

# Post-Oslo State-Building Strategies and their Limitations

Mushtaq H. Khan<sup>1</sup>

## *Transcript of the Yusuf A. Sayigh Development Lecture 2010*

Given at MAS (The Palestine Economic Policy Research Institute), Ramallah, 1st December 2010

Thank you for your very kind introduction and thank you to MAS and its organizers for giving me the privilege to be at the opening session of your new building and to give the Yusuf Sayigh Memorial Lecture.

I have mixed emotions coming and giving this lecture here because I was here ten years ago when Ramallah was much less developed. I come here after a long a time and it is a booming city with many buildings and a lot of development. But I also come here from East Jerusalem where the situation looks completely different where every day the Israelis are capturing land, demolishing houses and intruding into Arab areas. In fact during the two days I was there, there were two house demolitions in progress. I am not even speaking of the chaos in Gaza which is almost a separate country from the rest of the Palestinian Authority. We need to understand this differentiated Palestinian experience. Some parts of Palestine (like Ramallah) seem to be booming but even here a number of people in my last three days have told me of the so called 'five star occupation' where a new elite is living comfortably in nice houses but there is persistent poverty. We also hear that the PA is delivering in Ramallah but the Palestinian people are more divided than ever before. So what is going on?

In my lecture I want to comment on these observations. As an outsider I can perhaps talk freely and I hope I will not upset anybody. I want to speak openly and critically of my impressions about what is going on. I also want to put my analysis in the context of international debates in economics as I am an economist and I look at Palestinian development in terms of international debates on governance, institutions, state building and liberation struggles. I want to put the Palestinian experience in that context.

I will talk about three things which appear to be quite distinct but are actually connected because they are all related to rights and governance. The three things are first, the strategy of neoliberal good governance that has been adopted by the Palestinian Authority as its major policy plank. Under this governance agenda there has apparently been some improvements in life, at least in Ramallah. The huge constructions and activities going on in Ramallah appear to be connected to the adoption of the good governance strategy. So what is good governance and is this answering the question of long term development? Secondly, and connected to this question, I want to ask how do we build developmental capacity in a developing country? And finally I will talk about an apparently distinct topic that is actually closely connected, which is how do Palestinians actually bargain with Israel to get the rights that they need to do anything connected with governance and economic development?

So there are three different issues: One is about bargaining for sovereignty. The other is the good governance agenda of the present government, in a context far short of sovereignty. And the third is a more hypothetical one about developmental issues that Palestine would face were it to achieve

---

<sup>1</sup> Professor of Economics, SOAS, University of London, [mk17@soas.ac.uk](mailto:mk17@soas.ac.uk), <http://mercury.soas.ac.uk/users/mk17>

sovereignty. This is my agenda today. Let me begin with some basic definitions which come from my discipline of institutional economics. I work with concepts that I want to briefly explain because I will be using them in my lecture. These are concepts about rights and state building and institutions and how they are connected.

When we talk about rights, what do we mean? Rights, for an economist, are *politically enforceable* claims over assets, incomes or treatment – when I say I have a human right I have a right to a certain kind of treatment that is politically enforceable. If there is no enforcement capacity for this right it means nothing. So if I say that I have the right to a house but nobody will enforce my claim, then this claim is just a claim and not a right. A right becomes a right when it becomes enforceable. This is very important. Any economy needs to have a lot of rights defined because human interaction in terms of either production or exchange requires well defined rights. People engaged in economic interaction need to know who owns a certain piece of land, what rights employers have and do not have over workers when they pay for labor or who has the right to print money and on what terms, and so on. So an economy needs to have a clearly defined set of rights or it can't operate at all. And these rights have to be politically enforceable rights, not just an abstract set of claims.

There is a lot of debate within economics about the rights you need to have to achieve development. There is a debate between neo-liberalism, which talks about one set of rights which you need to have, and the critiques of neo-liberalism, coming more heterodox economists, which say that you need a somewhat different set of rights. Heterodox economics essentially says that market failures are much more widespread and pervasive than neo-liberal economics admits, and economic development therefore requires institutions that can solve these market failures. So there is a debate within economics about what kinds of rights you need to have to achieve development. But all economists agree that without rights that are clearly defined you will not have development. So there is a debate about what types of rights are needed but there is no debate about whether you need rights to achieve development.

If you need to have rights, this is where the issue of sovereignty comes in. Rights are only meaningful if there is a political authority that can enforce these rights. This is extremely important in the case of the Palestinian people because, of course, this is missing. Who is going to enforce the rights that you need to have for any kind of economic transactions? In this context, the debate between neo-liberalism and critiques of neo-liberalism is of secondary importance. First we have to decide whether any rights can be enforced in this place and by whom, and what is the nature of the limited rights that can be enforced?

Sovereignty simply means that there is an agency called the state which has the capacity to enforce, change, protect and negotiate rights in a certain territory. A state needs to have a territory and it needs to have borders and those borders have to be clearly defined. Within those borders the state must have two things: It must have a monopoly over violence and it must have legitimacy. Now this is a basic definition about which all political scientists and economists agree. If you have a state with no legitimacy but with a lot of force, it can maybe enforce things for a while but it will eventually collapse. If a state has a lot of legitimacy but no capacity to enforce anything through a monopoly of violence, it will also collapse. You need both.

Now this is all very fine, but then you come to the problem, of course, that Palestinians don't have a state. So as we are talking about rights and good governance and liberalism or intervention, we are actually

talking about these things in a society which is also engaged in a liberation struggle to create a state. And the problem in Palestine seems to be that we have jumped the gun. Before we have constructed a sovereign state we are having a debate about what the state should be doing. We are engaged in debating what rights the state should enforce without having a state that can enforce anything.

So there is a second set of debates in economics and political science about liberation struggles. And the problem is that the process of conducting a liberation struggle is very different from operating a state. Now what is a liberation struggle? A liberation struggle is also about rights. When a colonized people say that they are engaged in a liberation struggle, they are also negotiating for rights. But this is a different set of negotiations. This is a negotiation where the rights that a colonial society is demanding are not being enforced by anybody yet. These are just claims: 'we demand to have political rights'. But as of now nobody is enforcing them, and that is why it is a liberation struggle.

When we are talking about a liberation struggle the negotiation taking place is, in **game theory** terms, a different kind of game because here the parties are in a conflict. And the conflict is that each party is trying to impose costs on the other party until one of the sides gives up. In a bargaining game (in a game theoretic sense) in which a subject population is fighting a colonial occupier, the subject population is trying to impose costs on the occupier until the occupier gives up. Equally, the occupier is trying to impose costs on the subject population to persuade them to give up their struggle. The outcome depends not only on who can impose the greater costs, but also on who can absorb the greater pain over time. When an occupier gives up it is essentially accepting that the costs *it faces* are not acceptable and concedes that the rights demanded by the subject population will be enforced by a state.

Now, in this 'bargaining', what is going on? Game theory, which I teach my undergraduates, gives us some very simple messages here. When you are bargaining in the context of a conflict, each side is trying to demonstrate that they have more 'holding power' in this conflict. 'I can inflict more pain and/or I can take more pain than you can so I will survive in this conflict longer than you can and therefore I will win'. So holding power, the power to engage in a conflict and take pain, is a very important part of the conflict. When we talk about bargaining power in a conflict we are technically referring to holding power. A common way of establishing holding power is to establish that there are some non-negotiable claims that you will not give up on. If your opponent believes that you believe there is something non-negotiable in your claim, and you will fight for that until the end, this significantly increases your holding power and therefore makes it more likely that you will win. Of course, the outcomes of conflicts are to some extent always indeterminate and you may lose. Indeed, if you knew who would win you would never fight. The point of having a fight is that you don't know who will win. That is why there are conflicts. This is common sense but it is also a well known result in game theory. The issue in an ongoing conflict is that both sides have to struggle very hard to build and establish their holding power.

Holding power is based on two sorts of things. It depends on the strategies of each side to the conflict and signaling (given that strategy of conflict) that our side has the capacity both to inflict pain and to absorb costs. Often in conflicts, the side that is weaker in physical or economic terms can win because even though they have limited capacity to inflict costs they have much greater capacity to absorb pain, and therefore to continue the conflict beyond the capacity of the other side to hold on. This is always the case in colonial struggles because the colonial people are always poorer and less well-armed compared to the

occupier, but still they typically have won in the end. The answer is that in every case, the winning side succeeded in establishing why they are very unlikely to give up their strategy of struggle. Even for rich countries, winning requires establishing that there are non-negotiable claims that will not be given up and establishing the organizational and military power to make this claim credible.

