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DEVELOPING THE PALESTINIAN ECONOMY

AN INTERVIEW WITH GEORGE T. ABED

JPS: How would you assess the Paris protocol regulating economic relations between Israel and the self-governing areas concluded in late April?

Abed: Considering that the Paris protocol was conditioned by the Oslo agreement, itself based on the notion of “limited autonomy” for the Palestinians, one would have to say that the results achieved in the Paris negotiations in some respects are more favorable to the Palestinians than one would have expected from a careful reading of the Declaration of Principles (DOP) itself.

For example, in the area of trade with the outside world, the West Bank and Gaza Strip (WBGs) under Israeli occupation were prevented from developing normal trade relations with the neighboring Arab countries. Trade with Jordan did not exceed 10 percent of the total volume of trade of the WBGs, and most of the time it was far less. Under the protocol, the Palestinians have the right to define their own import policy, fix tariff rates, and set inspection and valuation standards for a large number of commodities, including such basics as sugar, rice, and various other foodstuffs well as development inputs such as cement, lumber, machinery, and petroleum products. Thus, although the Palestinians still have to import many of their requirements under an Israeli customs regime, the value of goods that can

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now be imported from the Arab world and beyond under a purely Palestinian trade regime could involve hundreds of millions of dollars a year. Of course, the agreement does not give the Palestinians the right to conduct their foreign trade as they please and in accordance with their own national interests. But for that, the blame falls to the DOP, not to the Paris accords.

In the area of money and banking, the Palestinians, according to the protocol, are now able to set up their own Palestinian Monetary Authority, the PMA, with powers to license and regulate banks in the WBGS, manage official reserves, serve as a lender of last resort, and settle foreign exchange accounts with Jordan and Israel. In fact, these powers were not even foreseen in the DOP.

In a third area—capital markets, income tax, investment incentives, insurance, and so on—the Palestinians have complete authority to conduct their affairs as they see fit. In the case of indirect taxation and specifically the value-added tax (VAT), the system in the WBGS will have to remain fairly close to that in Israel, but in the end this may not be such a bad thing. Israel has one of the most efficient and developed VAT systems in the world, and if the Palestinians were to run their system as efficiently they could cover a substantial portion—perhaps more than half—of their current budgetary requirements from the VAT alone. This would not only help mobilize domestic resources and dispense with the need for foreign budgetary support, but could also permit a reduction in the income-tax burden, especially on lower-income groups.

Finally, on trade with Israel, whereas in the past the Palestinians had no say whatsoever about what they could export to Israel, under the protocol they are able to export almost everything without limits, with the exception of six agricultural commodities which can now be exported to Israel within prescribed limits. I do not expect these limits to hold because of the porosity of the borders and the irrepressibility of market forces. In any event, even these restrictions will be lifted after four years, beyond which it will be totally free trade.

One area in which the Palestinians did not achieve improvement was that of labor, and Israel continues to control the flow of Palestinian workers into Israel.

There are, of course, other problems with the Paris protocol, and here I would single out its total neglect of the special relationship between the WBGS and Jordan. But perhaps we can return to that issue later.

JPS: You mention lack of improvement in labor inflows into Israel. Is this not a serious matter, Palestinian labor in Israel being one of the major sources of income in the occupied territories?

Abed: Unfortunately, yes. I suspect, however, that the Israelis sooner or later will have to open their borders again to Palestinian workers. Probably not at the pre-Gulf war levels, but perhaps as many as 50,000 or 70,000, which would relieve somewhat the pressure on the Palestinian labor market.

I must say, however, that I find it ironic that the Palestinian leadership, which presumably seeks total independence from the Israeli economy, should be pushing for a large share of its labor to seek work in Israel. It ought to be the priority of the leadership to mobilize the Palestinians in an urgent, national crusade to implement the development program as fast as possible so as to create employment for its people at home. Now I am realistic enough to know that such a goal can be achieved only over the long term and that there is no alternative for the immediate future. But I have not seen a Palestinian leadership articulate such a vision.

