



Monitoring and Analysis of Political, Social and Economic Development in Countries Affected by Conflict

1 January – 30 June 2006

Table of contents

I. Introduction

II. Political and Socio-Economic Developments in the Region

1. Divergent Regional Interests of Two Alignments
2. The rising ethno-sectarianism tensions in Iraq and their impact on socio-economic conditions
3. Impact of government change and occupation on socio-economic conditions in the occupied Palestinian territory (OPT)
4. The political tensions in Lebanon and their socio-economic impact

III. Other Regional Challenges

**Monitoring and analysis of political, social and economic development in countries
affected by conflict
1 January – 30 June 2006**

I. Introduction

This report provides an appraisal of the impact of conflict and political turmoil on the political, social and economic dynamics of the ESCWA region,¹ covering the period between 1 January and 30 June 2006. The report examines conflict areas, focusing especially on Iraq, Lebanon, and the occupied Palestinian territory (OPT). It surveys current and evolving trends. The sources of friction and possible future developments in countries suffering from political tensions are also examined.

This report traces regional geopolitical trends, particularly the increasing divergent regional interests between Iran and the Syrian Arab Republic, on one hand, and United States, Saudi Arabia, Jordan and Egypt on the other. The ongoing Middle East conflict, in particular its Palestinian-Israeli track, is also a focus of the current review period.

Strategies are proposed to contain and reduce tensions and mitigate negative socio-economic and political consequences.

II. Political and Socio-Economic Developments in the Region

During the reporting period and within the foreseeable future, political dynamics and socio-economic consequences in Western Asia are influenced largely by 1) Iran's changing role and its controversial nuclear program, 2) the situation in Iraq, 3) the Middle East conflict, and 4) the situation in Lebanon.

1. Divergent Regional Interests of Two Alignments

In February 2006, the IAEA Board voted to refer Iran to the UN Security Council in response to Iran's 10 January 2006 decision to resume nuclear research and development activities including uranium enrichment. Iran reacted by halting application of the Additional Protocol, prohibiting IAEA surprise inspections and inspections of non-declared sites. On 14 February, Iran declared that it had begun small-scale enrichment.²

The UN Security Council passed a non-binding statement on 29 March calling for Iran to end uranium enrichment and asking the IAEA to report to the Security Council within thirty days; the IAEA confirmed on 28 April that Iran did not abide by this deadline. UN Security Council permanent members failed to agree on a resolution proposed by the United States of America, the United Kingdom, and France that included sanctions;

¹ The ESCWA region is the area that comprises all Gulf States, the Levant excluding Israel in addition to Egypt and Yemen.

² International Crisis Group. Iran: Is there a way out of the nuclear impasse? Middle East Report N°51 – 23 February 2006.

Russia and China continue to reject sanctions.³ On 6 June, European Union foreign policy chief Javier Solana presented to Iran a package of rewards and penalties that was created by the five permanent members of the UN Security Council and Germany. The package asks Iran to suspend uranium enrichment in return for economic incentives.

Iranian President Mahmoud Ahmadinejad traveled to the Syrian Arab Republic in late January 2006 to consolidate Iran's geopolitical position. The visit aimed, among other things, at presenting a common front against international pressures facing the Syrian Arab Republic and Iran. Both countries signed a mutual defense pact on 14 June 2006. The Syrian Arab Republic remains Iran's main strategic ally in the region.

Iran may be taking advantage of the US preoccupation in Iraq and rising oil prices to confront the United States and its European allies with its nuclear program, enhance its influence among different Shia factions in Iraq, reinforce its ties with the Syrian Arab Republic, and consolidate its influence in the OPT as well as Lebanon. Iran has emerged as a key player in the geopolitical contest over Lebanon, after former Prime Minister Rafiq Hariri's assassination, and has also extended its influence among different political actors in the OPT.

Iran's rising regional status has been met with great apprehension among most Arab states. In response, Arab regimes are rallying domestic constituencies and attempting to contain Iran's growing geopolitical role. The political discourse between Iran and most Arab governments has assumed a sectarian tone, accentuating traditional sensitivities between Sunnis and Shias.

Sunni Arab states reportedly fear the development of a "Shia Crescent" running from Iran to Iraq, Syrian Arab Republic, and Lebanon, but also stretching to include important Shia communities in Kuwait and Bahrain. They have reportedly rallied "Sunnite fundamentalists" to reduce Shia popularity inside each state. Gulf States with significant Shia populations (such as Saudi Arabia, Kuwait, and Bahrain) fear that Iran's growing regional influence may embolden their own Shia communities to demand a greater role in political decision making and attempt to secure greater economic benefits. Gulf states fear that this allows Iran political leverage in their own domestic arenas.

Conclusion: Future Trends and Options

These trends suggest that Iran's regional ambitions will remain a source of apprehension to Gulf States. Negotiations over Iran's nuclear program will continue to set the agenda for other outstanding geopolitical issues, which are increasingly manifesting themselves in Iraq, OPT and Lebanon.

³ Crisis Watch No31. 1 March 2006.

2. Rising Ethno-Sectarian Tensions in Iraq and their Impact on Socio-Economic Conditions

Foreign intervention, growing sectarian and ethnic conflict, and deteriorating socio-economic conditions threaten the territorial unity of Iraq, rendering political consensus inextricably problematic, hastening open civil war and disintegration of the state.

A staggering rise in sectarian violence has been witnessed during the reporting period. In the first half of 2006, over 6,000 people were killed in Baghdad alone, mostly for sectarian reasons; around 20,000 people were kidnapped; and, approximately 180,000 people were displaced from their homes as a result of sectarian and ethnic cleansing.⁴ Sectarian violence and the breakdown of law and order are a manifestation of a failed political process and the absence of an all inclusive national reconciliation effort.