At the risk of simplifying, there are basically two sorts of strategies that we see in anti-colonial struggles. One is based on the capacity to inflict violence. If you can inflict violence on the other side, this is a form of pain and the outcome depends on the relative capacities of the two sides to inflict and absorb pain. Apart from the military capacity to inflict pain, it is also important to establish that there are non-negotiable issues for which our side can absorb any amount of pain if necessary. So there is an element of irrationality when people are engaged in violent conflicts, because each side is trying to establish non-negotiable ideological reasons that will credibly signal that they will not give up. This is 'irrationality' in a strictly economic sense in that the conflict is not based on a cost-benefit calculation. You actually have to signal that you are so irrational that you can take a lot of pain. So irrationality becomes very important in conflicts involving violence. This is also why in reality violent conflicts very rapidly become irrational. The people who win violent conflicts are ideological people who have a 'cause' that is non-negotiable. That is why in Vietnam communist ideology was very important or Islamic ideology in Algeria. Even for the powerful USA, when Bush was planning his wars in the Middle East, he had to signal that he was fighting a battle against 'evil' people, and you cannot talk or negotiate with such people. Now when you justify a conflict in moral or ideological terms you are basically making it irrational. And that's how you increase your chances of winning. Indeed, (provided you also have the capacity to fight) the more irrational the other side thinks you are, the faster they are likely to give in because there is no point inflicting pain on someone who will not give up. Therefore even a strategy based on violence has to build up both military and ideological holding power. A lot of liberation struggles have been won in that way. The Vietnamese, the Algerian, and other examples fit this strategy.

It is very unlikely that the Palestinians will win an all out conflict which is based on violence although there are many people within the Palestinian community who think they can. And we have a split in the Palestinian community on that basis. The other strategy of winning colonial conflicts is based on imposing economic and political costs on the occupier using legitimate mass mobilizations. This strategy also requires holding power, this time based on the ability to mobilize people and the ability to enthuse them to accept the large costs that will be inflicted on them during the conflict. This holding power also requires a series of non-negotiable claims over rights because otherwise it is very difficult to mobilize people to engage in costly conflicts. But these non-negotiable claims are even more effective if they have international legitimacy because then the costs inflicted on the colonial power is not just the economic costs of dealing with the mobilization but the potentially much greater political costs of gradually losing international legitimacy.

Thus, the alternative strategy is to impose costs on the other side based on mass mobilization around legitimate (and preferably non-negotiable) goals. It involves for instance organizing millions of people in different types of mass mobilizations around a non-negotiable set of legitimate rights. It involves coming out on the streets day after day, month after month, in different types of activities that could involve blocking roads, going on strikes or shutdowns, and otherwise demonstrating that an alternative leadership from the colonial one has the moral power and the legitimacy to command the activities of the population.

This also involves taking pain, but this is a different kind of pain, largely economic and organizational, but may also involve standing up to acts of violent reprisals by the colonial power. The more legitimate the demands, and the more that the colonized people follow laws, the more difficult it is for the occupier to kill people, but it is not impossible, as the history of other colonial struggles shows. So a legitimate struggle also has to have the organizational strength to manage its own anger and to keep the organization under central control. Even more important than disrupting the economy of the occupier is to impose political costs and to undermine the legitimacy of the occupier by demonstrating that the liberation leadership (and not the occupier) enjoys legitimacy and can organize and direct its own people. This is a strategy that was followed in many liberation struggles, for example in British India and other countries. So holding power can be established in different ways depending on the strategy of liberation. But without holding power, without the conflict that establishes who has holding power, and without winning that conflict, you will not actually win a liberation struggle.

One of the things that I find puzzling in the Palestinian case is that it is not clear what the holding power of the mainstream Palestinian movement is based on. It is not clear where the bargaining power of the mainstream leadership is coming from and therefore it is not clear why anyone expects the Palestinians to win. This is our third question which I will come back to once we decide what kinds of rights we want. How do we create a Palestinian state? This is the question about the liberation struggle. Let me begin with the other two questions first and I will return to this most important question in the end. Our first two questions are about rights. If we could enforce rights, what types of rights should we enforce? What types of rights and capabilities will sustain development in the oPt? Where do 'good governance' reforms fit in here, into the achievements of Palestinian developmental goals?

Firstly I think there is a trap that the Palestinian discourse has fallen into, a neo-liberal discourse of liberalism and rights which sounds very nice because they relate to real aspirations of people. However, it is wrong on two different counts as the appropriate dominant strategy for the post-Oslo period. It is based, I think, on wrong economic theory but more fundamentally it is not even implementable in Palestine, and the good results that we are observing are a result of some quite different things. It actually has nothing to do with the good governance reforms achieving an efficient economy but rather to do with small improvements in the efficiency of aid delivery achieved through good governance reforms. Let me explain this step by step using the diagram.

First, let us ask ourselves what is this neo-liberal theory of good governance? It is saying three things. It is saying that to have prosperity you need to have efficient markets. You need to have a market economy. At a general level, saying that markets are necessary is a statement nobody can have a problem with. Everyone believes in markets, even I believe in the importance of markets. Of course, the *kind* of market is critical. Who defines your rights in the market? Slaves can also be exchanged in a market. But when slaves are exchanged in a market it doesn't mean this is developmental. A developmental capitalist market economy is an economy where there is a state which defines the rules of the game for the people in that society in such a way that the market is beneficial for people in that society. But a market that is imposed in any way in any country is not necessarily good for that country. These details are typically not discussed by neo-liberal economists or addressed in the good governance theory.

The second point the good governance theory makes is that ‘the market’ does not work effectively in developing countries. The argument is that markets in developing countries are inefficient. They are inefficient because there are high transaction costs – this is a technical term from institutional economics. Transactions costs are the costs of contracting and enforcing contracts. So the argument is that if you can reduce the costs of contracting and enforcing contracts you will have more efficient markets and you will have development. It follows that good governance reforms are essentially about reducing these transaction costs to make markets more efficient. So the theory is that if you can make markets more efficient by reducing the contracting costs, people will buy and sell and trade more easily and there will be development. And so the theory looks like this in a simplified form: If you have low economic development or stagnation, the cause is high transaction cost markets, or inefficient markets. Why do countries have inefficient markets? The theory says the high transaction costs causing inefficiency are due to badly defined property rights. Property rights are not clear, are not properly defined or protected. In addition ‘bad interventions’ by the state create further uncertainties about property rights. For instance, sudden increases in taxation or the appropriation of assets by the state indirectly threaten property rights. And then the question is why do we have these badly defined property rights and why do some states engage in bad interventions? The answer from neoliberal theory is that these states are corrupt. There are rent-seekers within the state who benefit from creating disruptions in property rights and implementing ‘bad policies’ that create uncertainty. A few people can make a lot of money through these interventions. Then the final question is how do these people get away with being corrupt and making a lot of money through these interventions? The answer to that is that there is an absence of government accountability. If governments were accountable, a few people wouldn’t be able to steal from the many.

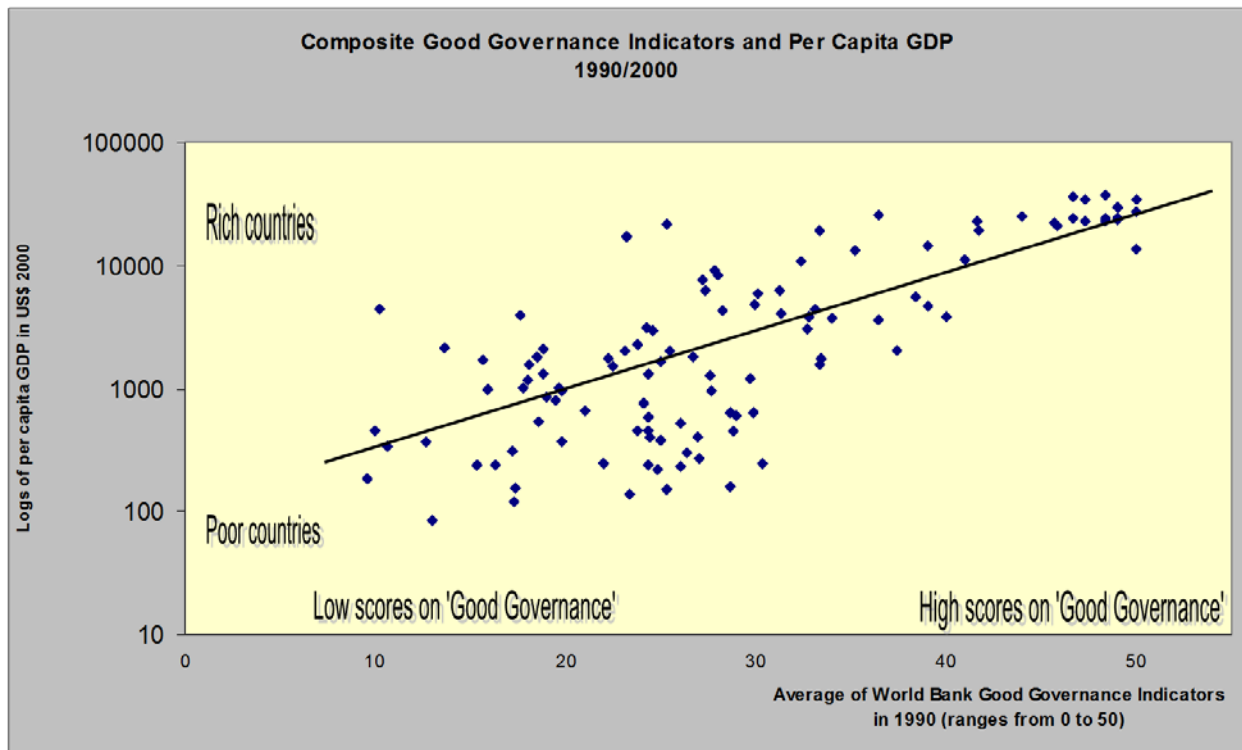
Thus, the good governance theory says that if you want to have an efficient economy, you need to have well defined property rights, you have to have low levels of corruption and you have to have accountability. Achieving these capabilities will make markets work more efficiently and then everything will be fine. And all this sounds very plausible, and from this very plausible economic theory comes a neo-liberal policy agenda that if you want to have economic prosperity you need to achieve not only liberalization, privatization and market promoting strategies, but on top of that you need to have the protection of property rights. You need to have the capacity to protect these property rights, you need to have anti-corruption strategies and you need to have accountability and democratization strategies. And some people in the donor community add that the best way to get accountability in a poor country is by having pro-poor service delivery. Once you start having governments delivering to the poor, because the poor are the majority, they will hold the government accountable. That will increase accountability and in turn increase the ability of people to make sure there is no corruption and to make sure that there are good services available. This is a theory. The theory sounds very plausible, so what is the debate about?