The leadership should mobilize Palestinians in an urgent, national crusade to implement the development program as fast as possible.

JPS: A World Bank press release notes that the per-capita gross domestic product (GDP) of the territories is better than that of Jordan and Egypt, but that services such as power, water, and telephones are on a par with some of the least-developed countries in the world. To what do you attribute this disparity, and indeed the state of the infrastructure in general?

Abed: There is no doubt that during the twenty-seven years of Israel's occupation, the infrastructure of the West Bank and Gaza fell far behind that of Jordan, for example, which during the same period achieved impressive progress in developing its infrastructure, transport, and communications systems, and health and education facilities despite its lower per capita income. Under the occupation, Israel's expenditures on the development needs of the West Bank and Gaza were insignificant, even while its expenditures on infrastructure for the settlements amounted to several billion dollars—more according to some estimates. These facts are not in dispute. Indeed, World Bank studies have indicated that at least since the mid-1980s, the Palestinians have been paying more in taxes to the Israelis than the Israelis have been spending in the occupied territories: the estimate for recent years is that about a third of the total tax revenues collected from WBGS residents never got remitted there—the amount has been broadly estimated at about \$150 million a year. Under the terms of the Paris protocol, the Israelis will continue to collect taxes on goods imported through Israeli ports or manufactured in Israel and shipped to the WBGS, but the funds thus collected will now be transferred to the Palestinian authority according to well-specified calculations and procedures.

JPS: From your various trips to the occupied territories and Tunis since the signing of the DOP, how would you assess the transfer of authority so far?

Abed: The transfer negotiations took longer than expected, and from the signing of the agreement on 13 September until the Israelis finally left Gaza and Jericho on 18 May, there was a significant erosion of support both for the agreement itself and for its architects within the PLO. At the same time, the economic (as well as political) situation on the ground deteriorated in many important respects. With the closure of the borders, delays in investment,

and disillusionment with aid prospects, the economic recession and political malaise deepened. Meanwhile, little has been done to elaborate the legal and regulatory environment necessary to stimulate private investment, and the development program that could have begun to be implemented as early as last October or November has not gotten off the ground. Precious time has been wasted even as the economic situation has continued to worsen.

As for the transfer process itself, in the narrowest sense of the term it has been successful. The Palestinian security forces are on the ground, the Palestinians have taken over all government departments, and above all intra-Palestinian peace has been preserved.

But one gets the impression that the Palestinians, in contrast to the Israelis, were improvising. Local Palestinian leaders, appointed from Tunis and often without adequate preparation, made valiant efforts to cope but were clearly hampered by lack of guidance from the PLO leadership. The situation is especially worrisome in the critical area of fiscal administration—that is, the management of public finances—which simply collapsed with the departure of the Israelis due to total Palestinian lack of preparation. Tax revenues could not be collected and public expenditures could not be effected.

Of course one would hope that these problems will be remedied now that the Palestinian National Authority (PNA) has been constituted and the officials charged with the financial systems have been appointed. At the same time, I would have to say that the appointment process has been murky, to say the least: one is unclear as to the constitutional basis on which the PNA or its individual members have been appointed, not to mention the legal framework for the discharge of their public responsibilities. One also has to say that the appointments thus far do not inspire great confidence, and it is disturbing that there has been little attempt to call upon the large numbers of highly competent and experienced professionals from among the wider Palestinian population.

JPS: One could not accuse you of excessive optimism . . .

Abed: The challenges are in fact enormous. It is not only a question of picking up the pieces and reconstituting a civil government out of an occupation administration. There is also the task of incorporating the incoming PLO governing structures, such as they are, into what is essentially a rebellious—but open and democratic—civil society in the West Bank and Gaza.

There is the challenge of constituting and efficiently running the institutions of national self-governance so as to generate the needed revenues and fund the basic services required by a population that has been deprived for so long of the essential requirements of a decent life. There is the need to establish the “rules” for a pluralistic and secular political life and ensuring that the forthcoming elections in the WBGS will be free and fair. Institutional machinery needs to be created to implement an ambitious development program of nearly half a billion dollars the first year and to administer the trade, monetary, and financial responsibilities acquired by virtue of the Paris protocol.

