

Israeli-Palestinian Trade Relations Before the Israeli Supreme Court: The Case for an FTA

Arie REICH^{*} & Guy HARPAZ^{**}

The Israeli Supreme Court recently delivered a judgment regarding a trade dispute between a Palestinian importer and Israeli trade authorities. The court relied on a trade agreement between the State of Israel and the Palestine Liberation Organization (PLO) (the 'Paris Protocol') of 1994 and concluded in favour of the Israeli authorities, based on a formal reading of the agreement. After analysing the judgment and concluding that its ruling is correct according to the prevailing law and trade agreement, this article suggests that the judgment underscores the fact that the Customs Union model used to regulate contemporary trade relations between the parties is inadequate. It further argues that a Free Trade Agreement would be a better model, which would allow the Palestinian Authority (the 'PA') to take responsibility for its trade policy, design a trade policy that would fit its needs, and promote more equal, reciprocal relations between the parties. Along with other democratic and governance reforms within the Palestinian Authority, such a model could reduce its economic dependence on Israel, improve diversification, support economic development, and reduce the concern for fiscal leakage connected to the current trade agreement. The article also calls for strong anti-corruption measures to be implemented within the Palestinian Authority to achieve these goals. Overall, the article highlights the need for a new trade agreement that promotes economic growth and development for both parties.

Keywords: Customs Union, Free Trade Agreement, Israel, Palestinian Authority

1 INTRODUCTION

This article addresses the recent judgment of the Israeli Supreme Court (**Alfaloga Food Products Company**),¹ dealing with trade issues between the State of Israel and the Palestinian Authority (**PA**), with a view to drawing from it broader conclusions regarding the desirable framework by which trade relations between the State of Israel and the PA should be regulated.

^{*} Prof. of Law and Vice Rector, Bar Ilan University. President, International Academy of Commercial & Consumer Law. Email: Arie.reich@biu.ac.il.

^{**} Arnold Brecht Chair of European Law, Faculty of Law and Department of International Relations, Hebrew University of Jerusalem and the University's Dean of Students. We are grateful for the useful comments and research assistance of Yuval Abramovich. The usual *caveat* applies.
Email: guy.harpaz@mail.huji.ac.il.

¹ High Court of Justice 1038/22 *Alfaloga Food Products Company v. Ministry of Economy and Industry* (2 Jun. 2022) (Isr.)

The case dealt with 1,300 tons of non-kosher meat that was imported by a Palestinian corporation, Alfaloga Food Products Company, to the Israeli ports of Haifa and Ashdod, with a view to selling it to Palestinian consumers in the territories of the PA (the **Territories**). The meat was stored in Israeli customs warehouses, awaiting its release. The Israeli Customs Authority refused to release the meat, relying both on agreements signed by the State of Israel with the Palestine Liberation Organization (**PLO**) and on Israeli Law.

The dispute illustrates the problems with the economic agreement concluded between Israel and the PLO in 1994 as part of the Oslo peace process, known as the **Paris Protocol**, and the dire need to revise it. We will argue that the Paris Protocol has failed to achieve its full objectives and that the time and circumstances are ripe for a fresh, mutually beneficial trade regime, in the form of a Free Trade Area (**FTA**).

2 THE CURRENT TRADE REGIME

The principle guiding the customs policy for goods imported through Israel to the Territories is a common customs envelope. According to this principle, Israel is required to implement its regulatory regime applying to these goods in the same manner as it does to goods imported into Israel. Thus, the common customs envelope is shaped in accordance with Israel's trade laws.

This principle is anchored in the framework of the Paris Protocol on Economic Relations between the Government of Israel and the PLO, representing the Palestinian people, dated 29 April 1994,² attached as Annex IV to the 1994 Agreement regarding the Gaza Strip and the Jericho area, between the Government of the State of Israel and the PLO dated 4 May 1994 (**the Cairo Agreement**). The 1995 Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip replaced the Cairo Agreement, yet the Paris Protocol was attached to it too, again as Annex IV. Whereas the Paris Protocol was initially applied only to the Gaza Strip and Jericho Area, it was extended to all of the Palestinian Territories under the 1995 agreement, as defined therein (Areas A and B).

² *Protocol on Economic Relations Between the Government of the State of Israel and the PLO Representing the Palestinian People* (Paris 29 Apr. 1994), https://unctad.org/system/files/information-document/ParisProtocol_en.pdf (accessed Jun. 2023). For analysis, see Umut Koldas, *From Coercion to Consent?: The Paris Protocol and Contours of Hegemonic Economic Communication Between the Israeli and Palestinian Societies*, 11(1) *Int'l J. Econ. Persp.* 740 (2017); Vincent El Hayek, *Palestinian Economic Development: Israeli Actions in Light of the 1994 Paris Protocol and International Economic Law*, 24(2) *Minn. J. Int'l L.* 223, 228–229 (2015); Sharif S. El-Musa & Mahmud El-Jafari, *Power Trade: The Israeli-Palestinian Economic Protocol*, 24 *J. Palestine Stud.* 14 (1995), doi: 10.1525/jps.1995.24.2.00p0069w; Arie Arnon, Israel Luski, Avia Spivak & Jimmy Weinblatt, *The Palestinian Economy: Between Imposed Integration and Voluntary Separation* (Leiden: Brill 1997).

