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The Kushner Plan: Economics or politics, which comes first?

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In June 2019, the White House issued the long-awaited "Peace to Prosperity A New Vision for the Palestinian People and the Broader Middle East."[1] The plan consists of three initiatives to support the Palestinian economy, people, and government and aims to raise than $50 billion in new investment over ten years. It will begin with an emphasis on economic development by strengthening property and contract rights, the rule of law, anti-corruption measures, capital markets, a pro-growth tax structure, and a low-tariff scheme with reduced trade barriers. These measures will be coupled with investments in the infrastructure to improve the business environment and stimulate private-sector growth. The plan aims to provide reliable access to electricity, clean water, and digital services. These will become available for homes, hospitals, schools and businesses. Businesses will have access to capital, and the markets of the West Bank and Gaza will be connected with key trading partners, including Egypt, Israel, Jordan, and Lebanon. The resulting economic growth has the potential to end the current high unemployment rates and transform the West Bank and Gaza economies.

The second initiative will strengthen the Palestinian educational system and will provide new data-driven, outcomes-based education options at home, expanded online education platforms, increased vocational and technical training. It will offer the prospect of international exchanges and ensure that students can fulfill their academic goals and be prepared for the workforce. Access to quality healthcare will be improved, as Palestinian hospitals and clinics will be equipped with the latest healthcare technology and equipment. Cultural and recreational activities, including parks and cultural institutions, athletic facilities and libraries will enrich the quality of life of the Palestinian people.

The third initiative is in the field of governance. This will support the public sector in undertaking the improvements and reforms necessary to achieve long-term economic success. A commitment to uphold property rights, improve the legal and regulatory framework for businesses, and adopt a growth-oriented, enforceable tax structure, while developing capital markets will increase exports and foreign direct investment. A fair and independent judicial branch will ensure this pro-growth environment is protected and that civil society flourishes. Government transparency and accountability will be developed. International partners will work to eliminate the Palestinian public sector's dependency on donors and move the economy towards long-term fiscal sustainability.

The plan relies on the private sector. Following the adoption of key reforms and the construction of essential infrastructure, it envisages private-sector investment in small businesses, tourism, agriculture, housing, manufacturing, and natural resources. The initial phase will be designed to remove constraints to growth and to target key projects that build momentum, generate jobs, and increase the national income. It also emphasizes improving regional development and economic integration to create new opportunities for Palestinian businesses. This will boost the economies of Egypt, Israel, Jordan, and Lebanon and reduce trade barriers across the region.

The experience of countries in East Asia and Europe are the inspiration, even though those countries developed with extensive government intervention. According to the plan, successful economic development is based on the development of key institutions and policy reforms that attract business investment and sustain long-term, private-sector-driven growth. South Korea, Singapore, Taiwan, and Japan built modern economies with an emphasis on investment-led growth, robust infrastructure development, and strong exports.

Property rights, the rule of law, fiscal responsibility and independence, capital markets, and anti-corruption safeguards are crucial components for economic growth. 'Peace to Prosperity' prioritizes their role. Advancing these core policy and regulatory reforms, along with supporting businesses and providing technical assistance, will create the business environment. The importance of human capital is also recognized. Drawing on the experiences of Germany and Sweden, the program proposes a strategy for training, developing, and employing the next generation through investment in technical and vocational education; science, technology, engineering, and mathematics training. Palestinian entrepreneurs would be able to build inventive, value-creating companies. In order to capitalize on this, an institutional framework for growth should be adopted. The use of incubators for start-ups in neighboring countries is not currently used by the Palestinians, and the diaspora offers a talent pool that could support a startup culture.[2]

The need for change is great because the Palestinian economy, especially in Gaza, is in a dire condition. According to the World Bank, real GDP growth in 2018 was minimal due to a steep deterioration in Gaza and a slowdown in the West Bank. Gaza's economy has been kept afloat in recent years by large transfers including donor aid and spending through the budget of the Palestinian Authority (PA), both of which amounted to 70-80 percent of its GDP. These two sources have significantly declined recently resulting in economic activity in Gaza falling by 8 percent in 2018. In the West Bank, real growth declined to around 2 percent in 2018, lower than its average growth rate in recent years. This was the result of the fall in aid inflows and the clashes with the Israeli forces that have affected economic activity. Domestic revenues grew by 9 percent in 2018 due to the PA's efforts to widen the tax base, while spending cuts in Gaza were the main contributor to a 7.6 percent decline in public spending. Together, this resulted in a one percentage point decline in the deficit (excluding grants) as a share of GDP to 7.5 percent. The deficit amounted to $1.08 billion while aid received was $676 million ($516 million in budget support, and $160 million for development financing), resulting in a financing gap of around $400 million (or 2.8 percent of GDP).

