Absorbing Returnees in a Viable Palestinian State:

A Forward-Looking Macroeconomic Perspective

By

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Abstract

Compensation to the Palestinian refugees should be an integral component of a comprehensive and durable solution to the Middle East conflict. Compensations may best be determined on basis of a forward-looking formula, linking them principally to the cost of rehabilitating the camps and absorbing the returnees in a viable and growing economy in the WBGS.

We attempt in this paper to develop a macroeconomic approach to demonstrate how the cost of absorption/compensation can be estimated. A macroeconomic framework is used to analyse the implications of resettling the returnees and rehabilitating the Palestinian economy under an assumed overall political settlement. The exercise of estimating the funds required for collective compensation is carried out under various scenarios regarding the number of returnees, the schedule of their return and access to the Israel's labour market. Our main aim however is to demonstrate the plausibility of the approach rather than to present precise calculation or argue for specific compensation figures.

The paper reviews first the three approaches found in the literature for determining the pool of resources for compensating the Palestinian refugees. Thereafter a brief survey of the distribution of the Palestinian refugees is presented along with the factors which are likely to affect the households' decision to relocate. The purpose of this is to give some estimate of the potential number of returnees to the WBGS. Lastly, Israel's experiences in absorbing immigrants are used to shed light on the policy options which will confront the future Palestinian state in designing and implementing a successful absorption strategy.

Although the paper recognises the multi-dimensional nature of the refugee/ compensation problem and leaves open the possibility of other forms of private/individual compensatory schemes, it argues that the forward-looking approach to refugee compensation is superior in many ways to alternative approaches, such as valuation of lost assets. It concludes that a solution to the refugee problem based on the forward-looking formula is feasible economically. The cost of absorption will be smaller the longer the period of implementation and the lower the uncertainty, especially with respect to the commitments of the parties to the peace agreement as well as the commitment of the international community.

1 INTRODUCTION

The question of the Palestinian refugees is probably the thorniest aspect of the Israeli-Palestinian conflict. It involves a wide spectrum of issues ranging from the legal right of return, as a basic human right, to the technicalities of estimating the refugees' material losses and sufferings. And it inevitably triggers memories of the tragic experiences of exodus, relocation of families, disintegration of communities, and intolerable suffering over half-a-century of refugeehood. For many people, a solution which fails to undo the historic injustice and to point a finger at who was morally responsible is not worth consideration. For the Israelis, on the other hand, the 'return' is a concrete threat to their national existence and the material, let alone the moral, responsibility is the last thing they are ready to assume. Repatriation, return and restitution are extraordinarily charged terms, politically and psychologically, on both sides of the divide. And in addition to all of this the issue of refugees involves not only the two parties directly affected, the Palestinians and the Israelis, but also a number of other countries currently hosting the refugees.

Here, however, we shall not attempt to discuss the whole range of these issues. We shall take as our starting-point that a political settlement has been agreed upon and implemented. More specifically, the hypothetical scenario incorporates the following three principles: i) an independent Palestinian state will be established in the WBGS, with borders essentially the same as those which existed between 1948 and 1967; ii) the Palestinian state will be a fully sovereign state with control of its own borders, natural resources, economic policy and international relations; and iii) the core of the Palestinian refugee problem will find a solution within the geographic borders of the new state. In other words, we shall assume that the major thrust of the Palestinian refugee problem will be resolved by granting the refugees the right to return to the sovereign Palestinian state in the WBGS and that a suitable package of compensation will be made available to facilitate the process of rehabilitation and absorption. Our aim is to abstract as far as possible from the highly sensitive legal and human complexities of the refugee question and concentrate instead on the macroeconomic implications of different scenarios for implementing that vision of a peaceful settlement of the conflict.

We aim to integrate the two key challenges which will confront a future Palestinian state: securing a decent and sustainable standard of living for the current inhabitants of the WBGS, including the refugees, and accommodating and successfully absorbing those refugees and displaced persons who will return to settle in the state. In this sense, the elimination of the refugee problem and the process of nation-building become one and the same thing. The basic idea in the chapter is to establish a link between the macroeconomic cost of absorbing the refugees in a viable WBGS economy and the compensation package to the refugee. Rather than estimating compensation on the basis of the value of abandoned properties or some obscure arbitrary formula, we suggest the adoption of a forward-looking approach whereby compensation is determined in conjunction with the costs of resettling the refugees and securing the economic viability of the Palestinian State.

The next section deals with the issue of compensation. After a brief review of the developments in the early 1950s with respect to repatriation and compensation, we analyse three approaches for determining the pool of resources for compensating the Palestinian

refugees. We discuss their pros and cons, with respect to both revenues and disbursements, stressing the significance of the forward-looking approach which links compensation to the cost of absorbing the returnees in a viable economy. The analysis recognises, nevertheless, the multi-dimensional nature of the refugee/compensation problem and leaves open the possibility of other forms of private/individual compensatory payments.

Section 3 presents a brief survey of the distribution of the Palestinian population and of refugees, and the factors which will affect the households' decision to relocate. Section 4 presents in non-technical terms a macroeconomic framework which we use to estimate the cost of creating a viable West Bank economy and absorbing the returnees. We analyse various scenarios for the numbers and timing of returnees, with two different assumptions concerning the flow of Palestinian labour to Israel. We also incorporate the Gaza Strip into the analysis, by estimating the extra resources needed to secure its convergence on the standards of living in the more prosperous of the two different wings of the Palestine State. This analysis re-links the two regions economically and ensures that even under the assumption that all the returnees will be resettled in the West Bank, the economic effect will also be felt in Gaza.

In section 5 we touch upon some aspects of absorption policy, using Israel's experiences in absorbing immigrants during the 1950s and 1990s to shed some light on the policy options which will confront the future Palestinian government in designing and implementing a successful absorption strategy. Section 6 concludes.

2 COMPENSATING THE REFUGEES

The aim of this section is to review various approaches for determining the pool of resources needed to compensate the Palestinian refugees. We will argue the need for a multiple-criteria approach, stressing the significance of taking the cost of rehabilitating and absorbing the returnees in a viable WBGS economy into account.

2.1 From repatriation to compensation

The first international resolution with reference to the Palestinian refugees affirmed their 'right of return' and envisaged compensation as an alternative that could be chosen by those refugees who freely opted not to exercise the right of repatriation. The UN General Assembly, in Resolution 194 of December 1948,

> Resolves that the refugees wishing to return to their homes and live at peace with their neighbours should be permitted to do so at the earliest practicable date, and that compensation should be paid for the property of those choosing not to return and for loss of or damage to property which, under principles of international law or in equity, should be made good by the Governments or authorities responsible.

To 'facilitate the repatriation, resettlement and economic and social rehabilitation of the refugees and the payment of compensation', the resolution established a Conciliation Commission (consisting of 3 countries, named in the following year to be the US, France and Turkey). The UN Conciliation Commission for Palestine (UNCCP) worked intensively during the first two years of its existence to secure the repatriation of the refugees, but was confronted by Israel's systematic refusal, and none of the various schemes for the

repatriation of even a limited number were implemented.[1] Faced with this deadlock, the UNCCP started to shift its attention towards a new strategy under which compensation, rather than repatriation, would be considered as part of an overall settlement. The UNCCP thought that compensation could be a constructive step to ensure quick economic rehabilitation of the refugees in their new places of residence.

During its fifth session (December 1950), the UN General Assembly supported this shift in strategy and directed the UNCCP to survey the abandoned property of the refugees and 'take appropriate measures to settle the compensation issue' (Resolution 394 V). Soon thereafter the UNCCP produced what it called a 'global assessment' of the abandoned property of the Palestinian refugees. This assessment was at the heart of the UNCCP's proposals to the Paris Conference to settle the Palestine conflict (September 1951), which consisted of two components. First, Israel would agree to the repatriation of a 'specified number of Arab refugees who could be integrated into the Israeli economy'. Second, Israel would accept to pay 'as compensation for property abandoned by the refugees not repatriated, a global sum based upon evaluation arrived at by the Commission…' Furthermore, the payment of compensation should be planned in a manner that takes 'into consideration the Government of Israel's ability to pay' (Gabbay, 1959: 331).

Thus there was a substantial shift in the attitude of the international community (or of the UNCCP, at least) to the repatriation of the Palestinian refugees. The 1948 UN resolution had considered compensation as payments to individuals who choose freely not to exercise their right to be repatriated (or to compensate them for damage), but the UNCCP proposal to the 1951 Paris conference 'imposed' compensation on all of those refugees who 'could not be integrated in the Israeli economy' and who, therefore, were in practice denied the right of repatriation.

2.2 Compensation based on the value of abandoned property

The Paris conference led nowhere, and the UNCCP declared its failure to the General Assembly at its sixth session in 1952. But the Conciliation Commission left a legacy behind it: the assessment of the value of abandoned Palestinian property in 1948. That assessment was a far from precise exercise. In fact, the team of experts which carried out the actual assessment asserted that 'no absolute evaluation could ever be obtained, and the whole estimation should be regarded with great caution'.[2]

The exercise was basically quite simple. Assets abandoned by the refugees were divided into immovable (land) and movable:[3]

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[1] The most important of these schemes was proposed in 1949 during the Lausanne conference where a figure of 200-300,000 refugees to be repatriated was discussed. Israel initially agreed to repatriate 100,000, but not to their original places of residence.

[2] Gabbay (1959: 342). The team of experts which carried out the assessment was called the Refugee Office. The Refugee Office was appointed by the UNCCP in May 1951 to 'make such arrangements as it may consider necessary for the assessment and payment of compensation', in accordance with UN resolution 394 V, Dec. 1950.

[3] The information about the evaluation is taken from Refugee Office: the 10th Progress Report of the UNCCP, A/1985, 1951, which is cited in Gabbay (1959, chapter 7).

Immovable assets: The experts estimated the size of the land area abandoned by the Palestinian refugees to be 16,324 sq. km (about 80% of the total land area of the state of Israel). This was based on a highly imperfect statistical survey of rural Palestine, known as the *Village Statistics*, collected in 1945. 72% of the total abandoned land was taken to be uncultivable (mainly in the Negev desert) and 28% cultivable. The built-up area was estimated to cover 14 sq km only. No value was placed on uncultivable land, while the values of the cultivable land and of the built-up area were fixed by the estimated productivity of crops and estimated rent. Both were derived from data on taxes paid on rural land and other real estate properties in the years preceding 1948. The experts put the total value of immovable property at £100.4 million (£69.5 million for rural land, £21.6 million for urban land and £9.5 million for land in Jerusalem).

