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## Mapping European and American Economic Initiatives towards Israel and the Palestinian Authority and their Effects on Honest Broker Perceptions

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## Executive Summary

The Israeli-Palestinian conflict is probably one of the most complex and drawn-out conflicts in the world, and it has attracted for decades the attention of all major players on the international scene. Since the 1990s, both the USA and the European Union (EU) have shown their commitment to play a role as a mediator, or as a facilitator, between the Israelis and the Palestinians.

In order for a third-party to become a successful mediator, he or she has to earn a certain degree of trust from both protagonists in the dispute. In this regard, one question to be answered is what characteristics the mediator should display vis-à-vis each party in conflict to be perceived as a reliable partner. Many historical, cultural, and social components naturally impact this “honest broker” status.

The type and kind of instruments the third party could exercise in order to encourage the negotiation is certainly another important element of the picture. This paper will precisely focus on the economic relationships between the external powers and the conflicting parties, assuming that some economic initiatives might affect the level of trust which is necessary to gain honest broker status. The aim is to identify American and European economic initiatives vis-à-vis the Israelis and the Palestinians in a comparative perspective, so as to understand if they have any effect to ameliorate the political credits of the US and the EU on the ground.

### Economic initiatives and the external powers' relationship with Israel

Israel currently receives around \$3 billion per year in total economic and military grants, refugee settlement assistance, and other aid. US military assistance amounts to 80% of the total. The US considers Israel as a close ally, targeting political and economic stability of Israel as a priority for their foreign policy in the Middle East. On the other hand, the EU officially declares that since Israel has high national income per capita it is not eligible for development aid. Yet the economic relationship between Israel and the EU is a close one, and it is maintained and developed essentially through an extensive system of commercial agreements. The EU is Israel's overall biggest trading partner, accounting in 2005 for around 37% of Israel total trade, while the relative trade with the US accounts for only 27%. Nevertheless, a closer look at the trade figures shows that when examining total flows over time, the picture becomes complex, with a progressive re-orientation of Israeli trade toward other geographical directions.

Israel has become habituated to US defence assistance and subsequently relies with great confidence on the latter to guarantee its security concerns. Not only is the massive economic and military aid connecting the two countries, but there are also active joint defence projects (e.g. the Arrow Missile project) that connect the two armies on the ground and their respective defence industries. Concerning the EU-IS relationship, some political elements seem to affect the evolution of bilateral trade, regardless of existing formal agreements. Israeli exports to the EU dropped by 10% immediately after the starting of the second Intifada, while they remained stable with the US, indicating that US-IS trade relations are more solid than EU-IS. The EU inclination to use trade agreements as foreign policy tool may thus be justified when dealing with Israel, yet it does not seem to be very effective in terms of confidence-building.

### The Palestinians: a case of economic uncertainty

Due to internal political and other structural constraints, the Palestinian economy is notably underdeveloped, very unstable and depending on outside stimuli.

The level of external trade is negligible and an average 70% of it is realized with Israel. A discussion of trade issues on the Palestinian side does therefore essentially focus on the administrative and legal constraints impeding the free circulation of goods inside the Palestinian territories and at border crossings. While the US action to ease these difficulties is quite limited, the EU has shown a certain continuity in supporting the Palestinian institutions to gain their economic autonomy. This dimension of the EU action actually affects in some way their political relationship with Israel, while it does not have a very concrete effect on trading conditions for the Palestinians.

International financial assistance to the Palestinians has been exceptionally high, with the international community spending on the whole over US 6\$ billion since the signing of the Oslo agreement (1993). The Europeans do collectively (The Commission + the Member states) account for over a half of this effort, while the US is the most important bilateral donor to the Palestinians. External aid was always accepted by the Palestinians as a tool

used by extra regional powers to advance their political agenda in the region. If the EU is widely seen as a firm supporter of the two-state solution, it is also considered as a very secondary political actor when it comes to devising a solution to the conflict.

In the period of transition opened by the Palestinian electoral process in 2005-2006, the EU launched two important missions translating on the field a greater motivation to be involved as a third party: the EU-BAM, with European presence contributing to the regular opening of the Rafah Crossing Point, and the EU-COPPS, in support to the Palestinian civil police. But the suspension of aid to the Hamas elected government in March 2006 has seriously and immediately downgraded the economic conditions in the Territories and put an immediate emphasis on emergency needs. The suspension of aid did affect the general level of trust placed in the Western powers, but it did not fundamentally change the perceived hierarchy of external actors: ultimately, there is on the Palestinian side a sense that the US are in command, and that they are not working in a direction that is favourable to the Palestinian people.

Our ambition was to discuss the relevance of economic initiatives as political tools to gain trust from both parties in conflict. The study initially started with the assumption that some symmetry could be found between the Israeli and the Palestinian side, with a differing system of alliances bolstered by the economic presence and initiatives of the US and the EU: the Israelis were thought to trust spontaneously more the US because they receive regular financial support from Washington, while the Palestinians should rely more on the EU, who has continuously worked in favour of the establishment of an autonomous Palestinian economy, considered as an essential aspect of state-building in the long run.

## A false symmetry

A review of existing literature, as well as extensive field-work, does relatively confirm the picture on the Israeli side, but also reveals that EU commercial initiatives failed to give rise to political trust in Israel. Collected data helped qualifying the picture on the Palestinian side, suggesting that there is no immediate link between the level of economic commitment from the powers and their perception as potential allies: the US did spend a lot of money in the Palestinian territories, but this did not raise their political credits. At the same time, they are still heeded to be the only external actor capable of influencing Israel for the framing of a final settlement. The EU may be relatively trusted by the Palestinians, as it is believed to hold a more balanced position, but it might not be trusted as a mediator, because it is essentially considered as a weak actor.

## 1. Introduction

The Israeli-Palestinian conflict is one of the most convoluted and drawn-out in the world, attracting the involvement of all major players in the international scene. In this dispute, leaders on both sides of the Atlantic have attempted for the last decades to formulate consistent views for a long-term solution and possibly act as legitimate brokers between the parties.

Despite the long historical relationship between Europe and the region and substantial European economic involvement in both Israel and the Palestinian territories, there is in Israel a deep-rooted mistrust of European intentions towards the conflict. In contrast, European economic efforts to support the PA seem to have consolidated its political status on the Palestinian side. Nonetheless, neither Israel nor the PA perceive the EU as playing a dominant role in the process of conflict resolution, leaving the US as the major actor. Recent efforts from the external powers to co-ordinate their positions regarding the conflict have permitted the emergence of a consensual position, admitting the need to establish a Palestinian State, end the occupation and bring an end to settlement activity in the West Bank and Gaza. Despite this transatlantic rapprochement, Israeli attitudes towards Europe are still more critical than attitudes towards the US. On the contrary, among the Palestinians, the EU is apparently considered as a more natural mediator than the US. Why has the EU failed to gain honest broker status in Israel but succeeded in the PA, while the US has succeeded to obtain it in Israel, though to a lesser degree among the Palestinians?

In order to answer these questions, this research proposes to investigate the link between EU and US economic initiatives in Israel and the PA, and their compared ability to impose themselves as mediators in the peace process, over a period of time extending from 1995 to early 2006. The project has proposed to fill this gap by conducting a two-step research, examining (1) the two Powers' vision of the Israeli-Palestinian conflict and their efforts to try and resolve the conflict; and (2) their contribution to honest broker perception vis-à-vis both Israel and the PA through the use of economic-diplomatic instruments. The mapping of the economic initiatives should help assessing to what degree they determine each superpower' role in the peace process, and also clarify whether the US and EU strategies are competitive or complementary by nature.

Although acknowledging that historical, cultural, and social components naturally affect honest broker status, we decided to focus on the economic relationships between the powers and the parties in conflict. By distinguishing the economic initiatives in a comparative perspective, the aim is to identify some viable policy recommendations on how to enhance an honest broker status.

## 2. The Role of Honest Broker

The literature on honest broker focuses on the ability of third-party actors to wield power by mediating effectively among two or more sovereign entities in conflict, and advancing partial compromise proposals based on uniquely reliable information about the nature and intensity of national preferences of both sides (cf. Kydd 2004). Mediators are often thought to provide reassurance in situations of mutual mistrust. In a conflict situation, mediators can reassure each side that the other is genuinely interested in peace, and not attempting to deceive and exploit the other. For instance, Kelman argues in the context of the Oslo negotiations that the Israelis and Palestinians “[...] had to be persuaded that there was a genuine readiness on the other side to make the necessary concessions” (Kelman 1997). The fact that they were able to develop this degree of trust enabled the parties to cooperate, at least for a while.

Issues of trust and reassurance are crucial for the process of mediation (for a recent review see: Wall et al. 2001.) John Herz developed this argument in international relations and argued that states face a security dilemma, in which anarchy plus uncertainty about the intentions of others leads states to arm themselves, which harms the security of others leading them to respond in kind in a vicious circle (Herz 1950). This argument has become a cornerstone of realist thought in international relations (Jervis 1978; Glaser 1995) and has also been used to explain domestic-ethnic conflict (Posen 1993). The Israeli-Palestinian case study is perhaps one of the best illustrations for the “security dilemma” problem, where whenever a chance to proceed with the negotiation process emerges, the uncertainty and the mistrust between the parties lead to its failure. Especially when fuelled by extremists from both sides, it appears the parties in conflict rely back on force and violence, depressing both sides both economically and psychologically, and in effect preventing any breakthrough in the dialogue between the two leaderships.

In order for a third-party to be successful mediator, he or she has to earn a certain degree of trust from both countries in conflict. In this regard, one question to be answered is what kind of characteristics the mediator should possess vis-à-vis each parties, and what kind of instruments he or she could exercise in order to be perceived as a credible mediator. Therefore, it is important to notice what kind of structural relations exist between the parties in conflict and the mediator. For example, the more we identify hierarchical relations, say for example, a Superpower as mediator and small countries as parties in conflict, the more we can expect the mediator to gain better respect and credibility based on asymmetrical power relations. Although the IS-PA case study is somewhere in between a pure international and domestic conflict, the need for a credible third actor that has the ability to bring both sides to negotiation, is evident. An important tool to force political development is the use of economic diplomacy. The rationale is that policy makers within the countries in conflict are exposed to domestic pressures to find a solution for the crisis-driven crumbling state of the economy. The relief could come from receiving economic or military aid, preferential trade or investment agreements, an assistance of third countries” non-governmental organizations (NGOs), etc. Economic diplomacy instruments are considered as well when third parties prefer not to be engaged in a military way in the conflict. The use of economic tools is perhaps less visible, but the indirect and less violent characteristics makes it an important instrument in terms of building legitimacy and trust.

Due to globalization forces that increased the economic interdependence among nations, international trade and other areas of international economic relations have increased in importance, and gained “high politics” status in the international scene. As a result, if one considers the incentives to enter the European Internal Market or the ability to export to the US, it is clear that there is a large potential for prosperity that could result from effective economic diplomacy. But more important to our topic, the use of economic initiatives is perceived as a long term instrument for consolidating peace. This is attributed to the success story of Western Europe after WWII, with the creation of the EU. The basic idea – to strengthen economic ties between European nations as an instrument for preventing future wars in Europe, was set as an example for other regions that by means of working together and with other important nations of the international community, and within the framework of international organizations, violence could be prevented (cf. Forsberg 2003).

Nevertheless, the problem with the use of such economic instruments is that it requires not only a long-term commitment of each party in conflict to realize the requested objectives, but also it requires an active cooperation between the former enemies (cf. Arad et al. 1983). That is usually set aside when a situation rapidly deteriorates, and may lead the conflict back to violence, perhaps even intensifying it.



### 3. EU and US Strategies of Intervention to Solve the Israeli- Palestinian Conflict

As two leading political actors on the international scene, the United States and the EU both have an interest in settling the Israeli-Palestinian dispute. For a long period of time their commitment in favour of a solution developed in parallel, albeit in separate ways. Each player elaborated its own approach, based on the historical particularities of their respective relationship with the parties, their specific interest in regional stability and their effective means to influence the course of the dispute.

American and European doctrines and strategies are therefore sometimes described as competing, especially by the protagonists of the conflict, who tend to project their own antagonism in the international arena and reflect it in a system of external alliances. In this frame of vision, the Americans are supposed to provide unconditional political and financial support to Israel, while the EU did materially contribute on a regular basis to the establishment and consolidation of the Palestinian institutions in the aftermath of the Oslo agreements.

Yet, American and European interventions have also often been presented as complementary, especially since the beginning of the Peace process<sup>1</sup>. In the years following the starting of the second Intifada, the Western powers have indeed tried to co-operate more actively to monitor the Israeli-Palestinian relationship and prevent the rapid degradation of the situation on the field.

#### The US as a major external player: a natural broker for a negotiated solution?

The American search for a long term solution to the Israeli-Palestinian dispute is framed by a few key strategic constraints. Support for the state of Israel and Israel's peaceful relations with its Arab neighbours give the overall rationale of US intervention in the Near East. Besides, the necessity to stabilize the Middle East as a region, and to ensure the free circulation for strategic commodities – essentially oil – chiefly depend on the possibility to prevent an escalation of violence in the Israeli-Palestinian context. Since 9/11, the US have also taken the lead on democracy promotion in the region, trying by all means to encourage political and socio-economic reforms in order to undercut the forces of radicalism in some Arab countries. The political evolution of the Palestinian administration stands as an emblematic issue in this regard: reviewing the performance of the Palestinian Authority in terms of good governance and organizing free and transparent elections were essential objectives for the American administration in the post-Arafat period.