To fill the gap, the PA has resorted to accumulating further arrears on the pension fund and the private sector. The balance of payments current account deficit (including official transfers) is estimated to have widened in 2018 to 12.2 percent of GDP due to an increase in imports and a fall in transfers. Exports were limited by trade restrictions and remained stagnant at around 19-20 percent of GDP, while imports increased by about 3 percentage points in 2018 and reached 58 percent of

GDP. Unemployment reached 30.8 percent in 2018, which was 2.4 percentage points higher than in 2017. The increase was due to a sharp rise in Gaza where in 2018, 52 percent of the labor force was unemployed - among Gaza youth it was over 67 percent. In the West Bank, unemployment has stagnated at around 18-19 percent over recent years. Around 24 percent of Palestinians lived below the US$5.50 2011 purchasing power parity (PPP) a day poverty line in 2016/17—2.9 percentage points higher compared to 2011. The gap between the West Bank and Gaza rose significantly in 2016/17, with 46 percent of the population living below the US$5.50 poverty line in Gaza, compared to 9 percent in the West Bank. In the West Bank, poverty status is sensitive to even small shocks in household expenditures, while in Gaza any change in aid flows significantly affects the population's welfare. The prospects are not good: assuming a continuation of Israeli restrictions and the continued internal divide between the West Bank and Gaza, private sector activity is not expected to improve and real GDP growth of the Palestinian economy is projected at 0.5-1.6 percent between 2019 and 2021. This rate of growth implies a yearly decline in real per capita income by around 2-3 percent, because it is simply not enough to keep up with demographic growth.[3]

Table 1 puts the Palestinian GDP into its regional context. In 2018, GDP per capita in the West Bank was similar to that in Jordan and was over 60 percent higher than in Egypt. GDP per capita in Gaza was 44 percent lower than in the West Bank and 28 percent lower than in Egypt.

Table 1: GDP per capita, 2018

Country	GDP/capita, current $
Palestine	3,199
- **West Bank**	4,127
- **Gaza**	1,823
Egypt	2,549
Jordan	4,248
Arab States average	6,626
Israel	41,614

Source: World Bank and author’s calculations

The International Monetary Fund has warned that the forecast increase of the West Bank and Gaza population to 7 million by 2030 and 10 million by 2050 poses significant challenges. (In 2014-2018 the average annual increase of the population was almost 2.3 percent). As almost 40 percent of the population is under the age of 15, the working age share of the population will continue to rise to around two-thirds. The economy will need to generate more than 2 million jobs by 2050 to absorb new entrants to the labor market. While this implicitly assumes higher female labor force participation, it does not account for people currently unemployed. The rigidity of the labor market magnifies this task. Unemployment in 2017 was 29 percent (and nearly 40 percent for young people), despite low participation (in 2016 it was 46 percent overall). A failure to generate enough new jobs will heighten risks. Insufficient job growth could compound the already high unemployment, increase poverty, and exacerbate social and economic strains. Revenues foregone from lack of job creation would add to fiscal pressures, compromising the PA's ability to invest in health and education just as the population's needs are increasing.[4]

The dismal state of the Palestinian economy requires urgent attention and some have welcomed the US plan as one that addresses the problems.[5] The main issue is whether economic reform should precede political ones. One view is that prosperity gives people an interest in peace or in peaceful change and not war because they have something material to lose. Those with nothing have nothing material to lose from violence. The economics first view seeks to use money to change the economic and then political reality.

The sceptics and/or opponents say that without hope for political change, economic change will not bring peace, and therefore will be seen as a trap by those for whom it is designed. They will see it as economics instead of politics. In less abstract terms, this means investment in the Palestinian economy without a state or with a very limited state, either geographically or politically or both. Another question is where the $50 billion would come from: The Plan gives no answer.

Economic historians might suggest that the economic rationale is faulty. The examples cited in the program, South Korea, Singapore, Taiwan, Japan, Sweden and Germany, all possessed a significant degree of political freedom when their economies developed. The institutions (democracy, independent legal systems, and civil society) came first and only when they were in place could economic development occur.[6] Palestinian institutions are far from being ready for an economic takeoff. Palestine is divided politically and geographically between the areas controlled by the Palestinian Authority in the West Bank and Gaza that is controlled (more or less) by Hamas. Both of these governments are perceived as relatively corrupt,[7] and the experience of outside powers imposing new rules in the Middle East is not encouraging. Iraq is the obvious example.

Until a political plan is announced the economic one is unlikely to progress. Two key issues are whether Israel will cooperate in the creation of a Palestinian state, and can the Palestinians create a unified, democratic and effective government within such a state. These remain very open questions.

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[1] The White House, "Peace to Prosperity A New Vision for the Palestinian People and the Broader Middle East," 2019.

[2] Paul Rivlin, *Arab Economies in the Twenty-First Century*, (Cambridge and New York: Cambridge University Press, 2009) 61-94.

[3] World Bank Group, "Palestine's Economic Update," April 2019.

[4] International Monetary Fund, "West Bank and Gaza Report to the Ad Hoc Committee," 31 August 31, 2017.

[5] Michael Boskin, Is Economic Development the Key to Mideast Peace?, *Project Syndicate*, Jun 26, 2019.

[6] The preconditions for economic growth are explored in Marcin Piatkowski**,** "Poland has become Europe's growth champion, but can this success continue?" London School of Economics, European Politics and Policy (EUROPP), 2018.

[7] Roberto Martinez and B. Kukutschka, "Corruption in Services in the Occupied Palestinian Territories," *Transparency International*, U4 Expert Answer, April 9, 2018.