Thus, the Paris Protocol is an international treaty aimed at establishing regulatory trade and economic relations between Israel and the PA, under the overarching agreements between the parties. (**The Oslo Accords**). The Protocol establishes a de facto Customs Union between the parties, although it does not explicitly refer to such a term. However, as we will see, the Customs Union has certain limited exceptions in relation to which it functions more like an FTA, leaving the PA certain limited autonomy to determine its own trade policy toward third countries.

The Protocol focused on seven main areas: customs, taxes, labour, agriculture, industry, tourism and insurance. It specified restrictions on importing goods to the PA via Israel that would be implemented under Israel's supervision. It determined that the Palestinian trade would only take place through Israeli seaports, Israeli airports, or border crossings between the PA and Jordan and the border crossing between the PA and Egypt (Rafah border crossing).³

In terms of customs provisions, the Protocol stipulated that Israel would collect and transfer to the PA the import charges on goods destined for the Territories, but Israel would have the right to unilaterally change the rates of charges imposed on imported goods to which the common customs envelope applies. Each party would be free to determine its own direct tax rates and tax policies,⁴ and the PA's demand to set a lower rate of value Added Tax (VAT) within the Territories was accepted.⁵

The Paris Protocol and its Customs Union model provided for well-defined exceptions for certain goods from certain countries, for which import licenses would be granted for the purpose of consumption in the Territories, in accordance with the trade policy of the PA, notwithstanding the fact that they do not meet the requirements of Israeli trade laws (**the General Exception or Lists A1 and A2**). These are goods produced mainly in Jordan, Egypt and other Arab and Islamic countries, with many of which Israel had no official commercial relations on the eve of the adoption of the Paris Protocol. There is also a List B, which includes additional goods, from any country, such as basic food items and other goods for the Palestinian economic development programme, imported by the Palestinians. Here too, the PA has the right to independently determine and from

³ The Paris Protocol, *supra* n. 2, Arts III:13-III:14.

⁴ *Ibid.*, Art. V:1. This includes income tax on individuals and corporations, property taxes, municipal taxes and fees.

⁵ *Ibid.*, Art. VI:3. While Israel's VAT rate is 17%, the PA can set its rate at 15% or 16%. It can also determine the maximum annual turnover for businesses under its jurisdiction to be exempt from VAT, within an upper limit of 12,000 USD (*ibid.*, para. 4). It was later agreed that the Palestinian VAT rate shall not be lower than 2% below the Israeli VAT rate (Appendix II, para. 3). At present, the VAT rate in the PA is 16%, while in Israel it is 17%.

time to time to change the rates of customs, purchase taxes, levies, excises and other charges on the goods, but Israeli technical standards and other trade laws would apply to them.⁶

Following the adoption of the Paris Protocol, the Knesset (**the Israeli Parliament**) enacted the Law on the Implementation of the Agreement Regarding the Gaza Strip and the Jericho Area (Economic Arrangements and Various Provisions) (Legislative Amendments), 1994 (**the Implementation Law**). The Implementation Law incorporated the principle of the common customs envelope into Israeli law, including the aforesaid exceptions.

3 THE TRADE DISPUTE BEFORE THE ISRAELI SUPREME COURT

According to the principle of common customs envelope, enshrined in the Paris Protocol, the provisions of the Israeli Meat and Meat Products Law of 1994 (hereinafter: **The Meat Law**) are applicable to meat imported to the Territories through Israel. According to the Meat Law, only kosher meat can be imported to Israel, except in special cases. In accordance with the Paris Protocol and List A2, the PA can import from certain countries a certain quota (12,500 tons of meat per annum) that need not meet the conditions for importing to Israel according to the Meat Law, thereby permitting importation of non-kosher meat. Thus, the Israeli Meat Law that allows only the importation to Israel of kosher meat is applicable to importation of meat to the Territories via Israel, unless the meat concerned has been granted an import license in accordance with the quota based on List A2.

Over the years, the Petitioner, the importer, Alfaloga Food Products Company, had imported non-kosher meat into the Territories in accordance with the above-mentioned exception-quota, which is allotted by the PA through import licenses to various Palestinian importers, among them Alfaloga. In recent years, it had raised the amount it imports and exceeded its allotted quota. At first (2016), the Petitioner obtained an erroneous approval from the Israeli authorities for such a deviation from the quota. However, in 2021 the Israeli authorities discovered their error in granting a license exceeding the permitted quota and decided to delay the transfer of meat exceeding the quota. Hence the Petition.

The Petitioner claimed that over the years, in addition to the quantities agreed upon in the Paris Protocol, it had imported quantities of non-kosher meat that exceeded the permitted quota, with the approval of Israel's Ministry of Trade and Industry. That deviation was made in accordance with Israel's secondary legislation (**The Free Import Order of 2014**). The Petitioner claimed that granting the exemption for the importation of non-kosher meat was a practice that had been in place for years and which created

⁶ *Ibid.*, Art. III:4.

legitimate expectations that such a practice would continue, and these legitimate expectations should be protected. Furthermore, it claimed, the Meat Law violates the Israeli Basic Law: Human Dignity and the Israeli Basic Law: Freedom of Occupation, as far as it pertains to Palestinian consumers who are not interested in consuming kosher meat, due to its higher prices. The Petitioner also argued that the quota of 12,500 tons should be abolished as it is unreasonable, disproportionate and vitiated by irrelevant considerations, failing to take cognizance of the growth of the Palestinian population, its needs and economic situation.