For various and complex reasons evolving over time, the United States thus have a real stake in settling the Israeli-Palestinian conflict. Their intervention as a broker between the two parties was indeed a determining element in starting the peace talks between Israel and Egypt leading to the 1979 Camp David agreement. After the Gulf war in 1991, the US administration declared that solving the Israeli-Palestinian dispute figured among its prominent post-war goals. The Peace conference held in Madrid in 1991 was the result of American efforts and marked the beginning of a decade dedicated to achieving peace, notably through unconditional support to the Oslo process<sup>2</sup>. Ever since, a constant American commitment for peace has become a necessary condition for the advancement of the Peace Process. But the constant difficulties in implementing the Oslo agreements and the loss of momentum on the road to peace, notably with the failure of the Camp David II agreement, explain the subsequent relative American disengagement<sup>3</sup>. The present American administration initially adopted a “hands off” attitude, leaving the two sides to sort out their own differences. The American interest in solving the conflict has been reinforced in the aftermath of the 9/11 attacks, as the situation of the Palestinians stands as a justification for the use of violence by jihadist Islamic groups, preaching anti-Western opinions and resorting to terrorism on Western soil<sup>4</sup>. At the same time, the present administration may lack the necessary room to manoeuvre on the Israeli-Palestinian issue in a context of growing regional instability; in fact, the US military intervention in Iraq does seriously impair their perception as a credible peacemaker in the short term, both for political and logistical reasons<sup>5</sup>.

The American strategy to advance, or now restore, the Peace Process, essentially takes advantage of the superpower status of the United States, who can impose themselves as the only external indispensable player in the Israeli-Palestinian game. The US position as a natural broker in the peace talks thus derives indeed primarily from its superpower status, with all the capacity to pressure and/or offer incentives associated, and also from its long term commitment in the search for a political solution. The capital of sympathy for the US on the Israeli side is also a very important parameter, allowing the American administration to suggest arrangements that would hardly reach a consensus otherwise<sup>6</sup>. In practice, the US is certainly in a position to act as the leading partner facilitating contacts

1 Perthes, V. (2000), 'The Advantages of Complementarity: US and European Policies Towards the Middle East Peace Process', *International Spectator* 35 (2), pp. 41-56.

2 Migdalovitz, C. (2005), 'The Middle East Peace Talks', CRS Issue Brief for Congress, updated Dec. 15, pp. 1-2.

3 On the difficulties of the US administration during Bill Clinton's second mandate, and the need for more American engagement, see Agha H. and R. Malley (2002), 'The Last Negotiation: How to End the Middle East Peace Process', *Foreign Affairs* 81 (3), pp. 10-18.

4 Kepel G. (2004), *Fitna: guerre au cœur de l'Islam*, Paris: Gallimard.

5 According to Yossi Alpher (2003), the intervention in Iraq has critically damaged American “prestige and deterrence, hence peacemaking capabilities in the region”; see 'New American Priorities', *Bitterlemons* Edition 33.

6 Robert M. Danin (2006), 'U.S.-Israeli Relations in an Era of Change', Remarks to the Annual Herzliya Conference, Herzliya, Israel, January 22, <http://www.state.gov/p/nea/rls/rm/2006/62244.htm>



between the Israeli and the Arab parties and offering viable political solutions. The political solutions supported by the US rest on a set of principles that progressively evolved to form the present platform of negotiations between both parties as seen on the US side. The respect of UN Security Council Resolutions 242 and 338 in all their parts are a prerequisite, implying that the Arab-Israeli conflict should be resolved through negotiations involving an exchange of territory for peace. The principle of an international conference to bring the parties to negotiations is admitted, as long as it preserves the US role as the principal broker, and is not considered as a substitute for direct negotiations between the parties. Pragmatism remains the rule; the Americans generally avoid articulating any official or legal formulas for reaching peace, estimating that “if the parties can reach their own formula for accommodation, (...) the purpose of the exercise has been achieved”<sup>7</sup>. Finally, as far as the final settlement is concerned, President Bush explicitly accepted the two states solution after the 9/11 events, issuing the strongest American statement yet endorsing an independent Palestinian state with East Jerusalem as its capital<sup>8</sup>. The final goal as affirmed by the American administration is eventually to ensure that Israel and Palestine live together in peace and security, as stated in the Roadmap endorsed by the Quartet in 2003.

The economic side of the American diplomacy regarding the Israeli-Palestinian issue is very active, especially through the channel of financial assistance to the protagonists. American foreign aid to the Middle East has historically been a function of their national security interests in the region<sup>9</sup>. Foreign aid was always used as an incentive to foster peace agreements between countries, especially in the context of the Israeli-Palestinian dispute; since the start of the second Intifada, it has apparently become a crucial tool to prevent further degradation of the political climate in the Palestinian territories<sup>10</sup>. Eventually, the recent decision to suspend aid to the new Hamas-led Palestinian government gives a blatant example of the crucial importance of this economic tool to influence political developments on the field.

The EU is also an important actor in the Israeli-Palestinian conflict for historical, political and economic reasons. Europeans tend to share the American view that failure to resolve the conflict is detrimental to regional stability and encourages the spreading of Islamist terrorism. As geographical neighbours, European states actually consider themselves as being on the frontline, more directly vulnerable than the US to the consequences of regional disorders. The presence of important Jewish and Muslim minorities in some of the EU member states reinforces European worries that the hardening of the Israeli-Palestinian conflict may have a disastrous impact on social cohesion at home<sup>11</sup>.

At the same time, it is necessary to take into consideration the specific political and institutional constraints that hinder an active involvement of the EU to work in favour of a permanent settlement of the conflict. The weakness of the decision-making process when it comes to formulating common European diplomacy, the paucity of means allowing for political action on the ground, as well as differences in sensitivities between the various member states, largely explain the lack of effectiveness of common European efforts in the Near East context<sup>12</sup>. During the Summer of 2006, the Lebanon crisis offered a blatant example of the permanent difficulties to conciliate various European expressions of national concern, agree on a shared reaction and devise a common strategy of action, then manage a satisfactory implementation of shared decisions in the Middle East<sup>13</sup>.

Yet the continuity of the European political position regarding the Israeli-Palestinian dispute is quite remarkable and the EU’s legal approach to the conflict has been rather bold since the common European diplomacy expressed its first statements on the Middle East in the early 1970ies. In 1973, shortly after the first oil shock had struck the European economies, the foreign ministers of the European Community issued a common declaration calling for Israel to withdraw from the Occupied Territories, for the respect of sovereignty of states within secure and recognized borders, the recognition of the “legitimate rights of the Palestinians” and the necessity of bringing the Palestine Liberation Organisation (PLO) into the peace negotiations. Ever since this first move, the EU has had a much more consistent record than the Americans of upholding international law, especially the UN resolutions relating to conflict. The Venice Declaration of 1980 added two important principles to the common European position: the Palestinians’ right to self-determination on the one hand, the condemnation of the Jewish settlements in the occupied territories and of any attempt to unilaterally change the status of Jerusalem, on the other hand. The keystone of the EU position thus became the exchange of the Territories for peace and since 1980 a call for an international conference under the aegis of the United Nations.

The EU’s involvement in the political process leading to the peace negotiation and in the implementation of the Oslo agreement was important, even if European governments kept

## The EU’s background contribution to the building of a just and lasting peace in the Near East

7 Hollis, R. (1997), ‘Europe and the Middle East: Power by Stealth?’, *International Affairs*, 73 (1), p. 22.

8 “President Bush Calls for New Palestinian Leadership”, Washington, The Rose Garden, 24 June 2002, <http://www.whitehouse.gov/news/releases/2002/06/20020624-3.html>.

9 Sharp, J. M. (2006), ‘US Aid to the Palestinians’, CRS Report for Congress, RS 22370, updated February 2, pp. 1-2.

10 Lasensky, S. (2004), ‘Paying for Peace: The Oslo Process and the Limits of American Foreign Aid’, *The Middle East Journal* 58 (2), pp. 210-234.

11 Especially on French society and the issue of importing the Israeli-Palestinian conflict at home, see Denis Sieffert D. (2004), *Israël-Palestine, une passion française*, Paris : La Découverte, and ‘La société française et le conflit israélo-palestinien’, special issue of the *Revue internationale et stratégique*, 58 (2), particularly the articles by Nissim Zvili, ‘La société française et le conflit au Proche-Orient’; Nonna Mayer, ‘Les opinions antisémites en France après la seconde Intifada’; and ‘Le paradoxe’, by Michel Wiewiorka.

12 For a pessimistic appraisal of the EU’s role with respect to a political settlement of the conflict, see Aoun, E. (2003), ‘European Foreign Policy and the Arab-Israeli Dispute: Much Ado About Nothing’, *European Foreign Affairs Review* 8 (3), pp. 289-312. On the differing positions of the member states, see Isabel Schäfer I. and D. Schmid (2006), ‘Ein Tandem für Nahost’, *Internationale Politik* 61 (2), pp. 88-94.

13 Dominique Moïsi (2006), ‘Fear and the Two Faces of France on Lebanon’, *The Financial Times*, 7 September.

a low profile, compared to the American status. They were actually never admitted as an officially recognized broker between the Israeli and Palestinian parties at any level of the peace negotiations. Excluded from the Madrid framework, the EU nonetheless expressed its satisfaction that the perspective of a negotiated solution was finally on the agenda. It later supported with no reservation the Oslo Declaration of Principles, as well as the various interim agreements which followed. The negotiations in Madrid and the subsequent Peace Process in fact inaugurated a sort of division of tasks: the United States and the Soviet Union sponsored the negotiations and were to guarantee the application of the accords, while the EU's contribution was limited to a complementary supporting role, essentially to help ensuring the material (financial) viability of the process. Europe participated in the multilateral negotiations, chairing the working group on regional economic development and co-chairing the working groups on refugees, water, and the environment. In the aftermath of the Oslo process, European financial assistance did contribute, with other major donors - essentially the US and the World Bank, to the establishment and consolidation of the nascent Palestinian institutions<sup>14</sup>.

Over the same period, the EU tried to maintain its intentionally balanced political stance, notwithstanding the successive shortcomings of the Peace Process<sup>15</sup>. On the long run, European diplomatic intervention in regional affairs seems essentially limited to a declaratory role, through the issuing CFSP and ESDP common positions. Yet a few common actions were also taken, some of them to try and stabilise the European diplomatic presence on the field, notably through the appointment of a Special Envoy, and others essentially aimed at supporting the Palestinian institutions (several observatory missions for Palestinian elections; more recently the EU-COPPS and the EU-BAM missions). A specific bilateral relationship was also established with the two protagonists of the conflict in the framework of the Euro-Mediterranean Partnership, so as to ensure their participation in the Euro-Mediterranean regional economic project.

Europe certainly lacks a distinctive and unified political and military capability to realize its legal stance regarding the conflict. The EU's rather timid attitude vis-à-vis any direct involvement in the peace negotiations reflects both the political hesitations of some European states, and the shared feeling that the US is much more likely to have some effective leverage on influencing Israel. Yet to several analysts, the EU should be seeking to play a more active role in settling the Israeli-Palestinian conflict, notably building on its long term responsibility for bankrolling the Peace Process<sup>16</sup>. The EU as a whole is presently Israel's largest trading partner and the biggest provider of foreign aid to the Palestinians. Envisaging the political implications of these economic parameters is one of the topics to be examined in this paper.

## The US and the EU in search of a solution: competitors or partners?

The establishment of the Quartet in 2002, as a multilateral frame of co-ordination and of expression for the international community has partly helped to close the trust gap between the US and the EU on matters relating to the Israeli-Palestinian conflict. The issuing of the Road map, a common document elaborated by the EU and finally endorsed by the US, does illustrate the current search for a more unanimous front for all major powers who are likely to influence the course of the conflict.

Achieving a just and enduring peace in the Middle East is doubtless a shared objective for both Western powers. Yet some difference in methods can still be observed between the American and the European approach to the final goal. Washington is notably traditionally disappointed with the European efforts to build a systematic legal frame, taking international law to the letter. On the contrary, EU member states keep affirming that the legal precedents comprise all the prerequisites for peace. Even now that both Western powers agree on the desirability of a two-state solution, with the Road map as the way to follow, their short term interests sometimes lead them to pull in different directions, with tendencies to pressure and /or encourage more one or the other party. One should also acknowledge that there exist some important discrepancies between the positions of some European governments on how to manage the Transatlantic alliance in the Middle East: brokering an EU/US agreement could sometimes be considered as an achievement in itself particularly in times of regional crisis, when other issues do interfere with the Israeli-Palestinian relationship<sup>17</sup>.

14 Balaj, B., Diwan I. and Philippe, B. (1995), 'Aide extérieure aux Palestiniens : ce qui n'a pas fonctionné', *Politique étrangère* 60 (3), pp. 753-767.

15 Schmid, D. (2006), 'Les Européens face au conflit israélo-palestinien : un front uni paradoxal' *Défense nationale* 62 (8-9), pp. 119-132.

16 See Avi Shlaim (1997), *op. cit.*; Rosemary Hollis stated as early as 1997 that "on economic and security grounds, Europe qualifies for a much more significant role in the Middle East than it is currently accorded"; *op. cit.*, p. 15.

17 This is especially true for the Lebanese file, where a temporary reconciliation between the American and the French could be observed after the assassination of Rafik Hariri. While the recent Israeli offensive in Lebanon was supported by the US it raised some controversies on the European side. On the common European diplomacy and the consequences of the Transatlantic divide after the war in Iraq, see Menon A. (2004), 'From Crisis to Catharsis: ESDP after Iraq', *International Affairs* 80 (4), pp. 631-648.

This research is conducted under the following 4 hypotheses:

- The level of inter-governmental economic aid between a superpower and a given country in conflict contributes directly to an honest broker perception in the recipient country.
- A preferential trade agreement between a superpower and a given country in conflict contributes directly to an honest broker perception in that recipient country.
- The effective level of economic exchanges (trade and investment) and the scope of economic integration between a superpower and a given country in conflict contribute directly to an honest broker perception in the latter.
- The scope of funding provided by a Superpower to non-governmental organizations (NGOs) operating within a given country in conflict contributes directly to an honest broker perception in the recipient country.

We conduct a two-step research: (1) mapping EU/US economic initiatives in the Israeli-Palestinian peace process during the last decade; (2) evaluating how these initiatives contribute to the status of honest broker.

In order to understand how economic diplomacy instruments have been determined and implemented, we: (1) analyze EU and US official documents concerning the transfer of economic and/or military aid to Israel and the PA, and evaluate the size and scope of the respective funds; (2) hold interviews with officials from the EU and US governmental agencies in Israel and the PA who are responsible for transferring and monitoring the allocated funds; (3) examine trade and investment agreements between the Powers and the parties in conflict; (4) examine the actual trade flows; (5) examine the economic size of non governmental organizations (NGOs) which were funded by the Powers.

