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



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annexation in the West Bank*

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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 into office. The idea received further support when the president of the United States, Donald Trump, released his Middle East peace plan. The announcement of the plan took place in January 2020 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 can take place prior to any negotiations. Many critic this decision, as a decision that instead of building trust between the sides 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 military chief of staff, 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 a significant outbreak 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 such it will be promoted in the coming months prior to the US presidential elections.

The purpose of this paper is to analyze the economic costs of such a decision both internationally and domestically.

International Economic Consequences of the Annexation

The formation of the Palestinian Authority took place in 1994 following the signing of the Oslo Accords between Israel and the Palestinians in 1993. In order to support

the peace process between Israel and the Palestinians, and as a means to support the existence of the Palestinian Authority, ever since its establishment, it has been provided with intensive funding from different European countries and organizations. In 1993 and 1994, the organizations belonging to the European Union provided 214 million USD for the establishment of the authority. In addition, in the same years, significant donations have been provided by some of the European countries themselves – Norway (26.8 million USD), Switzerland (23.7 million USD), Spain (23.5 million USD), Sweden (21.2 million USD), the UK (17.1 million USD), Italy (17.0 million USD), and Germany (14.5 million USD). All in all European countries and organizations provided 377 million USD for the establishment of the Palestinian Authority, 40% of the entire donations received in those years¹.

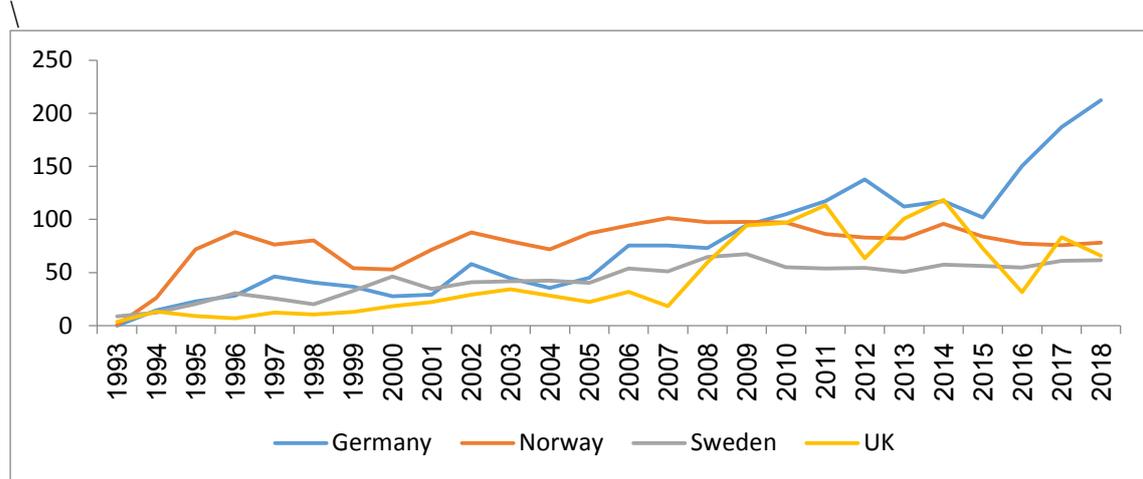
Over the years, institutions of the European Union donated 7.3 billion USD to the Palestinian Authority. In addition, the four main European donating countries to the Palestinian Authority, each donating more than 1 billion USD, are Norway (2 billion USD), Germany (2 billion USD), the UK (1.2 billion USD), and Sweden (1.1 billion USD). Other prominent donors are France and Spain, both donated nearly 1 billion USD. **All in all Europe has provided support of 19 billion USD to the Palestinian Authority.** As can be seen, over the years the amounts contributed by European countries rose significantly. The notion behind those donations is that the existence of the Palestinian Authority is in all sides interests, and that keeping it from collapsing improves the chances of reaching a peace agreement between the sides. Meaning, the European Union as well as member states are deeply invested in the existence of the Authority.