Firstly, there is a big question in a place like Palestine about the relevance of this model because you can do some things according to the model but not other things. In particular, the Palestinian Authority has very limited capacity to define and protect property rights. How can you protect property rights when you don’t have sovereignty? If a Palestinian cannot decide where to put a well or cannot decide where to make a house or cannot decide to go from one place to another place without getting permits, then the concept that Palestinians can define and protect their own property rights is simply not there. Even if you could do some part of it, like if you could reduce a little bit of corruption or you could get a bit more accountability you are not going to *even theoretically* get an efficient market economy. Contracting costs will continue

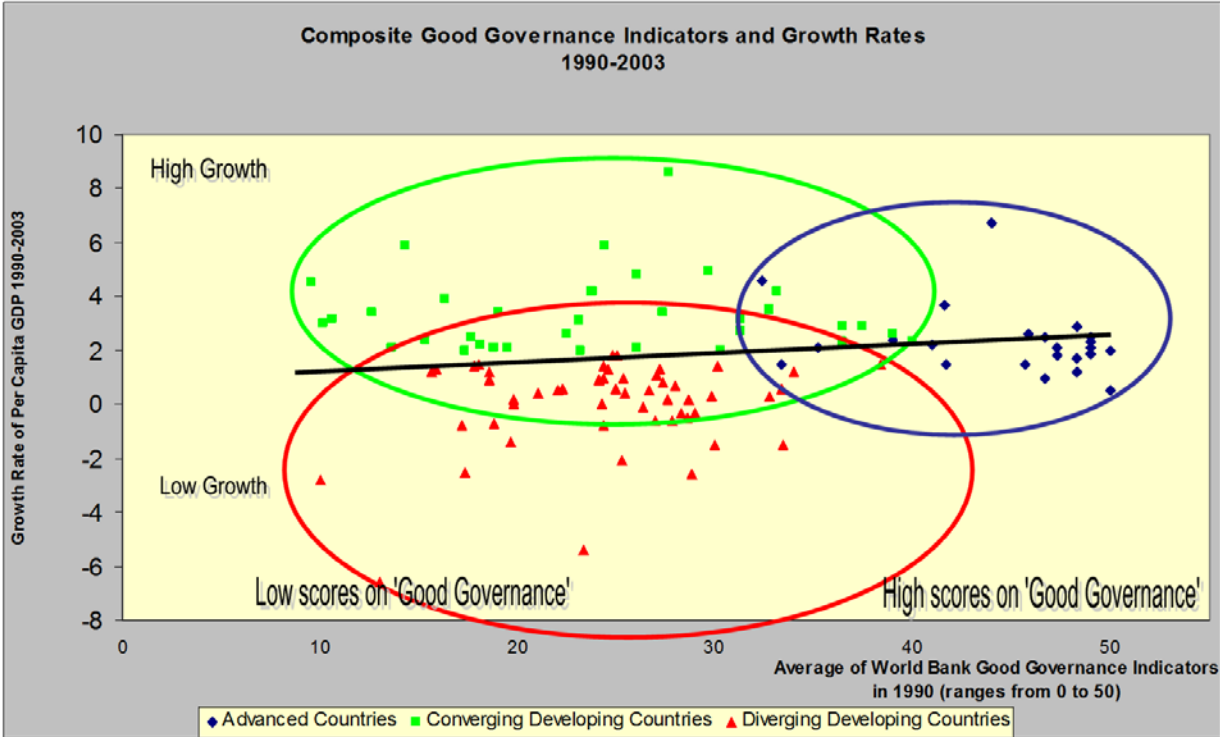
to be very high regardless of your reforms and there will be uncertainty and you will not get investments in the way a sovereign state would. However, those parts of the improvement in 'good governance' which are about accountability and better service delivery could result in much better delivery of aid.

In an aid dependent country (in Palestine I haven't seen the latest figures but about 40 per cent of GDP is aid) if you can deliver aid better it can look like good governance is working. The efficient delivery of aid is important, but it should not be confused with prosperity created by a market economy because this is not prosperity which has been produced. It is simply prosperity that is based on aid delivery. So even in terms of liberal economic theory, it is a mistake to associate good performance with good governance reforms with good governance achieving market efficiency.

But my real problem is that we need to avoid falling into the trap of good governance theory because there is no evidence at all that even sovereign countries that have succeeded in the last 50 years in East Asia, China today and India, did so by following good governance principles. There is no evidence of this. I am going to show you some data which shows this then you can draw your own conclusions. This is cross-country evidence. And the evidence is very interesting. These are data points from the World Bank's own statistics which measures 'good governance' using indicators. These indicators are really problematic, so I don't advise anyone to use these indicators. But even the World Bank's indicators don't support their theory. I have made this presentation many times, including at the World Bank, and increasingly people are becoming doubtful about their own story. But it has taken a long, long time. And it's not just me criticizing the theory; many people have been saying this. The quality of governance in terms of these good governance capabilities is measured along the horizontal axis in the first chart.



The indicator provides a judgment about how well a country protects property rights, how low corruption is, how good accountability is...so the more you move to the right, the better your 'good governance'. And on the vertical axis you measure the per capita income of the country. And if you compare the relationship between good governance and per capita income, you find a very strong correlation. You find that countries with higher scores on 'good governance' are rich and the countries with poor scores are poor. This is a very strong correlation in economics, I mean it may not look like it on the chart, but this is a very strong correlation in terms of relationships in social science. What this correlation doesn't tell us is what caused what. Do you have good governance because you are rich or are you rich because you have good governance? To test the causality of this you have to look at something much more complicated. You have to ask yourself, does an improvement in good governance increase growth rates? Does it actually make countries grow faster? And when you ask that question the evidence is much less clear. If you look at the same data in terms of growth rates in the next chart you get the following picture.



Here you have good governance on the horizontal axis as before, but instead of per capita incomes on the vertical axis, we have growth rates. Of course, we would expect rich and poor countries to perform slightly differently (poor countries should grow faster), so we need to separate countries into different groups. The most interesting group for us is the group of poor countries, but this group in turn is divided into two groups, one growing rapidly, the other not. The group of countries on the chart marked 'diverging countries' are poor countries which are growing slowly. They are falling behind (diverging) relative to rich countries. Poor countries which are growing score poorly on good governance, so they are towards the left of the chart. The group of countries marked 'advanced countries' are rich countries like the US and UK and so on. They have much better scores on good governance and they are growing faster. But where are the rapidly growing countries, where is China, where is India, where is Vietnam, where is



Thailand, where was South Korea in the 1980's? If you put the rapidly growing developing countries in *this* diagram you get a completely different story. The last group of countries is the set of 'converging countries' which are catching up with the advanced countries because their growth rates are higher than the average advanced country. These are the Chinas of the world. The diverging countries are like Congo and the advanced countries are countries like the United States. Now the point is that it does not make sense for developing countries to compare themselves with the US or Norway because they have a different resource base and social organization. The most relevant comparison is between fast-growing (converging) and slow-growing (diverging) developing countries. What is the difference between them? The staggering conclusion is that in terms of 'good governance' scores, the average score of rapidly-growing poor countries is the same as that of the slow-growing developing countries and the dispersion of their governance scores is almost exactly the same. In other words, if someone told you in 1990 what the good governance indicator of a particular developing country was, you would have not been able to predict if it was going to be a fast growing or a slow-growing country. So what is the use of this theory for policy-makers in developing countries? I don't know.