Next, by analyzing media news concerning the economic initiatives made by the superpowers and the respective attitudes of the public, and by conducting interviews with officials both in Israel and the PA, we will correlate the different Superpowers' economic initiatives with recipient country's perceptions on the legitimacy of the EU and the US to act as mediators, as well as evaluate the effectiveness of the Powers' strategies. Historical, cultural, and social components naturally affect honest broker status. However, while these components are socially constructed over a long period of time (and therefore hard to change), by identifying the economic initiatives in a comparative perspective some viable policy recommendations on how to enhance an honest broker status could be derived.

## 4. Research Arguments and Methodology Hypotheses

### Methodology

## 5. Case Study – Israel

### 5.1 US and EU economic assistance towards Israel

#### US economic aid to Israel

The US considers Israel as a close ally, targeting political and economic stability of Israel as a priority in US foreign policy in the Middle East. One of the objectives of the US strategy is to reduce Israel's balance-of-payment pressures as it promotes further economic reforms required for structural adjustments. The US assistance is officially targeted to promote a domestic Israeli agenda that reinforces the government's peace process policy, though it is worth noting that the US cash transfer is not conditioned on economic policy reforms.<sup>18</sup>

During the mid 1990s, Israel's economy has become increasingly sophisticated and technologically advanced. This has led the Congress in 1999 to begin a process to reduce economic aid as Israel registered further progress. Israel's economic boom in the 1990s was based on a successful high-tech sector, increased investment by venture capital firms, the opening of new markets to Israeli exports, and record levels of tourism. With the beginning of the 21st century, the downturn in the global economy and the worsening of the security situation, the country has faced growing unemployment and declining tax revenues. In addition, the second Intifada (2001-2004) has had a strong negative impact on foreign investment inflows to Israel, leading to GDP contracting by 0.5% in 2001 and 0.9% in 2002. On the last day of 2001 the US had scheduled a partial cash transfer to Israel in the amount of US\$ 149,917,000 since no budget appropriation was set to the following year. But on February 8 2002, it appeared Israel had received a total amount of US\$ 720,000,000 in economic assistance. Nonetheless, during the subsequent year (2003) US economic assistance was reduced to US\$ 596,100,000.

By the end of 2003 there were some positive signs in the Israeli economy, as the latter grew by 1.2%, in contrast to the negative growth in 2001 and 2002. The process of reducing civilian aid has continued, and in 2004 Israel received a cash transfer in the amount of US\$ 477,168,000. Still, as Israel's security situation remained unstable, the provision of US\$ 9 billion in loan guarantees over fiscal years 2003-2007, with an available rollover provision in 2008, was authorized in the Emergency Wartime Supplemental Appropriations Act of 2003 and in the Foreign Operations Appropriations Act of 2004.<sup>19</sup> The provision of the guarantees was predicated on the continued implementation of the Israel reform program and declining government deficits. The US provided US\$ 360,000,000 in 2005 to Israel as a cash transfer, which was used to repay Israeli debt to the US, including re-financed foreign military sales (FMS) debt, and to purchase American goods and services. Reaching 2006, the US has provided US\$ 240,000,000 in Economic Support Funds (ESF) to Israel as a cash transfer. Again, these funds are to be used by Israel to repay debt back to the US, including purchasing goods and services.

In addition to the US direct cash transfer, there is the Cooperative Development Research (CDR) Program which is a competitive grants program, which funds the collaborative research of scientists from Israel and the US. The Middle East Regional Cooperation (MERC) Program is another competitive grants program that supports joint research projects between Arab and Israeli scientists on topics relevant to the development of the Middle East region. Both CDR and MERC are directly managed by USAID and open to a wide variety of local institutions. According to USAID agency, CDR and MERC are presently funding around one hundred separate projects. Also, the American Schools and Hospitals Abroad (ASHA) program provides grants to schools, hospitals, libraries, and other academic and medical institutions in Israel to upgrade their research and training facilities.<sup>20</sup>

#### US military aid to Israel

At the cornerstone of US-Israel relations stands the US undisputable support in terms of military aid. US military assistance is an important factor in US policy in the Middle East in general, but it would be fair to argue that the Congress and the US President Administration place particular emphasis to maintain a close and supportive relationship especially with Israel. Israel currently receives around US\$3 billion per year in total economic and military grants, refugee settlement assistance, and other aid. From this amount, US military assistance captures 80%, and it is used both for research and development in the US and for military purchases from Israeli and American manufacturers. In addition, all US military funding for Israel is delivered in the first 30 days of each fiscal year, where most other recipients normally receive their aid in staggered instalments, and all the Economic Support Funds (ESF) directly go to the government of Israel as a cash transfer grant rather than allocating funds for specific development projects.<sup>21</sup>

The US set as objective to strengthen Israel's security and maintain its "qualitative military edge" (QME) over neighbouring militaries. US Foreign Military Financing (FMF) funds have been increased since 1998 by US\$ 60 Mio a year to a level of US\$ 2.4 billion by 2008. Congress has mandated that Israel receive its FMF aid in a lump sum during the first month

<sup>18</sup> The figures brought in this section were collected from various reports submitted to the US Congress by US official agencies, notably USAID mission in Israel and the Congressional Research Service (CRS) Agency.

<sup>19</sup> [www.house.gov/budgetforeignsa072103.pdf](http://www.house.gov/budgetforeignsa072103.pdf)

<sup>20</sup> See: <http://www.usaid.gov/policy/budget/cbj2006/ane/il.html>

<sup>21</sup> CRS Report for Congress, January 5 2006 RL33222.

of the fiscal year. Once disbursed, Israel's military aid is transferred to an interest bearing account with the Federal Reserve Bank. Israel has used interest collected on its military aid to pay down its debt (non-guaranteed) to the US (which, according to the US Treasury Department, stood at US\$ 1.5 billion as of December 2003).<sup>22</sup>

During the 1980s, the US and Israel worked on a joint project to develop a new ground-attack aircraft called "Lavi". As the project failed to reach operational status, the US agreed to raise the FMF earmark for procurement to US\$ 400 Mio. Since 1988, the FMF procurement earmark for purchases within Israel has been incorporated into annual foreign assistance legislation. Currently, approximately one quarter of Israel's FMF funds may be used for domestic defence purchases (US\$ 595 Mio in 2006). As US military aid to Israel has increased, the amount set aside for defence purchases in Israel also has increased.

There was a criticism that Israel's ability to use a significant portion of its annual military aid for procurement inside Israel is giving the local defence industry an additional leverage, allowing the defence industry to achieve necessary economies of scale and becoming highly sophisticated. Moreover, no other recipient in the world of US military assistance has been granted this kind of benefit. Israel was first granted FMF for use in Israel in 1977, when it asked for and received permission to use US\$107 Mio (1977 prices) to develop the "Merkava" tank (this project did succeed and Israel added the tank to its arsenal in 1979). Even so, Israel uses almost 75% of its FMF funds to purchase US defence equipment.

In April 1998, the US designated Israel as a "major non-NATO ally," which qualifies Israel to receive Excess Defence Articles (EDA) under section 516 of the Foreign Assistance Act and section 23(a) of the Arms Export Control Act. The Department of Defence's Security Cooperation Agency (DSCA) manages the EDA program, which enables the US to reduce its inventory of outdated equipment by providing friendly countries with necessary supplies at either reduced rates or at no charge. On July 2005, the DSCA notified the Congress of a possible FMF to Israel of a fleet management program for F-15 and F-16A/B Pratt and Whitney F-100 model engines as well as associated equipment and services. The total value is estimated to be around US\$600 Mio.

The US Administrations have shown as well strong support for joint US-Israeli missile defence projects. Since 1988, Israel and the US have been developing the "Arrow" anti-missile system, a weapon with a ballistic missile defence capability. The US has funded about half of the annual costs of the Arrow Weapon System, with Israel supplying the other half of the costs. In 2006, the Defence Appropriations Bill provided US\$60.25 Mio for the production of Arrow missile components in the US and in Israel. The Administration had requested US\$78 Mio for the program for 2007. Additional funds were requested by the US for the "Boost Phase Intercept" program (US\$53 Mio) and for the "Tactical High Energy Laser" program under development in Israel to complement the Arrow (US\$139 Mio).

All EU official initiatives towards Israel are held through the framework of the Euro-Mediterranean Partnership (EMP) and the derived agreements (see below). The EU, however, publicly declares that since Israel has a high national income per capita, it is not eligible for bilateral funding under MEDA. The EU does mention, though, other programs Israel can participate in, such as: (1) youth exchange programs with European and Mediterranean counterparts under the Euro-Med Youth Action Programme; (2) Euro-Med Audiovisual Programme where Israeli filmmakers can compete for funding; (3) the FEMISE forum of economic institutes; (4) EuroMeSCo – a network of research institutes, drawn from the thirty-five Members of the EMP, which provides a platform for regional North-South and South-South cooperation, notably in policy and security-oriented research activities and publications; (5) Euromed Cultural Heritage where Israel Antiquities Authority can participate in;

In addition, the European Investment Bank (EIB), which provides credits and guarantees for the funding of projects which the EU seeks to promote in domains such as infrastructures, energy, industry, services or agriculture, reached financial framework agreements to provide credit to the Mediterranean countries participating in the Barcelona Process.<sup>23</sup> The economic collaboration between the EU and Israel is thus also expressed through the permission of the EU to enable the EIB to grant loans for Israeli projects related to the Barcelona Process.

## EU programs open to Israeli participation

<sup>22</sup> Israel cannot use accrued interest for defence procurement inside Israel.

<sup>23</sup> The Barcelona Process does not have direct budgets for projects in the domain of infrastructures, and the EIB therefore acts as a European "tool" in this sphere.



## 5.2 Bilateral trade agreements US-Israel Free Trade Area (FTA) agreement

The US-Israel Free Trade Area (FTA) agreement of 1985 was designed to stimulate trade between the US and Israel. The agreement, which has no expiration date, provides for the elimination of duties for merchandise from Israel entering the US. As of January 1 1995, all eligible reduced rate imports from Israel have been accorded duty-free treatment. Still, the FTA does allow the two countries to protect sensitive agricultural sub-sectors with non-tariff barriers including import bans, quotas, and fees.

The FTA relates to most tariff items listed in the Harmonized Tariff Schedule of the US (HTSUS). An article imported into the Customs territory of the US is eligible for treatment as "Product of Israel" only if: (1) that article is the growth, product or manufacture of Israel; (2) that article is imported directly from Israel into the customs territory of the US; (3) the sum of: (a) the cost or value of the materials produced in Israel, plus (b) the direct costs of processing operations performed in Israel, are not less than 35% of the appraised value of such article at the time it is entered. If the cost or value of materials produced in the customs territory of the US is included with respect to an eligible article, an amount not to exceed 15% of the appraised value of the article at the time it is entered that is attributable to such US cost may be applied toward determining the 35%.<sup>24</sup>

## EU-Israel trade agreements The Association Agreement (AA) of 1995

On November 1995, a trade treaty between Israel and the EU was signed, which includes a declaration that the EU and the state of Israel are interested in promoting the integration of Israel's economy into the European economy. The agreement replaced the 1975 agreement, and included a number of new components, which were supposed to intensify relations between Israel and the EU, and notably, to provide a framework for political dialogue. The treaty was set to establish a regular dialogue at different levels (bureaucratic, diplomatic), in order to strengthen mutual understanding and solidarity. Economically, the accord expands the parameters of the existing free trade zone by updating rules of origin and making them more flexible, granting easier access to public and government procurement markets (see Ahiram and Tovias 1995). Moreover, Israel has been accepted as a full member of the 4th, 5th and 6th Research and Development Framework Programmes. With regard to industrial products, the agreement forbids customs duties from being imposed on imports and exports between Israel and the EU. As to agricultural products, the agreement calls for greater liberalization in agricultural trade with regard to products in which both sides have an interest.<sup>25</sup>

Beyond the punctual matter of trade, the AA was aimed to broaden possibilities for cooperation in other areas, notably greater reciprocal liberalization of financial services. The agreement also included a section concerning the right of establishment and supply of services, with both parties agreeing to broaden the scope of the agreement to allow the other party to establish firms in the other's territory, as well as further liberalization of the supply of services by one party's firms to customers of the other party. It was decided that there will be no restrictions between the parties on the movement of capital, nor will there be any discrimination on the basis of nationality, place of residence, or the place where the funds are to be invested.

With regard to competition, the two parties were committed to forbid any creation of cartels and other associations that prevent competition. In addition, the parties agreed to allow full accountability in all matters relating to public subsidies, and that is to ensure that the rules of fair competition are upheld. The primary areas of interest of economic cooperation that were set to be covered are: regional cooperation, industrial cooperation, agriculture, standards, financial services, duties/Customs, environment, energy, information infrastructure, tourism, correlation of laws, transportation, war on drugs and money laundering, and immigration.

The long list of topics indicates the seriousness by both parties to have a comprehensive legal and ordered accord that will integrate Israel in the European market. Furthermore, on Israel's request, the agreement also included new areas of cooperation in the promotion of culture, education, and audio-visual production. Another section of the agreement was devoted to social issues. It was decided to establish a dialogue in spheres of mutual interest, primarily on social concerns such as unemployment, gender issues, working relations, and professional training. Within the framework of the general instructions, the parties agreed to establish an Association Council, which is scheduled to convene once a year at a ministerial level, in order to examine important issues related to the agreement and also international issues of mutual interest.

<sup>24</sup> Direct costs of processing operations do not include costs which are not directly attributable to the merchandise concerned.

<sup>25</sup> The AA is part of the Euro-Mediterranean Partnership (EMP). The EMP was established at a Conference of Ministers of Foreign Affairs held in Barcelona on November 1995 and is endorsed by the 25 EU member states and 10 Mediterranean non-Member countries (MNMCS) partners. This partnership aims 'to create peace, stability and development in a region, which is of vital strategic importance for Europe', and focuses on three objectives: (1) basket I - the political and security partnership, which sets out to create an area of peace and stability based on the principle of human rights and democracy; (2) basket II - the economic and financial partnership, which aims "to create an area of shared prosperity through the progressive establishment of free trade between the EU and its Mediterranean partners and amongst the partners themselves"; and (3) basket III - the cultural, social and human partnership, which aims to focus on the improvement of "mutual understanding among the peoples of the region and the development of a free and flourishing civil society", see Barcelona Declaration. See as well: [http://ec.europa.eu/comm/external\\_relations/euromed/index.htm](http://ec.europa.eu/comm/external_relations/euromed/index.htm).

