REACHING THE UNTAPPED POTENTIAL

Enhancement of Trade Between the European Union and the State of Palestine

POSITION PAPER

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SUMMARY

In the present position paper, Palestine Trade Center (PalTrade) would like to address the Palestinian government's ministries to lay out the private sector's views on key challenges for trade with the European Union (EU).

Ever since the Interim Association Agreement (IAA) between the EU and the State of Palestine (SoP) entered into force in 1997, the number of EU member countries has increased from 15 to 28, tariff treatment of Palestinian exports entering these countries has been reduced until duty free, quota free trade was reached in 2012, and numerous programs in essential areas of economic cooperation have been induced in the framework of the 2005/2013 European Neighborhood (ENP) Action Plan. However, these measures have shown no significant impact: The SoP continues to be an insignificant trade partner for the EU and vice versa, Palestinian exports are not diversified, and the Palestinian integration in the Euro-Mediterranean Partnership is weak.

Challenges that impede trade relations between the EU and the SoP are not standing alone each on its own, but compose a matrix of interrelated challenges: High transaction cost mainly due to the occupation, the gap in standards and conformity assessment procedures, the lack of commitment of the Palestinian governments' bodies to eliminate the red tape, the deficient follow-up mechanisms, the non-consideration of the services sector in the IAA, the Israeli non-recognition of the IAA and the ambiguous position of the EU towards settlements' products which affects the developmental vision of the State of Palestine.

It is only an integrated and complementary matrix of responses that can address this set of challenges. Therefore, the Palestinian private sector calls for:

- Formulating and implementing a long-term EU intervention strategy that includes the complementary consideration of the 2013 Action Plan, the National Export Strategy (NES), the National Development Plan 2014-2016 and a full commitment from the EU to the developmental vision of the Palestinian state;
- Developing a clear position by the Palestinian government with regard to the failure to implement sanitary standards, ACAA and a one-stop-shop to date;
- Improving follow-up mechanisms, including developing and implementing specific responsibilities, indicators and time frames;
- Inducing a second phase of the Trade in Services program;
- Cooperating with the EU to develop market penetration programs and a Joint Investment Program targeting the EU markets.

