



# Palestinian-Israeli economic relations

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# Palestinian-Israeli economic relations: Outline

- Macroeconomic conditions in the “Shekel Zone”
- Palestinian-Israeli economic relations
  - Employment
  - Trade
- Fiscal status of the PA
- Policy recommendations

# External environment

## **General conditions**

- Gradual recovery from COVID-19
- War in Ukraine (February-May) 2022
- Security instability in Israel, WB and Gaza (May 2022)

## **Economic conditions**

- Global inflation accelerates
- Monetary tightening
- Appreciation of NIS vs. USD/Euro/JD

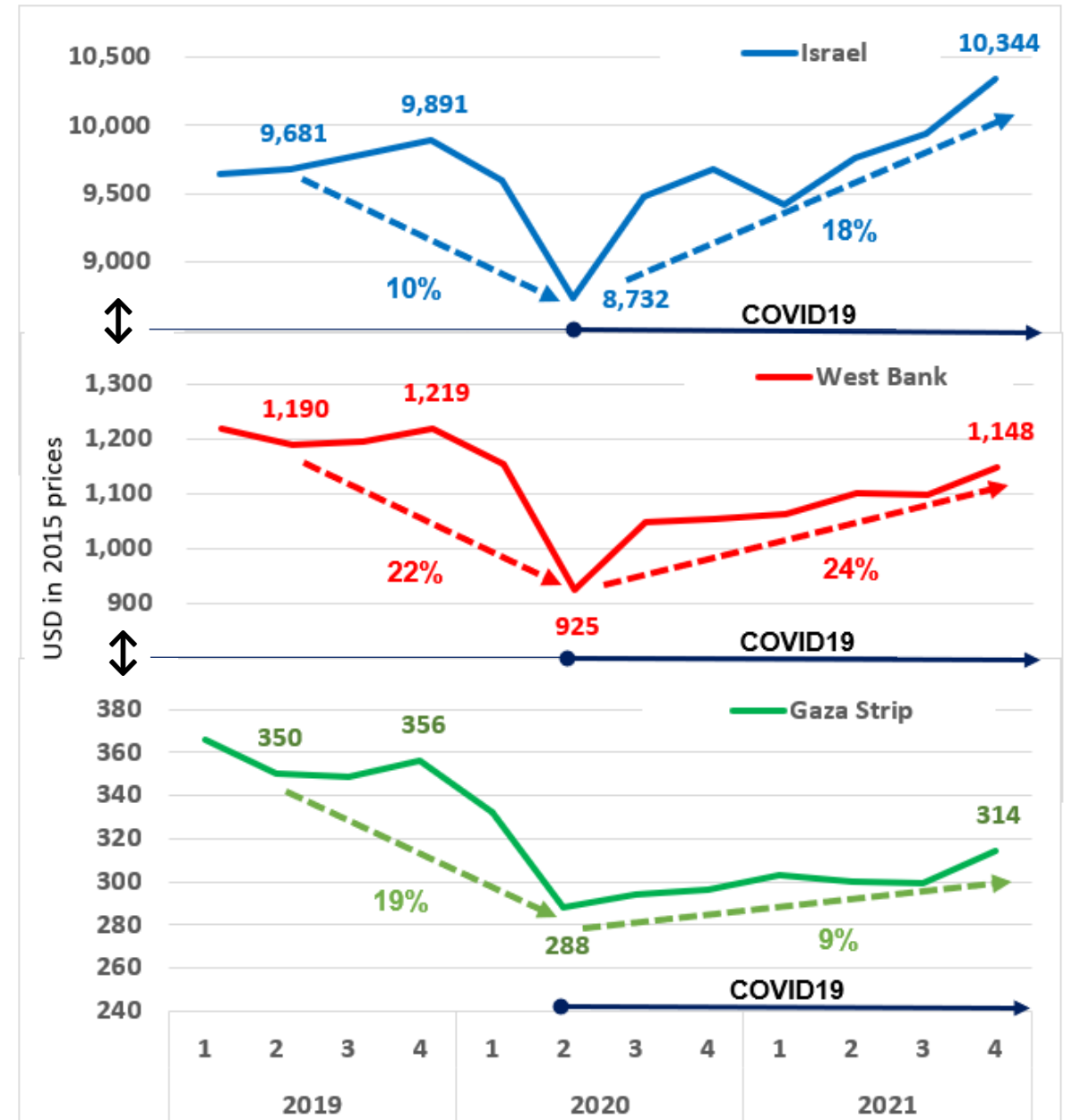
# Growth

After the onset of the COVID-19 pandemic:

- **Israeli GDP per capita declined** by 10% and fully recovered by late 2021
- GDP per capita in the West Bank and Gaza declined by about 20%
  - In the **West Bank** it **bounced back**
  - But in **Gaza** it **did not recover** yet

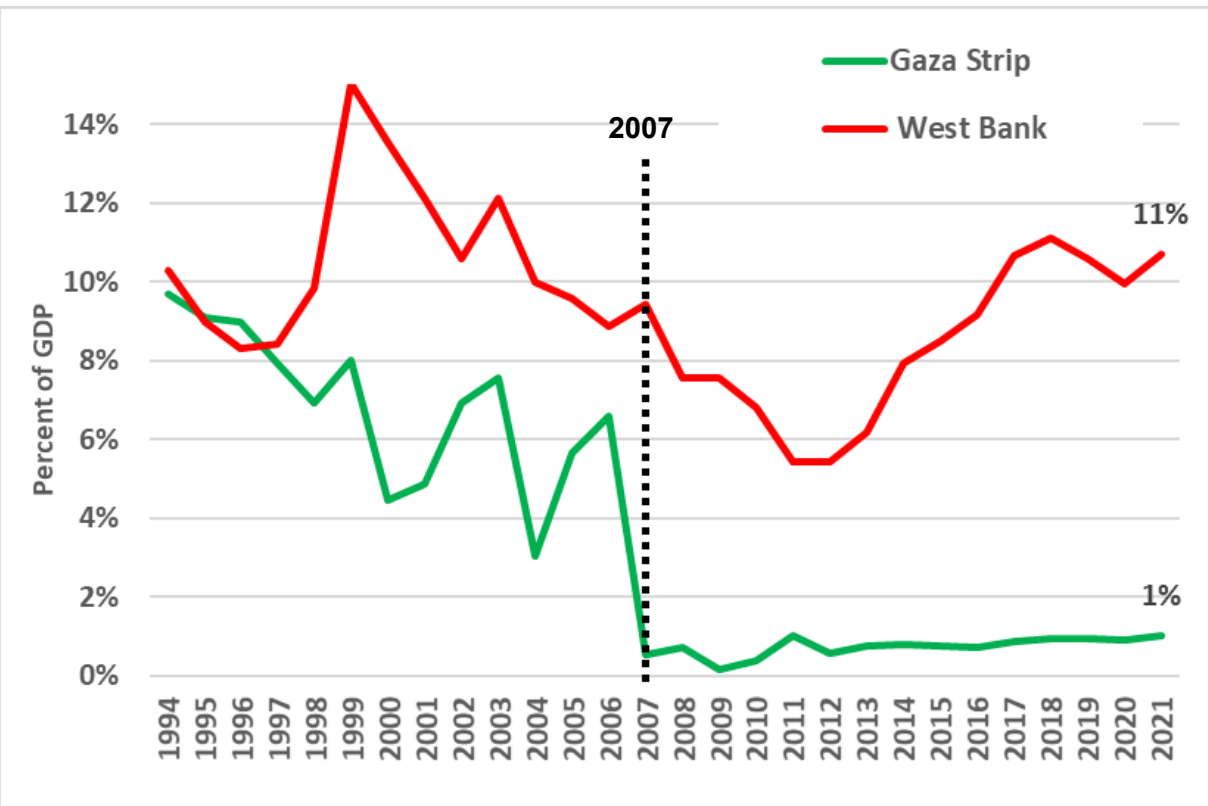
Sources: WB & Gaza – PCBS;  
Israel – calculations based on Israeli CBS

## Quarterly GDP Per Capita in constant prices



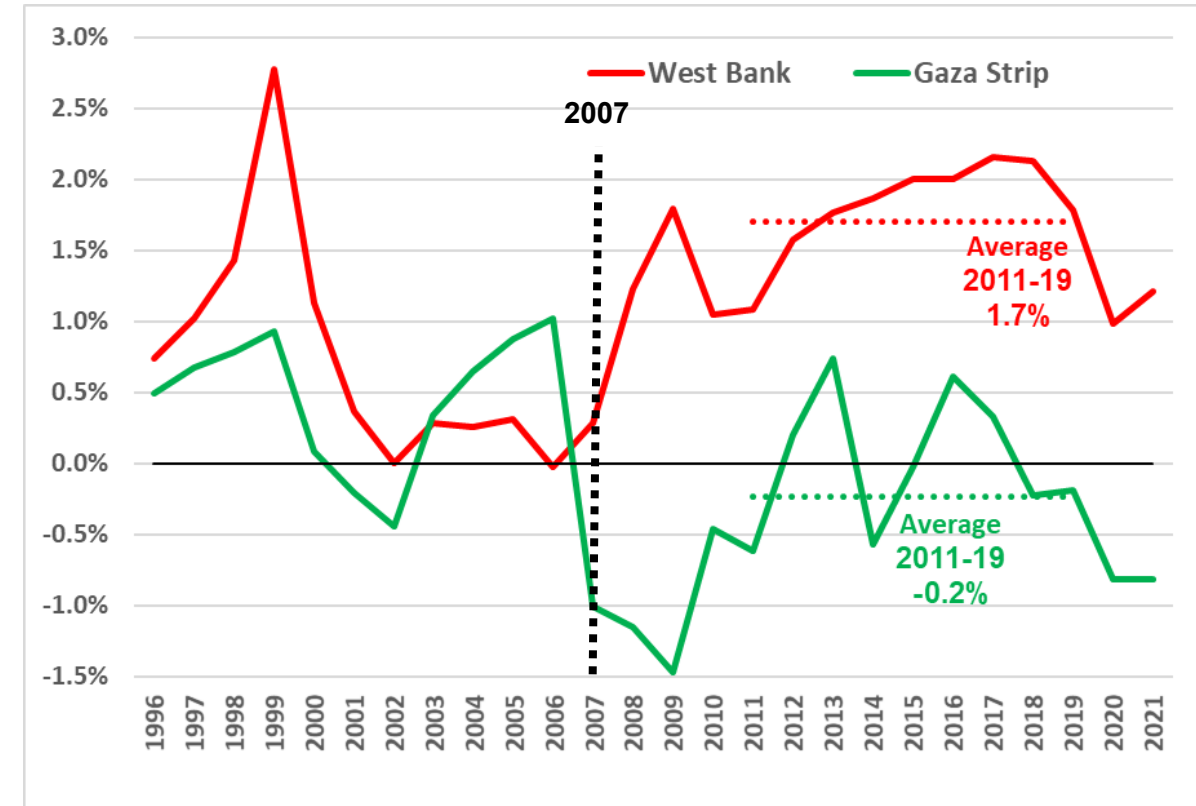
# Investment and contribution of capital to growth in the Palestinian economies, 1994-2021

