Implications of West Bank Economic Collapse

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The West Bank economy is in crisis. Since the Hamas attack on Israel on October 7, 2023, Israeli policies, compounded by Palestinian Authority (PA) governance and fiscal management weaknesses, have driven the economy into free fall. The measures are imposing severe hardship on the lives and livelihoods of Palestinians; risk destabilizing the West Bank; carry spillover implications for Israel and its neighbors; and threaten to derail the US administration's efforts to implement its 20-point plan for Gaza.

Israeli Finance Minister Bezalel Smotrich, now serving in a caretaker government after inconclusive elections, has openly tied these measures to punitive aims: withholding billions of dollars in clearance revenues owed to the PA, sustaining a cap on shekel repatriation, and withholding indemnity letters that Israeli correspondent banks need to keep facilitating Palestinian transactions.

This fiscal squeeze compounds the economic impact of a parallel set of movement and land-use restrictions, and of minimally checked and often-enabled settler terrorism that is killing and injuring Palestinians, destroying their property, and blocking or driving them from their agricultural land.

Why It Matters for the US

In addition to the humanitarian cost, the crisis matters to the US for reasons that include:

- **A collapsing West Bank economy undermines Palestinian capacity to contribute to Gaza's US-backed recovery.** Recovery and reconstruction of the devastated Gaza Strip requires a functioning Palestinian economy capable of absorbing investment and PA ministries capable of supporting the effort. A cash-strapped PA has accumulated arrears, is paying partial salaries for public employees, and has instituted a shortened school week. The private sector is suffering from disrupted supply chains and lack of market access. Left unaddressed, these conditions will perpetuate Palestinian aid dependency amid a massive shortfall in humanitarian and reconstruction resources.
- **An incapacitated PA undercuts stated US diplomatic goals.** President Donald Trump's 20-point plan for Gaza and the July 2026 implementation roadmap seek an end to Hamas influence in Gaza and nod toward Palestinian statehood. US allies key to the implementation of these plans are less equivocal about the need for Gaza's recovery and reconstruction to be geared toward a two-state end goal and tied to an indispensable role for a reforming PA. Current Israeli restrictions and ongoing PA dysfunction are further undermining the PA's popular legitimacy. Palestinian legislative elections set for November 2026 have been postponed until the fall of 2027. However, with Hamas having announced its intention to run as part of an alliance, an ineffective Fatah-led PA stands to lose ground to this alternative, an outcome that directly contradicts stated US goals.
- **West Bank instability directly harms Americans and threatens regional spillover.** At least six US citizens have been killed by Israeli settlers or soldiers since early 2024. More broadly, more than 1,000 Palestinians and at least 41 Israelis have been killed there since October 2023. A flare-up of violence in the West Bank will place additional strain on Israel's security services and will heighten the risk of Palestinians fleeing to neighboring countries. Jordan is especially vulnerable to a refugee influx that would burden its economy and security services and threaten the overall stability of a government that has long been a US strategic priority.

Policy Considerations

The West Bank economy depends largely on external forces, but PA economic governance weaknesses have left it vulnerable to Israeli measures. Accordingly, the US should call on Israel and the PA to take the following steps and commit to accountability measures. These recommendations are relevant for the current caretaker government in Israel and any future government. Waiting for a new coalition to form risks ceding a fragile period in which the caretaker government may seek to consolidate its policies.

Israel

- **Restore predictable clearance transfers and release arrears.** Monthly transfers and the release of accumulated arrears on a defined schedule should be a priority. Israel's 2018 law ties monthly deductions to what Israel assesses the PA pays to prisoners and "martyrs'" families, saying it encourages terror. Beyond this framework, deductions have been compounded by additional withholdings since October 7, 2023, and complete withholding since 2025. At a minimum, these new withholdings should end. The US should also pursue verification of reform on prisoner payments, as described below.

