Aid as carrot, aid as stick

The politics of aid conditionality in the Palestinian Territories

Rex Brynen

In January 2006, the Palestinian Islamist movement Hamas won a historic majority in elections for the Palestinian Legislative Council. In doing so, and especially with the formation of a Hamas-appointed government under Prime Minister Ismail Haniyah the following month, it wrested partial control over the Palestinian Authority (PA) away from the mainstream nationalist Fateh movement. Fateh had dominated the Palestinian nationalist movements since the late 1960s, had controlled the PA since it was first established in the West Bank and Gaza in 1994 and still controlled the PA Presidency.

Some (notably in Europe and the UN) argued that Hamas’ victory, however undesirable, was an opportunity to lessen its hard-line views by integrating it into the political mainstream. Certainly, its electoral victory reflected popular dissatisfaction with Fateh far more than it did any Palestinian rejection of a two-state solution to the conflict with Israel. Yet it was equally clear that Hamas hardliners are bitterly opposed to the existence of Israel, and that the group is formally considered a terrorist organization by both the United States and European Union. This made it politically and, in some cases, legally difficult for donors to continue aid to the PA. For the US administration of President George W. Bush, any response to the Hamas victory was heavily coloured by the ‘global war on terror’ and the perceived need – despite Washington’s rhetorical support for Arab democratization – to discredit, weaken, and marginalize militant Islamism.

In a statement immediately after the Hamas victory, the diplomatic Quartet consisting of the United States, the European Union, Russia and the United Nations warned that, “it was inevitable that future assistance to any new government would be reviewed by donors against that government’s commitment to the principles of nonviolence, recognition of Israel, and acceptance of previous agreements and obligations, including the Roadmap.” Canada and the United States announced that they were suspending all aid to the West Bank and

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Gaza that flowed through, or was implemented in conjunction with, PA agencies. They also banned any contact with senior PA officials. In April, the European Commission announced that the EU too would be suspending direct budgetary transfers to the PA.

Meanwhile, independently of the Quartet’s actions, Israel halted the transfers of all tax revenues that it collected on the PA’s behalf. The Palestinian’s heavy dependence on these transfers meant this had critical fiscal consequences for the PA far graver than any donors’ actions. Together, the two sets of actions dramatically heightened the economic pressure on both the PA and the Palestinian economy.

In his leaked confidential end-of-mission report a year later, outgoing UN Special Coordinator for the Middle East Peace Process Alvaro de Soto lamented that the Quartet had been, “effectively transformed... from a negotiation-promoting foursome guided by a common document (the Roadmap) into a body that was all but imposing sanctions on a freely-elected government under occupation as well as setting unattainable preconditions for dialogue.” The experienced UN envoy went on to argue that such aid restrictions had “devastating consequences” not only for immediate living conditions, but also for the very prospects for achieving peace through the eventual establishment of a Palestinian state alongside Israel.

His warning proved to be prophetic. Only a month later, simmering violence boiled over into bitter fighting between Hamas and Fateh, culminating in a full Hamas takeover of Gaza in June 2007 and the appointment of a new, rival cabinet in the West Bank by President Mahmud Abbas. This was not exactly the outcome the Quartet had sought when it sought to use international aid as an instrument of diplomatic policy: Hamas had been made more vulnerable, perhaps, but at the cost of losing Gaza to its control. What went wrong?

‘Peace conditionality’: a decade of failure

Outside economic incentives have figured prominently in international efforts to promote conflict resolution. The ‘carrot’ of present or future aid has sometimes been used to entice parties into an agreement, or to cement elite or popular support for an agreement once it is signed. Conversely, the ‘stick’ of withdrawing or withholding aid has been used (less frequently) in an effort to punish, and ultimately change, behaviour.
At first glance, the Palestinian-Israeli conflict might be a prime candidate for such ‘peace conditionality.’ Not only is the conflict of considerable global strategic importance, but it also involves unparalleled flows of external aid. Since the 1979 Egyptian-Israeli peace treaty, Israel has received approximately US$90 billion in aid from the United States – the world’s largest recipient of external assistance over this period. Since its establishment in 1994 the Palestinian Authority has received approximately US$8 billion in donor assistance – the world’s largest per capita recipient of donor assistance (see Figure 1). Surely these levels of assistance provide the international community with considerable leverage for encouraging peace?

In practice, there have been few efforts to use these levers, and when they have been used the outcome has been far from successful. In the case of Israel, the US has been profoundly unwilling to exert any sort of pressure. This reluctance has been rooted both in the close political relationship between the two, and the considerable efficacy of the pro-Israeli lobby in the United States. The Bush administration, whose foreign policy views have usually coincided with Israel’s and whose discontent has usually been overwhelmingly focused on Palestinian actions, has given no consideration whatsoever to withholding aid to bring about Israeli adherence to its commitments under the Oslo and various interim agreements, the US-sponsored Quartet Roadmap (released in April 2003), or even the November 2005 Agreement on Movement and Access (an agreement personally brokered by US Secretary of State Condoleezza Rice). Similarly, illegal Israeli settlement activity in the occupied West Bank has continued unabated.