Relations with the Arab countries, and above all with Jordan, currently not in the best of shapes, need to be improved and strengthened.

If you were to ask me whether the PLO can meet these challenges successfully, I would have to respond with pessimism.

JPS: You mentioned that the development program has not yet gotten off the ground. One also hears that all this aid pledged has been very slow in coming. What is the reason for this?

Abed: The responsibility for lack of progress in disbursement of aid funds lies both on the donor side and on the Palestinian side. But first it is worth noting that the expectations engendered by the announcement of the \$2.4 billion in pledges last fall were unrealistic: too much attention was focused on the size of the funds, and not enough on the institutions needed to translate the aid commitments into tangible projects on the ground.

Beyond that, one can point to two areas of weakness. One is that the Palestinians themselves were quite slow, as I indicated, in setting up competent and operational institutions for project and program management—definition of development projects, preparation of documents and studies, provision of managerial supervision, and interaction with the donors on priorities and funding mechanisms. Even today, nine months after the signing of the DOP, the institutions on the Palestinian side are not fully operational.

JPS: What was the bottleneck there?

Abed: One can only speculate. Certainly, there were delays on the part of the PLO in making the necessary decisions to authorize officers on the ground to act on its behalf. Part of the reason is undoubtedly the management style of PLO Chairman Arafat who, not surprisingly, was reluctant to permit the establishment of modern institutions with the kinds of built-in checks and balances, controls, audits, etc. that would undermine his personal control. In general, the PLO leadership in Tunis did not show sufficient understanding—or at least underestimated the complexities—of setting up and operating modern governmental institutions. Add to that the fact that they were so preoccupied for so long by the negotiations in Cairo and later in Paris that, given their limited administrative capacity, they had few resources left over to look after the task of institution-building or interaction with the World Bank and with donors and all the associated technical complexities on hundreds of development projects.

The sad part is that the Palestinian private sector, with its enormous capabilities and rich experience, could have been a key factor in the implementation of the entire development program if it had been called upon to do so. While for the PLO, the management of the proposed program poses an overwhelming task, for a number of Palestinian private companies the implementation of projects on the scale envisaged is routine. To illustrate my point, the entire first-year development program for the WBGS, estimated now by the World Bank at about \$400 million, represents less than 30 percent of the annual turnover of a single Palestinian company, the Consolidated Contrac-

tors Group, which has nearly a half-century of stellar performance in engineering and construction in the Middle East.

The donors, for their part, also showed a lack of understanding for the complexities of Palestinian society and the intricacies of decision making within the PLO. For example, too much emphasis was placed on PECJAR [Palestinian Economic Council for Development and Reconstruction] as the sole vehicle or outlet through which funds can be spent, to the neglect of the broader spectrum of institutional structures needed to provide support, complementarities, and proper reviews and controls.

At all events, the Palestinian authorities in the last few weeks have signed agreements with the World Bank on technical assistance and on at least a part of the development program so as to permit some of the funds, at least those allocated by the World Bank itself and by a few of the donors, to begin to be spent.

JPS: *Is some progress being made about setting up the other structures necessary for the aid effort?*

