Gaze Strip (Annex II and VI), the December 1995 Dayton Peace Agreement (Annex 3, 4, 6, 9), and the April 1998 Good Friday Agreement (Chapters 2-6). See also Friedman, G. (2005). Commercial Pacifism and Protracted Conflict: Models from the Palestinian-Israeli Case. *The Journal of Conflict Resolution*, vol. 49 (3), p. 369.

⁷ Hever, S. (2006). The occupation through the eyes of Israeli economists. *Economy of Occupation. A socioeconomic bulletin*, p. 16.

⁸ Arnon, A. (2007). Israeli Policy towards the Occupied Palestinian Territories: The Economic Dimension 1967-2007. *The Middle East Journal*, nr. 61 (4), p. 580.

⁹ *Ibid*, p. 586.

¹⁰ Israeli Ministry of Foreign Affairs and Israeli Ministry of Defence (1998). *Israeli-Palestinian Economic Relations*, p. 1. Available at: <http://www.mfa.gov.il/MFA/Peace+Process/Guide+to+the+Peace+Process/Israeli-Palestinian+Economic+Relations.htm>.

¹¹ Feldman (2009), supra note 3, p. 19.

Finally, part three briefly assess the practical implications of past and recent Israeli policies towards Palestine, thereby attempting to shed some light on the question if Netanyahu's economic peace is aimed at contributing to peace or normalization of the occupation. Important to note is that this paper mainly looks at Israel's economic policies towards the West Bank. With the Gaza Strip being subjected to Israel's closure regime, it is very clear that economic peace policies hardly apply there.

PART I THEORETICAL FRAMEWORK: THE ECONOMIC PEACE THEORY

1.1 Liberal Peace: Democracy and Economics as Paths to Peace

The economic peace theory derives from the more general liberal peace discourse. Liberal peace asserts that democracy and market economics are conducive to peace and prevent states from waging conflict.¹² The democratic peace theory, introduced by Kant in his essay *Perpetual Peace*,¹³ builds further upon this notion.

Democratic peace theory

The democratic peace theory asserts that democracy is conducive to peace because democracies constrain leaders that may be war-prone, have nonviolent norms of conflict resolution, and are economically interdependent.¹⁴ Numerous studies have reported a negative statistical association between democracy and disputes, crises and wars, although the specific nature of this correlation is not always clear.¹⁵ Later research refined the theory by distinguishing between its applicability at the dyadic and monadic level, concluding that democracies are perhaps not more peaceful in general (monadic), but at least do not fight each other (dyadic). The theory was advanced into practice in the early 20th century, for example by US statesman Woodrow Wilson and his efforts to establish the League of Nations, the predecessor of the United Nations. Also today the theory can count on the support from many democratic states that find democratization an important foreign policy goal.¹⁶

¹² Gartzke, E. (2007). *The Capitalist Peace*. *American Journal of Political Science*, vol. 51 (1), p. 167.

¹³ Although prior to Kant also Rousseau and Bentham provided similar arguments. See also Gartzke (2007), *supra* note 5.

¹⁴ Oneal, J.R., Oneal, F.H., Maoz, Z., Russett, B. (1996). *The Liberal Peace: Interdependence, Democracy, and International Conflict, 1950-85*. *Journal of Peace Research*, vol. 33 (1), p. 12. See also Gartzke (2007), *supra* note 5, p. 168.

¹⁵ Gartzke (2007), *supra* note 5, p. 168.

¹⁶ For example, the foreign policy of the European Union focuses on democracy and human rights. Also the United States defines democratization as one of its most important foreign policy goals. In 1994, Clinton asserted that 'Ultimately, the best strategy to ensure our security and to build a durable peace is to support the advance of democracy elsewhere. Democracies don't attack each other'. In 2004, Bush argued that 'Democracies don't go to war with each other... I've got great faith in democracies to promote peace'. See also Gartzke (2007), *supra* note 5.

Critique on the democratic peace theory

Criticism on the democratic peace theory mainly focuses on the exact nature of the correlation between democracy and peace. In addition, democracy may be an indicator for something different than regime type, and some statistical analyses indeed show that when introducing the variable economic development and market integration, democracy becomes insignificant. This has led various scholars to conclude that while democracy is desirable for various reasons, it probably does not contribute directly to peace.¹⁷

1.2 Economic Peace Theory

The theory of economic peace

The economic peace theory proposes that economic interdependence fosters peace and prevents conflict. The notion of economic peace dates back many decades,¹⁸ but has until recently received rather little attention. This is mainly due to the fact that history proved the theory to be wrong. Both WW I and WW II demonstrated that increased trade and economic losses did not suffice in preventing war. The subsequent Cold War tensions led academic research to be preoccupied with other topics, which for long led the economic peace theory to be ignored. When interest in liberal peace did return, the attention focused on democracy rather than economics as a source of peace.¹⁹ Recently, the economic peace theory has gained some popularity again and has resulted into some interesting research findings supporting the proposition that economic interdependence fosters peace.

Why economic interdependence leads to peace

The economic peace theory, sometimes called commercial peace, commercial pacifism or pax mercatoria, asserts that economic interdependence fosters peace through trade, economic development, capital market integration and compatibility of foreign policy preferences.²⁰ Explanations of why economic integration fosters peace are manifold and have developed over time. To name only a few, economic interdependence is conducive to peace because economic cooperation between private actors eventually spills over into the political domain,²¹ because conflict between economically interdependent states is too

¹⁷ See for example Gartzke (2007), *supra* note 5, p. 180. 'This study offers evidence suggesting that capitalism, and not democracy, leads to peace'. Other critique on the democratic peace theory focus for example on the fact that it often provides incomplete treatment of liberal economic process. Most democratic peace research examines trade in goods and services, but ignores capital markets and offers only a hasty assessment of economic development. See for example Maoz, Z. and Russett, B. (1992). Alliances, Contiguity, Distance, Wealth, and Political Stability: Is the Lack of Conflict Among Democracies a Statistical Artifact?. *International Interactions*, vol. 17 (3), p. 259.

