OFFICE OF THE QUARTET

(OQ)

Report for the Meeting of the Ad-Hoc Liaison Committee

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Executive Summary

With no political settlement in sight, stagnant growth, declining GDP per capita for the past three years, and an unsustainable fiscal deficit, there is an urgent need to create new economic opportunities in the Palestinian Territory. Of the four main growth engines of the Palestinian economy – the Palestinian Authority (PA), development assistance, the Israeli economy, and the private sector – only the private sector can be relied on to drive future job creation and investment. The PA is struggling to manage a sizable recurring deficit and budgetary gap of more than $550 million. Foreign aid has dropped sharply and is on a longer-term downward path. While Palestinian low-wage labor jobs in Israel have increased in recent years, they are not a substitute for a viable long term solution and do not generate productive growth in the Palestinian Territory.

The private sector, on the other hand, does have the financial resources and technical expertise to become a major transformational force for economic growth in the Palestinian Territory. There is significant growth potential in sectors such as agriculture, manufacturing, tourism, ICT, and infrastructure. The Palestinian private sector, though small, has performed well under incredibly challenging circumstances, including conflict, occupation, disrupted supply chains, and limited access to outside markets. Profit levels of listed companies are strong. Business owners are resilient and resourceful. The banking sector is well-capitalized.

Beginning with a combined strategy of more effectively capturing existing markets and export driven growth, supported through public-private partnerships, the private sector can help reduce the growing trade deficit, while becoming the driver of investment growth, job creation, and associated tax revenue to put the Palestinian economy on the path to independence.

To reduce the unemployment rate from 26% today to 10%, more than 740,000 new jobs will be needed over the next 10 years. The public sector and employment in Israel and the settlements provide 22% and 12% of employment respectively; however, there is little room for either to absorb the growing labor force, and the vast majority of the additional 740,000 new jobs required will have to come from the private sector.

Investment is the fuel needed to power the Palestinian Territory’s growth engines. Investment in the economy increases production capacity and productivity, modernizes production processes and allows for new and improved products. However, current Palestinian levels of investment are insufficient to keep pace with depreciation. Investment in plant and machinery in the West Bank and Gaza as a proportion of GDP has fallen from 12.9% in 2000, to 4.8% in 2014. The current annual level of under-investment in plant and machinery amounts to about $1.4 billion.

For investment to increase, the Palestinian private sector needs the investment climate to be improved through public-private partnerships and the combined efforts of the Government of Israel (GoI), the PA, and the international community. While each has taken constructive steps, each should do more to unlock the investment potential of the Palestinian private sector and help drive job creation. Israel should relax the constraints it places on the Palestinian economy, by improving access to land (Area C), access to movement and trade (internally and externally, including investor visas) and access to spectrum (3G in the West Bank, 2G in Gaza), and by facilitating investment in infrastructure projects.
The PA should continue improving the ease of doing business and accelerating land registration. The international community should pursue further risk-mitigating measures, including political risk insurance and loan guarantees, and seek to improve donor coordination.

The situation in Gaza is particularly acute. Poverty levels exceed 60% and the average income has declined by 31% over the past 20 years. While there has been substantial progress in reconstruction following the 2014 conflict, much more is needed. To help support private sector growth in Gaza, ways to limit the restrictions imposed by the dual-use list should be explored. OQ acknowledges Israel’s legitimate security concerns and would like to improve the specificity, transparency and predictability of the system for all actors.

This report also provides an update on nine key transformative projects and policy issues that are essential to realize economic growth, and which the OQ is involved in promoting. These activities are organized into three pillars: building infrastructure (Gas for Gaza, Renewable Energy, Gaza Desalination, 2G/3G, E-government and GIS Mapping); facilitating movement and trade (Jordan Valley Trade and Gaza Trade); and promoting the rule of law.

OQ has chosen to support these projects based on an assessment of their feasibility and economic impact, GoI and PA support, and in many cases, a role for OQ technical expertise. To be clear, they are not simply OQ priorities, but the development priorities of the PA. To help drive implementation, milestones have been categorized as immediate (referring to those milestones that can be achieved by the September AHLC meeting) and longer-term (referring to those milestones that should be achieved by the spring 2017 AHLC meeting). OQ will work with the PA, GoI, private sector and international community to help deliver on these milestones.
Building Private Sector-Led Growth to Create Economic Independence

Palestinian entrepreneurs have exported their capital and investments to more profitable and stable locations abroad for more than ten years since the Oslo Peace Accords. The Palestinian economy of 2016 is financed in significant part by donor assistance and remittances from Palestinians working in Israel, rather than by private enterprise growth. With donor assistance declining dramatically and the public sector unable to finance further job growth, the Palestinian private sector must take the lead to change this trajectory, using its financial and human capital, working effectively with the PA, GoI, and international partners, and focusing on the priority investments necessary for transformational economic change.

With no political settlement in sight, stagnant growth, declining GDP per capita for the past three years, and an unsustainable fiscal deficit, there is an urgent need to create economic opportunities in the Palestinian Territory. Since the signing of the Oslo Accords twenty-three years ago, real GDP per capita has increased by $2,200 in the West Bank and Gaza, compared to over $4,400 in Jordan and to more than $28,700 in Israel.

Figure 1: Growth in Real GDP per Capita between 1994 and 2014 (constant, 2014)

Source: World Bank, OQ calculations

Unemployment levels have remained structurally high (over 20%) since 2001 and the latest labor market survey for 2015 estimates this figure at 25.9%, with 17.3% unemployment in the West Bank and 41.0% in Gaza. Youth unemployment (ages 20-24) is at 36.5%.

Population growth and the increased participation of women in the labor force is only expected to intensify this employment challenge. To absorb the growing labor force and simply maintain the unemployment rate of 26%, 45,000 new jobs must be created in 2016, with yearly increases reaching
60,000 new jobs by 2026. To reduce the unemployment rate to 10%, more than 740,000\(^1\) new jobs will be needed over the next 10 years. The public sector and employment in Israel and the settlements provide 22% and 12% of employment respectively; however, there is little room for either to absorb the growing labor force, and the vast majority of the additional 740,000 new jobs required will have to come from the private sector.

