Macroeconomic and Fiscal Framework for the West Bank and Gaza: Sixth Review of Progress[1]

Staff Report for the Meeting of the Ad Hoc Liaison Committee

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[1] This report was prepared by a team comprising Oussama Kanaan (Chief of Mission), Javier Gomez, and Mariusz Sumlinski. The macroeconomic and fiscal framework set out in the Palestinian Reform and Development Plan (PRDP) was assessed by IMF staff in "Medium-Term Macroeconomic and Fiscal Framework for the West Bank and Gaza," issued on December 5, 2007. Staff reports on the West Bank and Gaza are published on the IMF website (www.imf.org/wbg).

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EXECUTIVE SUMMARY

The recovery of the West Bank and Gaza (WBG)'s economy has continued, with real GDP growth projected at 8 percent in 2010. In Gaza, growth was boosted by a gradual relaxation by the Government of Israel (GoI) of restrictions on imports, culminating in the lifting of import controls on consumer goods and inputs for donor-supervised projects. In the West Bank, growth has been driven by the Palestinian Authority (PA)'s security and public finance reforms supported by donor aid, and the easing of obstacles on internal movement of goods and people.

The economy is expanding from a very low base, especially in Gaza where living standards are well below those that prevailed in 1994. Gaza's output per capita is today at only 60 percent of its 1994 level, and its unemployment is still above 35 percent, one of the highest in the world. The West Bank has fared better, but its recovery started only in 2007, following a slump, with Prime Minister Fayyad's aid-supported reforms. Overall, the WBG's overall growth performance since 1994, as indicated by its general trend and volatility, has been weaker than for countries that had a comparable GDP per capita in 1994.

For growth to be sustained, it is essential that the remaining restrictions on economic activity be lifted. Gaza's recovery will wane unless the ban on exports and on imports of private sector capital inputs is removed. Similarly, the West Bank's growth is bound to decline with the persistence of restrictions on movement and access, in particular those on exports to Israel and East Jerusalem, and on access by the private sector to about 60 percent of its territory ("Area C"). Removing these restrictions is also important for a more efficient pattern of output where trade-dependent sectors, including manufacturing, are no longer suppressed.

The PA has continued in 2010 to build institutions and undertake reforms as set out in its Palestinian Reform and Development Plan, but has been facing serious liquidity difficulties due to shortfalls in donor aid. Since 2007, sound and transparent expenditure management and enhanced tax administration have led to a decline in the share of wages and utility subsidies in the budget, a pickup in domestic tax revenue, and a reduction in the recurrent deficit and of donor aid needed to finance it from $1.8 billion in 2008 to $1.2 billion in 2010. Fiscal performance during January to July 2010 has been broadly as envisaged in the 2010 budget. However, lower-than-budgeted donor aid has led to substantial borrowing from domestic banks and the accumulation of payment arrears. There is an urgent need to secure additional donor assistance of $0.3 billion to cover the financing gap for 2010.

To support private sector expansion and further enhance public sector efficiency, it is essential for the PA to maintain its solid track record by accelerating key structural reforms. These reforms include enhancing the social safety net, privatizing electricity distribution, improving the legal and regulatory framework for businesses, restoring the viability of the public pension system, and implementing civil service reform.

I. Recent Economic Developments

1. **The macroeconomic situation continued to improve in the West Bank and Gaza, with solid economic growth registered so far in 2010.** Real GDP growth in the first half of 2010 (compared to the first half of 2009) is estimated at 9 percent for the West Bank and 16 percent for Gaza. In the West Bank, private sector confidence continued to be bolstered by good management and reforms by the Palestinian Authority (PA) supported by donor aid, improvements in security conditions, and fewer controls on internal movement of goods and people than in early 2009. The recovery in Gaza was driven by a gradual easing of the blockade. However, exports from the WBG to Israel, as well as imports by the private sector of capital inputs and raw materials, continue to be restricted.[2] The growth pattern continues to be heavily skewed toward services, while activity in sectors that depend on investment inputs and export markets, notably manufacturing, continues to be suppressed. Given the uncertain prospect for further easing of trade controls in the remainder of the year, real GDP growth for the WBG in 2010 is conservatively projected at 8 percent.

