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Fact Sheet: The Paris Protocol – Historical Classification

The 1993 Oslo I Accord marked the beginning of the peace process between Israelis and Palestinians. The document provided for a five-year transition period, by the end of which a comprehensive peace agreement between the two conflict parties was to be gradually reached.[1] A separate protocol was drafted in order to formally regulate the economic relations between Israel and the Palestinian Territories during this interim period. Despite the expiration of the transition period more than ten years ago, the agreement that came to be known as the "Paris Protocol" continues to form the basis of the economic relations between the two contracting parties to this day.

Historical classification: 1967 to 1994

Israel gained control over the West Bank and the Gaza Strip in the course of the Six-Day War in 1967. Neither territory had previously had economic ties with Israel.[2] The new political realities also entailed the immediate end of the diverse economic relations between the Palestinian Territories and Jordan and Egypt, respectively. In order to prevent an economic collapse in the militarily occupied territories, Israel launched a partial integration of the territories into its own economic structures. This partial integration took the form of an Israeli-imposed, incomplete customs union.

Accordingly, the Israeli labour market was also opened up to Palestinian workers. Many Palestinians were tempted to seek work in Israel because of the higher wages. In 1972, one out of four Palestinian workers had found employment in the Israeli economy.[3] At the same time, the economy in the Palestinian Territories was facing problems. While the West Bank and Gaza Strip served as markets for Israeli products, the Israeli protectionism that prevailed until the mid-1980s limited third country imports to these territories. Exports, too, were restricted due to insufficient infrastructure and practical problems regarding trade across the Israeli-controlled external borders. Bureaucratic restrictions such as the granting of investment permissions by Israel further hampered the development of the Palestinian private sector.[4]

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1 Cf. the fact sheet entitled "Oslo Accords" on the homepage of the KAS in the Palestinian Territories.
2 Mansour, A. (1988). The West Bank Economy 1948-1984. In: *The Palestinian Economy: Studies in Development under Prolonged Occupation.* Ed. Abed, G. London, p. 71.
3 Arnon, A. and Weinblatt, J. (2001). Sovereignty and Economic Development: The Case of Israel and Palestine. In: *Economic Journal*, vol. 111, no. 472, pp. 292f.
4 Palestine Economic Policy Research Institute (MAS) and World Bank (1999). *Development under Adversity: The Palestinian Economy in Transition.* Ed. Diwan, I. and Shaban, R. Washington: World Bank, pp. 6f.

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The above facts indicate a clear trade imbalance as a consequence of this policy: the Palestinian imports were high and the exports low. Up to 90 percent of Palestinian imports came from Israel, while 60 percent of exports were destined for Israel. The resulting trade deficit was mostly counterbalanced by remittances from Palestinians working in Israel and abroad. These remittances constituted up to 30 percent of the West Bank's gross domestic product (GDP).[5] Thus, the standard of living in the Palestinian Territories rose significantly due to these transfers; however, they also indicate a severe dependence on the Israeli economy.

The Paris Protocol

The Paris Protocol (*Protocol on Economic Relations between the Government of the State of Israel and the P.L.O., representing the Palestinian people*) was signed as part of the Oslo peace negotiations on the 29 April 1994. The aim of the protocol was to formalize the economic relations that had previously been unilaterally determined by Israel and to establish a bilateral agreement for the five-year interim period by the end of which a comprehensive peace agreement between the two conflict parties was to be gradually reached. The signing of the Gaza-Jericho Agreement on the 4 May 1994, which the Paris Protocol was attached to as Annex IV, entailed the protocol's plan of implementation in the areas of Gaza and Jericho over which the Palestinian Self-Government then assumed authority.[6] The Oslo II Accords expanded the Paris Protocol's area of application and incorporated the newly defined Zones A and B, which are under full civil control by the Palestinian Authority (PA).[7]

The Israeli delegation to the talks drew considerably on the results of the "Economic Consulting Team to the Political Negotiations", on the basis of which the preferable Israeli negotiating positions had been strategically determined a few months earlier.[8] Accordingly, a central recommendation was to avoid setting any economic limits which could have created precedence for future negotiations. The political goal of Israel and the actual result of the negotiations was thus the maintenance of the prevailing *de facto* customs union.

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5 Arnon, A. and Weinblatt, J. (2001). Sovereignty and Economic Development: The Case of Israel and Palestine. In: *Economic Journal*, vol. 111, no. 472, p. 293.

6 Gaza-Jericho Agreement, Annex IV – Economic Protocol (Paris Protocol). Available at: http://www.mfa.gov.il/MFA/Peace+Process/Guide+to+the+Peace+Process/Gaza-Jericho+Agreement+Annex+IV+-+Economic+Protoco.htm (21/09/12).