The Respondents, the Israeli Minister and the Ministry of Trade and Industry, argued that the Petition should be dismissed. According to them, the aforementioned license for importing non-kosher meat in quantities that exceed the quota established by the Paris Protocol was granted by mistake and *ultra vires*. Moreover, the Free Import Order constitutes secondary legislation that cannot prevail over or contradict primary legislation, namely, in our case, the Israeli Meat Law of 1994. Moreover, the Respondents argued that the dispute is entirely within the realm of the foreign policy of the State of Israel, and hence it is a matter that the Israeli courts do not customarily intervene in, and should not do so in the particular case in hand.

The Israeli Supreme Court (Judge David Mintz, with the consent of Judge Alex Stein and Judge Gila Canfy-Steinitz) dismissed the Petition. The Court ruled that Israel and the PA are, according to the Paris Protocol, the Interim Agreement and the Implementation Law, subject to a common customs envelope policy, and hence, the importation of goods to Israel for the purpose of sale or marketing in the Territories is to be treated as if it is an importation to the State of Israel, unless a deviation is specifically provided for. Consequently, the importation of meat to the Territories is to be subjected in principle to the legal requirement of kosher meat.⁷

In relation to the exception found in List A2 in the appendix to the Paris Protocol, the Court ruled that the Petitioner asserted substantive claims against the rule adopted in the Interim Agreement, against the quota provided by it and against the applicability under the Interim Agreement of the Meat Law. Yet these issues form one dimension of the entire set of agreements and arrangements between the State of Israel and the PA. The Court clarified that the issue of the relationship between the State of Israel and the PA in trade matters is a matter of a distinctly political nature relating to Israel's foreign relations, and the Court does not usually interfere in the discretion of a governmental authority in such politically-charged matters.

⁷ The Minister has the authority, under Art. 3 of the Meat Law, to grant import licenses also to non-kosher meat 'in accordance with the practice prevailing until 13.7.1992'. However, as held by the Court, this exception relates to small quantities of meat of types (internal organs) that are different from the subject of this case.

The Court also rejected the claim that the Ministry, having granted the Petitioner import licenses of non-kosher meat in the past, then unreasonably withdrew this right. According to the Court, the issuing of the licenses over the years was done erroneously and *ultra vires*. If an administrative authority has decided in an illegal or *ultra vires* manner, it may change or amend its decision. A deviation from the Law (in our case granting a right to import non-kosher meat in quantities exceeding the permitted quota) does not create legitimate expectations that could justify persisting with this deviation, and such persistence is inconsistent with the principle of legality of the Executive and with the principle of the Rule of Law.

We are of the opinion that the findings of the Court are well-founded in legal terms, as they are the natural derivative of the model of a Customs Union, enshrined in the Paris Protocol. We further contend that the unwillingness, in principle, of the Court to review policy matters pertaining to an international trade agreement which Israel concluded is in line with the Court's consistent jurisprudence, and that this approach is of particular relevance in relation to the politically charged trade relations between the State of Israel and the PA. Nonetheless, the correct formal findings, *in concreto*, only underscore the inadequate trade regime between Israel and the PA.

4 ZOOMING-OUT: MOVING FROM A MODEL OF CUSTOMS UNION TO A MODEL OF FTA?

4.1 BACKGROUND TO THE PARIS PROTOCOL

In order to better understand the dispute and the Court's ruling, and the strategic lessons to be drawn from it, it is crucial to revert to the Paris Protocol, to the background to its adoption and to the reasons for the choice of a Customs Union model, with only a few components of an FTA.

The Protocol was negotiated in Paris in the interval between the Declaration of Principles (September 1993) and the Agreement on its implementation in the Gaza Strip and Jericho (May 1994).⁸ Since the Israeli occupation of the West Bank and the Gaza Strip, but prior to the negotiations, the Palestinian economy was very dependent on the Israeli economy and was largely integrated with it. There were no internal customs borders between Israel and the Territories, and Palestinian workers had a clear preference for working in Israel, where they could earn much higher salaries than the ones earned in the Palestinian Territories. It is estimated

⁸ Arie Arnon & Jimmy Weinblatt, *Sovereignty and Economic Development: The Case of Israel and Palestine*, 111 Econ. J. 291, 295 (2001), doi: 10.1111/1468-0297.00631.

that approximately 40% of Gaza's labour force and 30% of the West Bank's labour force were employed at the time in Israel. As a result, the workers' remittances became a significant part of disposable income in the Palestinian economy, amounting to 30% of Gross Domestic Product (**GDP**) in the West Bank, and even more in the Gaza Strip.⁹ More than 90% of the imports into the West Bank were from Israel, and 60% of its exports went there, and this trade did not have to overcome any tariffs or other trade barriers.¹⁰

Hence, it was agreed by both Israel and the PLO, that free trade should be allowed to continue in a future arrangement. This was also seen as critical in order to prevent the economic shock to the Palestinian economy that new barriers would have caused, and also in order to allow that economy to develop, based on free-market principles, free of artificial barriers and distortions.