LIMITED TRADE RELATIONS

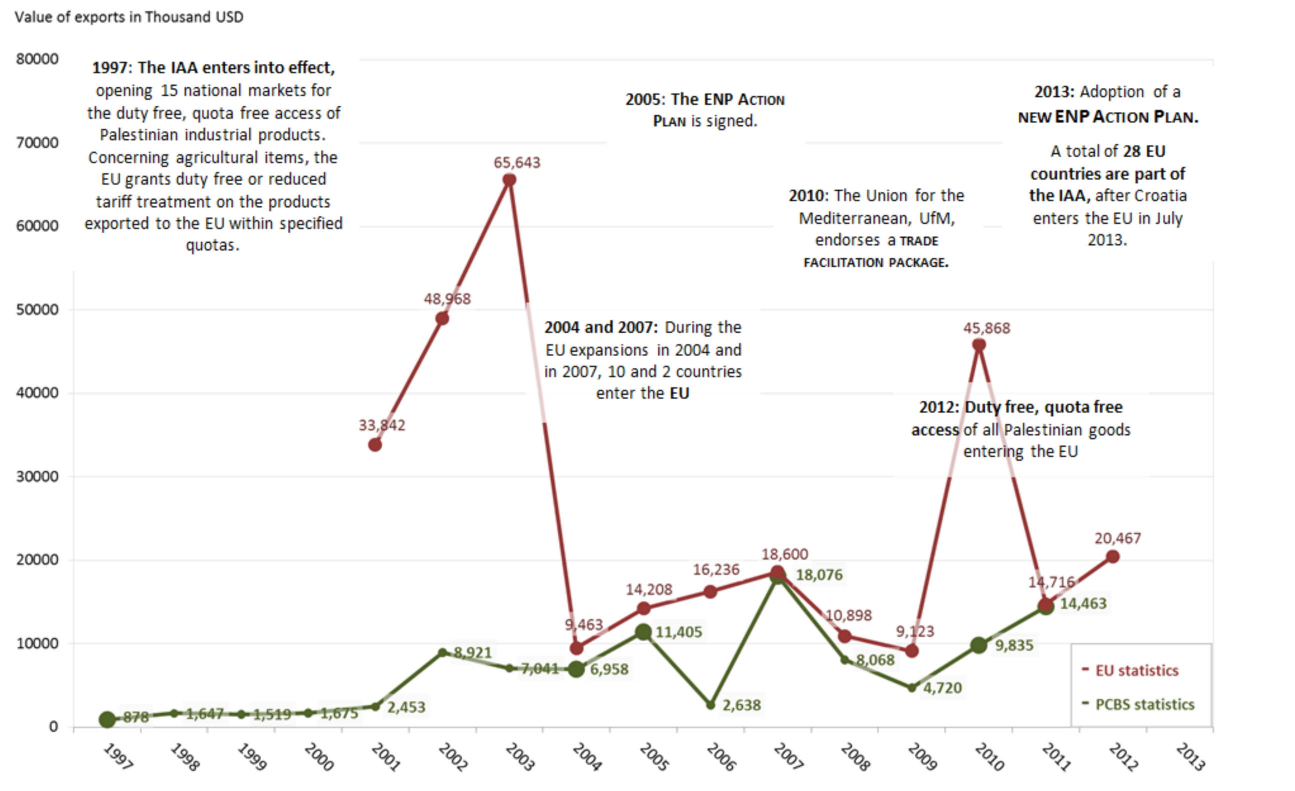

Figure 1: Timeline of economic cooperation: Palestinian exports to the EU and major economic developments from 1997 until today.[1]

As indicated in *Figure 1*, huge potential for trade enhancement has been created but remained untapped in the past 16 years. Exports to the EU have never exceeded an annual value of 20 million USD and the accumulated value of exports between 1997 and 2011 has reached 100.3 million USD only, which is three times less than Jordanian exports to the EU in just one year (2011).

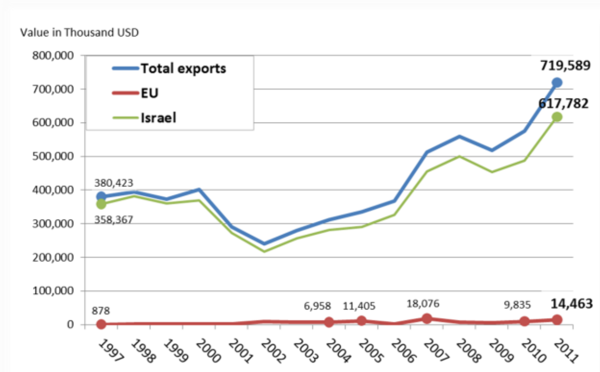

Figure 2: Palestinian exports 1996-2011 (Source: PCBS)

Despite the implementation of the IAA, the 2004 and 2007 EU expansions, which opened another 12 EU markets for Palestinian exports, the 2005 ENP Action Plan, the 2010 Trade Facilitation Package and the 2012 applied duty free, quota free entry of all Palestinian goods, the EU has remained an insignificant partner in trade for the SoP. Unless an integrated and complementary set of measures is taken as proposed in the present position paper, the 2013 adapted Action Plan is not going to have any impact either.

[1] All statistical data derives, if not stated otherwise, from Palestinian Bureau of Statistics (PCBS) and Trade Map: http://www.trademap.org/.
Figure 1 highlights that trade statistics usually differ, depending on whether they are based upon EU or Palestinian (PCBS) sources. PalTrade finds it difficult to provide an explanation for the particularly high divergences in the years 2003 and 2010.

An analysis of trade relations with the EU indicates that little progress has been made with regard to three key areas: The market share of Palestinian exports in the EU and vice versa are low, Palestinian exports are not diversified, and the Palestinian integration in the Euro-Mediterranean Partnership is weak.