## The new ENP

To supplement the forthcoming Eastern enlargement, in 2003 the Union launched the European Neighbourhood Policy (ENP) which has been designed to supplement and give new momentum to the EMP framework. The objective of the ENP was to find a suitable solution to all neighbouring countries which do not have the prospect of future accession to the Union. It was designed to prevent the increasing criticism about the emergence of a new border between those who are within the Union and those who remain at the periphery.

Due to the relative moderate success of the multilateral-style EMP, the ENP was set to bolster bilateral relations, that means, progress could be made through direct negotiation with partner countries of jointly agreed Action Plans, covering a range of fields in which the parties undertake to commit themselves. These were to include especially a political dialogue and agreed governance reforms, and measures preparing partners for gradually integrating (economically speaking) in the EU's Internal Market. In this context, the EU's three-year ENP Action Plan with Israel was endorsed by foreign ministers at the Association Council in December 2004, and entered into force in April 2005. Ten sub-committees have been established to enable the EU and Israel jointly to manage the detailed technical work of the Action Plan. From September to November 2005 meetings of six sub-committees were held in both Brussels and Jerusalem, and a further two sub-committees were held in Jerusalem in March 2006. Key areas that have been discussed were Israel's participation in international organizations, and countering racism, xenophobia and anti-Semitism. Other fields that are set to be covered are: a new EU-Israel business dialogue; e-commerce, services liberalization, mutual recognition of financial sector regulatory frameworks, and improved reciprocal access to public procurement markets.

Although there is an official political dimension to the institutional EU-Israel framework, there is no such political discussion within the daily dialogue between Israel and the Commission concerning the Palestinian dimension. Although both sides reaffirmed their commitment to the trilateral EU-Israel-Palestinian trade group, which aims to examine ways to improve trade flows and cross-border movements of Palestinian goods between Gaza, the West Bank, Israel, and the EU, most of the bilateral talks concern how Israel could be integrated better in the Internal Market. There was an attempt in 2005 to create a joint EU-Israel-Palestinian co-operation in energy and transport. The Commission backed joint activities between Israel and the PA in the form of financial and political support for Joint Israel-Palestinian Energy Offices to improve co-ordination in electricity and gas networks; but as soon as Hamas won the 2006 elections, all activities were set to halt.

Although Israel tries to separate economic relations with the EU from political ones, sometimes this proves impossible. One example can be brought when the EU demanded from Israel that any goods that were produced in the occupied territories will not be labelled "made in Israel". The reason is that from the EU perspective, the territories are not part of Israel, and goods produced there are therefore not eligible for the customs reductions that Israeli goods enjoy under the AA. Israel refused until November 2003 to distinguish between goods made in Israel and goods made in the territories. The argument, which stands behind it, is that since the EU recognized the Paris Agreement that created a customs union between Israel and the PA, there are no grounds for treating products made in the territories differently from products made in Israel. In 2004, Israel agreed to adopt a compromise solution of including the city of origin on the label. Yet, Ehud Olmert, the Industry Minister (nowadays Prime Minister), stressed that the agreement in no way implies a change in Israel's political positions or a willingness to concede those parts of the territories that the government insists must remain part of Israel under any future agreement.

The Israel ENP Action Plan intends to facilitate Israel's participation in the Pan Euro-Med system of cumulation of origin, which could be a significant progress on the road to create a Euro-Mediterranean FTA. At the Palermo Euro-Mediterranean conference of 2003, it was decided to open up the European system of cumulation to those MNMCs who are able to meet certain conditions. In the Israeli case, those conditions seemed to be fulfilled following the arrangement over the rules of origin dispute and the new Israel-Jordan trade agreement signed in December 2004. This means that the protocols of rules of origin applicable to the EU's AA with Jordan and Israel should be changed. It is worth mentioning that the inclusion of Israel in this Pan Euro-Med system of cumulation has followed previous US-Israel-Jordan and US-Israel-Egypt trade arrangements allowing for duty free exports to the US provided goods incorporate at least 35% value added by companies within Qualified Industrial Zones (QIZ) (See: Escribano 2006).

On November 10 2005, when Commissioner for External Relations and ENP Benita Ferrero-Waldner attended the Israeli Prime Minister's Conference for Export and International

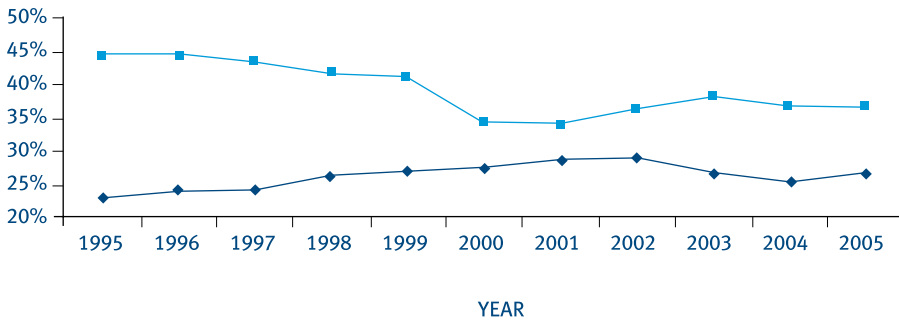


Cooperation, she stated: “[...] Israel is probably in the best position of all the EU’s neighbours to benefit from the economic opportunities offered by ENP. Your economy is well-suited to an advanced level of integration with our own, so the prospect of a stake in the EU’s single market is not so remote”.<sup>26</sup> But then she continued and mentioned at the same speech: “[...] so for Israel and the EU to reap maximum benefit from the economic possibilities of ENP, there has also to be an improvement in the Palestine economy”.

<sup>26</sup> [http://ec.europa.eu/comm/external\\_relations/news/ferrero/2005/spo5\\_675.htm](http://ec.europa.eu/comm/external_relations/news/ferrero/2005/spo5_675.htm).

Israel, as a small and open economy, depends much on international trade to increase its prosperity. The EU is Israel's overall biggest trading partner, accounting in 2005 around 37% of Israel total trade, while the relative trade with the US accounts for only 27% (see figure I). On the contrary, the share of Israeli trade with the EU relative to EU total trade is roughly 1%. This strong asymmetry may indicate that Israel should be rather dependent on the EU, and act with appropriate prudence to preserve its relations with the Union.

### 5.3 Trade relations



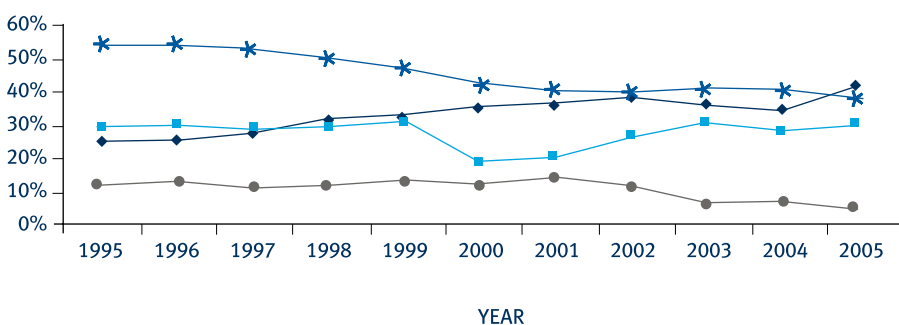
**Figure I**  
EU and US trade with Israel as % of Israeli total trade

Source: Israeli Central Bureau of Statistics (CBS)<sup>27</sup>

■ US total trade  
◆ EU total trade

And indeed, as we saw in the trade agreement sub-section, Israel invests valuable efforts to consolidate and develop its agreements with the EU, as one of its central objectives is to “have a stake in the internal market” (interview at the Israeli Ministry of Finance, international division).

Nevertheless, a closer look at the trade figures shows that when examining total flows over time, the picture becomes complex (see figure II). Bilateral trade with the EU has been losing relative importance in Israeli total exports and imports. In imports, there was a decrease from 52.3% in 1995 (when the Barcelona Process started) to 39.1% of total Israeli imports in 2005.<sup>28</sup> Comparatively, the share of Israeli imports from the US fell only by 5 percentage points.<sup>29</sup> Moreover, the US has replaced the EU as the main destination of Israeli exports, from 29.48% in 1995 to 42.34% in 2005. By contrast, Israeli share of exports to the EU remained the same around 32% of total exports. This is somewhat surprising, as we could have expected that Israel, as a developed country with geographic proximity to the EU, would have had higher Exports flows to the Union.



**Figure II**  
Israel trade relations with the US and the EU

Source: Israeli Central Bureau of Statistics (CBS)<sup>30</sup>

■ exports to US  
◆ exports to EU  
✱ imports from US  
● imports from EU

As a result, Israel runs a significant and constant trade deficit with the EU, while it has a trade surplus with the US. This trade deficit with the EU stands now as the larger deficit Israel has with regard to the rest of the world.

Escribano (2006) goes further and calculates export and import intensity indexes, and shows that EU-Israel trade has lost its dynamism, mainly when compared with US-Israel trade. In spite of distance, Israeli trade with the US is far more intense than with the EU, while Israel's trade intensity with the EU has actually declined between 1995 and 2003. One major breakdown occurred with the launch of the second Intifada in September 2000, when we can identify a sudden drop on Israeli exports to the EU (and which affected the good results of the first three-quarter of 2000). As the Intifada began to fade away, so did increase exports to the EU. This is in contrast to Israeli export to the US, which remained intact in absolute terms and even has been amplified in relative terms.

<sup>27</sup> As from June 2004, and following the accession of ten new members to the EU, EU trade statistics cover 25 members.

<sup>28</sup> It is noteworthy that all figures are in current prices, which may moderately bias the results. But as all the figures are expressed in relative terms, what matters is the relative trend of Israel's trade relations with the EU and the US.

<sup>29</sup> Both the EU and the US were losing trade shares as a response to increased intensified Israel relations with Asia, and especially with China.

<sup>30</sup> As from June 2004, EU trade statistics cover 25 members.

## 5.4 Israeli perceptions of external economic initiatives

Israeli ambivalence towards Europe has been a common theme in its foreign policy ever since the establishment of the State in 1948. On the one hand, Europe represents the place in which the Holocaust took place, leaving an ever lasting trauma to Israeli Jewish society, but on the other, nearly all of the founders' generation was European born, who tried to build Israel inspired by European culture and traditions, and saw in Europe an ally against a hostile Islamic neighbourhood (cf. Newman 2000). Still, despite the long relationship between Europe and Israel, the latter does not perceive the EU as playing a significant role in the process of conflict resolution. Israeli attitudes towards Europe have always been more critical than attitudes towards the US, even when there are similar statements from both powers about the need to establish a Palestinian State, end the occupation of the West Bank and Gaza and bring an end to settlement activity.

A public opinion poll carried out in 2002 by the Steinmetz Centre for Peace research has questioned Israeli attitudes towards the role of third party intervention in the conflict.<sup>31</sup> Over 30% of the Israeli Jewish population expressed some support for third party intervention.<sup>32</sup> This ranged from direct peace-keeping activities, aimed at keeping Israelis and Palestinians away from each other, to a more active monitoring role which would supervise the implementation of a peace process and ensure that each side is fulfilling its signed responsibilities. This relatively high support for third party intervention can be attributed to the failure of the Oslo process and the derived bilateral efforts, which were aimed at reaching a deal directly between the Israelis and the Palestinian at the negotiation table. In the same survey, respondents were asked who they prefer to see as active peacekeepers. The US achieved first place, followed by Britain (but with quite a gap). France was positioned at the bottom of the list. Although both Britain and France belong to the EU, therefore complicating the picture of how Israelis perceive Europe, what remains clear is that the main third party role is reserved for the US, or at least a US led-group of international observers.

When considering the composition of initiatives made by the US and the EU, a more understandable picture emerges. As Israel became habituated to US defence assistance, it is natural that Israel relies with great confidence on the latter to guarantee its security concerns.<sup>33</sup> Israel, as beneficiary of structured and solid aid from the US, will not make a significant move without the approval of Washington, including any progress with a further Disengagement plan (see as well: Schueftan 2003). As we saw earlier, it is not only the massive economic and military aid that connects the two countries, but also the active joint defence projects (e.g. the Arrow Missile project) that connect directly the two armies and their respective defence industries. To this must be added a vigorous US-Israel FTA that Israeli private businesses make the best out of. Moreover, Israeli former Head of Israeli Secret Services (the "Mossad") Efraim Halevi stated that even though former Israeli PM Sharon did not regard the proposed "Road Map" as lying within the best interests of Israel, and was also officially opposed to it, once President Bush decided to adopt the plan one week before the invasion to Iraq, he (Bush) influenced Sharon to accept the agreement, and the latter signed it within days.<sup>34</sup> Although Israel raised fourteen points of which it had reservation on the Road Map, they have not had any legal meaning.

The fact that Israel sees the EU as not being a major third party, whose intervention in the conflict is important, is reflected also in ambassadorial appointments to many EU countries which have not been considered vital by the Israeli Foreign Ministry. These positions are used as means of filling the "political" appointments reserved to the Israeli Foreign Minister, rather than employing professional career diplomats (see Newman and Yacobi 2004). This can be viewed as an indication of the low esteem in which Europe was being held by successive Israeli governments. This is not to say that Israel does not look for stronger and deeper ties with the EU. It does. But Israel would like to maintain the economic dialogue with the EU without broadening the political dimension.