One key scenario that can take place if Israel decides to annex some or the entire West Bank is the collapse of the Palestinian Authority. A blatant violation of the Oslo accords on the Israeli side could lead to the collapse of the authority – either by riots of the Palestinian people or through a decision of the President of the Palestinian Authority, Mahmoud Abbas, to "turn back the keys". This scenario bears severe economic implications on Israel that will be explained in detail in the next chapter. However, such a decision has also implications on the European Union. In this case, all the efforts and investment conducted by European partners to promote any type of normality in the region would go down the drain. For Europe, an investment of 19

¹ Source: OECD stats

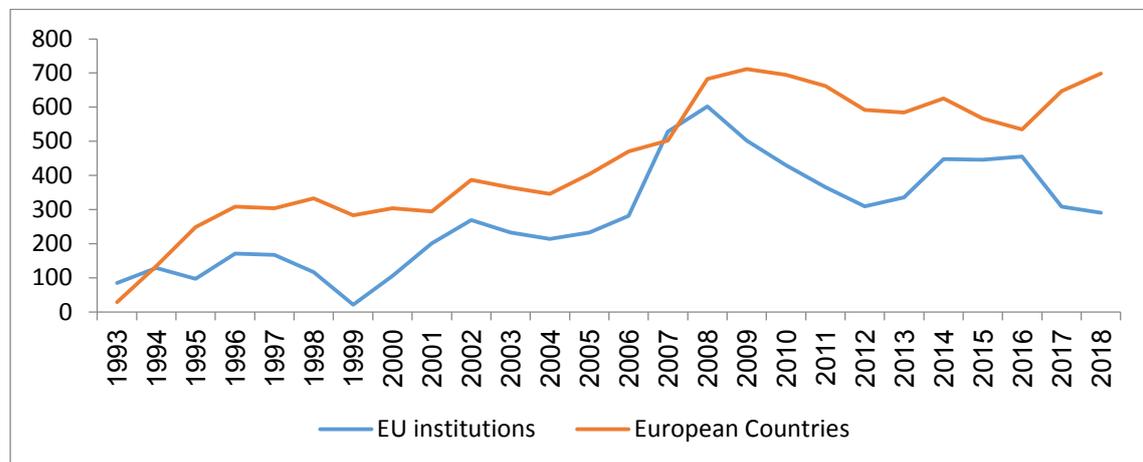
billion USD is at stake. This amount is not marginal for the Palestinian Authority – over the years, on average, 46.3% of the donations received to the authority comes from Europe.

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



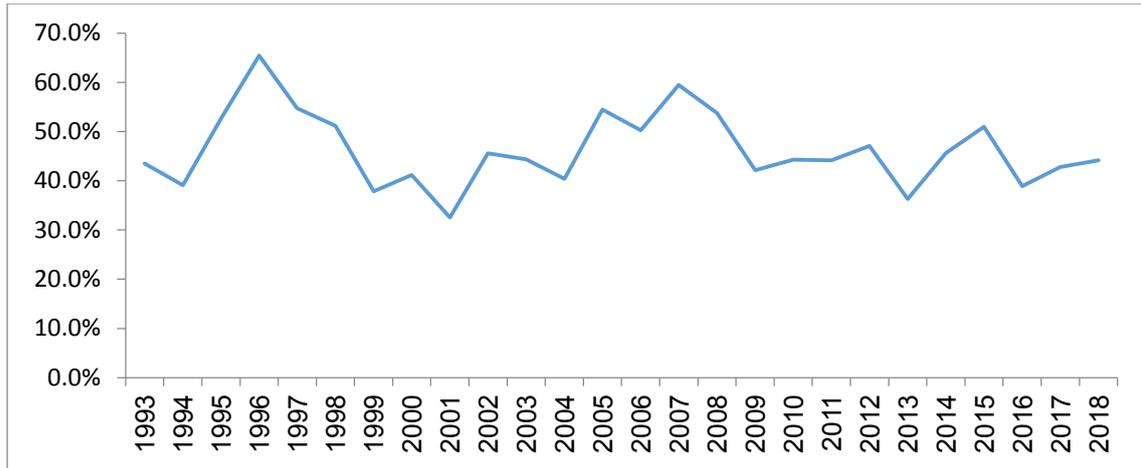
Source: OECD stats

Chart 2: Annual donations to the Palestinian Authority – EU institutions and European Countries, 1993-2018, million USD