## Fixed Capital Investment excluding buildings, 1994-2021 GDP percent



Source: PCBS

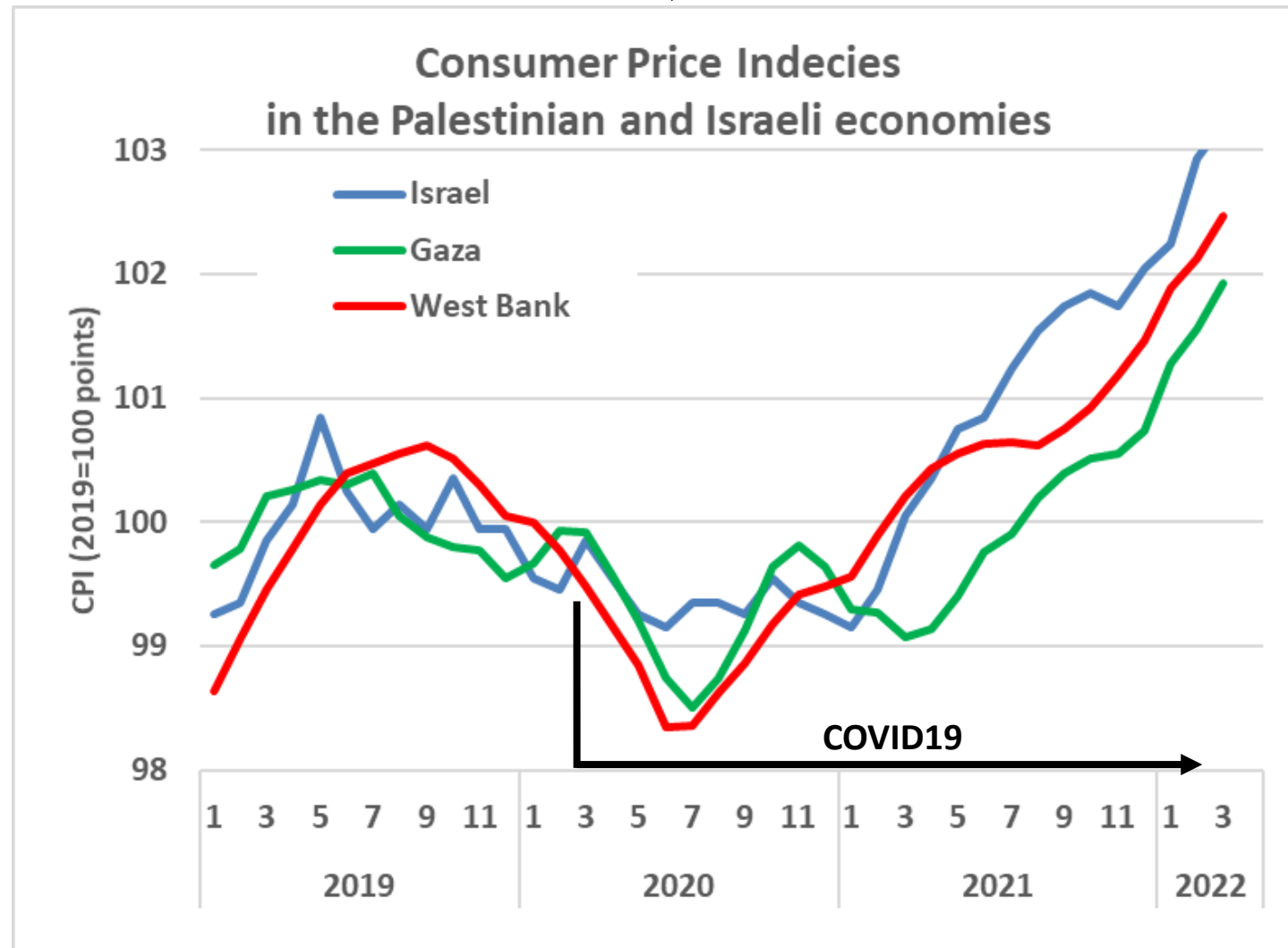
## Contribution of Capital to Growth 1994-2021



# Consumer Prices

- Consumer prices increased in 2021 and early 2022 when global energy and food prices soared
- Inflation in the “shekel zone” was moderated by the appreciation of the NIS.
- Inflation is expected to continue rising in 2022 due to additional price increases following the war in Europe.
- Yet, reforms in trade will probably attenuate inflation

## Consumer prices in the West Bank, Gaza, and Israel, 2019-2022

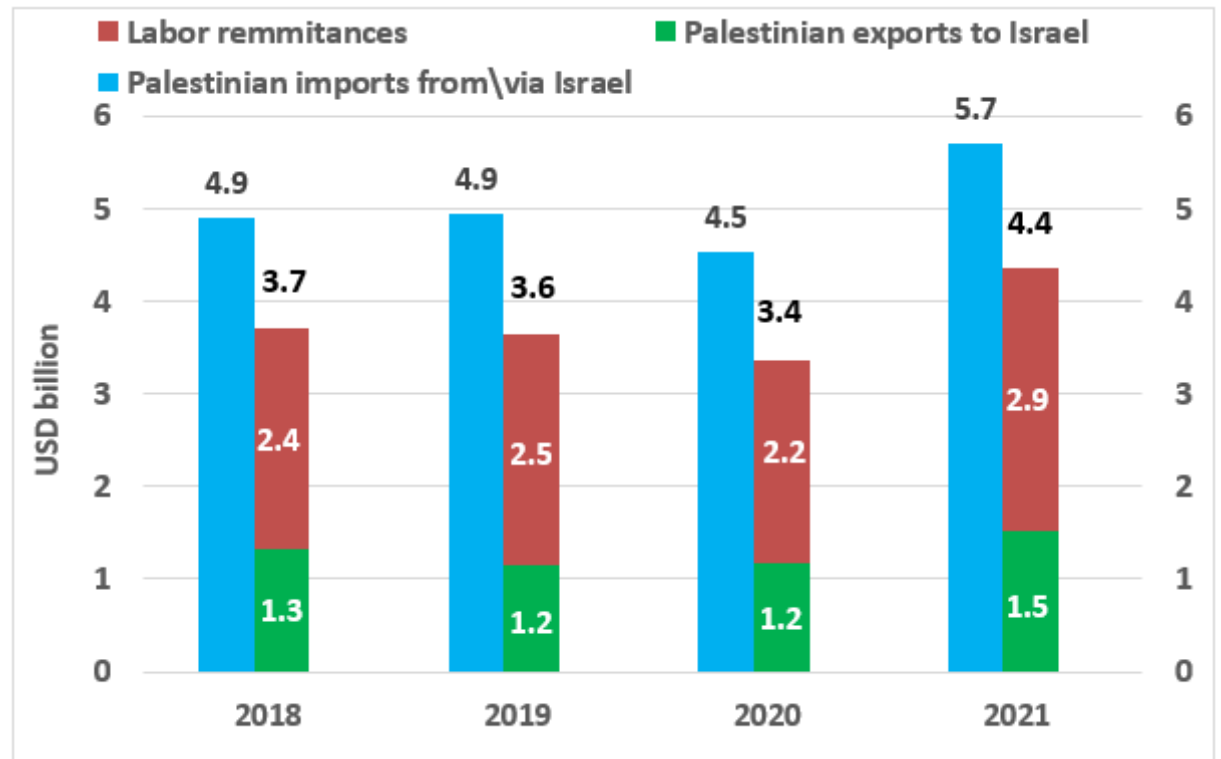


Sources: WB & Gaza – PCBS; Israel – Israeli CBS; Jordan - DOS.  
Note: Palestinian CPIs are moving averages of 5 periods.

