



Thinking Ahead
for the Mediterranean



WP2 – Geopolitics & Governance

Israel and Palestine and state (un)sustainability

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Abstract

This report explores the concept of state *(un)sustainability* in Israel and Palestine. The starting point sees conflict resolution as an independent variable for any change and progress in the area, in terms of a political, just and credible agreement between the two parties, which will then play a decisive role in the development of the Mediterranean region. These developments and prospects for a solution are then evaluated on the basis of state (un)sustainability, a broad notion that refers to the possibilities for long-term development at the political, social and economic levels.

The very nature of Israel's democracy and its relations with its Arab minority, the challenges related to the establishment of a viable and sustainable Palestinian state, and the regional dimension of all the actors involved are considered in order to evaluate future scenarios in this context. Three scenarios are tested: *sustainability*, which corresponds to the end of the conflict and the establishment of two viable and independent states with a tangible improvement in political and economic indicators; *unsustainability*, which refers to the perpetuation of the political status quo and the progressive deterioration of all political, economic and social indicators; and finally, *weak stability*, which entails the achievement of a sterile political stability, able to sustain the present status quo but unable to confront the main challenges for the future of the country(ies).

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Paolo Napolitano*

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*Honestly, I do not know how to answer this question,
it is something that occupies my mind:
How can we maintain unity among Palestinians,
when we are totally divided and physically separated?*

Palestinian citizen of Israel, Haifa

*Occupation is not just a state of forced control.
It is also a state of mind, a way of keeping
busy and of passing the time.*

Arthur Neslen (2006)

Introduction

The Israeli–Palestinian conflict is a main cause of the lack of intra-Mediterranean integration. The signing of the Declaration of Principles in 1993 (i.e. the Oslo Accords)¹ raised hopes for the political and economic development of the region and the spurring of democratization across the Arab world. The expected resolution of the conflict would have had positive effects on the rest of the region as well, in both political and economic terms. Palestine would have become the first truly democratic Arab state (Ibrahim, 1995). Sixteen years later, however, with the collapse of the Oslo process, those hopes have dissipated and the conflict remains the prime source of instability in the region. In the early years of the 21st century, the US strategy for the Greater Middle East and the spiralling of the Israeli–Palestinian conflict during the second intifada plunged the region to an all-time low. With the inception of the Obama administration, interest in conflict resolution regained relevance, revitalizing hopes for the Middle East among the international community. But the current stalemate in direct talks and the consequent ups and downs in the media and political discourse have brought back the mantle of impasse and inaction.

In this paper, conflict resolution in the Israeli–Palestinian context is viewed as a political, just and credible agreement between the two parties, which will then play a decisive role in the development of the Mediterranean region. We examine the developments in Israel and Palestine in recent years and the major challenges ahead. These developments and the prospects for a solution are judged against the notion of the *(un)sustainability* of state structure(s): namely, the prospects for long-term development at the political, social and economic levels.

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¹ In the present work we refer to the Oslo Accords as the entire body of agreements settled between the Israeli government and the Palestinians during the ‘peace process’ from 1993 to 1999: the Declaration of Principles on Interim Self-Government Arrangements (1993), the Cairo Agreement on the Gaza Strip and the Jericho Area (1994), the Agreement on the Preparatory Transfer of Powers and Responsibilities between Israel and the PLO (1994), the Protocol on Further Transfer of Powers and Responsibilities (1995), the Hebron Protocol (1997), the Wye River Memorandum (1998) and the Sharm el-Sheikh Memorandum (1999).

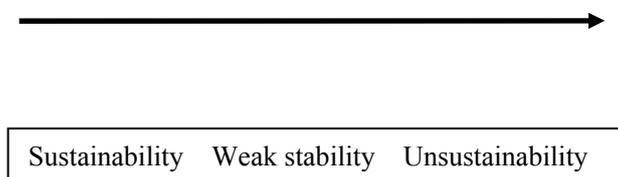
State sustainability is a very broad notion, and in the context of Israel–Palestine, its working definition depends on the political resolution to the conflict. Thus, resolution is viewed as an independent variable for any change and progress in the area. Yet it is possible to sketch out the main political, economic and social drivers of *sustainability/unsustainability* based on the nature of the solution achieved, in order to delineate future scenarios (Colombo, 2010).

Before proceeding, two preliminary observations are in order. First, a Palestinian state does not exist. Hence, talking about state sustainability in Palestine under the current conditions is meaningless. In Palestine, given the absence of a state, debates have instead focused on the “viability” of achieving a state through negotiations (Khan et al., 2004). In other words, the non-existence of the state represents the *a priori* obstacle for testing its sustainability.² Second, Israel is usually considered the only democracy in the Middle East, where a certain level of governance, rights and development are ensured. Nevertheless, as later discussed Israel exhibits critical problems inextricably tied to the conflict, despite being a state in all its features and prerogatives.

We look at Israel and Palestine as two separate political entities (evidently not equal in terms of power, international standing or legitimacy) and assume that the framework for a solution remains the achievement of two states, even though many obstacles and changes have emerged, making that option increasingly impracticable on the ground (Abunimah, 2006; Falah, 2005). Therefore, we believe that while the interaction between the two entities and broader regional dynamics are critical, the internal political processes occurring within them represent the key indicators for evaluating their paths towards sustainability or unsustainability.

As depicted in Figure 1, sustainability and unsustainability lie on a continuum with the option of weak stability halfway between the two ends.

Figure 1. Sustainability and unsustainability continuum



In Israel–Palestine, if *sustainability* entails a development path set in motion following the establishment of two viable states, *unsustainability* refers to the perpetration of the status quo and the progressive deterioration of all political, economic and social indicators. The two parties see the status quo differently. In Israel, the status quo reflects a conscious political choice – purposely leaving unresolved all the core issues of the military conflict and the character of the state. From an Israeli perspective, the status quo appears to be stable and profitable, leaving substantially unaltered its power in the context of the conflict. That said, the perpetuation of the situation exacerbates three critical issues: internal decision-making processes, the nature of

² There are key differences between these two notions, however. While state viability refers to the aim of establishing a Palestinian state in the short to medium terms, state sustainability relates to the long-term development of the political, economic and social potential of the future state’s structures. Certainly, the establishment of a viable state in the short term is a necessary condition for a sustainable Palestinian state in the long term. Thus, *sustainability* and *unsustainability* are necessarily two empirical referents of the state, and not the contrary. This is a critical point of departure that brings to the fore a key paradox: the search for a sustainable Palestinian state is part of the process of state-building, which is ongoing in the occupied Palestinian territories, notwithstanding the fact that a viable state, with attributes of sovereignty and which would represent the starting point for a sustainable state, does not exist.