**Figure 2: Labor Force Growth and Unemployment Rate (2000-2014)**

![Graph showing labor force growth and unemployment rate](image)

*Source: PCBS*

The Palestinian economy is dependent on the government, the private sector, donor assistance and the Israeli economy to drive job creation. The health of the Palestinian economy requires significant and sustained coordination between the PA, the GoI, the donors, and the private sector. This is not the situation today. The Ministry of Finance is struggling to manage a sizable recurring deficit and budgetary gap of more than $550 million\(^2\); foreign aid has dropped sharply and is on a longer-term downward path; while Palestinian low-wage labor jobs in Israel have increased in recent years, they are not a substitute for a viable long-term solution and do not generate productive growth in the Palestinian Territory. Consequently, only the private sector has the capital and technical expertise to deliver additional investment and employment growth.

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\(^1\) 210,000 new jobs to reduce unemployment from 26.5% to 10% and 531,400 new jobs to absorb yearly entrants to the labor force (growing at 3% per year) during 2016-26.

\(^2\) Report by the IMF to the AHLC on April 5, 2016.
The PA - Overcoming Fiscal Challenges, Budget Gap and Arrears

Despite commendable reforms by the PA Ministry of Finance, including improved tax collection and a zero net hiring policy, significant donor contributions are still required to achieve a balanced budget. In addition, the government invested only 5% of its 2015 budget in development (1.5% of GDP)\(^3\). The largest investments were on security ($32 million), Gaza reconstruction ($13 million) and public buildings ($11 million). While some resources were allocated for maintenance of roads and public schools, there was virtually no public infrastructure development in 2015. The vast majority of budgetary allocations were for wages and services. Structural economic challenges and low growth have contributed to a fiscal crisis and a cycle of arrears accumulation to both the private sector and the PA pension fund.

In the 1995-1999 period, PA employment averaged 16% of total employment. With the onset of the Second Intifada in the fall of 2000 and the imposition of stringent restrictions on Palestinian economic activities, private sector investment fell by half (16% of GDP in 2002) and PA employment rose to 26% of total employment in 2003\(^4\).

Although the public sector has become the ‘employer of last resort’ under the economic underperformance, stemming from the restrictions, the PA is no longer able to absorb new market entrants due to budgetary shortfalls. By 2015, the public sector accounted for 23% of total employment with low levels of productivity and a top-heavy labor structure, especially in the security sector, which currently employs 30% of public sector employees.

Declining Development Assistance

External aid has fueled public consumption, particularly in the second half of the 2000s. It was also the most significant contributor to the fast growth of investment in residential construction. Most importantly, it financed the fiscal deficit which reached 22% of GDP in 2009.

Between 2013 and 2015, financial support to the PA declined from $1.3 billion to $709 million, a reflection of competing international priorities, such as the Syrian refugee crisis, and growing donor fatigue in the face of limited political and economic progress. As aid flows diminish, it will be increasingly difficult to prop up the economy, whether through budget support or development projects.

Israel Provides Jobs but not Investment

More than 112,300\(^5\) Palestinians currently work in Israel. The number of Palestinian workers from the West Bank in Israel almost doubled between 2007 and 2015.

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\(^3\) Actual spending on development in 2015: $200 million, of which $88 million were funded by the PA.
\(^5\) Of these, 63,000 had a permit, 36,400 worked without any permit, 12,900 had an Israeli identity card or foreign passport. Moreover, 22,400 worked in Israeli settlements; PCBS Labor Force Survey, 2015. According to Israeli sources 136,500 Palestinians currently work in Israel and West Bank settlements (61,500 Palestinian workers with permit; 1,000 approved for Atarot; 7,000 approved recently; 40,000 working without a permit; 27,000 in the settlements).
This important source of employment cannot be taken for granted, and it does not provide a long term source of sustainable employment or investment. Palestinian participation in the Israeli economy is a double-edged sword. While it does provide welcome employment opportunities in the short term, it downgrades Palestinian human capital towards lower skills jobs and does not advance the longer-term creation of an autonomous and robust Palestinian economy.

If not for jobs in Israel and Israeli settlements, formal unemployment in the West Bank would be around 35%, comparable to the unemployment rate of Gaza 6.

**Palestinian Private Sector has Capital and Expertise to Build Growth**

The private sector has the financial resources and technical expertise to become a significant transformational force for economic growth in the Palestinian Territory. There is significant growth potential in sectors such as agriculture, manufacturing, tourism, ICT, and infrastructure. The Palestinian private sector, though small, has performed well under incredibly challenging circumstances, including conflict, occupation, disrupted supply chains and limited access to outside markets. Profit levels of listed companies are strong. Business owners are resilient and resourceful. *Beginning with a combined strategy of more effectively capturing existing markets and export driven growth supported through public-private partnerships, the private sector can help reduce the growing trade deficit, while becoming the driver of investment growth, job creation, and associated tax revenue to put the Palestinian economy on the path to independence.*

Since 2006, private companies and entrepreneurs have been responsible for more than 65% of net jobs created in the Palestinian Territory. However, given the inability of either the private or public sectors to invest in infrastructure due to the Israeli restrictions, and the high-risk political environment, the private sector has focused on lower-risk projects, such as retail and trade where returns are more lucrative. Over 80% of fixed investment in the Palestinian Territory is in housing construction, while productive sectors that would create significant employment, like agriculture and manufacturing, are suffering from extremely low levels of investment. The PA and the international community can help to attract investment to these important productive sectors by addressing investment risks with loan guarantees, investment insurance and other risk mitigating products, provided by partners such as the World Bank and the Overseas Private Investment Corporation.

Preliminary figures for 2015 estimate the trade deficit at $4.84 billion (38% of GDP), with imports of goods amounting to $6.86 billion and exports to $2.02 billion. The distorted trade balance is due in part to high transaction costs for Palestinian exporters and the lengthy processing time at the borders. Also, the dual-use goods list, which is specific to both the West Bank and Gaza, prohibits the import of key capital equipment and inputs, such as fertilizer 7 and other chemicals for agriculture and manufacturing.