However, there was disagreement between the parties as to the type of free trade model to be adopted. The Palestinians, who were striving for as many manifestations of independence and sovereignty as possible, in order to advance towards an independent Palestinian state, preferred an FTA model. Such a model would allow them to independently shape their own external trade policy towards third countries, and to conclude separate trade agreements with whichever country they chose, including those Arab and other Islamic countries with which Israel had at that time no official trade relations. Under a Customs Union model, by contrast, it was quite clear to the Palestinians that it would be Israel who would dominate their external trade relations with third countries, and that the FTAs that Israel had already concluded and would conclude in the future would automatically apply to the PA.

Israel, on the other hand, insisted that the relations should be based on the Customs Union model. Such preference was based on geo-political reasons as well as on trade and practical considerations. Contrary to the PA, Israel wished to diminish any manifestations of independence and sovereignty, and to defer as many sovereignty concessions as possible to the negotiations over the Palestinian entity's final status. There was also little trust on the Israeli side in the ability of a long-time terrorist organization to metamorphose into a peaceful state-building partner and trustworthy neighbour. Israel therefore wanted to see the PLO proving its good intentions, before granting it more concessions.

Moreover, the Customs Union model was preferable from the Israeli standpoint, in view of the fact that an FTA would require borders and border stations between Israel and the Territories, and these were not in existence at the time. They are required to ensure that only goods eligible under the FTA rules of origin and meeting the technical and sanitary standards of each party can enter duty-free

⁹ *Ibid.*, at 293.

¹⁰ *Ibid.*

into the territory of the importing party. There were also fears in Israel that under an FTA, unsafe products imported into the Palestinian territories of low standards and lax enforcement would flow into Israel and endanger the public. As a result of the asymmetric negotiating powers of the parties, the Paris Protocol adopted the Customs Union model (although the term is not mentioned in the Protocol), albeit with some FTA components (as reflected in Lists A1, A2 and B).

Thus, the adopted Customs Union continued to reflect Israeli policy. It was not a bilaterally coordinated trade policy as is the case with numerous other customs unions in the world,¹¹ and the power sharing of the Protocol gave significantly more power to Israel than to the PA.¹²

Consequently, the same system of importation, standards, licensing, rules of origin, valuation for customs purposes etc., was applied both in Israel and in the Territories.¹³ The Israeli rates of customs, purchase tax, levies, excises and other charges served under the Paris Protocol as the minimum basis for the PA, although the latter could make upward changes in the rates.¹⁴

Likewise, the Free Trade Agreements concluded by Israel before and after the conclusion of the Paris Protocol, such as those made with the European Union, the United States, Canada, Mexico and Turkey, were applied to the PA as well. The same is true of the entire Uruguay Round package of agreements concluded in 1995 within the World Trade Organization (WTO), and subsequently. Nevertheless, in 1997, the EU and the PA concluded a separate Association Agreement on Trade and Cooperation,¹⁵ in violation of the Paris Protocol.¹⁶ Israel's protests were of no avail.

However, and as explained above, the Protocol sets out well-defined exceptions for several goods from certain countries for which the PA can determine its own trade policy, and which are not bound by the common rules of the Customs

¹¹ *Ibid.*, at 297.

¹² *Ibid.*, at 301.

¹³ The Paris Protocol, *supra* n. 2, at Art. III:5(b).

¹⁴ *Ibid.*, Art. III:5(a).

¹⁵ See 97/430/EC: Council Decision of 2 Jun. 1997 concerning the conclusion of the Euro-Mediterranean Interim Association Agreement on trade and cooperation between the European Community and the Palestine Liberalization Organization (PLO) for the benefit of the Palestinian Authority of the West Bank and the Gaza Strip, OJ L 187, 16 Jul. 1997, at 1–2.

¹⁶ This agreement establishes its own rules in relation to all goods traded between the EU and the PA, and not just for those that were included in the List A1, A2 and B. This is contrary to what was agreed in the Paris Protocol, according to which goods not included in those lists shall be governed by the same rules as applied by Israel. (Art. III:5(b) and Art. III:10). In particular, the separate system for issuing certificates of origin established by the EU-PLO Association Agreement would prove to be fateful for the export of Israeli products from settlements in the West Bank, in the famous 2010 judgment of the European Court of Justice in this matter (Case 386/08 Brita GmbH v. Hauptzollamt Hamburg-Hafen ECLI:EU:C:2010:91). For analysis, see Guy Harpaz & Eyal Rubinson, *The Interface Between Trade, Law and Politics and the Erosion of Normative Power Europe: Comment on Brita*, 35(4) Eur. L. Rev. 551 (2010).

Union. In order to ensure that these goods would only be imported for Palestinian consumption, quotas were set in quantities estimated to meet the needs of the Palestinian population.¹⁷ The PA would have the sole authority to issue import licenses for these products to its importers and in general to determine the imports and customs policies.¹⁸ Thus, the Palestinians were able to import food products and other essential goods for their development programme (e.g., cement and motor vehicles¹⁹) from Arab and other Islamic countries, as well as from other countries, while the trade could continue to flow freely between Israel and the PA with no need for fences or border controls.