# Palestinian-Israeli economic relations

- Palestinian trade deficit with Israel is about USD 1.2 billion per year after accounting for labor remittances
- Labor remittances are almost double than Palestinian exports of goods and services
  - Palestinian estimates of remittances are higher by USD 0.3 billion than Israeli estimates
- 2021 trade-remittances flows recovered from COVID-19 and are even larger than 2018-19
  - This is partly due to NIS appreciation

## Palestinian-Israeli trade and labor relations, USD billion

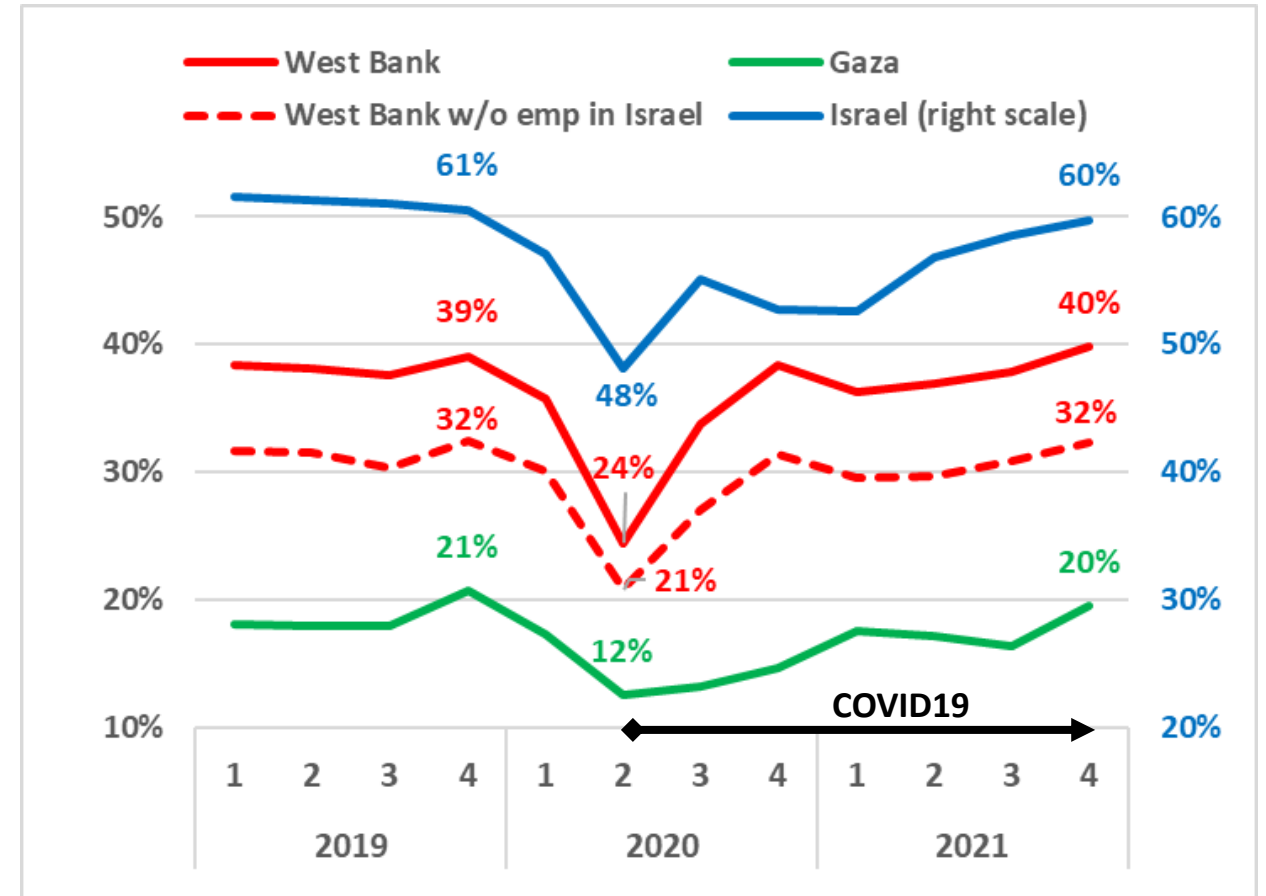


Source: Israeli CBS

# Labor markets

- Employment to population ratios in the West Bank and Israel dropped by about 12 percentage points due to COVID-19, and recovered by the end of 2021
- Most of the initial decline in West Bank employment was of workers employed in Israel
- Employment in Gaza returned to the very low levels prevalent before COVID-19

## Employment to population (age 15+) ratios, excluding absentees from work, 2019-21

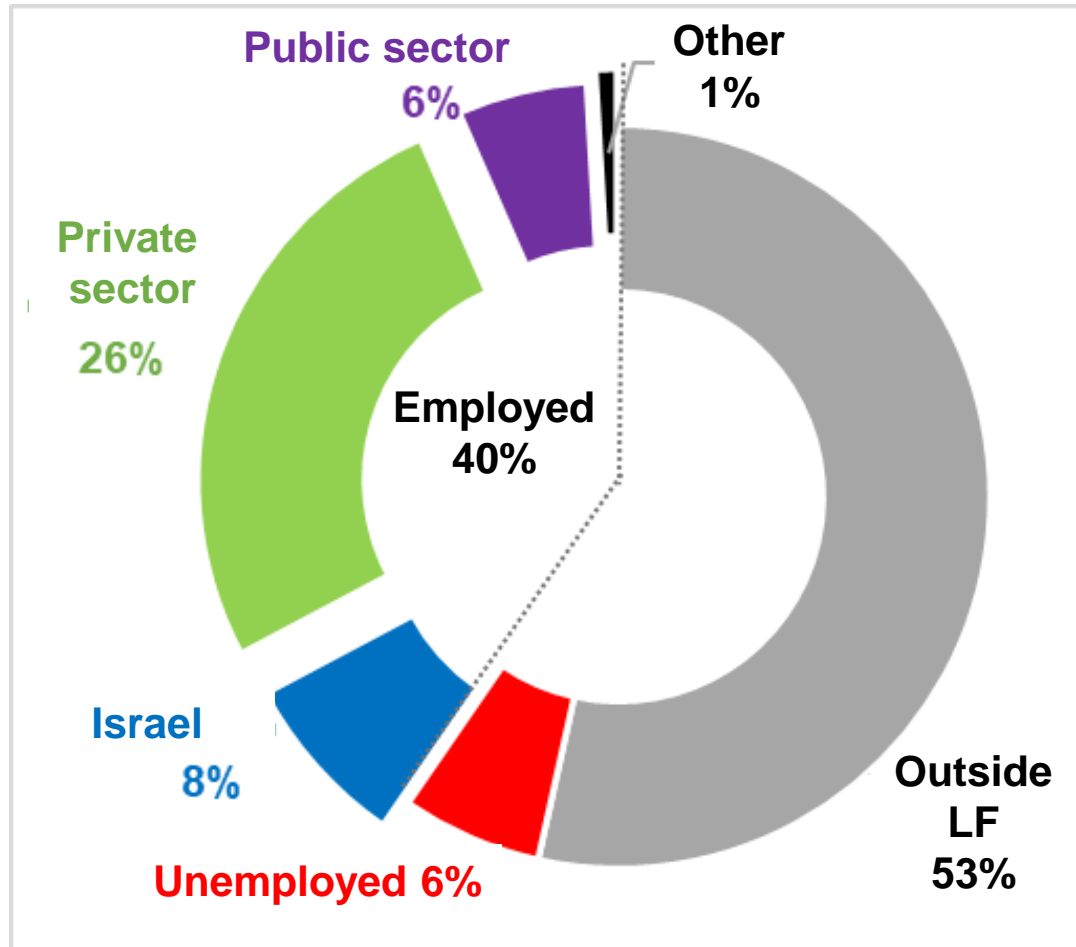


Sources: WB & Gaza – INSS analysis of Palestinian LFS;  
Israel – BOI analysis of Israeli LFS