The theory is obviously much more useful for international agencies because it enables them to stay within a neo-liberal reform agenda and also enables them to raise and spend billions of dollars on soft issues which taxpayers in the West will not criticize. Who will criticize spending lots of money on accountability or anti-corruption or building property rights? This ensures that international agencies keep getting the funds to sustain their own bureaucracies. But from our perspective, there are three basic groups of countries, the slow growing ones we called *diverging*, the rapidly-growing ones we called *converging* and the *advanced countries*. The next chart shows that the claim of the good governance theory that if you want to go from group one to group three you should *first* do good governance reforms is really unsubstantiated by the historical evidence. Their argument is that if you can increase your score on 'good governance' *then* you will grow faster. Looking at the evidence superficially may suggest that this is one way of getting from group one to group three. My problem is that when you look at the evidence historically, there is no evidence of anyone who has done this. The historically relevant question is actually how do you get from group one to group two? What do I need to do in terms of governance capabilities that will take me from group one to group two and keep me in group two for several? How do I become China? How do I become Singapore? How do I become Thailand or Turkey?

There are clearly some governance capabilities that take you to this group of countries but these are not good governance capabilities because in terms of 'good governance', group one and group two both score poorly. They both have bad governance in terms of the good governance criteria. But there are nevertheless important governance differences between them: there are obviously things they are doing in terms of their governance capabilities that we are missing. After a country has become middle income or upper middle income, in other words, after you have become a South Korea or a Japan in the 1970's, you can make the transition to a group three country. But there is no evidence of a group one country directly becoming a group three country through any strategy. This is my problem with the good governance agenda. There is nothing wrong with good governance; we all want to have good governance. But if poor countries can achieve good governance there is not much historical evidence of it, nor is there evidence that improving good governance ensures that poor countries will get rich faster. And if countries cannot get richer, it is difficult to sustain any improvements in good governance that we can achieve for a while. So while we make progress on good governance, the most important thing is to make sure that we are

building that governance capabilities required to sustain growth, in other words, to take us and keep us in the set of group two countries. Donors do not tell us about this because it is not the donors' problem.

We ourselves have to look at examples of successful countries and ask what they did. What we find is that not only did they do some difficult things like protecting critical property rights; they also had the capability to do some even more difficult things like promoting growth sectors and technology acquisition by these sectors. At the moment the Palestinian Authority cannot even protect critical property rights because they lack sovereignty. But if Palestinian policy-makers are beginning to think about long term development, not only do they have to ask themselves how they can define and protect critical property rights; they have to ask themselves how they can promote technology acquisition, job creation and high value-added sectors. What are the policies and governance capabilities that are required to assist the Palestinian economy to climb up the technology ladder and create new productive capabilities? The Palestinian economy is clearly not going to create three or four million new jobs if it focuses only on construction and tourism. The Palestinians have to develop a manufacturing sector as well as high value sectors in agriculture and services. What does this entail?

The problem is that productivity in producing products of the right quality is initially so low in developing countries that low wages do not help. Developing countries find they have much higher costs of production than their advanced country competitors despite the latter having much higher wages. In other words, low wages typically do not help developing countries to be competitive. What developing countries do not have is the knowledge about production methods, about how to lay out a factory, how to lay out the machines so that the bottlenecks are reduced, how to reduce waste in the factory, how to control quality, how to do the marketing, how to keep the quality control going, how to manage the supply chains and so on. I do a lot of research on manufacturing in developing countries and the difference, for instance, between 8 percent wastage of raw materials in a factory and 10 percent wastage can be the difference between profit and loss, the difference between success and failure. A bottleneck in a production line because of the wrong ratio between machines of different types can be the difference between success and failure. That knowledge of how to actually fine tune these intense production processes to achieve global competitiveness is only achieved by something that economists call '*learning by doing*'.

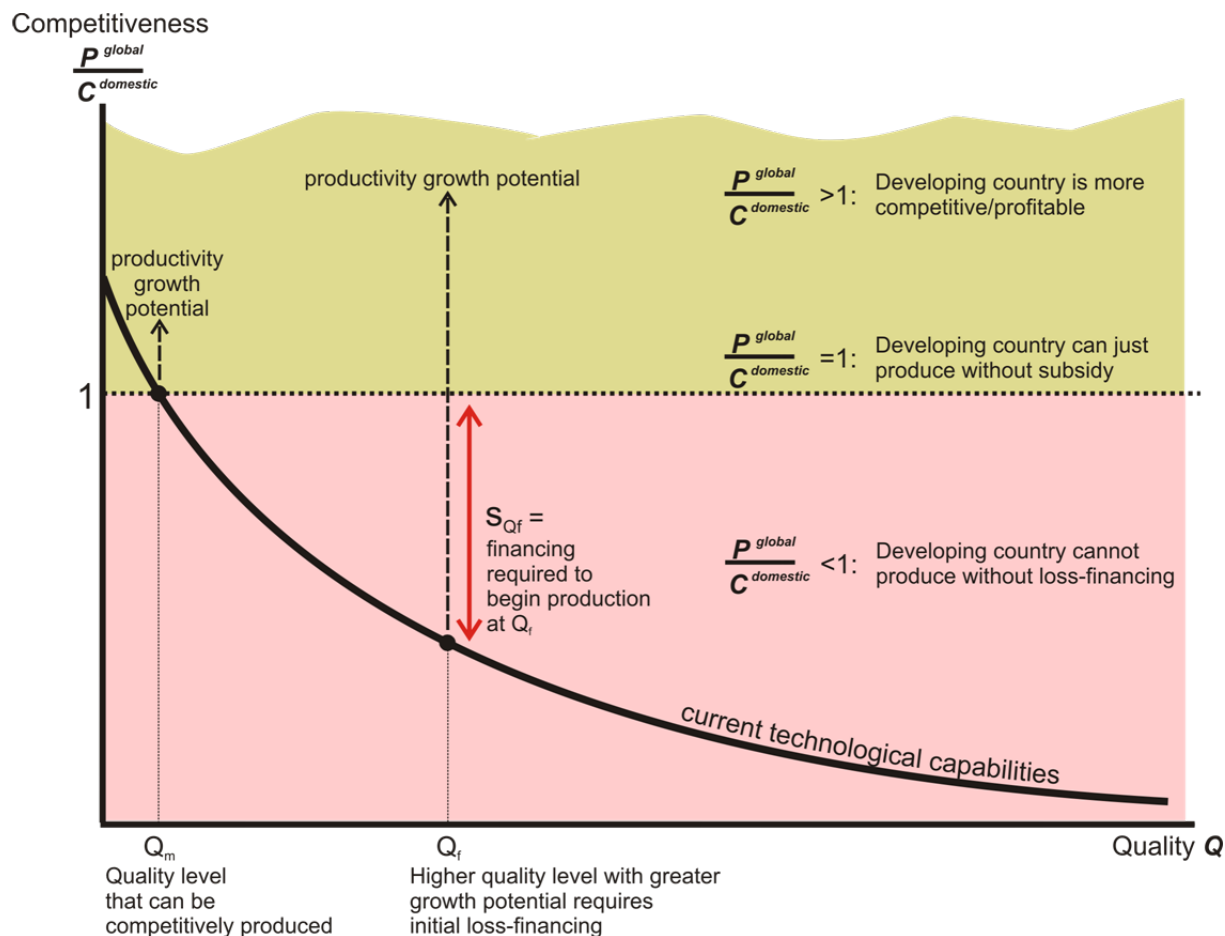
At the heart of learning-by-doing is the acquisition of something called '*tacit knowledge*', which is critical for achieving global competitiveness. Tacit knowledge is knowledge that you cannot learn in books. There is no manual about how to experiment to continuously improve competitiveness. You have to set up the factory, you have to keep experimenting, and you have to keep trying to do different things till you get it right and you become globally competitive. How does that happen? It requires a lot of financing and public/private partnerships to assist new start-up companies to move up the value chain and become globally competitive. Initially companies will not be profitable even with low wages. Financing has to be available both to take the firm through the learning period, but there also has to be credible governance arrangements to ensure that firms do not waste these resources. But it is clear from all the global experience that simply opening up markets and waiting for production to start, or waiting for international investors to come is not sufficient. Case studies from India, from Thailand, from Bangladesh, from China (these are countries that I work in) show that sectors and industries that succeeded had special

arrangements that allowed them to learn technologies and become profitable. They were not profitable in a free market sense as soon as they started.