Nevertheless, with the conclusion of the Oslo Accords in 1993, relations between Israel and the EU became much warmer. Prime Minister Rabin and Foreign Minister Peres were considered true partners for promoting the peace process, and indeed, in parallel, the EU agreed to launch talks with Israel on renegotiating the 1975 trade accord, ending with the famous EU-Israel Association Agreement. But with the assassination of Rabin in November 1995 and Peres' loss of the subsequent elections to Netanyahu (and the Likud party), political tensions resurfaced. It took the EU five long years (and frustrating from the Israeli perspective) to ratify the AA; and only following Netanyahu loss of 1999 elections to the Labor party candidate Barak, which was considered as a prospect for renewing the negotiation process.

Still, tensions in trade relations between the EU and Israel remained always in the background. At a March 1998 speech to the Anglo-Arab Association, British Foreign Secretary Cook reiterated European policy, stating that "international law requires Israel

<sup>31</sup> See: <http://www.tau.ac.il/peace/>

<sup>32</sup> It is noteworthy that the Arab-Israelis, who represent approx. 20% of the population, have always favoured greater international intervention.

<sup>33</sup> Furthermore, in a recent article Mearsheimer and Walt (2006), strongly advocate that the entire US Middle East strategy is being dominated by various Israeli lobbyist activities.

<sup>34</sup> Quoted in the Haaretz, 23/4/2005. see: <http://news.walla.co.il/?w=//705520>

to withdraw from the Occupied Territories, Southern Lebanon and the Golan Heights [...] we are clear about the illegality of settlements in the Occupied Territories”.<sup>35</sup> Two months later, the EU issued a policy recommendation calling on the EU to exclude Israeli imports from the West Bank, Gaza Strip, Golan Heights and Eastern Jerusalem from preferential trade benefits granted to Israel. At stake was an estimated US\$200 Mio worth of goods, mainly agricultural products. With the election of Ehud Barak, this issue was minimized with the prospect of political progress at the negotiation table. Only after the break of the second Intifada and the rise of Sharon to Premiership, this issue returned to the headlines. On April 2002 the European Parliament adopted a hard-hitting resolution calling for the suspension of the Association Agreement with Israel to protest the military offensive against the Palestinians during the second Intifada.<sup>36</sup> While the resolution was not binding, it was aimed to add pressure on European governments to consider their relations with Israel.

Regardless of the formal agreements, distrust between societies tends to lower bilateral trade even in the presence of a liberal trade policy. Some scholars (cf. Escribano 2006; Sadeh 2002) have raised the issue of European boycotts on Israeli goods. What we have seen in the trade relations sub-section, is that as soon as the second Intifada has commenced, Israeli exports to the EU dropped by 10% although remained stable with the US, indicating US-IS trade relations are thus much more solid compared to EU.

In addition, Europe is perceived in Israel by some as being anti-Semitic, an attitude which has been strengthened in recent years with the growth of media coverage concerning anti-Semitic incidents against Jewish communities and synagogues throughout Europe, notably in France. Furthermore, EU aid to the Palestinians is perceived negatively inside Israel, often being criticized by local media and academia. Steinberg (2003) argues that “EU officials spoke repeatedly of “Palestinian state-building” while the funds went to the corrupt and anti-democratic elite [...] the money provided by the EU’s taxpayers was diverted into the pockets of and bank accounts of officials and for the purchase of weapons”.<sup>37</sup> (pp.6-7). These kind of comments have been intensified in the Israeli media, making regular policy statements made by European leaders, which sound anti-Israeli, become translated into the rhetoric of anti-Semitism.

However, it is worth mentioning that there are other voices in Israel, calling for more European aid to the PA. Former PM Peres, for example, appealed in 2005 for a supplementary donation of US\$120 Mio to upgrade border crossings in the Gaza Strip, with the aim of boosting the Palestinian economy after Israel withdraws from the area. Peres called to invest in new technology that would allow goods to move quickly in and out of Gaza, and to reduce the waiting times for Palestinian labourers entering Israel.<sup>38</sup>

One of the famous obstacles the EU encounters in terms of its foreign relations is the lack of a single voice. Indeed, during the 1990s one could have heard different statements from European capitals concerning what should be the right European approach towards the Middle East (Alpher 2000). Over time, the EU has taken on a common policy with respect to the conflict, and on March 1999, the EU published its “Berlin Declaration” which supports an independent Palestinian state.<sup>39</sup> The Declaration opens the possibility of European recognition of an independent Palestinian state, even if this state is declared unilaterally following a failure in the bilateral negotiations. Given this sort of statements, Israeli leaders did not view Europe as constituting an honest broker, favouring increased American assistance and intervention over that of Europe. Furthermore, when the EU published the findings of a poll take in October 2003, in which the majority of respondents stated that they saw Israel as the single greatest threat to global stability, for most Israelis these results demonstrated that anti-Israeli policies were akin to anti-Semitism and that Europe was not to be trusted as a serious third party player in the peace process.

So, although EU policy does not differ greatly from US policy in terms of their demand for a two state solution, and that the EU and the US are equal partners in the quartet (alongside Russia and the UN), it seems that massive and unilateral US assistance to Israel contributed to the fact Israel perceives the US as the sole third-party actor who can play a honest broker mediator. The use of various trade agreements as economic leverage by the EU towards Israel appears to have little effect if any, since they cannot substitute for trust that is so essential for mediation, especially when crises escalate.

The recent violent conflict in southern Lebanon intensified the differences between the Powers and how they act in response to events in the Middle East. The Bush Administration supported unconditionally the decision of the Israeli government for military actions against Hezbollah, and placed all of the blame for the current crisis on Hezbollah and its sponsors in Syria and Iran. Furthermore, in the US Congress, both Republican and

35 [http://news.bbc.co.uk/1/low/world/middle\\_east/62560.stm](http://news.bbc.co.uk/1/low/world/middle_east/62560.stm)

36 <http://www.europarl.europa.eu/activities/archive;language=EN>

37 Steinberg, G.M. (2003), Learning the Lessons of the European Union's Failed Middle East Policies, a paper presented at the conference on “Troubled Waters: Europe And Its Relations With the United States And Israel”, The Helmut Kohl Institute for European Studies, Hebrew University

38 See: <http://abcnews.go.com/International/wireStory?id=985644&CMP=OTCRSSFeedso312>.

39 See: [http://europa.eu.int/council/off/conclu/mar99\\_en.htm#ME](http://europa.eu.int/council/off/conclu/mar99_en.htm#ME). In this context, it is worth mentioning that the member states of the European Community were among the first to support the creation of a Palestinian state, starting with the Venice Declaration in 1980.

Democratic representatives rejected speeches calling for Israel to practice restraint. Conversely, EU leaders criticized heavily what they saw as “disproportionate use of force by Israel in Lebanon”<sup>40</sup>. The EU, under the Finnish rotating presidency, has issued the following statement: “The European Union is greatly concerned about the disproportionate use of force by Israel in Lebanon in response to attacks by Hezbollah on Israel. The presidency deplores the loss of civilian lives and the destruction of civilian infrastructure [...] the imposition of an air and sea blockade on Lebanon cannot be justified”.<sup>41</sup>

In other cases of contemporary conflict, such as Cyprus, the Balkans, or Turkey, the EU has been able to offer the strong incentives of potential accession to the EU as a reward for conflict resolution. As Israel is not an eligible candidate to the EU (but see: Tovias 2003; Veit 2003), the EU has to rely on external relations capacity and the derived initiatives to have some influence over the Israeli-PA negotiation process. Currently, Europe continues to be considered as a suspicious neighbour, despite the warm relations it had for two short periods of time (under Israel’s Labour Government of 1992-1996 and 1999-2000). The perception of Israel regarding its relation with the EU as a strong economic partnership with a soft political dimension is as firm as ever. But it seems as if EU policy-makers are also aware of their limited ability to shape and mediate the conflict without American support. Quoting one official European diplomat: “The EU was behind all recent international initiatives during the last years [...] but the US will always appear in front because they [the US] are the Superpower and not us”.

40 See: “EU accuses Israel of ‘disproportionate use of force’”, Haaretz, 13/7/2006.

41 See: EU official response to the conflict in Lebanon, MEMO/06/306.

The Palestinian territories do not form an independent national entity in the form of a state. This transitional situation entails particular constraints when one wants to examine the strategies of influence devised by external players. External economic interventions impact the Territories through unconventional channels and the recipient of these interventions do not really have the full capacity to contract or react. Moreover, since the outbreak of the second Intifada at the end of 2000, all external economic initiatives directed at the Palestinian territories have to be operated under regular Israeli control and against the backdrop of escalating conflict. The political context thus seriously qualifies the use of economic tools by the powers. The result of the recent legislative elections, that brought a Hamas majority into the Palestinian Legislative Council, only emphasized the politicization of economic issues.

At the same time, one has to acknowledge that the Palestinian economy is highly sensitive to external stimuli, due to its excessive degree of dependence on Israel and on foreign assistance<sup>42</sup>. The economic presence of the Western powers is important in this context, and their interventions have somehow contributed to the emergence of an embryonic economy as well as to the establishment of Palestinian autonomous institutions to manage it. Two important categories of Western economic interventions should be primarily assessed in the Palestinian context. The first element is the provisional Association Agreement that was signed between the EU and the Palestinian authority in 1997, preparing the way for an economic opening of the Palestinian territories and their gradual insertion in a regional system of economic exchanges. The second important factor relates to the huge amount of financial assistance that was concentrated on the Palestinian territories since the signing of the Oslo agreements in 1993. Both the EU and the US have contributed in a large manner to this financial effort.

Some very specific political and legal constraints do weigh on the development of the Palestinian economy. The particularities of the legal frame under which the external powers have to conceive their intervention should be briefly recalled here before examining more closely both the US and the EU economic initiatives.

In 1994 Israel and the Palestine Liberation Organization (PLO) signed The Paris protocol, an economic protocol setting the terms of the Israeli-Palestinian economic relations. According to this document, the responsibility for the Palestinian economic policy is shared between the Palestinian Authority (PA) and Israel. The document has given the PA partial responsibility for the Palestinian economy and finance: it is entitled to regulate its own economic policy in various economic sectors such as banking, direct taxation and insurance. For its part, Israel has kept the right to regulate indirect taxes, import and export, standards and measurements and the introduction of a Palestinian national currency. The Paris protocol stipulates the freedom of movement of agricultural and manufactured goods between the two sides and the normality of labour movements. As far as exchanges with external actors are concerned, the PA has the right to determine independently the rates of customs duties, purchase tax, levies, excise and other charges on imports of limited quantities of commodities from specified sources in Lists A1 (some 24 goods whose origin, or at least 30 per cent of whose value added, derives from an Arab State, with 11 items having to come exclusively from either Egypt or Jordan.) and A2 (mostly food-related items, which the PA has the right to import from anywhere in the world); and imports with no restrictions on quantities of goods in List B (which includes a large number of items needed for investment and development<sup>43</sup>. Products not on Lists A1, A2 or B, or those on the first two lists but exceeding the quotas, are subject to a minimum of Israeli rates. To date, the PA has not made any change to the prevailing customs duties on non-listed goods and the Israeli tariff schedule is therefore being applied to most PA imports.

The arrangement was initially conceived to last for the duration of an Interim period of five years (until May 1999). Yet it remains in place due to the absence of a permanent status for the PA or another overriding agreement between the two parties.

Although the protocol denotes the same economic and trade treatment for Palestinian trade through Israeli ports and airports, the Palestinians argue that Israeli security measures at the main border crossings have seriously damaged the ability of Palestinian industries to extend their outreach beyond Israel. According to some accounts by World Bank officials, closures are in fact a key factor behind today's economic crisis in the Palestinian territories<sup>44</sup>. Another difficulty lies with the management of the common customs envelope that was created between the Palestinian Authority and Israel under the Paris protocol. As the PA had no control of their external borders, it was agreed that Israel would collect customs

## 6. Case Study – the Palestinian Authority (PA)

### 6.1 US and EU economic interventions in the Palestinian context

#### A particular context to situate economic initiatives

#### The Paris protocol, setting the limits of the economic status of the West Bank and Gaza Strip

<sup>42</sup> The World Bank (2006), 'West Bank and Gaza / Economic update and potential outlook', March 15.

<sup>43</sup> The scope of the lists was expanded in mid-2000 to include 1,400 additional tariff lines.

For further detail on the commercial regime organised by the Paris Protocol, see the UNCATD fact sheet on <http://ro.unctad.org/palestine/economy4.htm>, and Paltrade (2005), "Trade Impediments", February, <http://www.paltrade.org/old/Publications/Impediments%20issue%2015m.pdf>.

<sup>44</sup> See for instance Roberts N. (2005), 'Hard Lessons from Oslo: Foreign Aid and the Mistakes of the 1990ies', in Keating, M., Le More, A. and Lowe, R. (eds.), op. cit., pp. 17-26.



revenues for the Palestinians and transfer those revenues to the Authority. The transfers of collected sums have become a regular bone of contention between the PA and the Israeli government, who regularly suspends it on political grounds, thus urging intervention by external donors, notably the EU.

### External assistance to the Palestinians: from international mobilisation to donor fatigue and the sanctions

Since the signing of the Oslo agreement, the Palestinian territories have received a very important amount of external assistance. Over 6 billion dollars have been spent on assistance to the Palestinians since 1993. In the Palestinian context, development assistance was initially intended to develop the foundations of a viable Palestinian state<sup>45</sup>, even if it slowly slipped into a permanent system of emergency assistance, including an increasing proportion of humanitarian aid.

This long-term financial effort has been co-ordinated in rather close manner by the donors, who set up a multilateral management framework in the immediate context of the Oslo conference. The Ad Hoc Liaison Committee (AHLC) was established in 1993 at the Washington conference for donors by the Multilateral Steering Group of the multilateral talks on the Middle East Peace Process. Its essential function is to co-ordinate the assistance to the Palestinians, planning donor operations in the West Bank and Gaza Strip. The AHLC brings together major donors, including bilateral donors, the EU and the World Bank; the UN, Israel and the Palestinians enjoy observer status<sup>46</sup>.

After over one decade of continuous funding by the international community, the year 2005 saw the rapid emergence of a “donor fatigue” phenomenon in the Palestinian context. 2005 thus marks the peak of external aid in absolute terms, but it is also the year preceding the sanctions against the Hamas elected government<sup>47</sup>. The disillusion of donors was blatantly expressed into a few official documents, notably issued by the World Bank and the AHLC. The AHLC thus agreed in December 2005 that achieving desirable rates of Palestinian GDP growth would depend on Israel continuing to transfer revenues, rolling back the system of movement restrictions in force and maintaining or increasing labour access to Israel, and also on sustained high rates of donor and private investment as well as Palestinian governance reform<sup>48</sup>.