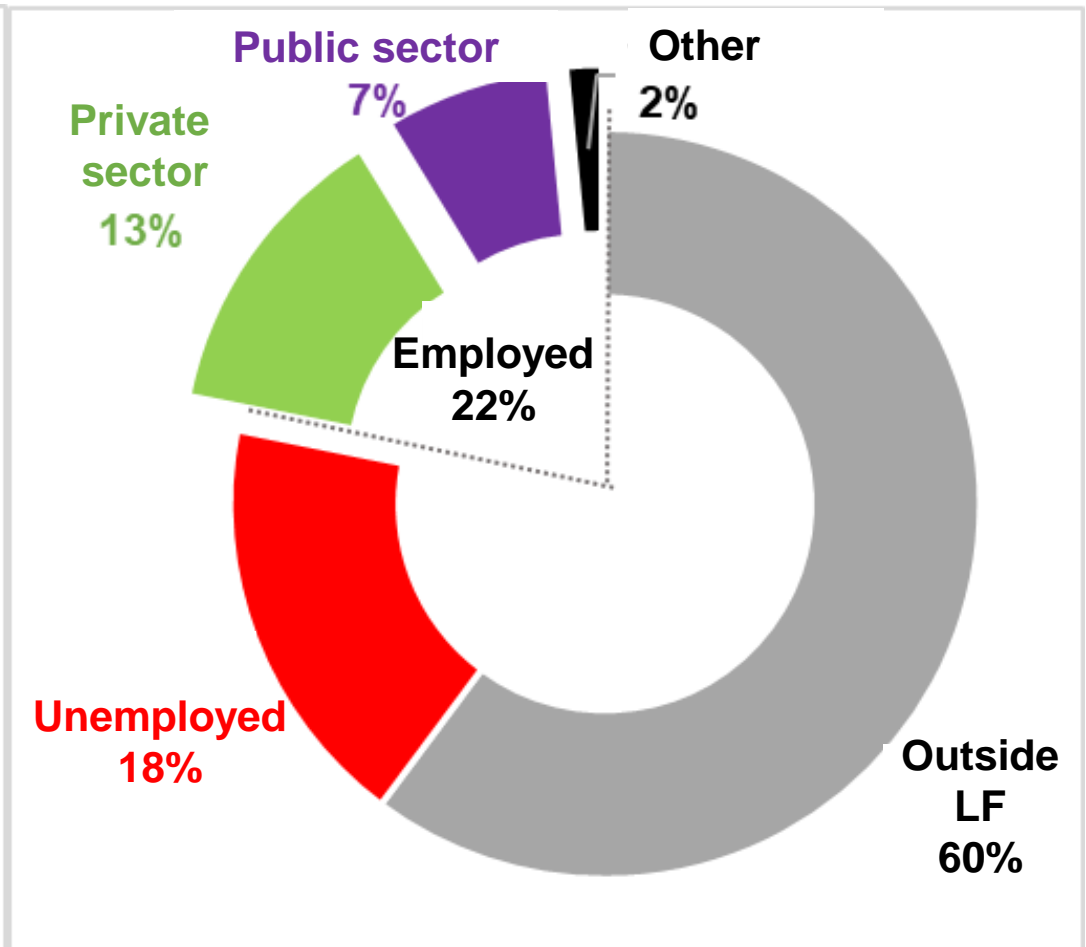


# Employment status of working age population (15 years old or older), 4<sup>th</sup> quarter of 2021

The West Bank, 2.0 million people



The Gaza Strip 1.2 million people



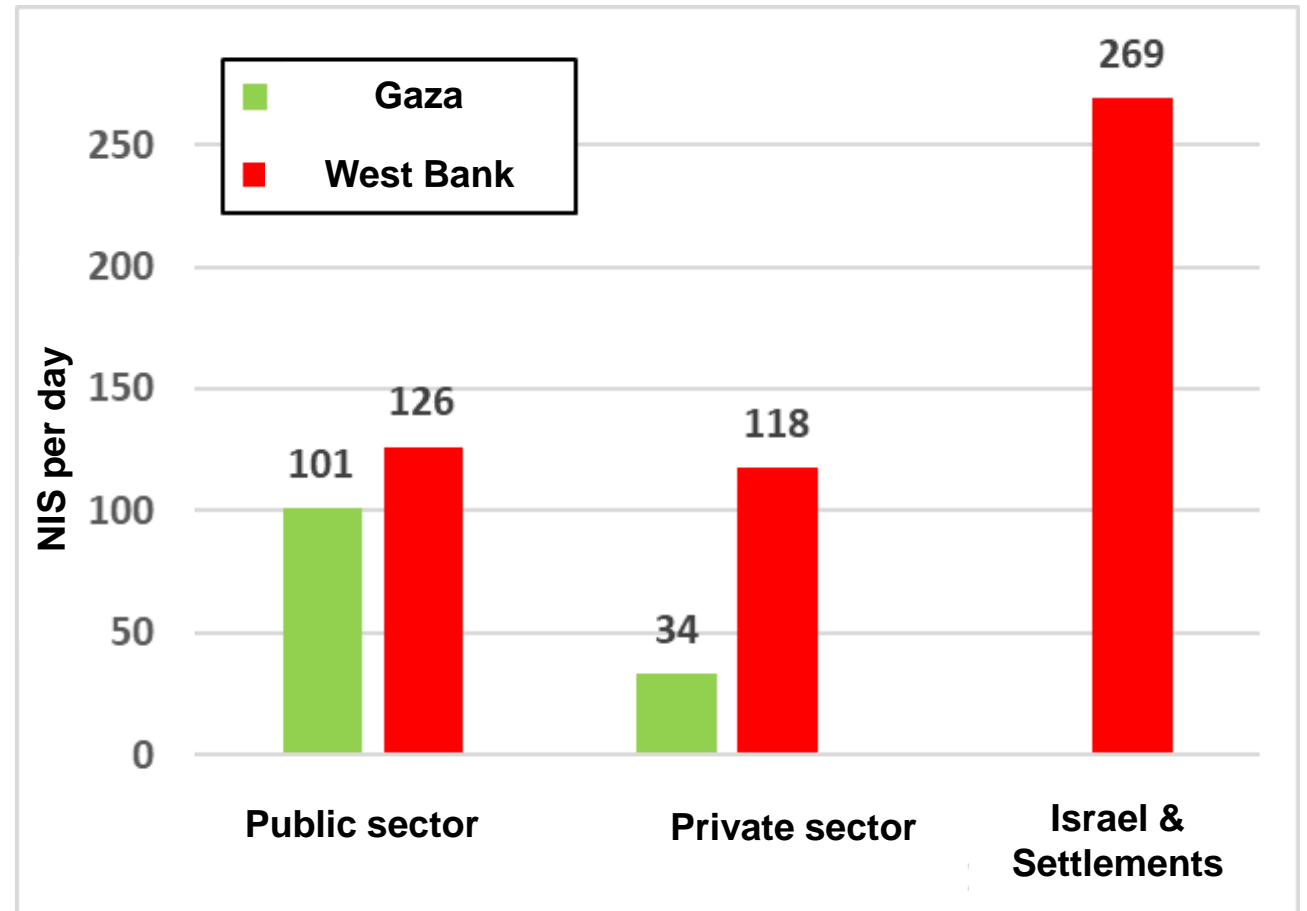
Source: PCBS

The employment rate in Gaza is low due to low employment in the private sector and insignificant employment in Israel

# Wages of Palestinian workers

- The weakness of the Gazan labor market is also evident from the very low private-sector-wages
- High wages in Israel lead also to high wages in the private sector in the West Bank
  - This benefits workers but hurts local businesses
  - Wage gaps between Israel and West Bank fuel illicit work-permit trade.

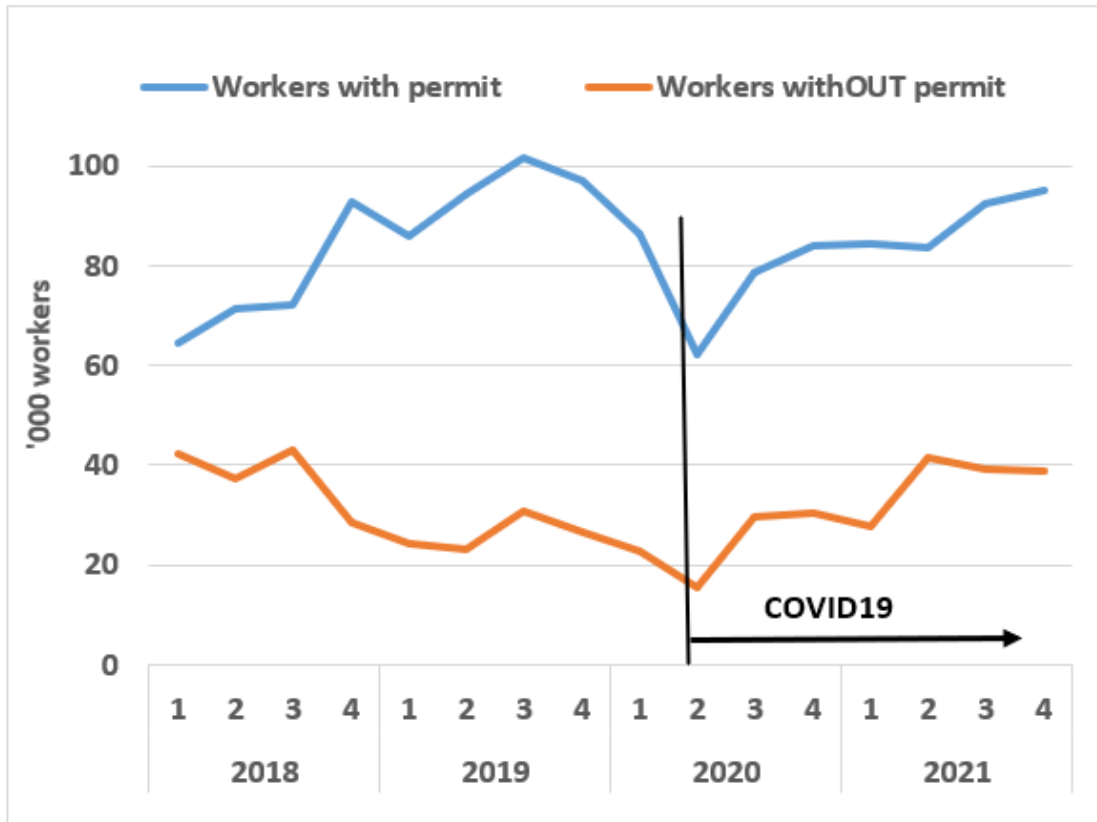
**Daily wage by territory and sector, 2020-Q4 (NIS per day)**