Israeli democracy, particularly with regard to the Palestinian minority in the country, and uncertainty regarding Israel's regional relations. A seemingly stable status quo, in other words, leads to growing unsustainability. In Palestine, the status quo perpetuates the prerogatives and the privileges of the political leadership in power and serves Israeli economic and political occupation interests (Allegra and Napolitano, 2009; Perthes, 2004). The recent reform process in the occupied Palestinian territories (OPT) is leading to a certain degree of stability, especially in the West Bank, but it lacks social legitimacy and a real alternation of power. That notwithstanding, the status quo gives rise to many risks for Palestinians in the OPT. More precisely, if the reform process is not accompanied by a viable political settlement to the conflict, it is unlikely that the Palestinian leadership will be able to hold on to power indefinitely: unsustainability and consequent political instability are likely to follow. Summing up, for different reasons, in both Israel and Palestine the persistence of the status quo, while viewed by some as guaranteeing the semblance of stability, firmly casts the trajectories of both entities towards long-term unsustainability.

What we define as *weak stability* is an intermediate point on the continuum between *unsustainability* and *sustainability* and represents the achievement of a sterile political stability – able to sustain the status quo, but unable to confront the main challenges for the future of the country(ies). Such stability is based on a simple assumption: only a Palestinian counterpart that is politically stable, capable of satisfying Israeli security demands, able to control internal turmoil and ease the living conditions of the population will be able to sign a comprehensive agreement with Israel. This assumption reflects the position of the international community towards the conflict. Israel, by contrast, is primarily concerned with the security functions of the Palestinian Authority (PA), insisting upon security guarantees as a precondition for any future settlement. So the only chance for Palestinians to have their 'state' is to exercise tight security control over the population, reducing at the same time the level of political pluralism and the popular legitimacy of the PA (Schlumberger, 2007; Albrecht and Schlumberger, 2004). The whole process of Palestinian reform appears to be inspired by a model of "competitive authoritarianism", whereby formal democratic institutions work alongside an authoritarian way of governing (Way and Levitsky, 2002). We can thus view the current status quo as aspiring to achieve a form of weak stability. Such stability, while far from attaining two viable states, nonetheless sustains the status quo through a mitigation of the most immediate and acute social and economic problems of the Palestinians and through tight security control, but with little or no concern for the broader challenges of sustainability.

To explore these arguments in detail, this paper examines a set of variables (political, socio-economic and external) as they apply to the present situation in Israel–Palestine and determines the conditions under which a specific scenario is more likely to apply.

From a methodological point of view, this paper is mainly based on primary sources, such as official documents and in-depth interviews with key commentators in Israel and the OPT, such as scholars, journalists, members of associations and NGOs, as well as senior officials and political representatives of the main parties and factions.³ Secondary sources refer to the socio-economic data for the two entities.

³ For the purposes of this report, 25 interviews were conducted with Israelis and Palestinians in the period from 26 November to 6 December 2010. Some of their remarks are directly quoted in the text, while others have been used as background to inform the author's reasoning. Not all of the interviewees agreed to be quoted by name and thus all are quoted anonymously.

1. State sustainability in Palestine: The challenges and risks of institutional reform

Ensuring a certain level of development may be an aim of any political leadership, but a development trajectory is not always sustainable in the long run. Sustainability implies some level of planning and farsightedness by the political leadership, both of which are almost absent in the Palestinian case because of the heavy external constraints (Israel and the international community) on the political system and the inherent features of the incumbent elites.

In principle, a sustainable Palestinian state is the goal of the reform project adopted by the PA leadership in the West Bank (Brown, 2010; PNA, 2008). In reality, however, this process is leading to a modicum of political stability that serves, on the one hand, to fulfil Israeli security requests, and on the other to consolidate the power of the PA. As mentioned above, the concept of sustainability in Palestine cannot be divorced from the existence of a state: without statehood as a final-status settlement, there is no possibility to discuss the sustainability of a state that does not exist. Thus, without a sovereign Palestinian state, all talk about sustainability in practice refers to the administration of day-to-day life and a sterile process of institution-building. Institution-building in the OPT without the accomplishment of a state entails building the core functions of a state – public taxation and expenditure, administration and internal security, education and planning – without the sovereign prerogatives that constitute the essence of the state itself. As one interlocutor aptly put it, “How can a state that has no power to impose and implement its choices be sustainable?”⁴

So the first step towards sustainability is the establishment of a viable Palestinian state. In this respect, three options are on the table:

- 1) dismantling the Palestinian Authority and proclaiming a state of permanent crisis.⁵ Alongside this, the Palestinian national movement would relinquish the goal of a Palestinian state and realign the debate on the one-state solution;
- 2) a unilateral declaration of statehood. Around 130 countries have already recognized the Palestinian state on the basis of the 1988 declaration of independence. A unilateral declaration of statehood would seek to build on this momentum, renewing the diplomatic push for a Palestinian state on the pre-1967 borders with East Jerusalem as its capital, and regaining international consensus on the Palestinian cause,⁶ and
- 3) a continuation of the current ‘peace process’ despite its discrediting through repeated failures and recently leaked documents (i.e. the Palestine papers).

The first option is unlikely to be endorsed by the Palestinian leadership and even less so by Israel. Dismantling the PA and abandoning the goal of a two-state solution involves high costs for both Israel and the Palestine Liberation Organization (PLO)/PA leadership: the former would be left with the pressing question of what to do with the Palestinians in the OPT, and the latter would have to abandon the ideological and political framework that has given rise to its

⁴ Remark by a Palestinian scholar at Bir Zeit University, Ramallah, in an interview with the author, 29 November 2010.

⁵ This idea regained currency after a speech by Palestinian President Mahmoud Abbas (also known as Abu Mazen) in early December 2010, in which he “threatened” the international community with dismantling the PA. The topic was and remains relevant, but the lack of credibility of the threat, particularly in view of its deliverer, has provoked little interest in this option.

