Development in Palestine: Toward a Vision

Chapter · January 2001

1 author:


Adel Al-Zagha
Birzeit University

Forschungsbericht des Bundesministeriums für wirtschaftliche Zusammenarbeit und Entwicklung – BMZ –

Band 128

Steffen Wippel

Inse Cornelssen

(Hrsg.)

Entwicklungspolitische Perspektiven im Kontext wachsender Komplexität

Festschrift für Prof. Dr. Dieter Weiss

Weltforum Verlag

Inhalt

Economic Development in Palestine: Toward a Vision [1]

Adel Zagha

1 Introduction

The Palestinian economy has been operating far below its enormous potential. Overall the economic performance of through 1994-1997 was weak, characterized by negative growth rates, declining per capita incomes and rising unemployment. A variety of factors contributed to this trend, most notably the Israeli policy of border closure and other restrictions on the mobility of goods and people. As a result, the initial experience of the peace process for many Palestinians was one of declining living standards. Ultimately a mutually advantageous resolution of political uncertainties is necessary for the economy to embark on a path of strong and sustained growth (Stiglitz, 1999: xi).

However, and without a clear vision on the part of the Palestinians on how they might wish to organize their economy, sustainable development will be

---

1 This article was written in honor of Prof. Dr. Dieter Weiss on the occasion of his retirement. To me Prof. Dr. Dieter Weiss is more than a educator. He has always been a source of inspiration. His teaching philosophy is a complex one. He managed to combine the ethics of a German scholar (highly intellectual, very disciplined with "glasklar" thoughts) and those of a "China-mentality": Chu-guko (China) literary means "center of the world". This attitude has given me, and the generations of his students, self-confidence, to see things in new light, and to disregard the usual answers in order to understand the basic causes and interrelationships of reality. This is a way of thinking which includes many perspectives and it is a source of motivation. In short, he is an advocate of self-organization and self-help. Because when you got that you will see no traffic sign which says "no entry!", this is the key, according to him, to success in a world without borders.

far from reality. Where are the Palestinians heading seven years after the creation of the Palestinian National Authority (PNA) and, most important, is the path the PNA has implicitly chosen a sustainable one? These are some important questions to ask while searching for a vision. In *Mortgaging Self-Reliance*, it was concluded that the commitment to peace and the commitment to development in Palestine are becoming intertwined (Zagha/Jamal, 1997: 46). The same conclusion, with more stress on the need for a clear, strong and unequivocal commitment to reform at the highest levels of the PNA, was made in *Aid Effectiveness in the West Bank and Gaza* (Brynen, et al., 2000: 118).

This paper is an attempt to answer some of these questions. The paper is organized as follows: section 2 reviews the development in Palestine since 1994; section 3 outlines the theoretical foundations on which a vision for the Palestinian economy can be based; section 4 sums up the paper with some conclusions.

2 Economic Development in Palestine since 1994: A review

2.1 General Trends

The economic record of the West Bank and Gaza Strip (WBGS) prior to the implementation of the peace process is best understood in the context of structural weaknesses that are associated with the history of long occupation, as well as a policy framework that has resulted in weak domestic productive activity. These structural weaknesses in the Palestinian economy arose from four key factors that remain serious constraints to growth and job creation. These weaknesses can be summarized as follow:

- *Asymmetric market relations with Israel*: Manual labor and manufacturers from WBGS had fairly access to Israel, as did skilled labor from elsewhere; but the domestic expansion of WBGS agriculture and manufacturing was restricted. All Palestinian goods had limited access to much of the region due to restrictions on trade with Jordan, practical difficulties in trading across Israeli borders, and inadequate infrastructure (see below). There were no restrictions on imports from Israel; but for imports from the rest of the world, the economy operated under the Israeli trade regime that was extremely protectionist until the mid-1980s.
- *Regulatory restrictions*: Expansion of the private sector, particularly medium and large firms, has been held back by regulatory restrictions (especially investment approvals required by the Israeli Civil Administration (ICA)), an uncertain legal and tax framework, and political risks. The formal financial system was literally shut down until 1993. These conditions caused a bias toward the export of labor.
- *Fiscal compression and institutional underdevelopment*: Fiscal compression and institutional underdevelopment have led to the under-provision of public goods. Spending on public goods has suffered due to low tax receipts, a close-to-balanced budget practice by the ICA and municipalities, and the inability of utilities to borrow for investment (in contrast to international practice). Public sector revenues were low at 16% of GDP - partly because a portion of Palestinian tax payments, perhaps as much as 10% of GDP, accrued to the Israeli treasury.
- *Restricted access to natural resources*: Administrative limitations on surface and aquifer water harvesting have meant stagnation in water usage for Palestinian agriculture. During the 1980s and early 1990s, agricultural production was also hampered by the loss of land to settlements and to urbanization in the Jordan Valley - land traditionally and currently irrigated.

The lack of clear zoning regulations and restrictive public land utilization policy has created barriers to industrial expansion.

A key outcome of the policy framework is little investment in public infrastructure for two and half decades following the 1967 occupation. Compared to other countries with similar levels of income, infrastructure in the WBGS is seriously deficient (Table 1), due to years of neglect and lack of investment.

Table 1: Infrastructure Services in the WBGS in a Comparative Context

Country	Population (million)	Per capita income (US $)	Electric power supply (kW per 100 people)	Electric power system losses (%)	Households with sanitation (%)	Number of phones (per 100 people)	Meters of paved roads (per 100 people)
Egypt	55.0	650	21.0	14.0	50	4.3	59
Jordan	3.9	1,120	25.0	19.0	100	7.0	170
WBGS	2.4	1,450	13.0	30.0	25	3.1	80
Lebanon	4.0	2,500	32.0	N.A.	N.A.	9.3	N.A.
Syria	13.0	2,800	30.0	N.A.	63	4.1	180
Israel	5.1	13,500	82.0	4.0	100	37.1	266
Mauritius	1.1	2,700	33.0	14.0	100	9.6	190
LMICs*	1,152.6	1,620	21.5	12.4	N.A.	7.9	N.A.
OECD**	N.A.	19,710	82.6	7.3	N.A.	45.1	N.A.

Note: Data are for the years 1992-94. * Lower middle income countries.
** Organization for Economic Co-operation and Development.
Sources: World Bank (1994); International Yearbooks of Telecommunications Statistics, Electricity Statistics, Road Statistics; KMPG report on telecommunications, and internal World Bank reports.

Despite the long occupation and the structural weaknesses facing the WBGS economy, there are distinctive assets that could lead to rapid growth if utilized properly. In the right environment and with the right mix of strategies and policies, the WBGS could thrive and become a leader in the region. These assets are:

- *The people*: The WBGS has high-quality human resources, as implied by the average years of schooling of the adult population (Table 2). There is no shortage of entrepreneurial talent or professional skills. The private sector is highly resourceful with a demonstrated ability to operate under challenging conditions.

Table 2: General Development Indicators
(for 1998 unless otherwise indicated)

Indicator	WBGS Total
Male life expectancy	70
Female life expectancy	73
Average years of schooling for 15+ years	8
Literacy rate for 15+ years (%)	86
Female literacy rate for 15+ years (%)	79.7
Male enrollment rate for 6-15 years (%)	90
Female enrollment rate for 6-15 years (%)	91
Infant mortality rate (per 1000) in 1998	23.7
Infant mortality rate (per 1000) in 1980	54
Child mortality rate (per 1000) in 1995	36
Child mortality rate (per 1000) in 1980	73
Total fertility rate (children per woman)	6
Family size	7
Refugees (% of total)	40
Female-headed households (%)	7

Figures do not include East Jerusalem because statistics for the city are not reliable.
Source: Extracted and computed from various tables in Palestinian Central Bureau of Statistics (PCBS) (1996 and on), and Palestine Economic Policy Research Institute (MAS), Social Monitor, issue no. 3, February 2000.

- *Financial capital*: There are plenty of private capital resources ready to be invested in the WBGS if the business environment and policy framework are conducive. The emergent banking industry attracted private deposits in excess of $2.9 billion by the end of April 2000, much of which is yet to be invested domestically (PMA, 2000: 16). Many of the successful businessmen in the Arab world are Palestinians who have already demonstrated great interest in investing in the WBGS.

- *Social capital*: There is a vibrant and well-organized civil society. Many institutions were formed during occupation to deliver public services, which were not adequately provided by the ICA. Non-governmental organizations (NGOs), universities, and hospitals have played a major role in delivering health services, education, agricultural assistance, and welfare aid to poor families.

