

Aid, Diplomacy and Facts  
on the Ground  
The Case of Palestine

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#### 4 CHEQUEBOOK DIPLOMACY: THE US, THE OSLO PROCESS AND THE ROLE OF FOREIGN AID

*Scott Lasensky*

In the light of Israel's 'disengagement' plan and the transition of the Palestinian leadership, optimism has grown that a new Israeli-Palestinian peace process can be initiated after years of escalating violence and confrontation. The United States and other third parties are searching for new ways to intervene and assist the two sides in returning to the negotiating table. As part of this new push for peace, the US is injecting additional economic assistance into Palestine, already one of the world's highest per capita recipients of international aid.<sup>1</sup> But what is the track record of aid? How has it influenced peacemaking? This chapter assesses the role of American foreign aid as an instrument of statecraft during the Oslo period. If US and international assistance is to be used as a more effective tool for peacemaking, then donors need to heed the lessons of the past.

The evidence from this period reveals that aid is a limited tool. By itself, it cannot serve as a substitute for basic political will, nor can it be used to paper over fundamental sources of contention in negotiations. Chequebook diplomacy does not work. Moreover, aid is not a crisis prevention tool. Its value is more prospective than immediate.

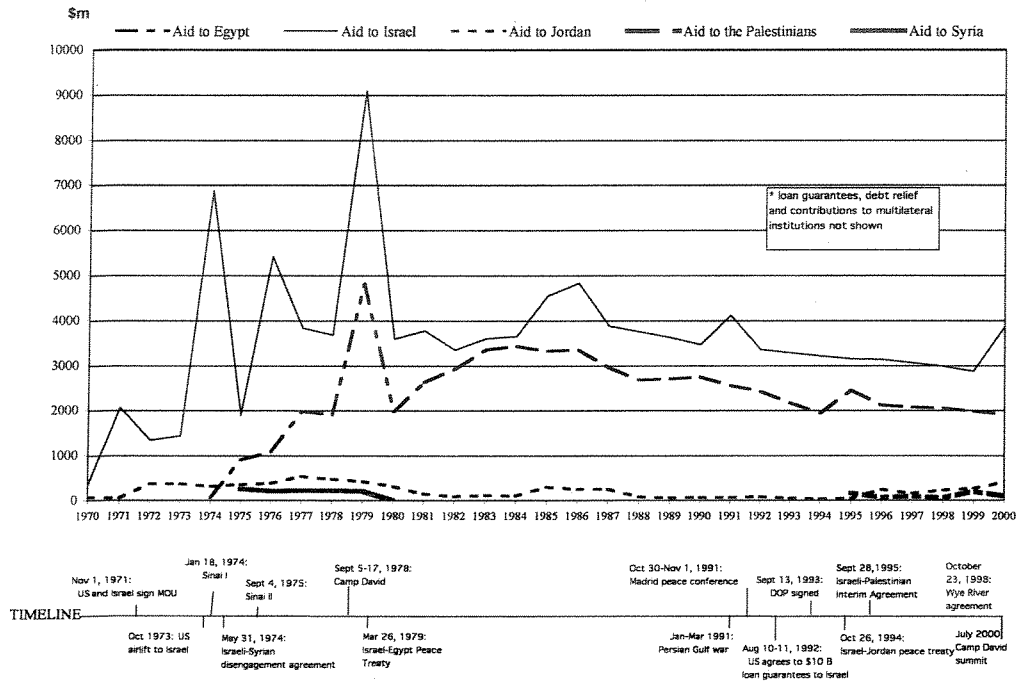
One of the central purposes of Oslo-era aid – to deliver a peace dividend to Palestinians and generate public support for a step-by-step process – went unfulfilled. A deteriorating Palestinian economy turned aid into life support, rather than an instrument for growth, development and peace-building. At times, aid also had a corrosive impact. Donor policies were complicit in some of the negative trends that ultimately overwhelmed the process. The poor performance of

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<sup>1</sup> Measured either as a proportion of the economy or as a percentage of the public budget. See also Steven Weisman, 'Donors consider large increase in aid to Palestinians', *New York Times*, 17 December 2004; and George W. Bush, 'State of the Union', 2 February 2005, [www.WhiteHouse.gov](http://www.WhiteHouse.gov).

Figure 4.1: The Middle East peace process and US aid, 1970–2000



Note: Constant 1996 dollars; loans and grants; actual disbursements.\*  
 Source: Congressional Research Service © Scott Lasensky, 2005.

Palestinian public institutions and Israeli settlement expansion are just two examples. Although far from being the decisive factor, aid could have played a more effective role in insulating the process from the extremist and obstructionist forces that eventually pulled it apart.

Despite its limitations, aid should not be dismissed as unimportant. During the Oslo process, it was used to underwrite the practical costs of peacemaking. It was instrumental in setting up the Palestinian Authority, the mutually agreed institutional mechanism for operationalizing Palestinian self-rule. Aid also had 'expressive' value and provided political cover for leaders who took risks for peace. Moreover, it provided momentum at critical diplomatic junctures.

This mixed record stands in stark contrast to the wider Arab–Israeli realm, where US foreign aid has been more successful – particularly in facilitating the implementation of agreements. Aid has been most effective when bundled together with political and security guarantees, as has been the case with America's involvement in Israeli–Egyptian and Israeli–Jordanian peace. Figure 4.1 illustrates the pattern of US aid to Israel and its neighbours from 1970 to 2000.

