How Much International Aid to Palestinians Ends Up in the Israeli Economy?

Shir Hever

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1. Introduction

The Israeli occupation of the West Bank and Gaza Strip is a prominent issue within the international community. Heavily reported by the global media, it also features on the agenda of governments around the world who seek a stake in shaping the future of Palestine. International aid to Palestinians is one of the highest per capita aid disbursements in the world. Yet the simple fact remains that despite over two decades of sustained aid, the occupation has not come to an end and Palestinians are not yet sovereign in their own country. The question that arises is not only whether aid is effective, but whether it also causes harm.

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We estimate that at least 72% of international aid ends up in the Israeli economy.

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The main harm discussed here is how international aid efforts ultimately reinforce the Israeli economy and subsidize the Israeli government in financing the occupation. There are several means (described below) by which money intended for aid projects to benefit Palestinians ends up being paid to Israeli companies and to the Israeli government.

¹ The OPT is the world's tenth biggest recipient of per capita aid accumulated over the years 1994-2011. The top nine (starting from the highest) are: Palau, Tuvalu, Marshall Islands, Federal States of Micronesia, New Caledonia, Israel, French Polynesia, Tonga and Cape Verde. It is of special interest that Israel is the sixth biggest recipient of per capita aid, positioned above the OPT. The data are from the World Bank, 2015 and Sharp, 2014.

Although this fact is well known and acknowledged by aid workers themselves (Hoseini, 2006; Karmi, 2005), the challenge remains to quantify the actual sums involved: How much of every dollar or euro spent by donors ends up in the Israeli economy rather than assisting Palestinians?

An article by Nikki Tillekens in 2010 conducted the first estimate of this figure. By tracing the connection between the trade deficit between the OPT and Israel on the one hand, and international aid to the OPT on the other, Tillekens found a 71% correlation between aid to the OPT and the trade imbalance between the OPT and Israel. In other words, aid money is used to purchase goods and services from Israeli companies. The sustained trade surplus Israel enjoys with the OPT, and the fact that the trade surplus is financed with foreign currency, has contributed substantially to Israel's economic stability, and therefore allowed the Israeli government to invest ever-increasing resources in the occupation of the OPT (Swirski, 2008). The aim of this paper is to update and expand the argument of Tillekens, and to assess the proportion of aid to the OPT which ends up in the Israeli economy.

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Aid has not brought the two-state solution closer.

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2. How and Why is Aid Diverted and Subverted?

Although aid is presented as a mechanism to facilitate the two-state solution, 22 years of sustained aid have failed to achieve this goal (Taghdisi-Rad, 2010; Wilderman & Tartir, 2013). Furthermore, many aid workers have confessed in interviews that they feel that their efforts, rather than empowering Palestinians to achieve freedom, help to sustain the occupation by relieving the Israeli government from its responsibilities towards the occupation population under international humanitarian law (IHL) (Hoseini, 2006; Karmi, 2005).

The continued occupation and the subsequent international aid efforts have allowed donors and aid agencies ample time to observe the ways in which Israeli policies divert aid, and to understand that their activities have become a factor that enables the occupation.

Conceptually, a distinction should be made between aid which is "diverted," meaning that the money never reaches the Palestinian population because of Israeli measures such as taxes, port fees, transportation fees, etc., and aid which is "subverted," meaning money received by the Palestinian population, but in a way that supports the Israeli economy and helps to fund the occupation, as in the purchase of Israeli products. Unfortunately, we lack the data to distinguish between the two. The question of whether aid has become a tool in perpetuating the occupation remains relevant even if we cannot distinguish between diverted and subverted aid (Murad, 2014).