- *International networks*: Successful Palestinian entrepreneurs in Europe and the United States (US) can help the Palestinian economy through networks and international contacts, whether for markets, expertise, technical know-how, or capital. The expatriate Palestinian community will be a key in developing the tourist and construction sectors.
- *Culture*: The unique religious and cultural heritage of the WBGS has the potential to revitalize tourism in the region. The tourism industry was the mainstay of the West Bank economy in 1967, but suffered serious setbacks due to the unsettled political and security situation. With peace and the normalization of relations in the region, tourism and related industries can again become a major source of employment for Palestinians, especially if cooperative arrangements can be developed with neighboring countries to promote tourism on a regional basis.
- *Newcomer's advantage*: As Palestinian economic management is a newcomer to the world of development policy, it can learn from the mistakes and successes of others in policy formulation and implementation. This should save the economy setbacks from the failed policies adopted by other developing countries, such as expanding public sector employment to reduce unemployment, using price controls to keep the cost of food low for urban consumers, or using state agencies to deliver private goods.
- *East-West link*: Given the WBGS' geographic location and Palestinian experience in trading with both the Israeli and Arab economies, the WBGS could become a significant transit point for future trade within the region. The free trade agreements (FTAs) signed with the European Union (EU) and the US should also make the WBGS an attractive economy to export-oriented industries.

- *No debts, good tax system*: Unlike most other developing economies, the Palestinian economy has not had to deal with the burden of a crushing external debt. It has succeeded in establishing a fiscal base that is relatively large by regional and even international standards (almost 25% of GDP in revenues). Sound macroeconomic conditions can, however, be swiftly lost by imprudent policies, especially if the public sector expands too much as a way of reducing unemployment.
- *International sympathy*: Because of strong international interest in resolving the Palestinian-Israeli conflict, there are good prospects for attracting international assistance to help overcome infrastructure bottlenecks and deficiencies. While much of the aid disbursed so far has gone toward ameliorating deteriorating conditions in the short-term, the international community would most likely continue to support long-term infrastructure needs in the interest of improving overall conditions.

Despite these assets of the Palestinian economy the economic performance through 1994-1997 was weak, characterized by negative growth rates, declining per capita incomes and rising unemployment. A variety of factors contributed to this- most notably the Israeli policy of borders' closure and other restrictions on the mobility of goods and people. As a result, the initial experience of the peace process for many Palestinians was one of declining living standards.

Since 1997, the WBGS economy has experienced modest economic growth, including rising per capita incomes and employment growth. The unemployment rate fell to 12.4% in 1999, about half its 1996 peak. With increasingly effective tax collection and economic growth, PNA tax revenues now cover almost all of the current expenditures. However, and despite the strong economic recovery in 1997-1999, real GNP per capita in 1999 was still around 10 percent below its level in 1993, reflecting the effect of the 1995-96 recession (PNA and IMF, June 2000: 2). Economic performance in the WBGS was, until relatively recently, poor. While underlying GDP growth was very weak, population growth remained high. GNP per capita declined significantly through 1993-1997, before showing a modest increase in 1998.

Poor economic performance in these years was the product of many factors.

- Despite prior economic growth, many aspects of infrastructure and of the productive sectors of the economy remained underdeveloped under occupation. Public investment was at very low levels.
- The late 1980s and early 1990s saw a contraction of the regional MENA economy, characterized by a decline in workers' remittances from the Gulf and elsewhere. Following the Gulf war this decline accelerated, compounded by a weakening of regional support for Palestinian NGOs.
- The effects of Israeli closures, permits policies, and other complex restrictions on the movement of people and goods aggravated this economic decline. These restrictions reduced employment opportunities, constrained internal mobility and external trade, and deterred investment. The average number of Palestinians holding work permits for Israel and the settlements fell from 70,000 in 1992 to a low of around 25,000 in 1996. While the actual number of Palestinians working in Israel was larger than the number holding valid permits, it too dropped sharply, from around 116,000 to 66,000.

Since 1997, there has been a reduction in the use of closure policy, and a concurrent increase in the number of Palestinians employed in Israel and Israeli settlements. By 1998-99, the number of permit holders rebounded to an average of over 45,000, and the number actually employed reached 125,000. This employment growth was accompanied by an expansion of the West Bank and Gaza economy: GDP grew by an estimated 3.8 percent in 1998

and 4.0 percent in 1999, and unemployment fell to 12.4 percent in 1999, almost half its 1996 peak.

Despite this recently positive performance, however, the Palestinian economy continues to face major challenges. Even if current rates of growth are sustained, it will take a decade before real Palestinian GNP/capita returns to its 1993 levels. The social and economic needs of the West Bank and Gaza remain substantial. Underlying population growth rates are very high, estimated at around 4 percent per year in 1997. Despite a reduction in the imposition of comprehensive closure, the present political and economic arrangements in the territories continue to represent a major constraint to economic development. For example, a recent study concludes that permit requirements, security procedures and overlapping bureaucracies increase the transaction costs for Palestinian exporters by 30 percent, and increase shipping delays by 45 percent (CMECS, 1998). The agenda remains large with respect to improving the physical (i.e., infrastructure) and policy environment for private sector activity. Problems of accountability, transparency, alleged corruption, and inefficiency afflict some Palestinian institutions. Compounding these factors will be the inevitable challenges associated with the transition to whatever permanent status arrangements are agreed by the parties.

Although external assistance has not been sufficient to offset the entire decline in the Palestinian economy, donor aid has played a key macroeconomic role in cushioning the impact of mobility restrictions and other external shocks, raising annual GDP per capita growth rates by 1-2 percent. By 1999, GNP per capita was an estimated 6-7 percent higher than it would have been without donor assistance (Brynen, et al., 2000: xi).

The relative magnitude of donor assistance has declined since Oslo Accord, from 18 percent of GDP in 1994 to 11 percent in 1999 - highlighting the need for dynamic economic growth to take place of diminishing aid flows. The level of private sector investment and activity has been disappointing since 1993, however.

Among the key stumbling blocks have been mobility restrictions, uncertainty about the ability to import and export, political uncertainty, a complex legal system and weak judicial system, increasing reports of public sector corruption, and the murky operations of PNA-linked commercial enterprises. All of this has heightened concerns about the PNA's commitment to transparency and the rule of law, increased the costs and unpredictability of doing business, and weakened the competitiveness of the marketplace, thereby deterring local and foreign investment.

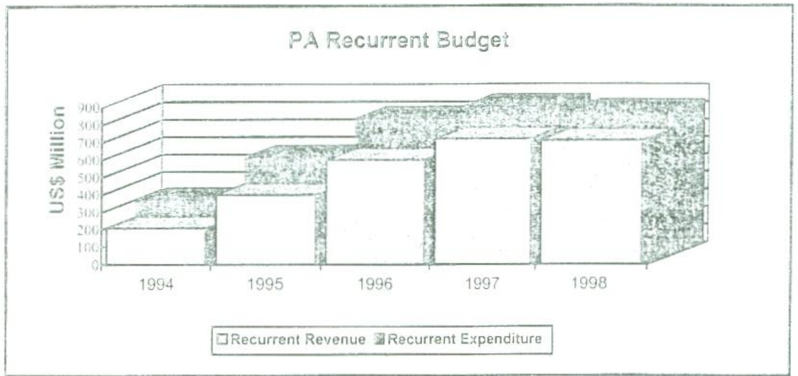
2.2 The Palestinian Authority Fiscal Stance

The Palestinian ***institutional framework for governance is unique*** among developing countries, given very limited Palestinian control of land, and lack of control over water, transport of goods and people or access to external markets. Since the 1993 Oslo agreements, the Palestinian Authority (PA) has acquired jurisdiction in varying degrees, in the small areas under its control, for delivery of public services, law enforcement and legislative power. It has not, on the other hand, the full attributions of a state and is limited in its ability to authoritatively allocate or mobilize resources.

Since its inception, the PA has substantially expanded its activities. The share of ***public expenditures to GDP*** has increased from 12 percent in 1994 to more than 25 percent in 1999, which is not only higher than most other lower middle income countries but is also ***among the highest in the region***. The initial background for the expansion was due to increased responsibilities, a need for improvement of the services hitherto provided by the Israeli Civil Administration, and the need to establish a police force in the newly controlled territories. Further, the limited mobility between West Bank

and Gaza necessitated some duplication of functions in the two areas. By the end of 1999, the PA employed more than 100,000 persons (one fourth of total domestic employment), and the wage bill amounted to 12.5 percent of GDP. It is however questionable whether the strong increase in public employment and consumption since 1994 has been accompanied by an equivalent increase in public services or expansion of responsibilities. Further, it must be kept in mind that the PA does not provide all social services, a considerable part of these being provided notably through bilateral and international agencies as well as non-governmental organizations. Finally, although most elements for a functioning government exist - as a result of substantial progress made in building institutions since 1994, ***efforts are still needed to reduce territorial, legal and functional fragmentation, to reinforce the predictability in application and enforcement of laws or to develop capacities for policy planning.***

Figure 1: Palestinian Authority Recurrent Budget, 1994-1998



Source: World Bank (1999).