The Parliamentary Elections and the Absence of a National Reconciliation Process

January parliamentary elections have underlined the political prominence of religion and ethnicity in Iraq with the victory of the Shia-led United Iraqi Alliance, which secured 128 of 275 seats. The non-sectarian “middle” party, won 25 seats.⁵

The United Iraqi Alliance chose Ibrahim al-Jaafari for Prime Minister in January, but Sunni and Kurdish communities rejected this choice. Nuri al-Maliki, deputy leader of al-Jaafari’s Daawa party, was nominated as Prime Minister in April after a two-month stalemate. Parliament approved a 37-member “unity government” on 20 May that included Sunnis, Shias, and Kurds. After a delay of several weeks, the positions of security, defense, and interior ministers were finally chosen on 9 June.⁶ A survey by the Program on International Policy Attitudes, reported in the *Washington Times* on 1 February, found that only five percent of Sunni Arabs approved of the 15 December 2005 elections and 92 percent thought that the new government was illegitimate.⁷

The five-month delay in the formation of a new government reflected tensions between Shia, Sunni, and Kurdish political factions, as well as divisions within the Shia Coalition and the unsettling influence of external interventions. The delay in appointing the security-related ministers presages difficulties for the new government and specifically for the Constitution Review Committee.⁸

⁴ Khadduri, Wallid. Contribution to the report. 21 June 2006.

⁵ *The Next Iraqi War? Sectarianism and Civil Conflict*. International Crisis Group. Middle East Report N°52. Found at <http://www.crisisgroup.org/home/index.cfm?id=3980&l=1>. 27 February 2006.

⁶ Crisis Watch No 34. 1 June 2006.

⁷ Power and Interest News Report. Red Lines Crisscross Iraq’s Political Landscape. Found at http://www.pinr.com/report.php?ac=view_report&report_id=449&language_id=1. 1 March 2006.

⁸ Cordesman, Anthony. The Quarterly Report on “Measuring Stability and Security in Iraq:” Fact, Fallacy, and an Overall Grade of “F”. Found at http://www.csis.org/media/isis/pubs/0605_iraquarterlyreport.pdf. 5 June 2006.

Exacerbation of Sectarian Violence: The Destruction of Shia Holy Shrine

The destruction of the Shia Al Askari Shrine in Samarra on 22 February, followed by reprisals against Sunni mosques and Sunni Arabs, brought into peril the likelihood of open civil war. Estimates indicate that 800 persons died in the aftermath of the bombing,⁹ and violence-related deaths during the reporting period reached 1,100 per month in Baghdad.¹⁰ According to MNF-I, the multinational force in Iraq, from February to May 2006, the average number of weekly attacks in Iraq was greater than 620, compared with around 550 a week on average in the period between September 2005 and mid-February 2006, and 400 a week in mid-2004.¹¹

Violence and criminal activities throughout the country have increased since 2003. Baghdad has an average of 90 crime-related murders per 100,000 residents every month, three times higher than in most major cities in the world.¹² Moreover, the number of internally displaced persons has increased considerably and general socio-economic conditions have been greatly exacerbated.¹³

Violence has not only been confined to Baghdad and the so-called Sunni triangle or central Iraq. In Basra, the second largest city in Iraq and a major outlet for fuel exports, various Shia militias are competing for control of the provincial government, as well as illicit oil trade. The local police force has failed to enforce order. Its members are loyal to different militias rather than the state. Rivalry in Basra is chiefly between Al Fadila al Islamiya, the Supreme Council for the Islamic Revolution in Iraq, and Muqatada al-Sadr's movement. The Al Fadila, an extremist Shia group, is an offshoot from Muqtada al-Sadr's movement and is reported to be behind attempts to empty the Basra province of its Sunni inhabitants. This situation led Prime Minister Nouri Jawad al-Maliki to declare a state of emergency on 31 May 2006. The situation in Basra is a clear indicator of the rift between the various Shia militias and groups, which is likely to spread to other parts of the country.

The Government of Nouri al-Maliki: The Liquidation of al-Zarqawi and a Reconciliation Initiative

A major security breakthrough was achieved on 7 June, when American and Iraqi forces killed al-Qeada commander Abu Misaab al-Zarqawi. Analysts maintained that although the liquidation of al-Zarqawi will not bring an end to al-Qaeda's terror activities in Iraq, it did constitute a major boost for Iraqi Prime Minister Nouri al-Maliki. Zarqawi's liquidation was followed by a number of steps, aimed at easing sectarian tensions and

⁹ Crisis Watch No 34. 1 June 2006.

¹⁰ Crisis Watch No 34. 1 June 2006.

¹¹ Economic Intelligence Unit Country Report: Iraq 2006

¹² *Iraq - Rebuilding Iraq: economic reform and transition*. World Bank report number 35141. Found at http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2006/02/22/000090341_20060222100550/Rendered/INDEX/35141.txt. 1 February 2006.

¹³ UN Assistance Mission for Iraq. Human Rights Report 1 March-30 April 2006.

decreasing violence across the country, including Al-Maliki's announcement (6 June) that he would release 2500 prisoners, the bulk of which are from the Sunni community.

Despite Prime Minister Nuri al-Maliki's presentation (25 June) of the National Reconciliation Plan and al-Maliki's announcement that Iraqi security forces will take charge of two provinces in July, political and security developments gradually eroded the hopes for progress. The massive security operation aimed at restoring security in Baghdad has not affected the number or severity of attacks and kidnappings. The reconciliation plan failed to generate political momentum. Analysts believe that a viable government plan to disarm the militias cannot be successful without an understanding between key international and regional actors.

As such, it is expected that al-Maliki's government will not be able to accomplish the three pillars of its programme: restoring security, advancing the political process, and disbanding the militias. The continuation of ethnic and sectarian strife coupled with the alignment of Iraqi players and external powers, it is feared, could lead to a *de facto* federalization of Iraq and disintegration of the state.

A Socio-Economic Environment Highly Conducive to Conflict

Oil production has decreased from an average of 2.6 million barrels per day (m b/d) in 2002 to an average of 1.8 m b/d in 2005 and 1.9m b/d in May 2006, with exports estimated to be around 1.4m b/d.¹⁴ Consequently, Iraq has not been able to meet domestic petroleum demand, due to two factors. A trade liberalization law, passed in mid-2003, allowed for the tax-free import of cars and trucks; over a million cars were imported in two years, thereby doubling the consumption of gasoline. More importantly, many insurgent groups have targeted the pipeline system extending from oil fields to refineries and distribution centers, and many insurgent groups fund their operations through an extensive black oil market.