The economic agreement between the PLO negotiating team and Israel in April 1994, the "Paris Accords," created conditions conducive to sourcing materials from Israeli companies by aid organizations (UNCTAD, 2014). Restrictions imposed on Palestinian movement by the Israeli authorities further contribute to aid agencies sourcing transportation services from Israeli companies. USAID went so far as to use Palestinian aid money to finance scanners and other equipment for the Israeli military checkpoints through which aid shipments must cross (Taghdisi-Rad, 2010:104). The currency and customs union imposed by Israel forces aid, in money and in kind, to flow in Israeli currency and donors must convert their funds into Israeli currency for the disbursement of aid (UNCTAD, 2014). All these factors contribute to transforming aid and the occupation into an important export sector for the Israeli economy, a source of foreign currency, and a source of income for many Israeli companies (BOI, 2014:54-55). Port and storage fees are paid to Israeli companies or to government institutions. On top of that, the Israeli authorities levy special taxes on aid agencies, termed "security fees," and levied from every truck carrying goods into the OPT. The largest aid distributor, UNRWA, reported that in 2001 it paid US\$2.5 million in taxes to Israel, nearly 1% of its total budget (Deen, 2002).

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Israeli policies cause aid to be diverted and subverted.

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Although the State of Palestine was recognized as a non-member state of the UN in November 2012, the Israeli military occupation persists in both the West Bank and the Gaza Strip. Israel remains the only sovereign government in the area of Israel/Palestine,

and the Israeli authorities wield control over border passes, seaports, airports, customs and currency. This control enables the Israeli authorities to determine the conditions for aid and to divert it to goods and services provided by Israeli companies, while restricting and hindering any kind of aid of which they do not approve (AIDA, 2011). Israeli economists have identified an unwritten, but consistently-applied, Israeli policy that prevents Palestinian economic development in sectors which could compete with the Israeli economy. This policy has kept the Palestinian economy heavily dependent on that of Israel. As a result, many of the goods and services required for aid projects are simply unavailable in the Palestinian market and must be sourced from Israeli companies (Arnon et. al., 1997:5-6). A clear example of this policy can be seen in the pharmaceutical sector, in which Israeli companies enjoy a monopoly of the Palestinian market and Palestinian companies are restricted in their freedom to compete (WhoProfits, 2012).

Palestinian economic dependency on Israel makes it impossible to differentiate between legitimate and non-legitimate purchases of Israeli goods by aid agencies managing projects in the OPT. In ordinary aid scenarios (such as relief following natural disasters), aid agencies spend a portion of their budget to source goods and services from neighboring countries. In the case of Israel/Palestine, Israel is not merely a "neighboring country" but is the occupying power with the ultimate responsibility under international humanitarian law to meet the needs of the population under its control (Waelbroeck & Aldershoff, 2014). Therefore, any form of aid by third party countries that relieves Israel of its obligations, or even that pays the Israeli government or Israeli companies for goods and services which the Israeli government is obligated to provide, are considered here as a form of aid subversion.

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The trade imbalance between the OPT and Israel indicates deep economic dependency.

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3. Methodology

The main methodological challenge in addressing the subversion of aid lies in how to measure it. The lack of separation in currency and customs between the Israeli and the Palestinian economies means that no statistical data exist to track money from aid projects to its ultimate destination. Money flowing into the Israeli economy from aid agencies contributes to Israel's overall balance of payments because the foreign currency is converted into Israeli currency in the process of conducting transactions. The Israeli authorities have not developed mechanisms to distinguish between exports to private customers and companies, or exports to aid agencies. The Palestinian government does not have the means to create this distinction.

The Israeli Central Bureau of Statistics (ICBS) and the Palestinian Central Bureau of Statistics (PCBS) both measure the trade balance² between Israel and the OPT. The prolonged trade imbalance between Israel and the OPT is a testament to the economic dependency of Palestinians on the Israeli economy, but it also poses an economic puzzle. If Palestinians are able to purchase Israeli goods and services whose monetary value is consistently higher than the value of goods and services provided by Palestinian workers and companies to Israeli customers, how is the trade imbalance funded? A trade imbalance is a common economic phenomenon between countries. In the long run, trade deficits are financed through debt, investments and trade surplus with third-party countries. This is not the case in Israel/Palestine because the Palestinian trade deficit in the years 2000-2014 was consistent at 27%-41% of the Palestinian GDP every year.³ This accumulates to a total of 512% of the Palestinian GDP in this period alone. If the trade deficit was financed by debt and investments, Israelis would privately own nearly everything in the OPT (which is not the case). Since trade with Israel is larger than the OPT's trade with all other countries combined, the deficit can also not be financed by trade. The argument presented here is that international aid can explain the origin of the funding of the trade deficit and of the balance of payments. Aid enables a consistent trade imbalance, which has a substantial impact on both the Palestinian and the Israeli economies.