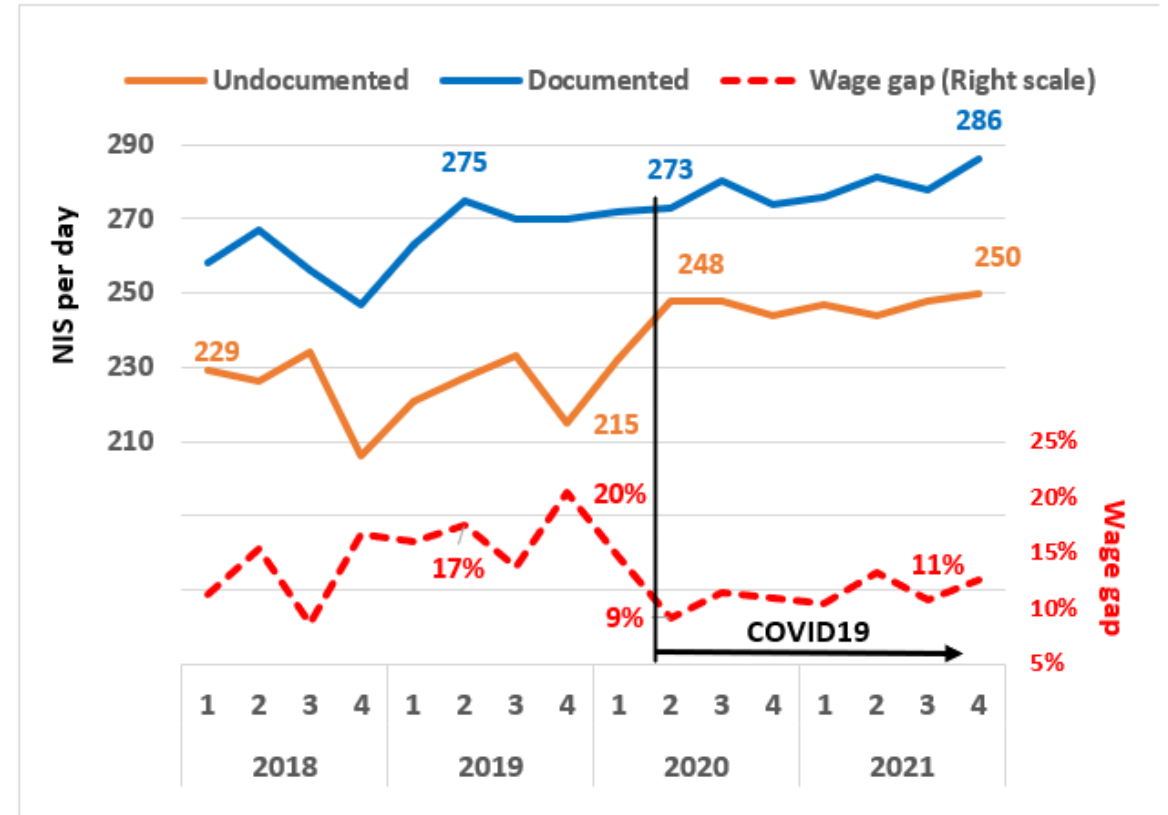
Source: PCBS

# Documented & undocumented West Bank employment in Israel

## Employment, thousands of workers



## Wages and wage gap, NIS and percent



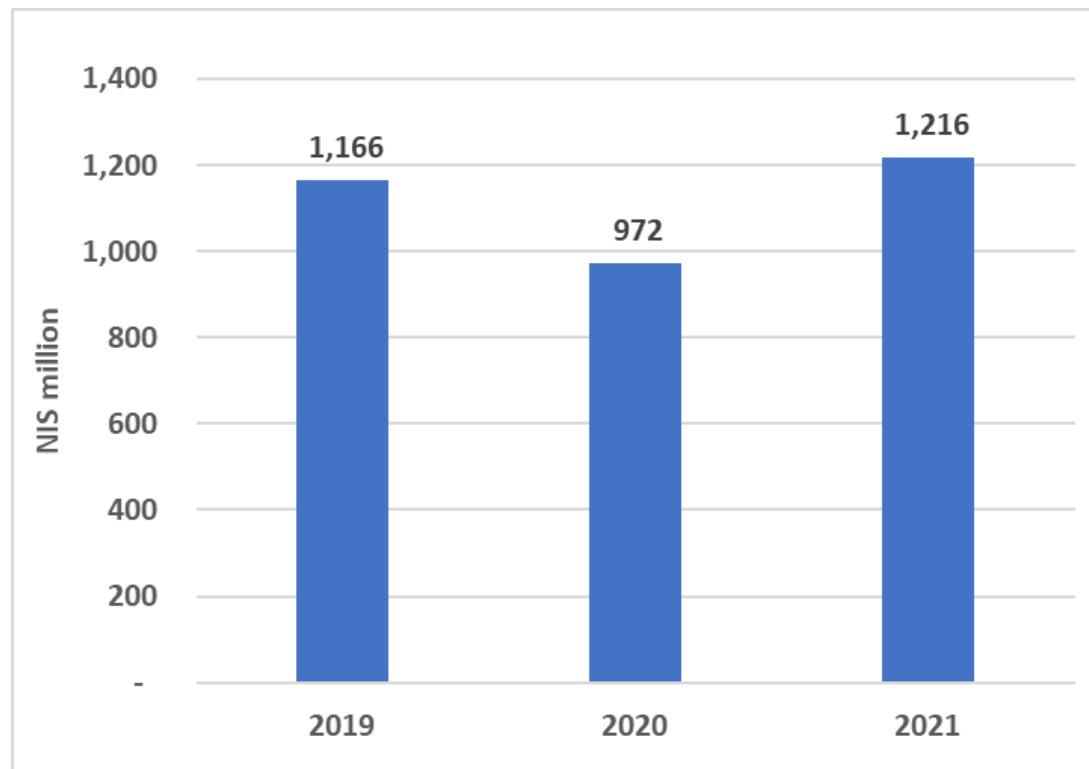
Source: INSS analysis of PCBS data

- Documented employment in Israel gradually recovered in 2020-21 from the COVID-19 decline in 2020-Q2
- Employment and wages of undocumented Palestinian workers in Israel increased since the outbreak of COVID-19 in 2020-Q2, as Israeli policies to deal with the pandemic resulted in stronger demand for undocumented workers.

# The illegal permit trade

- **Illegal permit trade continues** after the reform of late 2020
- In 2021, 44% of the permit holders paid to brokers NIS 2,450 per month for the permit.
- Brokers' total revenues from permits' trade in 2021 reached NIS 1.2 billion
- **Recommendations**
  - ✓ Obligatory wiring of wages from Aug. 2022
  - Enforcement against permit brokers
  - Adjusting the permit-system to reduce trade
  - Proceeds of corruption – potential fiscal source

**Revenues of the permit trade**



Source: INSS analysis of PCBS data

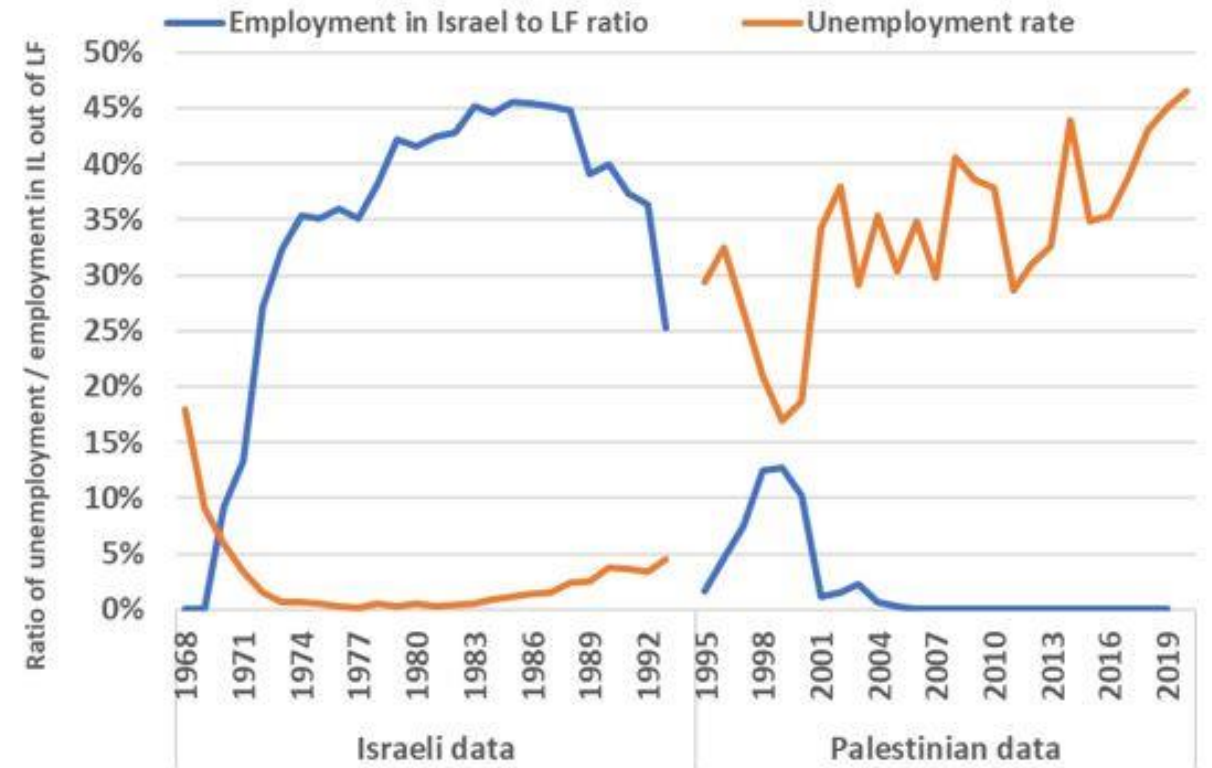
# Renewal of Gazan Employment in Israel

- **Late 2021 - early 2022:** renewal of the entry of Gazans to Israel and entry-permit quota increased to 12,000 workers
- **April 2022:** decision to increase the quota to 20,000 workers (4% of LF) and to formalize the permits as work-permits

## Historically:

- **1995-2005:** An increase of 1 percentage point employment in Israel was correlated with a 1.2 percentage points decline in unemployment
- **Mid 1980s:** Without limitations employment in Israel reached 45% of the Gazan labor force