The PA has so far avoided substantial current deficits as it has managed to increase fiscal revenues in line with expenditures. The overarching principles governing the PA's fiscal operations are laid out in the Paris Protocol of Economic Relations (PEP) signed in 1994 with Israel, which gives only limited room for designing its own fiscal and trade regime. Under the PEP, Israel and the PA also agreed on a revenue clearance system, which insured 63 percent of total government revenue in 1999, excluding foreign assistance. The following table summarizes the indirect tax revenues from all sources during the period 1995-1999.

Table 3: PA Revenues (All Sources) during the period 1995-1999

(Million US $)

Item	1995	1996	1997	1998	1999
Total Revenue *	424.9	634.2	825.4	863.1	1023.3
Domestic Revenue	158.5 (37.3)	264.6 (38.7)	329.4 (39.9)	321.1 (37.2)	377.3 (36.8)
Revenue Clearances with Israel	266.4 (62.7)	419.6 (61.3)	496.0 (60.1)	542.0 (62.8)	646.0 (63.2)

Figures in parentheses are relative share in total indirect tax revenues.

* On cash basis. Includes collections transferred to bank accounts outside the control of the Ministry of Finance.

Sources: Palestinian and Israeli authorities, and IMF staff estimates.

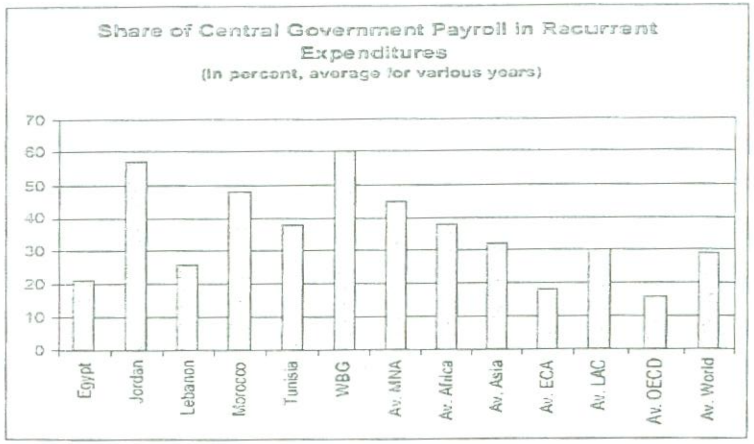
It is clear from the above figures that although the domestic revenue collection by the PNA has increased in absolute terms, however the relative shares of these collections during this period have declined from 39% in 1996 to 37% in 1999. This is annoying because it reflects economic dependency in higher ratios on Israel. The tax clearance with Israel as a share of the total tax revenues of the PA from 61.3% in 1996 to 63.2% in 1999.

Another issue of importance here is the divergence between the accrued revenue to the PA and its actual cash revenue. The divergence is due to the fact that there are funds transferred to accounts outside the control of the Ministry of Finance (MOF) stemming from revenue of petroleum taxes, excises and the like. The ratio of cash revenue to the accrued revenue was 81.8% in 1998 and increased to 84.9% in 1999 according to preliminary estimates. The PA is under pressure from the donor community in general and

the IMF and the World Bank in particular to put all sources of revenue under the control of the MOF.

There has been rapid expansion of public sector employment with the implication that the weight and cost of employment in the Authority is now very high in comparative terms. Figure 2 indicates that the share of the central government's payroll in recurrent expenditures in West Bank/Gaza is the greatest of any jurisdiction in the Bank's Middle East and North Africa Region and much higher than the average share in any of the World Bank's other regions. About one-fifth of the Palestinian labor force in the WBGS is employed by the PA. This is a costly solution to the unemployment problem. There are long-term costs associated with creating permanent civil service positions, such as recurring wages and future pensions. Efficiency may also suffer through over-staffing and ineffective distribution of jobs (e.g., excessive personnel in support, rather than front-line, functions). In addition, the heavy burden associated with public sector employment effectively reduces policy choices with respect to present and future budget allocations.

Figure 2: Share of Central Government Payroll in Recurrent Expenditures



Source: World Bank (1999).

An assessment of recent fiscal performance and the prospects for fiscal resources in the medium term highlights the risk that future revenue collections may not meet future expenditure needs. Since the PA was established in 1994, recurrent expenditures have risen in line with increasing revenue collections; recurrent expenditures rose from 18 percent of GDP in 1995 to 25 percent in 1997, whereas recurrent revenues increased from 16 percent to 24 percent of GDP (see Table 4). The rise in recurrent expenditure by the central government coincided with a decline in grant-financed current expenditure as the PA assumed responsibility for services previously provided by donors.

Table 4: Fiscal Accounts of the Central Government of the PA, 1994-1997

(% of GDP)	1994*	1995	1996	1997
Central Government				
Recurrent revenue	8.9	15.5	20.0	24.3
Recurrent expenditure	*11.0*	*17.6*	22.9	*25.4*
Recurrent deficit**	-2.1	-2.0	-2.8	-1.1
Capital expenditure	*7.1*	*5.0*	*5.4*	6.2
of which:				
Donor-financed	*5.6*	*5.0*	*5.4*	*6.2*
Capital grants	5.5	4.4	4.6	5.0
Loans	0.1	0.6	0.8	1.2
Overall deficit***	-3.6	-2.1	-2.9	-1.1

* Fiscal data for 1994 are consolidated accounts of the PA and the ICA.
** Differences are due to rounding errors.
*** Overall deficit = [recurrent revenue + donor-financed capital expenditure] – [recurrent expenditure + capital expenditure].
Sources: Ministry of Planning and International Cooperation (MOPIC), Ministry of Finance, IMF.

Although the central government's recurrent budget has remained close to balance, with deficits ranging from 1 to 3 percent of GDP, capital expenditure for 1995-97 was financed solely by donor assistance. Lower than anticipated revenue across all sources (i.e., taxes, clearances and non-tax revenue), due in part to the depreciation of the shekel, has raised the possibility of a slight recurrent budget deficit in 1998. Revenue shortfalls have resulted in liquidity constraints at the Ministry of Finance with implications across sectors. For

example, the Ministry of Health has scaled back non-urgent operations and drug dispensing to non-emergency patients due to the lack of access to its allotted budget.

The functional composition of public expenditure has changed over the last three years with the creation of new ministries. The share of public funds allocated for the government's central functions is dominant, reaching 58 percent of total current expenditure in 1997 and 1998 (see Table 5). Expenditure on public order and safety (i.e. police and judiciary) absorbs some 30 percent of the budget, while general public services (i.e. legislative, executive, financial operations and planning) rose from 21 percent in 1996 to 27 percent of current expenditure in 1998. Budget resources to the social ministries of health and education have increased in both nominal and real terms to keep pace with expanding service provision and demographic pressures. However, because the share of total budget resources has risen in favor of general government functions, the share available for education and health services has declined slightly. In view of the rapid population growth, competition for budget resources will make it increasingly difficult to sustain the current social indicators with respect to primary enrollment rates and access to health care, for example. The share of central government funds allocated to the health sector has fallen from 14 percent in 1996 to a budgeted 11 percent for 1998, while the education budget declined from 19 percent to 18 percent. Moreover, since a small but growing share of public funds goes to tertiary education, the funds available for primary and secondary education fell from 19 percent to 17 percent of GDP between 1996 to 1998, with negative implications for equity. In this context, it should be noted that UNRWA currently provides health and education services and other relief and social services to many of the 1.3 million Palestine refugees in WBGS. Over the medium term, health and education services to this growing population could cost in the range of US$100 million annually.

Table 5: PA Central Government Expenditure, 1995-1998

(Share of expenditure)	1995	1996	1997	1998
Functional Classification *Total expenditure*	n/a	100	100	100
General public services	n/a	21	27	27
Public order and safety	n/a	30	31	31
Education*	n/a	19	17	18
Health	n/a	14	12	11
Other expenditure	n/a	16	13	13
Economic Classification *Current expenditure*	100	100	100	100
Wages and salaries	62	52	55	54
Civil service	39	32	32	33
Police force	22	20	23	21
Interest payments	0	0	1	1
Transfers	3	3	2	2
Other expenditure	35	45	43	43

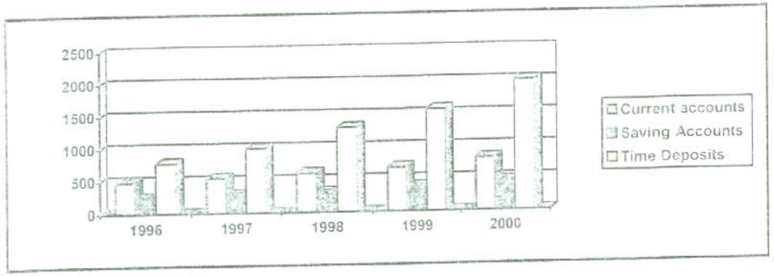
* Includes higher education.
Source: MOF, IMF, Budget documents (Palestinian Legislative Council).