² The balance of trade is the difference between a country's imports and exports. A trade deficit occurs when imports are higher than exports. A balance of payments is the difference between foreign money entering and leaving the country. It includes the balance of trade, but also includes financial transfers, investments, gifts, loans and repayments, etc. A balance of payments deficit means that the country sends out more money than it receives.

³ Data based on UNCTAD, 2015, http://unctadstat.unctad.org/wds/TableViewer/tableView.aspx, accessed August 2015.

The article by Nikki Tillekens, titled 71% of Aid to the Palestinians Ends Up in the Israeli Economy, was the first attempt to correlate the trade imbalance between the OPT and Israel with the aid figures for the OPT to assess the proportion of aid used to finance the trade deficit, and thereby contributing directly to the Israeli economy. The article surveyed a short period of time: the nine years from 2000 to 2008, and relied on data from the PCBS.

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The OPT trade deficit cannot be explained by debt or investments.

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For this article, we have access to a slightly larger dataset and can cover the 14 years from 2000 to 2013. We also have access to data on the trade deficit from the United Nations Conference on Trade and Development (UNCTAD), which differs from PCBS data. The PCBS collects trade data separately for trade in goods (PCBS, various years) and for trade in services (PCBS, 2014). This is important because the OPT services sector actually has a trade surplus: Palestinians sell more services (usually in the form of labor) to Israeli companies and individuals than vice versa. Together, they comprise the trade balance between Israel and the OPT.

UNCTAD, however, measures the balance of payments between the two economies. The balance of payments is very similar to the trade balance: It measures not only trade in goods and services, but also investments, fees and other money transfers. Restrictions imposed by the Israeli authorities sometimes take the form of fees collected from Palestinian companies and individuals. The balance of payments therefore offers a better and more comprehensive measurement of the relations between the economies. The service trade, in which the Palestinian economy enjoys a surplus, is also included in the balance of payments. The UNCTAD data have already been published for 2013 and will be used here instead of the PCBS data in order to cover a longer period of time (UNCTAD, 2015).

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Palestinians have a deficit in commodity trade, but a surplus in service trade.

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Tillekens applied the Pearson statistical correlation to measure the ratio between the trade deficit and aid. The advantage of the Pearson coefficient is that it can be applied to small samples. Also, it measures whether a correlation exists and gives an estimate of the strength of the correlation. The Pearson coefficient can have values of between -1 and 1. A value of 0 indicates that the two strings of data are completely uncorrelated. A value of 1 or -1 indicates that the two strings of data are perfectly correlated by a linear coefficient. The correlation can be positive or negative. The stronger the correlation (closer to 1 or -1), the more prediction power can be achieved from one string of data over the other and vice versa.

In a linear model it is possible to derive the R-squared of the model by squaring the value of the Pearson coefficient. The R-squared gives an estimate of how well one series of data can explain the other, and how important the unknown elements are to complete the picture. In Tilleken's model, the R-squared is 0.504. This means that the model is only 50.41% complete. Other factors which determine the trade deficit are missing: The missing factors could include Palestinians using their own purchasing power to obtain Israeli goods and services, buying them on credit and Israelis making investments in the OPT.

4. The Data

Israel is the main trading partner of the OPT as a result of Israeli control over all borders by land, air and sea to and from the OPT. Between 2002 and 2007, between 84% and 85.8% of all imports to the OPT came from Israel, and between 77.4% and 91.8% of all OPT exports were directed to Israel (UNCTAD, 2012:14). In 2012, Israeli exports to the OPT generated an added value of NIS 6 billion to 9 billion, which comprise 0.8%-1.2% of the Israeli GDP. These exports accounted for 5% of total Israeli exports, and 8% of total Israeli commodity exports. The US is the only trading partner which is a bigger importer of Israeli goods, indicating that Palestinian imports are of crucial importance to the Israeli economy (BOI, 2014:54-55). As of 2008, annual expenditure on the occupation by the Israeli government was estimated at US\$6.84 billion, or NIS 26 billion (Hever, 2010:70). The trade surplus enjoyed by Israel with the Palestinians has therefore funded approximately 23-34% of the costs of the occupation.