¹⁸ Montesquieu, Paine, Bastiat, Mill, Cobden, Angell and Adam Smith all saw in economic forces a power to end conflict.

¹⁹ Gartzke (2007), *supra* note 5, p. 170; and Oneal et. al. (1996), *supra* note 7, p. 11.

²⁰ Gartzke (2007), *supra* note 5, p. 16; and Goldstone, P.R. (2007). Pax Mercatoria: Does Economic Interdependence Bring Peace? MIT Center for International Studies, Security Studies Program. *The Audit of Conventional Wisdom*, p. 1.

²¹ Mansfield, E.D., Pollins, B.M. (2001). The Study of Interdependence and Conflict: Recent Advances, Open Questions, and Directions for Future Research. *Journal of Conflict Resolution*, vol. 45 (6), p. 835.



costly as it disrupts commerce and threatens foreign investment,²² and because economic exchange involves contact and communication which promotes learning about each other and teaches that people from other states are morally equal and reasonable.²³ Other explanations are that trade and military conquest are alternate means of acquiring scarce resources and more efficient trade thus makes conflict less attractive,²⁴ trade serves as an informational medium that allows states to signal preferences, tensions and solutions,²⁵ and trade increases the prosperity and political power of the peaceful and productive members of society at the expense of the aristocracy.²⁶

Nearly all the quantitative studies on economic peace find a negative correlation between economic interdependence and conflicts.²⁷ Some studies even indicate that states with the least integrated markets or the most dissimilar interests are about five times as likely to experience a conflict than those with globalized markets or similar interest.²⁸ This has led some authors to suggest that it is in fact economic interdependence that lies at the heart of democratic peace,²⁹ while others more generally claim that it is capitalism, not democracy that lead to peace.³⁰

Critique on the economic peace theory

One commonly heard criticism is that the economic peace theory is too state-centric, whereas it is firms, not governments, that are responsible for most of the commercial activities.³¹ Another important challenge is that economic ties between states not only offer mutual gains but may also create rivalry over the division of benefits. Economic interdependence may thus not only breed harmony, but also suspicion and incompatibility.³² Some studies suggest that trade that is highly concentrated with a single partner correlates with conflict, and that high levels of economic exchange act as an accelerant, enhancing either

²² ONeal et. al. (1996), supra note 7, p. 13; Gartzke (2007), supra note 5, p. 173; Krustev, V.L. (2006). Interdependence and the Duration of Militarized Conflict. *Journal of Peace Research*, vol. 43 (3), p. 244; and Friedman (2005), supra note 3, p. 362.

²³ See for example McMillan, S. (1997). Interdependence and conflict. *Mershon International Studies Review*, vol. 41 (1), pp. 37, 38; Stein, A. (1993). Governments, economic interdependence, and international cooperation, in: P. Tetlock, J.L., Husbands, R. Jervis, P.C. Stern, and C. Tilly (eds.), *Behavior, society, and international conflict*, vol. 3. New York: Oxford University Press, p. 249; Hirschman, A.O. (1977). *The passions and the interests*. Princeton, NJ: Princeton University Press, p. 61; Gartzke (2007), supra note 5, p. 172; and ONeal et. al. (1996), supra note 7, p. 11.

²⁴ Krustev (2006), supra note 15.

²⁵ Gartzke, E., Li, Q., Boehmer, C. (2001). Investing in Peace: Economic Interdependence and International Conflict. *International Organization*, vol. 55 (2), p. 422.

²⁶ ONeal et. al (1996), supra note 7, p. 11. See also Polacheck, S. W. (1980). Conflict and Trade. *Journal of Conflict Resolution*, vol. 24 (1), p. 63; and Mansfield and Pollins (2001), supra note 14. For more explanations, see also Gartzke (2007), supra note 5.

²⁷ The literature on economic peace is quite extensive. For a good overview of the literature, see Mansfield, E. and Pollins, B. (2001). *The Study of Interdependence and Conflict: Recent Advances, Open Questions, and Directions for Future Research*. *Journal of Conflict Resolution*, vol. 45 (6), pp. 834-859. See also Gartzke (2007), supra note 5.

²⁸ Gartzke (2007), supra note 5, p. 178.

²⁹ ONeal et. al. (1996), supra note 7, p. 14.

³⁰ Gartzke (2007), supra note 5, p. 180.

³¹ Krustev (2006), supra note 15, p. 245.

³² Hoffman, S. (1965). *The State of War*. London: Pall Mall. See also ONeal et. al. (2007), supra note 7, p. 11.

cooperation or conflict.³³ These findings suggest that it is important to further clarify the exact conditions under which interdependence is beneficial, and under which conditions it is not.

1.3 Economic Peace Theory and Asymmetric Relations

As just explained, the economic peace theory has in general shown that economic interdependence is conducive to peace, but the exact effect depends on the context. In a specific case, the effect can thus only be understood when taking into account the occurrence and dynamic of the conflict itself.³⁴ One specific feature of the Israeli-Palestinian conflict that influences the effect of economic interdependence is the asymmetric relation between Israel and Palestine. Not only has one of the parties to the conflict not achieved full statehood yet, the power relations in general are asymmetric. This is for example shown by the fact that almost 62% of the West Bank, the C areas, is under control of Israel.³⁵ In addition, the Palestinian Authorities do not control Palestine's borders, leaving Israel in control of all imports and exports. As a result, the Palestinian trade structure is heavily dependent on Israel. Israel absorbs about 90% of Palestinian exports, and is the source for about 80% of imports. In 2010, Palestinian trade with Israel accounted for 74% of total Palestinian trade, resulting into a very large trade deficit.³⁶

'Economic integration is already in place, but it is based on the premise of hegemony. Examples are Palestinian workers who participate in the build-up of settlements, Palestinian merchants who bring in Israeli goods, or the currency which Palestinians use (Israeli shekels). However, Palestinians economic space is restricted and blocked through Israeli policies that continue to promote this dependency. Palestinian goods are rarely sold in Israeli markets and their services are rarely utilized.'