All of these conditions in fact primarily relate to the political environment of economic activity in the Palestinian Territories, or the progression to a final settlement ending occupation and allowing for more autonomy of the Palestinian economy. International aid was initially conceived to support the implementation of the Peace Process<sup>49</sup>; symmetrically, its efficiency had been rapidly jeopardized by the failure of the Peace Process. This outcome illustrates well how much the economic and political parameters are intertwined in the Israeli-Palestinian context, and suggests some possible room to manoeuvre on the economic front to meet political objectives.

### The American economic presence in the Palestinian territories: a commitment under strict political conditions

The American arsenal of initiatives vis-à-vis the Palestinian territories is not as important as the European one, and apparently does not reveal a strategic commitment to favour the long term development of a viable economic system on the Palestinian side. Yet one has to acknowledge that the American presence remains important notably as the US were, until the recent decision to suspend external assistance, the first bilateral donor to the Palestinians.

### The US - Palestinian trade

From a commercial perspective, the present status of the Palestinian territories make it difficult to isolate actual trade flows; moreover, the deteriorating situation on the ground, especially since the starting of the second Intifada, has severely damaged Palestinian exporting capacities.

A Palestinian – United States Free Trade arrangement actually exists, granting duty free treatment to all Palestinian products entering the United States. Inclusion of the Palestinian economy in the regional context is also formally encouraged by the American administration, notably through the establishment of free trade with benevolent neighbours. Products manufactured in co-operation between Jordanian, Palestinian, and Israeli entities on the Jordanian Qualifying Industrial Zones can for instance be exported to the United States tariff free. A free trade agreement was also signed in 2005 between Jordan and the Palestinians, and the West Bank and Gaza Strip are officially mentioned in the American project of establishing a regional Middle East Free Trade Area (MEFTA)<sup>50</sup>.

Yet many material obstacles to bilateral trade hinder any serious development and the level of exchanges remains very low, both in absolute and relative terms. Bilateral trade with the Gaza Strip is almost non-significant, and aggregated figures with the West Bank confirm



the strong impact of the second Intifada on trade flows with the Palestinians. American figures show that American exports to the West Bank and Gaza Strip totalled US\$ 0,4 Mio in 1995, increased steadily afterwards and reached their highest peak in 2000 at US\$ 9.2 Mio before falling down sharply to 2.2 in 2001, thus slowly recovering to reach 3.9 in 2005<sup>51</sup>. The level of imports from the territories also remains very low, reaching a maximum of US\$ 6.1 Mio in 2001, and then degrading to 3 in 2005. The trade balance remains on the long period positive for the US, with a total of US\$ +0.9 Mio in 2005.

As a region, the Middle East is the largest annual recipient of American economic and military aid. For policymakers, foreign assistance is generally considered to play a key role in advancing national foreign policy goals<sup>52</sup>.

American assistance to the Palestinians should nonetheless be traced back in periods well preceding the launching of the Peace Process. The US actually started providing aid to the Palestinians in 1950 with contributions to the UN Relief and Works Agency's emergency fund and general fund for refugees (UNRWA). In 1975, following strong lobbying from private voluntary organizations, the American government also started to provide assistance for Palestinian projects, both in the humanitarian and infrastructure fields<sup>53</sup>.

After the signing of the Oslo agreements, assistance to the Palestinians was explicitly redesigned along a series of political objectives, essentially to accompany the development of the Peace Process. President Bill Clinton did immediately recognise the need for an active American role in supporting the experiment in Palestinian self-government<sup>54</sup>. Israeli and Palestinian negotiators themselves admitted early on that large-scale international aid would be required in order to implement an agreement: according to Scott Lasensky, Israel and the PLO agreed directly on the principle of massive international assistance to make the peace agreement viable. The central purposes of the post-Oslo assistance system was thus both to deliver a peace dividend to the Palestinians and to generate public support for the Peace Process, or build a "peace constituency". This strategy was pursued with remarkable continuity until the second Camp David talks, a time when some analysts argue that the political efficiency of US assistance promises started to decrease, and the financial carrots offered could not overcome the resistance of the parties<sup>55</sup>.

Two weeks after the Oslo Declaration of principles was signed, it was indeed the American administration that organized an international donors conference for the Palestinians, to mobilize the resources needed to support the nascent Palestinian institutional framework. The US were also from the beginning the largest single donor country. The American Congress approved aid for the West Bank and Gaza through the Middle East Peace Facilitation Act. At the same time, the Congress imposed strict conditions intended to guarantee Palestinian compliance with agreements with Israel. American law prohibits providing aid directly to the PA and, from 1995 to 2002, no US assistance went to the PA or any of its constituent bodies. Various legal constraints have also been issued in order to ensure that aid is not diverted to terrorist groups, and aid was especially heavily scrutinized by Congress throughout the period following Oslo, leading to the second Intifada. Growing anxiousness on the donor's side was perceivable in the following years, and the 9/11 events resulted in more restrictions on the delivering of US aid. The specificity of US anti-terrorist legislation and its effects on daily work for the USAID agency in the West Bank and Gaza Strip will be further examined in the section dealing with the Palestinian perception of American aid.

Since the signing of the Oslo Accord in 1993, the US government has committed close to US\$ 1.8 billion in economic assistance to the Palestinians. 80% of the American aid is channelled through US aid contractors, 20% through private voluntary organizations<sup>56</sup>. As to the nature of aid, prohibition to fund directly the PA officially means that most of the funding was directed to strengthen Palestinian civil society. In fact, the large majority of American assistance went to infrastructure and development projects, such as water works, housing, roads and education<sup>57</sup>. One should note that the amount of American aid reaches an estimated total of US\$ 8.5 billion since 1993 if one includes funding provided to the UNRWA, as the US are still a regular and important contributor to this organization's budget.

From the figures below, one can seize that the American financial effort did not weaken after the starting of the second Intifada. In the period following the death of Yasser Arafat, the Bush administration again significantly increased aid amounts to the Palestinians in order to strengthen president Abbas' political status<sup>58</sup>. In 2005, President Bush even authorized personally the provision of 50\$ millions in direct assistance to the PA<sup>59</sup>.

## The US as a prominent bilateral donor to the Palestinians

45 Brynen R., 'Donor Aid to Palestine: Attitudes, Incentives, Patronage and Peace', in Keating, M., Le More, A. and Lowe, R. (eds.) (2005), op. cit., pp. 129-142.

46 On multilateral co-ordination mechanisms for the Palestinians, see PASSIA (2003), 'Mechanisms of Donor co-ordination and Organization of the Development Effort in the West Bank and Gaza Strip', on [http://www.passia.org/palestine\\_facts/pdf/pdf2003/sections2/Donors.pdf](http://www.passia.org/palestine_facts/pdf/pdf2003/sections2/Donors.pdf)

47 On the period leading from donor discouragement to the sanctions, see Schmid D. (2006), 'De l'assistance aux sanctions: comment aider les Palestiniens ?', to be published in *Politique étrangère* 71(3).

48 AHL, 'Governance Priorities under the Medium Term Development Plan: A Donor View', 12 Dec. 2005; also see *The World Bank*, op. cit.

49 Lasensky S., op. cit.

50 MEFTA Fact Sheet, 06/23/2004, [http://www.ustr.gov/Document\\_Library/Fact\\_Sheets/2003/Middle\\_East\\_Free\\_Trade\\_Initiative.html](http://www.ustr.gov/Document_Library/Fact_Sheets/2003/Middle_East_Free_Trade_Initiative.html)

51 Source: US Census Bureau, Trade in Goods (Imports, Exports and Trade Balance) with Gaza Strip Administered by Israel/Trade in Goods (Imports, Exports and Trade Balance) with West Bank Administered by Israel, on <http://www.census.gov/foreign-trade/balance>

52 Sharp, J. M. (2005), 'US Foreign Assistance to the Middle East: Historical Background, Recent Trends and the FY2006 Request', CRS Report for Congress, RL 32260, updated June 13.

53 Mark C. (2005), 'United States Aid to the Palestinians', CRS Report for Congress RS 21594, Updated March 4, 2005.

54 Shlaim, A. (2001), 'America and the Israeli-Palestinian Conflict, 1991-2001', A Yale University Lecture in International Relations, 8 November.

55 Lasensky S. (2005), 'Chequebook Diplomacy: The US, the Oslo Process and the Role of Foreign Aid', in Keating, M., Le More, A. and Lowe, R. (eds.) op. cit., pp. 41-58.

56 Jeremy Sharp (2005), op. cit., p. 5.

57 Scott Lasensky (2005), op. cit. See also the USAID website, [http://www.usaid.gov/locations/asia\\_near\\_east/countries/wbgaza/westbank-gaza.html](http://www.usaid.gov/locations/asia_near_east/countries/wbgaza/westbank-gaza.html).

58 Sharp, J. M. (2006), 'US Aid to the Palestinians', CRS Report for Congress, RS 22370, updated February 2.

59 To allow for this exceptional funding, the President had to submit a waiver to Congress claiming that doing so was in the interest of national security.

## US Assistance to the West Bank and Gaza, 1992-2004<sup>60</sup>

FISCAL YEAR	AMERICAN ASSISTANCE IN THOUSAND \$
1992	7,074
1993	29,557
1994	56,769
1995	80,263
1996	63,806
1997	68,680
1998	60,685
1999	80,092
2000	118,641
2001	114,292
2002	181,036
2003	173,907
2004	84,786

In 2005, the repartition of total US assistance to the Palestinians as categorized by the State Department stood as follows, out of a total of US\$ 300 Mio: 245 Mio were spent on “basic Human needs” (US\$ 65Mio on Food Programs, US\$31 Mio on Health Programs, US\$ 14 Mio on Education Programs, US\$ 135 Mio for the UNRWA); and US\$ 42 Mio were dedicated to: “Securing and Expanding Democracy” (programs aimed at “Protecting and promoting moderation and democratic alternatives to Hamas”)<sup>61</sup>. For year 2006, the USAID had programmed to provide food, health care and education programs, as well as special assistance for the prevention of Avian Influenza. Yet the implementation of this agenda has been heavily disturbed by the decision to introduce sanctions against the Hamas-led Palestinian government.

### American assistance after the sanctions

The establishment of a Hamas-led government in the Palestinian territories has triggered severe reactions on the US side. The legal framework to organize economic operations with the Palestinians has become even more restrictive. According to the official word, U.S. companies may continue to engage in transactions with non PA entities (non governmental and non Hamas-related), but the US government has suspended all assistance to Palestinian government’s cabinets and ministries. Even if the Americans did not provide any direct budgetary assistance to the PA, most of aid was nonetheless conveyed through Palestinian bureaucratic channels. Such contacts are not allowed anymore and the State Department officially announced that all the money spent for the day-to-day operations of the PA should by now be channelled into strictly humanitarian efforts<sup>62</sup>. As an immediate consequence, some substantial additional funding should be attributed to the UNRWA, which is considered by the US administration as an effective and rapid vehicle to provide humanitarian assistance to the right place.

<sup>60</sup> Clyde Mark (2005), op. cit., p. 6.

<sup>61</sup> US Department of State (2006), Fact Sheet on ‘Palestinian Assistance: Humanitarian Assistance and Democracy Building’, Washington, DC, April 7.

European economic policies with regard to the Palestinian territories have a true record of continuity. European economic presence in the West Bank and Gaza strip is often presented as an example of EU's use of "soft power"<sup>63</sup>. Since 1995, the EU has indeed systematically organized its economic initiatives around the two pillars of trade and assistance, with unequal success.

European efforts to encourage the development of Palestinian external trade have been pursued in the more general framework of the EU's Mediterranean policy, lately its Neighbourhood policy. The legal frame that was put in place does hold political significance, but the economic results are not convincing.

An Interim Association Agreement on Trade and Co-operation was signed on 24 February 1997 between the EC and the PLO, for the benefit of the Palestinian Authority, and it entered into force on 1st July 1997. This interim agreement takes place in the larger framework of the Euro-Mediterranean Partnership, the PA being one of the stakeholders associated to the EMP since its launching in 1995. The two primary aims of the Association agreement are to help liberalizing commercial trade between the Palestinian territories and the EU, and to establish a comprehensive dialogue between the EU and the PA both on economic and political matters. The agreement provides for duty-free access to EU markets for Palestinian industrial goods, and a phase-out of tariffs on EU exports to Palestine over five years. The Agreement also foresees a gradual liberalization in agricultural and fisheries trade.

The Israeli government has not officially recognized the AA and some concrete difficulties have been regularly met for its full implementation. One recurrent obstacle relates to the status of products originating from Israeli settlements in East Jerusalem and the Golan Heights, or in the West Bank and Gaza Strip. On 13 May 1998 the European Commission sent a formal communication to the Council of Ministers and the European Parliament, insisting that these products cannot benefit from the preferential import regime established in favour of products originating in Israel. Above economic considerations, this can be considered as a political stance, the EU reminding Israel of the illegality of the Jewish settlements and the Israeli occupation of the West Bank and Gaza.

Since the outbreak of the second Intifada and the imposition of closure and curfews within the West Bank and Gaza Strip, implementation of various aspects of the Interim Association Agreement has proven extremely difficult. Under such circumstances, many Palestinian officials would actually argue that the Interim Association Agreement has become an empty shell. The real level of trade between the EU and the Palestinian territories does illustrate the transitory failure of efforts to encourage bilateral exchanges. The statistics are in fact rather erratic and aggregated figures are extremely low. The EU 25 merchandise trade with the West Bank and Gaza is not high enough to be accounted for in the Eurostat global external statistics of the EU (imports and exports from 2001 to 2004 reach zero). Sectoral trade statistics reveal the following breakdown: an estimated Eur.13 Mio were exported and imported in the machinery sector in 2005, exports and imports reached Eur.11 Mio in Transport equipment, Eur.9 Mio in the sector of chemical products; 6 million of imports from the WBGs in agricultural products and 5 million in imports, and 2 million of imports in the textile and clothing sector<sup>64</sup>.