Movable assets: the experts used three different approaches to estimate the value of movable assets: a) assuming a fixed ratio between immovable and movable assets (the ratio was based on the actual proportions of assets for refugees in other parts of the world), b) assuming the value of movable assets to be a fixed proportion of the national income (40%), and c) directly estimating the value of various types of assets left behind by the refugees. The experts concluded that the three methods gave somewhat similar results of about £18-20 million.

The UNCCP's global assessment, the sum of immovable and movable assets abandoned by the 1948 Palestinian refugees, was put therefore at £118-120 million.

The UNCCP's estimate confronted the Palestinians with a serious dilemma. On the one hand, they were reluctant to discuss the matter for fear of appearing ready to compromise on the right of return. On the other hand, the estimate was 'shamefully unrepresentative of the true market value' of the abandoned assets. This is especially the case when one recognises, as Gabbay (1959: 341) did, that 'the Arab community in Palestine was regarded as one of the most prosperous Arab communities in the Middle East. Its holdings extended over hundred of thousands of dunums of fertile land ... business concerns, including factories and also houses, shops and movable property of great value.'.

Nevertheless, the Palestinian response came promptly, though with the assertion that discussing estimates of lost assets should be without prejudice to the refugees' right of return. The Arab Higher Committee (AHC, the body which represented the Palestinians up to 1948) and the League of Arab States produced counter-estimates to that of the UNCCP in the mid 1950s. These assessments included several additional non-real estate assets (such as jewellery, frozen and expropriated bank funds, livestock, or factories), along with the valuation of land on the basis of use (type of cultivated crops, location, detailed estimation of the prices of dwellings in cities, etc.). The two studies produced similar results, with a staggering value for total losses of £1,900 million in 1948 prices, i.e. 16 times the estimate of the UNCCP (Kubursi, 1988).

Two other evaluations, much more disaggregated and better documented, have been made by Sayigh (1967) and Kubursi (1988) and (2001). These included two new components in their assessment of the losses: first, various types of real estate whether privately or publicly owned, including public infrastructure and utilities; second, a wider range of movable assets, including households' durables, tools and implements, industrial and agricultural

capital, financial assets, vehicles and stocks. The two studies arrived at a similar estimate, although their databases and valuation procedures were not identical. Sayigh's estimation of total losses, in mid 1940s prices, was £757 million, while Kubursi's was £743 million. Kubursi (1988: 186) concluded that 'The UN estimate of £120 million is a substantial undervaluation of Palestinian losses. The scale of underestimation is embarrassingly large: the UN estimate is 16.2% of ours'.[4]

Significantly, while the UNCCP study estimated the value of abandoned rural land to be £70m, Sayigh and Kubursi estimated it to be five times higher, at £395m. Also, against the UNCCP estimate of £30m for urban real estate, Sayigh arrived at £254m and Kubursi at £130m. In fact, the difference in valuing real estate assets explains more than 80% of the difference between the UNCCP's and Sayigh's estimates of total Palestinian losses. Table 1 presents a summary of the various estimates in 1948 dollars and in 2000 dollars. Kubursi also applies an annual interest rate of 4% on the 1948 losses to calculate the present real value of Palestinian losses, but this is not calculated in the table below.

Table 1: Alternative estimates of Palestinian losses in 1948

	UNCCP (1951)	LAS (1956)	Sayigh (1967)	Kubursi (2000)	
				Material assets	Human wealth
In 1948 prices (£m)	120	1,933	757	743	433
In 1948 prices (US$m)*	484	7,790	3,050	2,996	1,745
In 2000 prices (US$m)**	3,636	58,503	22,921	22,500	13,200

Notes: * 1 £= 4.03 US $. ** Adjusted for inflation, as measured by the US consumer price index (1948-2000).
Sources: Kubursi (1988), Kubursi (2001b) and Sayigh (1967).

Kubursi went further and attempted to calculate the human capital losses of the Palestinian refugees. Assuming that one-half of Palestine's national income in 1944 came from non-property income, and that 55% of the Arab Palestinians became refugees, he put total human capital losses at £433 millions. He pointed out that this was a maximum figure, since the refugees took with them at least part of their human resources, but he maintained that a good part of the human capital was lost because of the disappearance of jobs and complementary inputs.[5]

The above survey demonstrates how huge the gap is between the various estimates of Palestinians' assets in 1948.[6] And although it is often recognised that actual payments are only theoretically linked to the value of property lost, and that lump sum settlements, in

[4] Kubursi (1988) utilised two different approaches to estimate material losses, an aggregate approach based on capitalisation of the national income in Palestine in the mid 1940s, and another approach based on detailed itemisation and valuation of different types of assets. The two approaches led to reasonably comparable results.

[5] Kubursi (2001) also estimated a third category of losses, following the approaches adopted in the German reparation schemes for World Jewry: compensation for psychological damage and pain. He put the figure for such losses at about £220 million (in mid 1940s prices). This brings total losses of physical assets and human capital and psychological damage of the 1948 Palestinian refugees to the staggering total of £1,395 millions. Assuming an annual 4% interest rate, and deflating with the US price index, Kubursi arrived at a total value of $327bn (in year 2000 prices).

[6] The huge gap between various estimates is not totally due to alternative data sets. Kubursi (1988: 186) maintained that 'we used the UN data base, presumably the same that their assessors used to reach a different valuation. We were unable to find a vector of prices that is consistent with the UN estimate'. Also, 'What is surprising about this discrepancy is the fact that we have used exactly the same UN data that should have formed the basis for [the UNCCP's] valuation….' (Kubursi 2001: 246).

practice, result in claimants receiving only a portion of their losses, it is difficult to see how a compromise can be arrived at on the basis of such divergent estimates (Workshop, 1999). On the other hand, it is worth noting that the UNCCP approach of a lump-sum payment on the basis of a global estimate has, according to Benvenisti (1999), much in common with current international practices in solving large-scale disputes.

2.3 Compensation based on economic and political feasibility

Instead of seeking to estimate the value of assets abandoned by the refugees, a number of studies have maintained that compensation will most probably be fixed through a process of political bargaining and will depend largely on Israel's (and the international community's) political willingness and economic ability to pay. These 'abilities' clearly differ from time to time and depend on the overall political environment. Similarly Benvenisti (1999) has argued that compensation should be based on 'adequate' or 'just' principles, and that these criteria are more appropriate than restitution in kind, especially in cases of mass relocation and abandonment of property. Obviously, when based on political feasibility or 'fairness', estimates will differ widely, even more than when based on the value of lost assets.

Khalidi (1994) suggested that, if repatriation of the refugees was not attainable, then compensation might be fixed at about $20,000 per refugee, or a total of $40bn (assuming 2m refugees). Gazit (1995), on the other hand, recognised that Israel should assume responsibility for providing the bulk of a compensation scheme to the refugees, which he put at $7-8bn. Al-Shikaki, in his joint work with Alpher (1998), cited a figure of $15-20bn as being a reasonable amount of compensation from a Palestinian point of view.

Brynen (1999) approached the matter in reverse, asking first how much resources can be expected to be made available in a fund for compensating the refugees. He analysed the question under two scenarios, pessimistic and optimistic, over a ten year period. His conclusion was that an amount between $6.7bn and $27.3bn was economically possible. Israel's contribution would range between 'a plausible lower margin' of $5bn, and 'an extreme upper boundary' of $25bn. Brynen pointed out, however, that although these amounts are economically feasible, this 'does not mean that they are politically feasible', and concluded that much would depend on how the compensation regime would be 'packaged and sold to the Israeli public'.

Arzt, in her comprehensive proposal for 'turning the refugees into citizens' (1997), pointed out that the amount of compensation needed is much beyond the capability of one country such as Israel. She did not cite a specific figure but argued that 'compensation must be paid out of a combined pool created as part of the final peace settlement'. She also gave some hints with respect to disbursement, advocating uniform payments to various categories of refugees, so that claimants would only be required to prove their membership in the particular class to be eligible. Arzt made two interesting suggestions in her book: that a ceiling on payment of compensation to individual refugees should be imposed so that greater sums could be directed to community projects to generate collective benefits to the refugees; and that the houses of the Jewish settlers 'who decided to leave the WBGS' could be included in Israel's compensation package to the Palestinian refugees. She estimated the number of those settlers to be around 10,000 persons (1997: 98).

2.4 Compensation based on the cost of absorption

A third approach for determining the pool of resources needed for compensation builds, though usually implicitly, on the cost of absorbing the refugees. Instead of referring merely to the past, basing compensation on the value of lost assets or on an arbitrary concept of feasibility, this approach assumes implicitly that the key to normalisation and reconciliation lies in addressing the current and future needs of the communities and individuals. The basic idea here was hinted at by Badil (1999), a Palestinian NGO: 'Given the existence of favourable reintegration and peace-building efforts, refugees may find it acceptable to combine individual compensation… or part of it, with cost of reconstruction of the physical and social infrastructure on their lands, hence a type of compensation in-kind.'

An important historical precedent for this type of compensation can be found in the reparation agreement between Israel and Germany in September 1952. The preamble to the agreement provided clarification of its background, saying 'Whereas…The State of Israel has assumed the heavy burden of resettling so great a number of uprooted and destitute Jewish refugees from Germany …and has on this basis advanced a claim against the FRG for a global recompense for the cost of the integration of these refugees… The parties agreed that Germany will pay to Israel the sum of 3,000 million DM.' In addition, Germany agreed to pay to Israel a total of 450 million DM for the benefit of 23 Jewish NGOs (Sagi, 1980: 212).

It is true that Germany's direct payment to the Israeli government represents a very small fraction of the DM85bn total of reparations, restitution, and indemnification made by Germany to the Jews since the end of World War Two (Zweig, 1987: 155). The vast bulk of this total was actually paid as indemnification to individuals (compensation for loss of property as well as loss of freedom, income, financial advancement, health and tranquillity, etc). However, the significance of this small fraction, paid directly to the Government of Israel, is what interests us here. In the deliberation which led to the agreement, Israel set out its *locus standi* for making claims against Germany in a series of Diplomatic Notes to the four Allied powers. The most important of these notes was presented on 12 March 1951. After arguing for and asserting Israel's right to make claims, as the only State which could speak on behalf of the Jewish people (and inherit from heirless Jews), the note advanced the claims on the basis of 'expenditure incurred and anticipated' for the resettlement of the Jewish immigrants. The number of immigrants was estimated to be 500,000 persons and the cost of transport, maintenance and resettlement to be $3,000 per person. Thus a total of $1.5bn (DM3bn) was demanded, and granted (Zweig, 1978: 9). The German payments became one of Israel's most important sources for foreign exchange earnings by 1954.