## Gazan unemployment and employment in Israel to LF ratios, 1968-2020

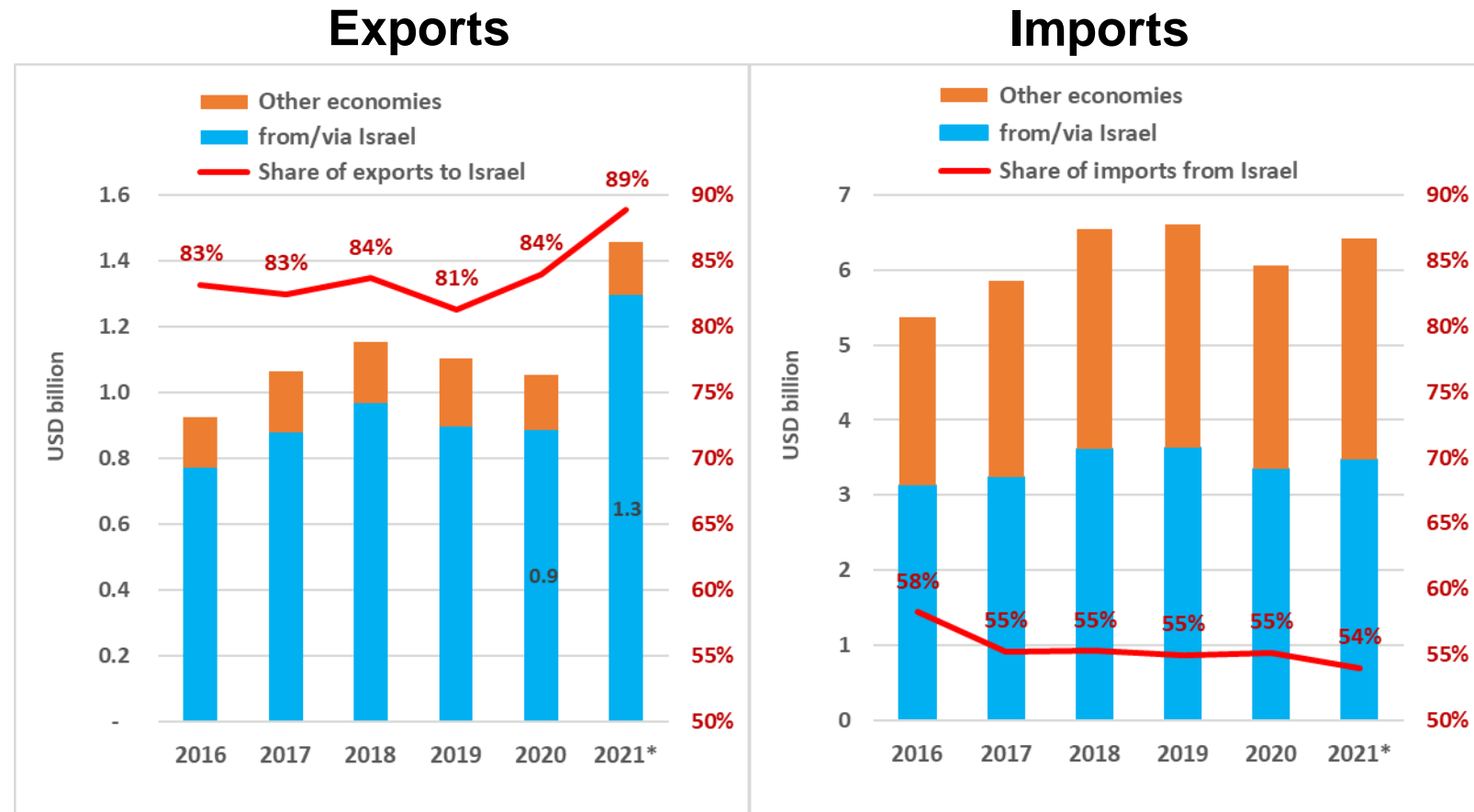


Source: Israeli and Palestinian CBS

# Palestinian Trade

- Palestinian exports to Israel increased in 2021 partly because of the NIS appreciated
- Palestinian imports are likely to shift from imports from Israel to imports from abroad as:
  - Israel adopts European standards
  - Israel reduces tariffs on agricultural produce
  - Israeli-Jordanian agreement

## Palestinian trade in goods by trade partner and share of trade with Israel , 2016-21 USD million

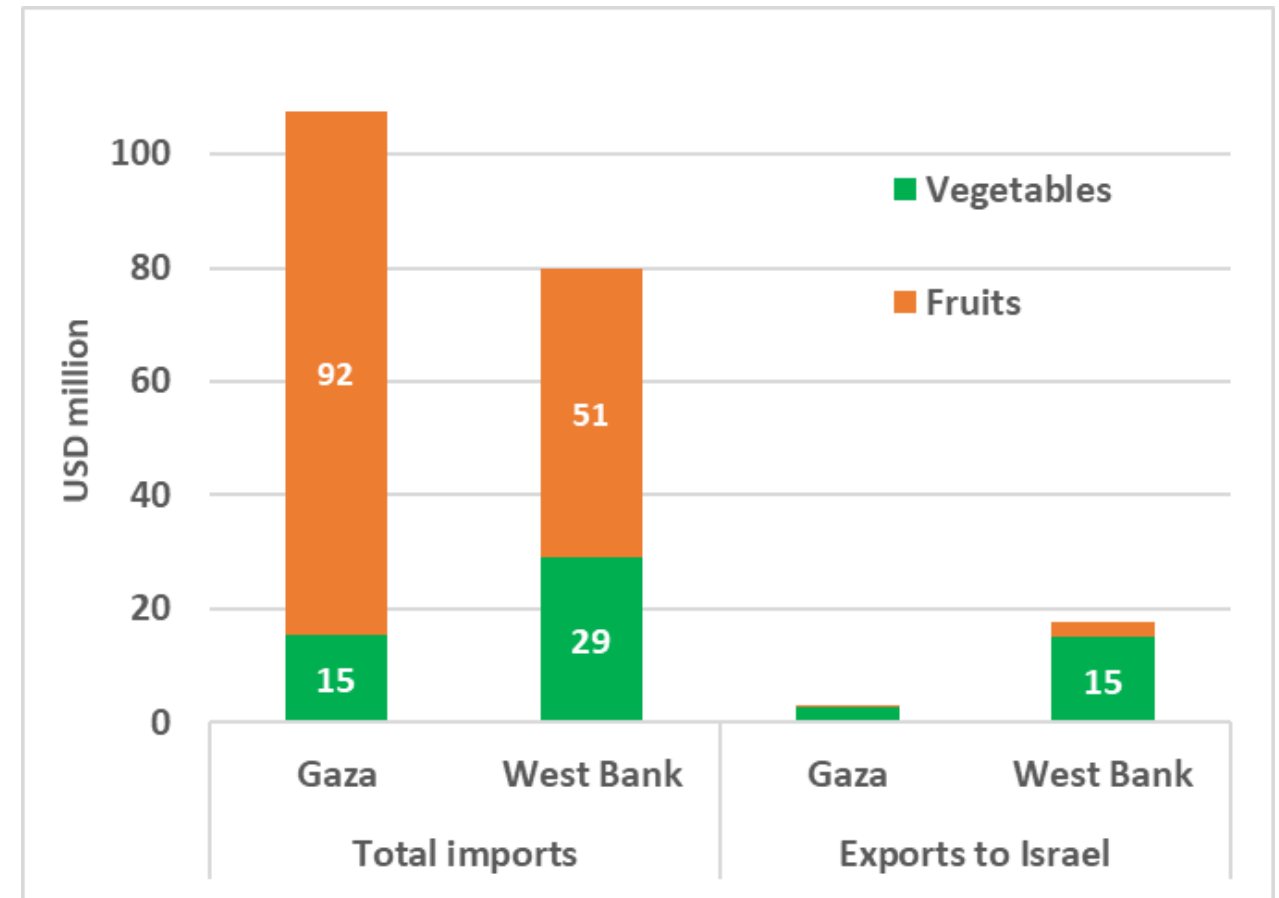


Source: PCBS  
\* Preliminary estimates

# Agricultural trade

- Israel intends to lower tariffs on agricultural produce imported from abroad (2022-27)
  - Implementation depends on coalition stability
- Lower tariffs are expected to
  - Reduce cost of produce imports to Gaza (by USD 26 M) and the WB (by USD 17M)
  - Reduce food prices
  - Unclear impact on Palestinian producers
- Policy will have a small adverse macroeconomic effect on the WB due to low exports to Israel

