

The Domestic and International Economic Implications of a Possible Israeli Annexation in the West Bank

Zoom conference, July 27th, 2020

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Background

In recent years, the idea of annexation of some parts or the entire West Bank has gained growing popularity in Israeli mainstream politics. During the three election campaigns of 2019 and 2020, Prime Minister Benjamin Netanyahu promised to promote such an annexation if reelected. The idea received further support when the president of the United States, Donald Trump, released his Middle East peace plan in January 2020. The announcement of the plan took place prior to the third election cycle in Israel, at the presence of Netanyahu. The plan provides Israel with a green light to annex up to 30% of the West Bank as part of an agreement with the Palestinians; however this step can take place already prior to any negotiations. Many observers criticized this decision, as a decision that instead of building trust between the conflict parties continues to deepen disputes and allows Israel to establish facts on the ground, while completely ignoring the Palestinian demands.

Following the formation of a joint government between Benjamin Netanyahu and his main opponent previous chief of staff of the Israeli armed forces, and incumbent minister of defense, Benjamin "Benny" Gantz, it has been agreed that Netanyahu has a green light to promote an annexation in the West Bank starting July 1st, 2020, a move that many consider, if happens, to be his legacy. For now, in light of disagreements both within the government and with the American administration, as well as significant outbreaks of COVID-19 in Israel and in the United States, such a move has not yet been promoted. Yet, there is still a possibility that it will be promoted in the coming months prior to the US presidential elections.

The Zoom conference conducted as part of the Israeli European Policy Network (IEPN) on July 27th, 2020, focused on the economic aspect of a possible

annexation as well as the implications on Israeli-European relations. During the conference the domestic and international economic implications of a possible Israeli annexation in the West Bank has been presented and discussed.

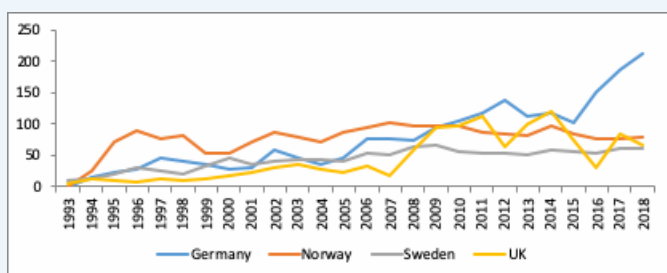
Minutes and Conclusions from the Conference

The conference focused on a presentation of a paper on the international and domestic economic implications of annexation, written by the Macro Center for Political Economics. The paper showed that ever since the establishment of the Palestinian Authority in 1994, it has been provided with intensive funding from different European countries, the European Union and other European organizations. In total, Europe has provided direct support of 19 billion USD to the Palestinian Authority. This is only the direct support and does not include additional support for Palestinian organizations not directly linked to the Palestinian Authority. In case that an annexation of some parts of the West Bank would lead to the collapse of the Palestinian Authority, all the efforts and investment conducted by European partners to support the two state solution, the existence of the Authority and the welfare of the Palestinian people would go down the drain.

All in all, it can be seen that over the years around 45% of the annual international donations for the Palestinian Authority arrived from Europe. Other main donors include mostly other Arab countries and the United States. Over the years, the main European donating countries were Germany, Norway, Sweden and the United Kingdom. The German donations increased dramatically in the past 5 years. A possible explanation is the decrease in donations provided by the European Union itself and the need of the state members to increase their contribution to the Authority as a complementary step. To summarize this point, European countries and institutions are deeply invested in promotion of the Palestinian

Authority and the two-state solution. As one of the possible outcomes of an annexation is the collapse of the Palestinian Authority this could mean a collapse of a 19 billion USD dollar investment.