The Harvard Project on Palestinian Refugees (HPPR, 1998) made an attempt to estimate the cost of absorbing the Palestinian refugees and rehabilitating the refugee camps, though without making an explicit link between these and the issue of compensation. The study started by assuming that 250,000 to 750,000 people (50,000-250,000 households) would return to the WBGS within 5 years. Based on a direct cost of absorption of $7000 per family, and additional cost of $25,000 for housing, infrastructure and education, the total cost of absorption was put at $1.6–4.8bn. As far as the rehabilitation of the refugee camps in the WBGS and Jordan is concerned, the study estimated the cost of improving the on-site physical infrastructure to be $94-188m (depending on the extent of the improvement).

When the cost of off-site infrastructure (schools and clinics, etc) was added along with the costs of consolidation and land distribution, the total cost of rehabilitating the camps amounted to $5.4-8.2bn. The study concluded by suggesting that 'while this number is large in relation to the funding that UNRWA has received over the past thirty years, it is not large in relation to the sums that countries in the region now receive in economic and military assistance'. (HPPR, 1998: 25).

Tuma & Darin-Drabkin (1978) treated the issue of absorbing the returnees in a viable economy in an explicit and thorough manner. Their work was designed to answer one central question: how much extra resources are required to secure an economically viable state in the WBGS while allowing for the return of the refugees? To answer this question the authors started by giving a functional definition of economic viability. The term was taken to be consistent with three objectives: 'productive employment, an acceptable level of income per capita and the potential for saving and investment or a rate of growth that is comparable to the growth rates of other countries in the region' (1978: 73). The three objectives were fixed at 4% structural unemployment, $800 annual per capita income (in 1975 prices), and a growth rate above 10% per annum. They assumed that the returnees would be equivalent to the population of the WBGS in 1975, and that repatriation would be spread over a five-year transitional period, 1977-1982.

The solution of the exercise, which also covered the sectoral allocation of employment and the construction of new houses for both returnees and original inhabitants of the WBGS, corresponded with an investment schedule of $8.3bn over the five transition years. The authors went further and attempted to identify possible sources of funds. They suggested that 15% of the total would come from domestic saving (assuming that the saving ratio in the WBGS would remain at its historic level of 15%). The remaining 85% was allocated somewhat arbitrarily: 50% was assumed to come from Arab and international donors, and the remaining 35% ($3bn) to come from Israel: 'it is our hunch,' the authors wrote 'that the total sum of not less than $3 billion will be expected' from Israel (1978: 94). Nevertheless, Tuma and Darin-Drabkin pointed out (in a footnote) that what Israel was expected to contribute was quite close to the UNCCP estimate of what the refugees had lost in 1948. Assuming a 6% annual interest rate and an exchange rate of 4 between the pound and the dollar, the £120 million estimated by the UNCCP in 1948 would be equivalent to $2,600 million in 1976 (1978: 101).

2.5 Compensation, moral responsibility and disbursement

The above review has highlighted three different approaches to the issue of compensation to the Palestinian refugees: a backward-looking approach whereby the pool of resources is determined on the basis of the present value of the abandoned property; a more pragmatic method, in which a lump-sum amount is determined on the basis of economic and political constraints; and a third approach in which compensation is linked to the cost of resettling the returnees and rehabilitating the refugee camps.

The issue of compensation, as an alternative to repatriation and to the exercise of the 'right of return', is more complex and more sensitive than the previous discussion suggests. One of the aspects not directly touched upon above is whether the resources designated for compensation (no matter how they are technically determined) are intended as an

acknowledgement of Israel's moral responsibility for the tragedy and the suffering of the Palestinians in the past half a century. Palestinian scholars (eg Khalidi, 1994) accept compensation only on this basis, while Israeli scholars (eg Gazit, 1995) stress that Israel's eventual contribution to a compensation scheme does not imply acceptance either of moral responsibility or of financial liability for the refugee problem. This explains the Palestinians' inclination to prefer an approach based on the valuation of abandoned property for determining compensation or, even better, an approach based on individual claims of lost assets and suffering. The claim-based approach emphasises the link between the money payment and the moral responsibility.

Another important aspect which has not been tackled explicitly here is the distinction between the criteria upon which the pool of resources for compensation would be determined and those upon which the disbursements to various beneficiaries would be based. A certain degree of harmony should probably exist between these two sets of criteria, in the sense that how the resources are estimated should have some bearing on what the resources will be used for. Such a linkage was made in the UNCCP proposal to the Paris Conference in 1951. After affirming that Israel should pay compensation based on the so-called 'global estimate' of Palestinian losses, the UNCCP established a committee of 'economic and financial experts' to decide how individual claims might be made and compensation be awarded.

Given compatibility between revenue and disbursement criteria, each of the three approaches to determining the pool of compensation would correspond with a pattern of allocation. When the pool is determined on the basis of the value of lost property, disbursement would be directed mainly toward compensating individuals for their losses (or on the basis of some other sort of measure of the suffering of individuals if human and psychological damages are taken into account). When the pool is fixed on the basis of what is politically and economically feasible, the lump-sum payment would probably be disbursed in the form of unified per capita payments. Finally, when the pool is determined on the basis of the cost of re-settling the refugees and rehabilitating the WBGS economy, the bulk of the compensation would be spent on public and community projects, budget support and the like.

Each of these patterns of disbursement has its advantages and drawbacks. A claim-based system whereby payments are made to compensate individual losses may satisfy the intuitive sense of justice. However, it would require detailed documentation of ownership, which may be practically impossible after more than half a century of exile and three generations born in the Diaspora. Furthermore, even if sufficient documentation exists to warrant disbursement on the basis of private losses in 1948, the consequent reproduction of the income and social inequalities of the time may not be acceptable now.

Disbursement in the form of a lump sum cash payment for each refugee is probably the easiest and cheapest approach. But such a scheme carries with it serious concerns about sustainability and the possibility of payments being totally wasted or quickly consumed. The collective compensation approach has a number of advantages: it allows for the payments to be smoothed over time, reduces the negative socio-economic consequences of a sudden inflow of large funds in the form of individual compensation and allows for the inclusion of various forms of in-kind compensation in the scheme (such as Israel's

settlements and other forms of infrastructure in the WBGS). Also, when compensation is linked to reconstruction and rehabilitation costs, other concessions from Israel, with regard to trade and labour flow for example, can conveniently be incorporated.

The main drawback of the approach which links compensation to the reconstruction of the WBGS is that the direct benefit would go to those Palestinians who live in (as well as to those who would return to) the WBGS. It may well be argued that the creation of a sovereign and prosperous Palestinian state would bring tangible benefits to all Palestinians, regardless of whether they choose to live in the WBGS or not. The existing relation between world Jewry and Israel, as well as different visionary ideas (such as the dual-citizenship proposed by Arzt, 1997), exemplify the types of positive spill-over effect to all Palestinians from the creation of a prosperous state. It is true that people may not find it easy to accept a collective, somewhat abstract and only probable gain in place of tangible personal compensation. The ability to see, let alone to agree, that personal justice and personal compensation can be integrated in collective benefits of national self-determination in a viable state requires a sophisticated political conscience and some altruism, neither of which may come easily to a population of which has suffered so much in the past half century.

The above discussion highlights the complexity of the issues involved in any compensation scheme for the Palestinian refugees. A successful formula should strike a fine balance between justice and efficiency, between material and moral compensation, and between addressing the injuries of the past and tackling present suffering and future needs. Clearly, a single criterion for resource allocation cannot adequately encompass the multiple material, humanitarian and psychological dimensions of the refugee problem, nor secure an adequate and lasting closure of the most important file in the Palestinian-Israeli conflict. Adequate closure requires a multi-dimensional solution, with multiple criteria to determine both the pool of resources and their allocation. Our argument is that the macroeconomic cost of absorbing the Palestinian returnees in a viable and sovereign economy in the WBGS should be one of the core criteria. The main advantages of this approach have already been pointed out above: it puts the emphasis on the future rather than on the past, on securing the durability of the two-state solution, and on establishing a direct link between compensation for past grievances and the prerequisite of collective future prosperity.

3 THE PALESTINIAN REFUGEES

The purpose of this section is to shed light on the number and distribution of the Palestinian refugees, and to put the number of those who would potentially return to the WBGS into perspective. It is useful to stress from the outset, however, that lack of comprehensive censuses and surveys makes the demographic data far from definitive. The geographical spread of the Palestinians and the successive and overlapping waves of exodus aggravate the data problems. Moreover, the number of refugees is a sensitive political issue, both to the parties directly involved and to the host countries. Therefore, all data presented here are merely tentative.

3.1 The refugees

A Palestinian refugee is a person who left, forcibly or voluntarily, the parts of Mandatory Palestine which became the State of Israel in 1948 and his descendants. The exact number of the 1948 refugees (and thus their number today), is one of the lasting disputes between the parties to the conflict. Estimates of the numbers of 1948 refugees range from as few as 520,000 to one million. The United Nations Conciliation Commission for Palestine (UNCCP) suggested a number of 726,000. This figure has been generally taken to be a reasonable estimate, not because it withstands serious scrutiny, but rather because it falls in the middle of other extreme estimates. [7]

The United Nations Relief and Works Agency for the Palestinian Refugees in the Near East (UNRWA) began its field work in 1950 and since then has kept records of the number and location of the refugees. However, the UNRWA definition of who was a refugee was different from that given above. The UNRWA definition is based on three criteria: need, displacement and original place of residence. Only a person whose 'normal place of residence was Palestine… and who lost both home and means of livelihood as a result of the 1948 conflict' was registered as a refugee. Furthermore, only those who resided in UNRWA's fields of operations (WBGS, Jordan, Lebanon and Syria) were registered. Current UNRWA records register also the descendants of fathers who fulfilled the triple-criteria definition.[8]

UNRWA recognises the functional nature of its definition: 'It should be noted that UNRWA's definition of refugees is necessarily restricted […] Thus, for the purposes of repatriation or compensation, as envisaged in UN General Assembly resolution 194 (III) of December 1948, the term "Palestine refugee" is used with a different, much less restrictive meaning as compared to UNRWA's need-based definition' (UNRWA, 2003).

However, in the absence of a better alternative and because the UNRWA data are based on a clear, if restrictive, definition we shall use them to estimate the number of refugees. Table 2 is constructed on the basis of the UNRWA database for registered refugees and the PCBS's data for the number and distribution of the Palestinian people in 2001. The total number of registered refugees is 3.874 million, which seems reasonable. Starting from the UNCCP's estimate of 726,000 refugees in 1948, and assuming a plausible annual growth of 3.2%, the number would have become 3.854m refugees in 2001 which is almost identical with the figure cited in the table. However, if we take the commonly cited figure for the

[7] The jargon of the Palestine-Israel conflict distinguishes between two categories of Palestine refugees; *refugees* and *displaced*. The *displaced* refers to the indigenous inhabitants of the WBGS who left their residence following the Israeli occupation in 1967 (mainly to East Jordan, but also to Syria and Egypt). The number of the 1967 displaced persons is even less certain than that of the 1948 refugees, because the 1967 exodus also included people who were originally refugees (from the 1948 war) in the WBGS. Estimates of the displaced (i.e. 'first-time' refugees in 1967) range between 180,000 and 240,000 persons. All the refugee data present in this chapter exclude the displaced persons.