Abed: The most crucial missing link is in fact the fiscal system. Most departments in the West Bank and Gaza that existed under the Israeli Civil Administration were managed largely by Palestinians and these will continue to function—health, education, social welfare, and so on. But without the support of a well-functioning fiscal system, these too will soon run out of funds and could cease operating altogether. When the Israelis left Gaza and Jericho, and in the absence of coordination, they left an enormous void that the Palestinians were unable to fill. All the finances for the West Bank and Gaza—taxation, cash management, budgeting, payrolls, financial audits, and so on—were in the hands of the Israelis. All data processing for the budget, tax, and treasury operations was done and continues to be done in Israel. There was no processing capacity in the West Bank and Gaza, so even if there were Palestinians with the training and experience to manage the system, they could not do so without agreement with the Israelis on the use of the computer hardware and software in three specialized centers in Israel. But in fact, there are very few Palestinians in the WBGS with the qualifications required for the highly sophisticated tax, budget, and treasury systems the Israelis have introduced over the past several years. The IMF, in the context of its technical assistance program, had urged that precautions be taken prior to the Israelis' departure so as to ensure at least some continuity in the processing of public revenues and payments, suggesting for example that Palestinian specialists could be recruited at an early date to work closely with the Israelis to learn about the systems in place. The IMF also offered to train Palestinian officials in the administration of taxes and in financial management in general. Unfortunately, the necessary preparations were not made, and the result is that the financial system in Gaza and Jericho is, as of now, not operational. Unless the Palestinians resort to some emergency measures to reactivate the systems in place, they will not generate the revenue

needed for the budget of the prospective Palestinian administration nor make the necessary payments for the various services, including the payroll of public employees. The danger—and tragedy—of such a situation would be that most of the revenues available to the self-governing authority would then derive from transfers from Israel of taxes collected there, making the WBGS even more dependent on Israel than before.

It is important to emphasize, though, that this situation may be only temporary, and that the Palestinians, after an initial period of adjustment accompanied undoubtedly by some loss of revenue, will be able to reconstitute the fiscal administration in Gaza and Jericho initially, and then make adequate preparations to assume full fiscal responsibility in the remainder of the West Bank once an agreement on this area is reached.

JPS: Getting back very briefly to the donor issue, there is some talk about the Palestinian authorities trying to bypass the international institutions and go directly to the donors or, as has been reported, to private companies on some of the projects. If this is the case, what are the implications of such bilateral dealings?

Abed: One hears about such contacts, and to the extent that it is a question of *contacts*, there is no harm. However, if actual *deals* were to be made between the donors or companies and the PLO or, even worse, certain individuals within the PLO, this would be most unfortunate. Each of the donors understandably has its own agenda in formulating its approach to aiding the Palestinians. It is important that the Palestinians avoid becoming captives of any one bilateral relationship or of a conflicting array of such relationships. In dealing with international institutions, the Palestinians would benefit not only from their rich development experience, but also from the accountability and transparency of the systems and procedures they use to process development aid. This is especially important for the Palestinians, not only because they are still new to this game but also because the amount of external assistance to total resources is disproportionately large. The Palestinian leadership would therefore be strongly advised to proceed as rapidly as possible with the establishment of modern institutions of financial management whose procedures are clear, transparent, and where officials are known and accountable. Once these systems are established in accordance with the law, then all contacts with external parties would proceed within the established guidelines and contracts would be subject to open and competitive bidding, audits, and all the checks and balances normally observed under internationally accepted standards of project management. Without this, the door is open to possible corruption, kickbacks, mismanagement, and, ultimately, economic and political failure.

JPS: Although, as you said, time has been lost or wasted in the delays, what should be done now?

Abed: There are certain basic tasks which would constitute the cornerstones of the new edifice that is being erected in the WBGS. The extent to which

the Palestinian leadership succeeds in completing these tasks will determine whether this edifice will endure or collapse under the accumulated weight of shortsightedness and mismanagement.

The first of these tasks is to create the appropriate political, legal, and administrative structures capable of accommodating the urgent requirements for justice and stability while, at the same time, permitting the kind of economic and social development that would fulfill the inflated expectations of the Palestinian population. There is presently no coherent legal structure to guide the Palestinian National Authority in carrying out its mission. What exists now is a confusing mix of British Mandatory laws, Jordanian laws in the West Bank, Egyptian administrative regulations in the Gaza Strip, and, superimposed on these systems, nearly 2,000 military orders touching on every aspect of daily life imposed by the Israeli occupation since 1967. Clearly, a new legal structure needs to be developed.