Interview with Palestinian citizen Lina, May 2012

³³ Gelpi, C. and Grieco, J.M. (2003). Economic Interdependence, the Democratic State, and the Liberal Peace, in: Edward D. Mansfield and Brian M. Pollins (eds.), *Economic Interdependence and International Conflict: New Perspectives on an Enduring Debate*. Ann Arbor, MI: University of Michigan Press, p. 53. See also Gasirowski, M. (1986). *Economic Interdependence and International Conflict: Some Cross-National Evidence*. *International Studies Quarterly*, vol. 30 (1), p. 31.

³⁴ See also Oneal et. al. (1996), supra note 7, p. 23; Morrow, J. (2003). Assessing the Role of Trade as a Source of Costly Signals, in: E. Mansfield and B. Pollins (eds.), *Economic Interdependence and International Conflict*. Ann Arbor, MI: University of Michigan Press, p. 93.

³⁵ Regarding control over land, the territory on the West Bank is divided in various zones of control. Area A corresponds to all major population centers and is under PA security and civilian control. Area B includes most rural communities and the PA exercises only civilian control there while Israel exercises security control. Area C, amounting to almost 62% of the entire territory, is under Israeli control for both security and civilian affairs related to territory, including land administration and planning. The border areas too are under Israeli control. Consequently, Israel collects the custom tax levied on the import of goods to Palestine from outside of Israel. On various occasions, Israel withheld this revenue as a punitive measure. See for example Friedman (2005), supra note 3, p. 367, and World Bank (2012). *Stagnation or Revival? Palestinian Economic Prospects*. Economic Monitoring Report to the Ad Hoc Liaison Committee, p. 19.

³⁶ UNCTAD (2011). *Report of UNCTAD assistance to the Palestinian people: Developments in the economy of the occupied Palestinian territory*. Note by the UNCTAD secretariat, p. 7. This report further highlights that at least 58% of the imports are in fact 'indirect imports', products stemming from third countries but exported to the OPT through the Israeli trade sector. The effects of these imports will be addressed in part III of this paper.

Effect of asymmetric relations on the pacifying effect of economic interdependence

Economic interdependence thus has both conflict promoting and cooperation promoting aspect, but ‘especially when relations are asymmetric, trade can be a source of influence, which may lead to dependency, exploitation and conflict’.³⁷ Research on the applicability of the economic peace theory on parties with asymmetric relations is scarce. But even the more conservative research suggests that although asymmetric relations do not eliminate the pacifying effect of economic relations, it does reduce the effect.³⁸

Why asymmetry makes a difference

The exact reasons why asymmetric relations between parties may influence the effect of economic interdependence is not exactly known. Various hypotheses exist. For example, in asymmetric relations, the dominant rival may monopolize the disposition of the essential stakes of the conflict which affects the types of concession that rivals can make to one another.³⁹ Also, the ‘underdog’ may regard economic exchange with the rival as exploitative and impeding rather than beneficial⁴⁰ and may not want to engage in economic interaction in the first place. This can be observed in relation to Serbia and Kosovo, Sudan and South Sudan before the latter became independent, and one can imagine the same thing to be true in relation to China and Tibet as well as Israel and Palestine. Furthermore, the weaker party may reject economic cooperation with the rival exactly because it recognizes the idea of economic peace.⁴¹

‘Palestinians used to come and work in Israel. But it did not prove to work either. Today, as far as I know, there are very little Palestinians which are allowed to come and work in Israel due to security issues’.

Interview with Israeli citizen Arnon, May 2012

³⁷ Gasiorowski, M. and Polachek, S. (1982). Conflict and Interdependence: East-West Trade and linkages in the Era of Détente. *Journal of Conflict Resolution*, vol. 26 (4), p. 713; Kroll, J. (1993). The Complexity of Interdependence. *International Studies Quarterly*, vol. 37 (2), p. 338; dos Santos, T. (1970). The Structure of Dependence. *American Economic Review*, vol. 60 (2), p. 233; Rubinson, R. (1976). The World-Economy and the Distribution of Income Within States. *American Sociological Review*, vol. 41 (4), p. 647. See also ONeal et al. (1996), supra note 7, p. 11.

³⁸ ONeal et al. (1996), supra note 7, p. 21.

³⁹ Friedman (2005), supra note 3, p. 365

⁴⁰ El-Erian, M. and Fischer, S. (2000). Is MENA a region? The scope for regional integration, in: J.W. Wright Jr. and L. Drake (eds.), *Economic and political impediments to Middle East peace: Critical questions and alternative scenarios*. New York: Sint Martin’s, p. 81; Khashan, H. (2000). Arab attitudes toward Israel and peace. Washington, DC: Washington Institute for New East Policy, pp. 34, 35; and Nachtwey, J. and Tessler, M. (2002). The political economy of attitudes toward peace among Palestinians and Israelis. *Journal of Conflict Resolution*, vol. 46 (2), p. 265. See for more literature Friedman (2005), supra note 3, p. 366.

⁴¹ Friedman (2005), supra note 3, p.366

The fact that economic exchange leads to a decrease in the negative effect of the conflict for the rival party can then be an incentive not to engage in economic cooperation. As a result, prior to a negotiated settlement of the essential stakes, the weaker party may regard enhanced economic relations with the more dominant party as capitulation.⁴² In fact, the weaker party may strive for economic segregation from, rather than integration with, the adversary party as long as the essential stakes of the conflict are not settled.⁴³ These aspects indicate that there is little room for economic leverage if the essential stakes of the conflict are still manifestly present and disputed. That this does not imply that in peace building processes economic elements are not important, will be discussed in the second part of this paper. Another explanation that is sometimes mentioned and much applicable to the Israeli-Palestinian conflict is that the prospects for beneficial economic exchange are limited when the weaker party does not control its own borders and thus cannot control its cross-border trade policy.⁴⁴ This in essence results in the non-existence of two economically integrated parties, as it is one party controlling the other. This fact may indeed be the reason why the economic peace theory is less applicable on asymmetric relations. Due to this type of relation, no ‘interdependence’ exists, but only ‘dependence’.