It is estimated that at least \$1-1.5 billion of oil revenue is lost monthly because of smuggling and corruption.¹⁵ In a report published in May 2006, the Inspector General of the Iraq Ministry of Oil revealed that there are eight illegal ports along the 65-kilometre Shatt al-Arab.¹⁶ According to data from the Iraq Revenue Watch at the Open Society Institute, oil smuggling costs accounted for between \$2.5 billion to \$4 billion in 2005, or almost 10 percent of Iraq's GDP.¹⁷

¹⁴ International Energy Agency. *Monthly Oil Market Report*. June 2006.

¹⁵ Khadduri, Walid. \$18 Billion: Iraq's Annual Oil Loss. Found at <http://english.daralhayat.com/business/04-2006/Article-20060411-89398c8b-c0a8-10ed-0105-0034c1c49534/story.html>. 12 April 2006.

¹⁶ Iraq Oil Ministry, Office of the Inspector General. *Smuggling Crude Oil and Oil Products: Second Transparency Report*. Found in English at <http://www.iraqrevenuewatch.org/reports/052206.pdf>. May 2006.

¹⁷ James Glanz and Robert F. Worth "Attacks on Iraq oil industry aid vast smuggling scheme." *New York Times*. 4 June 2006.

The Iraqi budget relies heavily on oil revenues, which accounted for 97 percent of budget revenues between 2004 and 2006.¹⁸ The Iraqi government hopes to reach an output of 2.5m b/d for 2006, but this target could not be reached due to lack of investments in oil infrastructure and insurgents attacks on oil fields and pipes. In a positive development, in mid-June and after four months of very little activity, the export pipeline from Kirkuk to Ceyhan, Turkey was reopened.¹⁹

National income has declined as direct consequence of the losses in oil revenues and deterioration in productivity. Per capita income is estimated at \$1,189 in 2005²⁰, a third of what it was 25 years ago. Real GDP in 2005 was less than 3 percent according to the World Bank, despite the global increase in oil production and prices. Weak economic activity in the non-oil sectors was noted. In spite of the fact that it has the second largest oil reserves in the world, Iraq has now one of lowest per capita incomes in real terms in the region.

According to the World Bank, unemployment in Iraq is almost 30 percent, with underemployment at 23 percent and a 60 percent unemployment rate among young males.²¹ The de-Baathification process involving thousands of civil servants and teachers in 2003 left many unemployed and state institutions with few experienced personnel. The disbanding of the Iraqi armed forces and police in 2004 not only created a security vacuum; it also left some two to three million people without income.

The negative impact of high unemployment is aggravated by a high underemployment rate and a low participation rate, especially that of females.²² Underemployment due to low working hours was estimated in 2003 at 23.5%, while underemployment due to low income was estimated for the same year at 21.2%. Regional inequalities in unemployment rates are also found to be striking ranging from 46.2% for Thi Qar to 14.0% for Kerabala.

Poverty in Iraq is rampant. According to the Iraq Ministry of Planning, one in 10 Iraqis lives on less than \$1 a day, with a further one in 10 vulnerable to falling into absolute poverty.²³ A 2003 WFP survey on food security in Iraq covering 16 out of 18 of Iraq's governorates revealed that 11 % of Iraqi households are extremely poor, 43 % are poor. Like unemployment, regional disparities in the incidence of poverty are quite serious with Ninevah having the highest rate of extreme poverty in 2003 (23%), almost twice the national average.²⁴

¹⁸ Ozlu, Onur. Iraqi Reconstruction and Development. Found at: http://www.csis.org/media/isis/pubs/060421_onuriraquireconstruct.pdf. (21 April 2006).

¹⁹ Economic Intelligence Unit Country Report: Iraq 2006

²⁰ International Monetary Fund (IMF), "IMF Country Report," 2006.

²¹ *Iraq - Rebuilding Iraq: economic reform and transition*. World Bank report number 35141. 1 February 2006.

²² Survey of Economic and Social Developments in the ESCWA Region 2004-2005, Economic and Social Commission for Western Asia, New York 2005, pp. 66-67

²³ Economy: Stuttering along Iraq. *Middle East Economic Digest*. 26 May 2006.

²⁴ Survey of Economic and Social Developments in the ESCWA Region 2004-2005, op. cit, p 59

After the 2003 war, Iraq opened up its economy and embarked on wide scale liberalization and structural adjustment programme. Iraq's economy is now wide open and some vital subsidies have been removed or drastically reduced. Since then, not only unemployment has soared, but also a de-industrialization process started mounting up. In March 2006, 80% of local industries are believed to have shut down and 20 % of those still functioning are operating at half capacity.²⁵ In spite of a stable peg to the dollar of the exchange rate, inflation rate is recorded at 53 between May 2005-May 2006²⁶ resulting thus in negative real interest rates.

In December 2005, the Iraqi government reached an agreement with the IMF that established the Social Protection Network (SPN), providing NID500bn (US\$340m) from the 2006 budget to expand Iraq's social welfare system, expanding coverage and increasing financial support for those who are eligible (March 2006, Economic policy). Five million Iraqis have been included in the program since its inception in January. Notwithstanding these successes, several cities (Diwaniyah, Mosul) have insufficient funds to accommodate all applicants.²⁷

Necessary legal reforms to increase private sector investment have yet to be promulgated. Reconstructing infrastructure is slow.²⁸ Donor agencies and contractors report security and insurance outlays at 25-40 percent of the total cost of work.

Conclusion: Future Trends and Options

The core challenge facing Iraq in the foreseeable future is achieving security and building the institutional bases for a non-sectarian integrated state. The prospects for this happening in the near future are not encouraging. The security situation remains a major challenge for the central authorities, and the sectarian state is being institutionalized *de facto*.

The ongoing regional geopolitical contest between the Iranian and US led alignments will continue to expose Iraq to difficult challenges. Iraq's stability may have to await a larger regional understanding or re-alignment, one that protects both parties' security interests. Until such time, the international community should expect more instability and divisive politics in Iraq.

²⁵ Al-Sabah Newspaper of 29 March 2006 quoted in Alnawwab, Nabil " Iraq Social News: Excerpts from Iraqi Newspapers on Social Concerns Issue No. 1," alnawwab@gmail.com, March 2006, p. 43.

²⁶ Statistics of Iraq's Central Organisation of Statistics and Information Technology cited in Almada Newspaper of 20 June 2006 and quoted in Alnawwab, Nabil " Iraq Social News: Excerpts from Iraqi Newspapers on Social Concerns Issue No. 4," alnawwab@gmail.com, June 2006, p. 20

²⁷ Economic Intelligence Unit Country Report: Iraq 2006

²⁸ *The Next Iraqi War? Sectarianism and Civil Conflict*. International Crisis Group. Middle East Report N°52. Found at <http://www.crisisgroup.org/home/index.cfm?id=3980&l=1>. 27 February 2006.