The EU did recently engage in a very concrete effort to participate in the amelioration of circulation of goods and encourage the normal functioning of Palestinian trade. After Israeli disengagement from Gaza, Israel and the PA concluded in November 2005 an "Agreement on Movement and Access" including agreed principles for Rafah crossing, between Egypt and Gaza. The Council of the EU thus agreed that the EU should undertake the Third Party role proposed in the Agreement and decided to launch the EU Border Assistance Mission at Rafah crossing point (EU-BAM), to monitor the operations of this border crossing point. The Rafah Crossing Point is vitally important to the Palestinian economy since it is the only border crossing not involving Israel. The EU was admitted to play the role of the third party to respond to Israel's worries about the security conditions associated with handing over control of the border directly to the Palestinian Authority<sup>65</sup>. Officially, the EU-BAM mission in Rafah is thus aimed at providing a third party presence in order to contribute to the regular opening of the Rafah Crossing Point and to build up confidence between the Government of Israel and the Palestinian Authority. The mission is thus a byproduct of the Commission's efforts in supporting the consolidation of sound and reliable Palestinian institutions, as it should also contribute to the building up the Palestinian capacity in all aspects of border management. All difficulties encountered by European governments to make their bilateral arrangements with the Palestinians work should also be re-assessed against the more global and

## 6.2 The EU's part in developing the Palestinian economy: a constant yet constrained partner

**Encouraging external trade  
through the interim Association  
Agreement: an arrangement still  
awaiting full implementation**

**Rationale and difficulties  
associated with the Interim  
association agreement**

62 For instance, in the area of infrastructure where the US did a lot of direct programming with the Palestinian institutions, all undergoing projects have been recently cancelled. See C. David Welch (2006), 'Special Briefing on U.S. Assistance to the Palestinian People', Washington, DC, April 7.

63 Rosemary Hollis, op. cit.

64 See the DGTrade website for a detailed account of existing data, on [http://trade.ec.europa.eu/doclib/docs/2006/may/tradoc\\_113382.pdf](http://trade.ec.europa.eu/doclib/docs/2006/may/tradoc_113382.pdf); and also Quéfelec S. (2006), 'Les pays du Machrek et l'Union européenne', Statistiques en bref/Commerce extérieur, Luxembourg : Eurostat.

65 Israeli notably evoked possible weapons transfers and the uncontrolled return of exiled extremist leaders and terrorists.

## The ENP applied to the Palestinian territories

ambitious vision of regional trade that still seems to prevail in some of the Commission's offices. In a recent trip to the Middle East, Commissioner for Trade Peter Mandelson summarized its objectives for the region, suggesting that an integrated vision of trade relations between Israel and the Palestinians was the intermediate rationale pursued by the Commission, with a final aim to participate in a wider regional, Euro-Mediterranean, integrated market<sup>66</sup>. This design translates into a grand vision with the statistical data revealing that Palestinian external trade is almost entirely directed at Israel<sup>67</sup>. At the same time the Commissioner explicitly evoked the linkage between economic prosperity and finding a political settlement to the Israeli-Palestinian dispute.

Recently the Commission has invited the PA to participate in the European Neighbourhood Policy, as all other Mediterranean Partner countries. The EU-PA Action Plan was endorsed by the foreign ministers at the Association Council in December 2004 and entered into force in May 2005. No tangible developments can be accounted for after this date.

## European financial assistance to the Palestinians in the post-Oslo context: a leading contributor

The EU is a leading contributor of external assistance to the Palestinians and durably affirmed its ambition to participate to long-term institution-building in the perspective of the establishment of a Palestinian state. Yet, European leaders agreed in March 2006 to apply the regime of financial sanctions agreed upon in the framework of the Quartet. The EU's overall financial effort and its claimed functions

European Community assistance to the Palestinians began as early as 1971, with a contribution to the budget of the UNRWA. Yet it is after Oslo that the EU imposed itself as the main donor to the nascent Palestinian institutions. The Commission explicitly states on its website that "as the biggest donor to the Palestinians, the EU has the potential to make a significant contribution to the future establishment of a Palestinian State living at peace with Israel"; "support for the creation of an independent, democratic Palestinian state" is also mentioned by the EU's delegation in the West Bank and Gaza Strip<sup>68</sup>. The purpose of aid is thus admittedly political. At the same time, negative developments on the ground following the second Intifada led the EU, like other donors, to shift much of its assistance from long-term institution-building to immediately needed humanitarian assistance, support to refugees (through UNRWA), and development assistance.

From a strictly administrative point of view, the EU's system of financial assistance to the Palestinians has been designed to meet emergency needs and adapt to constantly evolving political circumstances. The programming of financial assistance has been, since the outbreak of the second Intifada, carried out on an annual basis. After charges of alleged corruption of the PA, the EU also reconciled itself to imposing partial political conditionality to its aid and support to the reform process of the PA was narrowly monitored in co-operation with other donors, through the AHLC. Direct budget assistance was provided in 2001 and 2002, before the establishment of a Reform Facility, allowing for the disbursement of aid closely linked to progress in reform efforts and earmarked for specific needs identified in co-operation with the PA Ministry of Finance.

At the Oslo donor conference, the EU agreed to an amount of Eur.250 Mio in grants for the period 1994-1998, in addition to long term loans from the European Investment Bank. Yet the European effort went beyond this initial pledge during the first phase of the Peace Process, with commitments of more than Eur.400 Mio in grants. According to the Commission, the EU had committed from 1994 to the end of 2002 approximately Eur.1 billion in grants and loans, and a further Eur.500 Mio in contributions to UNRWA. Bilateral EU Member State assistance over the same period is estimated to an amount of Eur.2.5 billion. When taking into account the aggregated efforts of the Commission and the member states, Europe thus ranks first among the donors to the Palestinians.

## From sanctions to preparing an alternative mechanism of aid

The EU's High representative, Javier Solana, had early threatened that some financial measures could be taken against the Hamas Palestinian government, should it not abide by the political principles agreed by the Quartet. In April 2006, EU foreign ministers approved a temporary suspension of the Commission's aid to the Palestinian Authority, while agreeing to keep the humanitarian channel active. All European states agreed to the decision of sanctions.

Yet fear of a humanitarian crisis in the Palestinian territories rapidly arose in the international community. Soon after the sanctions were taken, the European Commission thus started to

work on designing an alternative mechanism to convey aid to the Palestinians, in accordance with political restrictions expressed by the Quartet. The new system, known as Temporary International Mechanism (TIM) was elaborated with an objective to facilitate needs-based assistance directly to the Palestinians, including essential equipment, supplies, and support for health services, support for the uninterrupted supply of fuel and utilities, and basic needs allowances to poor Palestinians. The Quartet insisted that the TIM should be “limited in scope and duration and operate with full transparency and accountability”<sup>69</sup>. The devising of the mechanism was a complex technical task and it has raised political tensions inside the Quartet<sup>70</sup>.

When envisaged beyond the alea of the present crisis, the EU’s commitment to the development of an autonomous Palestinian economy nonetheless remains a given. In October 2005, in the wake of Israeli disengagement from Gaza, the Commission had issued a document revealing its strategy to move forward to a two-state solution<sup>71</sup>. The communication comprised a full section on economic priorities of the Palestinian Territories and the policies the EU should carry out to address these priorities. Yet, EU member states do share the overall assessment collectively made by international donors that it will be extremely difficult to move forward economically in the absence of a political solution to the conflict, thus admitting that the efficiency of economic tools in the Palestinian context remains highly dependent on global political parameters.

## Future economic priorities as seen by the EU

66 Peter Mandelson (2005), “Trade and Stability in the Middle East”, Speech at the Hebrew University, Jerusalem, 19 May, on [http://ec.europa.eu/comm/commission\\_barroso/mandelson/speeches\\_articles/temp\\_icentre.cfm?temp=sppmo28\\_en](http://ec.europa.eu/comm/commission_barroso/mandelson/speeches_articles/temp_icentre.cfm?temp=sppmo28_en)

67 According to World Bank data, Israel amounts for more than 70% of Palestinian imports, and some 90% of Palestinian exports, in a context of overall compression of Palestinian trade since 2000.

68 [http://ec.europa.eu/comm/external\\_relations/gaza/intro/index.htm#2](http://ec.europa.eu/comm/external_relations/gaza/intro/index.htm#2) and <http://www.delwbg.cec.eu.int>

69 Quartet Statement, 17 June 2006, [http://www.un.org/news/dh/infocus/middle\\_east/quartet-17jun2006.htm](http://www.un.org/news/dh/infocus/middle_east/quartet-17jun2006.htm)

70 Interviews (2006), French economic mission to the Palestinian Territories, Jerusalem, June.

71 Commission of the European Communities (2005), Communication from the Commission to the Council and the European Parliament, ‘EU-Palestinian Cooperation Beyond Disengagement - Towards a Two-State Solution’, Brussels, COM 458 final, 5.10.2005. Economic priorities were listed as follows: developing bilateral and regional trade relations; building up a customs administration; reconstructing and rehabilitating the West Bank and Gaza Strip; creating the enabling environment for private sector investment; supporting the private sector; improving the management of public finances; developing a knowledge-based economy and addressing the social dimension of Palestinian development.



### 6.3 Palestinian perceptions of external economic initiatives

Different levels of awareness should certainly be distinguished to apprehend Palestinian perception of Western economic initiatives in the region. EU's financial support to the consolidation of the Palestinian institutions, as well as the humanitarian side of the European intervention, seems to remain the most widely acknowledged aspect of the Western economic presence, arising a certain degree of positive consensus per se, regardless of its effective political impact in terms of conflict-solving. In the long run, various indicators on the contrary suggest that EU's prominent role in backing the PA does not seem to influence decisively the perception of its political status in the region. Data from the field, as well as the feedback from the EU representation in the West Bank and Gaza strip, tend to confirm that the Palestinians always deem Europe to play a secondary role to that of the US to solve the Israeli-Palestinian dispute.

The overall perception of Western economic initiatives has been deeply affected by the suspension of aid imposed on the Hamas government in March 2006. The sanctions are widely considered by the Palestinian public and the officials to be a result of American pressure, ultimately triggered by Israel. One American interlocutor indeed described the present situation as one of "unprecedented use of American economic power"<sup>72</sup>, and the general impression to be drawn from interviews with Palestinian decision-makers, as well as from a series of opinion polls recently conducted in the territories<sup>73</sup>, is that economic factors tend to be used against them as a weapon to downgrade their negotiating capacities.

### Palestinian perceptions of the US economic assistance: a biased actor with a strong impact on any political solution

At a very general level, the appreciation of US financial assistance to the Palestinian people depends on the effective benefits drawn from it on the grounds. Since 9/11, the strict political constraints imposed on any contracting with the US administration did complicate substantially the work of USAID officials with Palestinian NGOs. Special procedures do apply to ensure that USAID-funded assistance does not inadvertently provide support to entities or individuals associated with terrorism. Organizations receiving US funding thus have to sign an anti-terror clause called the Anti-Terrorism Certification (ATC), guaranteeing that they do not promote or support terror. All contracts and grants also contain a mandatory clause reminding awardees of their duty to comply with US laws and Executive orders prohibiting assistance to terrorist organizations. Also, the planning and reviewing system of USAID-funded projects includes consultation with the Israeli government, as well as other governments and donors<sup>74</sup>.

These constraints have made it more difficult for the American agency to track down viable projects to be undertaken in partnership with Palestinian stakeholders. Some Palestinian NGOs have openly expressed their refusal to work under such strict political conditions. The USAID has nonetheless managed to widen its audience by searching for new partners outside of its traditional scope of intervention. Some Palestinian NGOs are still currently heavily depending on US funding to pursue their activities, and were therefore severely affected by the brutal decision to stop aid.

The perception of US use of its economic power by the Palestinian officials is generally negative. Most of them notably tend to publicly minimize the impact of US assistance on the welfare of the Territories, insisting that the total amounts delivered are not decisive compared to the effort of other donors, and that US procedures tend to advantage more the American NGOs than their Palestinian counterparts<sup>75</sup>. On the other hand, the Americans are overwhelmingly held to keep the final hand on the designing of any political solution to the conflict with Israel, and their present stance is considered to be as pro-Israeli as ever. The economic tool is thus considered as just another means of influencing the course of the conflict in a direction that will be detrimental to Palestinian interests. At best, the US have had no positive impact on the situation of the Palestinian territories; at worst, they have created a new form of economic dependence for some Palestinian economic and political actors, who now suffer badly from the consequences of economic sanctions.

Many opinion polls have also taken as a central subject the issue of external aid, its supposed political meaning and concrete effects. The results of these polls can also help identify the link between economic intervention and political influence from the great powers as seen by the Palestinians. According to Nader Saïd, who based his conclusions on a regular series of polls conducted at Birzeit University, the Palestinians do value the role of international aid after Oslo as a very important element shaping the political frame of the Israeli-Palestinian relationship. Aid is seen to have been political from the beginning and mainly conceived as a bargaining chip to influence both Israeli and Palestinian behaviour<sup>76</sup>. Palestinian civil society institutions and the public have in fact always understood international funding as driven by the political agendas of the donors rather than by the interests of the Palestinian population itself. The period following the decision by the donors to suspend aid

72 Interview (2006), USAID, Jerusalem, June.

73 A variety of opinion polls are conducted in the Palestinian Territories on a regular basis by several institutes. See, for instance, the material published by the Development Studies Program at Birzeit University (<http://home.birzeit.edu/dsp/opinionpolls/>), the Survey Research Unit of the Palestinian Center for Policy and Survey Research (PCPSR, <http://www.pcpsr.org/survey/survey.html>), and Near East Consulting (NEC, <http://www.neareastconsulting.com/>)

74 See USAID (2002), Acquisition and Assistance Policy Directive (AAPD) 02-19, issued on December 31. For a detailed description of the anti-terrorism system applied to the Palestinian Territories, see "Testimony of James R. Kunder, USAID Assistant Administrator for Asia and the Near East / US Policy toward the Palestinians, Before the International Relations Committee", U. S. House of Representatives, Washington, DC, March 2, 2006.