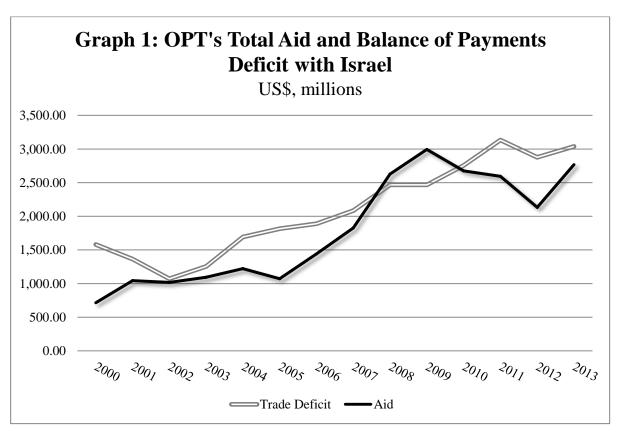
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The trade imbalance funds 23-34% of the costs of the Israeli occupation.

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Tilleken's article concluded that the correlation between the trade deficit and aid disbursement for the years 2000-2008 was 0.71, meaning that fluctuations in aid disbursements explain 50.41% of the fluctuations in the OPT trade deficit with Israel (Tillekens, 2010). To update Tilleken's conclusions, data were collected from UNCTAD (2015) and the World Bank (2015). Although the data are limited, different analyses of the data can offer an insight into the importance of aid in financing the trade imbalance between Israel and the OPT, and in contributing to Israel's ability to finance the occupation.

Graph 1 below presents aid and the balance of payments deficit for the years 2000-2013.



Source: UNCTAD, 2015; World Bank, 2015.

Expanded data and looking at balance of payments: By expanding the scope of the data to 2013 and focusing on the balance of payments as a whole rather than just the trade

deficit, we find that the Pearson correlation between aid and trade is 88.378, a significant increase over Tilleken's findings for 2000 to 2008. This signifies that the close correlation between the two forms of data is even more clearly observable for a larger set of data. If we know only the amount of aid in a given year, we can predict the deficit in the balance of payments with 88.378% accuracy. The R-squared of the model is now 0.781, meaning that the model can explain 78.107% of the balance of payments deficit using aid alone. This result confirms Tilleken's hypothesis that international aid to Palestinians is strongly correlated to the imbalance in trade between Israel and the OPT.

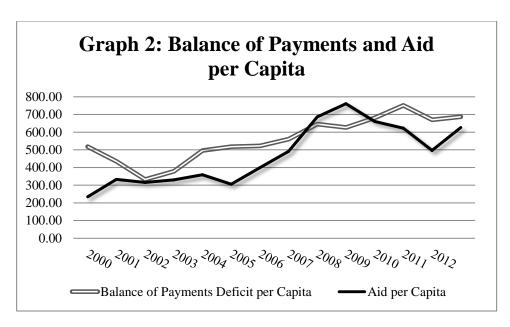
Looking at trade deficit instead: In a special 2014 report, UNCTAD also presented data on the trade deficit (separate from the balance of payments) for the years 1995, 1999, 2002, 2005, and 2009 to 2012. The sample only applies to eight separate years, but covers a time period of 17 years (UNCTAD, 2014), for which we also have data on aid from the World Bank (2015). When compared with aid data for those years, we find a Pearson correlation of 0.799, and an R-squared of 0.638. This strengthens the conclusion of a strong and sustained correlation between aid and the balance of payments deficit, as well as between aid and the trade deficit.

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Last year's aid is the best predictor of the current year's balance of payments deficit.