2.3 Financial and Banking Sector

Following the inception of the PA the banking and the financial sector emerged as a mushroom after a rainy week. In few years the number of banks operating in the WBGS reached twenty three banks, nine of which are local and the remaining fourteen are foreign banks, with 115 branches of which only 48 are local and the rest are foreign. This is to be compared with one foreign bank (the Amman-Cairo Bank) which was the only operating bank during the years of the Israeli military occupation. To see the point of the rapid increase in the number of the banks and their branches compare the figures for 1999 with those for 1995. In 1995 there were 13 banks with a network of 57 branches. The Palestinian Monetary Authority (PMA) is responsible for controlling and surveillance of the banking activities. It has the traditions of a central bank except for the right to issue money. According to the Paris Protocol this right was reserved to an agreement with Israel before it becomes a right of the PMA.

This change reflected an increased demand for the financial services. Private sector deposits with the banking system increased from insignificant levels in 1993, when most private savings were held with banks abroad or in cash, to \$3.3 billion in mid 2000 (about 66% of GDP). This level compares well with countries in the region. The fast growth in deposits reflected the re-intermediation process as people shifted their savings into domestic banking system and reduced their holdings of deposits abroad and cash faster than many had expected. (See figure 3).

Figure 3: Deposits Trends by Type at Licensed Banks, 1996-2000*
(Million $US)

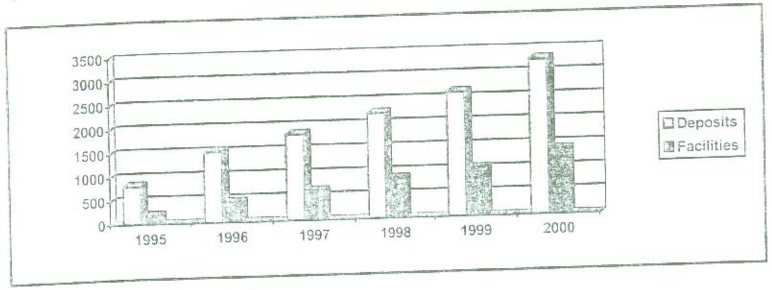


* The figures for 2000 are mid-of-the-year.
Source: PMA, different reports

A large degree of concentration remains to be one of the features of the banking system in the WBGS, and the three largest Jordanian banks operating (the Arab Bank, the Cairo-Amman Bank, and the Bank of Jordan) accounted for more than 80% of bank deposits. These banks are perceived as the most secure, well established and more experienced than the newer local banks, and are also subject to supervision by their home countries.

The fast growth in deposits allowed banks to increase their lending to the local economy (figure 4). Since 1994, credit to the private sector grew as a share of total deposits from 18% (3% of GDP) to about 32% (21% of GDP) in 1998, of which 80% approximately was extended by branches of foreign banks. While the level of credit to the private sector is still low when compared with that of other countries in the region, the implied annual (compounded) credit growth in 1994-1998 was about 45% in real shekel terms. This growth rate is rapid by any standards, and it is highly doubtful that bank credit could have grown significantly faster without creating undue risk to the quality of loan portfolio. A large portion of the claims on the private sector was in the form of overdrafts or very short-term credits (up to six months), including trade credits, while there was only limited growth in long-term credit. At the end of 1998, more than half of all credit to the private sector was in the form of overdrafts. It is possible, however, that overdrafts were used, and continuously rolled over, to finance investment as well, as is often the case in neighboring countries.

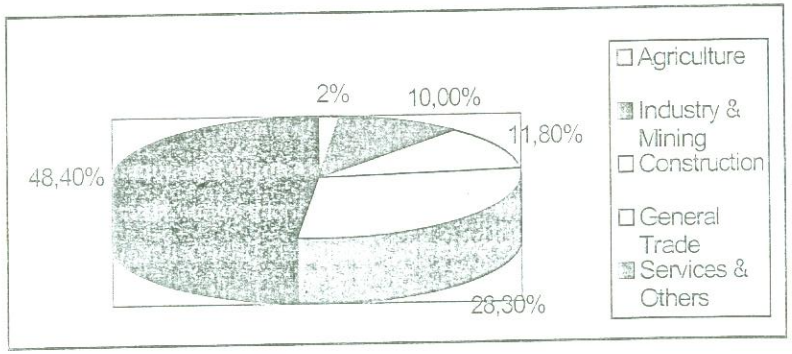
Figure 4: Growth of Credit Facilities and Deposits, 1995-2000*
(Million US$)



* Figures for 2000 are mid-of-the-year.
Source: PMA, different reports.

As for the distribution of credit facilities, most of the facilities were extended to the services sector, especially for trade. This explains the dependence on short-term credit, in the form of overdraft. In 2000, which is typical for other years, the distribution of these facilities is portrayed in figure 5.

Figure 5: Distribution of Direct Credit Facilities by Sectors
(% of total credit facilities, June 2000)



Source: PMA, different reports.

3 Theoretical Setting: Process Approach to Development and the Role of Government Intervention

3.1 Introduction

Disillusionment with the conventional approach to planning and managing development projects led to widespread calls for the adoption of "process" approaches throughout the 1980s (Gow/Morss, 1988; Honadle/Van Sant, 1985; Korten, 1980; Rondinelli, 1983)[2]. In contrast to rigid "blueprint" approaches these alternatives emphasized *experimentation, learning, adaptation, participation, flexibility, building local capacities and organic expansion.* During the 1990s NGOs, donors[3] and developing country governments have taken up such ideas (Eyben, 1991; Mosse/Farrington/Rew, 1998) but there remains a lack of clarity over exactly what a process approach to projects means.

2 For a fuller discussion of disillusionment with conventional project approaches see Hulme (1995).

Surprisingly, given the large volume of work done in the 1980s, there have been few attempts to explore the empirical experience of "process projects"[4]. Most discussion and study has focused on the important, but narrower, issue of participation. While there is much evidence that this project can be considered successful, there have been significant problems in managing a process approach that generate potential lessons. The paper highlights a number of important findings about how process approaches might be understood and operationalized more effectively in the future.

3.2 Process Approaches: A Long Voyage of Discovery

The concept of a "state of equilibrium" has become "*less and less suitable for modeling a sufficiently appropriate picture of reality*".[5] In the past 40 years and in spite of technical problems of the models and difficulties caused by the lack of statistical data, it was always assumed that socio-economic processes could basically be predicted and rationally planned. In principle, the economies of developing countries were treated as largely "determined systems". Weiss, D. (1990: 29) discussed this problem and the following quotation of him is quite in order.

> "*The turbulence in international trade, monetary and energy policies since the beginning of the nineteen-seventies had increasing effects on the domestic economies. These turbulences could no longer be ignored. In many cases, they were aggravated by counterproductive attempts to dam up evolutionary transformation processes, to delay necessary socio-economic structural changes by political-administrative inertia, or to give greater priority to short-term-oriented power-securing maxims and to postpone necessary action in favor of pressing issues of day-to-day politics. The increase in turbulence can be interpreted as a consequence of impeded evolutionary change. Processes of adjustment that would take place relatively smoothly without intervention to strengthen the status quo, are blocked, and the unavoidable transformation takes on turbulent forms.* Turbulence, a predominant characteristic of political-

[3] Even World Bank staff have pushed the idea forward (Picciotto and Weaving (1994)), although in contemporary practice the Bank remains wedded to conventional approaches to projects.

[4] One possible reason for this is the withdrawal of support for North American scholar-practitioners working in this field by USAID in the 1990s.

[5] See Weiss, D. (1990: 29).

> social systems today, is in this respect caused to a considerable extent by the institutions themselves. *In any case, it has become the dominating condition of all development efforts.* Socio-economic development can also be regarded as an evolutionary process of increasing differentiation and complexity.
>
> *Disequilibria, uncertainties, unpredictable factors, challenges, opportunities and risks accelerate this process. Therefore, successful development processes have been characterized by the interlinking of a medium-term, more* qualitative *strategic respective with the* ability to adjust flexibly to changes in the environment. *In this context what is needed is not radical cures but* transitional solutions. *These solutions require even greater efforts to manage the transition.*"[6]

The components of a successful strategy can be deduced from the observation of systems that show themselves to be capable of surviving. These components are:

> "- *the* sensitive early diagnosis *of new trends with the corresponding demands on the institutional efficiency of such future-oriented sensors in the governmental and private spheres,*
>
> - *a high degree of* flexibility and ability to adjust *as regards one's own reactions, i.e. the programmes and policies,*
>
> - *the ability to creatively develop a diversity of possible solution approaches, i.e.* variety,
>
> - *a continuous process of* individual and social learning, *i.e. the processing of all flood of information, which is tending to rise,*
>
> - *[...] the building up of a technical-scientific and* innovatory potential *that is efficient in international competition.*
>
> - *The fundamental organizational approach for dealing with increasing complexity is the* principle of self-organization."[7]

These principles are reflected in other studies to which this paper is referring. The term implementation" understates the complexity of the task of carrying out projects that are affected by a high degree of initial ignorance and uncertainty. Here "project implementation" may often mean in fact a long voyage of discovery in the most varied domains, from technology to politics (Hirschman, 1967: 35).