Second, the institutions that constitute the flesh and bones of any modern society have to be built, reconstituted, or modernized, and made fully operational. These include not only the core institutional structures such as an independent judiciary, a democratic legislature, and an appropriately defined executive, but also all the other institutions that define the web of the normal relationships between the authority and the citizenry—a financial administration, educational system, health and social-welfare system, and so on.

Third, it is critical that the development program be organized and launched immediately in order to prepare the basic infrastructure, create jobs and thus confidence about economic prospects under Palestinian self-government.

Fourth, economic and financial relations with Jordan (and in due course with the other Arab countries), which have been strained by negligence and lack of coordination, have to be resuscitated and put on healthier grounds so that the two economies can benefit from the synergies that exist between them—movement of goods and labor, financial intermediation, tax and tariff harmonization, and so on.

Finally, appropriate incentives have to be put in place to bring the dynamic and resourceful Palestinian private sector into the picture. We are all aware of the fact that Palestinian entrepreneurship has been instrumental in the development of neighboring Arab countries over the last forty years, and this rich and diverse resource needs to be brought into the reconstruction and development process on an urgent basis. In today's world, the government can only do so much—it is really up to the private sector in the end to carry the burden of job creation, industrial and touristic development, modernization of communications and transportation systems, and so on.

JPS: You have said on earlier occasions that the DOP is fundamentally flawed. Yet from your remarks you seem to be assuming that if there is failure it would be due mainly to Palestinian mismanagement . . .

Abed: I am not assuming that at all. What I am trying to say is that a Palestinian leadership that has unilaterally reduced its mission of “national liberation” to that of limited self-rule has no right to fail in this more limited endeavor. Such failure would be catastrophic for the Palestinian people.

Certainly, the constraints on the capacity of the Palestinians to make the agreement succeed are severe and may be crippling. If the problem of the settlements remains unsolved, if Jerusalem is out of reach for the Palestinians, if sovereignty on the land is not established, the agreement may not be able to stand. Aside from these political constraints, there are also serious constraints in the economic domain limiting the capacity of the Palestinian economy to grow in the most favorable directions. These constraints may not be critical in the very early period, just as the political constraints may not become an issue until the final-status talks begin. These are the implicit assumptions of the Oslo framework: they may be reasonable, but they could equally be wrong. I do believe, however, that the way the Palestinian leadership has positioned itself places a disproportionate share of the burden of succeeding on the Palestinians themselves.

The logic of the DOP is such that every step determines the step that comes after it, and if you fail in one step that means that you cannot go on to the next. Other nations seeking self-determination are not normally subjected to this series of trials of ascending difficulty in order to achieve their basic freedoms. Moreover, there is no guarantee whatsoever that at the end of this sequence of hurdles the Palestinians will achieve full self-determination. To the Palestinians, this is a fundamental flaw.

From a Palestinian perspective, there is still another sense in which the DOP is flawed. To Palestinians, the PLO has always embodied their deep sense of identity and national unity. It was to safeguard their national aspirations and historical claims. By engaging itself so directly and zealously in the arrangements for limited autonomy in the WBGS, the PLO has now reduced its stature; to Palestinians outside the WBGS—and they are, after all, the majority—it may have compromised its legitimacy. The wiser course might have been to promote the local leadership in the occupied territories to conclude, with PLO guidance, the agreements on limited autonomy. In this way, the PLO would have been able to safeguard its own broader role as the custodian of the Palestinians’ national claims until such time as they could be dealt with. At the same time, it would have reinforced its authority as the sole legitimate representative of all Palestinians everywhere.

But all this is academic now. The agreement is signed and thus a fact of life. What is the alternative? The leverage the Palestinians had before—the intifada, the pressure on Israel from the international community, the Arab consensus, the PLO’s ability to advocate the Palestinian cause and achieve

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resonance within the world community—most of these have been either dissipated or neutralized.

For all its restrictions, the agreement does give leeway to build a democratic and open society and a fast-growing economy. Success in these areas at some point could begin to erode the limits of the agreement. In any case, success in that enterprise is more desirable than the former state of affairs.