⁶ See “Abbas: Britain and France would recognize Palestinian state”, *Haaretz*, 20 April 2011 (<http://www.haaretz.com/print-edition/news/abbas-britain-and-france-would-recognize-palestinian-state-1.356814>); see also *Al Jazeera*, 28 December 2010 (<http://english.aljazeera.net/indepth/opinion/2010/12/20101228131929322199.html>).

existence. The second option – a unilateral declaration of statehood – is at present on the PLO/PA's political agenda, despite its limited prospects of bringing about tangible results. International recognition would actually bring positive effects only if it culminates in international pressure on Israel and that is not the case at the moment.

Third parties (the United Nations, the US and the EU) are broadly committed to the establishment of a Palestinian state by the end of August 2011 in the framework of the two-state solution and following the precepts of the Palestinian Reform and Development Plan that they have contributed to formulating and sustaining. Yet, the role of the US is especially questionable: the US tends to impose its influence on the peace process, forcing the Palestinian leadership to negotiate on those matters on which Israel agrees to negotiate. At the same time, the US administration has not been able to impose any freeze or stop to the Israeli settlement activities in the West Bank in spite of openly declaring its position against such activities on multiple occasions.⁷ For this reason, the US is losing its image as a 'credible broker' in the conflict, creating a vacuum for other actors. Notably Turkey, following its new strategic concept of "strategic depth", which is aimed at acquiring new political centrality in the region (Kirişçi et al., 2010), has significantly shifted its political stance towards Israel and Palestine. It has moved from an intensive strategic alliance with Israel in the 1990s to a more pro-Palestinian-oriented politics in the 2000s, especially after the accident with the Turkish flotilla near the Gaza Strip shore of May 2010. The Turkish leadership has continually kept open contacts with Hamas and has all the geopolitical potential to replace Egypt in the context of the conflict, not just as a mere reiteration of the US administration, but with a more autonomous and incisive role.

Finally, the third option persists by default and reflects the stark reality that Palestinians continue to face: their inability to effect a solution in view of the Israeli military, political and economic power and an American mediation essentially pressing Palestinians to "accept whatever Israel 'concedes', and only subsequently considering forms of compensation".⁸ In turn, as suggested by an Arab-Israeli scholar, the Palestinian red lines remain only on paper: a state on the pre-1967 borders with East Jerusalem as its capital, full national sovereignty over the natural resources and a just resolution to the refugee problem.⁹ In practice and as revealed

⁷ This position was exacerbated by the US veto in the UN Security Council on 18 February 2011, against a resolution to freeze settlement activity in OPT. This veto contradicted the formal US position on settlements as articulated by Secretary of State Hillary Clinton. Moreover, the speeches by President Barack Obama on the 19th and 20th of May 2011, respectively to the 'Arab World' and to the AIPAC (American Israel Public Affairs Committee) Policy Conference, indicate revitalized US interest in the conflict. Upon a close reading of the two speeches, however, they do not appear to add anything new to the debate: the US will continue to maintain a low profile in the conflict resolution, and the general reference to the 1967 borders, although important discursively, implies a land swap that has already and informally been on the table for a long time. The speeches by Obama are available on the White House website (see "Remarks by the President on the Middle East and North Africa", State Department, Washington, D.C., 19 May 2011, <http://www.whitehouse.gov/the-press-office/2011/05/19/remarks-president-middle-east-and-north-africa>; and "Remarks by the President at the AIPAC Policy Conference 2011", Walter E. Washington Convention Center, Washington, D.C., 20 May 2011, <http://www.whitehouse.gov/the-press-office/2011/05/22/remarks-president-aipac-policy-conference-2011>).

⁸ As remarked by a Palestinian journalist at *Al Ayyam*, in an interview with the author, Ramallah, 5 December 2010.

⁹ At Tel Aviv University, Tel Aviv, in an interview with the author, 1 December 2010. Indeed, the 'battle for Jerusalem' is being lost by the Palestinians: the possibility of the Palestinians keeping the Holy City as their capital is quite low. The recent tensions in Silwan, Essawia and Sheikh Jarrah reveal how Israel is unlikely to budge on this issue.

by the Palestine papers, the PLO leadership appears to be ready to compromise on critical issues such as settlements, Jerusalem and refugees.¹⁰

Beyond the peace process and the prospects of achieving statehood, internal political dynamics pose critical problems as well (Jarbawi and Pearlman, 2007): the political split between the Fatah-led West Bank and the Hamas-led Gaza Strip has marred the Palestinian political spectrum since June 2007. Here, common knowledge suggests that reconciliation between Hamas and Fatah is a precondition for any future political agreement with Israel. Yet, contrary to this view, the only practical possibility for Hamas and Fatah to reconcile their differences prior to statehood may well be on the basis of a renewed commitment to resistance. As suggested by a Palestinian journalist, longer-term reconciliation based on agreed formulas for power sharing and representation seems only possible alongside or after the establishment of a state.¹¹ In this sense the deal between Hamas and Fatah,¹² signed in Cairo on 4 May 2011, can be read as a beginning; the agreement has probably been made possible as a consequence of the changes that have occurred in Egypt since the fall of former President Hosni Mubarak, but its functioning must be tested practically on the ground in the following months. On the one hand, it shuffles the cards on the table from the Palestinian side; on the other hand, it consists practically in the extension of economic and reconstruction programmes from the West Bank to Gaza. A genuine process of state-building and national reconciliation, however, requires the prior existence of a state, rather than the reverse (Wesley, 2008).

By contrast, since 2003 the PA has seriously engaged in state-building and reform, in keeping with the demands of Israel and the international community (Brown, 2003). At the outset, the reform was supposed to be conducive to a resolution of the conflict following the controversial pattern of reinforcing democracy before the achievement of statehood: through reform, Palestinians would become equipped with effective institutions, which would make statehood possible.¹³ Over the years, however, as the prospects for a political solution have dimmed, reform and institution-building have acquired lives of their own, increasingly detached from the prerequisites of genuine statehood (Napolitano, 2010).