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6 Assuming constant wages in the West Bank.
7 Report by Applied Research Institute of Jerusalem on the Economic Cost of the Occupation estimates a 20% efficiency loss and cost of $99 million due to the inability to import the necessary fertilizer.
While transportation costs have significantly dropped around the world over the past several years, costs for Palestinian traders have increased.

These costs have also resulted in an over-reliance on Israeli products, with 70% of total imports from/through Israel and 82% of total exports going to/through Israel. This makes the Palestinian economy highly vulnerable to economic shocks and political changes in Israel. As a result, Palestinians need to diversify trade partnerships and access to markets in Arab countries through the newly renovated Allenby/King Hussein Bridge (A/KHB) crossing, while building stronger market linkages to the Gulf and other regional trade partners.

More than 95% of electricity in the Palestinian Territory is imported from Israel; electricity is the second biggest import. Palestinians purchase electricity at commercial prices that are higher than prices paid by some other government consumers in the region. It is estimated that Palestinians can produce a significant proportion of their electricity needs domestically with solar power and other renewable sources of power generation. This is a critical opportunity to reduce the Palestinian Territory’s economic dependence by diversifying the sources of power supply and reducing the cost of imports. Solar power has the estimated potential to enable the production of more than 300 MW of electricity in the West Bank by 2025, and save up to 25% of the total cost of electricity imported from Israel.

**Public-Private Partnerships are Key to Enabling Investment**

Investment is the fuel needed to power the Palestinian Territory’s growth engines. Investment in the economy – whether by the government, private sector or foreign entities – increases production capacity and productivity, modernizes production processes, and allows for new and improved products. However, current Palestinian levels of investment are insufficient to keep pace with depreciation. Investment in plant and machinery in the West Bank and Gaza, as a proportion of GDP, has fallen from 12.9% in 2000, to 4.8% in 2014. The current annual level of under-investment in plant and machinery amounts to about $1.4 billion. Over ten years, the average annual under-investment is approximately $1.9 billion. Investment in fixed assets has almost declined by half since 2000 and is well below that of Jordan.

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8 Report by the Peres Center uses a simulation tool to provide recommendations that improve trade efficiency across the value chain. It identifies primary root causes that impede Palestinian trade as: fragmented sovereignty of the PA; security interests of Israel; limited access to information and structural ambiguity; and the deterioration of institutional trust and coordination between the Israelis and Palestinians.

9 Assumes target investment level of 15% of GDP through 2026, with GDP growth rate of 5%.
Figure 3: Gross Investment in Fixed Productive Assets (1994–2014)

Source: PCBS, Jordan DOS

Notes: Fixed productive assets are defined as investment in non-buildings

For investment to increase, the Palestinian private sector needs the investment climate to be improved through public-private partnerships and the combined efforts of the GoI, the PA, and the international community. OQ appreciates the quality and quantity of collaboration it enjoys with all these stakeholders. Each one has a role to play. Each one has done much already but can also do more.

COGAT’s preliminary approval of the Gas for Gaza (G4G) pipeline and the desalination plant in Gaza has set a constructive precedent. COGAT’s active and constructive participation in the gas and desalination Task Forces has been essential. So too has been their role in supporting a number of key infrastructure projects, including facilitating renewable energy in the West Bank, developing the Jordan Valley trade route, improving movement of goods into Gaza, as well as supporting the negotiations and enabling implementation of the 3G/2G telecommunications agreement.

The GoI can do more to unlock the investment potential of the Palestinian private sector and help drive job creation. Relaxing constraints on the Palestinian economy, such as control over Area C, which encompasses 60% of the West Bank, including much of the land needed for industrial, agricultural, and urban expansion, would have a major impact, as would facilitating investment in infrastructure. Greater access to spectrum through the recently signed 3G/2G agreement should help develop the telecommunications industry, including mobile applications if the agreement is implemented according to schedule. The Palestinian economy would be further boosted through the facilitated movement of goods and people both within the West Bank and Gaza and to external destinations to strengthen supply chain management. Facilitating investor visas, especially for Arab investors who are most likely to invest, will increase opportunities for trade and investment. Allowing technicians, workers and management to travel in and out of the Palestinian Territory to receive training would promote transfer of technology
and raise factor productivity. Further unfettered access for Palestinian police to territories throughout the West Bank will also strengthen both security and investment.

OQ equally welcomes the strong and sustained efforts by key institutions in the PA to support private sector development and a positive investment climate. The President’s Office has championed the idea of growing Palestinian economic independence and building the infrastructure needed for a sustainable economy. The Prime Minister’s Office has shown real leadership through its consistent structural reform agenda, highlighted by the development of the National Policy Agenda. This will set national priorities and support land registration efforts through the creation of a dedicated first-time systematic land registration agency. The Ministry of Finance has worked hard to address public financial management challenges by strengthening revenue collection and containing expenditures. The Ministry of National Economy has led on key initiatives to facilitate trade, establish streamlined regulations for business and asset registration, and to promote the development of industrial zones. PENRA has been instrumental in driving progress on a variety of energy-related initiatives in partnership with the private sector, including the G4G pipeline and renewable energy in the West Bank.

More broadly, by recognizing the importance of a strong regulatory environment for investment, the PA has successfully established the institutions necessary for a well-regulated financial sector. Palestinian banks are some of the most liquid in the region, with net assets of $12.4 billion, total deposits of $9.7 billion and gross credit of $5.8 billion. The IMF regularly reports that the Palestinian Monetary Authority (PMA) is effectively and rigorously regulating the banking sector in a manner that is consistent with international practice. A 2010 banking law brought the PMA’s regulatory capabilities in line with the recommendations from the Basel Accords, the international best standard for regulating the banking industry.