#### US AID AFTER THE COLD WAR

At the end of the 1991 Gulf war, the United States turned its attention back to Arab–Israeli peacemaking. Just as President George H.W. Bush was seeking to convene an international conference on Arab–Israeli peace, Israel announced that it would soon ask Washington for a five-year, \$10 billion loan guarantee to help absorb immigrants from the USSR, eastern Europe and Ethiopia. Israel expected that the loan guarantee would be approved. 'It was a humanitarian issue, one that the United States had supported for many years,' according to the then Prime Minister Yitzhak Shamir.<sup>2</sup> But the request quickly sparked a showdown between the Shamir government, aided by the American Israel Public Affairs Committee (AIPAC) and Israel advocacy groups, and the Bush administration.

Shamir's West Bank settlement policy created a crisis of confidence for Palestinians and many Arab governments, who saw the issue as a test of American credibility.<sup>3</sup> 'We promised [Arab states] that after the war we would address the Israel issue,' says Brent Scowcroft; 'we wanted it on its own merits, but also because of our commitment to the Arabs.'<sup>4</sup> President Bush won Congressional backing to delay consideration of the aid request until after the peace conference.

<sup>2</sup> Yitzhak Shamir, former Israeli Prime Minister, interview by author, Tel Aviv, 16 June 1999.

<sup>3</sup> It also created a crisis of confidence within the Bush White House, where officials were angered by Shamir's lack of cooperation months earlier when a \$400 million loan guarantee was granted. See Dennis Ross, *The Missing Peace: The Inside Story of the Fight for Middle East Peace* (New York: Farrar, Straus and Giroux, 2004), pp. 82–3.

<sup>4</sup> Brent Scowcroft, former National Security Adviser, interview by author, 22 December 2004, Washington, DC.

With the new aid request on hold, Israel and its Arab neighbours attended the US-sponsored Madrid Peace conference in late October 1991, which was followed by a flurry of bilateral and multilateral talks.

The Madrid process was the most ambitious American effort to promote Arab-Israeli negotiations since the time of the Carter administration. By February 1992, the aid issue was again front and centre. Testifying before Congress, Secretary of State James Baker laid out a number of conditions for Israel to receive the loan guarantees, including a freeze on building Jewish settlements in the West Bank and Gaza Strip.<sup>5</sup>

In Israel, Shamir faced a growing wave of public criticism over the aid row and the chill it caused in relations with the United States. After losing to Yitzhak Rabin and the Labour party, many in Shamir's camp blamed Likud's loss on the loan guarantees 'fiasco'.<sup>6</sup>

Once Rabin came to office, the Bush administration quickly cut a deal that, ironically, fell far short of a full settlement freeze. 'The difference in this case was the difference between Shamir and Rabin', says Scowcroft. 'Rabin demonstrated to us that he was determined to reach a settlement, that's why we were prepared to look the other way.'<sup>7</sup> Since the Bush-Shamir dispute, Washington has avoided using explicit aid conditionality when confronting Israel on settlements.

#### OSLO AND FOREIGN AID

The Bush White House based the loan guarantees decision on the conclusion that Rabin was serious about the peace process. It was an assessment shared by the incoming Clinton team. In Bill Clinton's first meeting with the Israeli leader, in March 1993, he pledged to Rabin that if Israel took risks for peace, Washington 'would act to minimize those risks'.<sup>8</sup> The formulation may have been new, but the formula was not, having been introduced by Nixon and Kissinger in the 1970s.

During the initial Oslo talks, Israeli and Palestinian negotiators acknowledged early on that large-scale international aid would be required in order to implement an agreement. Both sides saw the massive US aid programmes to Israel and Egypt as a precedent.<sup>9</sup> 'The aid itself didn't radically change how the

<sup>5</sup> Yossi Melman and Dan Raviv, *Friends in Deed* (New York: Hyperion, 1994), p. 441. See also James Baker, *The Politics of Diplomacy* (New York: Putnam, 1995), Chapter 29.

<sup>6</sup> Moshe Arens, *Broken Covenant* (New York: Simon and Schuster, 1995), pp. 281, 298.

<sup>7</sup> Scowcroft interview.

<sup>8</sup> Ross, *The Missing Peace*, p. 257. See also Martin Indyk, former senior Clinton Administration official, interview with author, Washington, DC, 9 April 2004. Clinton would repeat the pledge on numerous occasions. See, for example, Bill Clinton, *My Life* (New York: Alfred A. Knopf, 2004), p. 626.

<sup>9</sup> Shimon Peres, former Israeli prime minister, interview with author, Tel Aviv, 27 June 1999; and Nabil Shaath, senior Palestinian negotiator, interview by author, Davos, Switzerland, 31 January 1999.

Palestinians negotiated', says Peres, 'but we both knew it would be crucial to the implementation of the agreement.'<sup>10</sup>

In Peres's view, Israeli-Palestinian economic cooperation would be critical to building common interests and laying the groundwork for reconciliation. Moreover, economic growth in the Palestinian territories would be essential for cementing Palestinian public support.<sup>11</sup> On 28 August, Peres travelled to California to brief Secretary of State Warren Christopher on the Oslo track and to discuss the need for economic support.<sup>12</sup> Washington quickly threw its support behind the breakthrough agreement. The principal task for the US, writes the former President Bill Clinton, 'lay in the future, in ... raising the money to finance the costs of the agreement'.<sup>13</sup> First and foremost, US assistance would be orientated towards implementing the Oslo agreement and keeping the process moving.

Just before the 13 September signing ceremony for the Declaration of Principles (DoP), Clinton met with Arafat and the Palestinian delegation and 'spoke in very clear terms about America's commitment to provide economic support'.<sup>14</sup> 'The Palestinians expected several dividends of peace', says senior Palestinian negotiator Nabil Shaath, 'including freedom, security and economic prosperity ... [the aid component] was critical to this process.'<sup>15</sup> Even though the United States was left out of the initial Oslo track, the parties moved quickly to bring Washington into the process. Unlike in previous agreements, Israel did not seek economic assistance for itself, choosing instead to help to raise funds for the soon-to-be-established Palestinian Authority. It did ask the US for permission to divert some of its annual aid to cover West Bank and Gaza military redeployments, but these were relatively small amounts.