[8] Zureik (1996) pointed out that four main categories of Palestinian refugees are not registered by the UNRWA: those who moved to areas outside UNRWA's work fields, the Bedouins, the middle-class Palestinians who are not in 'need' and the descendants of Palestinian women who married non-refugees. He estimated those to be 300,000 persons in the mid 1990s. Another reference argues that it is likely that as many as 12% of what the UNRWA would define as 1948 refugees may never have registered with the agency (Schiff, 1995: 24).

total number of Palestinians of 1.3m in 1948, and assume the same annual growth (3.2%), the total number of Palestinians world-wide would have amounted to around 7m in 2001. This is about 20% lower than the figure reported by the PCBS and cited in table 2.[9]

Table 2: Total Palestinian population and UNRWA registered refugees, mid 2001

	Total Palestinians	Registered Refugees	No. of Camps	Registered Refugees in Camps	Special Hardship Cases
West Bank	2,102,360	607,770	19	163,139	30,702
Gaza	1,196,591	852,626	8	460,031	73,316
Jordan	2,637,076	1,639,718	10 (+ 3 unofficial)	287,951	42,364
Lebanon	391,240	382,973	12	214,728	42,448
Syria	411,119	391,651	10 (+ 3 unofficial)	109,466	28,513
Saudi Arabia	291,811				
Egypt	58,363				
Kuwait	37,140				
Other Gulf Countries	117,099				
Other Arab countries	6,149				
USA	227,179				
Rest of World	289,289				
Israel	1,004,600				
Total	8,878,926	3,874,738	59 (+ 6 unofficial)	1,235,315	217,388
Total in Diaspora*	4,575,375	2,414,342	32 (+ 6)	612,145	113,325

Note * Total excluding WBGS and Israel.
Sources: column 1 is from PCBS (2001), the rest of the table is from UNRWA (2001).

In line with our focus on the potential returnees to the Palestinian state in the WBGS, we derive an index of 'Diaspora Palestinians'. This refers to all the Palestinians who currently reside outside the territories of Mandatory Palestine, i.e. outside the WBGS and Israel. It is important to stress that Diaspora Palestinians do not encompass all the refugees, since over one third of all the UNRWA registered refugees reside in the WBGS. The index is merely the absolute maximum of those who could return to the WBGS. The table indicates that about one half of the total Palestinian people are currently in Diaspora, and a little more than one half of these is registered refugees. Furthermore, only a quarter of registered refugees in the Diaspora live in refugee camps in Jordan, Lebanon and Syria.

3.2 The decision to return

The likely number of returnees from the Diaspora to the forthcoming state is a key question, because the size of the influx will determine the scale of economic adjustment required. It is obviously difficult to give a precise answer since much will depend on the provisions of the future political settlement, on individual choices and on the future economic, social and political performance of the new state. Let us assume, for a start, that neither the provisions of the Israeli-Palestinian settlement nor the future Palestinian government nor the host countries would limit or force the movement of the Diaspora Palestinians. In this case, the size of the immigration to the WBGS will depend totally on the free choices of the Diaspora Palestinian individual/household.

[9] Arzt (1997: 60) estimated the total number of Palestinians to be 6.376 millions in 1996. With annual growth of 3.2% the figure would be about 8m by 2001.

Three sets of factors will probably have decisive effects on households' choices: potential improvement in standards of living and economic gain, family affiliation in the WBGS, and the value which Diaspora Palestinians variously attach to the option of living in their own home country under their own sovereign authority.

There is abundant evidence that migration is very sensitive to economic conditions. Movement from one place to another proceeds in response to differences in earnings, actual and expected, as measured by the difference in wages weighted by the probability of obtaining gainful employment over a certain period of time. This suggests that the future influx of returnees to the Palestinian state would depend strongly on its economic performance: the better it performs relative to the neighbouring countries, especially with respect to creating jobs with high wages, the larger the migration would be. A dilemma seems to exist here, since the influx of the refugees would hamper economic performance, at least during the early stages. On the other hand, this suggests that the number of returnees to the WBGS would also depend on the efforts taken to improve and normalise the living conditions of the Diaspora Palestinians in their current places of residence.

The discrepancy in per capita incomes and wage rates between the West Bank and neighbouring Arab countries is one indicator of the economic pull factors. In 1998, the average monthly wage of a full time worker in the refugee camps in Jordan was JD146 compared with an average of JD190 in the West Bank, and about twice as much for Palestinians working in Israel (PCBS, 1999b). This is an important pull factor and will probably continue in future as long as legal (or illegal) work opportunities in Israel remain relatively open for residents in the WBGS.

An allowance should be made, however, for the real purchasing power of the above figures. The WBGS's proximity and relative openness to Israel means that its PPP deflator must be substantially lower than that in other neighbouring countries. Table 3 shows that, while nominal per capita GNP in Israel is more than ten times that in Jordan, the ratio is less than five times in PPP terms. If we assume that the price level in the WBGS lies in between those in Israel and Jordan, the average monthly wage in the WBGS would need to approach JD200 in order to secure the same purchasing power as JD146 in Jordan. In fact, only those Palestinians working in Israel and in the Israeli settlements were earning higher than that wage level. Unemployment is also relevant. For the refugee camps in Lebanon it was estimated at 40%, which is higher than in the camps in the West Bank. Otherwise unemployment in all Diaspora refugee camps is lower than in the WBGS. (HPPR, 1998)

Table 3: GNP per capita in current and PPP dollars, 1999

	Per capita GNP, $	Per capita GNP in PPP $	PPP deflator
Egypt	1,400	3,303	2.359
Jordan	1,500	3,542	2.361
Lebanon	3,700	4,129	1.116
Syria	970	2,761	2.846
Israel (1998)	15,940	17,310	1.086
WBGS	1,610	NA	(1.723)*

Note * Assumed to be the average of the PPP deflators in Jordan and Israel.
Sources: World Development Report (1999/2000) and (2001/2).

Another important factor that might weaken the economic pull from differential earnings is the cost of relocation which could exceed whatever capital assets the Diaspora refugees might possess. The effects of differential earnings will probably be strongest for the poorer segments of the refugees, those living in the refugee camps in the Diaspora, and particularly those which are defined by the UNRWA as 'special hardship cases' (see table 2). However, as many as 74% of the households in the camps in Lebanon have no savings of any kind. In fact, 50% said that they would not be able to mobilise $130 if and when an emergency need for that amount arose (Ugland, 2003: 177). On the other hand, the vast majority of the refugees in the Diaspora camps have access to free housing, although this accommodation is often of very low standard. Eight out of every ten refugee households in Lebanon believe that they 'own' their houses. This is not strictly legally true, but it means that the refugees do not pay house rents (Ugland, 2003: 190). Thus, unless the UNRWA or the PA were ready to provide comparable free accommodation to them in the WBGS, the decision of the refugees to return would involve substantial increases in their cost of living. On the other hand, in the wake of an overall settlement the refugees would probably receive compensation that would help them to relocate and permit the UNRWA to terminate its work.

The second set of factors which will affect the decision to move includes family affiliations in the WBGS and the degree of integration into the host societies. The unique surveys undertaken by FAFO in the refugee camps in Lebanon and Jordan provide enlightening information here. For while over 50% of the inhabitants of the refugee camps in Jordan have first degree family relations in the WBGS, the ratio is negligible among the refugees in Lebanon (Khawaja & Tiltnes, 2002: 40). In contrast, a high proportion of the refugees in Lebanon have close family relations in Europe or in Israel (Ugland, 2003: 30). Yet, the surveys also reveal that the refugees in Jordan are much more integrated into the local society and environment than the refugees in Lebanon: 20% of the households headed by a refugee in Jordan have a non-refugee member, mainly the spouse, and the majority of the refugees, while expressing dissatisfaction with their place of residence in the camps, expressed a strong desire to remain living within the camps' community (Khawaja & Tiltnes, 2002: 18, 38). Actually, even in Lebanon, it is estimated that a quarter of third generation refugees have one Lebanese parent (Brynen 1997:6). It is well known that large sections of the Palestinians in the Diaspora, especially the middle class, are well established and well integrated into the communities within which they have lived for the past 50 years.

So far we have been dealing with the socio-economic factors on the basis of which a 'cool' calculation of costs and benefits may be made. However, no matter how important these factors are, it is doubtful that a refugee's decision on where to live in the future would be taken entirely on the basis of such a limited cost-benefit analysis. As pointed out by Arzt (1997: 62), after three generations of exile the image of a homeland becomes too abstract, too spiritual, to quantify in the manner of an economist or even a demographer. Undoubtedly, many Palestinians will attach a high value to living in their own home country under their own sovereign authority. However, moving from one place to another to live under one's own sovereign national authority rather than to return to one's original property and parent's place of residence requires a relatively high degree of political consciousness. When an average Palestinian, young or old, spontaneously affirms his or her readiness to return immediately, he or she is making a political statement regarding the fairness of the Palestinian cause rather than expressing a concrete plan to move from one

place to another. The Palestinian identity has been sustained for more than 50 years as a form of deliberate resistance, and demanding that things be brought back to their original state prior to 1948 is a coherent component of the resistance mechanism. This phenomenon is not particular to the Palestinian refugees, for 'the majority of emigrants express desires for returning to their places of origin when asked, but a few do' (Khawaja & Tilnes, 2002: 37, citing Portes & Bach, 1988). Similarly, in the words of Brynen (1997), 'It is important to note that international experience suggests that the number of refugees who choose homeland repatriation is often much smaller than planners and activists initially anticipate. The proportion, moreover, usually declines over time.' This is not suggesting that refugees often lie, but rather that a distinction should be made between valuing an option and exercising it immediately. If a formula can be found whereby the refugees would be allowed to exercise the option of returning to the WBGS over a period of time, they would most probably then take their time and base their decisions more on their true needs and desires.

3.3 How many would return and from where?

The above discussion of the factors which affect the refugees' decision to move points at the complexity of the issue as well as the high uncertainty involved. As long as the provisions of the political settlement in the region are unknown and the future legal status of the Palestinians in the host countries is not clarified, only a tentative estimate of the number of returnees can be made.