75 Interviews, PASSIA, PECDAR.

76 Saïd N. (2005), 'Palestinian perceptions of international assistance', in Keating, M., Le More, A. and Lowe, R. (eds.) op. cit., pp. 99-107.

is particularly crucial in what regards Palestinian perceptions of the international community. It has apparently helped delineating better the border of tolerance and the level of trust awarded to different external donors. An opinion poll led by the Near East consulting team in March 2006 covered several issues related to the Palestinian public's perceptions about the international community, including: their trust in various members of the international community and the perceived fairness of US vs. EU policies towards the Palestinian people, as well as the "preferred" source of assistance by the Palestinians<sup>77</sup>. On the item "trust in members of the international community", the US win only 1,5 % of the Palestinian public, while EU's share is 15 %. The US are considered only by 2 % of the Palestinians to have "a more just policy towards the Palestinian people", while the EU attracts 33,6% of the public. At the same time, 57,9 % consider that they both have an unjust policy, thus suggesting that the hypothesis of a European entity seen as a more legitimate broker to solve the conflict should be very much nuanced. In any case, the Arab states and the Muslim non Arab states are quoted by more than 75 % of the people as their preferred source of assistance, the EU reaching 7,8 % and the US a rather severe 1,6 %.

In 1997, Rosemary Hollis stated that there was "no shortage of Arab voices calling for more European involvement to balance out US support for Israel"<sup>78</sup>. Until today, the author's case for a stronger European involvement essentially rests on the assumption that the EU could make political use of its economic assets in the region, especially in distributing better its economic favours between Israel and the Palestinians<sup>79</sup>. In effect, one has to observe that the EU's continuous economic commitment has only partly reinforced its political credit in the Palestinian public, and that it has done little to reinforce in absolute terms its political status: as is suggested by the polls quoted above, Europe is presently not systematically considered as a friend of the Palestinian people, nor is it thought to have any credible influence on the course of political events in the region<sup>80</sup>.

The difficulties associated with the implementation of the EU-PA interim association agreement are rather detrimental to the EU's image in the Palestinian camp. This macro-economic level of analysis is rarely if ever evoked in the opinion polls, but it is a recurrent theme of discussion for Palestinian officials. They are particularly aware of the incrementally positive evolution of the bilateral EU/Israel relationship, which they tend to assess in comparison with their own situation. Several officials who have been in charge at ministerial level would insist on the continuous discrepancy of treatment inflicted on Israel and the PA when it comes to their bilateral economic and commercial relations with the EU<sup>81</sup>. Israel's hindrance on the enforcement of the association agreement and its not being sanctioned in return by the EU feed overt resentment on the Palestinian side. The idea of taking commercial sanctions against Israel is still largely popular and considered as an easy political move; the fact that the EU is constantly refraining to take such a bold step is interpreted either as a sign of weakness, or as a sign of excessive complacency toward Israel. At the same time, the level of assistance delivered by the EC and its member states to the Palestinian people still balances the perception of the EU as being biased in favour of Israel. Yet the reluctance of the EU to make use of its economic power to influence Israel's behaviour to the Palestinians generally confirms the image of the EU as a non relevant political actor with regards to the Israeli-Palestinian dispute.

The launching of the ENP in the Palestinian context seems to inspire slightly diverging interpretations on the European and the Palestinian side. For Europe, the negotiation of an Action Plan with the PA (endorsed in December 2004) took place in the general Neighbourhood framework, aimed at restructuring the overall system of relations of the EU with its Eastern European and Southern Mediterranean neighbouring countries. The intrinsic political meaning of the Action Plan, as envisaged in the very specific strategic context set by the Israeli-Palestinian relationship, has not been explicitly emphasized by the EU.

For their part, the Palestinians seem to consider the development of the ENP as offering renewed occasions to express their grievances about the Israeli occupation and the absence of progress towards the recognition of an independent Palestinian state on the international stage. Short term political concerns are obviously taking precedence over long term economic considerations, as the PA essentially views its relations with EU through the prism of the conflict. According to the EU representation in East Jerusalem, the PA thus tends to privilege all measures which could have an estimated political impact and insist on maintaining a parallel approach with regard to concessions made

## EU as a second rank political player: European economic support as seen from the Palestinian territories

## The interim association agreement

## A particular political perception of the ENP

77 The results are available online at <http://www.neareastconsulting.com/surveys/intl/out/>

78 Rosemary Hollis (1997), op. cit, p. 15  
79 See also Hollis, R. (2004), 'The Israeli-Palestinian Road-Block: Can Europeans Make a Difference?', *International Affairs* 80 (2), pp. 191-255.

80 Between the end of 2005 and the beginning of 2006, the unfolding of the so-called "cartoons crisis" also caused a relative downgrading of the Euro-Arab bilateral diplomatic climate.

81 Interviews with Muhammad Shtayeh and Salam Fayyad.



by the EU to the Israelis<sup>82</sup>. The political role of the EU through its commercial policies is thus implicitly recognized, but only within a competitive interpretation building on the possible treatment that the Israelis could obtain from the Commission.

### From hesitations to sanctions: The negative effect of aid suspension on EU's image in the Palestinian public

The legitimacy and efficiency of international aid delivered to the Palestinians has been discussed extensively by the community of donors over the past two years<sup>83</sup>. When Nader Said discusses the Palestinian perceptions of Western aid, he identifies three levels of financial intervention to be taken into account: basic needs and relief, sustainable development and statehood<sup>84</sup>. The second and third items on the list still seem to be highly problematic at this stage. In the long run, a donor-fatigue phenomenon thus clearly started to emerge, firstly linked to the material destructions that occurred during the second Intifada, but also fed by the difficulties of the political reform of the PA. The donors actually increased their financial support in the immediate aftermath of Yasser Arafat's death; yet at the end of 2005, and especially in the months preceding the decision to suspend aid to the Hamas government, the Western donor community was progressively admitting that its enduring generosity had not contributed to the emergence of a sound Palestinian economic system, nor had it significantly helped to consolidate the political institutions of the would-be Palestinian state. The donor's growing reluctance to engage in what is perceived as useless efforts is probably not unconnected with the present consensus on financial sanctions applied to the Hamas government in Spring 2006.

The donor's evaluation of the financial reform of the PA conducted by Salam Fayyad when he was in charge of the Palestinian Ministry of finances was for instance rather severe and, according to most Palestinian officials, did contribute to the Fatah's electoral rout<sup>85</sup>. As the first global contributor to the Palestinians, the EU was primarily concerned by this background discussion. The former ministerial team considers that it would have been crucial for their electoral campaign that the EU assessed more positively the reform process and promised new resources to continue on the same path.

As far as aid is concerned, we already pointed to the manifest distrust of the Palestinians regarding any political linkage of assistance, fearing that it might convey some elements of the donor's political agenda that do not match the Palestinian needs or their political perspectives. The update of the Palestinian perceptions survey conducted in April 2006 by Near East Consulting does give a rather fair background picture of how the Palestinians see the European efforts in terms of relative importance, economic efficiency and political impact<sup>86</sup>. The EU does not seem to stand as particularly more legitimate than the US in this regard.

For one thing, the EU is widely acknowledged as being the number one donor to the Palestinian territories: it is perceived as "the International donor that provided most humanitarian and developmental assistance to Palestinian people", by 45.9 % of the people, while only 6.5 % quote the US, and 26.3% "the Arab countries". These results are in flagrant contradiction with the real amounts spent by each donor, except if one considers that the persons answering the poll did effectively take into account the continuation of some European projects after the international decision to suspend aid, while all US interventions stopped<sup>87</sup>. So, on the whole, the Palestinian vision of external assistance seems to be rather biased in favour of Europe. The contributions of the various EU member states also seem to be assessed in a rather uncertain way: a famous survey for instance revealed in early 2005 that France was thought to be the most important contributor to the Palestinians, whereas the French autonomous effort is rather modest compared to some other European states<sup>88</sup>.

The political qualification of the donor's efforts does stand in a rather stark contrast with this general appraisal of their financial effort. In the April 2006 Palestinian Perceptions Update, to the question "Who understands the Palestinian issue most?", the Americans rally 22.5 % of the people polled, which seems to be a rather fair proportion when compared to the 30.7 % gained by Europeans. Europeans are still heeded as "more understanding of the Palestinians" by 32.2 %, while the US mobilize only 8.6 % in this respect. One could infer from these results that the Palestinians do establish a link between the financial commitment of the donors and their moral commitment to the Palestinian people, but that it has a less direct link with their capacity to devise strategic views influencing a final political settlement.

On the whole, Palestinian analysts and leaders would also insist that the EU did not

82 Interviews with officials from the EU representation in the West Bank and Gaza Strip, June 2006.

83 See for instance the analysis by Nigel Roberts and Stefano Mocchi (2005), 'Palestinian Economic Revival', Bitterlemons-International, 15 (3), on <http://www.bitterlemons-international.org>

84 Nader Said (2005), *op. cit.*, p. 100.

85 AHLC, *op. cit.*; see also Fayyad's defence against Hamas accusations of corruption, 'O experts, Have Mercy on the Truth', 4th May, 2006, an op-ed published in the three main Palestinian newspapers.

86 <http://www.near-eastconsulting.com/surveys/update/out/>

87 At the exclusion of the US contribution to UNRWA.

88 Interviews (2006), French Consulate General in Jerusalem, June.

seriously oppose the American will to decide upon sanctions. The EU is apparently still not seen as having the capacity to influence such important policy decisions. Once again, the matter here is not with the EU being legitimate or not in interfering in the Peace Process; rather, the problem is about its chronic incapacity to exert any significant pressure on the US and Israel.

## 7. Conclusions and Recommendations

### Initial assumptions

- Honest broker status essentially depends on the level of trust expressed by the parties in conflict to the third party. In other words, the third party has to be perceived as legitimate.
- Legitimacy is gained through attending to the needs of the constituencies. This can be reached by means of economic initiatives.
- The US and the EU both could stand as potential honest brokers in the Israeli-Palestinian conflict.
- The US and the EU could gain legitimacy as honest brokers through their economic initiatives directed both at the Israelis and the Palestinians.
- The EU's capacity to act as a foreign policy power is weak and its main acting abilities derive from its economic status.
- US economic initiatives can be used as a complement to their active political diplomacy and their effective military capacities.
- The EU might be the only international actor capable of balancing materially the presence of the US as a superpower in the Middle East, therefore also balance their political views regarding a final settlement.

### Main findings and conclusions

- It is very difficult and artificial to establish symmetry between the Israeli and the Palestinian case.  
Both for legal and economic reasons, the two sides cannot react in the same way to external economic initiatives.  
The Israelis can determine their response to external initiatives in an autonomous way, while the Palestinians are essentially constrained and their margin of response is very limited.
- Since 1993, trade initiatives have not been explicitly considered by the US or the EU as political tools interfering with the path of the Peace Process. Yet these initiatives participate to the building of a peaceful environment and can be considered as confidence-building measures in that they encourage regional integration.
- Financial aid was used from the beginning by the international community to obtain political concessions from both sides during the negotiations, during the implementation phase of the Peace process.  
Since the starting of the second Intifada, the relative pressure was put essentially on the Palestinian side, through increased conditionality.
- The American role on the framing of the economic aspects of the Peace process has been relatively dominant. They were the initiators of the wide assistance effort of the international community for the Palestinians and they also originated the decision of Western donors to suspend aid to the Hamas government.
- Both the US and the EU powers had dreamt over the prospect of integrated economic development between Israel and the PA in the immediate aftermath of Oslo. The consistency of this design has been seriously eroded with the deterioration of the Israeli-Palestinian relationship, especially since the second Intifada.  
Both powers then maintained separate channels of influence with regards to both parties to the conflict. The overall economic rationale was lost on the way.
- The method of using material support to give Israel the confidence to go forward in the Peace Process has not achieved the desired results so far.  
US aid to Israel was never politically conditioned.  
The EU has not used the opportunity of the ENP negotiation to gain political leverage on Israel.
- As long as no final political settlement is reached, the development of the Palestinian economy remains conditioned to Israeli agreement.  
Under such conditions, some external economic initiatives cannot reach their objectives in the territories. In particular, the free trade agreements remain a dead letter.

- The US and the EU are not considered to be genuine honest brokers by the Israelis and the Palestinians at the same time. They have a rather complementary status, the former relatively receiving more trust in Israel and the latter among the Palestinians. Yet the Palestinians do not trust Europe to have any real influence on a final political settlement.
- On the whole, the Western powers have a problem with effectiveness more than with legitimacy.
- Despite a rather weak record so far, economic mechanisms should still be considered as an important instrument per se to influence future developments of the Israeli-Palestinian relationship. Both the US and the EU could reach considerable political leverage through an active, timely and adapted use of their economic tools vis-à-vis the protagonists of the conflict.
- The US and the EU should remain vigilant to see that their economic initiatives are effectively implemented, and reach their initial objectives, so that they are not reduced to shallow discourses.
- A balance could be stricken both on the Israeli and the Palestinian sides between “positive” and “negative” measures. The usefulness of “negative” actions has to be assessed in an interactive way, as their effect can be either constructive or detrimental for trust-building depending on the party involved.
- The Western powers should make their efforts to co-ordinate their respective approach to both parties in an integrated scheme, even if doing so in parallel. Reflecting upon a future assistance strategy for the Palestinians, the World Bank notably suggested that it would be wise to devise an approach conditioning assistance to the Palestinians on the performance of both parties – the Israelis and the Palestinians.
- The EU still has an option to pursue a rather independent policy, or to co-ordinate better its economic instruments with the US, if it is to contribute to a resolution of the conflict. This chiefly depends on the agreement of the Western Powers in what regards the terms of a final settlement.
- Future assistance strategy to the region should address more long-term regional development needs than short terms political concerns. Aid could thus be considered as a vital and successful tool capable of influencing Israel politically, especially as it should be actively searching for financial compensation for a possible withdrawal from the West Bank. Rather than focusing on military assistance to Israel and economic aid to the PA, the US could thus shift to more long-term development objectives.
- To gain more legitimacy, or trust, from the parties in conflict, both the US and the EU should give more publicity to their economic initiatives.

## Recommendations

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