Among other aims, reform is supposed to provide stability, good governance and a new class of senior, middle- and lower-ranking civil servants, rule of law, transparency, economic and social development, as well as civic engagement and political participation. The Palestinian government has issued several development plans, supported by international agencies (UNDP), following to the letter the precepts of the international community and Israel. Some results have

¹⁰ The ‘Palestine papers’ consist of nearly 1,700 files released by *Al Jazeera* in January 2011. They concern diplomatic relations (reports, minutes, private messages and emails) between Israelis and Palestinians from 1999 to 2010. The reports contain sensitive revelations about concessions that the Palestinian leadership was prepared to grant Israel in particular about Jerusalem, settlements and refugees. The papers are extremely important although their reliability is still under discussion. See “The Palestinian Papers”, *Al Jazeera*, 2011 (<http://english.aljazeera.net/palestinepapers/>); see also “Secret papers reveal slow death of Middle East peace process”, *Guardian*, 23 January 2011 (<http://www.guardian.co.uk/world/2011/jan/23/palestine-papers-expose-peace-concession>).

¹¹ Journalist at *Al Ayyam*, Ramallah, in an interview with the author, 5 December 2010. On 4 May 2011, a new deal between Hamas and Fatah was agreed, including the formation of a national unity government. The deal has probably been made possible as a consequence of the changes that have occurred in Egypt since the fall of former President Hosni Mubarak, but its functioning must be tested practically on the ground in the following months.

¹² The deal provides for the formation of a unity government, the renewal of the Palestinian National Council, legislative and presidential elections, and the reorganization of security services.

¹³ Since the outset, the PA has been accused of being incapable of administering the OPT (Khalidi, 2007, p. 158).

been achieved.¹⁴ Yet the reform has been criticized by many observers for its underlying political logic, such as the following remark by a Palestinian researcher:

[E]asing Palestinian living conditions in the occupied Palestinian territories, in fact, would entail a sort of appeasement of their main requests in negotiations and in general of their attitudes towards the conflict. However, the reform, a complex set of measures mainly financed by external aid, has just produced some scratches on the surface, while the core problems remain unaltered.¹⁵

In particular, institutions can change but the way the OPT is governed has remained the same (Parsons, 2005). While concrete results are being achieved in terms of institution-building, security and the economy, they are being done so at the expense of a growing gap between the PA and Palestinian society, and the progressive erosion of the Authority's social legitimacy. The security apparatus, for example, has grown significantly, exhibiting strict control over the population and the intensification of security cooperation with Israel. The rising authoritarian features of the PA and the lack of social legitimacy would seem to represent the highest risks for the Palestinians in the absence of the state.¹⁶ Moreover, considering the split between the West Bank and the Gaza Strip that occurred after the clashes between Hamas and Fatah in June 2007, and the de facto existence of two governments, it is notable that the reform process is showing effect in the West Bank alone, thus increasing the separation within the Palestinian community. As for Hamas, the Islamist party has always criticized the reform, considering it impracticable to reform institutions under occupation and refusing any likelihood of cooperation with Israel in terms of security. That notwithstanding, the Hamas–Fatah rivalry is still perceived by Palestinians as a determinant and as controversial for Palestinian interests.¹⁷ Following the recent revolts erupting in the Arab world, on 15 March 2011 a 'Day of Reconciliation' was promoted by several Palestinian youth organizations to put an end to the divisions among Palestinians and to ask the political leaderships for a new and shared political platform based on the renewal of the Palestinian National Council and including all the Palestinians living in the West Bank, the Gaza Strip, the refugees and the diaspora. The demonstration was repressed by the Hamas police in Gaza, however, while in the West Bank Fatah tried to take the lead in the movement, increasing the sense of fragmentation and blindness within Palestinian politics and betraying the spirit of reconciliation.

Delving into the progress achieved by the reform effort, in terms of the economy, macroeconomic indicators suggest that in 2009 GDP grew by 6.9%, GDP per capita by 3.7%, and unemployment dropped by 5.4% (Table 1). In the third quarter of 2010, GDP grew by 7.8% compared with the third quarter of 2009 while GDP per capita rose by 4.7%, although the unemployment rate swelled to 26.6%.¹⁸ The Palestinian economy has thus registered positive

¹⁴ See the *Palestinian Reform and Development Plan* (PNA, 2008); see also *Palestine: Ending the Occupation, Establishing the State* (PNA, 2009).

¹⁵ Senior researcher at the Palestine Economic Policy Research Institute (MAS), Ramallah, in an interview with the author, 5 December 2010.

¹⁶ Elections (presidential, legislative and local) have not been convened since 2006. According to the latest opinion poll conducted by the Palestinian Centre for Policy and Survey Research (PCPSR, 2011), 37% of respondents say that both governments (Fayyad in West Bank and Hamas in Gaza) are illegitimate, with a decrease among those who believe that the Fayyad government is the legitimate one (from 29% to 25%).

¹⁷ In this regard, 62% of population holds both Fatah and Hamas responsible for the continuation of the split, 61% opposes Abbas's acceptance of the conditions set by Hamas to end the division, while the belief that the split is permanent has fallen to 21% (39% in the previous poll) – see PCPSR (2011).

¹⁸ Macroeconomic indicators and main findings have been drawn from recent reports issued by the Palestine Economic Policy Research Institute (MAS) (see the MAS website, http://pal-econ.org/Newsite/?option=com_docman&%2520task=cat%2520_view&%2520gid=%252038&Itemid=29).

growth in recent years. Yet disaggregating the data reveals the snag: recent growth rates have been high because of the extremely low performance in 2003–07. The Palestinian economy was and remains entirely dependent upon external aid.¹⁹ The ever-rising influx of foreign assistance in recent years, particularly after Salam Fayyad’s appointment to lead the cabinet, coupled with relative quiet on the security front (in the West Bank), have resulted in GDP growth there. Moreover, GDP consists mainly of public expenditure and private consumption, while private investments remain extremely low, entailing a structural “inability to create sufficient capital accumulation to generate sufficient job opportunities, capable of absorbing the annual increase in the labour force” (Abdelkarim, 2009, p. 40). Indeed, development in the private sector has been rather hesitant because of Israel’s aggressive behaviour since 2002, resulting in an unprecedented high risk for this sector. Hence, unemployment and poverty levels remain extremely high (26.6% and 34.5%, respectively, in the third quarters of 2010 and 2009). The situation in the Gaza Strip is far graver. The closure of the Strip has resulted in a persistently acute economic situation and an ever-growing detachment from the developments in the West Bank.