(1) Low Trade Share: As illustrated in *Figure 2*, The EU has been an insignificant trade partner for the SoP vis-à-vis other trade partners and Israel in particular: In 2011, 86 percent of Palestinian exports were directed to Israel and almost 70 percent of Palestinian imports came from Israel. In contrast, the share of Palestinian exports directed to the EU represented only 2.01 percent of total exports. The share of imports from the EU reached 10.51 percent in the same year. Since 1997, the share of trade with the EU has increased by 1.8 percent for exports and 2.6 percent for imports.

From an EU perspective, the significance of trading with the SoP is much lower: In 2011, exports to the SoP accounted for only 0.008 percent of the EU's total exports, and imports from the SoP reached a mere 0.0002 percent of total EU imports.

(2) Low Diversification in Trade: On the one hand, the diversification of Palestinian export products and targeted markets is very low: Between 2007 and 2011, more than 80 percent of Palestinian exports were directed to only 5 countries in the EU, i.e., the Netherlands, Italy, United Kingdom, France and Germany.

On the other hand, products are not diversified either: *Figure 3* illustrates the five most exported products to the EU between 2007 and 2011. These products accumulated a value of 48.05 million USD during the aforementioned period, which accounts for a staggering 87 percent of the total exported value to the EU (55.3 million USD).

The figure also shows high instability throughout the years, even among the most important exported products. By way of example, monumental and building stone, as one of the top performing sectors, has continuously decreased between 2007 and 2011.

In total, the top 5 export products directed to the top 5 EU markets have accumulated 70 percent of the total export value between 2007 and 2011 *(Figure 4).*

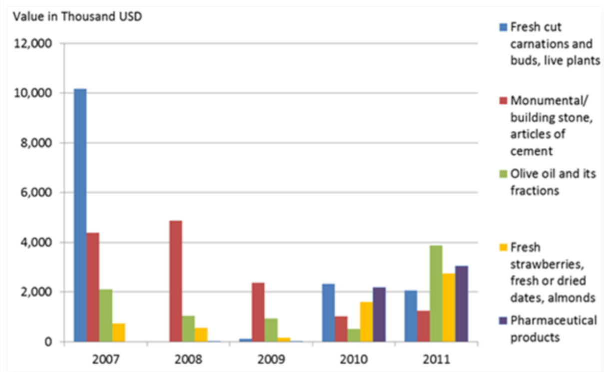

Figure 3: Palestinian export products to the EU 2007-2011

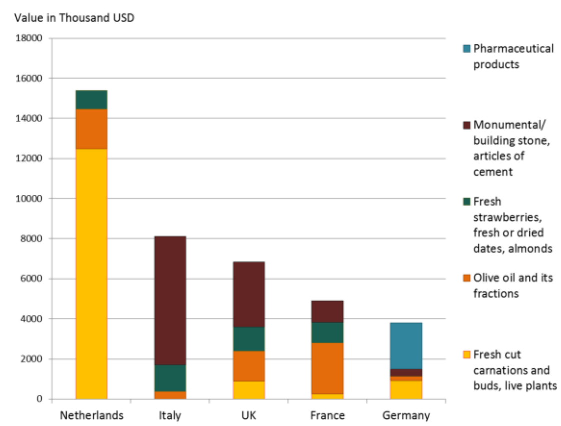

Figure 4: Distribution of the top 5 Palestinian exports among the top 5 export countries.

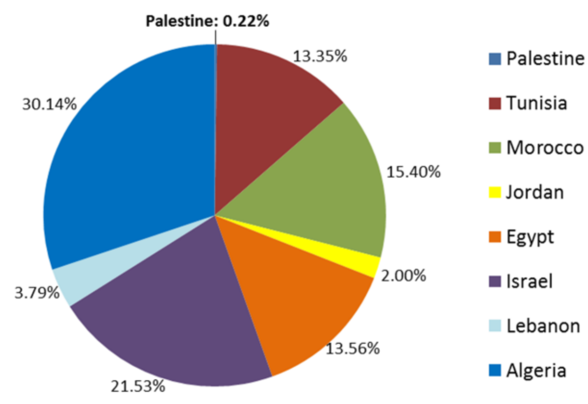

Figure 5: Trade with the EU: Share among South Mediterranean countries 2011 (Source: Trade Map and HCP Maroc).