2. **The sustainability of the strong growth performance for the remainder of 2010 and beyond is uncertain due to persisting restrictions on movement and access**:

- Since July 2010, the Government of Israel (GoI) has adopted a more liberal trade policy toward Gaza and lifted restrictions on imports of consumer goods and inputs for donor-supervised public investment and reconstruction projects.[3] However, the policy maintains the restrictions on private sector imports of capital goods and raw materials, as well as the ban on exports and on the movement of Gazans across external borders.[4] Given Gaza's limited domestic

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[2] Based on data from Israel's Central Bureau of Statistics, exports of goods and nonfactor services from the WBG to Israel are estimated to have contracted by 18 percent in real terms in 2009, followed by a further decline of 1 percent in the first quarter of 2010.

[3] The GoI's new policy is based on the application of a "negative list" of prohibited imports that covers (i) weapons; and (ii) items that could potentially have a dual military/civilian use, except imports destined for donor-supervised public investment and reconstruction projects. Since investment inputs, including construction materials, are classified as "dual-use" items, the policy in effect maintains the ban on imports of private investment inputs. The policy did not lift restrictions on exports and movement of Gazans across external borders.

[4] Changes in the number of truckloads of imports into Gaza, which are monitored by the Palestine Trade Center, give an indication of the impact of the new policy for Gaza. The weekly average number of trucks during January to June 2010 is estimated at 553. The average number rose by about 66 percent to about 920 in July, following the implementation of the policy. Nevertheless, the new level is well below the 2005 weekly average of about 2800, before the onset of Gaza's blockade in 2006. Two factors explain the difference. First, unlike in 2005, construction inputs and raw materials to the private sector are not allowed in. To illustrate, while inputs and raw materials accounted for 65 percent of the total volume of an average truckload in 2005, in July 2010 they represented only 4 percent. Second, today there are significant capacity constraints at the Gaza-Israel borders, which did not exist in 2005. See "Gaza Strip Crossings Bi-Monthly Monitoring Report, June–July 2010," see www.paltrade.org.

market, especially in view of its separation from the West Bank, the high economic growth hitherto recorded is unlikely to last if imports of private investment inputs and exports to Israel remain prohibited.

- In the West Bank, the GoI has continued in the first half of 2010 to remove roadblocks and other barriers to movement, which further reduced transportation costs and facilitated internal merchandise trade.[5] However, restrictions on exports to Israel persist, as well as on private imports of machinery and equipment classified as "dual-use" items. Also, there has been no easing of restrictions on private investment in "Area C", which represents 60 percent of the West Bank's territory.[6] The Separation Barrier continues to be tightened, with a particularly adverse impact on the traditionally strong trade links between the West Bank and East Jerusalem. Tapping the West Bank's full growth potential will require removing the above restrictions, especially as Israel's economy is over twenty times as large as that of the WBG, and given that the territories are fragmented into Palestinian areas and Israeli settlements, and have no direct access to external markets through their own seaports or airports.

- While overall growth has been strong in the first half of 2010, it continues to stem primarily from growth in services and construction, with the composition of private sector output reflecting long-standing controls on external trade rather than the WBG's comparative advantage. Figure 1 depicts the evolution of the sectoral shares in GDP relative to their 1994 levels when trade between the WBG and Israel was largely unhindered. Especially worrisome is the decline in the share of agriculture in total output from 13 percent in 1994 to 6 percent in the first half of 2010, as well as that of manufacturing from 20 percent to 10 percent over the same period. The manufacturing sector has been especially adversely affected by higher production costs owing to controls on imported capital goods and raw materials, as well as constrained revenue due to restrictions on access to outside markets. In contrast, sectors producing non-tradables and those that are less vulnerable to physical controls, notably in construction-related activities and services, have fared much better.