With regard to the Palestinians, the primary use of donor aid during the ‘Oslo era’ (1993-2000) was to support Palestinian institution-building and development efforts in the hopes that this would create (in the oft-heard phrase) ‘tangible benefits associated with peace’ as well as lay the foundations of a Palestinian state-in-waiting. In practice, there was little connection between economic growth and public support for the peace process, with the latter determined far more by the state of the peace process than by material incentives. Moreover, Israeli trade and mobility restrictions hampered development efforts. Indeed, the World Bank – in a comprehensive assessment on Aid Effectiveness in the West Bank and Gaza published in June 2000 – argued that such restrictions offset the positive economic effects of billions of dollars worth of donor investments.

Rarely during this period did donors threaten to slow or withhold aid in order to influence the Palestinians. This reflected differences among major donors as to who was responsible for what, what ought to be done to advance peace, and a consequent lack of a united position that would have sustained any efforts at conditionality. Donors were also reluctant to withhold aid for fear of weakening the pro-negotiation, Fateh-dominated PA, or contributing to political instability in the territories. Thus, despite periodic efforts to set fiscal and institutional benchmarks for the PA, donors had difficulty inducing Palestinian President Yasser Arafat to undertake governance reform. While some reforms did take place under donor pressure, Arafat’s preference for using widespread patronage to maintain his position distorted both fiscal accounts and institutional development.

Perhaps most serious of all, the primary donor focus on facilitating the peace process by investing in Palestinian development often seemed to provide an easy way out for an international community reluctant to pressure Israel. Aid was thus a dysfunctional substitute for the necessary political engagement.

End of the Oslo era

The question of aid conditionality changed dramatically in 2000-01. The failure of the July 2000 Camp David Summit, the eruption of the Palestinian intifada (uprising) in September, unsuccessful last-ditch efforts at Palestinian-Israeli negotiation at Taba the following January, and the election of Israeli Prime Minister Ariel Sharon the following month, all marked the end of the Oslo era.

During this new era, Arafat became a primary target for Israel and the US. While Israel physically isolated him in his Ramallah headquarters, the US pressed hard for the PA to undertake reforms that would weaken Arafat’s constitutional powers and strengthen governance capacity and fiscal transparency. Other donors, notably the EU, were less convinced about isolating the PA leader, but shared Washington’s interest in reform. Following President Bush’s ‘Rose Garden’ speech in June 2002, in which he made progress towards Palestinian statehood contingent on such reforms, new donor coordination mechanisms (the Task Force on Palestinian Reform) and other initiatives were undertaken.

![Figure 1. Donor Assistance to the WBG, 1994-2006](source: World Bank, Two Years After London: Restarting Palestinian Economic Recovery, 24 September 2007.)
In April 2003, the Quartet released its ‘Performance-Based Roadmap to a Permanent Two-State Solution to the Israeli-Palestinian Conflict,’ which laid out a series of immediate specific steps to be undertaken by both Israel and the PA, including measures to prevent terrorism, further governance reform and halt settlement expansion. These were to be followed by the establishment of a transitional ‘independent Palestinian state with provisional borders and attributes of sovereignty’ by December 2003, with subsequent permanent status negotiations leading to a final agreement and full statehood by the end of 2005.

Donor pressures achieved some successes in fostering reform, notably in matters of fiscal transparency and accountability. These took place, however, against a backdrop of increasing violence and even harsher Israeli restrictions, resulting in a severe recession in the Palestinian territories. Donor funding actually increased during this period (from almost half a billion dollars a year in the Oslo era to twice that), but was diverted away from development activities and into urgent humanitarian assistance programs. Thus, even as the rhetoric of the international community stressed humanitarian assistance programs. Thus, even as the rhetoric of the international community stressed humanitarian assistance programs, it provided accelerated decay of public institutions, it provided disincentives. Concerned the PA’s fiscal crisis would result in both an escalating humanitarian crisis and the accelerated decay of public institutions, it provided emergency payments to PA health and education institutions, notably Abbas’ presidency and the PA security forces. Many in the EU, by contrast, held out some hope that Hamas might moderate their behaviour given the right mix of incentives and disincentives. Concerned the PA’s fiscal crisis would result in both an escalating humanitarian crisis and the accelerated decay of public institutions, it provided emergency payments to PA health and education workers through a ‘Temporary International Mechanism’ that would obviate the need to work through the Hamas-controlled Ministry of Finance. While the US sought complete political isolation of Hamas, many European countries maintained some low level contacts, and the Russians maintained full diplomatic relations. The UN was uncomfortably caught in the middle, needing to engage the new PA government for both practical and mediatory reasons, yet facing substantial US pressure not to do so.