Source: OECD stats

Chart 3: Share of European annual donations to the Palestinian Authority from all donations, 1993-2018, %



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%
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Source: OECD stats

The Palestinian Economy and reference scenarios

Perhaps even more dramatic than the international costs of the annexations, are the domestic costs for Israel. In order to understand those costs it is important to understand the difference between the Israeli and Palestinian economies and the possible implications of the annexation on the region. The Palestinian economy significantly differs from the Israeli one. Its formation is based on the Parisian Protocols, the economic annex to the Oslo Accords. It has been agreed that the NIS will be the official coin in the Palestinian Authority; all international trade will take place through the Israeli border checkpoints; Israel would collect that taxes for the authority and provide it once a month back to the authority.

Currently 2.6 million Palestinian resides within the West Bank. In 2018, GDP per capita in the West Bank was 5,044 USD per year², only 12.1% from the Israeli GDP per capita in the same year – 41,735 USD³. The same year Unemployment in the West Bank stood at 17.6%, and labor force participation stood at only 46.1%. In Israel on the other hand, unemployment was 4.0% and labor force participation 63.6%. Latest indications about wages are from 2016. Average daily income stood at 94.1 NIS⁴ at the Palestinian Authority and 322 NIS in Israel. Meaning, the Palestinian economy on the one hand, with accordance to the Parisian Protocols completely depends on the Israeli one, and on the other hand completely differs from the advanced Israeli economy.

All indicators mentioned above, do not take into account the influence of the COVID-19 pandemic on the two economies. While both suffered significant damage to their economies – sharp increase in unemployment rate, direct hit in GDP growth, etc., the Israeli economy has the means to overcome the crisis, while the Palestinians are completely depended on the Israeli economy. The entry of more than 150,000 Palestinian workers to Israel has been halted to different period of times due to the outbreak. Furthermore, Palestinians do not enjoy social safety net as Israelis do.

² Source: Palestinian Central Bureau of Statistics

³ Source: OECD Stats

⁴ Source: Palestinian Central Bureau of Statistics

Therefore, it should be taken into account, that conducting an annexation of some parts of the West Bank during a severe economic and health crisis on both sides could have actual implications on the reaction to the decision. It has been shown before, that in periods of economic despair; Palestinians tend to increase the security challenges for Israel.

With regards to the territory being discussed, if actually occurs, annexation is to take place in Area C, 61% of the West Bank, being controlled militarily and civically by Israel. All Israeli settlements are located on this area. According to different estimations in the area also reside 300,000 Palestinians – some of them in villages entirely located in Area C, and other reside in cities and villages that were originally located in Area B or A, and over the years expanded to area C. Therefore, an annexation of Area C means providing residency rights to between 67,000 and 300,000 Palestinians⁵.

Table 2: The Israeli vs. the Palestinian Economy, 2018⁶

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)

⁵ Ramifications of the West Bank Annexation: Security and Beyond (2018). Commanders for Israel's Security

⁶ Unless mentioned otherwise. In some cases the last comparable data is prior to 2018.