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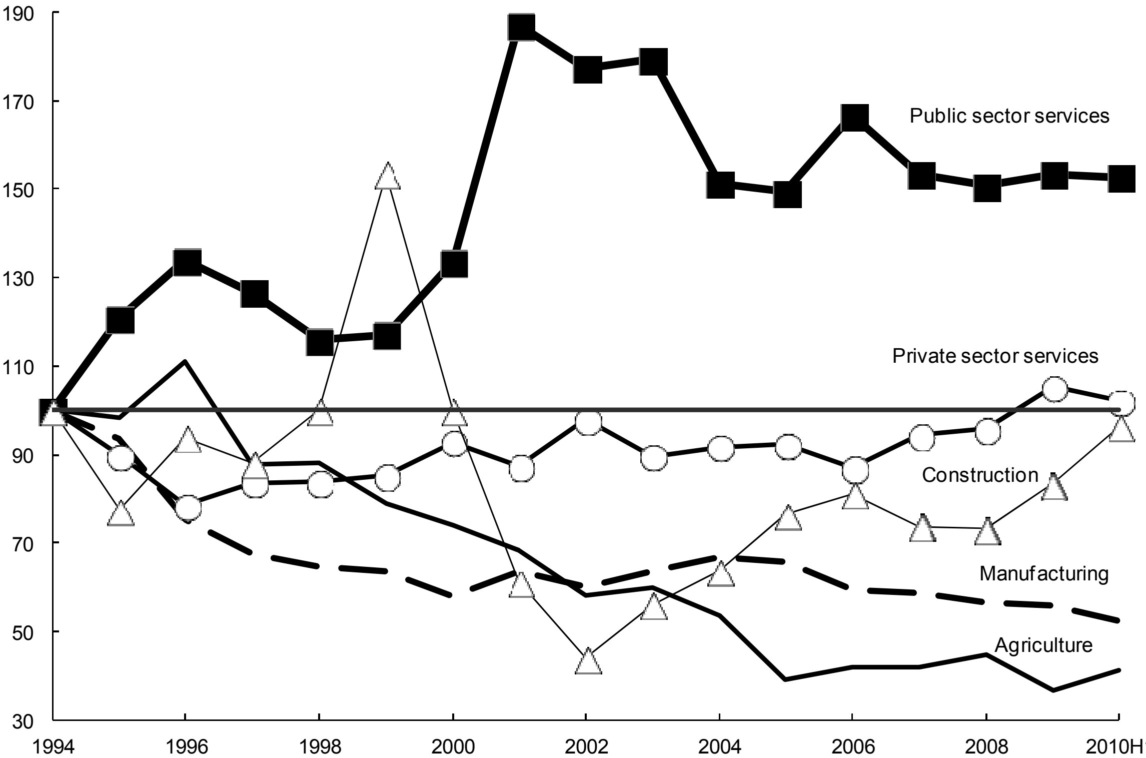
[5] According to the UN Office for the Coordination of Humanitarian Affairs (OCHA), the number of obstacles to movement within the West Bank declined from 626 obstacles at end-March 2009 to 505 obstacles as of end-March 2010. For updates, see www.ochaopt.org.

[6] For details of the restrictions on investment in "Area C", see the report by OCHA, "Restricting Space: The Planning Regime Applied by Israel in "Area C" of the West Bank," December 2009. For details on the physical obstacles and non-trade barriers to the access of goods from the West Bank to Israel see the World Bank's report "An Analysis of the Economic Restrictions Confronting the West Bank and Gaza," published on www.worldbank.org. For a description of non-physical restrictions see "Movement of Goods from the West Bank to East Jerusalem and Israel," January 2010, by the Palestine Trade Center, published on www.paltrade.org.

Figure 1. West Bank and Gaza: Shares in GDP of Sectoral Output Relative to 1994
(Index; 1994=100)



Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates.
Note: In 1994, the shares as a percent of GDP were as follows: 9 for public sector services, 46 for private sector services, 9 for construction, 20 for manufacturing, and 13 for agriculture.