4.2 BUT WHAT NOW? SHOULD A NEW TRADE ARRANGEMENT BE ADOPTED?

The Paris Protocol was intended as an interim agreement for a period of five years.²⁰ As part of the Oslo II Accord of 1995, which was intended to serve as the basis for subsequent negotiations leading to an eventual comprehensive peace agreement, the Protocol itself was also seen as provisional, with the possibility of undergoing changes if the parties so wished.²¹ Unfortunately, the peace process broke down in the midst of an unprecedented wave of Palestinian terrorist attacks on Israeli civilians,²² that totally eroded the Israeli public's trust in the Palestinian people as a partner for peace.²³ The PA's insistence on the Right of Return, whereby several million Palestinians and their descendants must be permitted to return and settle within Israel's pre-1967 territory, is also seen by most Israelis as an unsurmountable obstacle to peace. The strengthening of Hamas, an organization that denies Israel's right to exist, and its taking control of the entire Gaza Strip,

¹⁷ Article III:3 of the Paris Protocol provided that these needs will be determined by a sub-committee of experts: 'the Palestinian market needs for 1994 will be estimated by a sub-committee of experts. These estimates will be based on the best available data regarding past consumption, production, investment and external trade of the Areas. The sub-committee will submit its estimate within three months from the signing of the Agreement. These estimates will be reviewed and updated every six months by the sub-committee, on the basis of the best data available regarding the latest period for which relevant data are available, taking into consideration all relevant economic and social indicators'.

¹⁸ Article III:9 (to issue import licenses) and Art. III:2 (import and customs policies and procedures) of the Paris Protocol.

¹⁹ The rules pertaining to motor vehicles were dealt with in Art. III:11, and to petroleum products in Art. III:12 of the Paris Protocol.

²⁰ This is reflected mainly in the Oslo II Agreement, signed in 1995, in which the Paris Protocol was incorporated with minor amendments, but also in the Protocol itself. See for instance, Art. I:1.

²¹ For analysis of the failures of the Paris Protocol, see El Hayek, *supra* n. 2.

²² After the breakdown of the Camp David Summit in 2000, an unprecedented wave of terror attacks broke out (the so-called Al Aqsa Intifada) employing for the first time in the Israeli-Arab conflict the use of suicide bombers. These terror attacks exacted 1,028 Israeli lives in some 5,760 attacks – nine times the average death toll of the pre-Oslo era (Israel Ministry of Foreign Affairs, *Victims of Palestinian Violence and Terrorism Since September 2000*, <https://www.gov.il/en/departments/general/victims-of-palestinian-violence-and-terrorism> (accessed Jun. 2023)).

²³ See e.g., Efraim Karsh, *Why the Oslo Peace Process Doomed Peace*, 23(4) M. E. Q. 1 (2016).

have led many Israelis who previously supported a two-state solution, to lose faith in the process. On the Palestinian side, there is also a feeling that Israel offers too little and there is a mistrust of its actions and motives. In particular, the Palestinians see the continuation of the establishment and expansion of Israeli settlements in the West Bank as the major obstacle to the two-state solution envisaged by the Oslo Accord.

Be that as it may, and given the current state of affairs, the question arises whether the Paris Protocol should be amended. We believe that it should and that the Alfaloga case described above illustrates part of the problem with the Protocol. In the remainder of this short contribution, the case for replacing the current Customs Union model with an FTA will be advanced.

The first argument in favour of the FTA model is that such a proposed trade arrangement would advance greater reciprocity in the relations between the parties. The Preamble to the Paris Protocol purported to advance mutual, reciprocal relations between the State of Israel and the PA:

The two parties view the economic domain as one of the cornerstones in their mutual relations with a view to enhance their interest in the achievement of a just, lasting and comprehensive peace. Both parties shall cooperate in this field in order to establish a sound economic base for these relations, which will be governed in various economic spheres by the principles of mutual respect of each other's economic interests, reciprocity, equity and fairness.

The Paris Protocol offered the possibility of transformation from a coercion-based hegemony which had characterized the nature of inter-societal economic communication between 1967 and 1994 to a more consent-based Gramscian hegemony.²⁴ Yet despite its egalitarian discourse and quest for inter-societal economic cooperation, the Protocol's provisions did not alter Israeli control over foreign imports from third parties, borders, customs, collecting customs duties and import taxes, regulative means on tariffs for various products and exports from the Territories.²⁵ The Protocol formalized the de facto Customs Union in operation under occupation and locked in and perpetuated the dependence of the Palestinian economy upon Israel, institutionalizing the unequal trading relations between the parties.²⁶

The replacement of the Customs Union-based regime with the FTA regime would advance more reciprocal and symmetric trade relations and encourage the Palestinians to assume more responsibility for their trade policies and economy.

²⁴ Koldas, *supra* n. 2, at 740.

²⁵ *Ibid.*

²⁶ Raja J. Khalidi & Sahar Taghdisi-Rad, *The Economic Dimensions of Prolonged Occupation: Continuity and Change in Israeli Policy Towards the Palestinian Economy*, United Nations Conference on Trade and Development – UNCTAD (Aug. 2009), <https://mpr.ub.uni-muenchen.de/21808/> (accessed Jun. 2023).