So this process of assisting start-up companies to do learning-by-doing and moving up the value chain is one of the fundamental challenges of development. Let me spend two minutes on this because it is important to understand that good governance and the neo-liberal agenda are quite insufficient for ensuring development. The issue is that even with low wages, in the absence of the appropriate tacit knowledge, the cost of production of producing a good of a particular quality is in most cases higher than the world market price. So if the world market price for a product of a specific quality is  $P$ , the developing country typically has a cost of production  $C$  that is higher than the world market price. Why is this? Very simply this is because of low productivity and low efficiency in the use of materials. Startup companies in developing countries waste more raw materials, take more time to produce things, fail to manage supply chain effectively, in short, do not have the tacit knowledge to manage the production process at high levels of productivity. I can only be globally competitive if my ratio of price to cost, where  $P$  is the world market price and  $C$  is my domestic production cost, is more than 1. In other words, the world market price has to be more than my domestic cost of production for my country to be able to produce competitively without any assistance or loss-financing.

Now it turns out that as you move up the value chain, or produce higher quality products, competitiveness measured by this ratio of  $P/C$ , drops dramatically. The problem is that the higher the quality of the product, the bigger the gap between your productivity and the productivity of the slightly more advanced country. So what happens is that developing countries get stuck into producing very low technology products that add very little domestic value. And this is the trap of development which the market by itself does not solve. So in the post-Oslo period, when the Palestinians have been persuaded to think a lot about good governance and doing governance reforms according to the neo-liberal agenda, not enough attention has been given to this fundamental problem of how to create employment for millions of poor people who are not very skilled and who are currently close to or below the poverty line. How do you create jobs and employment for these pools of unemployed people?

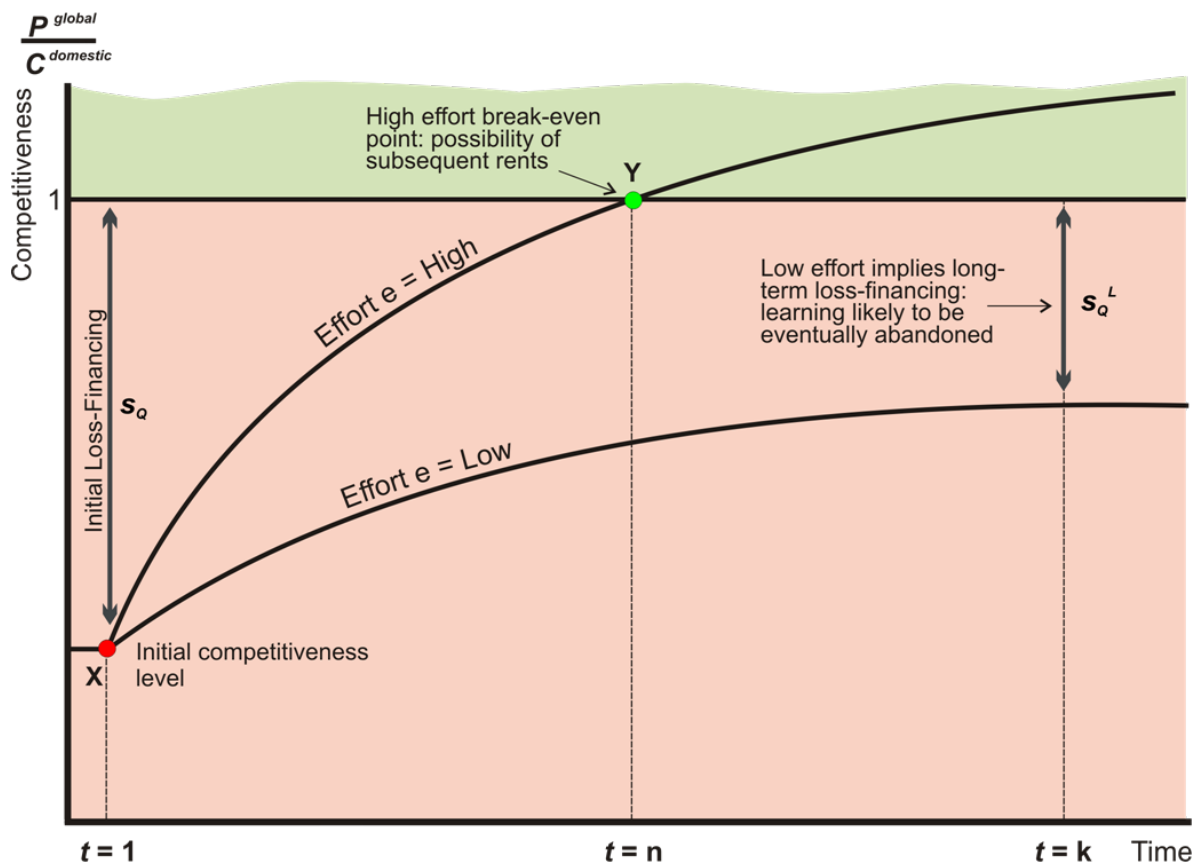
This is actually a regional problem because you find the same problem in Jordan, in Lebanon and in Syria. What is happening in this region is that countries like Syria and Lebanon and Jordan are not being able to compete effectively with countries like China, India, or Vietnam. With lower wage countries coming into production with very hard-working labor forces and effective strategies of acquiring the requisite tacit knowledge, middle income countries are finding it much more difficult to compete. So what I'm saying here is not just relevant for Palestine, it is relevant for much of this region. There is a desperate need for industrial policy and to create competitiveness in higher value and more sophisticated products. And I think it is important to start thinking regionally about regional industrial policies, not necessarily with Israel because Israel is a much richer country, with higher technology, but with countries which have a similar technology base as the Palestinians. Given the small domestic markets in these countries, it is necessary to cooperate in making high quality products by specializing on different parts, as the ASEAN countries do in making electronics and motor cars. The next diagram is a simple way of summarizing what I am saying.



The ratio of  $P/C$  is a measure of competitiveness on the vertical axis while the horizontal axis measures the quality of the goods produced. As you raise the quality of production, the typical developing country problem is that competitiveness falls dramatically. The line which is marked "1" shows the level of competitiveness at which the domestic cost of production is equal to the global price, in other words, the country achieves competitiveness when  $P/C$  is equal to one or higher. In a market economy, a country without any industrial policy can only sell products in which it is already competitive. In the diagram, the only thing that this particular developing country could sell is a very low quality product,  $Q_m$ , marked on the horizontal axis. For products of this quality or below, the developing country already has global competitiveness, but it may be very simple agricultural or industrial products with low value added and therefore low wages. If you want to move up the value chain and produce something which produces a higher wage and a higher value added, you find that you are not competitive, and you cannot sell in any market without protection, subsidies or some other form of assistance. In other words, for higher quality products, the cost of production is higher than the world market price. The gap in competitiveness for a product of quality  $Q_f$  means that unless a financing gap as shown in the diagram is met, production cannot even begin.

The financing gap has nothing to do with innate inefficiency. It is simply that producers in the country do not yet know how to produce this product yet. So if the country wants to start producing that gap has to be met by some form of cost sharing, such as some form of subsidy, protection, exchange rate policy or

interest rate policy. This loss-financing does not necessarily have to come from the government, but it is much less likely that this will happen in the absence of any specific policy assistance. But any form of policy assistance requires specific governance capabilities to make sure that the resources are not wasted. Without these governance capabilities, the country attempting to promote industries can easily end up with an infant industry or an entire industrial sector which never grows up, which permanently remains dependent on protection. And this is the lesson of industrial policy in the modern period, that you need a combination of opportunities created by policy but also the governance capability to ensure that resources are not wasted and the global competitiveness level is achieved very soon. If competitiveness does not rise, the policy will fail. Building these governance capabilities in critical government agencies and in financial institutions is therefore much more important than many of the very general good governance capabilities that developing countries are focusing on. The next diagram shows the governance issue very simply.



It shows that when you start off from a low competitiveness level, production involves an initial period of loss financing. But if you do not have the governance capability to ensure high levels of effort in learning to achieve competitiveness quickly, you are likely to fail. It is not enough to have public policies that enable startup companies to start production. Without credible governance that can ensure that entrepreneurs who put in low effort will not continue to be supported, these policies are likely to fail. The main point here is that when the Palestinian state eventually emerges, good governance will not be a sufficient strategy for ensuring high levels of growth and employment generation. Strong governance capabilities are required to assist the creation of new enterprises, new sectors of manufacturing, new types

of agriculture, and so on. The requirement of promoting domestic enterprises also raises questions about the wisdom of the customs union with Israel and the difficulty of having an autonomous monetary policy, exchange rate policy, and so on under the present arrangements with Israel. I will not be able to go into these subsidiary issues here. But clearly industrial promotion and technology policy cannot be implemented without the sovereign capacity to determine your own policies. And secondly, it is insufficient to rely on the neo-liberal ideology which says that if you simply have an open market the necessary investments will come.