‘Until Palestinians can negotiate from a position of strength, all such agreements, which are forged under the illusion of normal relations between Palestinians and Israelis, glossing over the inequalities inherent in dispossession and occupation, could create long-lasting damage to the Palestinian economy.’

Shir Hever (2012), Turning a profit from normalization.

1.4 Economic Peace Theory and Protracted Conflict

Another feature that is specific for the Israeli-Palestinian conflict is its protracted nature.⁴⁵ After all, the conflict started in the 20th century, was further shaped by the 1967 war and is still ongoing. This may seriously affect the applicability of the economic peace theory on the Israel-Palestinian conflict, as the theory asserts that economic interdependence fosters peace and reduces the chance for conflict to start. It does not address the possibility of economic interdependence to lead to the conclusion of a peace treaty and is thus not readily applicable to manifest conflict.⁴⁶

⁴² Ibid, p. 367.

⁴³ See for example Friedman (2005), supra note 3, p. 367. See also Carr, E. (1946). Nationalism and after. New York: Macmillan, pp. 119, 120.

⁴⁴ See for example Friedman (2005), supra note 3.

⁴⁵ For more precise definitions on the term ‘protracted conflict’, see for example Colaresi, M. (200). Strategic Rivalries, Protracted Conflict, and Crisis Escalation. Journal of Peace Research, vol. 39 (3), pp. 263-287.

⁴⁶ See also Feldman (2009), supra note 4, p. 21.

Effect of protracted conflicts on the pacifying effect of economic interdependence

Little research has been conducted on the application of the economic peace theory regarding protracted conflicts. Indeed, ‘many researchers have reported empirical support for the liberal proposition that increased trade between states reduces their propensity to engage in militarized conflict. However, the literature has been less vocal on the effects of interdependence once actual conflict has started’.⁴⁷ Some of the research asserts that once conflict has started, economic interdependence is unlikely to be beneficial and the economic peace theory no longer applicable.⁴⁸ Others describe that in protracted conflicts economic aspects will contribute to peace, but only if they are strong and prevalent.⁴⁹

Why the protracted nature of the conflict makes a difference

As already described, the economic peace theory focuses on preserving peace and preventing conflict rather than providing a tool for conflict transformation or resolution. The protracted nature of a conflict often implies that there are persistent root causes that mitigate the importance of the economic aspects and are likely to impede the pacifying effect of economic interdependence.⁵⁰ In other words, in protracted conflicts the importance of economic gains is often less appreciated than the essential stakes of the conflict. If the economic gains are likely to contradict the essential stakes, the economic stakes are likely to be sacrificed.⁵¹

1.5 Implications for the Applicability of the Economic Peace Theory on the Israeli-Palestinian Conflict

The specific dynamics of the Israeli-Palestinian conflict, of which mainly the asymmetric relations and the protracted nature of the conflict were mentioned here, impede the applicability of the economic peace theory on this particular conflict. Regarding the effects of asymmetric relations, a commonly heard assertion amongst critics is indeed that economic interaction would increasingly empower Israel while making Palestine further dependent rather than increasingly autonomous. The relation between Israel and Palestine is already asymmetric to such an extent that one can speak of a significant dependence of Palestine upon Israel. Increased economic interaction is therefore unlikely to result into interdependence, and rather into increased dependence. Simultaneously, increased economic interaction does not appear to be the key to more equal relations and a peaceful settlement of the conflict. As various international

⁴⁷ Krustev (2006), supra note 15, p. 243.

⁴⁸ See for example Krustev (2006), supra note 15, p. 249.

⁴⁹ Friedman (2005), supra note 3, p. 364

⁵⁰ See for example Carr (1946), supra note 35, and Friedman (2005), supra note 3, p. 367.

⁵¹ *Idem*.



institutions, including the United Nations Conference on Trade and Development (UNCTAD), and several authors note, ‘the past decades of Israeli-Palestinian economic relations have shown that no Palestinian economic development strategy can be effective as long as the Israeli occupation policy of asymmetric containment is not dismantled through ending occupation and achieving sovereignty and national rights’.⁵² This has led some scholars to call upon Palestine to adopt a strategy of economic resistance that would confront and redress Israeli asymmetric containment, which ‘may not lead to high or continuous growth, but it could help halt and possibly reverse the ongoing cycle of de-development’.⁵³ Indeed, the Palestinian Liberation Organization (PLO) in its 2012 paper on the economic costs of the occupation stressed that ‘the aim of Palestine is an economy of independence’.⁵⁴ As Israeli economist Nizan Feldman notes, ‘while Netanyahu urged that creating a reality of economic freedom and security in West Bank is what will allow Palestinians to sit down and start discussing real peace, Fayyad’s program is meant to create the conditions for establishing a de facto Palestinian state’,⁵⁵ indicating how for the one economy comes first and the political process later, and for the other independence is prime and economics of secondary concern.

⁵² Khalidi, R. and Samour, S. (2011). Neoliberalism as Liberation: the Statehood Program and the Remaking of the Palestinian National Movement. *Journal of Palestinian Studies*, vol. 40 (2), p. 17.

⁵³ *Ibid*, p. 18.

⁵⁴ PLO (2012). Position Paper: Economic Costs of Israeli Occupation, p. 1.

⁵⁵ Feldman, N. (2009), *supra* note 4, p. 24.

In relation to the protracted nature of the conflict, it was explained that the economic peace theory only asserts that economic integration is conducive to the prevention of conflicts and does not necessarily apply to ongoing conflicts. In protracted conflicts, the importance of economic gains is often less appreciated than the essential stakes of the conflict. This may be illustrated by the outbreak of the Al-Aqsa Intifada. The second intifada occurred despite the West Bank's economic growth of more than 9%⁵⁶ and caused major economic degradation, showing that economic stakes and possible economic losses are not sufficient to prevent conflict. The perception of Palestinians regarding the importance of economics

'There are economists who talked about 'economic development leading to peace' or 'peace dividends', arguing that an increase in the standard of living and the income of Palestinians would be more likely to make compromises because they 'have something to lose'. However, various surveys and polls conducted among Palestinians have shown that socioeconomic level does not correlate with political opinion in the predicted way.'