(3) LOW REGIONAL INTEGRATION: Regional cooperation was identified as one of the key priorities of the IAA, and it was attached particular importance during the Barcelona Process and with the creation of the Union for the Mediterranean. However, compared with the Southern partner countries in the Mediterranean region, the SoP is by far the smallest trading partner for the EU: As illustrated in *Figure 6,* the Palestinian share of trade with the EU in 2011 was only 0.22 percent among South Mediterranean countries (the share for exports was 0.016 percent and 0.392 percent for imports).

CHALLENGES

As outlined above, the Palestinian export performance has remained weak: In the past 16 years, trade shares have not significantly increased, exports have been limited to five major products and five EU countries, and the Palestinian integration in the Euro-Mediterranean Partnership is conspicuously low. This limited impact is not due to a stand-alone challenge, but results from a matrix of interrelated challenges that has paralyzed the ability of the Palestinian private sector to benefit from the trade agreement with the EU. The key challenges for Palestinian exporters are as follows:

First and foremost, Palestinian exports are subject to exceedingly **HIGH TRANSACTION COST.** A comparison study that was recently conducted by PalTrade highlights the huge differences in export cost for Palestinian and Israeli exporters. The cost for internal transportation (670-835 USD) is 50 percent higher than for Israeli companies, because Palestinians often have to use two different means of transportation. If Palestinian exporters containerize in the West Bank, containers can be stuffed at 90 percent only to leave space for security checks. On the other hand, if goods are containerized at ports, exporters have to cover the loading cost. Furthermore, Palestinian exporters are required to send their goods three days in advance to the ports, in order to perform security checks, and therefore have to pay storage fees at around 250-300 USD for this period. Additional cost is related to crossing fees (83 USD at Betunia crossing) and sometimes towing cost related to security checks.

Further evidence for highly increased transaction cost was given by a World Bank report "Trading Across Borders". Taking into consideration the cost for export documentation and domestic transportation, the report indicates 40 percent higher cost for Palestinians compared to Jordan and 50 percent higher cost than for Israeli exporters.[2]

At the aggregate level, the EU tariffs on global imports are low and almost stagnant since 2000 at around 4.5% percent. For Palestinian exports, the abolishment of tariffs has decreased Palestinian export costs by 0 to 10 percent and in the case of olive oil by 45.01 percent. On the other hand, Palestinians face 50 and 40 percent higher costs than Israeli and Jordanian exporters, as for export documentation and domestic transportation only. Obviously, the abolishment of tariffs is not sufficient to compensate for these costs.

The **GAP IN STANDARDS AND CONFORMITY ASSESSMENT PROCEDURES** constitutes a key concern of the Palestinian private sector. Cooperation with regard to implementing sanitary, phytosanitary and industrial standards between the Palestinian government and the EU has taken place since many years and yet, no mutual recognition agreement (MRA) has been concluded between the two parties. Whereas phytosanitary standards are consistent with EU norms, sanitary regulations have to date not been implemented. Unfortunately, it is even considered unviable by public sector representatives, who argue that the high related efforts and expenses make their implementation unfeasible. However, the NES, which identified the processed meat sector as one of the promising sectors in the SoP, has proven otherwise. Similarly, the non-implementation of international industrial standards

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[2] World Bank: Trading Across Borders. URL: http://www.doingbusiness.org/data/exploretopics/trading-across-borders (a dataset that provides estimates of bilateral trade costs in agriculture and manufactured goods for the 1995-2010 period).
For each exported container, Palestinian exporters have to pay an average of 1,310 USD, compared to 620 USD in Israel and 825 USD in Jordan.[3] http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2012-001278&language=EN

and regulations has impeded the Palestinian exporters, especially in the pharmaceutical sector. Although the implementation of industrial standards has been targeted already in the framework of the 2005 ENP Action Plan, the Agreement on Conformity Assessment and Acceptance of Industrial Products (ACAA) is yet to be prepared, as highlighted in the 2013 Action Plan, through regulatory reforms and the strengthening of institutions in charge of accreditation and conformity assessment, metrology and market surveillance.