Surprisingly, however, almost all the studies which have attempted to address this question have come up with figures which fall within a relatively narrow margin. Heller (1983) suggested, in his pioneering study, a figure of 800,000. Tuma & Darin-Drabkin (1978) argued that a little over one million would return to the WBGS during a transitional period of five years. Abed (1990: 37) worked with a figure of 750,000 (incorporating all the residents of the refugee camps in Jordan, Lebanon and Syria, an arbitrary 20% of the other Palestinians in these countries, and 30-50,000 refugees from other countries). Abed suggested also that 50,000-100,000 refugees would return to Israel. The Harvard Project on Palestinian Refugees (1997) put the number of returnees somewhere between 250,000 and 750,000, with an average of 500,000, over a five year period. The Palestinian Ministry of Planning and International Cooperation (MoPIC) came up with a figure of 700,000. Finally, the PCBS (1999a) assumed, in its population projection for 1997-2025, that net immigration to the WBGS would be 500,000 during 1997-2010, and zero thereafter.

Thus most of the studies seem to suggest between one half and one million returnees over a period of five years. Table 4 relates these numbers to the current population of the WBGS and the total number of refugees in the Diaspora. It is interesting to note that any figure higher than 650,000 allows in theory for the return of all the refugees who are registered in the Diaspora refugee camps.

As to where the returnees would come from, Abed (1990) assumed explicitly that the inhabitants of *all* the refugee camps in the Diaspora would constitute about 60% of the returnees to the WBGS. As in other studies, this was justified on the grounds that the camps' residents are the most impoverished of the refugees and the least integrated into the

host countries. It is also safe to presume that a future settlement in the region would require the elimination of the most striking symbol of the Palestinian tragedy, the refugee camps.

Table 4: Number of returnees relative to basic population indices (%)

Number of Returnees	500,000	750,000	1,000,000
Returnees relative to total WBGS current population	15	23	30
Returnees relative to total Diaspora Palestinians	11	16	22
Returnees relative to registered refugees in Diaspora	20	31	40
Returnees relative to registered refugees in Diaspora camps	81	122	163

Source: Table1

FAFO's recent surveys of the camps in Jordan and Lebanon document the poverty-enclave status of the camps. This is particularly true in Lebanon, where average household income in the camps was less than 30% of the average income in Lebanon as a whole. Actually nine out of every ten families in the camps in 1996 lived below the UNRWA poverty line (Ugland, 2003: 157). The situation in the refugee camps in Jordan is less dramatic but the camp population is clearly worse off than the rest of the population in Jordan in terms of income, and this is especially true for the groups at the lower income indices (Khawaja & Tiltnes, 2002: 55). The Jordan survey points out the 'presence of a rather vibrant "enclave" economy in the camps, with perhaps higher wages and a small affluent class of professionals, employers, and self-employed persons', but stresses that the 'camps suffer from a clustering of poverty, underemployment and other social dislocations' (2002: 68). The refugees in the camps in Lebanon are the least integrated and the most impoverished among all the Palestinian communities.

The suggestion that the economic 'pull' factor will be more powerful with respect to the most impoverished Palestinians is quite plausible. But for this to materialise some concrete form of support to cover the considerable relocation cost or to compensate for the free services which those refugees receive currently from UNRWA (especially free housing) will have to be in place. On the other hand, and along with the economic 'pull' factors, one also ought to consider the political 'push' factors. The situation of the Palestinian refugees in a number of places is particularly critical. For example, Brynen (1997) points out that in Lebanon there is very little support, at either the official or popular level, for the permanent settlement of a significant number of Palestinians. Abdullah (2002) has documented that since 1982 the Lebanese government 'has made every effort to make life uncomfortable, and Lebanon unwelcoming, for the Palestinian community'. In that sense most of the immigration out of the camps in Syria and Jordan would probably be pull immigration, while that from Lebanon will be of the 'push' type.

FAFO's surveys reveal that the demographic structure of the Palestinians in the refugee camps in Jordan is quite similar to that among the refugees in the WBGS. The camps in Lebanon have substantially smaller families, with lower fertility and mortality rates and a larger number of female-headed households. However, the inhabitants of the refugee camps in Jordan as well as in Lebanon are remarkably poor in human capital: one-third of the camps' inhabitants in Lebanon are without basic education, while only 5% have an education level higher than secondary (Ugland, 2003: 107). The illiteracy rate is as high as 17.6% (24% for women and 10% for men) among the camp population in Jordan (Khawaja & Tiltnes, 2002: 74). The labour participation rate is also relatively low in both places, at

about 40%, and as low as 13% for females in camps in Jordan. The sectoral allocation of employment exhibits a bias towards clerk and low-status manual occupations, with remarkably little occupational diversity.

However, as against this evidence of a relatively poor resource base among the current inhabitants of the Diaspora camps, the potential returnees to the WBGS, the FAFO surveys hint at the high level of entrepreneurship, high social capital, optimism about a better future, and deep eagerness to improve their physical and socio-political environment among the refugees.

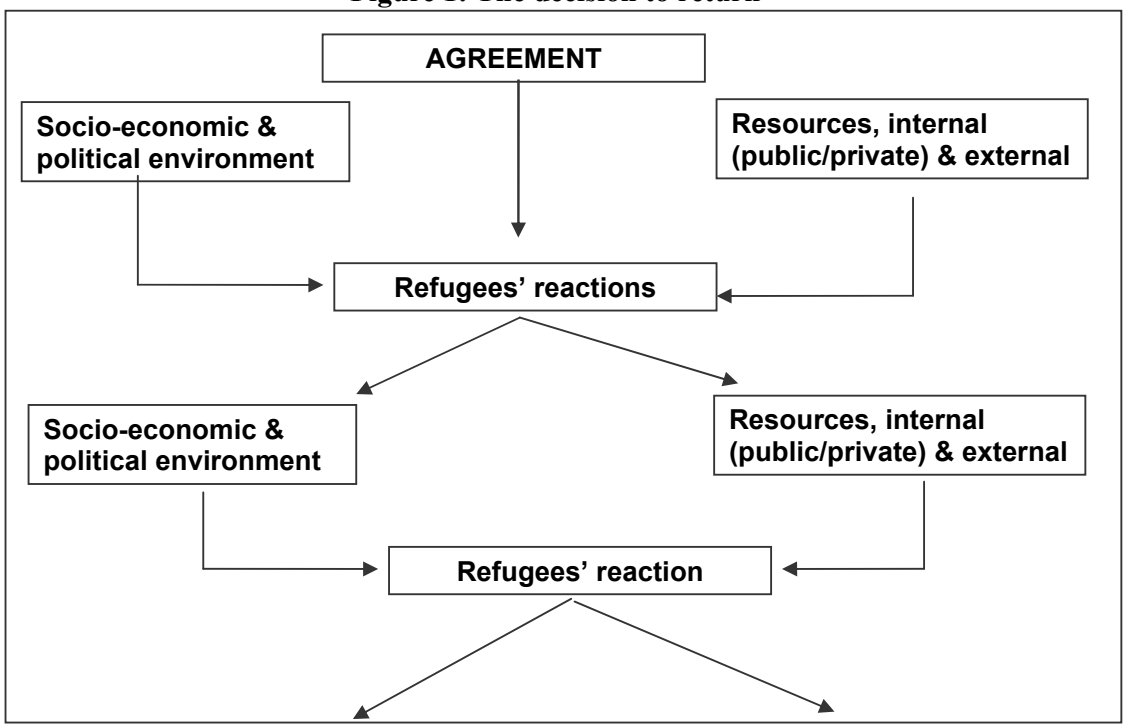
3.4 A framework for decision analysis

A solution to the refugee problem will have important consequences beyond the refugees themselves. Their decisions on whether to return or not, at what time and where to, will affect the WBGS economy as well as other economies in the region. The difficulty in assessing those consequences results from unavoidable uncertainties built into the process. The specifications of the peace agreements (between Israel and the Palestinians as well as between Israel and the countries currently hosting the refugees) are as yet unknown, while the reactions of the refugees to those agreements can only be guessed at. As pointed out above, their reactions will depend on both economic developments and the socio-political environment, in the new state as well as in the other countries in the region. None of these will be known to the refugees at the start of the process of implementing the agreements.

Figure 1 sketches the interlinkages between some of the factors that will affect, and be affected by, the refugees' reactions. We start from the peace agreement which will open the way for the return of the refugees and the payment of compensation. This, along with the initial domestic and international resources and the socio-political environment in the new state and the host countries, will determine the first round of the refugees' reactions. The number of returnees will have some bearing on the economic performance of the new entity, and this, along with the new extra resources and current socio-political conditions, will determine the second round of the refugees' reactions, and so on.

The reactions of the refugees will have immediate effects on several economic factors such as the labour market, the housing market and disposable income. These effects will be incorporated in the model which we present in the following section. The graph makes clear that the reaction of the refugees will also depend on the resources which will be mobilised by the private and public sectors in the WBGS and by the international community. The private sector's reaction will be measured by the change in investment behaviour while the public sector's reaction will be reflected in its direct decisions with respect to public consumption and investment, taxes and the fiscal deficit, as well as the indirect effects of public policies. This latter influence will prove to be of the utmost importance since the policies will determine, to a large extent, how conducive the economic environment will be for growth and development. All those 'reactions' can be subsumed in macroeconomic scenarios described in terms of the standards of living, employment and balance of payments.

Figure 1: The decision to return



The exposition in Figure 1 subsumes two of the hypotheses which will be incorporated in the following section. First, the return of the refugees to the WBGS will be a process, i.e. it will be gradual and will extend over a number of years. Second, a certain amount of resources from external sources will be made available to facilitate the absorption of the returnees. Part of these resources will be associated with the comprehensive scheme of compensation to the Palestinian refugees. As we discuss below, there may also be in-kind compensation, in the form of housing units and other infrastructure which will be abandoned by Israel on the establishment of the Palestinian state.

4 A MACROECONOMIC APPROACH

In this section we use a macroeconomic framework to assess some of the implications of resettling the refugees in the Palestinian economy. We distinguish between the West Bank and the Gaza Strip because the economic structure in the two regions is substantially different, refugees face different conditions, and only a few returnees are likely to resettle in the Gaza region.[10] We focus first on the economics of resettlement in the West Bank and then analyse the cost of raising the living standards of the Gaza Strip to levels comparable to those in the West Bank. Our approach allows us to estimate the extra resources needed to improve the standard of living for *all* inhabitants in the WBGS, including the refugees currently residing there and the returnees, with emphasis on the creation of employment opportunities and housing. Our main concern here is to test feasibility and to determine the

[10] A number of different quantitative studies have made such a distinction between the West Bank and Gaza. See for example UNCTAD (1994).

requirements for consistency rather than to provide a comprehensive model which captures behavioural and structural changes in the future. The analysis relies on a set of simplifying assumptions to deal with the enormous uncertainties involved in exercises of this sort, and it addresses only some of the aspects of the absorption and rehabilitation of refugees. However, its results indicate clearly that the economy of the WBGS could in principle absorb an inflow of refugees of the magnitude discussed in section 3.