Interview with Israeli economist Shir Hever, May 2012

versus the essential stakes of the conflict may furthermore be an indicator for the extent to which economic incentives may contribute to peace. According to the Palestinian Centre for Policy and Survey Research, 45% of the Palestinians in March 2012 believed the first most vital goal of the PA should be to end Israeli occupation, with other goals being right of return, establishing a democratic political system en building a moral and religious society.⁵⁷ Furthermore, 28% reported poverty and unemployment to be the main problem confronting Palestinians today,⁵⁸ signaling that although economics are certainly a concern of Palestinians, it does not seem to be so 'strong and prevalent' for economic integration to contribute to peace. If the proposition that economic interdependence does little when the essential stakes of the conflict are not resolved is indeed valid, this would seriously hamper the applicability of the economic peace theory to the Israeli-Palestinian conflict. The essential stakes of the Israeli-Palestinian conflict, such as self-determination, identity, borders, Jerusalem, status of refugees, have resulted into more than sixty years of war. Economic interaction on itself, without being imbedded in more comprehensive political efforts, does not seem to affect these stakes. Rather, it tries to avoid them by focusing on economics in times where the political environment does not allow for peace negotiations.

⁵⁶ See for example Feldman (2009), *supra* note 4, p. 22.

⁵⁷ Other goals that were mentioned were the right of return, building a moral and religious society, and establishing a democratic political system. Palestinian Centre for Policy and Survey Research, Survey Research Unit: Poll Nor. 43, 15-17 March 2012. Available at: <http://www.pcpsr.org/survey/polls/2012/p43efull.html#vitalgoals>.

⁵⁸ Other problems were the continuation of Israeli occupation (25%), absence of national unity (23%), corruption (14%), and closure of Gaza (9%). Palestinian Centre for Policy and Survey Research (2012), *supra* note 45.

PART II ECONOMIC PEACE AS A PEACEBUILDING TOOL

Part I analyzed the theory of economic peace and its applicability to the Israeli-Palestinian conflict. It was concluded that due to the asymmetric relations between Israel and the OPT and the protracted nature of the conflict, the economic peace theory is not applicable to the conflict. This does not mean that economy is not important. It is widely recognized that economic elements are essential in the process of peace building, with peace building theories asserting that in peace processes economics are of significance in order to 'address structural inequality and economic deprivation, and thus assist in building the peace process in post-violent societies'.⁵⁹ Thus, economics can be one type of peace dividend. However, also in the peace building discourse economic elements are mainly considered in post-conflict settings.

'In the end, if the root causes of the conflict are dealt with, economic cooperation between Israel and Palestine will most probably not only be conducive to peaceful relations, it is inevitable. Since they share various important resources, of which water is most prominent, cooperation is the only way forward.'

Interview with political anthropologist and specialist in the Israeli-Palestinian conflict Martijn Dekker, May 2012

An example hereof is the role of economics in post-conflict Northern Ireland. Here, the British and Irish governments engaged in economic assistance programs to enhance contact and reconciliation and reducing economic deprivation through economic cooperation.⁶⁰ Key to the success of applying economic elements in the peace building process was the fact that economic deprivation and inequality was one of the factors hampering the peace process. This is however a significant difference with the Israeli Palestinian conflict, where economic deprivation in the OPT is certainly a problem, but not the determining factor to resolve the conflict. Economic elements can only contribute to peace when considered in the context of the political situation and applied accordingly. If this is not the case, they merely constitute economic pacification rather than tools for

'Economic peace is a term on its own, created earlier in 2009, as a way to avoid peace negotiations and offer the Palestinians only economic benefits without or instead of political negotiations. I am very much against it. Economic dimensions of peace is when we have a process of true and genuine negotiations, both parties should leverage economic cooperation as a way to build confidence while negotiation. One of the ways to do that is to engage leading business people in the process. Economic dimension of peace building is yet something else. Upon signing peace treaties, economic cooperation is one of the most important tools to show people that the sacrifices and concession made were important and that the balance of costs/benefits is favorable. This is what the Israeli Peace Initiative aims to do.'

Interview with Israeli economist and businessman Koby Huberman, May 2012

⁵⁹ Byrne, S., Thiessen, C. and Fissuh, E. (2007). Economic Assistance and Peacebuilding in Northern Ireland. *The Canadian Journal of Peace and Conflict Studies*, vol. 39 (1), p. 7.

⁶⁰ Matic, M., Byrne, S. and Fissuh, E. (2007). Awareness and Process: The Role of the European Union Peace II Fund and the International Fund for Ireland in Building the Peace Dividend in Northern Ireland. *Journal of Conflict Studies*, vol. 27 (1), p. 94.

peace. As already mentioned, the second intifada erupted while the West Bank was experiencing considerable growth. After the 1994 Paris Protocol and up to 1999, the OPT witnessed a GDP growth of 2.5% and a decrease of 4.9% in unemployment, pointing to an improving economic situation in the OPT and in fact closer economic cooperation with Israel as an increasing number of Palestinians worked in Israel and the settlements. The economic improvements were however undermined by the political context that showed no sign of positive change. Frustration about stalled peace talks, continuing dependence, the continued Israeli presence in the West Bank and Gaza Strip, continued practices of closure and blockades, and continued settlement expansion all undermined the value of economic improvements,⁶¹ showing that the success of economic peace elements in peace building settings depend on the political process rather than the other way around. Part III of this paper will further assess to what extent Netanyahu's economic peace is indeed meant to be an integral part of the political process.