[6] Emphasis added.

[7] Weiss, D. (ibid.: 33). Emphasis added.

The process approach to development projects has several differing origins. All stemmed however from concern about the poor performance of development projects which took a blueprint or top-down approach to development. *The blueprint approach* is based within the concepts of objective rationality and reductionism and has roots in the fields of engineering and construction. Prescribed steps lead through the stages of the project cycle; experts design and control activities; detailed planning at the beginning specifies objectives, targets, outputs, resources and schedules; local institutions are bypassed if they have inadequate capacity and the job of management is to implement as closely as possible to the plan. *Process approaches* have evolved as a reaction to the ineffectiveness of such a method to achieve development goals in diverse and complex environments.

At their heart is the recognition that the challenges of development are not well-structured problems that can be "thought through" by clever people. Rather, they are "messes" that have to be "acted out" by social experimentation and interaction (Johnston/Clark, 1982: 23-28). *They accept that many things are unknown at the start of a project; that problem-solving capacities and local institutions must be built-up not simply "bought in"; that much activity is experimental and error must be embraced; that the intended beneficiaries of projects are actors in their own right and not mere recipients; and that large-scale initiatives should start small and grow organically at rates dependent on their achievements.*

Proponents of process approaches fall into two main schools of thought. Purists (such as Chambers, 1997; and Korten, 1980) emphasize beneficiary participation and learning and, in effect, argue for the abandonment of the concept of "project". Process is seen as *synonymous with local institutional development in which the role of external agents and resources should be minimized.* Where external interventions occur then these should not be projects but "para projects" (Uphoff, 1990) that help poor and disadvantaged

people to help themselves, through raising their capacities, rather than attempting to achieve exogenously defined "impacts". In contrast, managerialists (such as Brinkerhoff/Ingle, 1989; Brinkerhoff, 1992; Rondinelli, 1993; and Sweet/Weisel, 1979) still see a significant role for external actors but *argue that projects, managers and management systems must be more flexible and adaptive.*

In practice, these schools of thought can be seen as points on a continuum that ranges from minimalist approaches to support pre-existing, endogenous development initiatives and organizations, to relatively conventional project approaches that see a limited need for "process" to strengthen their problem-solving abilities. The former position is one that relatively idealistic NGOs seek to achieve. The latter, is the one which many aid donors, particularly those under pressure to account for performance on short time horizons[8], have found it expedient to adopt.

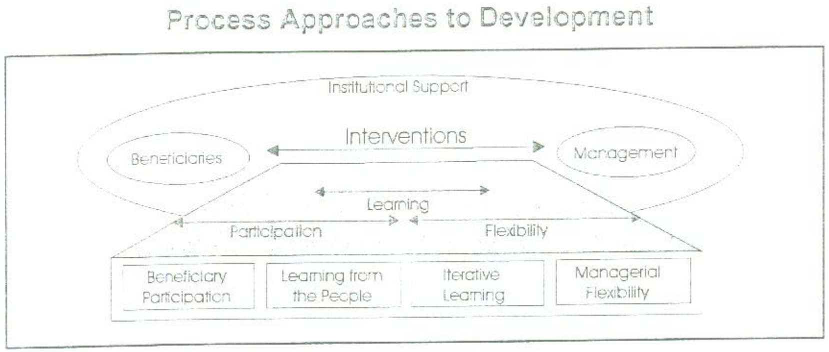
In the paragraphs that follow five main elements of a process approach are identified and drawn from a comprehensive review of the literature (Bond, 1997). This creates a conceptual framework that permits the development of a vision for the Palestinian economy. The relationships between the major elements of a process approach are illustrated in Figure 6.

In this diagram, process defines relationships between the beneficiaries and the management, not in an abstract, conceptual way, but through the activities of specific interventions. The diagram therefore links beneficiaries to management by interventions. The spectrum of characteristics of the interventions connects the three main elements of process directly relevant to that relationship: participation, learning and flexibility. These characteristics overlap; participation is required of the beneficiaries, flexibility is required of the management and learning links the two, overlapping as shown. This

8 The UK's Department for International Development would fit into this category.

gives a spectrum of four distinct characteristics: beneficiary participation, learning from the people, iterative learning and managerial flexibility. Institutional support relates to the environment containing management, beneficiaries and the interventions. Internal managerial aspects of process lie within the circle of management.

Figure 6: Interrelationship of the main characteristics of intervention in a process project



Source: Adapted from Bund and Hulme (1999: 1341).

(a) Flexible and phased implementation

Within the framework of a clear vision of goals, deliberate phasing and flexibility are required (Sweet/Weisel, 1979; Brinkerhoff/Ingle, 1989; Conyers/Kaul, 1990).

- *Start small and expand*: piloting to build capacities and making inevitable mistakes only on a small-scale is imperative (Brinkerhoff/Ingle, 1989; Conyers/Kaul, 1990; Cernea, 1991; Picciotto/Weaving, 1994).
- *Long time frames*: poverty reduction and pro-poor economic growth are unlikely to be achieved in conventional three-year or five-year projects - 10 to 20-year timeframes are more realistic (Morss, et al., 1976; ODA, 1995; Thompson, 1995).

- *Experimentation*: flexibility (in methods, finances and human resources) and careful phasing are necessary for experiments to be trialed and to be carried into further action (Rondinelli, 1983, 1993; Brinkerhoff/Ingle, 1989).
- *Action Learning Cycles*: activities need to be phased according to the experiences of earlier learning cycles - they cannot be programmed at project initiation, thus rolling planning becomes necessary (Lewin, 1946; Honadle/Van Sant, 1985; Brinkerhoff/Ingle, 1989; Zuber-Skerritt, 1991).

(b) Learning from experience

Learning from experience means recognizing and managing "the unknown" in development through systematized and institutionalized learning. It also implies seeing development as a product of learning (Ackoff, 1984; Pretty/Chambers, 1993).

- *Embracing error*: attitudes and organizational cultures must accept error as an aid to learning (Korten, 1980). Without this mistakes may be hidden and repeated (Michael, 1973; Korten, 1980; Rondinelli, 1993; Chambers, 1997; Hulme, 1989).
- *Links between implementation and planning*: deliberate links between planning and implementation should be established to ensure lessons learned feed into new plans (Korten, 1980; Rondinelli, 1983, 1993; Honadle/Van Sant, 1985; Brinkerhoff/Ingle, 1989).
- *Iterative improvement of small interventions*: the chief mode of learning is through the repeated application of lessons learned to ongoing or new initiatives often on a small, but expanding scale (Brinkerhoff/Klauss, 1985; Uphoff, 1992).
- *Be effective, become efficient and then expand*: a "learning process approach" is needed where one first learns how to do something effectively, then how to do it efficiently and finally how to expand its impact (Korten, 1980).

- *Appropriate technologies*: this represents learning from indigenous knowledge and the local environments only to use technologies that are appropriate to the local context (Sweet/Weisel, 1979; Korten, 1980).

(c) Beneficiary participation

Project managers have to understand the complex social realities of local situations if they are to be successful (Korten/Alfonso, 1983). Therefore, beneficiary participation in different levels of decision-making process is an important ingredient for success. These levels are outlined below.

- *In problem analysis*: local people are the ones who best know their situation and problems (Cernea, 1985).
- *In planning and decision-making*: beneficiary involvement in the planning process ensures relevance, support and some measure of control over their futures (Sweet/Weisel, 1979; Korten, 1980; Rondinelli, 1993).
- *In resource mobilization and implementation*: local people can often mobilize many resources thus encouraging sustainability and lower external costs. Their involvement in implementation increases a sense of ownership and subsequent maintenance of assets created (Sweet/Weisel, 1979; Honadle/Van Sant, 1985).
- *In monitoring and evaluation*: an important aspect of local control, participation in monitoring can ensure timely and quality work; in evaluation it can ensure ultimate acceptability of the project interventions (Uphoff, 1985; Mosse, 1995; Mosse/Farrington/Rew, 1998).
- *Empowerment of beneficiaries*: finally participation throughout the process of change has its own benefits in terms of strengthening local organizations and increasing confidence to undertake self-initiated development (Friedmann, 1984; Brinkerhoff/Ingle, 1989; Conyers/Kaul, 1990).

(d) Institutional support

Avoiding bypass and helping to build-up local institutional capacities within an improved operational environment are key elements of institutional support (Dale, 1988). Under this support the following issues must be addressed.

