



Economic Policy Programme
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**International Agreements With
Third Parties**

Draft

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INTERNATIONAL AGREEMENTS WITH THIRD PARTIES

Scope of Palestinian authority in trade policy decisions

1. The **scope** of PLO/PA authority in the field of trade policy and therefore in trade relations with third parties is **circumscribed** by the terms of the Interim Agreement, signed by the PLO/Israel in Washington on September 28, 1995. (1) The relevant parts of the Agreement which together form the legal basis for the PA's relations with third parties are found at Article IX and in the Economic Protocol at Annex V. (The Economic Protocol, which defines the Israeli-PLO/PA economic relationship, was signed in Paris on April 29, 1994 and subsequently incorporated with modifications in the Interim Agreement as Annex V.)

2. The limits of PA competence with regard to forging trade relations with third parties are set out in Article IX of the Interim Agreement according to which:

"the PLO may conduct negotiations and sign agreements with states or international organisations for the benefit of the Council in the following cases only:

- (1) economic agreements, as specifically provided in Annex V of this Agreement;*
- (2) agreements with donor countries for the purpose of implementing arrangements for the provision of assistance to the Council;*
- (3) agreements for the purpose of implementing the regional development plans detailed in Annex IV of the DOP or in agreements entered into in the framework of the multilateral negotiations; and*
- (4) cultural, scientific and educational agreements."*

3. Those areas of import policy which might potentially be the subject of signed agreements between the PA/PLO and third parties are set out in Annex V i.e. the Paris Protocol. According to the Protocol the PLO/PA and Israel must generally apply the same import policy, that of Israel, but the PLO/PA is granted some independent trade policy making authority which is set out in precise terms:-

* It may set at a *lower level* (than Israeli rates) customs duty and other charges on imports of goods specified in Lists A1, A2 and B subject to provisions relating to origin and quantity in the cases of lists A1 and A2, and without quantitative restriction in List B. Special provisions designed to prevent re-export apply to the import of motor vehicles and petroleum products.

* In addition it may decide on an *upward change* in the Israeli rates of customs, purchase tax, levies,

excise and import charges on all goods *not specified* in Lists A1, A2 and B, and to quantities exceeding those agreed upon with regard to products in list A1 and A2.

The above exceptions relating to imports from third parties (and there are other deviations relating to mutual trade) amount to deviations from a customs union concept and it is the scope that these provide for the Palestinians to set their own import regime with third parties that we are concerned with here.

4. The fact is that the Paris Protocol does **not** provide for a full, but rather a semi-customs union and it does not prevent the Palestinian areas from being legally identified as a separate customs territory. (2) In short it is unclear from its wording whether the Paris Protocol provides for a customs union or a free trade agreement. (2A)

Palestinian and Israeli interpretations

5. The Preamble of the Protocol provided *inter alia* for the Palestinian side "exercising its right of economic decision making in accordance with its own development plan and priorities" and recognised its "economic ties with other markets". Despite this intention, and the spirit in which it was agreed, the enactment on the ground of the Protocol's provisions has revealed sharp differences with regard to the two sides' interpretations of the scope - as set out in the Interim Agreement - for PA decisionmaking in trade relations with third parties. The differing interpretations, not surprisingly, reflect the respective political goals as well as the economic interests of the two sides .

PLO/PA agreements with third parties

EC-PLO Interim Association Agreement

6. Israeli-PLO differences have been brought to a head with the signing and implementation of the EC-PLO Interim Association Agreement. Israeli officials regard the agreement as a breach of Article IX of the Interim Agreement, which they argue does not permit the PA to enter into independent trade agreements. (2B) In February the Israeli Foreign Ministry's deputy director-general for economic affairs, Victor Harel, voiced his concern at the European Council of Ministers' call for the full and rapid implementation of the EC-PLO agreement, which Israel argues also encourages the contravention of the Paris Protocol.

7. Israeli objections to the EC-PLO agreement on **economic/technical grounds** are as follows:

- i) EC-PLO agreement is a *de jure* instrument that creates a separation between Palestinian and Israeli markets by treating the Palestinian areas as a separate trading entity with borders, thereby negating the Paris accords, which established the notion of a single Israeli-Palestinian territory" (3), or in current Israeli parlance "single customs envelope".
- ii) Technically speaking the EC-PLO trade accord therefore puts an end to the de facto cumulation according to which goods jointly produced by Israelis and Palestinians had qualified for duty-free entry to European markets – the EC's association agreements with Israel and the PLO do not allow for diagonal cumulation of origin of this kind