The DoP agreement was mainly about political and security arrangements. But it also contained economic provisions. Annex III, which covered bilateral economic cooperation, called for joint efforts in the fields of water, energy, finance, transport, communications, trade and industry, although in vague terms. It also called for promoting international investment and forming a 'Palestinian Development Bank'. Annex IV covered regional cooperation and implicitly called for a major international aid effort to help the Palestinians,

<sup>10</sup> Peres interview.

<sup>11</sup> See Shimon Peres, *The New Middle East* (New York: H. Holt, 1993), and Uri Savit, *The Process: 1100 Days that Changed the Middle East* (New York: Random House, 1998), p. 56.

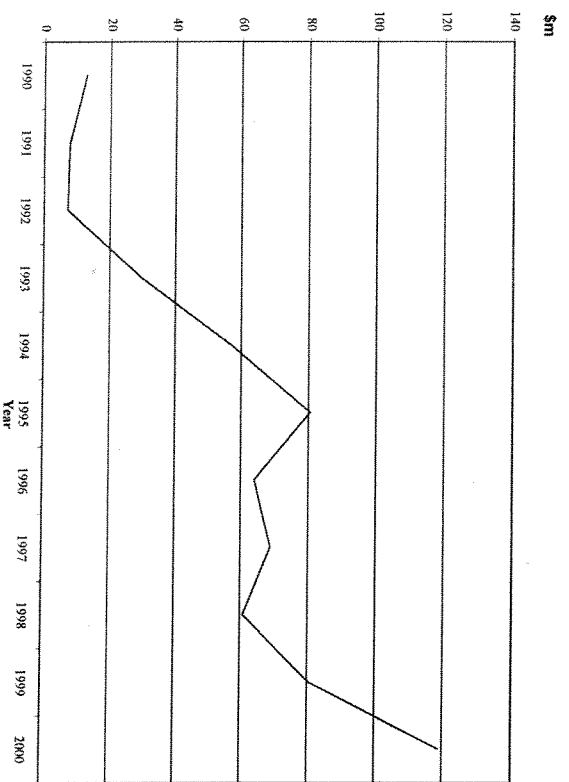
<sup>12</sup> Warren Christopher, *In the Strain of History* (Stanford, CA: Stanford University Press, 1998), p. 80. Ross reports that during the meeting at Point Magu, California, Norwegian Foreign Minister Holst and Peres told Christopher that international aid would be needed so that 'Palestinians could feel the benefits of peace'. See Ross, *The Missing Peace*, p. 115.

<sup>13</sup> Clinton, *My Life*, p. 541.

<sup>14</sup> Mahmoud Abbas, *Through Secret Channels* (Reading, UK: Garnet Publishing, 1995), p. 213.

<sup>15</sup> Shaath interview.

Figure 4.2: US development assistance to West Bank &amp; Gaza, FY 1990–2000



Note: These figures cover funds from USAID and do not include US contributions to UNRWA.

Source: Clyde Mark, *Palestinians and Middle East Peace Issues for the United States* (Washington, DC: CRS, 16 March 2005).

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Jordan, Israel and the entire region. Furthermore, the document called on the G-7 to initiate a 'Development Program for the region, including the West Bank and the Gaza Strip'. These provisions were worked out directly by Israel and the PLO. The US and other outside parties were only brought in after the event.

Two weeks after the DoP was signed, the Clinton administration organized an international donors conference for the Palestinians. According to Christopher, the meeting was intended to mobilize 'the resources needed to make the agreement work'.<sup>16</sup> More than two billion dollars was pledged over five years, mainly by the United States, the European Union, Japan, Norway and Saudi Arabia.<sup>17</sup> These figures went well above the aid levels the West Bank and Gaza absorbed before Oslo. Although the United States, pledging \$500 million, was the largest single donor country, the combined pledges of European states represented the largest portion of the total aid effort.<sup>18</sup> The goal, says Toni

<sup>16</sup> Christopher, *In the Stream of History*, p. 84.

<sup>17</sup> See Rex Brynen, *A Very Political Economy* (Washington, DC: US Institute of Peace, 2000).

<sup>18</sup> In addition to Oslo-related aid, American contributions to Palestinian refugees, via UNRWA, averaged about \$75 million annually during the Oslo years.

Verstandig, a former State Department official was to 'build a peace constituency'.<sup>19</sup> Norway took a leading role in organizing the aid consortium, which came to be known as the Ad Hoc Liaison Committee (AHLIC).

The Clinton team did not have an easy time getting Congress to fund the Palestinian aid pledges. A variety of reporting and certification requirements were imposed, mostly through the Middle East Peace Facilitation Act, the legislation that authorized post-*Oslo* direct US assistance to the Palestinians.<sup>20</sup> Despite the hurdles imposed by Congress, many of which originated with anti-*Oslo*, obstructionist forces in the Israel advocacy community, the administration still obtained the aid levels it sought (see Figure 4.2).<sup>21</sup>

A combination of development, political and practical considerations led the US and the international community to focus the aid agenda on the Palestinians. The West Bank and Gaza, like other post-conflict settings, had major development needs. It was mainly left to the World Bank to identify these. Aid was also used for political purposes, to reward the Palestinian leadership and help Arafat maintain popular support for the process. Moreover, there were practical considerations. The institutions of Palestinian self-rule needed to be set up. At the same time, Israel was dismantling its 'civil administration' in the territories, which was indirectly funded by Palestinian tax assessments and resource exploitation.