## Palestinian agricultural trade, 2019-20 averages USD million



Source: PCBS

# Palestinian-Israeli economic relations: Outline

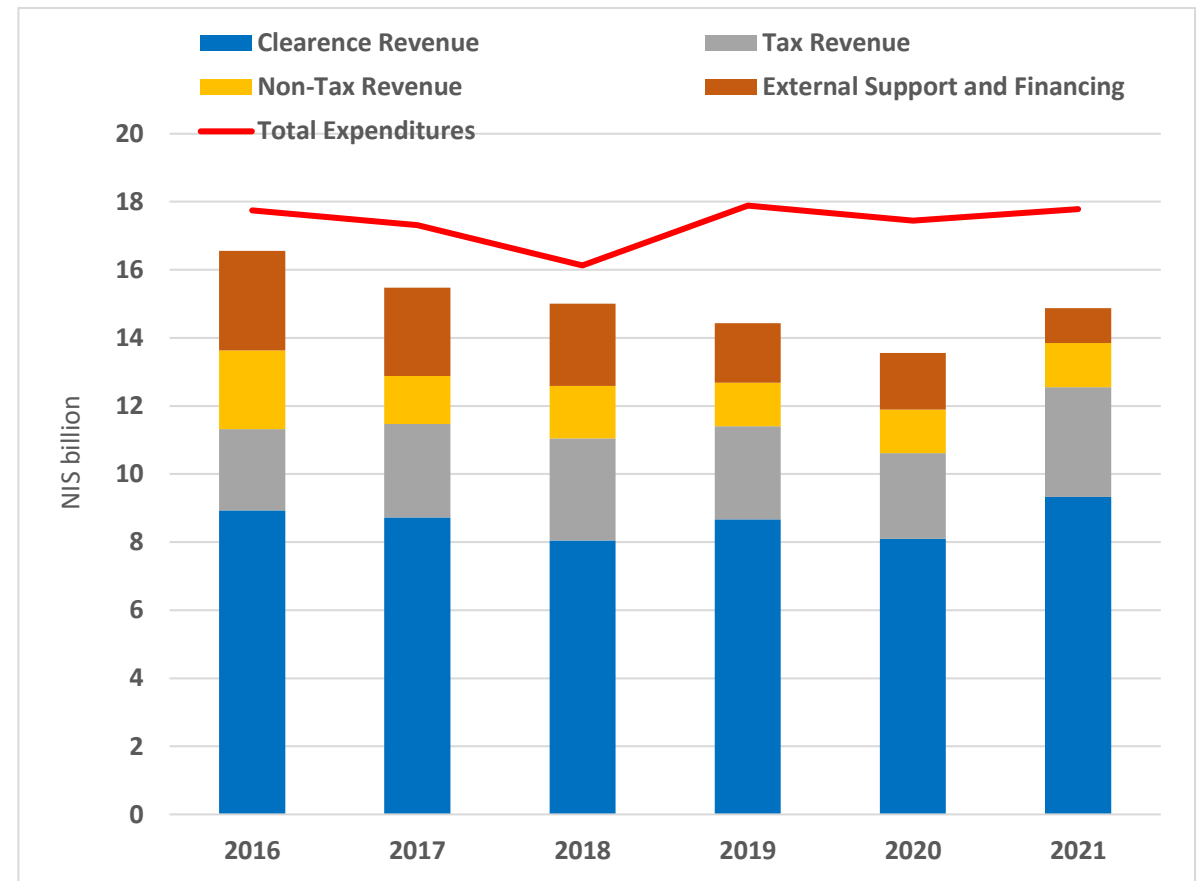
- ✓ Macroeconomic conditions in the “Shekel Zone”
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# Fiscal stance of the Palestinian Authority

- The PA has a structural deficit.
  - Expenditures in 2021 were 20% higher than revenues
- Clearance revenues account for 63% of the P.A. revenues in 2021
- Domestic tax revenues are small
  - But increased in 2020-21 to 22% of all revenues
- Donors grants consistently declined in recent years
  - Decreased from 17% of revenues in 2016 to 7% in 2021

## Revenues, External Support, and Expenditures

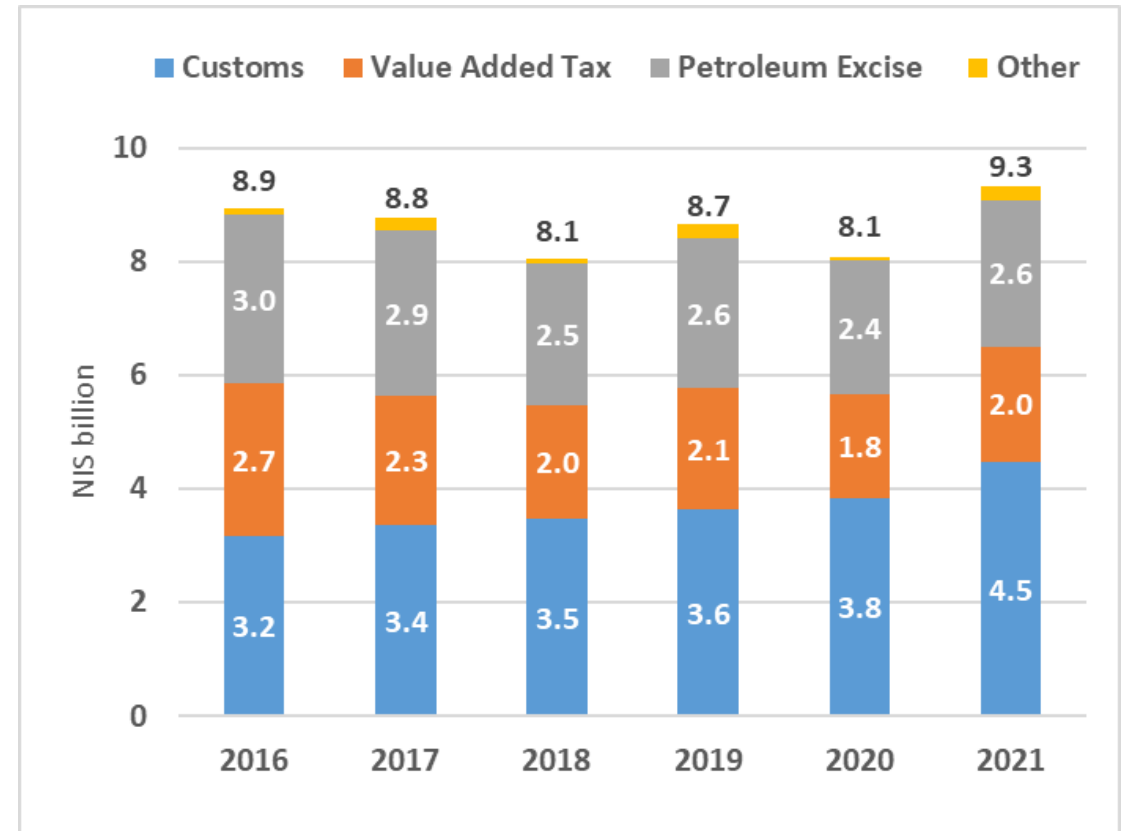


Source: Palestinian Ministry of Finance

# Fiscal stance of the Palestinian Authority

- **Clearance revenues** reached a record level in 2021: NIS 9.3 billion
  - Practically, only regressive indirect taxes
  - Income tax on employment in Israel is marginal (less than 3% of clearance revenues)
- **Customs revenues increased** over time and account for most of the increase of clearance revenues in 2021
  - They are likely to continue increasing due to NIS appreciation and trade reforms
- **Israel policies increasingly affect Palestinian fiscal revenues**
  - Decrease of NIS 0.5 on petroleum excise for 2022Q2 potentially reduces PA revenues by NIS 100M
  - Expected similar effect of lowering tariffs on agricultural products

**Clearance revenues by tax type,  
2016-21 NIS billion**

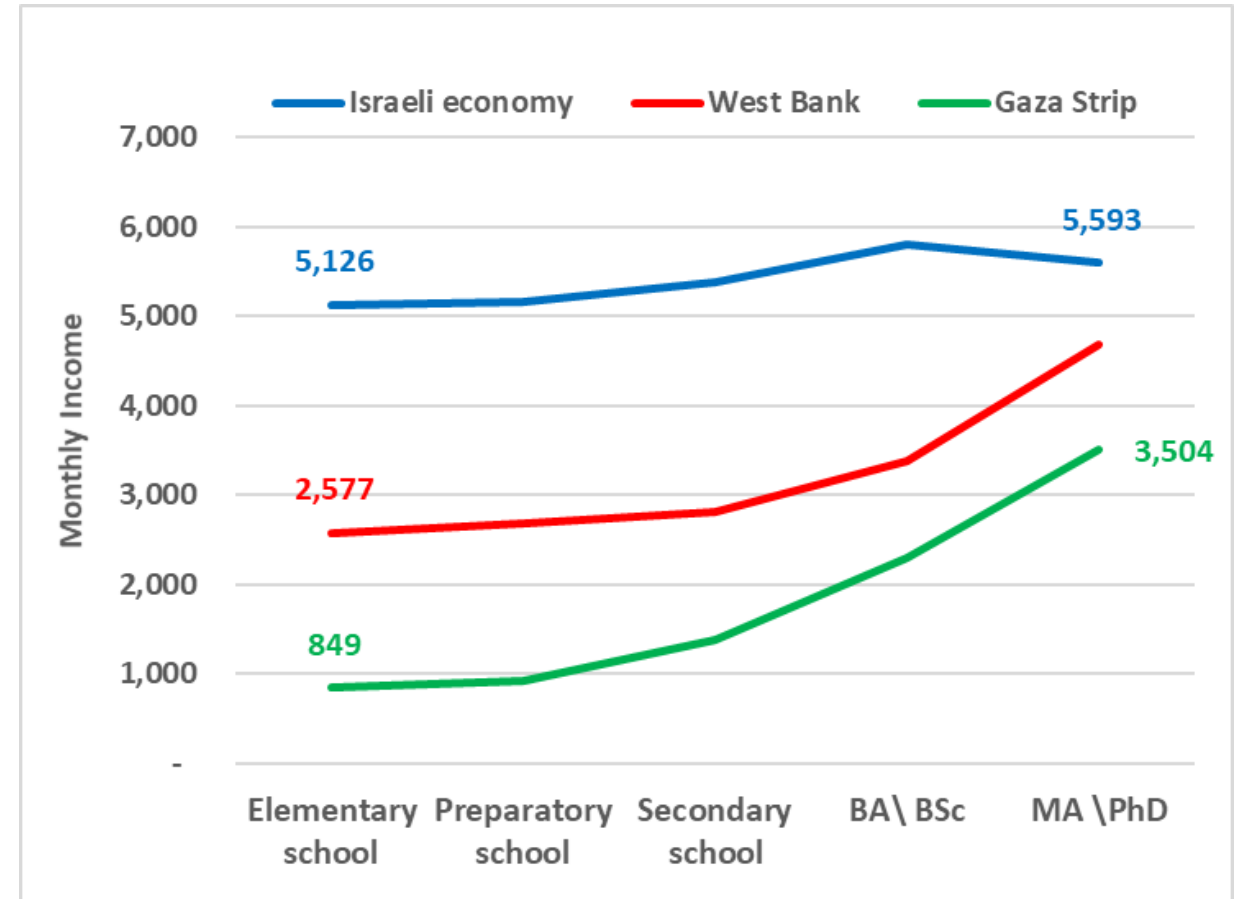


Source: Palestinian Ministry of Finance

# The case for taxing Palestinian workers in Israel

- The next slides consider an option to increase Palestinian fiscal revenues by taxing Palestinian workers in Israel
- Wages in Israel are high particularly for low-skill workers. But they
  - Lead skilled workers to unskilled jobs in Israel
  - Reduce incentives for schooling
  - Increase local wages and harm Palestinian businesses
  - Incentivize illegal work-permit trade