The PA should continue to improve the investment climate and ease of doing business. Despite the strong banking and regulatory environment, there is limited availability of credit due to the uncertain political and economic conditions and high collateral requirements. The World Bank’s ‘Doing Business’ report ranked the Palestinian Territory in 129th place in 2016, with particularly low scores for protecting investors, resolving insolvency and obtaining credit. The new Moveable Assets Registry, coupled with the Commercial Leasing Law, is expected to improve the rank by as much as 25 places in 2017. Despite the creation of a new land registration agency, land registration remains another major challenge, with only about 35% of the West Bank registered, including in Areas A and B. Very limited progress has been made on this issue, despite long-standing donor support to increase registration rates. Without secure and clear title deeds, investment becomes very difficult.

The international community can play a key role in strengthening the investment climate. Donor funding contributing to key infrastructure improves the foundations of the economy. Donor support for political risk insurance, cheaper access to credit (through developmental type debt facilities with long tenure, low interest, and soft collateral requirements), loan guarantee facilities and various other credit schemes help investors achieve risk adjusted returns. Donors also support capacity-building both in the private and public sectors, including improved business plan development, marketing and strategic

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10 As of the end of January 2016.
11 Non-registration of land in the West Bank prevents its use as collateral.
planning. However, the international community, including OQ, can deploy scarce resources more effectively in tandem with increased investment. Risk-mitigating measures can be pursued further. Development coordination can be improved, both in the planning and execution phases. Project implementation skills need to be upgraded. Political and economic messaging to both parties need to be more streamlined, including messages from consulates and embassies of the same country to Israel and the PA. All these improvements can be achieved with little or no additional resources.

**Gaza**

The situation in Gaza is particularly acute. Poverty levels exceed 60% and the average income has declined by 31% over the past 20 years. Unemployment in Gaza is among the highest in the world, reaching 41% at the end of 2015, with up to 60% unemployment amongst youth and recent graduates. Trade is restricted through one crossing point; in 2014 only 84 truckloads were exported from Gaza, in comparison to more than 13,000 in 1999, a 99% decrease. In order to build the foundations necessary for private-sector led growth, it is critical for the PA, GoI, and international community work together to remove barriers to economic growth.

There has been substantial progress in reconstruction following the 2014 conflict. Nearly all of the two-million tons of rubble have been removed, 90% of damaged schools have been rebuilt and coordination has improved through the establishment of the National Office of Reconstruction and the Gaza Reconstruction Mechanism (GRM). Further progress will depend on three factors: ensuring donors meet their Cairo Conference pledge commitments; securing key policy changes by all parties; and the acceleration of work on infrastructure projects, which are the structural foundation for development in all key sectors.

In addition to the necessary policy reforms and key projects in the field of electricity (gas pipeline, 161kV line), water and sanitation (North Gaza Emergency Sewage Treatment facility (NGEST), desalination plant), which are addressed later in this report, ways to limit the restrictions imposed by the dual-use list should be explored. OQ acknowledges Israel’s legitimate security concerns and would like to improve the specificity, transparency, and predictability of the system for all actors. Assuming Israeli security concerns can be met, OQ would welcome the removal of critical items from the dual-use list. It is important to streamline the processing of dual-use goods approvals and to make all related procedures transparent. The GoI should also establish efficient, transparent working procedures that will allow for expedited completion and operation of large scale infrastructure works (e.g. Gaza’s desalination plant), including regular access for technical experts to dual-use materials required to construct and operate the infrastructure.

**OQ Priority Projects**

To advance the range of issues identified above, the international community and the OQ are focused on key transformative projects and policy issues that are essential to realize economic growth. These activities are organized into three pillars: building infrastructure, facilitating movement and trade and promoting the rule of law. OQ has chosen to support these projects based on an assessment of their feasibility and economic impact, GoI and PA support, and in many cases, a role for OQ technical
expertise. To be clear, they are not simply OQ priorities, but the development priorities of the PA. To help drive implementation, milestones have been categorized as immediate (referring to those milestones that can be achieved by the September AHLC meeting) and longer-term (referring to those milestones that should be achieved by the spring 2017 AHLC meeting).

1. Gas for Gaza

Gaza is suffering from an acute energy crisis. At peak supply, Gaza has around 200 MW of capacity available, versus a current demand of around 450 MW and expected demand of over 850 MW by 2020. Linking Gaza to a reliable and cost-efficient natural gas supply has been identified as the only viable long-term solution to its energy crisis. A cost-efficient energy supply will facilitate electricity generation on a significantly enhanced based in Gaza, and can also be used directly for essential water infrastructure projects, such as the proposed large-scale desalination plant. Increasing access to electricity in Gaza will build stability and reduce poverty on a massive scale.

In the shorter-term, constructing a 161kV line is essential to increase the electricity supply and improve the reliability of electricity, thereby helping to reduce the electricity deficit and increase collections. In addition, solving the electricity requirements for the North Gaza Emergency Sewage Treatment Plant (NGEST) is an additional electricity requirement that must be met pending the increased supply of natural gas. Resolving the outstanding Palestinian debt owed to the Israeli Electricity Corporation will not only settle a long standing fiscal dispute between the parties, but will also lead to more productive discussions to create a sustainable and constructive energy purchasing arrangement.

In August 2015, OQ launched the G4G Task Force, working closely in coordination with the Palestinian Energy and Natural Resources Association (PENRA), to facilitate the agreement and construction of a natural gas pipeline connecting Gaza to the Israeli natural gas network. Shortly after in September 2015, at the AHLC, the Israeli Government announced its approval in principal for the G4G project.

The Task Force is chaired by OQ (working closely with the Governments of Netherlands and Qatar, respectively) and brings together a wide array of stakeholders. It meets regularly on a technical level to advance project implementation. To date, there have been five Task Force meetings, roughly one every two months. The Task Force mechanism has worked well because it is focused on project delivery; it has a clear purpose and the stakeholders involved have been active and constructive. The G4G Task Force maintains strict standards of confidentiality and participation. This strategy has proven to be the most efficient way to achieve project milestones. OQ acknowledges that not all projects are similar and that other approaches can be more appropriate for different projects. However, the Task Force mechanism can be a very powerful tool to advance complex and politically sensitive projects as it provides a neutral forum to facilitate project delivery.