Chart 1: Annual donations to the Palestinian Authority by 4 leading European Countries, 1993-2018, million USD



Source: OECD stats

Table 1: Total donations received to the Palestinian Authority and share from European Donation, by country, 1993-2018

Country / Institution	Total donation, million USD	Share of European Donations
The European Union	7,343.39	38.5%
Austria	146.61	0.77%
Belgium	439.67	2.31%
Cyprus	3.23	0.02%
Czech Republic	24.16	0.13%
Denmark	365.83	1.92%
Estonia	2.74	0.01%
Finland	203.81	1.07%
France	989.49	5.19%
Germany	1,988.85	10.44%
Greece	79.2	0.42%
Hungary	3.35	0.02%
Iceland	16.76	0.09%
Ireland	140.28	0.74%
Italy	591.86	3.11%
Latvia	0.04	0.00%
Lithuania	0.29	0.00%

Luxemburg	918.38	4.82%
Malta	0.19	0.00%
Norway	1,998.81	10.49%
Poland	12.91	0.07%
Portugal	9.24	0.05%
Romania	3.55	0.02%
Slovak Republic	1.53	0.01%
Slovenia	3.49	0.02%
Spain	939.22	4.93%
Sweden	1,138.76	5.98%
Switzerland	515.3	2.70%
UK	1,172.25	6.16%
Total	19,054.18	100%

Source: OECD stats

Prior to the presentation of the domestic costs of an annexation, a short comparison between the Israeli and Palestinian economies has been provided. In the West Bank reside 2.6 million Palestinians. The Palestinian economy depends completely on the Israeli one, however completely differs from the Israeli economy. Conduction of an annexation in some parts of the West Bank during a severe economic and health crisis such as the one caused by the outbreak of the COVID-19 pandemic, could have severe implications. Even prior to the crisis, the GDP per capita in the West Bank was only 12.1% of the GDP per capita in Israel – \$5,044 in the West Bank, compared to \$41,735 in Israel. Another measure that highlights the gaps between the Israeli and Palestinian economies is unemployment. In 2018, the unemployment rate in the West Bank was 17.6% compared to 4.0% in Israel. In addition, labor force participation rate in the West Bank is much lower compared to Israel – 46.1% and 63.6% respectively. This is mainly due to a lower degree of female participation in the labor force in the West Bank. In the West Bank, unemployment among young adults is even more common – the youth unemployment rate in the West Bank was 29.8% compared to 4.8% in Israel. These data illustrates the dependency of the Palestinian economy on the Israeli one, and that the Palestinians that will be annexed to Israel would be significantly supported by the welfare institutions in Israel.

Table 2: The Israeli vs. the Palestinian Economy, 2018¹

Indicator	Israel	West Bank
Population (thousands)	8,884	2,600
Life Expectancy at birth (2016)	82.4	74
GDP (million USD)	370,645	13,297
GDP per capita (USD)	41,735	5,044
Economic growth (2016)	4%	3%
Cumulative GDP growth 2011-2016	21.09%	19.3%
Consumption (million USD)	286,863	11,575.3
Consumption per capita (USD)	32,289.8	1,149.3
Public consumption (million USD)	85,326	2,680.2
Public consumption per capita (USD)	9,604.4	1,030.8
Private consumption (million USD)	201,537	8,895.1
Private consumption per capita (USD)	21,873	3,421.1
Gross domestic investment (million USD) (2016)	72,438	2,511
Gross domestic investment per capita (USD) (2016)	8,153.7	844.9
Export of goods and services (million USD) (2016)	112,294	5,311.1
Import of goods and services (million USD)	112,407	7,744.6
Labor force participation rate	63.6%	46.1%
Unemployment rate	4.0%	17.6%
Youth unemployment rate (2016)	4.8%	29.8%
Average daily wage (2016)	322.2	94.1

Source: Israeli Central Bureau of Statistics (CBS) and the Palestinian Central Bureau of Statistics (PCBS)

In addition, it has been presented that in case the Palestinian Authority collapses in response to an Israeli decision to annex some parts of the West Bank, the economic cost of the decision would be 52 billion NIS per year. 29.1 billion NIS would be paid

in form of allowances to the Palestinian population. Those allowances include income support, child allowances, disability allowances, unemployment benefits, maternity grants and old age pension. In addition, Israel would have to provide education and health services to the Palestinians, services that are currently being provided by the Palestinian Authority. Therefore, education expenditure on the Palestinian population is expected to be 14.6 billion NIS and National Health Services 16.1 billion NIS. Other governmental expenditure is expected to be 5.4 billion NIS. In addition, there will be a need to form again the civil administration in the West Bank, which is expected to cost 2 billion NIS. All in all, those costs conclude to 67.2 billion NIS. Yet, income from different taxes and fees are expected to make a profit of 15.3 billion NIS, making the economic cost of an annexation in case the Palestinian Authority collapse 52 billion NIS.