Domestic Economic Cost of the Annexation

As Palestinians with average income, are considered to be below poverty line in Israel, providing those rights to the Palestinians means that vast majority of them will be eligible to welfare benefits provided by the Israeli Institute for National Insurance, and other budgetary expenses. Therefore, the following expense is estimated:

- **Income support** – the gap in income between Israelis and Palestinians and the completely two different economies, creates a situation in which income support would be one of the main benefits annexed Palestinians will receive. If 67,000 Palestinians will receive Israeli residency rights the total sum is estimated at 390 million NIS per year and if 300,000 Palestinians will receive those rights the total sum is estimated at 1,774 million NIS.
- **Child allowances** – According to the Israeli law parents receive child allowances on each child under the age of 18. The sum received varies based on the number of children and additional payments are being received if child attends different education programs. In addition, every child under the age of 18 is eligible to a deposit of 50 NIS to a saving fund. If 67,000 Palestinians will receive Israeli residency rights the total sum is estimated at 98 million NIS per year and if 300,000 Palestinians will receive those rights the total sum is estimated at 444 million NIS.
- **Disability allowances** – disability allowances (including work accidents allowances) are estimated at a sum that varies from 100 million USD to 455 million USD based on the number of Palestinians that will reside in the areas annexed.
- **Unemployment benefits** – As mentioned above, unemployment is high in the West Bank and therefore the payment are expected to be high. While there is no data on how the COVID-19 pandemic influenced unemployment in the West Bank, it is estimated that it rose dramatically in the past couple of months. Most noticeably, many Palestinian workers that are being employed in Israel could not cross the border on a daily basis and lost their places of work. The expected cost is therefore to be between 41 million USD to 186 million USD.

- **Maternity grant** – every woman who gives birth is entitled to a maternity grant. In addition, if she is employed, she receives maternity leave covered by the Israeli Institute for National Insurance. If 67,000 Palestinians will receive Israeli residency rights the total sum is estimated at 32 million NIS per year and if 300,000 Palestinians will receive those rights the total sum is estimated at 153 million NIS.
- **Old age pension** – every Palestinian, aged 67 or more in the area annexed will be eligible for all different benefits senior Israeli citizens receive. The estimated cost of this move is between 76 million NIS to 345 million NIS, based on the number of Palestinians in this area.

In total, allowances sum to 737 million NIS per year if the number of annexed Palestinians is 67,000 and to 3.36 billion NIS per year if the number of annexed Palestinians is 300,000.

Table 3: The Economic Costs of Allowances paid to Palestinian Annexed

Allowance Type	67,000 Palestinians are annexed	300,000 Palestinians are annexed
Income Support	390 million NIS	1,774 million NIS
Child Allowances	98 million NIS	444 million NIS
Disability Allowances	100 million NIS	455 million NIS
Unemployment Benefits	41 million NIS	186 million NIS
Maternity Grant	32 million NIS	153 million NIS
Old Age Pension	76 million NIS	345 million NIS
Total	737 million NIS	3.36 billion NIS

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

In addition to the cost of different allowances and benefits, there are expenditures related to other government activities. From example the education expenditure per student in Israel is around 7,710 NIS per year. Even if assuming that the expenditure on Palestinian students will be as nearly as half of that the total cost varies between 371 million NIS to 1,687 million NIS, based on the number of Palestinians resides in those areas. National health services that every Israeli resident is entitled to will cost as well between 409 million NIS to 1,860 million NIS. Other government expenditure includes those of ministry of interior (for municipalities and villages), ministries of welfare, transportation, agriculture, and housing. In total those expenditure varies

between 137 million NIS and 623 million NIS. In addition, it is expected that a declaration on annexation could lead to unrest among the Palestinian public, which would be similar to the unrest seen during the second Intifada, during the years 2000 and 2003. That would force Israel to initiate a military operation in the West Bank. Based on past estimations about the economic costs of military actions in the west bank, it is estimated that the cost of such an operation would be 4.5 billion NIS. In addition, Israel will have to re-establish civil administration headquarters that would cost 2.7 billion NIS per year.

As the Palestinian people are considered poor in an Israeli perspective, revenue from tax collection are expected to be very modest – only 387 million NIS in the case that 67,000 Palestinians are being annexed and 1,760 million NIS in case 300,000 are being annexed.