- *Political support*: is often essential to the successful outcome of projects and programs, this includes both national-level and local-level support (Ickis, 1983; Conyers/Kaul, 1990; Rondinelli, 1993).
- *Devolved authority*: the flexibility of a process approach requires some measure of devolved authority. Frequent decision-making and the means to carry them out, both at a locality close to the activities being undertaken is the nature of process management (Sweet/Weisel, 1979; Birgegård, 1991; Rondinelli, 1993).
- *Use of permanent institutions*: temporary, well-resourced project management units can implement projects quickly and efficiently but do not contribute to sustainable institution building. A process project will support the use of existing agencies according to their capacities (Honadle/Van Sant, 1985; Goldman/Mellors/Pudsey, 1989).
- *Local capacity building*: development is not just about improved facilities but also about stronger, more capable institutions and individuals (Korten, 1980; Brinkerhoff/Ingle, 1989; Birgegård, 1991; Rondinelli, 1993).
- *Organizational change*: sometimes quite fundamental re-orientation is required within key institutions for development to proceed (Korten, 1980; Korten/Alfonso, 1983; Korten/Siy, 1988; Rondinelli, 1983, 1993).
- *Facilitating beneficiary organization*: while many project activities may be carried out using existing government, private commercial and voluntary agencies, membership organizations of the beneficiaries should be encour-

aged and supported to provide a strong civil base for on-going development (Sweet/Weisel, 1979; Honadle/Van Sant, 1985; Friedmann, 1992).

(e) Program management

Management is central to process approaches that should not be used to justify management by abandonment (Honadle/Van Sant, 1985; Roe, 1993). Program management involves the following aspects that should not be neglected.

- *Well-qualified and motivated leadership*: an important element in successful projects generally and more so in process projects. Flexibility and the management of complexity require strong leadership (Korten, 1988; Conyers/Kaul, 1990; Brinkerhoff, 1992; Thompson, 1995).
- *New professionalism*: the *reversals of attitudes,* the concept developed by Chambers (1993), typical of normal professionalism have a special place in the management of process approaches where the quality of intervention by key facilitators is so important.
- *Retention of key staff*: stability and continuity of staff so that complex lessons are not lost and so that there is a good corporate understanding of the "different" approaches being undertaken (Chambers, 1988, 1993; Rondinelli, 1993).
- *Variety of short-term technical assistance*: response to complex and diverse problems often needs external advice, an ability to provide short-term consultation to remote areas is needed (Honadle/Van Sant, 1985).
- *Long-term technical assistance in a facilitating role*: the role of long-term technical assistance (TA) support should be restricted to facilitation, advice and training, and should exclude executive roles where dependency may be created (Honadle/Van Sant, 1985; Brinkerhoff/Ingle, 1989; Birgegård, 1991).

- *Project management unit (PMU) with flexible, informal approach*: whatever institution is chosen to host the project management unit, it must be free to develop a flexible, innovative and informal approach in order to avoid bureaucratization, to initiate relevant and fast responses and to encourage action by other agencies (Honadle/Van Sant, 1985).
- *Creative management*: the fast-moving world of a process project needs imaginative approaches to problems and project management (Brinkerhoff/Ingle, 1989; Rondinelli, 1983, 1993; Thompson, 1995).
- *Inter-organizational coordination*: many agencies and groups will come together in a process project or program, especially in large-scale integrated programs (Korten/Alfonso, 1983). This requires the establishment of good coordination, independent of the PMU (Sweet/Weisel, 1979; Rondinelli, 1993).

3.3 The Role of Government Intervention

Another important aspect of the development process has to do with the role of the government or state. Much has been written about the role of the government and it has been the focus of the World Bank 1997 Development Report: The State in A Changing World. The general trend now emphasizes that the role of the state must be held to a minimum in which the government provides for national defense and security, police services, primary health services and basic education in addition to a regulatory framework. Lobbying government officials to secure monopoly rights may be self-interest; however and in contrast to Washington consensus, not necessarily unproductive. Likewise, the government's granting of exclusive rights to certain trades and businesses may not produce economic waste. *An important factor overlooked in the neoclassical public choice theory is* ***coordination under uncertainty***. In this paper, I assign a coordinating function to an ***enlightened*** government in economic affairs. Owing to uncertainty, market exchange requires some form of ***central coordinating intelligence***, in order to adjust to the continuously changing conditions of competition (Weiss, L./Hobson, 1995: 8). The government can assume this role. It possesses some unique features that distinguish it from the firm. Such features allow the government to do the following:

- regulate competition,
- reduce uncertainty, and
- provide a relatively stable exchange environment.

Specifically, in the area of industrial policy, the government can help private enterprises tackle uncertainty in the following ways:

- first, locating the focal point by initiating projects; providing assurance and guarantees to the large investment project; and facilitating the exchange of information;
- second, reducing excessive competition by granting exclusive rights; and
- third, facilitating learning and diffusion of technologies, and assisting infant industry firms to build up competence.

The history of developmental success indicates that the market and the state are not opposed forms of social organization, but interactively linked (Rodrik, 1997: 437). In the prospering and dynamic nations, public-private coordination tends to prevail. Dynamic private enterprises assisted by government coordination explain the successful economic performances in the post-war Japan and the Asian newly industrializing economies. It is their governments' consistent and coordinated attentiveness to the economic problems that differentiates the *entrepreneurial states* (Yu, 1997) from the *predatory states* (Boaz/Polak, 1997).

To elaborate this view a review of theory regarding the role of state in the economy is in order. In 1920, A.C. Pigou argued that, because of the divergence between marginal social net product and marginal private net product, government intervention, either through taxes or through other forms of regulation, is required if the economy is to achieve an optimal level of output. Pigou's argument, later known as externality, opens a new world for the role of government in the market economy. Following the experience of the Great Depression in 1929-1933 and the publication of J.M. Keynes' General Theory in 1936, most economists believed that the government has the responsibility of maintaining full employment, reasonable levels of inflation and growth rates. In 1954, Paul A. Samuelson, extending H.R. Bowen and E. Lindhal's partial equilibrium analysis, formulated his famous theory of public goods. The non-rival nature of the consumption of public goods generates free rider problems and therefore a need for a compulsory taxation on all members in the society. By the late 1950s, the orthodox neoclassical economics broadly assigned three major roles of government in economic affairs, namely allocation, redistribution and stabilization (Musgrave, 1959: 5-27; Bator, 1958: 351-79). In summary, the traditional public finance, at both micro and macro levels, designated a significant role of government in economic affairs.

This view had been generally held until the re-discovery of Coase's contributions. From Coase (1937, 1960), economists understand that inefficiencies in the market economy are due largely to transaction costs and that the so-called public goods and externality problems in fact arise from poorly defined property rights. The high costs of defining, metering and enforcing property rights lead to market failures (Cheung, 1983). Coase's arguments have significant theoretical implications for the choice of economic institutions (Cheung, 1988). Because of the existence of transaction costs, the socialist system is not necessarily superior to the capitalist system, or vice versa. Coase's contributions, which laid the foundation of the new institutional economics, had the effect of limiting the scope for government intervention. Together with the emergence of the public choice school, founded by James Buchanan, inefficiencies in the public sector are now largely explained in terms of rent-seeking arguments, or from a property rights/transaction cost economics perspective. Research interest in the *market failures* in the 1960s has been replaced by interest in *government failures*. In the early 1980s, views concerning a smaller and more limited government were held strongly (Stiglitz, et al., 1989: 20). In the view of liberal economists, protectionism and other forms of government interference are doomed to fail, since they raise prices for consumers and shield inefficient industries from the bracing effects of international competition. Costly government failures, as free market economists now contended, called for liberalization or deregulation.

The transaction costs paradigm analyses economic problems from the market perspective. Production activities tend to take the form of vertical integration when the relative costs of using market are too high. The firm in this perspective is only a second best alternative. For the neoclassical institutionalists, the government is often treated as a firm and the difference between the two is explained mainly in terms of monitoring problems and agency costs. For the large corporation, performance can be indirectly monitored through a stock market. Poor performance will result in the depreciation of share prices which in turn leads to a change in the directorate boards (Alchian/Allen, 1983: 185-92). For the government, there is no residual claimant. Its performance cannot be reflected in a stock market. In the democratic society, change in the government can only be made through the political process. Otherwise, for the neoclassical institutionalists, there is no conceptual difference between the government organization and the large corporation. In a typical neoclassical public choice tone, Auster and Silver (1979) portray the state as a firm which supplies democracy with a production function. Obviously, the firm and the government are two distinct types of economic institution. The significance of this conceptual distinction emerges when we analyze industrial reforms in the transitional economies such as Mainland China

and Russia, where their state owned enterprises have been massively privatized into listed companies. If a large corporation and a state owned enterprise are essentially not different, as portrayed by the transaction costs economists, enterprise reforms in these countries would be superfluous.