3. **Given the uncertainty regarding its quality and sustainability, the WBG's real GDP growth for 2010 as a whole is conservatively projected at 8 percent**, despite the 10.5 percent growth estimated for the first half of the year. In Gaza, output had been highly suppressed in the first half of 2009 by the exceptionally tight blockade and impact of the war. The relaxation of import restrictions allowed the satisfaction of substantial pent up demand by consumers for goods and services that had hitherto been scarce. The extent of this pent up demand, and the duration of its impact on output, are still unclear. The absence of a significant decline in unemployment in Gaza (see below) is especially worrisome, as it could indicate that the rise in output took place on the basis of a better utilization of already employed resources, without significant investment and hiring.[7] In the West Bank, there is a risk of continued donor aid shortfalls and consequent sharp curtailment of government expenditures in the remainder of 2010. This could dampen growth both directly and through reduced private sector confidence in the ability of the government to prevent further payment arrears.

[7] The hiring of workers by Gaza businesses could be indirectly constrained by the restrictions on private sector imports of capital goods and raw materials, depending on the extent of capital-labor complementarity in production.

4. **Unemployment has been declining in the West Bank but virtually unchanged in Gaza.** Unemployment in the West Bank has declined from an average of 18 percent in the first half of 2009 to 16 percent in the first half of 2010. However, Gaza's unemployment has remained unchanged at about 37 percent in both periods. While in the West Bank unemployment has been on a declining trend since 2002, Gaza's unemployment rate has remained above 30 percent since then. Although the number of West Bank workers allowed into Israel has been rising since 2007, as a share of the labor force it has remained at about 11 percent, thus contributing little to the decline in unemployment.[8] Unemployment should decline faster once controls on exports and on investment inputs are relaxed, uncertainty on the sustainability of growth diminishes, and the private sector becomes more confident of steady access to outside markets.

5. **Inflation has been on a declining trend so far in 2010.** The WBG's twelve-month CPI inflation rate (assessed in NIS) fell from about 5 percent in January to 3 percent in July. The decline reflected lower inflation in Israel, the easing of import restrictions, as well as the fall in world food prices. While Gaza's inflation had risen sharply above that of the West Bank as the blockade intensified during 2008, it has been on a declining trend following the end of the Gaza war in early 2009. By July 2010, inflation was significantly lower in Gaza (1 percent) than in the West Bank (3 percent), and East Jerusalem (5 percent), reflecting the marked relaxation of the blockade on foodstuffs and other consumer imports, as well as food's higher weight in Gaza's consumption basket compared to the other regions.

6. **Commercial banks have not been significantly affected by the global financial crisis and are performing well.** Overall, banks in the WBG continue to have very limited exposure to global markets, and apply conservative lending practices domestically.[9] In the West Bank, private deposits in U.S. dollar terms rose by 7 percent in the year to June 2010, in line with private income growth. In Gaza, private deposits declined by 9 percent, reflecting large cash withdrawals to satisfy pent up demand for consumer goods following the relaxation of import controls. Credit to the private sector in the West Bank rose by 40 percent mostly to finance internal trade and construction activities. In Gaza, banks' prospects have improved as a result of the easing of restrictions by the GoI on the entry of consumer goods and bank-notes (see below), and as depositors have become increasingly confident in their ability to withdraw cash. While the restrictions on the entry of Jordanian dinars and

[8] The restrictions on the number of Palestinian workers allowed into Israel since 2000 have been much tighter in Gaza than in the West Bank. While about 27,000 workers were allowed from Gaza in 1999, or 13 percent of its labor force, the number over the past decade has been negligible. In the West Bank, the restrictions led to the decline in the number of workers from 108,000 in 1999, or 19 percent of the West Bank's labor force, to an average of 54,000, or 11 percent of its labor force, during 2001-06. While the number of West Bank workers in Israel has increased since the advent of Prime Minister Fayyad's government in 2007, reaching an average of about 80,000 in the first half of 2010, as a share of the West Bank's labor force it has remained at the 2001–06 average of 11 percent.