Now let me come to my third question. All of the previous discussion was to some extent academic, because the discussion about property rights and technology policy is academic without sovereignty. The most immediate question in Palestine is what is the bargaining power of the mainstream Palestinian leadership as it negotiates with Israel about sovereignty? Is this negotiation based on a credible violence capacity or credible capabilities for mass mobilization or what? Well, I have to say it is not clear what Palestinian bargaining power is based on at the moment. I worked a lot on the Oslo period with many colleagues, some of whom are in this room. One of the really interesting things about the Oslo process was that the bargaining behind the Oslo process was actually not based on the so called 'land for peace' formula. Land for peace suggests that the Palestinians had the violence capacity to threaten the Israelis with the absence of peace. It suggests that the bargaining power of the Palestinians was based on their capacity for violence and in exchange for giving that up, the Israelis said OK you can have a piece of land and establish sovereignty over that. Actually, that was not the case, we all know this. The Palestinians had very limited (and still have very limited) capacity to inflict real pain on the Israelis through violence. So what was the bargaining in Oslo based on? It seems to me that the Oslo bargaining was based on a really remarkable assertion. It was the remarkable but apparently plausible assertion that the Palestinians did not need any bargaining power with Israel because Israel would create a Palestinian state *in its own interest*. Why? Because it was assumed that this was the only way that Israel could ensure a demographic basis for Zionism. It appeared that Israel was losing the demographic battle, and without creating a Palestinian state there would soon cease to be a Jewish majority within Israel and the territories it claimed as its own.

An important implication of this assumption was that if a two-state solution was in the interest of the dominant party, all that the Palestinians needed to do was to establish that a two-state solution was also acceptable to them. So the second assumption behind Oslo was that on the Palestinian side, the 1967 borders with small modifications were the least that the Palestinian leadership could 'sell' to its own people. Given these two assumptions, it is not surprising why we found key people saying (if not in public, certainly in private) that 'we all know what the solution is, you don't have to talk about the solution, the solution is obvious'. Eventually, Clinton actually said it explicitly. And because everyone thought that the solution was obvious, nobody bothered about the interim agreements, nobody bothered about the details of what the Palestinians were signing because everyone thought the endgame was clear. In the end the two-state solution would emerge because the dominant party knew or would accept that it was in its own interest. So why do we need to bother to read the documents? We just sign, we go and start talking and they will give us the two-state solution.

As a result, Oslo was really structured and presented to the Palestinians as a confidence-building exercise rather than a serious negotiation based on bargaining power. You sit at the table, you get to like each other, you have some trust, because in the end they will give you what you need (with minor

modifications), you don't have to worry about it too much. Actually, Oslo did not lead to a Palestinian state, to the surprise of many people. One of the weaknesses of the post-Oslo negotiations has been that the underlying assumptions have never been challenged even though all the facts on the ground tell us it is not true. All the facts on the ground tell us actually that Israel failed to create a Palestinian state when it had ample opportunity to do so. And yet we have not asked ourselves, why did this happen if Israel's self interest was so clear? I think we need to go back to the assumptions behind Oslo as these are extremely important. And the reason for that is the first assumption is false, and I'm going to suggest some reasons why I think that assumption is false. A two-state solution can ensure a Jewish-majority state of Israel, but actually it undermines the protection of Zionism. If all that Israel was interested in was a Jewish majority state, the two-state solution would have emerged by now. But if a two-state solution undermines Zionism, it is not at all surprising why it has not emerged, and why it cannot emerge without much more significant Palestinian bargaining power. This is very important, for subsequent Palestinians strategies, when we are talking about combining a liberation struggle with a rights struggle. It is very important to understand how to develop the bargaining power on which an outcome which is good can be based.

Actually, we know that Oslo didn't work from day one. I was here in Palestine on and off during the Oslo period and the facts on the ground contradicted the assumption of Oslo from the start. We didn't want to see it; we closed our eyes to the facts on the ground. After signing Oslo Israel did not detach itself from the OPT. In fact, Israel invaded the OPT much more significantly. It signed treaty after treaty to gain control over key Palestinian economic variables: foreign trade, taxation, currency, labor movements. Integration with Israel had this strange character which we describe in our book on *State Formation in Palestine* (which we wrote with many people who are in the audience today), as *asymmetric containment*. It was neither integration nor was it separation, but containment on Israel's terms which meant Israel penetrated into the OPT and tried to control it from within. Now why would you want to do that if you were trying to go back to 1967 borders? What is the logic here? Despite all this, we tried to find positive things during the Oslo period, and in the analysis we developed in our book on *State Formation in Palestine*, we said that even with all these adverse things, Arafat was trying to play a double game and trying to build quasi-sovereignty by using his power over resources to do things which Israel hadn't planned for the Palestinians. This is in our book, if you are interested. You might disagree with me about this interpretation of Arafat. We had a more favorable interpretation of Arafat than many Palestinian friends who were critical of the whole exercise. But we were favorable in our interpretation because Arafat tried to do things which were not allowed under the rules. Eventually Arafat became a problem for Israel and eventually Arafat was, as we all know, locked up in a compound not far from here till he died.

Now what happens after Arafat's death is very interesting. It seems we have kept all the assumptions behind Oslo and on top of that now we have leaders who follow the rules. So not only do we not question the assumptions, now we follow all the rules underpinning that assumption. As a result, something quite disastrous happened. The Palestinian leadership with no bargaining power kept on participating in negotiations not going anywhere. This continued year after year after year, and every year that the Palestinian leadership participated in negotiations without any bargaining power which went nowhere, their internal legitimacy collapsed, and the extreme outcome of this was the tragic and unprecedented split in the Palestinian polity in 2007-2008 and the departure of Gaza. This is enormously significant for the Palestinian movement, I'm sure everyone here agrees. And it happened because the Palestinian leadership is trapped into a process which everyone knows isn't going anywhere but no one can say that. And we

haven't actually gone to the root of this problem to explain why it is not going somewhere, and we are still in that position. What is going to happen now? We need to return to the question which I have kept on asking myself: what does Israel really want? There must be some logic to the Israeli strategy, and we must understand what Israel wants not only because it is the stronger party but also because in any case you must know what your opponent wants before you can negotiate and bargain.

Well Israel has one argument that we need to immediately dispel because it is completely false. Israel's argument is that it is willing to negotiate with the Palestinians and indeed talk about a Palestinian state, but only if the Palestinians can first ensure security for Israel. This is the 'security first' doctrine, on which I wrote a paper and even presented it to Israelis in a dialogue where some of you in the audience were present. Israel's argument was that Palestinians did not offer enough security for the Israelis to feel secure to engage in a withdrawal. In game theoretical terms this argument makes no sense. In the bargaining between an occupier and the occupied, if the occupiers say they will withdraw provided they are sure the occupied will not subsequently attack them, how can this be ensured? It certainly cannot be ensured by asking the occupied to prove their goodwill by not attacking for a period of time before the withdrawal. However long the period chosen, this does not guarantee that the occupied will not change their mind after this period is over. Suppose the Palestinians stopped attacking the Israelis for six months, and then the Israelis withdrew. But in the seventh month, the Palestinians might change their minds and attack. So how long do the occupiers have to wait before they are sure that they will never ever be attacked? The answer is they have to wait forever. Not getting attacked today can never credibly guarantee there will not be an attack tomorrow. That is why countries have to have deterrence. It is deterrence that ensures that a country will not be attacked in the future. If Israel has sufficient deterrence capacity to protect itself on its 1967 borders, it could and should withdraw tomorrow (if that is in its interest). And if it doesn't have sufficient deterrence to protect its 1967 borders, it should never go. But it makes no sense to say that after six months it will have the confidence to go. This is a deeply flawed logic in terms of strategic theory, and it only makes sense as a cover for not withdrawing for other reasons. But nobody questioned Israel's peculiar logic. Moreover, while presenting this flawed argument Israel kept on building new settlements inside the OPT. We all know this and what is more interesting is that these settlements are all strategically located, deliberately planned it seems to fatally undermine the prospect of a sovereign Palestinian state.

The settlements deprive the Palestinian territories of water. They force significant changes in the borders from the 1967 ones and thereby undermine the legitimacy of any agreement that the Palestinian leadership enters into. They separate the Palestinians into territories and impede movement of Palestinians within the territories. All this is too systematic to be unplanned, too strategic to be accidental. So what is going on here? In our book we came up with this idea that actually the only sense you can make of this Israeli strategy is that there is a long term 'management strategy' going on here, which we described as 'asymmetric containment' and which Jeff Halper calls the 'matrix of control'. People have given the strategy different names. But what is it that the Israelis are trying to contain, and what exactly is it that they are trying to control? What is it that they are afraid of? My hypothesis explaining Israel's strategy is in a sense quite worrying because if true, it means there will be no simple solution to the Palestinian struggle. The hypothesis is this: the problem for Israel is *not* how to achieve a sustainable Jewish-majority state. If this was the objective, it could have been achieved in 1994. The problem for Israel is how to maintain Zionism within the Jewish-majority state, and this is a completely different problem. Once you



make explicit the objective of maintaining Zionism in a Jewish majority state, you find that actually everything Israel is doing makes sense. The problem is that if this is what Israel is trying to do, Israel is not going to give the Palestinians a sovereign state in its own self-interest. This is a frightening conclusion given that the Palestinians have not spent much time developing any Plan B. Now I may be wrong, I hope I'm wrong. But this is my hypothesis, and I am going to explain why this can explain many puzzles about Israel's strategy and why we are still here in 2010-2011 more than 15 years after signing Oslo.