As for inducements for Israel, the Clinton pledge, first articulated to Rabin in the March 1993 meeting, initially translated into a successful diplomatic campaign to normalize the Jewish state's relations with much of the world. But in terms of increased economic and military assistance, the Clinton pledge would remain largely in reserve until a final peace agreement with the Palestinians (or Syria) was on the table. Nevertheless, the pledge was meant to reassure Israeli leaders and bolster their confidence for the tough concessions that lay ahead. It was also a real promise – on which Clinton would deliver later in his second term. The Clinton pledge also harked back to the generous aid packages employed by the US in the 1970s, thus demonstrating continuity in Washington's approach.

In the subsequent talks that produced the Gaza-Jericho Agreement (May 1994), the Early Empowerment Agreement (August 1994), the Interim Agreement (September 1995) and the Hebron Accord (January 1997), economic aid

<sup>19</sup> Toni Verstandig, former Deputy Assistant Secretary of State, interview by author, Washington, DC, 2 November 1998. Of the initial \$500 million US pledge, \$375 million was disbursed from 1994 to 1998. An allotment of \$125 million in investment credits went largely untapped.

<sup>20</sup> American contributions to UNRWA continued throughout this period, at high levels, but this chapter treats these as separate from the assistance that was tied to the Oslo process.

<sup>21</sup> For background on the lobby effort against Oslo and US aid to the Palestinians, see Sidney Blumenthal, 'The Western Front', *The New Yorker*, 5 June 1995, pp. 36–42.

for the Palestinians was not a critical element of the negotiating 'moments' or 'decision points'. In fact, except for the Hebron agreement, the other accords were largely negotiated by Israelis and Palestinians, without the US playing a central role.<sup>22</sup> Even though aid did not have a prominent place at the negotiating table, it remained an essential part of the process. The US-led donor effort was an ever-present concern for the new Palestinian Authority. Arafat was constantly striving for larger and condition-free disbursements.

Donors preferred to fund long-term development projects, rather than cover recurrent expenses such as public-sector salaries. This led to an early crisis over budgetary support for the fledgling Palestinian administration. As a compromise, the World Bank established the 'Holst Fund' to cover recurrent expenses for a limited time. 'It was not intended', says former senior Clinton official Martin Indyk, 'as walking around money. ... But within a few months, we became very concerned about the Holst fund and instead began to fund projects directly.'<sup>23</sup> But all the while, Israel was encouraging the United States and other donors to disburse more to Arafat so that patronage could be used as a way to control the situation in the Palestinian territories and generate a wider base of support for Oslo.

From the outset, there was a built-in tension between political (patronage) and development (sustainable growth) imperatives – between what the negotiators viewed as immediate challenges (Arafat building public support in the territories) and the long-term objective of establishing efficient and accountable public institutions. The effectiveness of aid was complicated even further by the growing humanitarian needs that unexpectedly arose with Oslo.

Corruption and financial mismanagement were an open secret, but the imperatives of the peace process and of continuing to move towards permanent status negotiations overshadowed these negative aspects of aid. 'Arafat ... had great difficulty acceding to the donors' demands for transparency and accountability – concepts that were alien to him,' writes Uri Savir, a former Israeli negotiator.<sup>24</sup> 'My money', says Indyk, 'is how Arafat typically referred to international assistance.'<sup>25</sup> In addition to his desire for patronage, Arafat's demands for quicker disbursement were fuelled by the deteriorating economic situation

<sup>22</sup> During talks on the Interim Agreement (also known as 'Oslo II', signed in September 1995), the Clinton administration did use the Congressional certification/waiver requirement in order to pressure the Palestinians to conduct the negotiations. Ross encouraged Palestinians to conclude an agreement before 1 October, when the new fiscal year would begin, hinting that an agreement would improve prospects for continued aid. 'Was I manipulating the waiver issue to try to create a deadline?', writes Ross. 'Yes, but I would never have been able to do so if there hadn't been a genuine problem on the Hill.' Ross, *The Missing Peace*, p. 216.

<sup>23</sup> Indyk interview.

<sup>24</sup> Savir, *The Process*, p. 146.

<sup>25</sup> Indyk interview.

in the territories. This was largely due to severe Israeli closures. At least from the American perspective, it was an understandable policy response to Palestinian suicide bombings against Israeli civilians, which began in mid-1994.

However, the closures had a dramatic effect on the Palestinian economy and undercut the ability of donors to build Palestinian support for the peace process. Palestinian per capita gross national product (GNP) fell every year from 1993 to 1997. The number of Palestinians working in Israel, a major source of income, declined by 60 to 80 per cent in this period.<sup>26</sup> With every downturn in the economy, there was increased pressure on donors to fill in the gaps. Senior US officials, feeling the pressure from their Palestinian counterparts, directed USAID staff to divert some assistance to quick action and high-visibility projects, such as employment programmes. But aid was not well suited to crises and quick fixes, as would become clearer later in the process.

Throughout these years, a growing disconnection emerged between senior US officials who managed the negotiations and those involved in disbursing aid on the ground. Senior American officials, like their predecessors in Arab-Israeli peacemaking, focused most of their attention on day-to-day management of the peace talks. When aid was on the agenda, it was usually in terms of how to use aid pledges to move the negotiations forward, rather than how to assess the impact of aid on the ground and whether results correlated with the full range of US objectives.<sup>27</sup>

Initially, aid disbursement seemed inversely correlated with the dramatic speed at which the negotiations were moving. Disbursement was seriously hampered by 'intra-PLO politics, the Palestinian leadership's resistance to donors' standards of accountability, and inexperienced [Palestinian] middle management', according to one US official.<sup>28</sup> In addition, the multilateral nature of the donor effort slowed the process. But by the end of 1994, disbursement began to pick up, with 66 per cent of donor pledges (\$523 million of \$789 million) going to projects on the ground. Implementation improved slowly in 1995–7, with disbursement levels reaching 70–75 per cent of commitments.<sup>29</sup>

The vast majority of US assistance – which was heavily scrutinized by Congress throughout this period – went to infrastructure and development projects, such as water works, housing, roads and education. As noted above, there were

<sup>26</sup> Brynen, *A Very Political Economy*, pp. 21 and 67. The Palestinian economy did pick up in 1999, but nosedived again following the outbreak of the second intifada.