3. Impact of government change and occupation on socio-economic conditions in the occupied Palestinian territory (OPT)

Three trends threaten the viability of Palestinian self-rule and increase the likelihood of political, social, and economic deterioration in the occupied Palestinian territory (OPT): first, continued occupation, separation and closure, as well as Israel's withholding of Palestinian tax revenues; second, the growing rift between donors and the Palestinian Authority (PA), the withdrawal of funding, and the ensuing economic repercussions; and third, the deteriorating domestic Palestinian political environment. Claimed security for Israel continues to be the principal driver of Israeli measures. The following sections describe the three trends in more detail.

Palestinian Elections and Internal Tensions

Palestinians voted to elect members of the Palestinian Legislative Council (PLC) on 25 January. Hamas won 76 of 132 Parliamentary seats, defeating the formerly governing Fateh majority who won 43 seats. Hamas assumed power on 29 March. Facing international boycott, the new Hamas government has been unable to pay government employees since February.

Clashes between Hamas and Fateh have served to precipitate declining internal security in the OPT. The Palestinian Interior Minister approved the deployment of a "Security Forces Support Unit" in the Gaza Strip of approximately 3,000 armed persons on 20 April, raising the level of tension and potential for violent infighting. Fateh deployed 3,750-armed persons in response. Violence escalated between the two groups, with armed clashes occurring on nearly a daily basis. According to arms dealers, Fateh and Hamas have been stockpiling weapons and ammunition.²⁹

Civil discontent has so far largely been aimed at the international community. However a demonstration on 30 May attended by hundreds demanded that the PA government "produce solutions or resign."³⁰ On 1 June large numbers of security personnel attacked the Palestinian Legislative Council in Gaza City, demanding payment of unpaid wages.

The Palestinian National Dialogue convened on 25 May, bringing together representatives from political parties and factions, civil society, the private sector, and others. Intensifying existing political tensions, President Mahmoud Abbas declared on 25 May that he would call for a national referendum within 10 days if Hamas did not agree to the principles outlined in the prisoner's Reconciliation Document, which calls for a two-state solution thus implicitly recognizes Israel. The right of resistance in the occupied territory "by all means" is also recognized in the document. After an extension of two days under pressure from Arab states, on 10 June Abbas called the referendum for

²⁹ Adam Entous and Haitham Tamimi, "Hamas, Abbas Rivalry Spurs Palestinian Arms Race", Reuters, 8 June 2006.

³⁰ Palestinians, Israel and the Quartet: Pulling Back from the Brink. International Crisis Group. Middle East Report N°54. Found at <http://www.crisisgroup.org/home/index.cfm?id=4171&l=1>. 13 June 2006.

26 July. Hamas responded by sharply criticizing Abbas for undermining democratic principles.

Donor Retreat

With the election of Hamas, donor countries withdrew funding from the Palestinian economy and Israel began to withhold the \$750 million in tax revenue it collects on behalf of the PA. The United States has frozen an estimated \$400 million, and the EU terminated its transfers amounting to approximately \$600 million annually. The Arab League, Iran, and Saudi Arabia have declared their willingness to commit funds, but banking restrictions by the end of the reporting period posed transfer problems; the Amman-based Arab Bank, for example, has frozen the PA's Single Treasury Account.³¹

As a result, the Palestinian legislative council has fallen short of obtaining the \$165 million required to pay monthly expenditures. With its revenue, the PA runs 75 percent of the schools in the OPT, and the ministry of health provides 62 percent of primary health clinics and 57 percent of hospital beds. A full 60 percent of the PA's funding is for public employee salaries.

In the wake of the recent impoverishment of nearly a third of the Palestinian population in the OPT,³² the incomes and living standards of another third are directly threatened by the withdrawal of donor funding for PA government employees, who make up 28 percent of all domestic Palestinian workers. In the Gaza Strip, approximately 40 percent of employed persons work for the PA. Security forces make up almost half of these employees.

The Quartet (composed of the US, Russia, EU and UN) agreed on 17 June to endorse a temporary mechanism, proposed by the EU, to channel aid to the Palestinian people while bypassing the government. The proposal calls for 100 million Euros to go to Palestinians through three channels: existing health programs operated by the World Bank, the European Commission's emergency relief plan for essential needs such as fuel, and direct financial assistance to individuals in the OPT. A detailed plan for the third mechanism has yet to be formulated; the funds will not be used for wages.

It remains to be seen whether a growing political divide at a time of economic and social crisis will force Palestinians to choose a more moderate political leadership. It is plausible that increasing poverty and hardship will lead to even greater internal social tensions, as has recently been observed between Fateh and Hamas supporters. Non-payment or unequal payment of salaries could catalyze breakdowns in discipline in the PA security services, which could halt or slow relief efforts.³³ The International Crisis

³¹The Impending Palestinian Fiscal Crisis. World Bank. Found at: <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/PalestinianFiscalCrisis,PotentialRemediesMay7.pdf>. 7 May 2006.

³² Palestinian poverty increased by roughly thirty percentage points since severe closure was imposed on the OPT in 2000.

³³The Impending Palestinian Fiscal Crisis. World Bank. Found at:

Group has noted that the situation is “but one tragic step – the assassination of a senior Fateh or Hamas leader, for example – from all-out chaos.”³⁴ These are ominous declarations.

Israeli Elections, Continued Occupation, Separation and Closure

On 28 March, Israelis elected Prime Minister Ehud Olmert, the leader of the new Kadima party, which won 28 of the 120 Knesset seats. Olmert has declared that he and his Kadima party will draw Israel’s final borders by 2010, unilaterally if necessary, indicating that Olmert will continue with the unilateral approach espoused by his predecessor Ariel Sharon.

Israel continues to refrain from politically engaging with the PA, and has continued during the reporting period to reject the provisions of the Oslo agreements and the Paris Protocol with exorbitantly restrictive permit policies. Israel also continues its military activities, engaging in missile attacks, artillery fire, house searches, arrests, detentions, land requisitions and leveling, curfews, house demolitions, closure-caused food shortages, the limitation of access to basic health and educational services, and the limitation of access to agricultural lands and other natural resources.