7 The interim agreement divides the Palestinian territories in zones A, B and C. Zone A is under full Palestinian control, zone C is under full Israeli control. In zone B, the competencies are shared between the PA and Israel. The PA exerts full civil control, while Israel remains in charge of security issues. Cf. The Israeli-Palestinian Interim Agreement On The West Bank And The Gaza Strip, Annex V - Protocol on Economic Relations (Paris Protocol). Available at: http://www.mfa.gov.il/MFA/Peace+Process/Guide+to+the+Peace+Process/THE+ISRAELI-PALESTINIAN+INTERIM+AGREEMENT+-+Annex+V.htm (21/09/12).

8 Arnon, A. (2007). Israeli Policy towards the Occupied Palestinian Territories: The Economic Dimension 1967-2007. In: *The Middle East Journal*, vol. 61, no. 4, pp. 573-595.

Content of the protocol

The protocol grants the then newly established PA the right to conduct its own economic policies – albeit only to a limited extent. This includes, *inter alia*, the right to levy direct and indirect taxes, create a monetary authority and employ people in the public sector. The protocol also provides for the gradual abolition of export restrictions for agricultural products, which had hitherto protected Israeli farmers from Palestinian competition. Furthermore, no additional taxes are to be levied on any goods traded between the two territories.

Imports from and exports to third countries are subject to Israeli supervision as well as quantitative restrictions and cannot be independently regulated by the PA. A common external border, encompassing Israel and the Palestinian Territories, was created for the interim period. The border is controlled and the territory taxed by Israel. Taxes on imported goods can be unilaterally levied and altered by Israel. Taxes on goods that are destined for the Palestinian Territories are transferred to the PA[9], as is the value added tax on Palestinian products that are sold in Israel or made for the Palestinian market.[10]

The protocol further obliges both parties to facilitate the continued exchange of workers. Restrictions are only temporarily possible according to the protocol. This is an important issue for the Palestinian economy, in view of the large number of Palestinians working in the Israeli economy, whose retransfers partially counterbalance the trade deficit. The incomplete customs union imposed by Israel in 1967 was hence bilaterally codified through the provisions of the protocol.[11]

Implementation

The escalation of Palestinian violence during and after the Oslo negotiations and the subsequent Israeli response, *inter alia,* undermined the possible positive effects of a customs union. The outbreak of the Second Intifada in 2000, in particular, led to the establishment of numerous checkpoints and impeded the movement of persons and goods within the Palestinian Territories as well as with Israel and the rest of the world.[12]

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9 United Nations Conference on Trade and Development (2009). *The Economic Dimensions of Prolonged Occupation: Continuity and Change in Israeli Policy towards the Palestinian Economy.* Ed. Khalidi, R. and Taghdisi-Rad, S. New York and Geneva: United Nations, pp. 13-16.

10 Molkner, K.C. (2002). Legal and Structural Hurdels to Achieving Political Stability and Economic Development in the Palestinian Territories. In: *Palestine and International Law*, ed. Silverburg, S., J. McFarland & Company, pp. 386 ff.

11 B'Tselem (2011). *Restriction of Movement – The Paris Protocol.* http://www.btselem.org/freedom_of_movement/paris_protocol (21/09/12).

12 United Nations Conference on Trade and Development (2009).International Network for Economics and Conflict. (2011). *Renegotiating the Paris Protocol.* Available at: http://inec.usip.org/blog/2011/dec/05/renegotiating-paris-protocol (21/09/12).

In addition to the restricted movement of persons and goods, the number of work permits for Palestinians decreased significantly at this time. As a consequence, Israeli employers made do without Palestinian employees and gradually replaced them with foreign workers. Work permits for foreigners increased from 4000 in 1992 to 107 000 in 1996 alone. Those workplaces seem to be definitely lost for Palestinians.[13] These developments led to rising unemployment and a steep decline of the level of income in the Palestinian Territories.

Hence, the economic imbalance between Israel and the Palestinian Territories remained in place due to the agreement and the restricted movement of persons and goods. Palestinian imports amounted to 64 percent of the GDP between 2000 and 2008, while exports made for a mere 10.5 percent of the GDP. Furthermore, the gradual crowding out of Palestinians from the Israeli labour market caused a decline of remittances. Accordingly, the retransfers could no longer counterbalance the high trade deficit, as they had in the years prior to 1994. The retransfers were then essentially replaced by international donations that financially support the PA. International donor's payments increased from 18 percent of the Palestinian GDP to 58 percent between 2000 and 2008.[14] As a consequence, the Palestinian Territories have become very vulnerable to fluctuations in the flow of international funds and the withholding of tax money, as practiced by Israel as a means to exert political pressure.[15]

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