<sup>27</sup> In his memoirs, *The Missing Peace*, Dennis Ross rarely mentions the issue of foreign aid or economic statecraft.

<sup>28</sup> Joan Spero, Under-Secretary of State for Economic Affairs, speech at Columbia University, 3 April 1995.

<sup>29</sup> Rex Brynen, Hisham Awartani and Clare Woodcraft, 'Donor Assistance in Palestine', draft, Montreal, April 1998, p. 49, and MOPIC 2000 report. See also Brynen, *A Very Political Economy* Chapter 5.

times when funds were diverted to short-term projects, such as job creation programmes. Other donors followed suit. But unlike the US, most were more willing to contribute also to budget support and the growing PA payroll.

Despite all the political delays, corruption and organizational problems, the aid effort was unfolding on a grand scale, going well beyond other post-conflict multilateral efforts. In 1997 alone, per capita aid to the Palestinians was \$203, equivalent to roughly 15 per cent of GNP, an extraordinary figure.<sup>30</sup> Measured against the size of their economy, Palestinians were quickly becoming the highest per capita recipients of international development assistance in the world.

At the beginning of the Oslo process, aid was not expected to be the only instrument for Palestinian economic revival. Private-sector investment was expected to pour into the territories.<sup>31</sup> Initially, a good deal of interest was expressed, particularly in tourism. However, it was not long before the investment climate turned sour, the security environment deteriorated and private-sector interest evaporated.

Besides direct aid and investment, the United States and other donors tried to implement a regional economic programme, as called for in the DoP. In October 1994, a major regional business conference was held in Casablanca, the first of four annual meetings. The post-Madrid multilateral talks were renewed and the Regional Economic Development Working Group (REDWG) was revived. The United States was involved in a number of other economic initiatives, including efforts to create a Middle East development bank and a regional tourism board. Although much publicized, these regional initiatives did not get very far. By mid-1997, the multilateral track had come to a halt. Arab states refused to participate, in protest against Prime Minister Binjamin Netanyahu's policies.

In addition to its aid to the Palestinians, the United States occasionally offered inducements to Israel. In early 1996, following a spate of suicide bombings that put the re-election of Shimon Peres in doubt, Clinton promised Israel an additional \$100 million in anti-terrorism assistance.<sup>32</sup> This use of aid was as much for expressive purposes as it was addressing a need. Against the backdrop of three billion dollars in annual US assistance, \$100 million was a modest sum. Israel was also allowed to divert some existing assistance to cover costs associated with its West Bank redeployments.

<sup>30</sup> See Patrick Clawson and Zoe Danon Gedal, *Dollars and Diplomacy: The Impact of US Economic Initiatives on the Arab-Israeli Peace Process* (Washington, DC: Washington Institute for Near East Peace, Policy Paper No. 49, 1999), p. 23.

<sup>31</sup> The Clinton administration also backed a number of public-private initiatives, such as 'Builders for Peace', chaired by James Zogby and Mel Levine. But these efforts also stalled.

<sup>32</sup> Clinton, *My Life*, p. 702.

#### THE WYE AGREEMENT

The Wye River Memorandum of 23 October 1998 marked a clear transformation of the US role in the Oslo process. Previously, the United States had served as facilitator and mediator, using political support, security guarantees and economic aid (both positive and negative) to help implement peace agreements and create an atmosphere conducive to further negotiations. However, at Wye it assumed the role of referee and arbitrator. With its new role came a greater reliance on foreign aid. For the first time since Madrid, the United States used aid to sign, seal and implement a peace deal.

From the beginning of Netanyahu's tenure as Prime Minister, there was tension with the White House, particularly over the settlements issue. But unlike his predecessor, Clinton would not link disagreements about settlements to US aid. During the Oslo period, Israeli settlements doubled in size. But in some respects the dispute about settlements paled in comparison with an even larger problem facing the Clinton administration: the process was on the verge of collapse.

In early 1998, the US put forward a bridging proposal that called for an Israeli pull-back from 13 per cent of the West Bank (as part of the continued implementation of the Oslo agreements). In May, Netanyahu asked for \$1.2 billion in new aid to cover the costs of a further redeployment, even though Israel had not fully accepted the plan. The Israeli aid request initially went nowhere. But it would be revived in the autumn, when peace talks were resumed at Wye.

To gain final Israeli acceptance of the 13 per cent formula, and Palestinian agreement to additional Israeli security and political demands, the United States relied on new promises to both sides. Its political assurances centred on a commitment to monitor and verify each side's compliance with the accords, including Palestinian security measures against terrorism. Also, Clinton said that he would visit the region in order to oversee implementation of the accord – a promise he would fulfil a few weeks later.

For the Palestinians, Clinton promised at Wye to increase economic aid. Hard the heels of the agreement, Clinton reconvened the donor countries to formulate a second five-year aid programme. Planning for the donors' conference had been on hold for months awaiting progress on the political track. Even though the United States was not delivering the lion's share of the aid, Washington remained the dominant force within the donor process. At the post-Wye donors meeting, over \$2 billion was pledged to the PA for 1999–2003. The US commitment rose 80 per cent to \$900 million over five years. There were even financial rewards for Jordan, in recognition of King Hussein's last-minute mediation at Wye. The new US pledges were noteworthy given the sour mood in Congress concerning foreign aid programmes.<sup>33</sup>

<sup>33</sup> At the time, US aid to Israel and Egypt was being restructured and reduced.