Monthly wage of male workers by place of employment & education, 2021

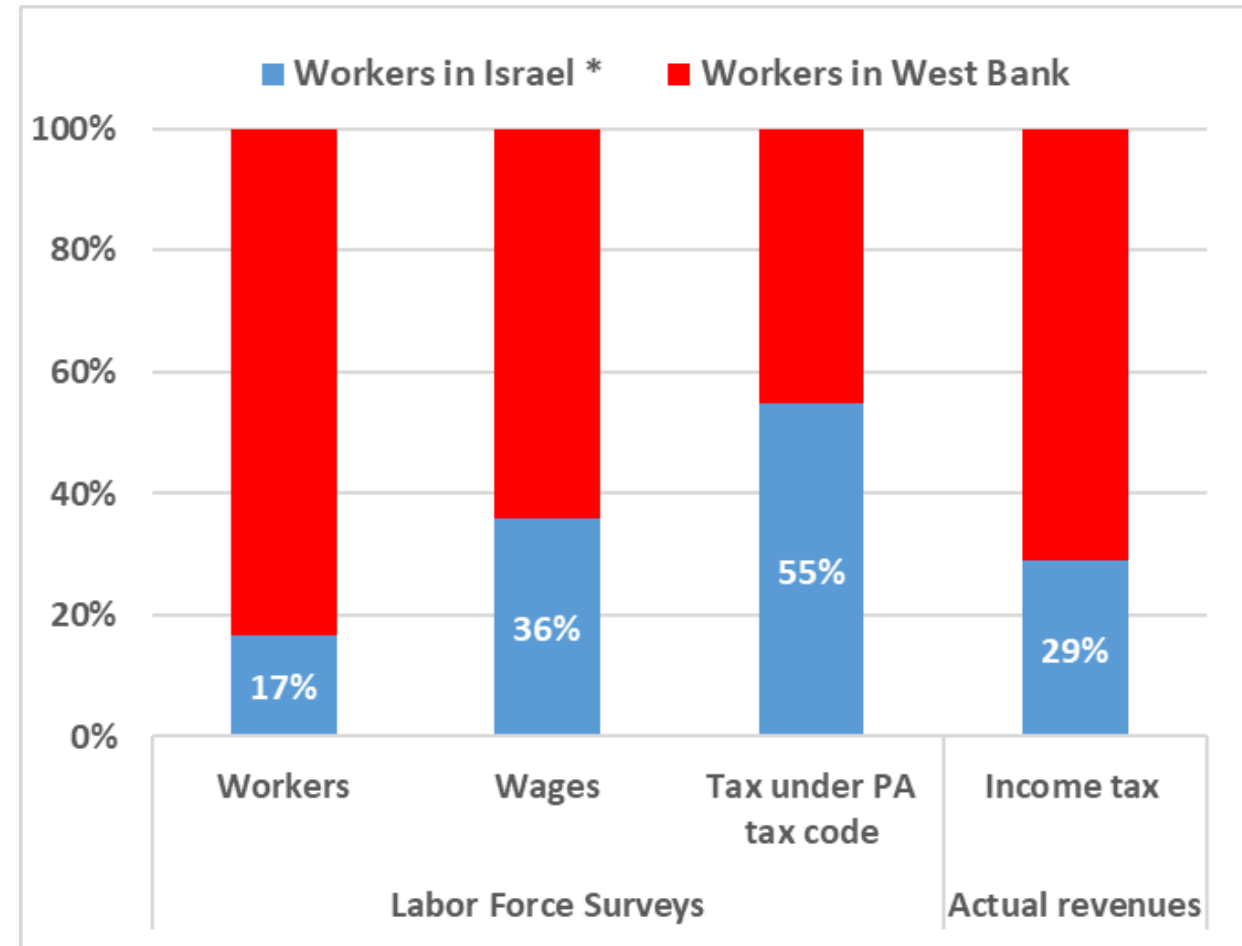


Source: INSS analysis of Palestinian LFS

# The case for taxing Palestinian workers in Israel

- In 2021 West Bank workers in Israel and settlements:
  - Were 17% of WB workers
  - Received 36% of the wages
  - Would've increased to 55% of income tax revenues Under the PA code
  - Actually paid 29% of income tax revenues
- Diverse tax codes of WB workers:
  - West Bank – Palestinian code
  - Israel – Israeli code
  - Settlements – Jordanian code

## The share of workers in Israel in total West Bank employment, wages and income tax revenues



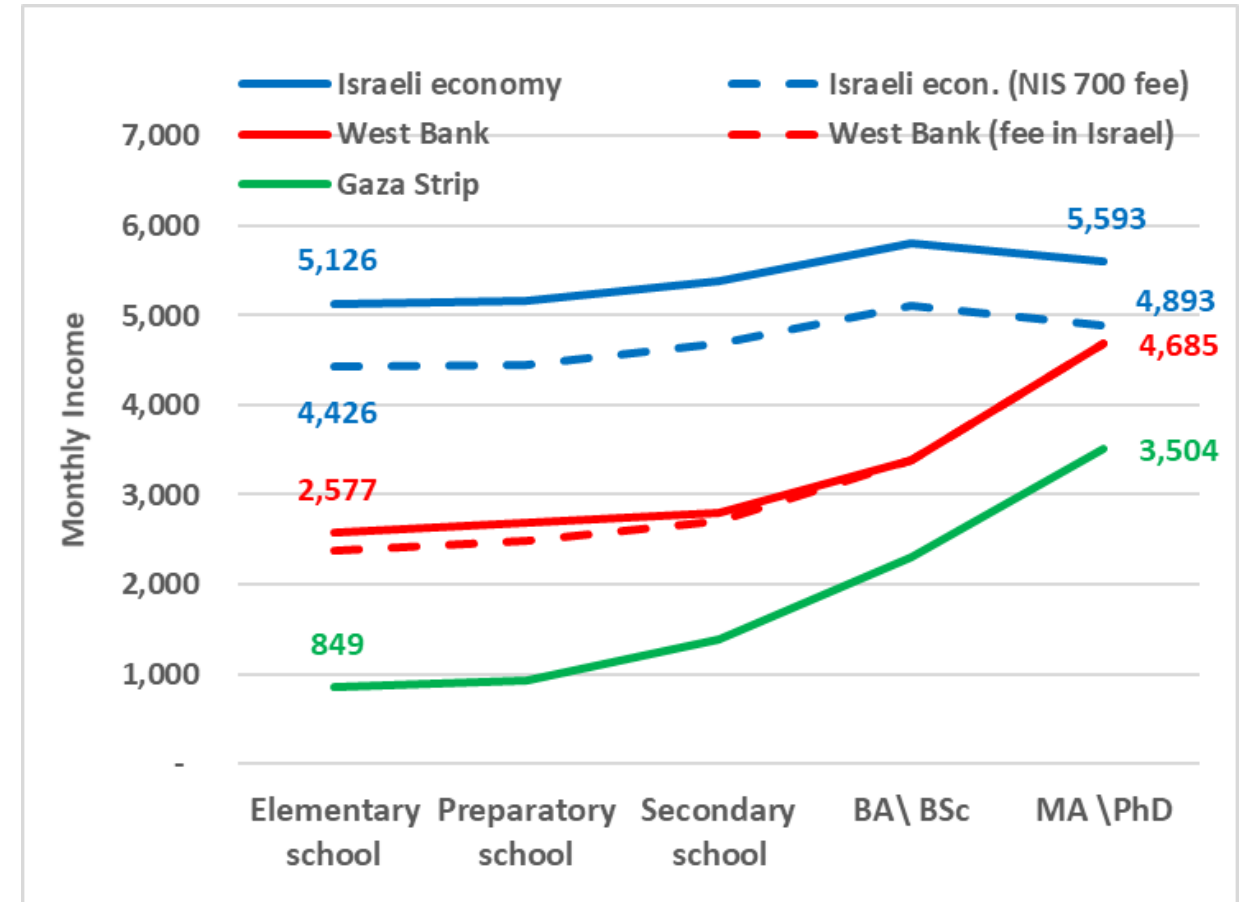
Source: INSS analysis of Palestinian LFS and PMOF

# The case for taxing Palestinian workers in Israel

A fixed NIS 700 fee on employment in Israel (instead of Israeli/Jordanian tax code)

- Generates revenues of NIS 1 billion. This covers a third of Palestinian current budget deficit.
- Narrows wage gap between workers in Israel and those in Palestinian economies
  - Partially addresses issues related to schooling incentives, harm to local businesses, income inequality, etc.
- Reduces potential tax base for Hamas from Gazans working in Israel
- West Bank workers: fee should not be too high so it doesn't incentivize undocumented work

**Monthly wage of male workers by place of employment & education, 2021**



Source: INSS analysis of Palestinian LFS

# Policy recommendations

- **Employment**

- Formalizing Gazan and West Bank informal employment in Israel
- Permit trade: enforcement by both sides
- Continuing reforming the system to account for actual employment patterns
- Wiring wages to bank accounts instead of paying in cash also for workers in the settlements

- **Trade**

- Taking into account the impact of Israel changes to trade policy on the Palestinian economy (e.g. standards, tariff)

- **Fiscal**

- Taxing Palestinian workers in Israel to increase Palestinian revenues
- Taking into account the impact of Israel changes to indirect taxes on PA revenues (e.g. fuel excise)

Thank you!