The weak functioning of the private sector and an over-reliance on external aid has in turn led to a bloated public sector (consisting of around 157,800 employees), the size of which is expected to rise over the years (Abdelkarim, 2009, p. 6). This generates a high level of deficit that can be managed only through the inflow of external aid (leading to a net deficit of US\$). In other words, the Palestinian economy is evidently unsustainable, requiring the heavy assistance of international donors to prevent its collapse. Indeed, Prime Minister Salam Fayyad and his cabinet are perfectly aware of the Palestinian dependency on external aid and they are strongly committed to progressively reducing it by the end of 2013.²⁰ Such external intervention, while assuring a modicum of social stability, cannot spur sustainable growth (Abdelkarim, 2009, p. 21).

Table 1. Main economic indicators in the occupied Palestinian territory in 2009 and 2010 (\$ million)

	Q3 2009	Q4 2009	Q1 2010	Q2 2010	Q3 2010
GDP	1,307.1	1,327.4	1,344.3	1,417.8	1,409.5
GDP per capita	351.8	354.6	356.6	373.4	368.4
Participation in the labour force (%)	41.7	41.6	40.7	41.5	40.5
Unemployment rate (%)	25.8	24.8	22.0	22.9	26.6
Total net revenues	453.8	397.3	447.1	455.5	504.2
Public expenditures (excluding development expenditures)	952.2	597	708.1	755.5	673.8
Surplus/deficit before support	(555.2)	(258.3)	311.4	352.6	263.9
Surplus/deficit after support	(113.4)	35.8	(101.6)	(12.9)	(92.2)
Total public debt	–	1,732	1,813	1,845	1,940

Note: Negative values in brackets.

Source: Palestine Economic Policy Research Institute (2011).

¹⁹ For an interesting evaluation of external aid in the West Bank and Gaza, see *The World Bank Group in West Bank and Gaza 2001–2009: Overview* (IEG, 2010); see also Challand (2008).

²⁰ In this regard, see PNA (2010).

Aware of these problems, the private sector has represented a core focus of the PA's reform efforts, such as the establishment of a public-private partnership to ensure a greater return on investments in strategic sectors (residential and commercial construction, ICT and agriculture).²¹ Many attempts have been made to revitalize this sector, mainly consisting of services (in retailing, hotels and restoration) and small industry (furniture, food and handicrafts), to make it as vibrant and independent as possible. But apart from a few large companies, which have hugely benefited from the reform effort, the bulk of the Palestinian private sector has not recorded any structural progress.

The banking system has also represented a core focus of the reform effort: a decree issued by the government and the Palestinian Monetary Authority called upon banks to invest from a minimum of 40% to a maximum of 55% of their deposits in the West Bank and the Gaza Strip, limiting their activities overseas. This has meant that banks make local loans primarily for private consumption over and above what the banks can afford: according to a Palestinian researcher, the volume of loans has spiralled from \$1 billion in 2007 to \$2.6 billion in 2010.²² This has certainly stimulated domestic demand, but it has also dramatically reduced savings. Moreover, the bulk of liquidity is provided by external aid: once again, unless the economy reduces its dependence on external aid, a prospect that is close to nil until a viable political settlement is reached, the consumption bubble in the West Bank will ultimately burst.

Summing up, the reform process has brought with it some achievements (GDP growth and transparency in public administration), but it has not been able to tackle the principal structural deficiencies of the Palestinian economy, which is characterized by a bloated public sector, weak private enterprise and investment, the absence of external economic ties and high rates of unemployment and poverty. In addition, the significant differences between the West Bank and the Gaza Strip are sharpening the division between the two areas. These structural deficiencies in turn require an end to the conflict and the establishment of a viable state. In the absence of these conditions and in an attempt to sustain a modicum of stability, many of the actions of the PA and the international community could result in the long-term unsustainability of the OPT.

A parallel story can be told of the political level. Through reform, the OPT has seen an increase in security with a reformed security sector in strong cooperation with Israel. Yet largely as a result of this, the PA's legitimacy has plummeted. Parliament has effectively been dormant since the 2006 elections; the government is appointed by the president, whose own mandate has long expired. The security apparatus increasingly displays the features of an authoritarian system, despite (and in part because of) its 'efficiency'. The reform effort thus serves to perpetuate the PA's control at the expense of its popular legitimacy. At both the economic and political levels, 'weak stability' has taken root, marked by external economic aid and internal security control, the long-term sustainability of which is not on the horizon. In this respect, the EU, the most important financial backer of reform, risks finding itself on shaky ground. More specifically, if promoting and financing institution-building and democracy results in no state for the Palestinians, or even worse in the rise of authoritarian features of a controlled Palestinian administration, evidently this cannot be considered a good result for EU involvement in the conflict resolution.²³ For this reason, the EU is entering a blind alley: on the one side, it cannot abandon the international framework of a two-state solution and refrain from supporting reform, despite the risk of complying with an increasingly authoritarian dynamic, while on the other, it is experiencing rising internal divisions on how to urge Israel to respect international law and

²¹ *Ibid.*, p. 25.

²² At the Palestine Economic Policy Research Institute (MAS), Ramallah, in an interview with the author, 5 December 2010.

²³ For a critical evaluation of the EU's attitude towards the Israeli-Palestinian conflict, see Institute of Security Studies' publication by Aymat (2010).

obligations. For this reason, the EU has positively welcomed the deal signed between Fatah and Hamas in Cairo; looking forward to further developments, the formation of a unity government would be judged positively, given that Palestinian reconciliation is one of the goals of the EU.²⁴

2. The (un)sustainability of the state of Israel

As in the case of Palestine, the questioning of Israel's sustainability is an arduous task, but for different reasons. Israel is a strong state and a regional power in the Middle East, which is economically stable and experiencing continual growth (GDP growth of 4% in 2009, with an unemployment rate of 6.6% in 2010).²⁵ Theoretically, Israel has all the attributes of a modern state (Poggi, 1990), and a rather successful one at that. It is nonetheless a state without a clear definition of its borders, with a political and economic trajectory that is entirely divorced from its region, and a highly fragmented political and social situation. Thus, the sustainability of the state of Israel cannot be taken at face value.

At the political level, the core tension is that between the definitions of Israel as a Jewish and as a democratic state. Whereas the former stresses the cultural, religious and ethnic features of the majority Jewish population, the latter hinges on the equal rights and political participation of all citizens, including the Palestinian Arab minority (Ghanem et al., 1998; Rouhana, 1998; Lustick, 1980).²⁶ The main concern for the sustainability of the state refers to Israel's ability to manage this tension adequately. Granting priority to the former appeases the nationalist aspirations of the Jewish majority, but also leads to rising tensions among communities and the absence of prospects for a comprehensive peace (Neuberger, 2003). At the heart of this tension is also the broader conflict with the Palestinians: without a successful conclusion to the peace process through the establishment of a Palestinian state, not only will Israel continue to confront the situation in the OPT, but also the tensions within Israel between the Jewish majority and Arab minority are set to grow.