After Clinton's December 1998 visit, with Netanyahu freezing Israel's implementation of the Wye terms, the administration asked Congress to hold up Israel's supplemental aid package. In contrast, the White House said Palestinian aid should be expedited because the PA was fulfilling its obligations. But politics soon intruded. The entire process was put on hold as Israel went into an election cycle. By summer 1999, Netanyahu was out of office and his Labour party successor, Ehud Barak, was preparing to accelerate the peace talks.

In the autumn, the administration lobbied hard for Congress to sign the Wye supplemental request. With optimism running high, the White House hoped that the aid package would send a positive and encouraging signal. It was one of the clearest attempts to use aid for political purposes. After a brief, fiercely partisan confrontation over the FY 2000 foreign aid bill, which led to a temporary delay of the Wye request, Congress approved the aid package in its entirety in mid-November.<sup>34</sup> The new tranche of US aid was approved at the same time as the Palestinian economy was rebounding, following several years of steep decline.

#### BARAK'S PEACE OFFENSIVE

Soon after Barak took office, the new Israeli leader met with President Clinton at Camp David in July 1999. He told Clinton of his plans to fly high and fast on the peace process, to which Clinton responded approvingly. Barak also told him that massive new aid packages would be needed to cement peace treaties with Syria and the Palestinians. The amounts Barak mentioned raised eyebrows among US officials but nonetheless received a positive response from the President.<sup>35</sup> The peace process, from the White House's perspective, was now back on track.

The United States, encouraged by Barak, turned its attention first to the Israeli–Syrian talks. In late 1999 and early 2000, Clinton tried to broker a deal, first at the Shepherdstown summit and later in bilateral meetings with Barak and the Syrian President Hafez Assad. Although the story of these failed negotiations is not the focus of this chapter, US–Israel discussions at the time would later influence the Palestinian track.

During the Israeli–Syrian talks, Barak reportedly asked Clinton for a mutual defence treaty, a pledge to station US peacekeepers on the Golan Heights and billions of dollars in economic and military aid.<sup>36</sup> Barak's strategy resembled

<sup>34</sup> *Jerusalem Post*, 3 December 1999. The package consisted of \$1.2 billion in foreign military financing (FMF) for Israel, \$400 million in economic support funds (ESF) for the Palestinians and \$300 million in FMF and ESF for Jordan.

<sup>35</sup> Ross, *The Missing Peace*, p. 500, and Indyk interview.

<sup>36</sup> See 'Clinton breaks impasse at the Israel–Syria talks', *New York Times*, 5 January 2000. During the course of the January talks, there was intense speculation about the size of a future

earlier attempts by Yitzhak Rabin (1974–5) and Menachem Begin (1978–9) whereby Israel would accept inducements and security goods from the US in lieu of what it could not obtain from its Arab neighbour.

However, the Israeli–Syrian negotiations soon stalled. Barak quickly turned his attention to the Palestinian track and pushed the White House to hold a summit at which a permanent status agreement could be worked out. In mid-July 2000, Clinton brought Barak and Arafat to Camp David. For the first time, Israel and the Palestinians held serious, far-reaching discussions about final status issues, including Jerusalem and refugees. Clinton, eager to close a deal, pledged an enormous US and international aid package in an effort to cement an agreement.

Bits and pieces of Clinton's pledges at Camp David have filtered out through media reports and participant accounts. One of the most detailed descriptions comes from Bruce Riedel, Clinton's National Security Council assistant for the Middle East. According to Riedel, Israel's requests from the failed Syrian track, including a mutual defence treaty, were resurrected at Camp David. 'Equally important to the proposed ... US-Israeli defence partnership, Barak also asked for an enormous new US financial package to help buttress the chances an Israeli–Palestinian peace agreement would endure.'<sup>37</sup>

At one point, Clinton promised \$35 billion, some of which would come from other donors. Of this \$10 billion would go to compensate Palestinian refugees, another \$10 billion would go towards Israeli–Palestinian–Jordanian water desalination projects and \$15 billion would go to Israel – for upgrading the IDF, for West Bank/Gaza redeployment costs and for resettling Jewish settlers.<sup>38</sup> '[T]here was also a fair degree of sticker shock at the size of the package,' writes Riedel, 'some aides wondered whether the Congress would balk at a request of this magnitude.'<sup>39</sup>

But Arafat, according to another American participant, showed little interest in discussing future aid packages. This official said, in retrospect, that the United States was dangling carrots to compensate for fundamental gaps in the talks.<sup>40</sup> 'Chairman Arafat made only one request from the President,' writes Riedel, '[that] American military personnel would form the core of a peacekeeping force to be deployed in the Jordan Valley to replace the IDF deployment there.'<sup>41</sup>

<sup>37</sup> US aid package. Estimates ranged from \$17 billion to as high as \$70 billion. See Zeev Schiff, 'Full asking price for peace aid: \$65 billion', *Haaretz*, 7 January 2000.

<sup>38</sup> Bruce Riedel, 'Camp David – The US-Israeli Bargain', *Birkbecknews.org*, 15 July 2002.

<sup>39</sup> *Idem*. Riedel says the US team knew the aid figure for refugees was low but considered it to be an opening bid.

<sup>40</sup> *Idem*.

<sup>41</sup> Robert Malloy, former special assistant to President Clinton, telephone interview by author, 12 March 2004.

<sup>42</sup> Riedel interview.