Israel had declared its intention to disengage from the West Bank, as indicated by Olmert’s statements.³⁵ This threatens to exacerbate economic decline; with Israel’s withdrawal from Gaza, the majority of Gaza’s trade and labor was shut out of Israel. Perhaps in anticipation of this trend, Israel has asked UNRWA to expand its programs.

According to OCHA,³⁶ Israel has tightened its security measures since the beginning of 2006, and continues to impose severe mobility restrictions inside the West Bank, between the West Bank and Gaza Strip, and between the OPT and the rest of the world. These measures include the continued construction of the Barrier, increased number of checkpoints and roadblocks, permit restrictions, and military operations. Karni was closed nearly 40 percent of the time in Gaza while obstacles hindering internal West Bank mobility increased eight percent between January and April.³⁷ Israel continues to obstruct donor relief and development activities; it has yet to offer donors guarantees that it will not interfere with the operation of the seaport.³⁸

<http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/PalestinianFiscalCrisis,PotentialRemediesMay7.pdf>. 7 May 2006.

³⁴ Palestinian poverty increased by roughly thirty percentage points since severe closure was imposed on the OPT in 2000.

³⁵ Olmert has stated that Israel would trace its West Bank border roughly along the lines of the wall it is building in the West Bank. Olmert said Israel could not abandon the Jordan Valley because of the eastern region’s strategic importance, and has pledged that occupied Jerusalem would remain “Israel’s united capital”, signaling that he has no plans to give up control of occupied Arab East Jerusalem.

³⁶http://www.humanitarianinfo.org/opt/docs/UN/OCHA/Assessment%20of%20the%20future%20humanitarian%20risks_oPt_En.pdf

³⁷<http://www.humanitarianinfo.org/opt/docs/UN/OCHA/Movement%20and%20Access%20Report%20No%2012.pdf>

³⁸ *ibid.*

Israel's withholding of Palestinian revenue is a significant cause of the PA's budgetary problems and economic hardships in the OPT. Without a resumption of these transfers, nothing will restore fiscal predictability and stability.³⁹

Socio-Economic Impact of the Political Crisis and Conflict on the Palestinians in the Occupied Territory

Gross Domestic Product (GDP) is expected to have declined sharply during the first six months of 2006 due to deteriorating security and political situation and to the block of revenues and aid by the Israeli government. GDP was estimated to have increased by 2 percent in 2004 and is estimated to have increased another 4.9 percent in 2005⁴⁰. The unemployment rate in the OPT is currently 25.3 percent. The unemployment rate reached 21 percent in the West Bank, 34 percent in the Gaza Strip, and 40 percent for those between the ages of 15 and 24.⁴¹ Figures indicate that underemployment is a serious challenge; share of full-time employed in the labour force amounting to 68% only in the first half of 2006.⁴²

Public finance was severely hit by blocking the main sources of revenues of the PA. Donors withheld funding to the Palestinian economy and Israel withheld the \$750 million in tax revenue it collects on behalf of the PA. The United States has frozen an estimated \$400 million, and the EU terminated its transfers amounting to approximately \$600 million annually. The Arab League, Iran, and Saudi Arabia have declared their willingness to commit funds, but banking restrictions by the end of the reporting period posed transfer problems⁴³. As a result, the Palestinian legislative council has fallen short from obtaining the \$165 million required to pay monthly expenditures. The PA runs 75 percent of the schools in the OPT, and the ministry of health provides 62 percent of primary health clinics and 57 percent of hospital beds. A full 60 percent of the PA's funding is for public employee salaries. Deficiency in the provision of education and health is highly predictable.

As of April 2006, 70 percent of households in the OPT were impoverished, with a rate of 66 percent in the West Bank and 79 percent in Gaza. The percentage of PA employee households in poverty has increased from 37 percent in July 2005 to 46 percent in April 2006.⁴⁴ Palestinian poverty indicators show a wide gap between income poverty and consumption poverty, reflecting the ability of food relief to alleviate only part of the

³⁹The Impending Palestinian Fiscal Crisis. World Bank. Found at: <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/PalestinianFiscalCrisis,PotentialRemediesMay7.pdf>. 7 May 2006.

⁴⁰ ESCWA, "Survey of Economic and Social Developments in the ESCWA Region 2005-2006," 5 April 2006.

⁴¹ Palestinian Central Bureau of Statistics.

⁴² Overview of Current Economic Conditions in Palestine, op. cit, p. 4

⁴³The Impending Palestinian Fiscal Crisis. World Bank. Found at: <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/PalestinianFiscalCrisis,PotentialRemediesMay7.pdf>. 7 May 2006.

⁴⁴ UN Humanitarian Monitor: occupied Palestinian territories, May 2006

consequences of income loss. It also indicates that there is an underlying dependency on aid for consumption. Palestinians have permanently lost a source of income upon which they were once vitally dependent. More than one third of the Palestinian GDP was typically earned in the Israeli labor market from the mid-1970s to the mid-1990s. Today, the portion of GDP earned in Israel remains below 10 percent. The incomes and living standards of one third of the population are directly threatened by the blocking of public revenues for PA government employees, who make up 28 percent of all domestic Palestinian workers. In Gaza, approximately 40 percent of employed persons work for the PA half of whom are security forces employees. Loss of income have resulted from the decline in Palestinian exports to Israel with the continued building of a wall separating the West Bank from Israel, travel regulations against Palestinians, and new restrictive banking policies.

The Palestinian economy lives under serious threats to its growth potential. The existing constraints have aggravated its structural weaknesses and vulnerability to external shocks. The wall, the checkpoints, the mobility restrictions and the system of internal and external closures form serious impediment to mobility of goods and services and of human, physical and financial resources. Besides, the cost of destroyed physical infrastructure is estimated around US\$3.5 billion, amounting approximately to 30% of pre-2000 capital stock. The reduction in productive capacity has been intensely exacerbated by the loss of agricultural land resulting from the erection of the separation barrier.⁴⁵

Conclusion: Future Trends and Options

The political and socio-economic situation in the OPT remains worrisome. Israel's punitive policies and domestic Palestinian conflict have stretched weak institutions to the breaking point. Warnings of an impending civil strife between different Palestinian factions have not materialized in the reporting period, but internal Palestinian politics remains deeply divisive. A solution to this protracted conflict awaits a much-needed reengagement from the international community.