In addressing the sustainability of the state of Israel, the following paragraphs focus on two main indicators: i) the internal political dynamic with particular reference to the stalemate in Israeli decision-making over the peace process, and to relations between the state and the Arab minority and the nature of Israeli democracy; and ii) the regional dimension in terms of both the security dilemma and economic integration in the Mediterranean region.

Starting with the Israeli political system, over the last decade the Israeli political leadership has shown an unprecedented degree of non-decision-making on issues related to the conflict. Non-decision-making has constituted the dominant Israeli strategy and has alternately taken the form of maintaining the status quo and pursuing blind unilateralism. It seems that the Israeli political leadership is not following any strategic path in the peace process; it has no clear answer to the question, "What does Israel want from the peace process or from the Palestinians?" As put by one interlocutor, "there is one man in the political system able to take the fundamental decisions for the country, and historically that man is the prime minister. I have a clear sense that the

²⁴ See the position of EU Foreign Affairs Council on 23 May 2011 as set out in "Remarks by EU High Representative Catherine Ashton at the end of Foreign Affairs Council", A201/11 (http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/122184.pdf).

²⁵ Statistics are available on the website of Israel's Central Bureau of Statistics (http://www1.cbs.gov.il/www/indicators/ind_tab11.pdf) and (http://www1.cbs.gov.il/publications/isr_in_n09e.pdf).

²⁶ An interesting perspective on the Jewish character of the state is provided in the article "The 'Jewish state' condition", bitterlemon.org, Edition 20, 25 October 2010 (<http://www.bitterlemons.org/previous/bl251010ed20.html>).

present one has no idea of how to carry out the political agenda, and that is quite astonishing!”²⁷ In this respect, there appears to be an interesting parallel between the Israeli and the Palestinian political leaderships.

Looking at the present stalemate in the peace process, the two-state solution is distant from the horizon. That notwithstanding, there is no political room for an alternative (Hilal, 2007). The mainstream consensus within the Israeli body politic converges on neither the greater Israel nor the bi-national one-state solution. Hence, Israel persists in the *discourse* of two states but *practically* continues to pursue its policies of dispossession and separation, as demonstrated by its policies and activities on the ground (Gordon, 2008). As stated by one interlocutor, “Israel accepted *de jure* or *discursively* the two-state solution only when it became impossible to reach it *de facto* on the ground”.²⁸ This dichotomy serves to protract the status quo, distracting the international community and boxing the Palestinians into a diplomatic process that buys Israel time to pursue its policies on the ground. The present status quo is founded upon a tangible disequilibrium whereby Israel holds the greatest power and the Palestinians have little chance to impose any solution or drive to modify the situation.

But while sustaining the status quo, this approach generates progressive unsustainability within the Israeli democracy itself. There are two factors that influence each other: the general conflict with the Palestinians (in the West Bank, the Gaza Strip, the refugees and the diaspora) and the fact that around 20% of the Israeli population consists of Palestinians living within the Israeli political system. Our hypothesis is that the non-resolution of the general conflict with the Palestinians would have negative effects on Israeli democracy too. Among recent poll findings, relations between Jews and Arabs in the country, for example, impress the reader: among the Jewish population a narrow majority (54%) supports full equality of rights for all Israeli citizens, while “53% of Israeli Jews believe that the state has the right to encourage its Arab citizens to emigrate”.²⁹ A recent report on Israeli democracy³⁰ also points to problems: respondents were asked for their views on the possibility of Arabs being appointed to senior positions in Israel. A stark 70% were opposed. Moreover, there is “a large majority of the Jewish public that is opposed to including Arab parties and Arab ministers in the government”.³¹

Israelis themselves have questions about their democracy. One Israeli journalist strongly criticizes the very nature of Israeli democracy:

[D]emocracy is not the tyranny of majority, but the respect of minorities; democracy does not mean that if we are the majority, we trample on the basic rights of people, especially those of the minority. In Israel there is a sense of racism and nationalism that is only partially connected to the conflict with Palestinians, but that is taking root within society.³²

²⁷ Remark by an Israeli activist at the IPCRI (Israel Palestine Centre for Research and Information), in an interview with the author, Tantur, 6 December 2010.

²⁸ Remark by an Arab–Israeli scholar, Tel Aviv University, in an interview with the author, Tel Aviv, 1 December 2010.

²⁹ See “Poll: Most Israeli Jews believe Arab citizens should have no say in foreign policy”, *Haaretz*, 30 November 2010 (<http://www.haaretz.com/news/national/poll-most-israeli-jews-believe-arab-citizens-should-have-no-say-in-foreign-policy-1.327972>).

³⁰ See Arian et al. (2010), op. cit.,

³¹ *Ibid.*, p. 140.

³² Statement by an Israeli journalist at *Haaretz*, Tel Aviv, in an interview with the author, 1 December 2010.

The clarity of such a statement points to a widespread trend within Israeli public opinion: the present system of power is entrenching public attitudes towards the particularistic features of the state, settlements and relations with the Palestinians. Maintaining the status quo is increasingly taking the form of a default strategy and a pervasive state of mind. Indeed, the hard-line policies carried out by the composite Israeli government³³ in the labour market and in social and civil affairs have contributed to nourishing this particular feeling.