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And here I think everyone has a real responsibility—not only those who support but also those who oppose the agreement. It does not help the future of the Palestinian people to simply stand on the sidelines and attack the agreement without offering constructive alternatives. We have to do better than that. There are plenty of ways of contributing to the development effort even if one is less than

happy about the path chosen.

JPS: I wonder if you could return the point you mentioned about the need for the Palestinians to coordinate with Jordan?

Abed: One of the unfortunate consequences of the go-it-alone strategy of Chairman Arafat is the negative fallout on the Palestinian-Jordanian relationship. There is no doubt in my own mind that it is in the Palestinians' own interests to maintain a close and open relationship with Jordan. Jordan can easily do without the WBGs, but I am almost certain the reverse is not true. It is thus imperative that consultation and coordination between the two sides remain the key features of their special relationship.

In the economic sphere, some issues have been left to fester unnecessarily. They should be resolved without delay. On the question of trade between the WBGs and Jordan in the wake of the Paris protocol, the Palestinians did their best to open up trade with Jordan and, as I indicated earlier, achieved a great deal although they did not—they could not—free the Palestinian economy completely from its close association with that of Israel. The challenge for both Palestinians and Jordanians is to exploit the opportunities opened up by the Paris protocol and seek to expand them toward completely open and free trade in the future.

Another issue of contention relates to the question of the currency or currencies to be used in the WBGs, and perhaps some remaining issues related to the regulation of banks, especially Jordanian banks opening up branches in the West Bank and Gaza. A third area that has come under discussion relates to the intermediation of foreign funds for aid projects in the WBGs, where the Central Bank of Jordan could serve as an effective vehicle until the Palestinians establish their own institutions. In any case, the Palestinians should reach agreement with the Jordanians on all these issues as soon as possible, because delays will be more costly to the Palestinians.

JPS: *Do you think the Palestinians will ever have an independent state?*

Abed: We are a long way from a state, despite the optimistic pronouncements from the leadership. Transforming the present arrangements into statehood would depend on enormous goodwill and flexibility on the part of the Israelis, including readiness to yield on the vital and highly charged questions of the settlements, Jerusalem, land and water rights, and so on. It would also require enormous ingenuity, resourcefulness, and hard work on the part of the Palestinians, as well as sustained support from the international community. I am not sure one can count on all three requirements to materialize. The Israelis have been extremely correct in meeting their obligations under the agreement, and they certainly want the experiment to succeed insofar as they do not want to live with the consequences of Palestinian collapse. But they have been strict constructionists so to speak in interpreting the agreements, and could not be accused of excessive generosity or goodwill. As for the international community, I suspect that beyond the initial period of a year or two it could very well begin to lose interest and go on to occupy itself with other things.

In the final analysis, it will depend on the Palestinians' own capacity to organize and to mobilize their resources for reconstruction and development. This is their chance: if they succeed in establishing a democratic and open society and a vibrant and dynamic economy, then I have no doubt that the claim to a state will be heard and, I think, accepted.

To my mind, one of the dangers facing the Palestinians at this point is not to recognize the opportunities that exist now, and either not to exploit to the utmost the full panoply of instruments at their disposal or to try to jump over them in attempt to achieve something larger than what is in the agreement.

In my view, it is really far more important for the Palestinians at this juncture to work hard to create a democratic, open, and prosperous society, and to let the path to statehood take its course, rather than insist on all the trappings of statehood at the expense of political and social and economic development. What is the point of a state that is sovereign with all trappings of independence—a central bank, a currency, borders, armies, a police force, and so on—but which is totally destitute, dependent on aid, heavily in debt, and unable to manage its own affairs? We have enough examples of sovereign states such as this.

It would have been ideal for the Palestinians to have gained full independence first and then gone on to build a democratic society and a prosperous economy. Then the Palestinians would have had the best of both worlds. This did not happen and, I am afraid, we have to do it the hard way. For the sake of everyone in the region, and above all the Palestinians themselves, let us hope it works.

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