The neoclassical institutionalists fail to explain satisfactorily why human agents are willing to devise a "necessary evil", namely government, to interrupt their free economic activities. At most, they only accept the minimum role of the government as a night-watchman. The reason for this oversight is that most theories of the firm and their approach to economic problems are static in nature. As Langlois and Robertson (1995: 30) argue, "*most theories of the boundaries of the firm are static in an important sense. They take the circumstances of production as given and investigate comparatively the properties of market-contract arrangements, internal organization, and other modes of organization. No account has been made regarding the rapidly changing technologies of production and other environmental factors*".

Langlois and Foss (1996) have remarked that transaction costs theory as it applies to economic organizations has been dominated by interest in issues of incentive compatibility. Furthermore, the studies after Coase's (1937) paper have narrowed the explanation of the firm and moved its focus away from the issue of coordination. In their view, the dominant transaction-cost theories of the firm have only a short-run perspective. One cannot have a complete theory of the firm without considering the processes of learning and coordination in firms and markets in the long run. A satisfactory theory of the firm would contribute enormously to our understanding of the role of government. Some scholars recently attempted to re-direct the analysis of the firm in terms of coordination (for instance, see Langlois/Robertson, 1995; Langlois/Foss, 1996). *In this paper, I emphasize the point that the government is an institution which helps to coordinate economic activities. The coordinating* *view of government is fundamentally anti-deterministic, with policy makers involved in learning, making errors and revising plans.*

Human action is forward-looking and always oriented toward other individuals (Weber, 1964; von Mises, 1949). Market actors live in a murky world where the consequences of actions are never clear (Fligstein, 1996: 659). Uncertainty arising from the actions of others generates economic problems. On this, Hayek (1945: 523) poses a famous statement: "*all economic problems are knowledge problems, arising out of uncertainty*". Human agents are always eager to reduce uneasiness arising from uncertainty (von Mises, 1949; Knight, 1921). They construct an account of the world that interprets the murkiness and justifies the action decided upon. "*Actors need a coherent view that allows them to simplify their decision-making processes*" (Fligstein, 1996: 659). *Action is therefore directed toward the creation of stable worlds.*

4 Conclusion

The Palestinian economy is emerging and it undergoes a transitional phase to suit a small country facing the winds of globalization. This economy has many assets and is not inventing the wheel of development. However, it has a lot to learn and experience. Although the natural-resource base is poor, Palestine has a potential, when political independence is won, to become the Singapore of the Middle East. After decades of negligence and oppression a people willing to succeed is the most precious resource this country has. The last six years after Oslo were not encouraging for the growth, and development records were neither in line with aspiration nor in line with resources of international assistance. The peace process was in a stalemate. However, the discouraging record of the Palestinian Authority style of management is a matter of concern. Many observers have correctly attributed the failure partially to the economic management of the PA itself. Without a change in this

style of management Palestine would be beset with typical failure of an underdeveloped nation. This is becoming a concern of a high degree of importance to the private sector, the civic society and the donor community[9]. The need for a clear vision of what to be, what to do, and how to do things timely and less costly is beyond the utmost concern of post-Oslo era. Without a clear vision, development efforts in the Palestinian context would be doomed to failure.

Our long journey through the process approach to development and the discussion of the role of the government has led us to illuminate the "essential elements of success". These elements are a spectrum of four distinct characteristics: beneficiary participation, learning from the people, iterative learning and managerial flexibility. Institutional support relates to the environment containing management, beneficiaries and the interventions. Internal managerial aspects of process lie within the circle of management. I emphasize the point that the government is an institution which helps to *coordinate economic activities*. The coordinating view of government is fundamentally anti-deterministic, with policy makers involved in learning, making errors and revising plans. The whole country has to build skills and generate innovations and entrepreneurships. The state is a catalyst is this process. But eventually, the nation has to "graduate" to compete openly in the world markets.[10]

9 See for example Palestine Trade Centre (2000).

10 For more on this see Reinert (1999: 268-326). His paper argues that the classical Anglo-Saxon tradition in economics - fundamentally focused on barter and distribution, rather than on production and knowledge - systematically fails to grasp wider issues in economic development, and it brings in and discusses the role played by the state in alternative traditions of non-equilibrium economics.

References

Ackoff, Russell L.: On the nature of development and planning. In: David C. Korten/Rudi Klauss (Eds.), People Centered Development: Contributions Toward Theory and Planning Frameworks. Kumarian, West Hartford 1984, CT, pp. 195-197.

Alchian, Armen Albert / Allen, William R.: Exchange and Production. 3rd ed., Wadsworth Publishing Co., Belmont, CA 1983.

Auster, Richard D. / Silver, Morris: The State as a Firm: Economic Forces in Political Development. Marinus Nijhoff Publishing, Boston, MA 1979.

Bator, Francis M.: The anatomy of market failure. Quarterly Journal of Economics, Vol. 72, August 1958, pp. 351-379.

Birgegård, Lars Erik: A process approach to policy and project analysis. Issue Paper No. 13, Swedish University of Agricultural Sciences, International Rural Development Centre, Uppsala 1991.

Boaz, Moselle / Polak, Ben: A model of a predatory state. Paper presented at a Seminar at Department of Economics, Faculty of Economics and Commerce, Australian National University, Canberra, 21 July 1997.

Bond, Richard: Operationalising process: The experience of the first decade of the Moneragala IRDP in Sri Lanka. IDPM Discussion Paper Series 50, Institute for Development Policy and Management, University of Manchester, Manchester 1997.

Brinkerhoff, Derick W.: Looking out, looking in, looking ahead: Guidelines for managing development programs. International Review of Administrative Sciences, Vol. 58, 1992, No. 4, pp. 483-503.

Brinkerhoff, Derick W. / Ingle, Marcus D.: Integrating blueprint and process: A structured flexibility approach to development management. Public Administration and Development, Vol. 9, 1989, No. 5, S. 487-503.

Brinkerhoff, Derick W. / Klauss, Rudi: Managerial roles for social development management. Public Administration and Development, Vol. 5, 1985, No. 2, pp. 145-156.

Brynen, Rex, et al.: Aid Effectiveness in the West Bank and Gaza. The World Bank, Washington, DC 2000.

Bund, Richard / Hulme, David: Process approaches to development; theory and Sri Lankan practice. World Development, Vol. 27, 1999, No. 8, pp. 1339-1358.

Cernea, Michael M. (Ed.): Putting People First: Sociological Variables in Rural Development. World Bank / Oxford University Press, New York 1985.

- (Ed.): Putting People First: Sociological Variables in Rural Development. 2nd ed., Oxford University Press, New York 1991.

Chambers, Robert: Normal Professionalism and Early Project Process: Problems and Solutions. IDS Discussion Paper No. 247, Institute of Development Studies, Brighton 1988.

- : Challenging the Professions. IT Publications, London 1993.

- : Whose Reality Counts? Putting the First Last. IT Publications, London 1997.

Cheung, Steven N.S.: The contractual nature of the firm. The Journal of Law and Economics, Vol. 26, 1983, No. 1, pp. 1-21.

- : Economic organization and transaction costs. In: John Eatwell, et al. (Eds.), The New Palgrave: A Dictionary of Economics. Vol. 2. Macmillan, London 1988, pp. 55-58.

CMECS (Center for Middle East Competitive Strategy): Transaction Costs for Palestinian Business. In conjunction with the Federation of Palestinian Chambers of Commerce, Industry and Agriculture, Ramallah 1998.

Coase, Ronald H.: The nature of the firm. Economica, Vol. 4, November 1937, pp. 386-405.

- : The problem of social cost. Journal of Law and Economics, Vol. 3, October 1960, pp. 1-44.

Conyers, Diana / Kaul, Mohan: Strategic issues in development management: Learning from successful experience. Part I. Public Administration and Development, Vol. 10, 1990, No. 2, pp. 127-140.

Dale, Reidar: A donor perspective on the Hambantota district Integrated Rural Development project (HIRDEP) - with emphasis on the promotion of institutional capacity. Manchester Papers on Development IV/1, University of Manchester, Manchester 1988, pp. 42-51.

Eyben, R.: The process approach. Report of the natural resources advisors Conference, ODA, London 1991.

Fligstein, Neil: Markets as politics: a political-cultural approach to market institutions. American Sociological Review, Vol. 61, 1996, No. 4, pp. 656-673.

Friedmann, John: Planning as social learning. In: David C. Korten/Rudi Klauss (Eds.), People-Centred Development: Contributions Towards Theory and Planning Frameworks. Kumarian, West Hartford, CT 1984, pp. 189-194.

- : Empowerment: The Politics of Alternative Development. Blackwell, Oxford 1992.

Goldman, Ian / Mellors, Robert / Pudsey, David: Facilitating sustainable rural development: An experience from Zambia. Journal of International Development, Vol. 1, 1989, No. 2, pp. 217-230.