[9] The share of non-performing and watch list loans in total loans continued its downward trend, falling to 3.1 percent at end-June 2010, from 11.0 percent at end-2008 and 3.7 percent at end-2009.

U.S. dollars are still formally in place, their impact has been limited since June/July 2010 with the inflows of these currencies through crossings at which controls have been eased, as well as the facilitation by the GoI of their entry for the purpose of payments by international organizations. The improved conditions in Gaza led to a rise in private credit by 8 percent, reversing a declining trend since end-2007. However, the latter recovery is unlikely to last without a revival in private investment, which requires lifting restrictions on imported inputs. The rise in credit in the WBG also stems from significant improvements in financial market infrastructure since 2009, including the establishment of the credit registry, which allows a better assessment of borrowers' creditworthiness. The PMA continues to make progress in institutional reforms with intensive Fund technical assistance (Box 1).

7. **The Palestine Monetary Authority (PMA) and the Bank of Israel (BoI) have been collaborating closely to facilitate cooperation between Palestinian and Israeli commercial banks**. In 2009, large shekel cash surpluses had accumulated at Palestinian banks due to Israeli banks' refusal to accept these cash deposits on concerns about legal implications. That problem was resolved in July 2010 through a special arrangement whereby the excess shekel cash is regularly deposited at Israeli banks' accounts with the BoI. The BoI and PMA are currently working on ways to ensure the regular transfer into Gaza of cash amounts adequate to cover fully commercial banks' needs, without pre-set limits on quantity or currency composition.[10] Such flexibility has already allowed the transfer into Gaza, since July 2010, of cash amounts beyond the usual NIS 50 million per month limit, and the replacement of NIS 31 million in tattered bank-notes with new ones.

[10]An informal agreement was reached in 2009 between the PA and Israeli authorities to allow the passage of 50 million shekels per month. The agreement does not cover the entry of Jordanian Dinars or U.S. dollars.

Box 1. Reforms by the Palestine Monetary Authority

The Palestine Monetary Authority (PMA) has continued institutional reforms, supported by IMF technical assistance. The PMA's principal goal is to support a healthy banking system through rigorous supervision and prudential regulations in line with international practice. These regulations are applied to all Gaza and West Bank banks through regular on-site and off-site supervision. The PMA applies a broad range of prudential instruments, including required reserves ratios, minimum capital requirements, minimum liquidity ratios, and limits on credit concentration and currency exposure. Since 2008, it has been monitoring banks' compliance with a corporate governance code in line with Basel II standards. The PMA's medium-term objective is to become a full-fledged central bank, and over the past year it has made progress in several areas:

- The PMA has further strengthened **the supervision and regulatory framework**. It has advanced along its roadmap aimed at a full implementation of Basel II standards by end-2011. In May 2010, the PMA issued regulations governing the disclosure of information by financial institutions according to those standards. In January 2010, a unit was created at the PMA to enforce "Fair Lending Regulations" to standardize and improve the quality of information on banks' credit policies and conditions applied to borrowers and guarantors. In August 2010, regulations governing the process of commercial banks' mergers and acquisitions were adopted. These regulations are being applied to two recent bank mergers undertaken to strengthen the smaller banks' capital base. The PMA has also been applying Basel standards and procedures in the liquidation of banks that cannot meet prudential standards, including the liquidation of the Principal Bank for Development and Agricultural Credit in 2009 and the Al-Aqsa Islamic Bank in April 2010.

- In July 2010, **a modern credit scoring system** became fully operational as part of the online-based credit registry, further enhancing the quality of information on borrowers' creditworthiness and facilitating bank's lending to new customers. The check-tracking system, in operation since end-2009, has contributed to the decline in bounced checks by an estimated 27 percent during the first half of 2010.

- The PMA is aiming at completing the installation of **an electronic payment system** by end-2010, including a Real Gross Time Settlement System (RGTS) and an Automated Clearance House. The system will raise bank payments' efficiency and help reduce liquidity risk. User Acceptance Testing (UAT) of the system, in line with international practice, has started in July 2010, with a view to identifying potential problems before the start of operation scheduled for January 2011. The PMA will be holding workshops in the remainder of 2010 to train staff of commercial banks in the use of the system.

