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TRADE POLICY IN PALESTINE: A RE-ASSESSMENT

Marco Missaglia and Giovanni Valensisi *

The paper develops a CGE macro-model for Palestine, departing in three fundamental ways from the set-up applied in earlier studies. The present framework: (i) reformulates the modelling of fiscal policy in light of context-specific elements, including the absence of a government bond market and the incomplete transfer of revenues collected by Israel for the PNA; (ii) endogenizes private capital flows; (iii) postulates a demand-driven causality structure. Various policy scenarios are then assessed, with one crucial novelty: the overall effect of further trade liberalization turns out to be slightly contractionary, due to its fiscal implications.

JEL Classification: C68, F13, O24

Keywords: CGE models, trade policy, macroeconomics, Palestine

1. Introduction

Together with a series of econometric studies by UNCTAD, the analysis by Astrup and Dessus based on CGE modelling remains a key reference for trade policy simulation in Palestine, be it in its static or dynamic version (Astrup and Dessus 2001 and 2005 respectively).¹ After a decade since its development, though, the time is ripe for an update of that work – which is ultimately an application of the World Bank LINKAGE model (van der Mensbrugghe 2005) – as well as a re-assessment of its theoretical underpinnings. Taylor and Von Arnim (2006 and 2007), for instance, have argued that the support lent by “standard CGE models” to fiscal discipline and trade liberalization is to a large extent in-built, and derives ultimately by the closure rules and causality assumptions adopted by the modeller. Supposedly, macroeconomic considerations should inform the choice among alternative theoretical approaches that could be applied to a simulation exercise. In the case in point, however, some specificities of Palestine's conflict-torn economy, starting from the prevalence of widespread unemployment, are in contrast with the theoretical assumptions underlying “standard CGE models”.

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¹ In a nutshell, UNCTAD (2006, and 2009) apply Seemingly Unrelated Regression analysis to a multisectoral demand-led model à la Klein, using the information extrapolated from time series data to subsequently simulate changes in closure, macroeconomic, trade and labour policies. References concerning CGE models of the Palestinian economy include, among others, Missaglia and de Boer (2004) and Flaig et al. (2011); however, none of these simulations is focused on trade liberalization issues.

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