At the side talks between technical experts held in Emmitsburg, Maryland, the same US strategy was unfolding. According to one Palestinian negotiator, when discussions in the water committee become acrimonious, a US official intervened, went up to a blackboard in the room, and proceeded to draw a large dollar sign. 'The only formula you need to worry about is this,' said State Department official Toni Verstandig, 'just tell us how much.'<sup>42</sup>

But the talks were deadlocked, and US aid pledges seemed to have no effect. An Israeli-Palestinian permanent status accord could not be bought. Clinton's unprecedented offers of American aid were important to Barak. There is strong evidence that these promises had a positive impact on Barak's calculations about the negotiations. But US pledges and assurances were insufficient to persuade Arafat to accept the peace deal discussed at Camp David. As Barak's political fortunes sank after Camp David, he still wanted to cash in on the American aid pledges in order to bolster his position at home. But without the momentum of an agreement, the White House demurred, as did Congress.<sup>43</sup>

#### OSLO AND FOREIGN AID: LESSONS LEARNED

During the Oslo years, just as in the Nixon-Kissinger period, foreign aid worked best when combined with other inducements. But when aid appeared more like a transaction, as with the Palestinians at Camp David, it was ineffective. Nor was it an effective tool for defusing crises or serving as a substitute for basic political will. In what was expected to be a drawn-out, step-by-step process, foreign aid was intended to maintain momentum and build a peace constituency among Palestinians. But the process did not unfold as policy-makers expected. As the Palestinian economy contracted, Palestinian expectations were shattered. Rather than driving economic growth and building constituencies for peace, aid became life support. As the international community grapples with the post-Arafat era and Israeli 'disengagement', donors should have more modest expectations of the transformative effects of aid.

Nevertheless, during the Oslo years aid did serve several important, if modest purposes. Without international economic assistance, the parties themselves would not have been able to cover the practical costs of Oslo. Moreover, despite the poor environment on the ground, donors were able to complete some critical infrastructure projects. In addition, Arafat used donor money to provide jobs and public services and thereby establish a base of public support. During and after Wye, both Arafat and Netanyahu relied on aid to sell the agreement to their own sceptical political camps.

<sup>42</sup> Omar Dajani, former aide to Palestinian minister Maher Masri, telephone interview by author, 12 May 2005.

<sup>43</sup> Malley interview.

#### Patrons and influence

During the Oslo years, the United States increasingly monopolized mediation while relying on multilateral efforts to underwrite the process. The arrangement was not unique to the Arab-Israeli realm; it was also being used with Bosnia (post-Dayton) and North Korea (the Agreed Framework). Moreover, consortium aid efforts in post-conflict settings have become a hallmark of the post-Cold War era, from El Salvador and Cambodia to Afghanistan and East Timor.<sup>44</sup> However, the American strategy of relying on other donors to cover most of the aid bill – even as Washington monopolized the political track – had negative consequences.

There was competition within the process, with Palestinians able to exploit differences between the donors. Moreover, by keeping other outside actors largely out of the negotiations, the US was unable to draw on their potential influence with Palestinians. The Camp David summit, where Arab and European parties were absent, is the clearest example of this missed opportunity. President Clinton, following a model set by his predecessors, promised Israel an extensive set of political, economic and security inducements in exchange for taking 'risks for peace'. But there was no similar patron to induce Palestinians to do the same.

Moreover, in the aftermath of Oslo's collapse, Washington's insistence on PA reform and leadership change was hampered by its inability to dictate how other donors, especially European and Arab states, spent their aid dollars. For example, from mid-2002, the Bush administration refused to deal with Arafat, hoping to marginalize him, but all the while other donors were increasing their budgetary support for the PA, thus throwing Arafat a lifeline. To be fair, coordination among donors has been much more intense (some would say unprecedented) than in other post-conflict settings. But the collective influence of the patrons could have been leveraged more effectively.

For its part, Israel premised its willingness to sign a final status agreement on a security exchange with the US, much like the security exchanges in the 1970s on the Israel-Egyptian track. In lieu of security goods it needed but could not receive from its adversary, alternatives (based on foreign aid and other inducements) were offered by the Americans. Barak was promised almost anything he said Israel needed, but Palestinians were not offered a similar deal – either by the United States or by a third party.

#### Did the US attach enough strings?

What about the role of conditionality and donors' twin goals of economic growth and good governance? Before the collapse of Oslo, some outside observers argued that the PA should receive more direct aid and that donors should be more

<sup>44</sup> See Shepherd Forman and Patrick Stewart (eds), *Good Intentions: Pledges of Aid for Post-Conflict Recovery* (Boulder, CO: Lynne Rienner, 2000).

generous in funding recurrent costs.<sup>45</sup> But aid levels were already very high. It seems unlikely that less conditionality and more direct aid to the PA would have turned around an already difficult situation. After the outbreak of the second intifada, with increasing evidence of widespread PA corruption and support for violence, these earlier recommendations seem misplaced.

Donor insistence on transparency and accountability had a positive but extremely limited effect on PA administrative practices and good governance. In response to the many reports of misuse, the PA occasionally cracked down or enacted cosmetic reforms. Also, donors put in place strict monitoring mechanisms, some of which were far more invasive than in similar settings. But fundamental change did not occur.

Why? This was partly because money is fungible.<sup>46</sup> It was also partly due to the multilateral nature of the aid process and the difficulty of getting all the donors to speak with one voice. But the failure was also due to the unwillingness, at the political level, to strongly confront Arafat and the PA leadership.<sup>47</sup> At the height of the process, US policy-makers, and their counterparts among other large donors, were hesitant to take strong actions on aid so as not to jeopardize prospects for achieving the ultimate goal – a final status agreement. This goal took precedence over day-to-day failures in security cooperation or governance.

After the collapse of Oslo, donors remained largely unwilling to cut off aid (especially budgetary support), to avert a total collapse of the PA and/or a humanitarian crisis in the territories. In retrospect, it seems that aid was as much a hostage of the Israeli–Palestinian conflict as an instrument for resolving it.