4. *The political situation in Lebanon and its socio-economic impact*

Over a year has passed since the Syrian Arab Republic withdrew its troops from Lebanon on 26 April 2005, and most of the optimism born on that day has dissipated as a result of political tensions between Lebanon's ruling elite.

The national dialogue among the political leaders representing the main sectarian communities was successful to a certain degree in containing political tensions. It has nevertheless failed to resolve all outstanding issues. Moreover, relations between the Syrian Arab Republic and Lebanon remain tense.

⁴⁵ The Palestinian War-torn Economy: Aid , Development and State Formation, UNCTAD, Geneva 2006, pp.6-8

The current impasse is expected to last unless dramatic developments take place concerning the International Independent Investigating Commission (IIIC), the Middle East conflict, Iran's nuclear ambitions, Syria's internal as well as external political dynamics.

Political tensions

During this reporting period Lebanon witnessed intense domestic political conflict overlapping with external intervention that aims to draw Lebanon out of the Syrian-Iranian sphere of influence.

Bombings and assassinations declined markedly during the first half of 2006, compared to the previous period. Sectarian tensions, however, increased. This was reflected in a number of incidents, though most ominously on 5 February 2006, when a Muslim demonstration against the publication of the cartoons offensive to Prophet Mohammad turned into a violent riot. The demonstration which took place in a majority Christian populated area raised fears about the return to civil conflict.

Most crucial in this reporting period is the political understanding between Maronite and Shia leaders Michel Aoun and Hasan Nasrallah on 6 February 2006. The understanding broke the political isolation of Hizbullah, impeded the take-over of state institutions by the 14 March coalition, and created an alternative cross-sectarian alliance between two political heavyweights. Some commentators hailed the event a Syrian political victory. Political tensions between the 14 March coalition and their opponents poured into the streets on several occasions. The former, led by Walid Jumbulatt, Saad al-Hariri and Samir Geagea, held a mass rally in commemoration of the death of former Prime Minister Rafik Hariri (14 February). The rally re-emphasized their demands concerning the removal of president Emile Lahoud as well as the disarmament of Hizbullah and Palestinian militias.

External actors were also concerned with Lebanese matters. The main actors remain the United States, France, the EU, Saudi Arabia, Egypt, Iran, and Syrian Arab Republic. On one occasion Saudi Arabia and Egypt tried to broker an understanding between Lebanon and Syrian Arab Republic, labeled the Saudi initiative. The initiative rested on the following pillars: Syrian Arab Republic's unconditional cooperation with the IIIC and cessation of interference in Lebanese affairs. In return, Saudi Arabia and Egypt undertook to oppose any regime change in the Syrian Arab Republic as well as agreed to a Syrian request to cease media campaign against Syria through Saudi controlled outlets. The Saudi initiative faced fierce opposition from the Christian and Druze leaderships allied to the 14 March movement. They feared that Syrian Arab Republic might use the agreement to legitimize as well as reclaim its influence in Lebanese affairs. The initiative was also vague regarding the future role of Hizbullah.

Earlier, political tensions reached breaking point in December 2005 when five ministers representing the Shia community boycotted government meetings. The ministers were protesting what they considered to be the unconstitutional manner in which major cabinet decisions were being taken – ie., by voting rather than by consensus. Shia Ministers returned

to government in February following an understanding with Prime Minister Fouad Siniora that consecrated consociation as the main mechanism for decision taking in cabinet. The boycott ended when Mr. Siniora accepted the principle of consociation and addressed Hizbullah as “national resistance fighters” rather than “militias”, implicitly exempting them from the call in UN Security Council Resolution 1559 to “disband militias”.⁴⁶ Significantly, there was also an understanding to undertake consultations prior to cabinet meetings on major national issues, in particular those related to the “resistance”.

Nevertheless, the situation remained tense between Hizbullah and the 14 March cabinet majority. Hizbullah representatives complained that their input and the interests of the Shia community were not being considered in Cabinet policies and government appointments. The latter reflected the interests of the 14 March alliance. This threatened to diminish Shia political influence in the country. The political battle over domestic and foreign policy making in Lebanon continues.

National Dialogue

On 2 March, 14 political leaders met in the first session of the National Dialogue, which was initiated by Parliament Speaker Nabih Berri. The agenda items of the dialogue were the investigation into the assassination of former Prime Minister Rafiq Hariri; the Palestinian issue in Lebanon; the relations between Lebanon and the Syrian Arab Republic; the status of the Shebaa farmlands; the fate of the presidency; and the military arsenal of Hizbullah.

During the nine sessions of the Dialogue that took place, participants agreed on the removal of weapons from Palestinian factions outside refugee camps within six months, the establishment of an international court for the trial of those suspected of involvement in the assassination of Mr. Hariri, and the establishment of full diplomatic ties with Syrian Arab Republic. Participants have also agreed that Syrian Arab Republic and Lebanon should each exercise control over its borders and that the Government of Lebanon should take the necessary measures towards that end. Finally, the dialogue reiterated the “Lebanese identity” of Shebaa Farms, which Syrian Arab Republic has agreed to in principle.

Positively, the National Dialogue is the first such dialogue in Lebanon without a third-party presence. Yet the agreements reached lack detail and direction for implementation. Moreover, agreements related to Syrian Arab Republic require the latter’s cooperation. Damascus has yet to receive Prime Minister Siniora to discuss bilateral diplomatic relations and demarcation of borders. Nor did participants at the National Dialogue agree on the future of the Lebanese Presidency.

UNIIC Investigation

The United Nations International Independent Investigation Commission (UNIIC) investigating the terrorist assassination of former Lebanese Prime Minister Rafiq Hariri and 22 others in downtown Beirut on 14 February 2005 continued its work in Lebanon. UN Special Investigator Serge Brammertz released a third report 15 March and a fourth

⁴⁶ Crisis Watch No 31. 1 March 2006.

on 10 June. The Security Council agreed to extend the Commission for another year and to widen its scope to include 14 other assassinations that the Commission believes are linked to the Hariri assassination. The Security Council passed in March Resolution 1664 that approves a tribunal of an international character to try eventual suspects in the assassination.