PART III NETANYAHU'S ECONOMIC PEACE

Whether economic peace as put forward by Netanyahu and several Israeli governments in the past is conducive to the peace process or not is much debated. The critical question is whether economics are considered in the broader picture of the political situation, or are meant to distort the political process and engage in a process of normalization aimed to strengthen the occupation. This question can hardly be answered within the limited space of this paper, but certain developments within the Israel-Palestinian relations can shed some light on this question. First it is important to consider the numerous challenges confronting the OPT in its economic development. Many of these challenges essentially result from Israel's control over the West Bank's C areas, East Jerusalem and Palestine's external borders, and examples are the restrictions on movement, blockades, limited access to external markets, shrinking capital, and restricted access and control over natural resources bases.⁶² Efforts to stimulate economic peace would at a minimum entail improving opportunities for the Palestinian economy to develop, for example by softening security measures or by easing the access to, from and within the West Bank. However, considering various developments in the

Economic integration during negotiation and while the occupation continues is another form of strengthening the occupation and avoiding the political conflict resolution strategy. Economic integration after peace treaties, then it is a vital tool to allow the Palestinian state to grow and develop the economy.

Interview with Israeli economist and businessman Koby Huberman, May 2012

⁶¹ See for example Khan, M. (2005). 'Security First' and its Implications for a Viable Palestinian State, in: M. Keating, A. Le, and R. Lowe (eds.), *Aid, Diplomacy and Facts on the Ground: The Case of Palestine*. Royal Institute of International Affairs, Chatham House (UK), p. 62-64.

⁶² UNCTAD (2011), *supra* note 36, p. 2.



relations between Israel and the OPT both before and after Netanyahu's return to power in 2009, it seems that rather than trying to make economics an integral part of the political process, the economic peace of Netanyahu and previous Israeli government is considered in isolation of political peace processes and in fact opposing it.

Various economist describe how as early as the seventies and eighties Israel pursued the containment of the OPT because of its economic value deriving from access to cheap labor and a captive market for Israeli goods.⁶³ Around that same time Defense Minister Moshe Dayan refused to disengage from the OPT as he expected economic integration to bring better living standards for the Palestinians and decreased opposition to Israeli rule as the increasing development in the OPT would replace the Palestinian desire for political rights.⁶⁴ Decades later the attention for the economic interests of the population was still present in Israeli policy making towards the OPT. Around the 1990s, promoting economic interests was about employing Palestinians in the Israeli economy within the Green Line, and 'rarely did the policy opt for developing an infrastructure and encouraging the creation of factories and employment'.⁶⁵ Little attention was given to promoting local entrepreneurship or the business sector, and where such initiatives threatened to compete with existing Israeli firms were in fact actively discouraged. Although a lot has changed since the 1990s, current Israeli security and economic policies and practices continue to hamper the economic development of Palestine and show little sign of contributing to establishing a just peace. Indeed, 'the Israeli focus on economic cooperation in the absence of political negotiations does not contribute to the maturation of conditions for future political negotiations between the sides'.⁶⁶ Some of these policies and practice are briefly discussed below.

⁶³ Hever (2006), supra note 7. See also Arnon (2007), supra note 8.

⁶⁴ Arnon (2007), supra note 8, pp. 5, 8, 9.

⁶⁵ Idem, p. 12.

⁶⁶ Feldman (2009), supra note 3, p. 27.

Trade restrictions

In the year 2008 and 2009 Palestinian trade was seriously hampered by a number of restrictions, including the separation wall which caused a decrease of Palestinian export to Israel, accounting for 90% of the entire Palestinian export, with 30%. A year later, restrictions on Palestinian trade opportunities continued to be further tightened.⁶⁷ In 2011 Israel undertook several steps to ease the movement within, to and from the West Bank, but as recent as February 2012 still over 500 obstacles in the West Bank trouble the movement of people and goods.⁶⁸ These obstacles consist for example out of Israeli security checks at crossing points, which often have only limited working hours and inadequate services to facilitate trade, and thereby destabilize the movement of goods.⁶⁹ Recent reports by UNCTAD as well as the MA'AN Development centre list many of the obstacles faced by the Palestinian private sector. MA'AN for example describes the procedures and effects of the so called 'Back to Back-procedure', a process requiring all goods and commodities transferred from the OPT to Israel to be moved from the Palestinian truck to an Israeli truck at the border crossing.⁷⁰ At these crossings, Palestinian truck drivers are required to register their names and wait for Israeli trucks to arrive. Trucks may start entering from 8am and registration takes place from 7am, causing queues from 4am. As this is a very time consuming process, truck drivers can only make one delivery each day.⁷¹ In addition, trucks are allowed to contain only one type of product, adding up to the transportation costs.⁷² A good example of the difficult conditions Israel places on Palestinian trade, and the high costs this bring for farmers, is furthermore the crossing of compost from Israel to the OPT.⁷³ As this may only take place between July and October, while the need for compost is during Spring, Palestinian farmers are forced to acquire the compost months before the time of use. This requires them to leave the purchased compost unused and in open air for months, leading to 40-50% loss in quantity and more losses in quality.⁷⁴ Moreover, entrance of East Jerusalem is often denied to Palestinians. As East Jerusalem has been the centre of the West Bank economy, with a significant concentration of people purchasing Palestinian goods living in the city, the separation from East Jerusalem has direct and negative effects on the Palestinian economy.

⁶⁷ International Monetary Fund (2012). Overview Note West Bank and Gaza, p. 3.

⁶⁸ UNSCO (2012). Palestinian state-building: an achievement at increased risk, p. 8, in which the following specification is provided on blockades: 'In February 2012, there were still about 520 obstacles blocking Palestinian movement within the West Bank. These include 62 permanently staffed checkpoints (excluding checkpoints on the Green Line), 25 partial checkpoints (staffed on an ad hoc basis) and about 440 unstaffed physical obstacles, including roadblocks, earth mounds, earth walls, road gates, road barriers, and trenches'.

⁶⁹ UNCTAD (2011), supra note 36, p. 6.

⁷⁰ MA'AN Development Centre (2012). 'Israeli imposed restriction on the movement of agriculture products from Northern West Bank', pp. 14, 17.

⁷¹ *Idem*.

⁷² *Ibid*, pp. 22, 23.

⁷³ *Ibid*, p. 19.