In late 2015, the G4G Task Force initiated the first phase of the feasibility study, a technical assessment to determine the route of the gas pipeline, which is now nearing completion. The next phase – a commercial and legal assessment – is also underway. Key deliverables going forward include: commencing the permitting and regulatory processes, securing other regulatory approvals and financing, and finally constructing, the pipeline.
In addition, the Task Force will support the efforts of the Government of the Netherlands to strengthen relevant Palestinian institutions established as part of the current comprehensive hydrocarbons reform law, led by PENRA.

Although the primary focus of the G4G project is to facilitate the agreement and construction of a gas pipeline, OQ also supports additional work-streams which need to be advanced in parallel. These include reconversion of the Gaza Power Plant (GPP) to gas and expansion of the GPP, interconnection and improvements to the grid (including financing) and continued improvements in the collection of electricity fees. In addition, OQ stresses the importance of electricity and gas pipeline connectivity to the West Bank, which should be supported by international stakeholders, and which is crucial to address the increased energy needs in the West Bank.

Immediate milestones:

- **Q2-Q3 2016**: Technical feasibility study is completed.
- **Q2 2016**: Commercial and legal feasibility studies have commenced; new capacity building work to support Dutch efforts on the development of the Palestinian Hydrocarbons Marketing Company (PHYMCO) has begun.
- **Q2 2016**: Regulatory and permitting process is underway in both the Israeli and Palestinian systems.

Longer-term milestones:

- **Q4 2016/Q1 2017**: PHYMCO established.
- **Q4 2016/Q1 2017**: Gas Sales Memorandum of Understanding (MOU) signed.
- **Q2 2017**: Regulatory and permitting processes are completed in Palestinian system and continue to proceed in Israeli system; capacity building work with PHYMCO completed.
- **Q4 2017/Q1 2018**: Engineering, procurement and construction phase expected to start.

2. Renewable Energy: Solar

Electricity demand in the West Bank is approximately 860 MW; this is expected to increase to 1310 MW by 2020. There is currently no utility-scale domestic power generation in the West Bank.

In order to help meet the increased need, PENRA has partnered with OQ to lead the development of a technical and financial feasibility study to explore the development of a utility-scale solar power plant in Area A of the West Bank.

Having established the project’s technical and financial feasibility, initial discussions have taken place with the GoI. A potential major developer and land have now been identified. OQ will continue to work with various Israeli stakeholders to build consensus on the project and to secure their cooperation throughout its implementation. In parallel, OQ is working to identify all local technical and legal requirements to take the project forward. The solar project will decrease Palestinian dependency on Israel for electricity, contribute to employment, and build a new renewable energy capacity in the
Palestinian Territory. In addition the solar project will build a private sector partnership between Palestinian and international investors while decreasing electricity prices and generating increased revenues for the PA.

Over the coming months, a number of important issues will need to be addressed on the technical, legal and financial aspects of the project. This includes further grid and environmental and social impact studies, the finalization of a power purchase agreement (PPA), a PPA guarantee, securing political risk insurance, and the finalization of the necessary structures and consortium of investors.

Immediate milestones:

- **April/May 2016**: Technical design and financial feasibility of project completed and shared with stakeholders; regulatory and permitting process underway in both the Israeli and Palestinian systems.
- **May/June 2016**: International developer is on board.
- **May 2016**: Investor consortium is assembled and project finance fully identified.
- **September 2016**: MOU between key stakeholders signed at UNGA.

Longer-term milestones:

- **April 2017**: Regulatory and permitting processes are completed in Palestinian and Israeli systems; construction phase is either underway or near launch.

3. Gaza Desalination

It is approximately 15 years since USAID funded the Coastal Aquifer Management Program (CAMP), which, among other interventions, recommended the construction of a large desalination plant to provide a sustainable solution to the severe water shortage in Gaza. In parallel, CAMP provided a feasibility study reconfirming the importance of the desalination option. The PA has subsequently sought to secure support for a Gaza desalination project from the international community, in order to avert the collapse of the aquifer by 2020 and to avoid the resulting humanitarian disaster. In 2011, the 43 Member States of the Union for the Mediterranean (UfM) endorsed the desalination project under the leadership of the Palestinian Water Authority, suggesting that the “desalination option represents the main solution to the (water) crisis”. Subsequently the European Investment Bank (EIB) agreed to undertake a technical assessment. This was launched with a Project Information Memorandum created in 2012, which was used to mobilize European Commission (EC) funding to update the earlier feasibility study and to prepare tender documents for the plant’s engineering, procurement and construction. In January 2016, the GoI conveyed its approval, in principle, of a sea water desalination plant to the PA.

Despite early fundraising success with the Arab Gulf States and the Islamic Development Bank (IsDB), which agreed to a 50% commitment of funds for the project – originally estimated to cost $500 million – other donors have expressed reluctance to pledge additional funds. This is due to the cost, complexity and concerns of political risk, impediments to material entry and a lack of reliable energy. In addition, donors have questioned the capacity of the PA to implement such a large project against the backdrop
of a slow-moving water sector reform. The EC and the US have committed funds, and are willing to mobilize additional funds, but the broader international community is cognizant that the PA has not yet established a high-level PA steering committee to govern the project, or outlined the project management structure essential for delivering the plant and associated works within the estimated budget.

In February, in response to a request from the PA, the OQ convened a first meeting of a Gaza Desalination Task Force, including the parties and core members (World Bank, EU Representative Office), and also invited a number of other key stakeholders (i.e. the EIB, USAID, UfM Secretariat, and IsDB), to support the preparation and future implementation of the project. Modelled on the G4G Task Force, the Task Force will work with the parties and the core financial and technical partners in their pursuit of four integrated project components, including the desalination plant, a north-south water carrier, and the non-revenue water improvement comprising the repair of existing pipelines.

**Immediate milestones:**

- **April 2016:** Task Force initiated; tender document for Desalination plant shared with GoI for review of dual-use materials or acceptable alternatives; continued progress in technical work streams to facilitate project implementation, including preparation of procurement documents and expression of interest documents for prequalification; financial support from the EC announced and the EC’s outreach to potential donors intensified; several project Implementation Unit models shared by the EIB with the PWA; and agreement reached, in principle, among the international financial institutions on a financing mechanism.