In Follow-up to Resolution 1559

Terje Roed-Larsen, UN Special Representative for the Implementation of Security Council Resolution 1559, released his third semi-annual report on 18 April. In resolution 1559, the Security Council called for the withdrawal of all remaining foreign forces from Lebanon; the disbanding and disarmament of all Lebanese and non-Lebanese militias; the extension of the control of the Government of Lebanon over all Lebanese territory; and strict respect of the sovereignty, territorial integrity, unity, and political independence of Lebanon under the sole and exclusive authority of the Government of Lebanon throughout Lebanon.

Roed-Larsen praised the efforts of the national dialogue, particularly Hizbullah's participation, but noted that its agreements have not yet been translated into practice. Roed-Larsen emphasized the need for a formal border agreement between Syrian Arab Republic and Lebanon, particularly given continued uncertainty in the Deir al-Ashayr area. Roed-Larsen reported that, in contradiction to the Taif Agreement and SC resolutions 425 (1978), 426 (1978), and 1559, Hizbullah has retained control of the Blue Line and its vicinity; he called for the "timely implementation of tangible measures towards the disarming and disbanding of Lebanese and non-Lebanese militias and towards the delineation of the border between the Syrian Arab Republic and Lebanon [as] an important step towards the extension of the Government's control over all its territory."⁴⁷

UN Security Council Resolution 1680 (17 May) amplified and added to the previous demands of Resolution 1559. Resolution 1680 calls on Syrian Arab Republic to take measures against movements of arms into Lebanon, "strongly encourages" it to respond positively to Lebanese requests to delineate their common border [especially in the contested Shebba area] and establish full diplomatic relations, and calls for the disbandment of militias inside Lebanon.⁴⁸ The Syrian foreign ministry denounced Resolution 1680 as "unwarranted pressure and a provocation which complicates matters rather than resolving them."⁴⁹

Syrian Arab Republic

Throughout the reporting period, the Syrian Arab Republic remained intransigent on issues that are domestically divisive in Lebanon: Lebanese Presidency, Shebaa Farms,

⁴⁷ Roed-Larsen, Terje. *Report on UNSG Resolution 1559*. 19 April 2006.

⁴⁸ "Security Council calls on Syria to take steps against arms movements into Lebanon", UN News Centre. Found at <http://www.un.org/apps/news/story.asp?NewsID=18514&Cr=middle&Cr1=leban>. 17 May 2006.

⁴⁹ Agence France-Presse, May 18, 2006.

demarcation of the Lebanese border (with Syria as well as Israel) and disarming Lebanese militias. Noteworthy in this regard were the statements of Syrian Foreign Minister Walid Muallem at the Arab Summit in Khartoum (28-29 March 2006), in which he called for a new Lebanese election law based on large electoral districts and proportional representation. In his view, early elections based on such a law would remove tensions from the Lebanese political scene.

Israel

The blue line along the Lebanese-Israeli border remains tense with sporadic confrontations between the Israeli army and Hizbullah fighters. Hizbullah and the Israeli Army exchanged fire under different pretexts. On one occasion, 28 May, unidentified rockets were fired into Israel in response to the killing of an Islamic Jihad group leader and his brother in Sidon. Israel responded with air strikes, targeting the Popular Front for the Liberation of Palestine camps in Lebanon.⁵⁰

Although Islamic Jihad accused Israel of assassinating its members, it denied responsibility for carrying out the rocket attack. The Israeli army responded with air strikes against positions belonging to the Syrian backed Palestinian Front for the Liberation of Palestine-General Command in the Bekaa Valley and on the outskirts of Beirut. In turn, these developments intensified the domestic debate on Hizbullah's weapons arsenal.

Socio-economic indicators

The economy was able to gasp in the first six months of 2006 and to show signs of recovery since the turbulent events of 2005 did not escalate in the first half of 2006. The introduction of the National Dialogue and absence of assassination raised positive expectations that political tensions would remain under check. The economy has also passed a difficult financial test restoring domestic and external confidence about its viability. GCC countries witnessed a surge in oil revenues with oil prices going above US\$ 60 per barrel. The domestic developments along with the oil boom in the GCC countries have restored GDP growth in the country and revived plans for public reforms.

GDP is expected to grow by 6 percent in 2006⁵¹ representing a rebound in growth from near zero level in 2005. Economic activity gained momentum in many sectors. Construction permits in squared meters have grown by 82 percent in the first 4 months of 2006 compared with the same period in 2005.⁵² The total area of permits given in May and June 2006 exceeded the averages of 2004 and 2005. The construction sector was experiencing a rebound after stagnating for the past 4 years. This is also shown by the volume of cement deliveries, which continued to grow in 2006. Cement deliveries increased by 30.49 and 23.6 percent in May and June 2006 respectively compared with the same months in 2005.⁵³ Part of this growth was also attributed to higher regional

⁵⁰ Crisis Watch No 34. 1 June 2006.

⁵¹ Banque Audi, "Lebanon Economic Report," 3rd quarter 2006.

⁵² Banque Du Liban, "Monthly Bulletin," June 2006.

⁵³ Ibid.

demand for cement, particularly from Iraq and the Syrian Arab Republic.⁵⁴ Tourism has similarly benefited from a relatively quiet period. The number of passengers increased by 20.8 percent in June 2006 compared with June 2005.⁵⁵ This rate is similar to that of June 2004 indicating a promising tourists' season for the first time after year 2004. The imports of industrial equipments grew by 6.1 percent in the first six months signaling increased industrial activity⁵⁶.