Israel's problem is the following: if it goes back to 1967 borders, 15-20% of its population (depending on what happens to East Jerusalem and where the borders are drawn) will be non-Jewish. These people will now be inside Israel. Of course Israel will be an 85% Jewish-majority state, so you may think, what is the problem? If Israel wanted to be a Jewish majority state, this 'solution' would assure a Jewish majority into the indefinite future. But that 15% actually is a problem not for a Jewish majority state, but for Zionism. Why? It is worth spelling this out. Zionism is not about a Jewish majority, it is about differential rights for Jews whether or not the state is a Jewish-majority one. Zionism demands different rights for Jews and non-Jews. The differential rights affect everything, access to land, to jobs, subsidies, marrying foreigners, migration and so on. In a conference we had a couple of days ago we had Israeli Palestinians, the so called Israeli Arabs, recounting their experiences of differential rights inside Israel. Of course, everyone knows this, but maintaining these differential rights has significant implications for Israel's strategies. The problem, from Israel's bargaining perspective is that the coalition supporting the two-state solution always collapses at some point, because if you are going to have to maintain differential rights for 15% or 20% of the population, why not have differential rights for 35 or 40% of people and keep Judea or Samaria, or at least large tracts of Judea or Samaria? What does Israel gain by giving up land which is very significant in terms of the Israeli mythology concerning Judea and Samaria, when at the end of the day Israel will still have the problem of justifying to the world why it has to maintain differential rights for a significant number of its citizens?

Zionism as an ideology asserts that Israel is a home for any Jew anywhere in the world, who can come to the border and become Israeli citizens without notice. But to sustain this right in a country with a very limited amount of land, land has to be kept under the control of the state. Land and resources have to be differentially allocated, and all kinds of things follow from this. Subsidies have to be prioritized for people who might be coming, claims on resources by non-Jews have to be contained and so on. So when you question differential rights, you are really questioning the core of the Zionist state, which is the claim that it is a homeland not just for Israeli citizens but for any Jew in the world. Now this is a huge problem to address, but if you keep that in mind, then many apparently irrational Israeli actions become explicable. The problem for Israel is that handing over some territory and creating sovereignty for some Palestinians when other Palestinians have differential rights within Israel raises some contradictions and I am going to suggest some. Indeed, the difficulty of maintaining Zionism could become much more severe once a hard border is drawn and a sovereign Palestinian state is created.

Such a sovereign Palestinian state will not necessarily protect Zionism, and may indeed create more serious political problems for Zionism. I think the Israelis understand this extremely well, which is why they are finally explicitly demanding that Palestinians recognize Israel as a 'Jewish state'. Now a Jewish state is basically a code word for a Zionist state because it is not just a Jewish-majority state. No one has

to say that they are aware of a Jewish majority in a state that has a Jewish majority. What the Israelis want is an advance commitment from Israeli Palestinians and Palestinians elsewhere that they recognize Zionism as a system of differential rights for Jews and non-Jews within the state of Israel. Unfortunately, from a strategic game theoretic perspective, a prior guarantee from the Palestinians that they recognize Zionism does not in fact constitute a credible guarantee because Palestinians can of course change their mind in the future. So suppose the PA says tomorrow 'we accept that Israel is a Jewish state'. After they get sovereignty they might change their mind. It is just like defense, you cannot make a prior commitment to not attack that you can never change. Because Israel understands strategic bargaining very well, they probably hope that Palestinians will not recognize Zionism (and the Palestinians should not), but whether they do or not, Israel will try to ensure that they retain the power to ensure that Zionism can be maintained in the future.

A future Palestinian state makes life difficult for Zionism on several counts. The first count is that if Israel has a significant problem with its internal Palestinians, the so called Israeli Arabs, moving them around in terms of internal displacement becomes much more difficult if there are hard international borders. As long as the international borders are not clear, you can move them around. You can redefine territories as different zones, with different types of rights, different types of areas and so on. Just the threat that you can do this keeps the Israeli Palestinians quiet. Once you have an international border, you cannot change the status of Palestinian territories within Israel that easily nor can they be shifted across international borders very easily. This makes their management much more difficult than it is at the moment. This is of course why many right wing Israelis are already talking about transfer in *advance* of a Palestinian state (but this is very difficult to achieve I think). So if I were a Zionist and thinking strategically, would I like to have a hard border *anywhere*? The answer must be no. I would not want a hard border when I will have 15-20% of my population as non-Jews who may demand equal rights after the hard border has been decided. If I then give them equal rights, Zionism is gone, so what have I gained by accepting a two-state solution?

And this is the second problem. Israel actually relies on the acquiescence, the lack of political mobilization of the Israeli Arabs, the Palestinian Israelis. I think the Palestinian Israelis are relatively quiet (though not entirely) precisely because the borders are not clear. The Palestinians Israelis do not want to make a lot of demands which might result in their transfer into other territories or a change in the status of their territories which can be defined as special zones whose status will remain under negotiation during the 'indefinite transition' that can go on forever. However, the day you draw the border and say this is Israel and that is Palestine, then the Israeli Palestinians will say fine I am an Israeli Palestinian, where are my rights? And then Israel will find it very difficult to threaten that they will again change their status or throw them out. So in terms of empowering the Israeli Palestinians, if you are an Israeli Zionist, you definitely do *not* want a hard border.

I think that the problem from the Palestinian perspective is that we have always thought that the issue was about land, where will the border be drawn, 5% here, 2% there, 3% there. But the issue is not about land, certainly not *just* about land. The issue is that Israel has a strategic interest in keeping non-definite borders: borders which are not clear. The Israeli strategy has been to create facts on the ground so that they keep changing any borders that the Palestinian people are beginning to get used to. A legitimate Palestinian state has to have borders that its people accept, but if Israel keeps changing the borders, there

can never be a legitimate Palestinian state. This is not an accident, but is exactly what is good for Israel. Israel wants temporary borders, so if tomorrow the Palestinians declare a state without clear borders, or borders that are far removed from the actual borders, the happiest people will be the Zionists. This is exactly what they want from a strategic point of view. They want a state without clear borders so they can keep on negotiating about the borders. This will keep the pressure on the Israeli Palestinians to keep quiet, and this is exactly what they want.

And there is a final problem, the refugees who we keep forgetting about. There are lots of them and Israel has to manage that problem too. When the refugees insist on coming back, if Israel has a client state which they control and which is not legitimate or viable, Israel can insist that the Palestinian 'state' should take the refugees. It can do this because it controls the state and can offer small land swaps or other concessions. But if there is a sovereign Palestinian state, with legitimate borders and genuine sovereignty, there is a problem for Israel. If the refugees do not want to go to this Palestinian state (if they did not come from those areas), the sovereign Palestinian state can simply say this is not our problem. The refugee has the right to demand to go back to where they came from. The refugees after all did not all leave from Ramallah, they went from somewhere else. Then Israel has to deal with this problem on its own and its legal position is very weak. So once again, Israel's bargaining position with the refugees actually *declines* if it creates a sovereign Palestinian state.

I am sure Palestinians in the OPT do not want to hear this. You want to solve your own problems in the occupied territories and you want to breathe freely. This is very understandable. The whole agenda of building a Palestinian state is also based on the assumption that you can separate these questions. The problem is you may *want* to separate it, you may *want* to say: I just want a state in the West Bank and Gaza for the West Bank and Gaza Palestinians. I don't care about the Israeli Palestinians. And the refugees can take their demands up with Israel. The problem is *Israel* does not separate these issues. Israel's management of the Israeli Palestinians and the refugee issues depends on controlling the borders and the territories of the OPT, therefore you cannot separate these issues whether you like it or not, unfortunately. And so, your struggles are actually joined because Israel doesn't see you any differently, they see all Palestinians as part of the same problem. Israel understands that the creation of a sovereign and legitimate Palestinian state actually makes its management of the two other problems unmanageable. And this is now very clear with the introduction of a discourse about transfer, recognition of the 'Jewish nature of Israel' and other issues into the discussion about the two-state solution.