- **September 2016:** Project funding secured through PA managed donor conference; financial mechanism in place and presented to the donor community; finalized list of dual-use materials for desalination plant agreed with GoI; strategy defined for tailored monitoring system; and completion of the Environmental and Social Impact Assessment for desalination plant completed.

**Longer-term milestones:**

- **April 2017:** Decision reached on monitoring system for entry of material; completion of technical plans for north-south water carrier; and non-revenue water improvement program tender documents.

### 4. Implementation and Delivery of 3G/2G Agreement

The Principles Agreement on the Allocation of Spectrum on the 2100 MHz band was signed by the GoI and the PA in November 2015 after more than eight years of protracted negotiations. The agreement allows Palestinian cell phone providers to provide 3G services and allows Wataniya to provide 2G services in Gaza. The OQ worked in close partnership with the PA Ministry of Telecommunications to facilitate the technical dialogue with the Palestinian mobile phone companies that formed the base of the Joint Technical Committee (JTC) dialogue that led to the signed agreement. In addition, the US
Department of State Economic Bureau, led by Ambassador Daniel Sepulveda, was a critical player in encouraging the GOI to sign this historic and long overdue agreement.

Over the past three years the Palestinian mobile sector lost between $400 million and $1.15 billion due to “years of delay in mobile broadband, the presence of unauthorized Israeli operators in the Palestinian market, restrictions on importing equipment and absence of an independent regulator”\(^\text{12}\). In addition, the PA lost over NIS 184 million in revenues. These issues need to be addressed to put the telecommunication sector on a profitable trajectory and a level playing field with Israeli operators.

3G services are projected to increase the GDP per capita growth rate by 1.5 percentage points,\(^\text{13}\) increase investment by approximately $120 million,\(^\text{14}\) create 10,200 new employment opportunities,\(^\text{15}\) and provide an estimated $54 million in revenue for the PA over the first two years. Furthermore, improved telecom speed and bandwidth will allow for the emergence of an industry for data applications that could develop commercial applications, health, education, and government services. 2G services in Gaza are projected to increase investment by approximately $36 million, beyond the $14 million already invested, and create 150 direct jobs and 450 indirect jobs.

In 2015, OQ provided the PA and GOI with strategic and technical advice during Joint Technical Committee (JTC) meetings. The OQ continues to coordinate with the US Department of State to facilitate implementation discussions between the two parties through the implementation process. Since the agreement was signed, the implementation process has been complicated by a number of factors (see below) that the OQ and the USG continue to monitor in preparation for an upcoming meeting of the International Telecommunication Union’s Council in May, at which a progress report will be required from the implementing partners.

**Immediate milestones (2G for Wataniya in Gaza):**

- **May 2016:** Joint Technical Committee approval for the use of the same portion of frequencies that Wataniya uses in the West Bank to be used in Gaza and entry of remaining equipment to build a comprehensive network in Gaza concluded.
- **September 2016:** Deployment (construction) of 2G network and Wataniya 2G commercial operations launched.

**Immediate milestones (3G):**

- **April 2016:** Frequency Sharing Agreements between Palestinian and the identified Israeli Cellular Communications Operators concluded.


\(^\text{13}\) According to a 2012 GSM Association Report, *What is the impact of mobile telephony on economic growth?*. Assumes 20% penetration of 3G (10 more 3G connections per 100 mobile connections, a 100% increase from the actual 3G penetration level of 10%),\(^\text{13}\).

\(^\text{14}\) Based on estimates by Jawwal and Wataniya

\(^\text{15}\) Based on estimates by telecom companies and international trends; assumes 3 new indirect employees for each direct employee.

\(^\text{16}\) Assumes additional license fee for Jawwal, revenue sharing fee, income tax, and VAT.
• **September 2016:** Israeli Civil Administration (ICA) approval for Palestinian import of 3G equipment; ICA approval for building new mobile communications sites in Area C for the Palestinian Cellular Communications Companies; clearance of 3G equipment for the Palestinian Cellular Communications Operators from Israeli ports; and deployment (construction) of networks in the West Bank.

**Longer-term milestones (3G):**

• **April 2017:** Soft launch of operations followed with a commercial launch in the fourth quarter of 2016; frequency Sharing Agreements between the Palestinian and the Israeli Cellular Operators to the Gaza Strip extended; ICA approval for import of 3G equipment to Gaza; and entry of 3G equipment to Gaza scheduled and started.

**Remaining Challenges to Implementation:**

1. **2G:** Goli informed the PA and OQ that it will be difficult for Israel to allocate 2MHz on the 900MHz band for Wataniya in Gaza. This would mean that Wataniya would need to change the equipment that it has already imported into Gaza to enable a single band network\(^\text{17}\) instead of the dual band network\(^\text{18}\). Such a change in the network would require import of new equipment with a significant additional equipment cost (estimated at more than $6.5 million) and would result in a delay of the deployment of the network and the commercial launch to the end of 2016 at the earliest.

2. **3G:** Limited progress on spectrum sharing discussions between the Palestinian and Israeli cellular communications operators. There has been good exchange of data relevant to the networks of the operators but setting the arrangements for the frequency sharing is still very challenging. The Israeli firms are insisting on continuing the use of the shared spectrum in the West Bank. Such use would significantly limit the Palestinian utilization of the same shared spectrum which could undermine the whole investment.

### 5. E-services: Introduction of Government to Citizen (G2C)

The Palestinian Government, with the support of the international community, has been working for many years to introduce e-government services. These services are considered essential for Palestinian economic development since they are expected to reduce government service delivery time and costs, while providing an effective tool for improving business, and creating significant opportunities in the IT sector for Palestinian firms. In 2014, the PA established a Ministerial Committee chaired by the Prime Minister to manage the development of e-government services in the Palestinian Territory. Progress to date includes the establishment of a platform enabling Government to Government (G2G) services and the successful introduction of thirty-three G2G services, supported by the Estonian Government.