There are two important aspects to any attempt to quantify a resettlement and absorption of this kind: the creation of employment opportunities for the returnees and the provision of housing. In the quantitative evaluations we aim to measure the overall impact on the WBGS economy. Clearly the evaluation will depend crucially on assumptions concerning the reactions of the refugees. The current study will seek to present the complicated relationship between the number of returnees and the timing of the return, the expected changing patterns of aggregate demand schedules, and the additional resources necessary to secure compliance with certain constraints. In particular, we shall attempt to estimate the consequences of a number of scenarios on the labour market, capital accumulation, standards of living (including housing) and the balance of payments.

4.1 A macroeconomic framework

From a macroeconomic perspective, the most important parameters to consider are how many will return and how much new resources will be made available, and where do they come from? A related issue concerns the impact of the new setting, i.e. the establishment of a sovereign Palestinian state, on private and public investment schedules: will entrepreneurs and government behave differently?

The answers to these questions will be captured by the various schedules where, for each year after the peace agreement, the appropriate changes will be specified. These schedules, which specify the number of returnees, the number of workers, the sums of additional resources and the parameters in the behavioural equations, will constitute the inputs in the detailed scenarios below.

The macroeconomic framework captures the essential elements of the newly established Palestinian state: (a) the peculiar structure of the labour market where, due to the differences in income levels and wages in the economies, an important segment of employment will be outside the domestic economy; (b) the impact of the substantial increase in population, and thus in labour supply, due to the 'return'; and (c) the effects of different assumptions concerning the availability of funds through either unilateral transfers or capital movements.

On the supply side, we assume a Cobb-Douglas production function relating output (GDP) to productive capital and domestic employment. Labour supply is determined by demographic trends, including natural growth and the ratio of working age population to total population, and the participation rate. Local labour demand is derived from the production function. Labour is also employed in the Israeli economy.[11]

[11] The model draws heavily on Arnon and Gottlieb (1996) and Arnon, Luski, Spivak, and Weinblatt (1997).

On the demand side, the consumption function is linear and dependent on disposable income and the well known olive cycle, where in 'good' years consumers save more than in 'bad' years (see Arnon and Gottlieb, 1996). We distinguish between investment in productive capital, which affects output via the production function, and investment in residential housing, which increases welfare but does not contribute directly to future production. For the former, a simple linear investment function is assumed which includes current output as its only variable. For investment in residential housing, it is assumed that behaviour during the first few years is similar to the historical trend, but the unusually high proportion of this type of investment will gradually decline in later years.

Government consumption is modelled as a proportion (22%) of GNP. Exports must depend on foreign demand for the goods produced at home and on their relative price compared to that of the main competitors abroad. However, due to the lack of a good export function and the very stable ratio of exports to GDP in the past, we assume that, after recovery from the present difficulties, exports will continue to be 20% of GDP. Imports depend on GNP. The balance of payments will be the result of exports, imports, unilateral transfers, factor income from abroad and capital movements. The latter are assumed to compensate for whatever imbalances are created by the other items: they are the residual in the model. Thus, the implied level of capital imports can be used to determine whether a particular scenario is feasible.

4.2 The scenarios

The model is solved first for a base scenario which assumes natural population increase only, i.e. no returnees, constructed on pre-intifada data on the economic structure adjusted for population increase. We then consider five different scenarios with respect to the number of returnees and the time span of the return, over a period of twenty years. This allows us to compare the economic changes which take place in each scenario with that of the no-returnees base scenario.

Concerning housing supply in the West Bank, one possible source that will be available immediately under the assumptions of an agreement on two states is that of the settlements. Since Palestine will be sovereign and its territory will have contiguity, the Israeli settlers now within this territory will leave unless the agreement will allow them to stay under Palestinian jurisdiction, which seems unlikely. The land will return to its owners, whether private or public, and the existing housing units where settlers live can then be used for absorption purposes. The exact number of housing units available for this purpose can be estimated at tens of thousands, reducing the cost of building as well as the time necessary for construction. We will not deal here specifically with the quantitative impact of this additional supply nor with the difficult issue of whether the value of these units will be part of the compensation package, nor will we address the issue of how they will be allocated. However, clearly the value of these housing units will affect the calculations of necessary capital imports provided below.

The base scenario

The base scenario assumes population and employment increase at an annual rate of 3.5% in the West Bank, with a natural rate of unemployment of about 6%; it is calculated with two different levels of labour integration with Israel: ‘high labour market integration’ where

employment in Israel absorbs 28% of the labour force, and 'low labour market integration' (18%). The performance of the economy in this scenario is satisfactory. Per capita GNP increases over the 20 year period at an average annual rate of 3.1%, and consumption per capita at 2.9%. Productive capital per capita rises at an annual rate of 4.5%, while government consumption and the housing stock grow at annual per capita rates of 3.1% and 3.6%. These are typical rates for a reasonably growing economy. Under the high labour integration assumption, the capital imports needed to realise the base scenario amount to about $14bn in nominal value over the 20 years (or about $8bn in present value terms at year 1, with a 5% discount rate). These capital imports represent about 9% of the average annual GDP in the West Bank.

Five scenarios for the returnees

The five different refugee return scenarios are as follows:

Scenario 1: 500,000 returnees in two years (500, 2).
Scenario 2: 500,000 returnees in five years (500, 5).
Scenario 3: 1,000,000 returnees in two years (1000, 2).
Scenario 4: 1,000,000 returnees in five years (1000, 5).
Scenario 5: 1,000,000 returnees in ten years (1000, 10).

We assume two crucial mechanisms of adjustment. In the labour market the sudden increase in population from the influx of refugees causes unemployment to increase, the excess supply of labour pushes real wages down, and the economy adjusts towards a new equilibrium with one half of the excess supply of labour finding work in each period, until the involuntary unemployment has disappeared.[12]

Second, with respect to investment (both in productive capital and in housing) and consumption (both private and public), we assume in all the five scenarios that these variables increase with, but less than proportionally to, the increase in population relative to the base scenario, because the returnees' initial consumption and investment are smaller than those of the 'veterans'. The two sections of the population then converge gradually over the 20 years, so that by the end of the simulation the old base scenario functions hold again for the whole population.

The performance of the economy under the five scenarios makes clear that as the number of returnees increases and, especially, as the period of return gets shorter, absorption becomes more difficult and costly. Unemployment is highest (and real wages lowest) during the first five years of implementation under the third scenario (1m returnees in two years), lower under the first and fourth scenarios (500,000 in two years and 1m in five years) and much lower under the fifth and second scenarios (1m in ten years and 500,000 in five years). There are corresponding declines in living standards, as measured by per capita GNP and consumption. Figures 2-4 (at the end of the paper) exhibit the overall trends with respect to GNP per capita, unemployment and capital imports.

The results of the exercise imply a decline in the stock of housing per capita during the early stages due to the pressures caused by the increases in population. This is the case even

[12] Alternative assumptions, i.e. faster or slower adjustment, did not result in significant changes in the basic calculations.

in medium scenarios (like scenario 4) during the first five years. One possible way to ease this problem is the handing over of the existing Israeli settlements to the new Palestinian state as a part of a comprehensive peace deal in the region. A similar pattern is witnessed in productive capital per capita, although a compensating mechanism is at work here. However, unlike residential housing, where the economy starts from a relatively high per capita stock, the initial levels of productive capital are very low in the Palestinian economy, and productive capital grows more quickly than the housing stock during the 20 years.

The short term decline in living standards under the return scenarios can be seen in the low growth rates over the first five years for both per capita GNP and consumption. However, there is a marked 'recovery' in a number of scenarios (with both low and high labour integration) after the first five years of implementation, notably in employment.

Table 5 presents the cumulative sums of additional capital imports necessary in each scenario, beyond what is required in the base scenario, calculated for the first ten years and for the whole 20 years of implementation. The table also presents the amount of capital imports needed to implement the base scenario (i.e. without returnees). Scenario 3 (1m returnees in two years) is the most difficult to finance: $18.6bn in nominal terms or $11.5bn in the present value calculation. This is over and above the $14bn nominal dollars required in the base scenario. The second scenario (500,000 returnees in 5 years) is the 'cheapest', requiring $7.2bn in nominal terms and $4.4bn in present value (at a 5% discount rate) beyond the base scenario.

Table 5. Capital Imports with high and low labour flows (US$m)

Scenarios	BASE	1	2	3	4	5
Years		500, 2	500, 5	1000, 2	1000, 5	1000, 10
High labour flows (nominal sums)						
1- 10	5155	4366	3395	9377	7221	4421
1- 20	13942	8591	7227	18630	15527	11317
High labour flows (present value at year 1)						
1- 10	3895	3271	2475	7004	5251	3148
1- 20	8017	5337	4350	11536	9321	6523
Low labour flows (nominal sums)						
1- 10	6757	4747	3695	10169	7838	4809
1- 20	18571	9721	8194	21007	17543	12836
Low labour flows (present value at year 1)						
1- 10	5098	3549	2690	7577	5690	3420
1- 20	10627	5967	4878	12858	10419	7327

The scenarios explicitly assume that the Israeli labour market will be relatively open to Palestinian workers. In fact changing this assumption could upset the outcomes of the scenarios, including the base scenario. In the first and second scenarios close to 290,000 Palestinian workers (and in the other three scenarios about 330,000) will be working in Israel at the end of the simulation period under the high labour integration assumption. Under the low labour flow hypothesis, the figures are about 185,000 and 215,000 respectively. These are lower figures than those experienced before the 'Oslo period', but

much higher than those of recent years. Without this labour access the process of absorption would be much more difficult. The capital imports required depend partly on the links between the Palestinian and Israeli labour markets: The higher the flows of labour to Israel the easier the absorption process would be in terms of both the capital needed to finance it and economic performance in general. The cost of absorbing 1m returnees in 2 years (scenario 3) is $18.6bn under high labour market integration but $21bn in the low labour flow case ($11.5 and $12.9bn in present values). However, the increase in the required capital imports between the low and high labour integration may appear to be small relative to what is suggested by other studies (see for example the World Bank, 2002), at about 13% in the various scenarios. This is probably because of the stringent adjustment process assumed here for the labour market.