Relations with the Arab minority represent the litmus test for the content and quality of Israel's democracy. First, Arab citizens symbolize a demographic time bomb within the Israeli Zionist imagery: in 2020 Palestinians living in Israel will reach 2 million, and 3.1 million in 2050. If we add to this the inhabitants of the West Bank and the Gaza Strip, the number of Palestinians living in historic Palestine (the territory including Israel and the OPT) will rise to 7.6 million in 2020 and 14 million in 2050.³⁴ Second, despite the formal bond of citizenship, there is no organic tie between the Arab minority and the Israeli state: citizenship is just a legal link between the citizens and the state, but there is no emotional or symbolic relationship between Palestinians and the state of Israel. In the view of an Arab-Israeli scholar, to some extent, Israel is encouraging this in order to become the state of the Jewish people.³⁵ In this context, we can interpret the loyalty oath bill approved by the Knesset in 2010, whereby all non-Jewish citizens have to swear loyalty to the 'Jewish and democratic state', as a tool to discriminate against those who do not feel an emotional bond with the (Jewish) state. Israel's independence day coincides with the commemoration of *al-Nakba*, the catastrophe for the Palestinians.³⁶ How can the Arab minority swear loyalty to a state whose official narrative celebrates uncritically what is viewed by the minority as its greatest historical catastrophe? Are these the premises for mutual recognition and reconciliation? No doubt the establishment of a Palestinian state would assuage Israeli demographic fears, opening the possibility for a more open political debate in Israel. In its absence, the matter of state sustainability for Israelis is quintessentially emotional and existential, and inextricably tied to relations with the Arab minority and the composition of Israeli society as a whole.

A recent report published by the Mossawa Centre³⁷ shows how the status of Palestinians living in Israel remains unclear at both the structural and institutional levels, and how discrimination against Arabs is expected to rise in the near future.³⁸ Discrimination ranges from the scarce opportunities for building houses and finding jobs to the series of daily obstacles faced by the community.³⁹ In addition, all socio-economic data reveal how public expenditure devoted to the

³³ The present Israeli government is based on a composite coalition formed by right and extreme right parties (Likud and Ysrael Beiteinu), a leftist (Labour party) and a religious one (Shas).

³⁴ We refer to the medium value projections elaborated by Sergio della Pergola (2007) in *Israele e Palestina: la forza dei numeri. Il conflitto mediorientale fra demografia e politica*, p. 169.

³⁵ Remark by an Arab-Israeli scholar, Tel Aviv University, in an interview with the author, Tel Aviv, 1 December 2010.

³⁶ The term *nakba* [catastrophe] refers to the expulsion of around 725,000 Palestinians from their homes during the first Arab-Israeli war in 1948.

³⁷ See Norwich et al. (2010), p. 27.

³⁸ In recent years, many tragic clashes have characterized relations between Jewish and Arab Israelis: Akka, Rahat Umm al-Fahem, Jaffa and Ramla are just few of the places where rising tensions between the two communities have erupted in violence, especially after the Israeli decision to relocate to these areas some of the settlers removed from the Gaza Strip in 2005. This step has raised the level of tension in mixed cities.

³⁹ The Israel-Lebanon war in 2006 represented a drama for the Arab community living in the north of Israel. As remarked by a representative at the Mossawa Centre (Advocacy Centre for Arab Citizens in Israel), in an interview with the author, Haifa, 6 December 2011, the evacuation of cities reminded them of the 1948 *nakba*, with the serious likelihood of losing their properties once again.

Arab community is expected to drop dramatically, while a greater share of public funds is needed to counter existing discrimination in education, employment and local development.⁴⁰ The Supreme Court increasingly seems to implement the government's decisions instead of acting as a supreme arbiter of the political, civic and legal life of the country, a role that it played in the past. What Palestinians living in Israel call for is the full recognition of their rights as citizens and members of a community. They do not claim internal self-determination, but just demand equality of rights without losing touch with their homeland. Rather than being viewed as an obstacle to the country's national aspirations, Arab citizens of Israel believe they could act as "a bridge for reconciliation and integration; integration does not mean accepting passively any acts of the government, but listening to the demands of all communities".⁴¹

Moving on to the regional dynamic, the deepening conflict with the Palestinians has increased the security and economic dilemmas for Israel, making the balance of power in the region much more unstable. Yet Israel is a regional power, with strong economic drivers, a leading position in the high tech industry and military technology, and a recently discovered gas field offshore of Haifa. Despite its impressive economic performance, the socio-economic inequalities in the country are stark: around 20.1% of families are living below the poverty line.⁴² In view of this mixed economic picture, would a sustainable Israeli state require regional cooperation with its Arab neighbours? On the one hand, Israel enjoys strong bilateral ties with the EU as well as with other regions (the Balkans). On the other hand, the absence of organic economic and political ties with its immediate neighbours – the Arab states – has placed Israel in a situation of chronic isolation. Indeed, Israel does not show interest in or worry about reshaping its economic ties with the Arab countries in the region, nor about the recent Turkish activism in leading this effort.⁴³ Israeli positions on this matter show a sharp dichotomy, as revealed in a statement by an Israeli journalist at *Haaretz*: "Israel must work to become accepted in the region, but now it works in the opposite direction; Israel is [doing] everything not to be accepted in the region."⁴⁴ This dichotomy is also reflected in the remark by an Arab-Israeli scholar at Tel Aviv University: "It seems that Israel stays in the Middle East but lives in Europe, whilst it must be integrated firstly in the security system of the Middle East and then in the economic one."⁴⁵ Politically, US-Israeli relations reached an all-time low in 2010 on the question of settlements, when Israeli Prime Minister Benjamin Netanyahu publicly defied the US administration by announcing several times the continuation of settlement-building in the West Bank and de facto block of any possibility to revive side-by-side talks with the Palestinians. These tensions have not been tangibly detrimental, however, and the US remains Israel's major ally. At the same time, they reveal the extent to which Israel enjoys a high level of bargaining power in orienting the peace process.

Israel looks at the regional dimension only in terms of security, but the uncertainty caused by the recent turmoil in Egypt, one of the pillars of Middle Eastern regional security, has increased the alert levels for the Israeli government, which is now seriously concerned about developments in the area. In the regional context Israel has never seriously considered the Arab Peace Initiative, the attempt made by the Arab League to cease the conflict by granting Arab recognition to Israel in return for the creation of a viable Palestinian state (Baghat, 2009); probably in this respect, Israel has underestimated or miscalculated the strategic significance of

⁴⁰ Norwich et al. (2010), p. 44.

⁴¹ Remark by a representative at the Mossawa Centre (Advocacy Centre for Arab Citizens in Israel), Haifa, in an interview with the author, 6 December 2010.

⁴² See the National Insurance Institute report by Endeweld et al. (2010).

⁴³ Remark by an Israeli official, in an interview with the author, Jerusalem, 29 November 2010.

⁴⁴ Interview with the author, Tel Aviv, 1 December 2010.

⁴⁵ Interview with the author, Tel Aviv, 1 December 2010.

that initiative but a sudden change on this matter seems very distant on the horizon. In the end, when debating the country's long-term sustainability, its complete detachment from its surrounding environment places a clear question mark over the country's future.