The **"RED TAPE"** among the ministries related to export procedures is strongly perceived by Palestinian export companies: A recent survey conducted by PalTrade, aiming at assessing the impact of non-tariff measures (NTMs), as well as several face to face interviews with companies that export to the EU, reveal that a considerable number of Palestinian companies is subject to export related measures applied by the State of Palestine. Agribusiness and leather industries are particularly affected, followed by the handicraft sector. A chemical industry company states that, in sum, "[obtaining] the [export] certificates takes too much time and moves". Similarly, a handicraft company complains that "to get the EUR1 certificate takes two days for me. Why don't they make all of the procedures in one office? It would be finished in just five minutes".
Since many years there has been a consensus among all private sector stakeholders on the importance of having a one-stop-shop to ease burdensome export procedures related to certification and other documentation. As highlighted during the focus group meetings, the Ministry of Agriculture has even submitted such a request for the herbs sector only, but the Ministry of National Economy and the Ministry of Finance turned down the request, claiming that such a one-stop-shop has to be implemented on a national level and for all sectors.

The reason why the implementation of the one-stop-shop, the ACAA and sanitary standards has not succeeded despite several programs and initiatives targeting each of these issues is a general **LACK OF TIME FRAMES AND FOLLOW-UP MECHANISMS.**

Similarly, the ENP Action Plan from 2005 and the new Action Plan do not provide a **LONG-TERM INTERVENTION STRATEGY**, including specific responsibilities, indicators and time frames, and complementary strategies, e.g. the NES, have not been appropriately considered. The activities of the Joint Committee and subcommittees have been similarly deficient, especially with respect to follow-up activities and private sector involvement: Although the private sector has been invited for preparatory meetings, no private sector involvement has taken place during the Joint Committee meetings and access to drawn up minutes has been limited.

Taking into consideration that the services sector contributed with 20 percent to the annual Palestinian GDP in 2011, and that its exposure to physical barriers is very low compared to other sectors, the **NON-CONSIDERATION OF SERVICES IN ANY TRADE AGREEMENT** with the EU certainly constitutes a loss for the Palestinian economy. In the course of the fifth EuroMed Trade Ministerial Conference in Marrakesh in 2006, it was agreed that negotiations for the liberalization of services should start between the EU on the one hand, and the Mediterranean partners on the other hand. However, it was later pointed out that the Palestinian services sector is not yet ready for negotiations due to the limited Palestinian capacities to negotiate, and the deficient legal and regulatory framework in the services sectors. The EU supported "Trade in Services" project was a positive step towards building capacities with this regard. Unfortunately, the project was limited to 4 sectors and a project period of 2 years only.

Other challenges are related to the **AMBIGUOUS POSITION OF THE EU** towards the developmental vision of the Palestinian state: While the EU condemns the illegality of settlements, it continues to support the economic viability of those very settlements by continuing to trade with them. Israel has orally informed the European Commission (EC) that settlement exports amount to 0.87% of total

Israeli exports to the EU, which equates a value of 124 million USD in 2010. This value is 12 times higher than Palestinian exports to the EU in the same year.[3]

Furthermore, the **Israeli non-recognition of the IAA** affects Palestinian importers in particular, because Israeli customs do not recognize certificates of origin (EUR1) that are issued pursuant to the IAA. Consequently, imported goods can only be exempted from customs, if the final destination of the EUR1 specifies the Association Agreement between the EU and Israel. The lack of concrete measures from the EU with regard to the Israeli non-recognition of the IAA and the entry of settlement products to the EU markets reflect the ambiguous EU position towards the developmental vision of the Palestinian state.

Recommendations

It is only an integrated and complementary matrix of responses that can address this set of challenges. The implementation of a long-term EU intervention strategy should be targeted as an overarching response. Based thereupon, the Palestinian government's bodies should develop a clear position with regard to SPS, ACAA and a one-stop-shop, improve follow-up mechanisms, induce a second phase of the Trade in Services program, and develop market penetration programs and a Joint Investment Program in cooperation with the EU. Whether or not the implementation of this matrix will be successful depends on the commitment of both the SoP and the EU. Whilst the Palestinian government needs to be more committed with regard to sanitary standards, the deletion of the red tape, and the adaption of efficient follow-up mechanisms in line with a long-term intervention strategy, the EU needs to be fully committed to the developmental vision of the Palestinian state.