- iii) The EC agreements with the PLO/PA and Israel create a problem with regard to the territorial definition of Israeli and Palestinian trading entities, says one Israeli interviewee, and Israel argues that it does not now know to what territory exactly the agreements apply. Israel does not accept the European interpretation of UN Security Council Resolution 242 with regard to territory and points out that the political border with regard to the West Bank is still to be established in final status talks. However, this interviewee maintained the position with regard to Gaza is clear.
- iv) As a consequence of ii) Israel argues that “industrial cooperation” between Israel and the Palestinian areas with regard to manufacturing aimed at the European market will be inhibited. The Israeli view is that the Palestinians have more to lose economically than Israel from this development. This, Israelis say, is because Israel’s exports to Europe that depend on de facto cumulation with the WBSG are marginal in relation to its total exports to the EU, while the Palestinians stand to lose thousands of potential job opportunities with the end of de facto cumulation - their goods will not qualify for duty free exemption in Europe without the benefit of cumulation.
- v) Israel regrets this development since it wants, it maintains, to develop job opportunities in the Palestinian areas in the interest of economic symbiosis, Palestinian economic development and the peace process. The textile industry in particular will be hard hit. Despite Israel’s good marketing and production skills, the industry is not competitive in global markets. If Israel loses its de facto cumulation link with the Palestinian areas where it currently benefits from cheap labour, Israeli producers will have to go to Pakistan or Turkey etc.
- vi) The PA will have to operate as an independent entity with its own border controls - difficult to achieve in current circumstances, says Israel.

8. Israeli interviewees also concede that there is an important **political dimension** to the above objections, namely that because the EC-PLO accord is a free trade agreement between entities with implied borders it works against the spirit of the Oslo accords: The Interim Agreement (Article 00) agreed that borders would be decided in final status talks and, consistent with this, the Paris Protocol creates a semi customs union with no borders between Israel and the Palestinian areas. Israel argues that in concluding a free trade agreement of this kind with the EC the Palestinians are not using the Oslo transitional period, as was intended, namely to build confidence through economic cooperation, but rather to acquire symbols of statehood.

9. However, the Palestinians consider that the Israelis also downplay the economic reasons for its opposition to the EC/PLO accord. The EU is Israel’s closest market and absorbs 60% of its agricultural exports. If the Palestinians were able to export their agricultural products directly to EU member states, these would compete with Israeli products.

Trade agreement between Jordan and the PLO/PA

10. The Palestinian-Jordanian trade agreement of 1995 aims to achieve free trade in all goods, but currently comprises only lists of goods which can be imported duty-free from each other – the PLO-PA grants customs duty exemptions to 45 products originating in Jordan on List 1 and to 32

products in List 2; Jordan grants customs duties exemption and customs duties and other tax exemptions to a total of 60 products from the WBGS.

11. Unlike the EC-PLO/PA trade agreement which it regards as a violation of Article IX of the Interim Agreement, Israel considers the Jordanian-PLO/PA trade accord to be in full compliance with the terms of the Paris Protocol and with Article IX of the Interim Agreement. Israeli concerns with regard to the EU-PLO agreement cited above provide a guide as to why:

The **scope** of the Palestinian-Jordanian trade agreement is of quite a different order:

It is not a free trade agreement between two entities with implied borders but rather a protocol trade agreement limited to lists and specific quantities in conformity with provisions set out in the Paris Protocol. There is therefore no implied territorial definition of the WBGS and the agreement does not imply the exercise of independent decision-making authority on the part of the PLO/PA other than specifically provided for in the Protocol;

The agreement provides for duty free treatment according to lists and specific quantities in conformity with provisions set out in the Paris Protocol and approved by Israel. Israel therefore controls the degree of competition posed by Jordanian entry into the Palestinian market/Palestinian penetration into the Jordanian market.

Furthermore the Jordan-PLO/PA trade accord does not involve Israel forfeiting a past trade link from which it derives economic advantage – in contrast with its key export market in the EU countries, Israel never had much trade with Jordan.

Implications

12. The wording of the Interim Agreement has provided leeway for the Palestinians to make agreements with third parties in the area of trade which serve their economic interests but which also help build the case for statehood. It would appear that this outcome was not foreseen by Israel, hence the intensified talk of breaches of the Interim Agreement and Paris Protocol. However, Israel's claim that such trade agreements violate the Interim Agreement and Paris Protocol provisions are not regarded as legally sound by EU member states.

Political symbolism

13. European countries (EU and EFTA) have chosen to use the scope provided in the Paris Protocol to contractualise trade relations with the PLO/PA. This is a recognition that the Palestinians want where they can to represent their own commercial interests – in defining their own import regime for European goods and in negotiating concessions with regards to exports. For their part the EU has clearly stated that it wishes the Palestinians to be put on an equal footing in the Barcelona process with a view to their inclusion in the Euro-Med space. Europeans make no bones about the political point which is that trade agreements of this sort – in which the PLO/PA represents its own interests - are a symbol of European support for Palestinian “self determination”.