- A new Banking Law to strengthen the financial sector's **legal framework** has been approved by the Cabinet in March 2010, and is expected to be signed by the President by October 2010. A new Central Bank Law, which guarantees the independence of the PMA, is currently being reviewed by the Cabinet. An Anti-Money Laundering (AML) law has been in force in line with international standards since October 2007, with technical assistance from the IMF and USAID.

II. Fiscal Developments in 2010

8. **While the PA's fiscal performance during January to July 2010 has been broadly as envisaged in the budget—with the recurrent deficit still projected at 18 percent of GDP—shortfalls in donor aid have led to domestic payment arrears and borrowing from commercial banks**:

- Budgetary revenue, excluding one-off items such as dividend payments and license fees, was in line with the budget. Clearance revenues were lower than the pro-rated budget amounts, reflecting suppressed imports into Gaza due to the restrictions until July 2010.[11] The lifting of restrictions on consumer imports into Gaza since July is expected to raise Gaza's clearance revenue in the remainder of the year. The shortfall in clearance revenue was offset by the strong pick-up in the West Bank's domestic tax revenue, reflecting higher-than-expected growth in early 2010 and better compliance. One-off items, classified under "non-tax revenue", were lower than budgeted due to lower license fees and dividend payments.

West Bank and Gaza: Clearance Revenues

	2008			2009			2010
	Jan.-Jul.	Aug.-Dec.	Year	Jan.-Jul.	Aug.-Dec.	Year	Jan.-Jul.
	(In millions of shekels)						
Total clearance revenue	2,217	1,700	3,918	2,393	1,979	4,372	2,702
West Bank	1,992	1,522	3,514	2,216	1,804	4,020	2,510
Gaza	225	178	404	177	175	352	192

Source: Ministry of Finance.

- The 2010 wage bill is projected to be about 2 percent higher than budgeted (or by about $30 million) partly reflecting adjustment of allowances to some categories of employees, consisting of: (i) a one-off payment of arrears on "hardship allowances" owed to health workers; and (ii) an adjustment of allowances to supervisors that was not taken into account in the budget. Aside from the latter adjustments, the rise in the wage bill was limited to the budgeted increase in the general wage rate by 4 percent, and a rise in net public sector employment within the yearly limit of 3,000 employees. The number of public sector employees rose by 2,107 during January to July, of which 421 in health, 865 in education, 465 in security, and 365 in other sectors.

[11] Clearance revenue from taxes on fuel and other petroleum products has also been lower than usual in the first half of 2010 due to the decline in the quantity of fuel and other petroleum products imported into Gaza, including as a result of the increased substitution of fuel from Israel with cheaper fuel from Egypt.

- Facing aid shortfalls and uncertainty regarding the timing of disbursements, the MoF issued orders to line ministries to keep their non-wage expenditure commitments below the pro-rata budgeted amounts. This was facilitated by the computerized accounting system that now links the MoF with all line ministries. Non-wage recurrent expenditure commitments were lower than the pro-rata budget amounts by about $77 million during January to July. All spending categories were lower than budgeted, including operational expenditures (by $30 million), transfers (by $33 million), and minor capital expenditures (by $14 million).

- Net lending (including payments by the central government for utility bills owed by municipalities) declined as envisaged in the budget. The decline reflects: (i) better monitoring and incentives to pay bills, including installation of pre-paid meters in the West Bank; and (ii) increased payments by the Gaza Electricity Distribution Company (GEDC) for fuel used by the Gaza Electricity Generating Company (GEGC) to produce electricity. Net lending is expected to continue to fall as responsibility for electricity distribution in the north of the West Bank is transferred from municipalities to a private company, the Northern Electricity Distribution Company (NEDCO).

- Donor aid to finance the recurrent budget in January to July 2010 was significantly lower than envisaged in the 2010 budget. Only about $546 million was disbursed compared to $725 million that the budget anticipated. In addition, aid for development projects was lower than planned by about $142 million, out of which $116 million was covered in cash by the treasury in anticipation of external aid disbursements, while the remaining $26 million accumulated as arrears.