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\(^{17}\) A network that works on the 1800MHz band only  
\(^{18}\) A network that works on the 900MHz band and the 1800MHz band
Building on previous efforts, the OQ, PITA\textsuperscript{19}, USAID\textsuperscript{20} and the Ministry of Telecommunications and Information Technology developed a G2C pilot project in 2015. The pilot assessed the status of E-government in the Palestinian Territory and the Palestinian private sector’s ability to develop and outsource e-solutions for the government to serve its citizens. Ten high-priority G2C e-services that could be implemented by the local IT sector were identified in collaboration with the PA ministries and were approved by the Palestinian cabinet in November 2015. According to the cabinet decision, the project will be implemented in partnership with the private sector.

OQ will continue its work with the relevant stakeholders to solicit Palestinian development of the regulatory framework to enable the deployment of e-services and to mobilize funding for the pilot’s implementation.

Immediate milestones:

- **April 2016**: USAID to recruit an expert or a consultancy to develop a Request for Proposal (RfP) for each of the 10 services in the pilot.
- **September 2016**: RFPs for each of the ten G2C services are developed and tenders issued; private sector application for tenders submitted; funding secured for the implementation of the pilot project.

Longer-term milestones:

- **April 2017**: Implementing Company for each of the services selected; E-solutions under development/implementation commenced.

6. GIS Mapping

Detailed spatial information and analyses in the West Bank and Gaza are extremely important for strategic planning, forecasting, and economic development. Key data is currently dispersed among a number of offices within the PA and other private research organizations. The lack of holistic spatial information inhibits strategic planning for government officials, donors and the private sector.

In 2015, the OQ developed the first stage of a new GIS economic mapping tool, by collecting detailed economic and statistical data, which was plotted on an interactive web-based map of the West Bank and Gaza. OQ will continue the development of this tool, focusing on extending the collection of data and building new layers that can be combined for specific applications such as land development, the expansion of agri-businesses, water and industrial sites and energy/infrastructure development. The tool enables the compilation and layering of multiple factors affecting potential investment and economic development and consolidates land-related data on issues such as demography, access to energy and water, topography, location of natural resources, and housing. In doing so, it allows investors to make informed business and investment decisions, PA institutions and senior

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\textsuperscript{19}Palestine Information Technology Association of Companies

\textsuperscript{20}USAID funded project that focuses on strengthening the competitiveness and export potential for the ICT, Agriculture, Tourism and Stone & Marble sectors in the West Bank and Gaza Strip
representatives to develop strategic plans, and international organizations to make informed and
decisions in partnership with the PA.

Immediate milestones:

- **September 2016**: Tool data and functionalities are evolved to an advanced level and the tool is
  used inform key stakeholders in both the public and private sectors; tool is handed over to and
  institutionally owned by the Office of the Prime Minister to support the PA’s strategic planning
  and economic development. (Note: The technical management and functional development of
  the tool will continue to be managed by the OQ for the remainder of 2016.)

7. **Jordan Valley Trade**

Commercial trade across the Jordan River at A/KHB is constrained by poor infrastructure and limited
capacity. This hinders the ability of Palestinian products to reach Eastern markets and Palestinian
exporters to diversify their trade partners. The lack of scanners for the screening of containers has
traditionally prevented the shipping of containers to/through Jordan.

In partnership with the international community and the GoI, OQ has coordinated the installation of
new infrastructure to enable the expedited export and scanning of containers, including refrigerated
cargo containers for the first time, through A/KHB. The facilities are now in place on the Jordanian side,
including the installation of a U.S.-donated scanner. OQ has conducted workshops with the Palestinian
private sector across the West Bank to raise awareness about this new opportunity and worked directly
with twenty-two Palestinian companies to ensure they are prepared to plan business strategies on the
basis of improved market access.

Additionally, the Government of Japan, working through JICA, is hosting trilateral meetings with the
Israelis and Palestinians to agree on the details of constructing an exclusive road for industrial parks
through A/KHB. So far proposals have been submitted to the Israeli side and they are under discussion.
This effort by the Japanese has the potential to provide many significant enhancements to Jordan Valley
Trade.

Immediate milestones:

- **April 2016**: Export trade in containers at A/KHB operational;
- **September 2016**: Import trade in containers at A/KHB underway and scanner testing completed;
completion of customs interconnectivity and standards alignment between PA and the
Government of Jordan (GoJ); ‘known trader’ program between PA and GoJ agreed upon and
operational at A/KHB; standards alignment underway between PA and GoI; online platform to
provide trade route information for traders is operational.

8. **Gaza Trade**

Gaza trade suffers from enduring restrictions on access to raw materials and technical equipment,
limited access to export markets and the limited ability of business and technical people to move in and
out of Gaza. The burden of cost, unpredictability and inefficiency of the route for goods into and out of Gaza creates major trade barriers.

OQ is working in three main areas: building and reconnecting market linkages of the private sector with the West Bank, Israel, and rest of the world; the development of capacity and logistical improvements at Kerem Shalom (KS); and increasing the transparency of listed dual-use goods for the West Bank and Gaza.

A second Dutch-donated scanner will be installed at KS in April 2016. OQ has surveyed businesses in the two highest potential sectors (garments and furniture) on their readiness to meet demands of the Israeli market and to assess the current quality of their links to former Israeli customers. Trade with Israel was delayed due to issues faced by the PA issuing VAT invoices to Gaza businesses, and OQ worked with the PA and Israeli authorities to resolve this matter to enhance the flow of goods to Israeli markets.

Immediate milestones:

- **April 2016**: PA resolves issue of VAT invoices for Gaza traders; installation and operation of Dutch funded scanner by GoI; GoI allows ‘entry of UN containers’ trial to begin.
- **September 2016**: Infrastructure development of covered area at Kerem Shalom (KS) by GoI; PA designates and commits to building, if necessary, of dedicated export area at KS; all three dual-use lists readily available on an easily accessible website by GoI; GoI allows export of goods from additional sectors (e.g. processed food, handcrafts); online platform to provide trade route information for traders is operational.