⁷⁴ *Ibid*, p. 21.

Land: settlements and control

As mentioned above, since 2010 Israel undertook several steps to stimulate the notion of economic peace in a positive way. For example, Israel eased the access to the West Bank and the safety protocols,⁷⁵ facilitated the private sector in general through improvements at some border crossings, established four electrical substations in the West Bank, and in 2011 removed three major checkpoints.⁷⁶ However, and as many critics note, in light of the continuous growth of settlements and continuous Israeli control over the West Bank the effects of these steps on the peace process are rather minimal.⁷⁷ Indeed, the continuous expansion of illegal Israeli settlement and the increasing settler population in both the West Bank and East Jerusalem sketch a worrying image of further normalization of the occupation. In 2011, construction projects within illegal Israeli settlements on the West Bank increased with 20%, while East Jerusalem was confronted with the highest number of new construction projects in a decade.⁷⁸ In light of these numbers the PLO underlines that it feels threatened that the occupation will become permanent,⁷⁹ and that Israel is continuing a process of normalization. Very recently, in April 2012, the statuses of three illegal settlement outposts, which are considered illegal even under Israeli law,⁸⁰ have seen their status changed into 'legal' settlements in April 2012.⁸¹ Besides the Israeli settlements and the outpost, also the West Bank's C areas, covering over 60% of the entire West Bank, are controlled by Israel. Control over these areas continues unabated under Netanyahu's rule, despite its detrimental effect on the Palestinian economy and human development. Agriculture, water management, industry, housing and tourism are among the sectors that are negatively affected by the Palestinian lack of control over the C areas. For these

Positive and conducive steps by Israel are: 1) enabling the Salam Fayyad government to build their economy and institutions as they are getting ready for a state, 2) eliminating many road blocks and increasing freedom of movement, 3) recently starting to allow transportation of economic supplies and products to Gaza. Negative and unproductive steps by Israel are: 1) withholding PA monies from tax collection as a political sanction against the PA political moves (such as UN approach etc.), 2) implementing sanctions against Gaza, which created a flourishing 'tunnels economy'.

Interview with Israeli economist and businessman Koby Huberman, May 2012

⁷⁵ Gevel, A. van de (2010). 'De gevolgen van Israël's beleid voor de Palestijnse economie', Me Judice, Vol. 3, p. 3.

⁷⁶ UNSCO reports that two checkpoints were removed early 2011 and one at the end of 2011.

⁷⁷ Gevel, A. van de (2010), supra note 75.

⁷⁸ Peace Now (2012). Torpedoing the two state solution: summary of 2011 in the settlements.

⁷⁹ Palestinian Liberation Organization (2012), supra note 54, p. 3.

⁸⁰ Israel Prime Minister's Office communication office (2005). Summary of the Opinion Concerning Unauthorized Outposts/ Available at: <http://www.pmo.gov.il/PMOEng/Archive/Press+Releases/2005/03/spokemes090305.htm>. The following is stated in the summary: 'I must emphasize: an unauthorized outpost is not a "semi-legal" outpost. Unauthorized is illegal.'

⁸¹ BBC News (2012). US voices concerns at Israel outposts legalization. Available at: <http://www.bbc.co.uk/news/world-middle-east-17836400>. Also see Peace Now (2011). Torpedoing the two state solution: summary of 2011 in the settlements. Available at: <http://peacenow.org.il/eng/2011Summary>. Both last accessed on 10th May 2012.



sectors land and more specific control over land is fundamental.⁸² In order for tourism in Palestine to flourish for example, tourists must of course be able to enter the OPT in the first place.⁸³ Despite the fact that tourism has the potential to be an important sector for the Palestinian economy,⁸⁴ and is often mentioned as one of the opportunities for close cooperation, for example through package deals, access for tourists to the Palestinian territories is troublesome. Many tourists who wish to visit the West Bank often face interrogations at the Ben Gurion airport. Touristic cities, such as Jericho and Bethlehem, are often visited by pre-arranged touring cars that return to Israeli territory for overnight accommodation. As argued by Israeli economist Shir Hever: 'While claiming to promote 'economic peace' with the Palestinians, Prime Minister Netanyahu signed the death warrant of the Palestinian tourism industry by preventing tourists from entering the West Bank and Gaza Strip'.⁸⁵

⁸² World Bank Report (2012). Stagnation or Revival? Palestinian Economic Prospects, p. 19.

⁸³ Hever, S. (2011). 'Unwelcome in Israel. Want to visit the West Bank? Don't try flying to Ben Gurion airport: you won't be welcome'. Available at: <http://www.jnews.org.uk/commentary/unwelcome-in-israel>. Last accessed on 8th of May 2012

⁸⁴ PLO (2012) Economic Costs of Israeli Occupation p. 3 Also see: Palestinian National Authority (2012) Equitable Development: Moving forward despite the occupation, p. 10.

⁸⁵ Hever, (2011), supra note 83.

Taxes and indirect imports

According to UNCTAD, the OPT's economy grew by 7.4% in 2009, and with 9.3% in 2010.⁸⁶ Despite these numbers indicating economic growth, the expected economic growth of the Palestinian economy is limited due to Israeli restrictions as discussed above in relation to trade and land and its effects on the private sector.⁸⁷ The growth is however possible due to donor assistance rather than increased trade or income, indicating the large degree of dependence of the Palestinian economy on this type of assistance.⁸⁸ While the PA has kept its expenditures in line with its budget, it is currently facing a major fiscal crisis and economic slowdown,⁸⁹ which must be regarded in light of the diminishing donor support alongside the lack of significant and new easing of the restrictions applied by Israel.⁹⁰