¹ Unless mentioned otherwise. In some cases the last comparable data is prior to 2018.

Table 3: Total Expenditure and Income expected from Israeli Annexation in case of the Palestinian Authority collapse

Expenditure Type	Economic Cost
Allowances	29.1 billion NIS
Education expenditure	14.6 billion NIS
National Health Services	16.1 billion NIS
Other governmental expenditure	5.4 billion NIS
The formation of civil administration in the West Bank	2 billion NIS
Income	-15.3 billion NIS
Total	52 billion NIS

Source: The Macro Center for Political Economics and Commanders for Israel's Security

Other possibilities in which the Palestinian Authority does not collapse has also been presented. One of those scenarios is that Israel will annex area C. According to different estimates, in those area resides up to 300,000 Palestinians. If these 300,000 Palestinians will be annexed to Israel, the economic cost is expected to be 8.5 billion NIS per year. However, if only a partial annexation will take place, and the Palestinian Authority does not collapse, and only 67,000 Palestinians will be annexed, the economic cost is expected to be 4 billion NIS per year.

Taking into account the economic implications of an annexation alone, the heavy direct costs, as well as the indirect economic damage, indicate that the plan should be abandoned. Yet, maintaining the status quo does not allow any promotion of negotiation and re-building trust between the two sides. It seems as if there are many difficulties in bringing the traditional two-state solution back on the table. There is a need to out of the box thinking in order to put the peace process between the sides back on track. A recent study conducted by the Macro Center for Political Economics tried to do just this. In this study, Israeli settlers living in the West Bank have been presented with the following scenario: "Israel and the Palestinian Authority reach a permanent agreement in which Israeli Jews who currently reside within the West Bank would be allowed to remain and would still be citizens of the state of Israel, but they would


live under Palestinian sovereignty alongside security coordination with Israel. Each settler would be given the option to decide to remain in their settlement or to evacuate". Similarly, Palestinians were presented with a similar scenario: There's an agreement for two separate states, and Palestine becomes independent. In this agreement, settlers are allowed to stay in Palestine as permanent residents, if they are law-abiding, and they will be under Palestinian sovereignty although they remain citizens of Israel. Both leaders sign it".

Following a presentation of policy provisions that explain the scenario into more details, both settlers and Palestinians were asked to mention if they support or oppose such an agreement. Among settlers, support was only 16%, However, one of the most interesting findings is that support among Palestinians received a majority of 59%. To conclude, the research produces evidence that there is value to 'out of the box thinking' in trying to promote negotiations and solutions to the Israeli-Palestinian conflict. While the settlers are the hard core of those who refuse to cooperate, the Palestinian population agrees to consider new scenarios to end the conflict with Israel.

The European Perspective

Considering the international economic implications of an annexation some more aspects should be taken into account. First and foremost, is has been mentioned that it is important to note that European aid to the Palestinians has not been exclusively limited to the Palestinian Authority, as an effort to decentralize its support to the Palestinians. Therefore, even in a case in which the Palestinian Authority collapses as a result of an annexation, European projects that are not depended on the Authority could continue and not the entire European investment is on the line. This statement, though, does not diminish the grave consequences of a possible collapse and on the European efforts to promote the peace process between Israelis and Palestinians via its donations to the Authority.

Secondly, it has been noted that over the years, the financial aid originating from the European Union itself has been decreasing, while the donations from



several member state has been increasing, mainly aid originating from Germany. This, as was raised in the discussion, may be a result of the inability of the EU to reach a joint decision with regards to the Israeli-Palestinian conflict. Instead of giving a united approach, the EU avoids action and state members that choose to get into the shoes of the union do so. This is just another example of the challenge for the EU to reach joint decisions, a process not exclusive to the Israeli-Palestinian conflict.