The second, inter-related argument supporting our thesis is that it would enable the PA to advance its own particular, tailor-made interests. The Preamble to the Paris Protocol aspired to lay ‘the groundwork for strengthening the economic base of the Palestinian side and for exercising its right of economic decision-making in accordance with its own development plan and priorities’. Yet, the design of the Protocol prevented it from realizing this objective.

The *Alfaloga* case discussed in the first part of this article illustrates the problems with the existing arrangements and supports our thesis. The quota for the importation of meat, which the Supreme Court insisted upon, was determined three decades ago and it was calculated on the basis of the estimated consumption of the Palestinian population at the time. The Protocol was intended as a temporary agreement for five years, to be renegotiated as part of a final peace agreement. True, it did establish a Joint Economic Committee whose mandate includes among other things deciding on additions of items to Lists A1, A2 and B as well as updates of the quotas based on estimates of the sub-committee of experts, considering population growth and rise in per-capita Gross National Product.²⁷ However, the Joint Economic Committee has not convened since 2009, as a result of the political tension between the parties.²⁸ As a result, Palestinian importers of meat have no choice but to import kosher meat, despite its higher cost, in order to meet the additional demand of the grown population. Thus, however well-founded the judgment may be in purely formal, legal terms, it only underscores the inadequacy of the existing Protocol’s regime and the need for its reform.

While the Paris Protocol, and the free trade regime it established, has no doubt contributed to the development of the Palestinian economy, it has not done enough in fulfilling its potential. The exports from the PA increased from USD 401 million in 1994 to USD 1.1 billion in 2019 (an increase of 174%) and the export of services to Israel increased by 57%.²⁹ The GDP per capita in the West Bank and Gaza has increased from USD 1,200 in 1994 to USD 3,664 in 2021.³⁰ This represents an increase of 205%. Despite this significant increase, it remains lower than the global increase during the same period, which amounted to 343%.³¹ There is an untapped potential that has not been realized, namely the

²⁷ See Art. III:16(2) and Art. III:3 of the Paris Protocol.

²⁸ Information obtained by the authors from Israeli government sources.

²⁹ Palestinian Central Bureau of Statistics, Registered Foreign Trade 2019, Table 1, and at 21, <https://www.pcbs.gov.ps/Downloads/book2537.pdf> (accessed Jun. 2023). The data in this publication regarding export of services relates only to export to Israel, while export of goods data relates to the whole world.

³⁰ According to World Bank data: ‘GDP per capita (current US\$) in the West Bank and Gaza’, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD?locations=PS> (accessed 9 Jun. 2023).

³¹ The World Bank, ‘GDP per capita (current US\$)’, <https://data.worldbank.org/indicator/NY.GDP.PCAP.CD> (accessed Jun. 2023).

potential for a Palestinian industry to take advantage of the low labour costs in the PA and the free trade agreements with markets where labour is expensive (such as the EU and the US), which should enable it to establish export-oriented labour-intensive industries (such as textile and food processing). Instead, over 80% of the PA's exports are directed to the Israeli market, and its huge trade deficit is mostly covered by personal remittances by Palestinians working outside the Territories, as well as through foreign aid.³² No doubt, part of the problem can be traced to the unstable political and security situation and to widespread corruption within the Palestinian administration.³³ The PA has one of the highest ratios in the world of security personnel to civilians and the security forces' budget accounts for nearly one third of the total resources of the PA.³⁴ Hence, there is much room for the PA to take more control of its trade and industrial policies, to invest more of its budget and human resources in developing its economy, to encourage more foreign investment instead of aid, and to design policy measures that are tailored to its particular economic needs. This should be coupled with measures to restore democracy and fight corruption.³⁵

³² Hakeem A. Eltalla, *Workers' Remittances and Economic Growth in Palestine: Evidence from a Computable General Equilibrium Model*, 40(3) J. Econ. Cooperation & Dev. 69 (2019). There are still many Palestinians working inside Israel, and even more in industries situated in Israeli settlements in the West Bank, but much less than in the past.

³³ Qassam Muaddi, *Corruption Is the Main Concern for Palestinians, Says Local Corruption Watchdog*, The New Arab (30 Mar. 2022), <https://www.newarab.com/news/corruption-leading-concern-palestinians-says-watchdog> (accessed Jun. 2023). According to Transparency International, 47% of Palestinians think government officials are corrupt and as many as 17% of public service users report having paid a bribe in the last twelve months of the survey (Global Corruption Barometer, Middle East and North Africa, 10th ed. 2019). The organization ranks the risk of corruption in the PA as 'very high' (E) in some areas and as 'high' (D) in other areas. See Transparency International, Government Defence Integrity Index, *Country Brief: Palestine* (2020), <https://ti-defence.org/gdi/countries/palestine/> (accessed Jun. 2023).

³⁴ European Council of Foreign Relations, *Mapping Palestinian Politics*, in *Security Forces* (2021), https://ecfr.eu/special/mapping_palestinian_politics/introduction_security_forces/ (accessed Jun. 2023). This is quite strange considering that the Palestinian Authority does not have to protect its outward borders against foreign armies, since they are protected by the Israeli Defence Forces. Rather, much of these security personnel are employed in internal security agencies whose main task is to monitor political dissent and prevent internal threats from Hamas and other non-Fatah organizations. If at least some of these resources were invested in more productive economic activities, it would contribute significantly to the standard of living of the Palestinians.