Table 4: Total Expenditure and Income expected from Israeli Annexation

Allowance Type	67,000 Palestinians are annexed	300,000 Palestinians are annexed
Allowances	737 million NIS	3,360 million NIS
Education expenditure	371 million NIS	1,687 million NIS
National Health Services	490 million NIS	1,860 million NIS
Other governmental expenditure	137 million NIS	623 million NIS
The formation of civil administration in the West Bank	2,700 million USD	
Income	-387 million NIS	-1,760 million NIS
Total	4 billion NIS	8.5 billion NIS

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

Therefore the total expenditure based on allowances, budgetary expenditures, and the formation of a civil administration in the West Bank, cleaning income, will be 4 billion NIS per year if 67,000 Palestinian will be annexed and 8.5 billion NIS per year if 300,000 will be annexed. In addition, a 4.5 billion NIS expenditure will take place in case Israel will be forced to conduct a military operation in the West Bank. The cost of a full annexation will be 1.9% of the annual Israeli budget, and a partial annexation 0.9% from its budget. In addition, the indirect damage to the economy is expected to be significant. Based on estimations on the damage that the second

Intifada caused to the Israeli economy, it is estimated that the GDP will shrink by 2.4% - between 40 to 77 billion NIS. Even in a period of economic growth, those economic implications are severe and cannot be ignored, so more forcefully in a period in which the Israeli economy is suffering from a severe crisis caused by the COVID-19 pandemic.

A scenario that has not been ruled out is a scenario in which as a result of an Israeli decision to conduct an annexation in the West Bank, the Palestinian Authority will collapse. Under such a scenario, the civil responsibility for 2.6 million Palestinians that reside in the area will fall on Israel and they will receive residency status in Israel and will be entitled to all rights previously mentioned. The economic cost of this scenario is 52 billion NIS, 12.8% of the Israeli budget. This amount of money cannot be raised only by increasing the Israeli debt. A budgetary cut in Israeli civil services will take place. It is estimated that Israel will have to decrease its civil expenses by 6,026 NIS per citizen per year. For a household this means a cut of 25,700 NIS per year. Government expenditure will decrease from 39.5% of the GDP (the OECD average is 43.0%) to 34.9%. Only in Ireland, South Korea and Switzerland will have lower government expenditure compared to Israel.

Table 5: Total Expenditure and Income expected from Israeli Annexation in case of the Palestinian Authority collapse

Allowance 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

Conclusions and Alternative Courses of Action

This paper focused on the economic costs of an annexation conducted by Israel in the West Bank. The main findings are that on an international aspect, in case the Palestinian Authority collapses following this decision, a 19 billion USD investment

by the European Union Institutions and member countries would go down the drain. Domestically, the cost of an annexation to Israel will be 4 billion NIS if the number of annexed Palestinians is 67,000 and 8.5 billion NIS in case 300,000 will be annexed.

In addition, the cost of a military operation, if needed, will be 4.3 billion NIS. The Israel GDP is expected to shrink by 2.4% – between 40 and 77 billion NIS. If the Palestinian Authority collapses and Israel takes responsibility over 2.6 million Palestinians, the economic cost is expected to reach 52 billion NIS. The impact is expected to be 25,700 NIS per family. This is a large sum for the Israeli economy, when it flourishes, and especially during an economic crisis, such as the one taking place following the COVID-19 pandemic.

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 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.*

At first, such a scenario received very low support among the settlers. Only 11% said they would support the agreement, while 85% said they oppose to such an agreement. Among Palestinians 39% said they would somewhat or strongly support such an agreement, while a majority of 58% would somewhat or strongly oppose it. The negative reaction is understandable, as the scenario presented to the respondents

significantly differs from scenarios they encountered in the past. Therefore, in order to better explain the scenario, following its presentation, both settlers and Palestinians were asked to state their opinion on a series of policy provisions regarding specific situations that might occur if settlers stay under Palestinian sovereignty in a future Palestinian state.