In relation to imports and tax revenue, Israel determines the value added tax (VAT)⁹¹ which the PA can either increase or decrease by 2% on certain goods. As agreed upon under the Paris Protocol the PA follows the tariff structure of Israel and taxes are collected by Israel on behalf of the PA.⁹² These taxes can be retrieved if copies of the necessary receipts⁹³ are presented to the Israeli government. This control of Israel over Palestinian borders and the collection of tax make Palestine highly dependent on Israel, especially since tax income accounts for a substantial part of the PA's budget.⁹⁴ On several occasions, the Israeli government has refused to give clearance for refunding tax revenues.⁹⁵ Most recently, in May⁹⁶ and November 2011 and well into the period of Netanyahu's economic peace, Israel refused to clear revenues, withholding tax revenues belonging to the PA for political reasons.⁹⁷ Moreover, the so-called indirect imports, import coming from a third party and channeled through Israel to the OPT, is absorbed by Israel as if these goods were exported by Israel itself. According to a recent UNCTAD report in 2008, 58 % of Palestinian imports from Israel was in reality import from a third party.⁹⁸ Israel benefits from this because the custom revenues from the import channeled through Israel, are not collected by the PA but by Israel

⁸⁶ UNCTAD (2011), *supra* note 36, p. 1 Also see World Bank Report (2012): Stagnation of Revival? Palestinian Economic Prospects, p.5 which clarifies that while Gaza has faced a double digit grow the West Bank has received a slowdown in its growth.

⁸⁷ Office of the United Nations special coordinator for the Middle East peace process, UNSCO (2012), *supra* note 68, p. 3.

⁸⁸ *Ibid*, pp. 2, 3.

⁸⁹ World Bank Report (2012), *supra* note 82, p. 6.

⁹⁰ *Ibid*, p. 17.

⁹¹ The largest part of public revenue (imports and sales tax) is determined by Israeli rates that are not tuned to the Palestinian economy's needs.

⁹² UNCTAD (2012). Limited economic policy space. Available at:

<http://archive.unctad.org/Templates/Page.asp?intItemID=5063&lang=1>. Last accessed on May 8th 2012.

⁹³ World Bank Report (2012), *supra* note 82, p. 10. Copies of receipts must be presented to Israel by the PA in order to receive the VAT. Seeing as borders are controlled by Israel it is difficult for PA to collect the receipts.

⁹⁴ In 2011, total taxes collected for the PA amounted to NIS 5,068,544,766 See report of the government of Israel to AHLC (2012) Measures taken by Israel in support of developing the Palestinian economy and socio-economic structure, p.27

⁹⁵ UNCTAD (2011), *supra* note 36, p. 2.

⁹⁶ *Idem*.

⁹⁷ UNSCO (2012), *supra* note 68, p. 2.

⁹⁸ UNCTAD (2011), *supra* note 36, p. 7.



itself. Rather than the 35% share that Israel is genuinely exporting to the OPT, Israel absorbs about 80 % of Palestinian imports,⁹⁹ withholding an estimated 480 million per year in revenues from the PA.¹⁰⁰ 'Real economic peace' would entail distinguishing between regular import from Israel and indirect import, leading to a less dominating position of Israel as a trading partner.¹⁰¹ These examples illustrate a one-sided fiscal policy of Israel imposed upon the PA with direct effects on the Palestinian economy.¹⁰²

PART IV CONCLUSION

The theory of economic peace is not applicable to the Israeli-Palestinian conflict. As discussed in Part I, this is due to the asymmetric relations between Israel and the OPT and the protracted nature of the conflict. However, this does not make the economy irrelevant for the Israel-Palestinian issue nor does it affect the importance to examine the use of the 'economic peace'- logic within Israeli politics. On the contrary, for many years, Israeli statesmen put forward the notion of economic peace. Whether intentions were sincerely aimed at bringing just peace is another question, and in some cases clearly not the case. Stimulating economic growth in the hope that the call for political rights will be forgotten,¹⁰³ has created suspicion and frustration towards this concept. However, in order to answer the critical question whether economics today are considered in the broader picture of the political situation, or are meant to distort the political process and engage in a process of normalization aimed to strengthen the occupation, this paper examined the realities of Netanyahu's economic policy for the Palestinian economy. Only in light of the effects of his policy can we understand his version of 'economic peace'.

Discussing the implications of Netanyahu's policy in respect to the control of land, it was argued that through lack of control over land, the Palestinian economy has been struck in its fundamentals. No control over land means no control over trade, no tourism, disconnectedness between the West Bank East, Jerusalem and Gaza and isolation from the world economy. This lack of control is directly linked to the significant dependence of the PA on Israel, illustrating the negative effects of the asymmetrical relationship which, as discussed in Part I, clearly mismatches with the concept of economic peace. It was then described how Israeli economic policy negatively affect Palestinian trade in light of the restrictions on both export and import. The numerous difficulties faced by Palestinian traders have deeply disturbed the private sector in the OPT and contributes to the PA's fiscal crisis while the PA kept its expenditures in line with its

⁹⁹ *Idem.*

¹⁰⁰ *Ibid.*, p. 10.

¹⁰¹ *Ibid.*, p. 7.

¹⁰² UNCTAD (2012) *supra* note 92.

¹⁰³ Arnon (2007), *supra* note 8, p. 9.



budget.¹⁰⁴ Rather than using economic policy for improving the relationship between Israel and Palestine, Netanyahu like previous governments has adhered to its economic policy in order to pressure the PA, using economics as a political tool. Whether it is through withholding tax revenues from both Palestinian export and Palestinian indirect import, huge amounts rightfully belonging to the PA have either been temporarily held from the PA or fully absorbed by Israel. Does this lead to peace and improvement of the relations or does this lead to strengthening the occupation? Based on the complex and arbitrary¹⁰⁵ regulations and restrictions set out by Israel, the isolation and fragmentation of the Palestinian economy, and above all the complete lack of improvement within the political process this paper concludes that Netanyahu's economic peace policy will not lead to improvement of relationships, let alone peace. The Palestinian economy runs indirectly and directly by the grace of Israel and it is worrying that the root causes, the political dimensions, of the conflict are neglected.

¹⁰⁴ UNSCO (2012), *supra* note 68, p. 3.

¹⁰⁵ Often when Israeli demand for a product is high, regulations are less problematic. See MA'AN Development Centre (2012), *supra* note 70, p. 20.

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