So here is the bad news first. A sovereign Palestinian state is not on offer from the Israelis. The first condition of sovereignty is that there should be legitimate borders within which a state has a monopoly of violence and the capacity to legitimately define and change rights. Well, these two conditions are against the interests of Zionism and since the Oslo and post-Oslo processes rely on the Israelis to grant Palestinian sovereignty in its own interest, sovereignty in any part of the OPT is not on the cards. Israel may reach an agreement about Palestinian self-governance, and you can call it sovereignty, you can call it a state, you can call it what you like. But it won't be, just like the Israeli withdrawal from Gaza did not create a Palestinian state in Gaza. The implication of this analysis is that the continuing expectation that if we keep on negotiating and sitting at the table, then Israel will finally give up and create a sovereign Palestinian state is wrong. They may create some entity and you may call it a state but it won't be a state in the classical definition of a state. It will not be a state because a Palestinian state will threaten Zionism

more than the status quo. To create a Palestinian state requires forcing the Israelis to give something that is actually not in their interest. In other words, Palestinians need bargaining power and the problem is that you need *significant* bargaining power because you actually have to force Israel to concede on Zionism.

If Israel was a normal state and was only concerned with maintaining a Jewish majority, creating a Palestinian state would not have been a problem. By now, Palestinians would have achieved a state on the occupied territories. The problem is that maintaining Zionism as a system of differential rights for Jews actually requires that the Palestinian state in the OPT is weak, with disputed borders, dependent on Israel, and in a permanent status of negotiating the final status. Unfortunately, Israel has no better mechanism for controlling the Palestinians. You have to understand Israel's dilemma and its strengths and weaknesses. It means that the struggle for a sovereign Palestinian state in the OPT is also a struggle against Zionism. If Israel abandons Zionism, a two-state solution becomes possible. Israel will not need to control its internal Palestinians or the refugee problem because they will be full Israeli citizens with equal rights. A reasonable deal with the Palestinians and generous compensation could ensure that Israel remains a Jewish-majority state, but it would not be a Zionist state. The flip side is that the only way Israel can protect Zionism is by not having a sovereign Palestinian state.

Now here is the good news. It may look like an impossible task to build sufficient Palestinian bargaining power to take on Zionism. So how do you build your bargaining power? The good news is that demographically the Palestinians are in an unassailable position but they lack the organization to connect up the different parts of the Palestinian rights movements. The day that happens, Israel cannot win. It might take a long time but Israel cannot win because there are too many Palestinian. If there were 20,000 Palestinians or even 200,000 Palestinians, they would have become unfortunate victims of settler colonialism like the Red Indians or the Australian Aborigines and would have become a negligible minority. But Palestinians are not going to disappear. The problem is that the Palestinians have not put in the sustained effort in building a unified organization that can deploy this collective bargaining power because they mistakenly thought they would not need bargaining power to achieve a state. Today the Palestinian movement is more fragmented than ever before. But today it is also clear that the one thing that potentially gives the Palestinians bargaining power is mass mobilization and the collective activity of different groups of Palestinians confronting Israel to say we all have the same demands, we have joint rights. Israel knows this and fears this, and will try to prevent it but I do not see any alternative source of bargaining power for the Palestinians.

I think the primary task for the Palestinian liberation movement is to build that bargaining power. It is too early to say what the solution will be, whether one state, two-state, three-state, or something else. My point here is that in fact it does not matter how many states we think of, there will only be a solution to Palestinian aspirations when Palestinian mass mobilization has enough bargaining power to challenge the differential rights faced by Palestinians in general. If Israel is eventually forced to abandon differential rights, there could be a very viable two-state solution, but equally, there could be a bi-national state, or indeed other options. But right now that discussion is academic because the Palestinians have no bargaining power to demand anything, and it is clearly not in Israel's interest to create a viable and sovereign Palestinian state on *any* part of the occupied territories.

There is no question that the bargaining power based on organizational capacity will take a long time to develop and Israel will attempt to block it. And here I have a problem with many Palestinian leaders who participate in negotiations with Israel and say: if you don't give us a two-state solution, we will start a civil rights movement and Israel will be in real trouble. This is not a credible threat. It is a bit like a country saying, we don't have a nuclear weapon but if you attack us we will build one. Now if you think about it, the technology for making nuclear weapons is pretty freely available, even fissile materials are available on the international black market. It just takes twenty years to learn how to do it. So if you don't have it, you can't say well I will never forget what you did. If you attack me, eventually I will make a bomb and I will come back and hit you. From the perspective of bargaining theory this is not a credible threat. It's not a credible threat because by the time you make the bomb everything will have changed. In the same way, when a Palestinian leader says: if you don't give us a two-state solution we will start a civil rights campaign and that will really threaten you, it's not a credible threat. The Israeli response, very justifiably, is to ask where this organization is, what are you talking about? So it is best not to make these empty threats. It is important to actually start working on building the organization. Once you start making progress, every rights campaign anywhere in historic Palestine should be connected up with every other rights campaign and should be projected by the Palestinian leadership as parts of the same struggle. Eventually, Palestinian bargaining power must be based on coordinating all these struggles, not just in Ramallah, not just in East Jerusalem, but also in West Jerusalem, Tel Aviv and Haifa, and in the refugee camps. Even if you only want a two-state solution, you need to do this. You cannot get your two-state solutions without actually connecting up with other Palestinians, even if they are not going to be part of your state. You need to have the bargaining power to force Israel to abandon Zionism because without that there cannot be a sovereign Palestinian state. And the Palestinians in Israel and the refugees also need you to achieve their rights. And this is the realization that I think is missing in the Palestinian leadership, and it will take time to persuade the leadership that they are stuck in a blind alley.

But if Palestinians begin to understand this, and start organizing and mobilizing, they will be building bargaining power that is extremely threatening to Israel. Israel has no answer to a legitimate mass mobilization that makes legitimate demands. You have to remember that Israel is very vulnerable even to a gradual loss of its international legitimacy, much more than any threat of violence that the Palestinians can pose. And therefore Israel actually wants the Palestinians to engage in violence, to which they have an answer. I suspect that they also want you to declare a temporary state to which they also have an answer, which is to claim that you have abandoned negotiations, so they can continue the occupation and wait another decade to begin negotiations. But Israel has no answer to legitimate long term mass mobilization which creates legitimate holding power for a struggle for non-negotiable rights. The demand for equal rights for human beings is clearly a non-negotiable right. If you have a mass movement which is demanding something that is non-negotiable, not even the friends of Israel can continue to say that these are non-negotiable rights in general, but in the Palestinian case they can be waived. Of course, we do not expect them to say this immediately, and initially there will be a great effort by Israel to argue that any Palestinian rights movement must be anti-Semitic, intending to destroy the state of Israel, that Israel is the only democracy in the Middle East and so on. But a persistent and legitimate Palestinian mobilization will undermine these arguments over time provided the Palestinian leadership has the organizational capacity to sustain this struggle and absorb the costs that Israel will inflict on the leadership.

The problem is that we see no movement in the Palestinian leadership in this direction. So, although the prognosis is very optimistic, the immediate diagnosis is not optimistic at all because the negotiations appear to be continuing on the basis that the Palestinians do not need this bargaining power. Either the Palestinian leadership still expects Israel to create a sovereign Palestinian state in its own self interest, or they believe that if they simply threaten a civil rights movement that will be sufficient. It will most certainly not be sufficient. You actually have to start doing it, and even if you start doing it, it may take three, four or five years before anyone starts taking this activity seriously. But I suspect that if the Palestinians seriously started building an all-Palestinian organization, they will not have to wait for very long before Israel starts serious negotiations.

So I end by reiterating the connections between my three questions to end my lecture. Are we sure that creating a liberal market economy is sufficient for generating growth? Are we sure that we have really understood the lessons of China, Malaysia, South Korea (we have some South Korean dignitaries in the audience), India or Thailand? I don't see this. When we look at the experience of these countries we do not find that they grew by first doing 'good governance'. Some of these countries have eventually graduated into a good governance phase, but the prior achievement of good governance was not what made them powerful and rich. And even in terms of this very limited liberal theory of good governance, are we sure that the requirements for a market economy can be achieved in the occupied territories given that the fundamental rights over land and movement of people cannot be ensured? The Palestinians do not have sovereignty. So even in the limited sense of the good governance program, this is really not achievable in an occupied territory like Palestine. Rather, good governance in the Palestinian context appears to be a cover for achieving some of the conditions for improving the efficiency of aid delivery. Efficient aid delivery is important in the short term, but it is not a development program, it is not sustainable, and not even liberals support good governance as an aid delivery strategy. And finally, it is now more than clear that Israel is not offering full sovereignty in any part of the Palestinian territory for a very obvious reason: it is not in their interest. Therefore, Palestinian aspirations cannot be met without building credible bargaining power to force Israel to do things which are not in its interest. And I think those are the three questions that face post-Oslo development strategies. From my position as an outsider I may have gotten many things wrong. Please excuse me if I have. Thank you very much.