In addition, it has been agreed that further discussion should be given to the indirect economic costs of an annexation both on the domestic and international levels. For example, the possibility of European economic sanctions that will be applied on Israel should be taken into account. Europe is the main trading partner of Israel, and as such could have a big influence on its economy. Currently, the EU leadership separates between the lack of political and strategic dialogue between Europe and Israel and the fruitful and advanced economic cooperation of the two sides. Annexation could lead to the end of this separation. While reaching an unanimous decision about economic sanctions on Israel is unlikely, a decision of annexation could lead to several of economic decisions that would harm Israel and the economic cooperation with Europe – for example, the cancellation of the Freedom of the Air agreement, and the suspension of Israel from the Horizon 2020 research funding program. Meaning, in case of an annexation the EU will be forced to provide at least some kind of an economic reaction, which means breaking the separation between the political and economic dimensions of the cooperation with Israel. This will have indirect economic cost on Israel. EU member states are also expected to reach decisions on the economic implications and the cooperation with Israel. Some of the European countries express a firm line against an annexation and are expected to show a sharper economic response. Other countries show a less firm line and would show a less firm economic reaction.

A further point that has been stressed is that for Europe the scope of the annexation should not make any difference on the response. Whether Israel decides to annex only certain settlement blocks, Area C or the

entire West Bank, Europe is expected to be against it and would use its economic influence and power to respond to this decision. Even if it is expected to be hard to reach a rigid line within Europe, there will be an effort to provide an economic reaction to any annexation decision in Israel.

The Israeli Perspective

Following the successful stop of the first wave of the outbreak of the COVID-19 pandemic, and the succession in forming a government, Prime Minister Benjamin Netanyahu started to reach another achievement and to fulfill his election promise – to annex (some parts of) the West Bank. In the coalition agreement signed with the Blue and White party, headed by Benjamin “Benny” Gantz, he received a green light for annexation starting July 1st. Yet, due to the significant increase in COVID-19 cases, the increasing economic crisis caused due to the social distancing restrictions, the internal coalition disagreements, and lack of attention from the United States, thus far an annexation decision has not been reached. In August 2020, it has been announced the Israel and the United Arab Emirates reached a normalization agreement in return to in Israeli promise to halt its intentions to annex any part of the West Bank. This step has not been known at the time of the event.

On the Israeli perspective, a major reference point is the upcoming US presidential elections in November 2020. As long as President Trump is in office it is considered a window of opportunity to conduct an annexation, and for those that support this move, a unique one, that might not happen again. As many believe that we are likely to witness a victory of former democratic vice president, Joe Biden, who is against annexation, the window of opportunity for an annexation is open until November 2020 or January 2021 the latest. President Trump might promote this decision in the coming months to increase the support in his evangelist base. Of course, if Trump is re-elected, the window of opportunity expands.



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For those in Israel who support the annexation decision, the economic implications are not a significant factor. The economic cost is something that the hard core supporters of a decision to annex some parts of the West Bank are willing to bear, as they are only the means to an end – the greater land of Israel. They consider other implications of the annexation to be more important – fulfilling their vision to the state of Israel, greater security for the settlements and the application of Israeli sovereignty over the West Bank. The economic argument can work in Israel on the more pragmatic audience – those who are less concerned whether Israel annexes the West Bank or not on ideological grounds.

In addition, it should be noted that Israel will try to annex as much as territory as possible with the intention to minimize the number of Palestinians that receive resident status. Meaning, even if 300,000 Palestinians reside in Area C, Israel will try to provide only a small number of them resident status, which could make the economic cost smaller than expected. In addition, part of the economic costs of the decision depends on the steps taken by the Palestinian Authority. While declaratively they announce halting any cooperation with Israel in case of annexation, in reality they are much more dependent on the cooperation with Israel, and it is not unlikely that cooperation will continue and that it will not collapse even if Israel conducts some sort of annexation.

For the full-text article presented at the conference:
<https://bit.ly/3gdfyf1>



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