Longer-term milestones:

- **April 2017**: GoI manages transparent application process for dual-use items and makes content more focused on items of risk; export and import in containers at KS operational; conveyor for aggregates at KS fully operational.

9. **Rule of Law**

a) **Support for the Justice Sector**

A longstanding challenge for the PA is the resolution of ambiguities in the mandates and responsibilities of the key justice sector institutions. The OQ Rule of Law team, together with EUPOLCOPPs, has worked to provide clarity on the mandates between the justice sector institutions. A proposal was submitted to the heads of the justice sector institutions to reform the system of court administration and clarify the legal identity of the Public Prosecution. To further strengthen the performance of the justice sector, OQ will produce a comprehensive mapping and analysis of courts, caseloads, and locations of litigants in the West Bank to expand court accessibility, including for residents of Areas B and C. OQ will also work with a range of partners and institutions to improve the capacity to investigate and prosecute security-related crimes, and will continue to work with the PA and GoI to re-activate the Palestinian-Israeli Joint Legal Committee and develop day-to-day cooperation between the respective justice systems.
Immediate milestones:

- **September 2016:** Legislation drafted to revise the respective mandates of the judiciary, prosecution and Ministry of Justice and relevant stakeholders, including civil society, participate in review; GIS court mapping completed and put into use by the Higher Judicial Council in strategic planning for the judiciary; analysis and recommendations produced for improved processing of security-related crimes.

Longer-term milestones:

- **April 2017:** Legislation on institutional mandates adopted and implemented.

b) **Support for the Security Sector**

Restrictions on the movement of security forces, uncertainty regarding access rules, and inefficiencies in the communications chain to coordinate such movement have hampered public order, safety, rule of law, and economic development in the Palestinian Territory. Over the past two years, OQ has sought to improve the freedom of movement and access of security forces in the West Bank. In collaboration with USSC and EUPOL COPPS, OQ worked with Palestinian and Israeli security authorities and developed a comprehensive mapping of PA police access in the West Bank. As a result, in April 2015, Israel dramatically eased the coordination rules for the Palestinian security forces (PASF).

OQ is currently working with the PA and the donor community on the establishment of new police stations based on the expanded access. OQ will also support initiatives that will help improve the chain of communication to reduce police response time. A set of draft laws was prepared in 2015 to govern the military justice system, including a draft law on the military courts that would improve their independence and clarify their jurisdiction. The draft law is currently before the Council of Ministers.

Immediate milestones:

- **September 2016:** Analysis completed of the chain of communications pertaining to police movement, and proposals developed for a more efficient process.

c) **Developing the Legal Framework of an Independent Economy**

Palestinian legislation and regulations need to be better tailored to the specific market needs of each of the key Palestinian economic sectors in order to make it easier for Palestinians to start new businesses, compete regionally, and attract new investment. OQ will provide guidance on the key measures needed. In addition, efforts to investigate and prosecute corruption are required for both a healthy economy and confidence in government institutions. To support these efforts, OQ will conduct an analysis of the work of the Anti-Corruption Court and produce recommendations to bolster the effectiveness of the court.

As a first step to reforming Palestinian-Israeli economic relations, with the aim of fostering the growth of the Palestinian economy, OQ has identified a range of specific and feasible measures for creating economic growth in the Palestinian Territory based on Annex V of the Interim Agreement (the Paris
Efforts related to the Paris Protocol aim to deliver an immediate boost to the PA’s economic and trade performance, help maintain the viability of the two-state solution until the right conditions are in place for the resumption of political negotiations, and promote efficiency and stability in PA-GoI day-to-day relations. OQ will continue to work closely with the Palestinian and Israeli Ministries of Finance to advance dialogue on a number of measures, and more broadly with the PA, the GoI and other partners to facilitate more effective implementation and potential updates to existing agreements pertaining to finance and trade. OQ will work with the PA, the GoI and Jordanian and Egyptian authorities to facilitate expansion of the A1 list of goods for import. Twenty years after Oslo, most products on the original A1 list are not in demand; updating the list will reduce costs for Palestinian consumers while also contributing to neighboring economies.

Immediate milestones:

- **September 2016:** Items identified for revision of A1 list; recommendations completed and adopted regarding priority legislation and regulations to advance economic growth; report provided to Palestinian authorities on measures to strengthen the Anti-Corruption Court.
Office of the Quartet: Role and Priorities

OQ’s mission statement is “Building the State, Empowering the Economy”. We work with the PA, the GoI, the international community, and the domestic and international private sector in support of Palestinian institutional and economic growth and empowerment. To develop the foundations for a thriving economy and good governance, we have prioritized five strategic pillars:

- **Effective Government**: To support the building of state institutions through boosting governmental capacity and reforms in the justice and security sectors.
- **Movement and Trade**: To encourage increased trade and access for people and goods through improving border crossings and removing restrictions.
- **Unlocking the Value of Land**: To facilitate Palestinian access to land and leverage untapped economic potential.
- **Reliable Infrastructure**: To support the construction of sustainable, reliable, and cost-effective energy and water infrastructure.
- **Investment Promotion**: To attract major new investment (both domestic and foreign) in Palestinian enterprise to create jobs and GDP growth.

OQ’s role is to help ensure the progress of the various projects and associated policy reforms within the five pillars. We seek to do so in the following ways:

- **Identify solutions** to a cross-section of the top issues impacting Palestinian economic and institutional growth – solutions which are technically, financially and legally feasible.
- **Facilitate meaningful progress** by convening, informing, and mobilizing key stakeholders across the PA, GoI, international community, and domestic and international private sector.
- **Bridge divides** by respecting both Palestinian and Israeli needs and concerns.

To achieve this, OQ makes significant investment in human capital to ensure expertise in all five pillars. OQ’s staff currently includes international, Palestinian, and Israeli experts in the fields of investment, finance, development, engineering, law, politics and governance.

The main donors that currently support the OQ are the United States, Canada, and the Netherlands. Additional financial and staff support is provided by the World Bank, DFID, the United Nations, the Governments of Sweden and New Zealand, and the US Institute of Peace. OQ is grateful for this support.