- **Raise the shekel repatriation cap and restore predictable banking access.** Raising the shekel repatriation cap will relieve the glut of shekels in Palestinian banks, unusable for vital cross-border transactions, and allow the government and private sector to effectively provide services. Issuing long-term indemnity guarantees will prevent Israeli banks from severing ties, and remove constant uncertainty from the system. Smotrich has granted only short-term extensions to these letters, frequently traded for broader government support for settlement expansion. **The most recent extension until the end of 2026 reinforces that American pressure can work**, but the ad hoc and short-term fixes have still caused the banks to waver on a commitment to providing correspondent services.
- **Lift movement and access restrictions.** Extending operating hours at the Israeli-controlled Allenby Crossing between the West Bank and Jordan would ease the bottleneck of aid and commercial traffic. Reducing the number of West Bank checkpoints, which have increased significantly since October 7, 2023, would make it easier for Palestinians to access jobs and conduct commerce. Reinstating the approximately 100,000 work permits to enter Israel that were revoked after October 7 would alleviate unemployment. Israeli military officials have long argued that work permits enhance Israeli security, and at least one Israeli statistical analysis suggests no correlation between permit holders and security threats to Israelis. Israel cannot be expected to ignore security threats, but in the context of an Israeli government official who has articulated a goal of "encourage[ing] the migration" of Palestinians, the implementation of restrictive measures should be weighed against a clear correspondence to a stated security need.
- **Enforce security and rule of law.** Israeli enforcement of its own laws against what US officials have described as settler terrorism and against construction of outposts would help prevent disruption to Palestinians' access to agricultural land and markets and ease the burden on Israel's security resources. Where Israeli enforcement falls short, the reimposition of US sanctions on perpetrators of terror would bolster existing efforts by allies.

The Palestinian Authority

- **Require and support PA economic reform, commit to verification, and strengthen ties.** Washington with European and regional partners should require and offer support for PA efforts to: increase financial transparency; improve domestic revenue and expenditure management; and institute reforms geared toward private-sector growth. These include published budgets; audited accounts; a plan to reduce the wage bill and arrears; steps to expand domestic revenue; and regulatory and legal reforms that support investment and job creation and build investor confidence. Washington should also commit to verifying the PA's stated reform of the prisoner payment system on which the Israeli deduction law and America's parallel Taylor Force Act limiting US support rely. The US downgraded its ties with the Palestinians during the first Trump administration, closing the Palestine Liberation Organization Mission in Washington and the Consulate General in Jerusalem, which had reported directly to Washington. Restoring these would provide the US with better oversight, insight, and leverage over the PA's contributing role in the West Bank's economic decline.

The US also has smaller instruments at its disposal. They are no substitute for the steps above but belong in a holistic response. Congress and the administration should consider:

- **Explicitly authorizing funds for the US-led Office of the Security Coordinator (OSC).** Direct authorization would put on a firmer footing an office with a strong record of training Palestinian Security Forces, monitoring violent extremism by settlers and Palestinians, and serving as a trusted interlocutor between the parties. Funding has so far come from broader security assistance lines. There is bipartisan precedent for directly funding OSC (formerly the US Security Coordinator or USSC): the Middle East Security Coordination Act (S.2956) of 2023, and, later that year, the USSC Emergency Supplemental Act (S.3238).
- **Reactivating and scaling existing authorized instruments intended for the Israeli-Palestinian arena.** Approximately $100 million is available for activation from the Middle East Regional Cooperation (MERC) Program and bipartisan authorizations such as the Middle East Partnership for Peace Act (MEPPA) that can be used for joint Arab-Israeli endeavors, including with private-sector partners, and in keeping with their mandates to foster economic growth and development through joint innovation projects. These are among the few open channels for supporting Palestinian private-sector capacity. Congress and the administration should direct a share of this funding to projects benefiting both the West Bank and Gaza.

For more information on the West Bank, please visit: **www.mei.edu**. To arrange briefings on this topic with MEI experts Lucy Kurtzer-Ellenbogen, Natan Sachs, or Yael Lempert, please contact Ezra Mannix: **emmanix@mei.edu**.