4.3 The Convergence of Gaza with the West Bank

The Gaza region, whose population is currently about one third of the population of Palestine (see table 1), deserves a closer consideration which would go beyond the scope of this paper. However, it is clear that the impact of the above return scenarios on the Gazan economy will be different from that in the West Bank, since we have assumed that all the returnees will settle in the West Bank. We will attempt here nevertheless to incorporate Gaza into the analysis in a simple and straightforward fashion.

If Palestinian policy makers adopt the goal of securing convergence in the living standards of the two wings of the state, Gaza and the West Bank, then the Gazan population will be 'indirectly' affected even when all the returnees are assumed to settle in the West Bank. On the other hand, and since 70% of Gaza's population is refugees, policies aiming at alleviating poverty and raising standards of living in Gaza to levels comparable with those in the West Bank will need to be specifically targeted towards the refugees. We will attempt here to estimate the additional external resources needed for these policies. Basically, we assume that the two regions will converge with each other so that gaps in standards of living, including in particular housing, will be eliminated over the absorption period of twenty years. We deploy a macroeconomic framework for Gaza similar in structure to the one used above for the West Bank. However, the driving force behind the calculations here is not the demographics of return, as in the West Bank, but rather the mechanism of convergence between the two regions.

The impact of the five scenarios on the Gaza Strip will depend, to a large extent, on the degree of economic integration of the West Bank and Gaza. The more integrated the economies will be in future the more similar will developments in the Gaza area be to those described above for the West Bank. In that sense, the five scenarios can be extended to Gaza so that the rehabilitation of the refugees currently resident in Gaza as well as the convergence process will take place at the same time. The analysis assumes that economic policies will be reflected in three variables: consumption, investment in productive capital and investment in housing. All three are based on their past behaviour in the economy of Gaza, supplemented by an adjustment mechanism which closes the gap over time between the levels of per capita consumption (and productive capital and housing stock) in the two regions. 40% of the gap is closed in the first year, and lower proportions in subsequent years.

For each of our five scenarios we create a 'mirror' scenario for Gaza. These mirror scenarios capture the complex processes whereby refugees living in Gaza are rehabilitated and the two regions converge economically (see figure 5 at the end of the paper). The resulting rough estimates of the capital imports required in the five scenarios are presented in Table 6. They indicate that the macroeconomic costs of rehabilitation and convergence that will bring the Gazan economy close to that of the West Bank are between $24bn and $27bn in present value terms in the five scenarios.

Table 6. Additional capital imports necessary for the convergence of Gaza, US$m (present value at year 1)

Scenarios	1	2	3	4	5
	500, 2	500, 5	1000, 2	1000, 5	1000, 10
Years 1-10	11,161	9,756	9,752	8,918	8,820
Years 1-20	27,222	25,694	25,390	25,059	24,381

The grand total for the cost of rehabilitating the economy of the WBGS and absorbing the refugees can be obtained by adding the estimated required capital imports in the base scenario, the additional amounts needed under one of the five return scenarios, and the amount needed for the convergence of Gaza's economy. Under the high labour flow assumption, for example, the total cost of the fifth scenario amounts to about $40bn in present value terms.

It is clear that the capital imports necessary to make the scenarios 'work' are not negligible. However, the amounts are not outside the range of regional and international capacities, including the ability of Israel to contribute substantially to a fund which would create a sustainable Palestinian economy in conjunction with solving the problem of the refugees. Thus, our calculations indicate that although the additional capital imports are significant, they fall within what is 'feasible'.

The five scenarios show that, under the assumption that the external constraint can be lifted, the Palestinian economy could indeed absorb the returnees, rehabilitate the refugees and move towards sustainable growth. The absorption process, like other major shocks to an economy, is associated with many structural economic responses. The shocks were assumed in this exercise to be countered by 'positive' reactions from the various agents in the economy. In this sense, the right policies become crucial, since they have to 'convince' the various economic agents to behave 'positively' in order to allow the scenarios' results to materialise.

5 ABSORPTION OF RETURNEES: POLICY OPTIONS

When an economy faces the challenge of absorbing a significant number of returnees, the choice by policy makers of the right strategy is crucial, particularly for a new but impoverished state such as Palestine. Even if it can be assumed that additional resources (domestic or foreign) will be available, they must be used efficiently. The core challenge is to create employment opportunities and housing - which are long term processes - and at the same time answer the immediate demands of the expanding population.

There are two major issues for absorption policy. First, should policy makers concentrate on housing and employment creation, or only on one of these goals? It can be argued, for example, that efforts should focus on job creation rather than upon housing or social benefits because 'If people have jobs they can provide for their own housing and social welfare'. Second, should absorption policy be implemented through a 'centralised' or a 'free market' model?

Israel's absorption experiences in the early 1950s and the 1990s shed light on these two central issues and provide some answers which could be useful for Palestine. Massive immigration in the early 1950s led to a doubling of the population (from 0.6m) in four years (1948-52). These immigrants were penniless and poorly skilled, with large families and low expectations. The waves of immigration in the 1990s increased the population by about one fifth in five years. But unlike the early waves, these immigrants were highly skilled – a fifth of those of working age were engineers (Alterman, 2002: 82) – and they were secular, with small families and with high expectations of Western standards of living: this was mainly 'pull' immigration.

In the 1950s the absorption strategy was designed to help achieve other goals than merely accommodating the immigrants. The public sector was seen as the only body which could provide comprehensive solutions to mass immigration, and it was involved directly, and in a very centralised fashion, in the planning and construction of new towns and houses, as well as in deciding who should live where. Immigrants were received in poor and primitive transit camps, and many of them remained there for a long time: about a fifth of Israel's population were living in temporary houses up to 1951 (Newman, 2000). New Development Towns were built as permanent settlements for immigrants, 30 being established during 1948-63. However, strategic considerations played a decisive role in selecting the locations of the new towns: the aim was to secure a strong Jewish presence in various parts of the country, especially the Negev and Galilee.

By the 1980s, however, new immigrants were more qualified and skilled, and coming mainly from developed countries. Moreover, the old absorption policy had been criticised for trapping the less dynamic immigrants in a vicious circle of poverty and dependency. Thus, the immigrants of the 1990s were met with a fundamentally different policy, which became known as *Direct Immigrant Absorption.* Under the new strategy immigrants were given wide freedom to find work, and to choose where and how they wanted to live. They were provided with a generous package of support and subsidies, during the first year of their arrival, but then were left to make their own way. The package covered the costs of living (from the government's budget), house rent, language courses, and the fees for higher education (for three years). The subsidies were gradually phased out into the country's general social and national insurance systems (including unemployment benefits). Immigrants were also eligible for subsidised loans to buy their own houses.

The two strategies differ substantially in the role which they assign to the public sector. The latter was dominant in designing, executing and micro-managing the absorption of immigrants in the 1950s. Public agencies also carried out the construction works, first through the construction division in the Ministry of Public Works, then through the Ministry of Housing. 75% of the housing units built during 1951-61 were built by public

agencies (Newman, 2000). The Development Towns were established on public land and the government provided for all infrastructural work, planning, zoning, etc.[13]

The role of the public sector in the 1990s became a focus of heated political controversy in Israel. One camp, the '*housing first*' camp (led by Ariel Sharon, then Minister of Construction and Housing) argued that most, if not all, public investment should be diverted to secure an adequate supply of new houses. The '*economy first'* camp (led by Modaii, the Minister of Finance) maintained that immigrants needed jobs more than new houses, and public investments should be designed to create job opportunities: once incomes were generated, private developers would smoothly solve the housing problem. The 'housing first' camp won the day, and its strategy consisted of two programmes: one to be executed directly by the government, and another to be carried out by private real estate developers, supported by a wide range of incentives and subsidies. The government programme consisted of two components: temporary reception caravans (27,000 units) and the construction of 12,000 permanent, low-priced and small (45-60 sq m) housing units).[14]

Israel's experiences with centralised and semi-free-market approaches produced mixed results. The former were associated with severe housing shortages over a long period of time. Little attention was paid to the issue of quality, which proved to be expensive in the long-run. The new Development Towns were artificial creations and remained (until the new waves of immigrants in the 1990s) below the threshold needed to allow them to thrive economically, socially and culturally. They became (ethnically and socially) segregated ghettos with high unemployment and deteriorating environments. In contrast, the building programme carried out by private developers in the 1990s was relatively successful, unlike the public programme (caravans and emergency low-priced houses). It is thought that since potential buyers were not limited to new immigrants, high quality was maintained in order to attract buyers. However, the 'obsession' with housing first, at the expense of wider public investment to create jobs, was unfortunate. As Alterman (2002: 110) points out, the policy choice was politically motivated: it is far easier for politicians to build houses than to stimulate the economy and create new jobs.[15]

The right choice will depend on the conditions under which the economy operates. The 'free-market' absorption strategy adopted by Israel in the 1990s would probably have been inapplicable in the 1950s. This is partly due to the substantial differences in the qualifications of the immigrants and in the resources which they brought with them, and partly due to the dramatic shifts in the Israeli economy and its ability to respond to market

[13] Gabbay (1959: 362) points out that 'Of the 370 new Jewish settlements established between 1948-1953, 350 were set up on abandonees' property'.

[14] Alterman (2002: 99). The government anticipated a repetition of the experience of the 1950s and was planning to import 60,000 'caravans' to be used as temporary arrangements. The actual number of immigrants turned out to be much smaller and only 27,000 caravans were made available. The incentive package to real estate developers consisted of five elements: free public land, subsidy for infrastructural works, bonuses for fast building, freedom to sell to all buyers, and finally (most importantly) a buy-up commitment – a guarantee to purchase 50% of the units at a price of $80,000 per unit. Furthermore, to encourage the rental market, a 10% tax reduction on income generated from house rents was adopted.

[15] The government was obliged to buy up some 40,000 housing units from private developers. Alterman (2002: 110) argues that actually there was no over-supply of houses in the market: many immigrants were merely postponing the decision to buy a house until they had settled the issue of whether work could be found and where.

signals. However, even under the so-called free market model the public sector has played a significant role in the absorption process, either via the initial 'absorption package', or via a wide range of subsidies for housing and job creation (eg Eckstein & Weiss, 2001).

It is probably fair to argue that, while current overall economic conditions in the WBGS are close to those which existed in Israel in the 1950s, construction skills, building techniques and financial resources are much superior. Thus the WBGS would be in a position to avoid the basic construction and quality flaws which accompanied Israel's massive housing programmes of the 1950s. Temporary, fast and 'cheap' solutions, including temporary 'returnee camps', should be avoided, not only because they are more expensive in the long run but also because of the Palestinians' traumatic experience of 'temporary' camps, and because the first thing the returnees should get rid of is the mind set of refugeehood and temporariness.