³⁵ The last parliamentary elections in the PA were held in 2006. They resulted in a Hamas majority and a brief civil war in 2007 between the two dominant parties, Fatah and Hamas, as a result of which the parliament was left in a state of paralysis. After more than a decade of complete deadlock and inactivity, Palestinian leader Mahmoud Abbas dissolved the legislature entirely in 2018, and elections initially scheduled for May 2021 have been postponed indefinitely. Transparency International reports: 'As a result, despite formal provisions for oversight by a standing committee in the Palestine Legislative Council, no such council exists and there is a complete absence of parliamentary scrutiny. Auditing practices are similarly ineffective. Though internal and external auditing mechanisms are formalised, they are not active. The internal audit unit's assessments are superficial and procedural, and not subject to publication or release to external institutions. In the absence of a legislature, the State Audit Bureau is heavily dependent, financially and politically, on the executive, jeopardizing its independence. Its

As El Hayek postulates, the PA needs the power to set independent tariff rates in order to reverse the situation in which Palestinian customs duties and tariff rates are pegged at Israeli levels, taking away its ability to effectively craft a tailor-made trade policy. Such power would allow it to pick and choose which industries to protect with higher tariffs, and negotiate trade agreements with third countries.³⁶ Such powers are inherent in an FTA. His conclusion is supported by Arnon and Weinblatt, who postulate that under a more balanced, reciprocal trade arrangement, the Palestinians would be free to choose their own trade regime, including their trade relations with third countries, and to adopt trade policies according to their perceived interests and relative advantages,³⁷ policies that better suit living standards and development requirements in the PA.³⁸

Moreover, the FTA model is preferable because the trade diversion from which the Palestinians may suffer may be lower under such a model than under the Customs Union model.³⁹ In addition, the FTA model would put an end to the fiscal leakage whereby Israel collects import taxes and at times refrains from refunding them to the PA.⁴⁰

Such a move of the adoption of an FTA would also contribute to the maturation of the PA's trade regime in the multilateral arena. Following the adoption of an FTA model, the PA could in principle accede to the WTO. This is something it is unable to do under the current trade regime, when it does not meet one of the prerequisites for WTO membership, namely to be a separate customs territory with full autonomy in the conduct of its external commercial

reports are not published nor are its recommendations enforced by formal follow-up mechanisms, resulting in them being regularly ignored'. (Transparency International, *supra* n. 33, at 4). Also, until 2019, the PA did not have a so-called whistle-blower law. Hence, people who spoke out against corruption often paid a high personal price, including stigma, intimidation, arrest and job loss (Hama Ahmad, *Building a Whistle Blowing Culture in Palestine* (11 Dec. 2019), <https://www.transparency.org/en/blog/building-a-whistleblowing-culture-in-palestine>) (accessed Jun. 2023).

³⁶ El Hayek, *supra* n. 2, at 241.

³⁷ Arnon & Weinblatt, *supra* n. 8, at 304.

³⁸ Samia Al-Botmeh & Numan Kanafani, *The Paris Economic Protocol and Beyond: In Search of an Optimal Trade Agreement*, 14 *Palestine Y.B. Int'l L.* 75 (2006/2007), doi: 10.1163/22116141-90000006.

³⁹ *Ibid.*: Because countries can select their own external tariffs to preserve the competitive edge of efficient third-country producers. Knowing its own demand of imports, the PA could identify the third countries where Israel's existing FTAs cause most trade diversion for the Palestinian market (i.e., products that the PA ends up importing even though less expensive like products could be imported from those third countries), and then negotiate an FTA with those countries, or simply lower unilaterally the tariffs on those products in relation to the existing Israeli tariffs.

⁴⁰ Al-Botmeh & Kanafani, *supra* n. 38. The refunds are sometimes blocked or frozen in response to terror attacks by Palestinian perpetrators. Also, in 2018 an Israeli law was enacted that requires the Minister of Defence to deduct from the tax refunds sums equal to the payments made by the PA to terrorists and their families as a reward for terror attacks performed by them against Israelis. In view of this, Israel may oppose the adoption of a new regime whereby this tool of economic pressure against terror attacks would be eliminated, or at least insist that also under the FTA the current arrangements of tax collection in Israeli ports from products destined to the PA should continue.

relations.⁴¹ The PA could then conduct its own external trade policy, tailored to the needs of its underdeveloped economy, which are very different from those of Israel. The expected end-result would be healthier, more balanced economic relations between the parties and an improved Palestinian economic performance,⁴² thereby contributing to a more stable atmosphere in the West Bank and Gaza and to the stimulation of private investment and further economic development in the Territories.⁴³ This outcome, which is in line with the declared desire of the Protocol to bring prosperity to the Palestinian economy, could ultimately contribute to the strategic political relations between the PA and Israel. Since accession to the WTO is not reserved exclusively to independent states, the accession of the PA to the WTO should not be a cause for political opposition on the part of Israel, just as China gave its consent to the accession of Taiwan to the WTO.⁴⁴