3. Between sustainability and unsustainability: Weak stability

Looking at Israel–Palestine, the scenario of *weak stability* seems to sum up the current situation on the ground. In reality, Israel looks favourably at the process of PA reform in the West Bank and the resulting weak stability as a tool to preserve the status quo, which is the dominant strategy for the Jewish state. At the same time, Israel is experiencing growing tension internally, which it is able to manage at the moment, but which risks deteriorating dramatically towards unsustainability, particularly with respect to relations with the Arab minority. The PA, for its part, is also heading towards weak stability or sterile political stability – able to sustain the status quo, but unable to confront the main challenges for the future. The Palestinian leadership is ready to accept any solution that can bring to life the semblance of a state, in whatever form.

Israel prefers the status quo. The state retains the upper hand and shows no interest in ending the conflict. Yet when people start demanding equal rights and the improvement of social and economic conditions, the state's *security-first approach* reveals all its weakness with regard to the Palestinians living in both Israel and the OPT. Nevertheless, the present Israeli political leadership does not show notable interest in or appear to see the strategic implications of deterioration in the levels of equality in the country. In this respect, the aim seems clear: reinforcing the Jewish character of the state and transforming Israel into an “ethnic democracy” (Smootha, 1997), rendering painfully transparent the inherent tension in and vacuity of the ‘Jewish democratic state’. As for the region, a sustainable development trajectory for Israel cannot be entirely divorced from security and economic integration in the Mediterranean and the Middle East. Still, at present Israel does not seem worried by its economic or security isolation: the agreements with Jordan and Egypt seem tenable despite the recent turmoil, and in general a condition of weak stability at the regional level allows Israel to control the broader Arab–Israeli conflict. Obviously a probable extension of revolts in neighbouring countries (Jordan, Syria and Lebanon) will raise the alert levels in Israel, inducing a serious rethinking of its attitude towards the Arab countries, starting with the revival of the Arab Peace Initiative (API).⁴⁶ Moreover, Israel will face the changing role of Turkey in reshaping the geopolitical framework of the region: indeed, Turkey is supposed to become an autonomous and credible pillar of the Mediterranean security system with a prosperous economy and a stable political system.

The US is still decisive in the process of conflict resolution but is progressively losing its image as a credible broker, being unable to achieve any significant results on the ground in the last few years. For this reason, the EU can intervene in the present framework. The Palestinian reform process is financially backed by the EU, which has room to operate more directly in the mediation process. The threat of cutting aid for Palestinian institution-building, for example, although highly risky for the Palestinians, can be used as a credible threat to both the Israeli and Palestinian leaderships. In this sense, Israel would cease to bypass the occupation costs being mitigated by international aid and would have to take up its responsibilities for the Palestinians, while the Palestinian leadership would fear losing its power and all the political capital invested and dispersed in the last 20 years. Probably this option would take the conflict back to the beginning of the 1990s, before the start of the Oslo process, but at least it would compel a serious redefinition of the terms of the peace process. The EU has a window of opportunity to play a more decisive role in the area, but it depends on the political will of its members to do so.

⁴⁶ Formally, the API was revived by the Arab League in 2007, yet given the recent turmoil in the Arab world, a re-examination of this initiative by the Arab League seems understandable.

In relation to the Palestinian case, until now the leadership has been marked by a certain degree of realism: they have never capitulated, at least discursively, on Palestinian red lines (Jerusalem, borders, natural resources and refugees), although they have shown flexibility in negotiations. At present, the tightening of the security system within the OPT is protecting the current leadership from the risk of internal turmoil. Hence the PA has been more ready to appease Israel, as revealed by the Palestine papers. This process is potentially dangerous: without statehood, social legitimacy and civic engagement the Palestinian political system risks collapsing. For the Palestinian leadership, weak stability means securing its power while waiting for a state. In doing so, the authoritarian features of the regime are entrenching and a dramatic deterioration in economic and social indicators will follow, generating a situation of increasing instability. Moreover, the reform efforts are highly concentrated in the West Bank, which contributes to the separation between the West Bank and Gaza, leaving the relations between Fatah and Hamas in a continual stalemate and casting the Palestinian national movement in a limbo that undermines both the viability and the sustainability of any future Palestinian state. As for economics, the reform effort – maintained by copious external support – tries to ease Palestinian living conditions but faces structural obstacles, first of all being the perpetration of Israeli occupation. The Palestinian leadership can keep the PA afloat but cannot plan for the future of the state. The Palestinian economy has great potential: in the case of statehood, many sectors could boom easily (tourism, real estate and services) while the Gaza Strip could become a tax-free trade area between the Mediterranean and the Arabian Peninsula. All this remains purely speculative, however, in the absence of a state.

Sustainability and unsustainability may have different features in Israel and Palestine. Yet both externally and internally these two cases remain indivisible; any progress in Israel's sustainability is premised upon the creation of a viable Palestinian state, where a new political leadership will enjoy the autonomy to make free choices for the future of the country. This prospect is nowhere near on the horizon.

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About MEDPRO

MEDPRO – Mediterranean Prospects – is a consortium of 17 highly reputed institutions from throughout the Mediterranean funded under the EU's 7th Framework Program and coordinated by the Centre for European Policy Studies based in Brussels. At its core, MEDPRO explores the key challenges facing the countries in the Southern Mediterranean region in the coming decades. Towards this end, MEDPRO will undertake a prospective analysis, building on scenarios for regional integration and cooperation with the EU up to 2030 and on various impact assessments. A multi-disciplinary approach is taken to the research, which is organised into seven fields of study: geopolitics and governance; demography, health and ageing; management of environment and natural resources; energy and climate change mitigation; economic integration, trade, investment and sectoral analyses; financial services and capital markets; human capital, social protection, inequality and migration. By carrying out this work, MEDPRO aims to deliver a sound scientific underpinning for future policy decisions at both domestic and EU levels.

MEDPRO in a nutshell

Title	MEDPRO – Prospective Analysis for the Mediterranean Region
Description	MEDPRO explores the challenges facing the countries in the South Mediterranean region in the coming decades. The project will undertake a comprehensive foresight analysis to provide a sound scientific underpinning for future policy decisions at both domestic and EU levels.
Mediterranean countries covered	Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, Tunisia and Turkey
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