Gow, David D. / Morss, Elliott R.: The notorious nine: Critical problems in project implementation. World Development, Vol. 16, 1988, No. 12, pp. 1399-1418.

Hayek, Friedrich August: The use of knowledge in the society. American Economic Review, Vol. 35, 1945, No. 4, pp. 519-530.

Heyne, Paul T.: The Economic Way of Thinking. 4th ed., SRA, Chicago etc. 1983.

Hirschman, Albert O.: Development Projects Observed. The Brookings Institution, Washington, DC 1967.

Honadle, George / Jerry Van Sant: Implementation for Sustainability: Lessons From Integrated Rural Development. Kumarian, West Hartford, CT 1985.

Hulme, David: Learning and not learning from experience in rural project planning. Public Administration and Development, Vol. 9, 1989, No. 1, pp. 1-16.

- : Projects, politics and professionals: Alternative approaches for project identification and project planning. Agricultural Systems, Vol. 47, 1995, No. 2, pp. 211-233.

Ickis, John C.: Structural Responses to New Rural Development Strategies. In: David C. Korten/Felipe B. Alfonso (Eds.), Bureaucracy and the Poor. Kumarian, West Hartford, CT 1983, pp. 4-32.

Johnston, Bruce F. / William S. Clark: Redesigning Rural Development. Johns Hopkins Press, Baltimore 1982.

Keynes, John Maynard: General Theory of Employment, Interest and Money. Macmillan, London 1936.

Knight, Frank H.: Risk, Uncertainty and Profit. Houghton-Mifflin, Boston, MA 1921.

Korten, David C.: Community organization and rural development: A learning process approach. Public Administration Review, Vol. 40, 1980, No. 5, pp. 480-511.

- : From Bureaucratic to Strategic Organization. In: Frances F. Korten/Robert Y. Siy (Eds.), Transforming a Bureaucracy, The Experience of the Philippine National Irrigation Administration. Kumarian, West Hartford, CT 1988, pp. 117-144.

Korten, David C. / Alfonso, Felipe B.: Bureaucracy and the Poor: Closing the Gap. Kumarian, West Hartford, CT 1983.

Korten, Frances F. / Siy, Robert Y. (Eds.): Transforming a Bureaucracy, The Experience of the Philippine National Irrigation Administration. Kumarian, West Hartford, CT 1988.

Langlois, Richard N. / Foss, Nicolai J.: Capabilities and governance: the rebirth of production in the theory of economic organization. Working paper, quoted in Tony Fu-Lai Yu (2000), A new perspective on the role of the government in economic development: Coordination under uncertainty. International Journal of Social Economics, Vol. 27, 1996, pp. 994-1012.

Langlois, Richard N. / Robertson, Paul L.: Firms, Markets and Economic Change: A Dynamic Theory of Business Institutions. Routledge, London 1995.

Lewin, Kurt: Action research and minority problems. The Journal of Social Issues, Vol. 2, 1946, No. 4, pp. 34-46.

Michael, D.N.: On learning to plan - and planning to learn. Jossey-Bass Publishers, San Francisco 1973.

Mosse, David: "People's knowledge". Project Planning: The Limits and Social Conditions of Participation in Planning Agricultural Development. ODI Agricultural Research and Extension Network, Paper No. 58, ODI, London 1995.

Mosse, David / Farrington, John / Rew, Alan (Eds.): Development as a Process: Concepts and Methods for Working Complexity. Routledge, London 1998.

Morss, Elliott R., et al. (Eds.): Strategies for Small Farmer Development: An Empirical Study of Rural Development Projects in the Gambia, Ghana, Kenya, ... Westview Press, Boulder, CO 1976.

Musgrave, Richard A.: The Theory of Public Finance. McGraw Hill, New York, NY 1959.

ODA (Overseas Development Administration): A Guide to Social Analysis for Projects in Developing Countries. HMSO, London 1995.

Palestine Trade Centre - PALTRADE: National Economic Dialogue Conference, Conference Conclusions and Private Sector Recommendations. Ramallah, May 2000.

Picciotto, Robert / Weaving, Rachel A.: A new project cycle for the World Bank? Finance and Development, Vol. 31, 1994, No. 4, pp. 42-44.

PMA (Palestinian Monetary Authority): Statistical Bulletin, Issue 27, October 2000.

Pretty, Jules N. / Chambers, Robert: Towards a learning paradigm: New professionalism and institutions for agriculture. IDS Discussion Paper No. 334, Institute of Development Studies, Brighton 1993.

Reinert, Erik: The role of the state in economic growth. Journal of Economic Studies, Vol. 26, 1999, No. 4/5, pp. 268-326.

Rodrik, Dani: Coordination failures and government policy: a model with applications to East Asia and Eastern Europe. Journal of International Economics, Vol. 40, 1996, No. 1/2, pp. 1-22.

- : The "paradoxes" of the successful state. European Economic Review, Vol. 41, 1997, No. 3/5, pp. 411-422.

Roe, Emery M.: Public service, rural development and careers in public management: A case study expatriate advising and African land reform. World Development, Vol. 21, 1993, No. 3, pp. 349-365.

Rondinelli, Dennis A.: Development Projects as Policy Experiments: An Adaptive Approach to Development Administration. Methuen, London 1983.

- : Development Projects as Policy Experiments: An Adaptive Approach to Development Administration. 2nd ed., Routledge, London 1993.

Samuelson, Paul A.: The pure theory of public expenditure. Review of Economics and Statistics, Vol. 36, 1954, No. 4, pp. 387-389.

Silver, Morris: Enterprise and the Scope of the Firm, The Role of Vertical Integration. Martin Robertson, London 1984.

Stiglitz, Joseph: Foreword. In: Ishac Diwan/Radwan A. Shaban (Eds.), Development under Adversity: The Palestinian Economy in Transition. Palestine Economic Policy Research Institute and The World Bank, Washington, DC 1999, pp xi-xii.

Stiglitz, Joseph E., et al.: The Economic Role of the State. Blackwell, Oxford 1989.

Sweet, C. F. / Weisel, P.F.: Process versus blueprint models for designing rural development projects. In: George Honadle/Rudi Klauss (Eds.), International Development Administration, Implementation Analysis for Development Projects. Praeger, New York 1979, pp. 127-145.

Thompson, John: Participatory approaches in government bureaucracies: Facilitating the process of institutional change. World Development, Vol. 23, 1995, No. 9, pp. 1521-1554.

Uphoff, Norman Thomas: Fitting projects to people. In: Michael M. Cernea (Ed.), Putting People First: Sociological Variables in Rural Development. 2nd ed., Oxford University Press, New York 1985, pp. 359-395.

- : Paraprojects as new modes of international development assistance. World Development, Vol. 18, 1990, No. 10, pp. 1401-1411.

- : Participatory evaluation of rural development projects. IFAD Report No. 385, International Fund for Agricultural Development, Rome 1992.

von Mises, Ludwig: Human Action, A Treatise on Economics. 3rd ed., Contemporary Books Inc., Chicago, IL 1949.

Weber, Max: The Theory of Social and Economic Organisation. The Free Press, New York, NY 1964.

Weiss, Dieter: Theoretical foundations of development planning under changing global economic integration. Economics (Tübingen), Vol. 41, 1990, pp. 21-38.

Weiss, Linda / Hobson, John M.: States and Economic Development: A Comparative Historical Analysis. Polity Press, Cambridge, MA 1995.

World Bank: West Bank and Gaza: Strengthening Public Sector Management. Social and Development Group, Middle East and North Africa Region, The World Bank West Bank and Gaza Resident Mission, Jerusalem 1999.

- : World Development Report 1997: The State in a Changing World. Oxford University Press, New York 1997.

- : World Development Report 1994: Infrastructure for Development. Oxford University Press, New York 1994.

- : The East Asian Miracle: Economic Growth and Public Policy. Oxford University Press, Oxford 1993.

Yu, Tony Fu-Lay: Entrepreneurial state: the role of government in the economic development of the Asian newly industrialising economies. Development Policy Review, Vol. 15, 1997, No. 1, pp. 47-64.

Zagha, Adel / Jamal, Manal: Foreign Aid and Development in Palestine: Mortgaging Self-Reliance, Phase II Report. Jerusalem and Media Communication Center, Jerusalem 1997.

Zuber-Skerritt, Ortrun: Action Research for Change and Development. Avebury, Aldershot etc. 1991.

Prof. Dr. Adel Zagha ist Dekan der Faculty of Commerce & Economics an der palästinensischen Birzeit University in der West Bank. Er promovierte bei Prof. Dr. Dieter Weiss und erhielt 1994 seinen Grad eines Doktors der Wirtschaftswissenschaft an der Freien Universität Berlin. Kollegiale Beziehungen zu Prof. Weiss haben sich seitdem vertieft und weiterentwickelt.