<sup>45</sup> See Clawson and Gedal, *Dollars and Diplomacy*, p. 32, and Nicole Ball et al. in David Cortright (ed.), *The Price of Peace: Incentives and International Conflict Prevention* (Lanham, MD: Rowman and Littlefield, 1997), pp. 254–9.

<sup>46</sup> The PA had many sources of non-donor aid, including tax revenue, commercial enterprises and secret PLO accounts.

<sup>47</sup> Many reports of PA corruption, mismanagement and complicity in terrorism have been published, including material released by the Israeli army (available at [www.idf.tl](http://www.idf.tl)) claiming that Arafat directly approved funds for terrorist operations. Of the numerous governmental, NGO and media reports on the PA's poor governance record, see Palestinian Authority Public Monitoring Department, 'First Annual Report 1996', May 1997, Ramallah; 'Strengthening Palestinian Public Institutions', Independent Task Force on Strengthening Palestinian Public Institutions, Council on Foreign Relations, 1999; 'Aid Effectiveness in the West Bank and Gaza', The Secretariat of the Ad Hoc Liaison Committee, 7–8 June 2000, Lisbon; Report of the European Parliament Working Group on Budgetary Assistance to the Palestinian Authority, Brussels, 2004; and the report of OIAF, the European Commission's anti-fraud office, Brussels, March 2004.

#### RECOMMENDATIONS

Should Israeli–Palestinian negotiations resume, aid could play an important and positive role. At a minimum, it would be critical for implementing a permanent status arrangement: if the two sides can reach one. But even without a resumption of serious negotiations, donors could use economic assistance proactively in order to minimize the fallout of an extended Israeli–Palestinian stalemate. It could also be used to point the parties towards a settlement. For example, should the US and the international community articulate clear, specific parameters for final status, these could be accompanied by serious aid pledges designed to mobilize the moderates. To give added weight to such pledges, a small portion of current aid could be placed in a trust fund to be tapped only if a settlement is reached.

At the same time, aid could continue to be used to promote good governance – essential for the long-term viability of a Palestinian state. In this regard, the record of the immediate post-Oslo period is promising. Granted, some advocates of Palestinian institution-building have used the cause as an excuse to avoid moving towards a viable two-state settlement. Nevertheless, despite conditions that were far from conducive for reform, outside actors, together with Palestinian reformers, have made greater strides post-Oslo than during the 1990s. The appointment of Salam Fayyad as minister of finance and the extensive reforms to PA accounting and investment practices are just two examples.

Aid could also be used to address the refugee problem. If the kind of donor arrangement proposed by President Clinton at Camp David in July 2000 could be organized and funded, even in advance of a final settlement, it would be the first time Palestinian refugees are offered a real choice about the future, instead of facing an environment that only reinforces grievance. It could also have a positive impact on Palestinian public discourse.

From a practical standpoint, aid effectiveness could also be improved if there were a clearer picture of what Palestinians receive from outside actors. The US could release a periodic report that covers bilateral assistance, aid from international organizations, transfers from Arab countries, estimates of non-governmental donations, and estimates of PLO and Hamas account balances. Such a document would serve the cause of transparency and improve donor coordination, and could also help bring further pressure on governments to crack down on illicit funding.

Such a report does not need to come from the United States. It could also be compiled by the UN or the secretariat of the AHLIC. At a time when Palestinian aid dependence is increasing and plans are being made to further increase international assistance, it is surprising that no government or international agency produces such a publicly accessible comprehensive report. How can donors make smart decisions about the best use of aid, whether for diplomatic or

development purposes, without a full and complete understanding of what is flowing into the Palestinian areas?

With Israel, aid policies could do much more to limit or stop the expansion of Jewish settlements in the West Bank. Aid could also play a positive role in ensuring that unilateral Israeli actions are tied to a diplomatic horizon and a resumption of peace talks. The point here is not to sanction current aid to Israel, which is likely to be counterproductive, but to offer new, conditional promises of assistance – bundled together with political and security assurances. Here, the burden lies primarily with the United States, which (unlike Europe) can tap into a tremendous reservoir of influence that has been built up over three decades as the principal patron and international benefactor of the Jewish state.

Finally, US policy-makers need to focus more attention on aid delivery, especially long-term implications. For example, just because economic growth and recovery in Gaza are critical to stability after Israel withdraws, it does not mean international donors should rush to launch large-scale, high-profile projects such as rehabilitating the airport or completing the seaport, if such projects will only be held hostage to Israeli measures. Donors need more than just transparent and efficient Palestinian institutions; they also need to reach stronger understandings with Israel. It is fair to expect that international assistance, now at an all-time high, can do more than simply address short-term humanitarian needs while at the same time reinforcing the political impasse. Unlike other tracks in the peace process, aid delivery is far more influential in the Palestinian case. How foreign aid is delivered is as important as the timing of pledges and the high politics of economic statecraft.

Looking back at Oslo, there is a certain irony in the fact that so much of the infrastructure in the Palestinian territories that was built and paid for with US and international aid, often at Israel's behest, was later destroyed by Israel during the first two years of the second intifada. Before the police stations, government offices, roads and other infrastructure are rebuilt, most likely with large injections of international assistance, donors need to give more thought to protecting their investment. They also need to give more thought to whether the post-Oslo architecture of aid perpetuates or ameliorates the present impasse. Much evidence points to the former. As the above recommendations suggest, there are ways to improve the situation and use aid more proactively.

The US and the international community seem to be suffering less from 'donor fatigue', as many claim, and more from donor frustration. As Israel reoccupied most Palestinian territory, donors saw their contributions skyrocket (more than one billion dollars in 2002), even though prospects for peace plummeted. Only by learning the lessons of the past can policy-makers adjust their approach and ensure that economic statecraft ultimately contributes to a lasting resolution – and not a perpetuation – of this conflict.