Towards a separate customs territory

14. The Palestinian areas are de facto part of a customs territory with Israel but they can legally be defined as a separate trading entity (or a separate customs territory in some trade

related areas). The degree of autonomy that the PA/PLO is assuming in trade decision-making as reflected in the conclusion of its agreement with the EU (but also in a future trade agreement with EFTA) during the transitional period means that the Israeli understanding of a single customs “envelope” or territory is not shared by the international community which regards the relationship more as one of free trade area between two customs territories. Thus the question as to who represents Palestinian trade interests has become politically charged before final status talks – in this regard note Israel’s criticism of the decision to send the EC-PLO/PA trade deal to the WTO for review. (4)

(Under WTO rules, free trade accords should relate to deals between customs territories with a significant degree of autonomy. Israel maintains that the self-rule areas do not conform with that definition, while the European countries are likely to maintain that the PLO legally has treaty-making powers in certain trade related areas (elimination of duties as long as they use the Israeli tariff as a minimum basis).)

Interim trade agreements

13. As a separate customs territory the PLO/PA can, under Article XXIV of GATT, make interim agreements leading to the eventual formation of a free trade area. Under international law this would represent a step in the direction of a recognition of Palestinian statehood.

Third party agreements and WTO rules

14. The PA is not a member of the WTO and does not yet comply with the requirements to join as an independent state or customs territory with full autonomy in trade regulations. However, WTO regulations could be used to encourage Palestinian trade with third parties: Since the Paris Protocol implicitly establishes a single customs territory, it can be argued that Israel’s obligations, as a WTO member, apply to it. In short, WTO memberstates could invoke world trade law when Israel impedes trade to WBGS.

Implementation of third party agreements and cumulation issues

In view of the above line of argument the Palestinian Authority is likely to argue for the proper implementation of the EC agreements with Israel and the PA, in particular in relation to origin rules, in order to develop trade with Europe. This would require that Israel cease hindering Palestinian exports to the EU – in short that it implement the Paris Protocol. Proper implementation of the EC-PLO/PA accord would also require a cessation of Israeli export of products from the settlements and East Jerusalem as Israeli products – Article 83 of the EU-Israel Association Agreement excludes the possibility of products from the Palestinian areas being exported as Israeli.

The Israeli response to the above has been to finetune its position on cumulation. It now distinguishes between a continuation of informal de facto cumulation between Israel and the WBGS which it would favour and the implementation of diagonal cumulation based on the EC’s trade agreements with itself and the PA, which it opposes. This is because the latter approach would amount to recognition that the PA is moving towards the status of a separate customs territory.

The Israeli preference therefore is to argue that the status quo – namely the existence of a single customs envelope as provided for under the Paris Protocol – is the best situation for the transitional period. This would help to arrest the growing trend in the international community to treat Israel and the WBGS as separate economic entities with all that this might imply in terms of political recognition. On February 27 the Jerusalem Times cited Victor Harel saying “Our customs system does not cause problems. As much as the PA exports, we encourage without any problems”. However this is patently not the case while closure continues.

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Footnotes:

(1) The Interim Agreement superseded the terms of the Gaza-Jericho Accord of May 1995 of which the Paris Economic Protocol had hitherto been part.

(2) A customs territory according to Article XXIB:2 of GATT is any territory with respect to which separate tariffs or other regulations of commerce are maintained for a substantial part of trade of such territory with other territories.

(2A) The JEC's consideration of the extension of lists A1, A2 and B implies further movement away from a customs union to free trade between Israel and the WBGS.

(2B) The Paris Protocol is not part of Israeli law. Israelis therefore invoke Article IX of the Interim Agreement when they cite their opposition to the EC-PLO trade agreement.

(3) Israeli spokespersons, formally and informally, have consistently indicated their concern at the conclusion of the EC-PLO Interim Association Agreement on Trade and Cooperation signed in late 1996 and came into force in early July 1997.

(4) In July 22 Israel's representative to the WTO told the WTO's council on trade in goods that his country had reservations on the EC-PLO Interim Association Agreement and the decision to send it to the WTO for review. His main arguments were that the accord appeared inconsistent with the Oslo peace accords, notably the Interim agreement which, he said, does not permit the PA to enter independent trade agreements. Second, Israeli officials say the accord treats the West Bank and Gaza Strip as a separate trading entity, which they say breaches another protocol to the Washington accords which stipulates a "single customs envelope".

The logical outcome of the above arguments is likely to lead to a closer assessment of the Paris Protocol by outside parties. To what extent are clauses of the Protocol not compatible with WTO law. This is important.

The Palestinian interpretation enjoys widespread support - in the EU, EFTA states - and is likely to be generally supported in WTO circles. This has economic and political implications for Israel.

As Palestinian trade decisionmaking authority evolves and the question of whether they are moving towards customs union or free trade area become more keen, Israeli opposition will become more vociferous because a) of the economic price to be paid; b) of the consolidation of the Palestinian political aims, at the expense of Israel's; c) the manner in which the

international community will respond the political advantage that Palestine has in taking the case for WTO compatible trade relations to the international community.