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Handling Hamas?

Despite the seeming unity of the Quartet’s response to the Hamas victory, it embodied potentially contradictory policy objectives. For the US, the primary purpose of sanctions was to fatally undermine the Hamas-led government, so as to delegitimize it and ultimately end it. To this end, Washington also favoured direct aid to the remaining Fateh-controlled institutions, notably Abbas’ presidency and the PA security forces. Many in the EU, by contrast, held out some hope that Hamas might moderate their behaviour given the right mix of incentives and disincentives. Concerned the PA’s fiscal crisis would result in both an escalating humanitarian crisis and the accelerated decay of public institutions, it provided emergency payments to PA health and education workers through a ‘Temporary International Mechanism’ that would obviate the need to work through the Hamas-controlled Ministry of Finance. While the US sought complete political isolation of Hamas, many European countries maintained some low level contacts, and the Russians maintained full diplomatic relations. The UN was uncomfortably caught in the middle, needing to engage the new PA government for both practical and mediatory reasons, yet facing substantial US pressure not to do so.

The resulting policy was ineffectual. Polls showed that most Palestinians blamed the international community, and not the policies of the Hamas cabinet, for dire
economic conditions. High levels of aid continued to flow to the West Bank and Gaza, especially in the form of humanitarian assistance. The Hamas-controlled ministries were also able to obtain some budget support from Arab countries, an unknown amount of funding from Iran, and to smuggle funds across the border into Gaza. Ironically, such irregular transfers, coupled with the circumventing of the PA Ministry of Finance by Western donors, undid the fiscal reforms that donors had pressed for a few years earlier.

Hamas entered into a power-sharing arrangement with Fateh with the formation of a national unity government in March 2007. Within the Quartet, there were again differences over the significance of this move, with the Russians and the UN generally welcoming it, the Europeans adopting a wait-and-see position, and the US very unhappy at anything that might give Hamas a lifeline. In the meantime, the US continued to both provide and facilitate support for the Fateh-controlled security services through the offices of the US United States Security Coordinator, Lt. General Keith Dayton. On the ground, despite the formation of a joint cabinet, Hamas-Fateh tensions and clashes escalated.

For Hamas, US goals were clear: to strangle Hamas and strengthen Fateh until the latter could regain power. Ignoring the concerns of others in the movement, hardliners decided to strike first, and after a few days of fighting defeated Fateh and seized complete control of Gaza. President Abbas responded by condemning the Hamas action as an illegal coup and establishing a new and rival Fateh-supported government in the West Bank under the leadership of Salam Fayyad, a reformer and independent.

Looking ahead

In late 2007, the donor community maintains its sanctions against the Hamas-controlled Palestinian administration in Gaza, while now embracing the Fateh-controlled government in the West Bank. Hamas’ popularity has been dented somewhat for the first time since the 2006 elections (see figure 2), but this is more to do with the mis-step of the Gaza takeover than with anything donor conditionality has achieved.

The US also hopes that Abbas – freed from the constraints of Hamas – will feel more able to negotiate with Israel, just as Israel will find him a much more palatable negotiating partner. Abbas certainly hopes that progress on permanent status positions would strengthen Fateh and weaken his rivals. However, Israeli Prime Minister Ehud Olmert – himself politically weak – clearly doubts whether Abbas is in a position to deliver anything, and is unlikely to be forthcoming at any negotiating table.

Given the dramatic shifts that have taken place since the failure of the National Unity government, there is currently little hope of engaging Hamas and its marginalized moderates. Until the international community is prepared to articulate a clear vision of final status arrangements and actually use its leverage to encourage and push both parties towards it, the revival of political hope seems unlikely. Donor assistance to the Palestinian territories cannot, in the end, obscure the failures of Middle Eastern peacemaking during the past decade or more, nor can aid substitute for focused political engagement that addresses the key issues in dispute.

Figure 2. Palestinian public opinion

According to a September 2007 poll by the Palestinian Center of Policy and Survey Research:

- 73% of Palestinians disapproved of the Hamas takeover of Gaza
- 30% view the Haniyah (Hamas) cabinet as legitimate, whereas 38% view the Fayyad cabinet as legitimate, and 22% view neither as legitimate
- Were both to run for the office of president, 59% of Palestinians would support Abbas (Fateh) and 36% would support Haniyah (Hamas).
- 71% of Palestinians support the peace process
- 80% of both West Bankers and Gazans rate the current situation as “bad” or “very bad.”
- 51% of West Bankers believe economic conditions in the West Bank will improve, while only 25% of Gazans believe economic conditions will improve there.