Recommendation I: Endorse a long-term intervention strategy

The Palestinian private sector suggests that a long-term intervention strategy should be endorsed that provides a basis for cooperation in the framework of the IAA and all related activities of the Joint Committee and the subcommittees. In this framework, the 2013 Action Plan should be reviewed, taking into consideration that the Action Plan, the NES, the current NDP, the 2014-2016 NDP and the Trade Facilitation Package are complementary and therefore need to be included in a long-term intervention strategy.

In order to ensure the efficient implementation of such a long-term intervention strategy, a full commitment from the EU to the developmental vision of the Palestinian state is required. In this context, the EU should explain why it continues supporting the economic viability of Israeli settlements by trading with them. In a further step, it is necessary that the EU entirely bans settlement products from the EU market, instead of only excluding them from preferential treatment.

Furthermore, a parallel track by the EU is needed to put pressure on the Israeli government to facilitate Palestinian exports and therefore recognize the concluded trade agreements between the EU and the SoP.

With respect to the number two priority objective of the recently concluded new Action Plan – to prepare for the establishment of a fully-fledged Association Agreement – the private sector calls for a long-term intervention strategy and a full commitment from the EU to the Palestinian developmental vision and set up priorities within the NES.

Recommendation II: Develop a clear position with regard to SPS, ACAA and one-stop-shop.

The private sector has continuously stressed the significance of a one-stop-shop to facilitate export procedures. The Palestinian private sector therefore calls upon the Palestinian government to develop a position to identify the reasons why a one-stop-shop seems to be a "mission impossible"

[3] http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2012-001278&language=EN

and why the ministries have not followed up on previous initiatives for the herbs sector. Provided that a one-stop-shop is considered possible, immediate meetings should take place with the concerned ministries and stakeholders to develop an implementation strategy at the soonest possible.

Furthermore, given that the SoP has not succeeded in concluding MRAs even after so many years of internal institutional building, the Palestinian private sector suggests that the Palestinian government develops a position to identify the reasons behind this failure and to tackle the state of affairs with regard to SPS and ACAA. This position should consider the NES and the identified priority sectors within the NES, since for many of them the implementation of SPS and ACAA would be vital. Under the condition the implementation is not considered impossible, a program should be developed to tackle the required measures for the implementation of the food safety strategy, the food safety law and ACAA, and support the establishment of accredited laboratories and the Palestinian Standards Institute (PSI).

Recommendation III: Improve follow-up mechanisms

In line with the long-term intervention strategy, all activities related to the Joint Committee and the subcommittees should be accompanied by a performance measurement framework to follow-up on the adaption of specific responsibilities and time frames. Particular emphasis should be placed on monitoring the integrative and complementary consideration of the ENP Action Plan, NES and NDP. Having said this, the private sector recommends:

- The conduction of quarterly meetings to discuss and assess the progress made with all key stakeholders;
- Encouraging and facilitating the private sector's involvement in all activities of the Joint Committee and the subcommittees, including annual Joint Committee meetings;
- Strengthening the communication channels for a better private sector access to information about Joint Committee and subcommittee meetings, the taken decisions and drawn-up minutes.

Recommendation IV: Launch a second phase of the Trade in Services program

In view of its high significance in the Palestinian economy, the Palestinian private sector suggests launching a second EU supported program that directly follows up on the first Trade in Services project. In this follow-up project, further priority sectors (other than the four identified sectors in the first Trade in Services program) should be identified and the capacities should be built to enter negotiations with clearly identified private sector interests and priorities.

Besides, an assessment of legislative, technical and administrative capacities in the priority sectors should take place, in addition to capacity-building of the PSI.

Recommendation V: Develop market penetration programs

With support from the EU, the creation of market penetration programs and a Joint Investment Program should be targeted as a tool to facilitate market access to the EU and develop sustainable relations in trade and investment between the EU and the SoP.