The socio-economic and environmental implications of housing policy are just as important as the physical aspects. Although the returnees will probably have poor qualifications like the immigrants to Israel in the 1950s, they will be much younger, with a common language and with far less divergent cultural backgrounds. However, it will be just as important to avoid establishing 'ghettos' for returnees from specific places or for specific social groups. The new Palestinian state should also be in a position to avoid the creation of new artificial and non-viable urban centres, since its absorption policy will not be guided by strategic and ideological considerations as Israel's was.

The real challenge in designing and implementing a successful absorption policy will be in striking a balance between stimulating the returnees' (as well as the veterans') own initiatives to create foundations for their new lives on the one hand, and establishing efficient public institutions to trigger, aid, facilitate and sustain these initiatives. Absorption, especially in the case of the Palestinian refugees, should precisely mean breaking the vicious circle of dependency, temporariness and hand-outs. This implies, among other things, that the 'one absorption basket fits all' model should be avoided in favour of a multiple baskets approach which takes into account the resources and the particular needs of each segment of returnees and veterans.

As pointed out earlier, the role of the public sector in absorption and reconstruction will need to be significant, especially under the current conditions of the Palestinian economy. However, it is important to emphasise that the government should not take upon itself direct involvement in spheres where the private sector can do better. An indirect approach, via financial arrangements to support private initiatives, would probably be more appropriate. We envisage, in particular, a set of financial arrangements which would answer the basic needs of the impoverished population, including the returnees, for a limited period of time. A comprehensive system of subsidised mortgage credit should be put in place, to be partly financed perhaps from the proceeds of selling the houses in the settlements. A parallel system of easy credit to support small and medium size enterprises and to provide liquidity for entrepreneurs and real estate developers will also be needed. Along with providing and improving the basic infrastructure in the existing camps and in the WBGS in general, the public sector should be ready to step in to ease any bottlenecks in the process, especially with regard to large scale investment for upgrading human capital and vocational education and training.

6 CONCLUDING REMARKS

We started the paper with a survey of the literature on the issue of compensation, and concluded that the main body of compensation to the Palestinians may best be determined on the basis of a forward-looking approach which links it with the cost of absorbing the returnees in a viable and growing economy in the WBGS. We then surveyed the Palestinian population and the geographic distribution of the refugees, to arrive at an estimate of the number of potential returnees to the WBGS, and presented a framework for analysing the relocation decisions of individual households. Section four contained a macroeconomic model through which the costs of establishing a thriving West Bank economy, absorbing various possible numbers of returnees there, and raising living standards in the Gaza Strip into line with those in the West Bank were estimated. Finally, the paper discussed some policy options with regard to concrete strategies of absorption and economic reconstruction.

The exercise which we developed deals mainly with the limitations of the WBGS's absorptive capacity and tries to assess the restrictions on the ability of the Palestinian state to accommodate the returnees. The main conclusion, we argue, is that a solution to the problem of the Palestinian refugees along the lines discussed is feasible economically: under reasonable assumptions the return of the refugees can be economically as well as politically beneficial. The costs of absorption will be less painful the longer the period of implementation, and the lower the uncertainties related to the number and schedule of the returnees. The strategic decisions taken by the private and public sectors, as well those taken by the parties to the peace agreements and the international community will be crucial.

The forward-looking approach to refugee compensation is superior in many ways to the backward-looking approach based on evaluation of lost assets. However, there are real issues of historic justice and intolerable personal suffering which cannot be ignored and which should be addressed in order to heal the wounds and allow reconciliation. This would necessitate some form of personal compensation parallel with the collective fund. Israel's commitment to finance the individual compensation fund and the reconstruction and absorption fund (which is the main concern of this paper) is a precondition for the healing process and for creating the foundation of a lasting settlement. Israel's payments, which would surely be augmented by international contributions, could incorporate certain concessions, whether with respect to labour or trade flows. They could also incorporate in-kind compensation, in the form of buildings and infrastructure currently in the Israeli settlements in the WBGS.

Finally, a word of caution. The exercise carried out in this paper is limited and it does not cover all the aspects which should be taken into account in a comprehensive arrangement. We have not considered specifically the rehabilitation of refugees, whether within camps or outside, in the WBGS or elsewhere. More importantly, our macroeconomic framework is subject to a number of limitations: it is based heavily on the past and does not incorporate dynamic changes in behaviour of the kind that might be expected in the new situation, and it does not take into account all of the uncertainties involved. However, our main interest was to introduce an analytical framework for dealing with the issue of compensation, rather than to provide a precise estimation of the amount of compensation, and the model demonstrates the feasibility of the resettlement and absorption of the refugees.

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Figure 2: GNP per capita (2 year average)
(US$1000 at constant 1986 prices)

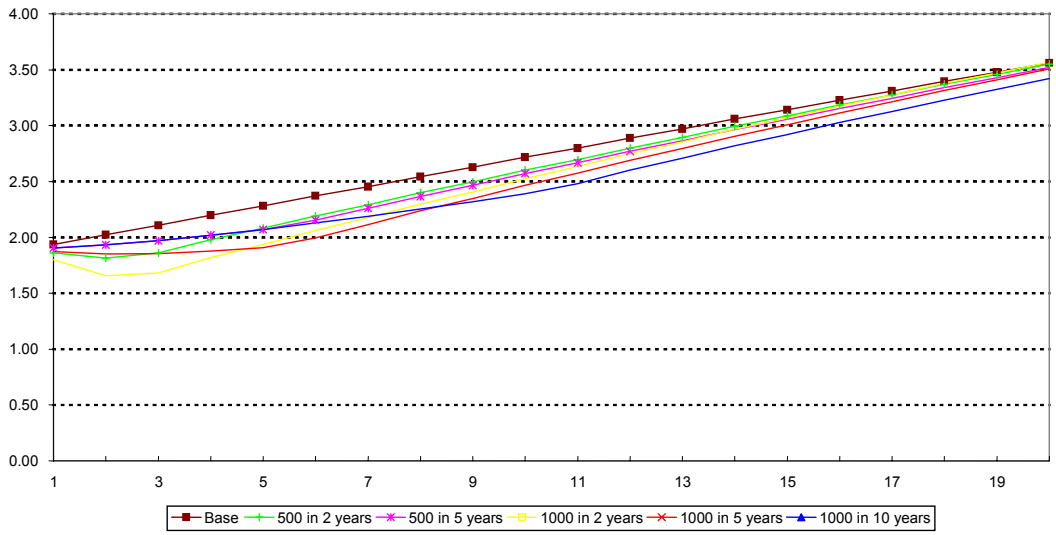

Figure 3: Unemployment rate (%)

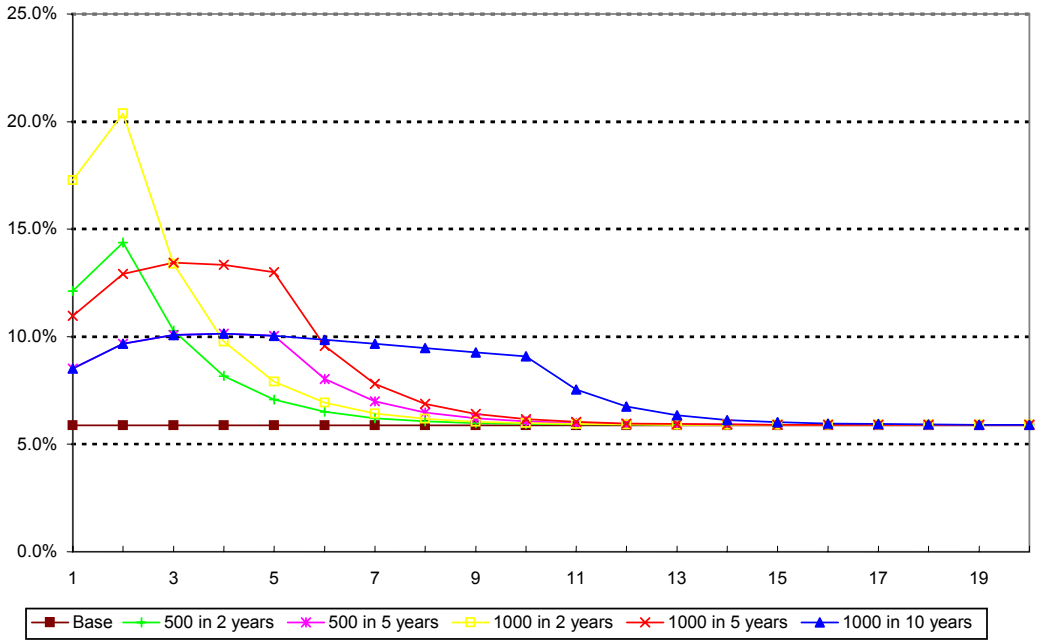

Figure 4: Capital imports beyond base scenario
(As % of GDP, two-year average)

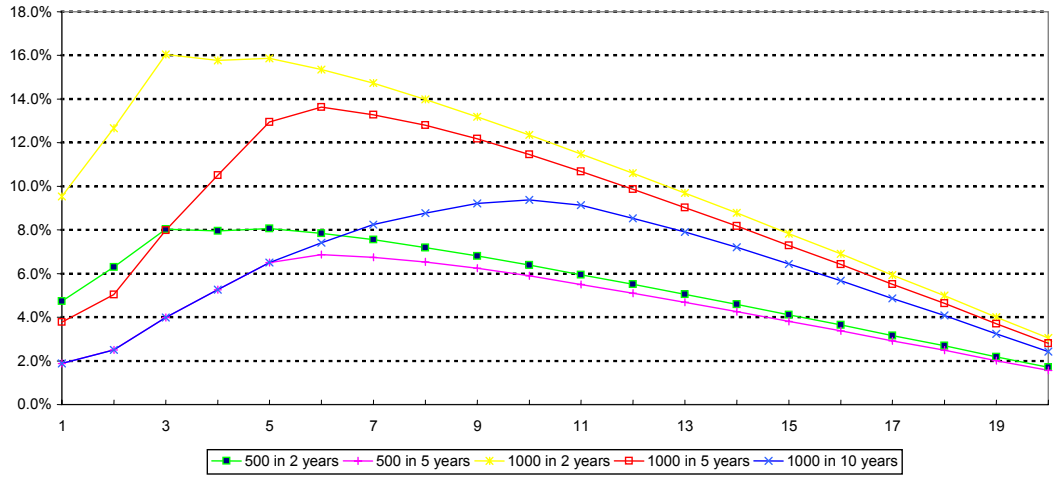

Figure 5: Convergence of Gaza's per capita consumption, capital and housing with the West Bank's (scenario 5: 1000/10)