Domestic and external private demands were also stimulated by a relatively stable atmosphere. The number and size of investment projects improved during the first half of 2006. Foreign investments, mainly by GCC nationals, increased. Some of the notable projects included residential and office buildings by the Dubai Investment House worth US\$ 600 and a residential project by UAE's DAMAC worth US\$ 120.⁵⁷ Solidere recorded US\$ 1.1 billion in real estate sales in the first quarter of 2006.⁵⁸ The external demand for Lebanese products expanded by 49 percent between January and June 2006 compared with the same period in 2005. A hike in exports occurred in May and June and was attributed to a notable 4 times growth in the exports of jewelry to Switzerland. Demand for imports went up by 17.2 percent after a slump in 2005.⁵⁹

The Government introduced in March 2006 a 5-year public finance plan that aims to reduce budget deficit and mitigate public debt. According to the Ministry of Finance, public debt reached US\$38.6 billion at the end of April 2006.⁶⁰ Public debt is the equivalent of more than 180 percent of GDP or \$10,000 per capita. Mounting public debt is still one of the most urgent challenges faced by the economy. GDP growth during the past 15 years was below what was needed to finance the debt. The Government Plan proposed raising the value added tax (VAT) from its 10 percent level to 15 percent within the 5 years period. It also proposed privatizing telecom enterprises and selling public shares in Middle East Airlines (MEA). The plan was faced by economic and social concerns about an increase in the income gap that would result from levying more taxes to finance public debt. VAT as a regressive tax would put more burden over the poor. Labor representatives demanded for the minimum wage level of US\$ 200 to be increased and for more jobs to be created. The unemployment rate in Lebanon stood at 8 percent in 2004.⁶¹ However, the Government also faced renewed calls from the international community to reduce public deficit and debt by introducing long-term real, monetary as well as fiscal reforms.

In November 2002 at the Paris II donor conference, Lebanon agreed to a number of hitherto unimplemented reforms as conditions for debt rescheduling. These reforms

⁵⁴ The Daily Star, "Lebanese Cement Makers Profit from Regional Boom-but for How Long?" 7 April, 2006.

⁵⁵ Banque Du Liban, "Monthly Bulletin," June 2006.

⁵⁶ Ibid.

⁵⁷ Banque Audi, "The Lebanon Weekly Monitor," various issues.

⁵⁸ Financial Times, "Lebanese Property Boom Boosts Confidence," 10 April 2006.

⁵⁹ Banque Du Liban, "Monthly Bulletin," June 2006.

⁶⁰ Bank Audi. *The Lebanon Weekly Monitor*. 19 June 2006

⁶¹ The Republic of Lebanon, Ministry of Social Affairs and United Nations Development Programme (UNDP), "The National Survey of Households Living Conditions 2004," 2006.

include fiscal adjustment, restructuring and privatizing public enterprises, promoting investment, cutting red tape and enhancing accountability, transparency, and predictability.⁶² Donors and the World Bank have called for an internal debate to put together a reform road map. The conference, which the government hoped would help raise up to US\$5bn in finance from donors, was delayed because of internal political bickering. In April, Lebanon's Association Agreement with the EU was activated, which includes a commitment to implement political and economic reforms.⁶³

Because of the unstable political environment, economic growth slowed sharply in 2005, with a decline in investment, service exports, and private consumption. The government has failed for two years running to adopt a national budget punctually. It took the government until April 2006 to produce an economic reform plan. Analysts who have seen the proposal have described it as “lacking specific prescriptions for controlling spending”, and lacking reforms such as bolstering the independence of regulatory agencies, enforcing merit-based hiring and promotion in the civil service, cutting red tape suffocating investors, and putting in place a transparent framework for privatization.⁶⁴

On Transparency International's perceptions of corruption index, Lebanon is ranked 97 of 159.⁶⁵ Reducing corruption would reduce government spending and improve service quality, particularly in the state-run electricity company and the National Social Security Fund. The government has pledged to do so by hiring international auditing firms, a solution that has proven ineffective in the past.⁶⁶

Conclusion: Future Trends and Options

Outstanding issues during this reporting period – such as the debate around the Lebanese Presidency and Hizbullah's arms – have yet to be resolved. In both cases, a domestic solution has to overlap with a regional understanding among key international as well as regional powers. In the meantime, local political groups continue to advance their narrow sectarian interests, at a time when warnings by local stakeholders of eminent social and economic collapse are increasing. The contest over state institutions and Lebanon's foreign policy orientation is expected to continue into the next reporting period.

III. Other Regional Challenges

During the reporting period, the region witnessed a notable increase in religious extremism and ethno-sectarian tensions.

In Bahrain, sectarian tensions remain high, particularly following the December 2005 detention of Shia Sheik Khalid Hamed Mansour Sanad upon his arrival from Iran.

⁶² International Crisis Group. *Lebanon: Managing the Gathering Storm*. 5 December 2005.

⁶³ <http://www.merip.org/mero/mero052306.html>

⁶⁴ <http://www.merip.org/mero/mero052306.html>

⁶⁵ Transparency International, “Global Corruption Report 2005”, London 2005, pp. 233-241.

⁶⁶ Notably, international auditors screened the Council for Development and Reconstruction. A 1999 World Bank study of customs collecting practices and a 1996 review of road building contracts, did unearth corruption, but did not prompt any measures to curb it.

Hundreds of protestors were arrested. Since December, demonstrators have held weekly protests to demand the release of the arrested, and confrontations with Shia youth have occurred throughout the country. Following the 22 February attack on the Shia Al Askari Shrine in Iraq, more than 100,000 Shia protested in Bahrain.⁶⁷

Sectarian violence continued in Egypt during the reporting period. Violent disputes between Copts and Muslims occurred on 19 January south of Cairo, leaving one person dead. In February, one person was killed in sectarian rioting in Luxor and eight were injured in a Christian-Muslim clash in Al-Ayat village. Sectarian attacks on three churches in Alexandria left at least two dead and sparked three days of protests by Coptic Christians and violent clashes 14-16 April.⁶⁸ Christians and secularists argue that the government is not doing enough to protect Christians and religious freedom.⁶⁹

Government leaders in Saudi Arabia are concerned that sectarian violence in Iraq could spread to engulf the whole region, especially in the so-called 'Shia Crescent'. Many in Saudi Arabia fear the radicalization of the Kingdom's Shia community.

Also noteworthy in this regard was Zarqawi's statements regarding Hizbullah on 1 June 2006. He accused the Shia party to be in collusion with Israel, and that its main function was to prevent Sunni militants from launching attacks against Israel from Lebanon. These declarations were interpreted as yet another attempt by Zarqawi to ignite sectarian tensions in the region.

⁶⁷ Fattah, Hassan. Ripples from Iraq disturb Bahrain. *The New York Times*. 15 April 2006.

⁶⁸ Crisis Watch, No 30, 33. 1 February, 1 May 2006.

⁶⁹ EGYPT: Sectarian tensions felt in the south. UN Office for the Coordination of Humanitarian Affairs. http://www.irinnews.org/report.asp?ReportID=51295&SelectRegion=Middle_East&SelectCountry=EGYT