Among settlers, statements about security cooperation with Palestine and the ability to hire private security forces were received with mixed feelings. While 27% of settlers and 24% of Palestinians mentioned that it would increase their support in the agreement, 32% and 30% respectively said it would decrease their support. It is possible that some felt that coordination with Palestine and the ability to hire private security forces would improve their sense of personal security; however, others felt it would decrease their sense of security since the IDF will no longer be protecting them became clearer.

Nearly half of the settlers (48%) mentioned that if a rabbi that they respect would support the agreement and encourage settlers to stay in the WB, it would increase their support in the agreement. Comparatively, only 12% mentioned it would decrease their support, meaning rabbinical influence was the most powerful influence in shifting support towards the agreement. Support of generals, military, and political figures also leads more people to support the agreement but less dramatically compared to the support of a respectable rabbi. In addition, 40% said that if a significant number of settlers would choose to remain in the small settlements, then it would increase their support in the agreement compared to 27% who said it would decrease their support.

Table 6: Influence in support of policy provisions about the agreement among settlers

Policy provision	Increases	Doesn't effect	Decreases
Tight security coordination between Israel, the IDF, and the Palestinians security forces including a joint force to prevent terror.	27%	35%	32%
The ability to hire private security force to settlers who chose to remain	24%	41%	30%
The fact that a significant number of settlers would choose to remain in the small settlements	40%	25%	27%
The agreement will include open borders between the two states, and coordination would exist between Israel and the Palestine on issues such as security, economy, water, and infrastructure.	28%	34%	31%

A rabbi that you respect would encourage Jewish settlers to stay in the WB	48%	35%	12%
Generals and military commanders in the IDF encourage Jewish settlers to stay in the WB	30%	47%	19%
Politicians from the national camp encourage Jewish settlers to stay in the WB	25%	54%	17%

Among Palestinians, two policy provisions seemed to be widely accepted – both generally and among those who opposed the agreement: (1) Adding a section to the agreement mentioning that settlements such as caravan outposts, those on private lands, those with recent history of violence against Palestinians, and those that disrupt travel routes, will be evacuated in any agreement. (2) There has been a wide support to open borders and coordination between Palestine and Israel on issues such as security, economy, water, and infrastructure.

Two more policy provisions received a majority of support among Palestinians⁷. (1) Settlers who chose to remain can be transferred to Israel if they break the law or conduct any violent act. (2) The continuation of the security cooperation under the condition that the Israeli military will not be allowed to enter Palestine unless by agreement.

Table 7: level of acceptance of policy provisions about the agreement among Palestinians and among Palestinians who originally opposed the agreement

Statement	Total	Opponents to the agreement
In the agreement, settlements such as caravan outposts, those on private lands, those with a recent history of violence against Palestinians, and those that disrupt travel routes, will be evacuated in any agreement	78%	73%
The agreement will include open borders between the two states and coordination would exist between Palestine and Israel on issues such as security, economy, water and infrastructure	69%	57%
In the agreement, security cooperation continues but Palestine is completely independent, and the Israeli army does not have a right to enter Palestine unless by agreement	63%	51%
Settlers who choose to remain will live under Palestinian law and they can be transferred to Israel if they break the law, including committing any violent act	58%	43%
Settlers who choose to remain will live under Palestinian sovereignty, but they will remain Israeli citizens and will vote only in Israeli national elections – they are not allowed to vote in Palestine and cannot elect people to the Palestinian government.	50%	38%
In the agreement, Palestine commits to protecting Jews living in	48%	34%

⁷ However, did not receive a majority of support among those who originally opposed the agreement.

Palestine just like any other resident		
In the agreement, settlers who choose to remain can hire private security guards for their settlements, but all private guards are subject to Palestinian sovereign law	48%	38%
Settlers are given a choice to remain as residents under Palestinian sovereignty, while remaining citizen of Israel, or they can go to Israeli sovereign areas – they are not required to remain	40%	23%

Following the presentation of the policy provisions, both settlers and Palestinians were asked once again to mention if they support or oppose such an agreement. Among settlers, support increased only slightly from 11% to 16%, However, one of the most interesting findings is that support among Palestinians increases from 39% to 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.

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