The third argument that supports the adoption of a new FTA regime is that such a regime would reflect the changes on the ground since the adoption of the Paris Protocol, thirty years ago. This would end the anomaly by which the prevailing legal regime implicitly insists on the lack of borders, whereas realities on the ground include such de facto borders. An FTA assumes delineation of trade borders. In fact, on the eve of the adoption of the Protocol, no borders or crossing points existed between Israel and the Territories and hence an FTA model was not a natural alternative. Since then, a de facto border was established in the form of the Separation Barrier (or the Wall, as it was coined by the International Court of Justice in its 2004 Advisory Opinion⁴⁵) and a very large number of crossing points and stations were established. The replacement of the Customs Union-based regime with an FTA regime would thus reflect that evolutionary change. Such a regime can be supported by the opening of customs stations where inspection of the certificates of origin of those commodities crossing from Israel to the PA, and *vice versa*, would be conducted.

Two further comments which support the article's thesis are warranted. The first is that Israel already considered the option of an FTA, as part of the renewed

⁴¹ Article XII of the Agreement Establishing the World Trade Organization. For further analysis, see Khalidi & Taghdisi-Rad, *supra* n. 26, at 28–29.

⁴² Armon & Weinblatt, *supra* n. 8, at 303–304 and 307.

⁴³ *Ibid.*, at 307.

⁴⁴ As explained above, under Art. XII of the Agreement Establishing the World Trade Organization, 'any separate customs territory possessing full autonomy in the conduct of its external commercial relations and of the other matters provided for in this Agreement and the Multilateral Trade Agreements may accede to this Agreement', even if it is not an independent state. Hence, in 2002, both Taiwan and the People Republic of China became members of the WTO. However, because of Chinese sensitivity to any hints of political independence, Taiwan joined under the name: 'Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (Chinese Taipei)'. For further discussion, see Steve Charnowitz, *Taiwan's WTO Membership and Its International Implications*, 1 Asian J. WTO & Int'l Health L. & Pol'y 401 (2006).

⁴⁵ Guy Harpaz, *The Israeli Supreme Court in Search of Universal Legitimacy*, 65(1) Cambridge L.J. 7 (2006).

negotiations following the Wye River Memorandum. This was an agreement reached between Israel and the Palestinian Authority in 1998 that aimed to resume the implementation of the 1995 Oslo II accord. The Memorandum provided among other things that the parties should launch a strategic economic dialogue to enhance their economic relationship.⁴⁶ As part of the preparations for this dialogue (in which the first author of this article had the privilege to participate) it was assumed that the PA would demand a move to the FTA model, and the participating group of experts prepared recommendations on how such a move could be implemented, should the demand be accepted by the Israeli negotiators. However, the dialogue never materialized due to the prevailing unfavourable political circumstances.

The second comment is that a dynamic reading of the developments that have taken place since 1994 support the article's thesis from an additional perspective, namely that two major obstacles that made the adoption of an FTA regime on the eve of the adoption of the Paris Protocol impossible are no longer relevant.

The first obstacle relates to the Palestinians workforce. The Palestinian economy was then too dependent on manual Palestinian workers being employed in Israel. This prejudiced the ability of the Palestinian economy to develop its niche sectors in terms of goods and services. Yet, due to security crises, Israel severely limited the entry of these workers, and Israeli employers consequently reverted to alternative sources of foreign employment. Moreover, in the 1990s Israel feared competition from Palestinian industrial goods, but such a fear is no longer relevant, given Israel's sharp economic development and its transformation from a labour-intensive economy, based on traditional industry, into an economy based on services and high-tech. Hence the FTA model which would incentivize the PA Authority to specialize in the production of goods in which it has a comparative advantage, could provide an answer to the Palestinian's high rate of unemployment, without threatening Israel's economic interests.

The second obstacle, which may be viewed as being much less relevant, is that in the 1990s, Israel reserved the option of an FTA, with its stronger sovereignty elements, in order to obtain future concessions in the political negotiations dealing with the more sensitive political bones of contention (borders, refugees, Jerusalem and settlements). Such negotiations no longer exist, and in the current violent political environment they are not feasible in the near future. Hence, the reason for withholding the FTA option for future political bargaining purposes is of much less relevance.

⁴⁶ The Wye River Memorandum (23 Oct. 1998), Art. III:6.

5 SUMMARY AND CONCLUSIONS

This article was prompted by a recent judgment of the Israeli Supreme Court dealing with a trade dispute between a Palestinian importer and Israel's trade authorities. The judgment relied on the trade agreement between the State of Israel and the PLO, and on the basis of a clear-cut formal reading of the agreement arrived at a conclusion in favour of the Israeli authorities. The article drew upon this judgment to conclude that the Customs Union model underpinning the trade agreement between the parties is an inadequate model to regulate contemporary trade relations between the parties. The article then proceeded to argue that such a model should be replaced by a Free Trade Agreement, which would allow and encourage the PA Authority to take more responsibility over its trade policies and economic development strategy, and promote more equal, reciprocal relations between the parties. This could serve, along with other much-needed democratic and improved governance reforms within the PA (in particular strong anti-corruption measures), to reduce Palestinian economic dependence on Israel, improve diversification, support trade creation and economic development, and end the fiscal leakage that is inherent in the current trade agreement.