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Per capita perspective: It could be argued that the two series of data are correlated not simply because of the way aid contributes to purchasing goods and services, and paying fees and taxes to the Israeli economy, but are also correlated to additional indicators which are not part of the model. Specifically, both aid and the balance of payments tend to grow over time as a result of economic and population growth. To partially address this, the calculation can be repeated, but rather than comparing aid with the balance of payment deficit (or the trade deficit), we can calculate the correlation between aid per capita and the balance of payments deficit per capita. The population numbers are taken from the PCBS (2015). In effect, we are neutralizing the population size of the OPT in order to capture the relationship between aid and trade more effectively. The results of this comparison are somewhat weaker than the previous results, as can be seen in Graph 2:



Although the correlation is weaker, it remains at 0.788 and the R-squared is 0.621. Although the sample is smaller and the per-capita adjustment weakens the correlation, the results remain stronger than in the original article by Tillekens. When we use the data from UNCTAD on the trade deficit for eight years between 1995 and 2012, we arrive at a Pearson correlation of 0.653 and an R-squared of 0.426. These results demonstrate a clear positive correlation, although they are not as strong as the results in Tilleken's article.

Time lag: Striking results are achieved when the correlation is calculated not between aid and the balance of payments of the same year, but by using a one year time lag. Thus, the correlation is calculated between aid in a given year and the balance of payments deficit in the following year. Three elements cause a delay between aid and trade. First, aid is disbursed gradually throughout the year rather than delivered at the start of the year. Second, payments by aid agencies are often delayed until the aid is received and their budgets are approved. Third, payments to suppliers for goods and services are often delayed and not paid immediately upon receipt. For these reasons, a delayed effect between aid and the balance of payments may be anticipated. The data accessible to us are annual and permit an attempt to measure the correlation with a lag of one year. Aid is cited for the years 1999 to 2013, and the balance of payments deficit for the years 2000 to 2014 (based on UNCTAD's estimates for 2014 in UNCTAD, 2014). Effectively we can increase the sample to 15 years. The Pearson correlation in this case is 0.899 and the R-square is 0.809, the clearest and most robust results achieved so far.

5. Conclusion

The role of international aid to the OPT in relieving Israel of its responsibilities under IHL is widely acknowledged and referred to frequently in the context of the complicity of aid agencies with the Israeli occupation. However, the issue has both legal and economic implications. International aid disbursements to the OPT serve a crucial purpose of keeping the Palestinian population from plunging into a humanitarian catastrophe that could cost the lives of thousands. The population of the OPT has become heavily dependent on aid to survive. Yet the side effect of this aid is not lost on the Israeli authorities as it turns the occupation of the OPT into an effective export sector for the Israeli economy. Israeli companies offer goods and services to the aid agencies, Israeli employees work for them, and Israeli ministries levy tolls and fees from them. Aid agencies pay these costs in foreign currency, which contributes to Israel's foreign currency reserves and increases the demand for Israeli currency. Indeed, Lieutenant Colonel Sharon Biton wrote in the Israeli military journal *Ma'arakhot* on the invaluable service provided by international aid agencies, which he described as an "asset" to Israeli interests (Biton, 2013).

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Donors bear a responsibility stemming from the consequences of their aid efforts.

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The strong correlation between aid and the balance of payments deficit discussed in this article indicates that, regardless of how one chooses to measure the relationship between aid and the trade deficit, the inescapable conclusion is that the majority of aid money finds its way sooner or later into the Israeli economy. As exports to the OPT account for approximately 5% of total Israeli exports (BOI, 2014:54-55), and the majority of these exports are financed by international aid, one can conclude that international aid to Palestinians contributes billions of dollars to the Israeli GDP and makes it possible for Israel to afford the continued military occupation. The findings here indicate that at least 78% of aid money is used to import from Israel, thereby covering at least 18% of the costs of the occupation for Israel.

The question arises of whether the Israeli government would end the occupation if aid ceased? Would the Israeli authorities rebuild the Civil Administration to assume their responsibilities under IHL in place of international donors? Or would they remain indifferent to a mass humanitarian disaster that could cost the lives of thousands of Palestinians? The tremendous moral implications of these questions indicate that aid is not something to be toyed with when so many lives are at stake. Nevertheless, the dependence of the Israeli authorities on international aid to the Palestinians as a mechanism to finance the ongoing military occupation gives donors important leverage to put pressure on Israel. This leverage carries with it political responsibilities. Donors cannot close their eyes to the fact that their donations are enabling the occupation and have funded grievous violations of international law. They are not themselves the occupiers of the Palestinians in the OPT, but decades of acquiescing to Israeli demands and conditions on the disbursement of aid have turned them into accomplices to Israel's crimes.

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