- The aid shortfalls led to the accumulation of a total of $118 million in payment arrears including to the pension fund[12], private sector suppliers, and development projects (see table below). The liquidity difficulties also led the PA to borrow about $200 million from domestic banks during January to July, yielding a stock of debt to commercial banks of about $0.8 billion as of end-July 2010. While the interest rate on the commercial debt is on relatively good terms

[12] The MoF is currently taking stock of arrears owed by the government on pensions. These arrears consist of two broad categories (i) arrears related to employee service performed for the PA since 1994; and (ii) arrears related to employee service performed for the PLO prior to 1994. A preliminary estimate was made by the MoF for the stock of arrears in the first category, at $410 million as of end-July 2010 (out of which $41 million was accumulated during January to July 2010). The calculation of arrears for the second category is expected to be completed before end-2010.

compared to the average rate charged to private borrowers,[13] the large stock still yields a significant burden on the budget in interest payments (about $40 million in domestic interest payments is projected for 2010, or about 3 percent of non-wage expenditures), which ultimately will be reflected in increased external financing requirements for the budget.

- Development spending during January to July 2010 was well below the budgeted amount, reflecting the restrictions on the import of investment inputs into Gaza, as well as delays in disbursements noted above. The implementation of public investment projects is expected to accelerate in the remainder of the year, reflecting the recent relaxation of controls on imports of inputs destined to Gaza's donor-financed projects.

9. **Serious liquidity problems will emerge in the remainder of the year unless adequate donor aid is promptly disbursed.** From January to early September 2010, about $0.67 billion has been disbursed, and another $0.25 billion was indicated by donors for the remainder of the year, yielding total financing already disbursed or indicated of $0.93 billion.[14] Given the projected deficit of $1.24 billion, this yields a financing gap of about $0.3 billion for 2010. An improved donor coordination framework is needed to help ensure timely disbursements of committed aid, and allow the PA to better prepare for delays in disbursements.

Composition of Net Arrears Accumulation 2009–10

		2010
	2009	January to July
(In millions of U.S. dollars)		
Contributions to the pension fund:		
of which: employee's share 1/	43	20
government's share 2/	90	21
Private sector suppliers 2/	117	51
Development projects 3/	30	26
Total	**280**	**118**

1/ Item classified under "wage expenditures."
2 Items classified under "non-wage expenditures."
3/ Item classidied under "development projects."

[13] The average interest rate charged by domestic banks on commercial loans, the bulk of which is owed to the Arab Bank and the Bank of Palestine, is about 5 percent (an interest rate of 4 percent is charged on PA loans denominated in dollars, and 7 percent on loans denominated in shekels).

[14] Net bank borrowing for 2010, estimated at about $200 million as of end-July 2010, is envisaged to be fully repaid by end-2010 in line with the budget law.

Recurrent Budget Financing in 2008-10 (position as of September 7, 2010)

	2008 Disbursed	2009 Disbursed	2010 Budget	Jan. to Sept 7 Actual	Sept. 8 to Dec. Indicated 1/	2010 Indicated 1/	2010 Gap 2/
				(In millions of U. S. dollars)			
Total international aid	1762	1349	1240	674	251	925	315
Domestic bank financing (net)	-29	176	0	200	-200	0	0
Total Financing 2/	1733	1525	1240	874	51	925	315
			(a)	(b)	(c)	(b)+(c)	(a)-(b)-(c)

1/ International aid in the columns labeled "indicated" consists of amounts that have been disbursed or confirmed by the donors.

2/ The calculation of total financing gap in this table assumes no net domestic borrowing for 2010, in line with the budget.

Fiscal Indicators for 2009–11

(In millions of U.S. dollars, unless otherwise indicated)

	2009	2010				2011
		Budget	Jan.-Jul. Pro-rata budget	Jan.-Jul. Est.	Year Proj.	Year Proj.
Total net revenues	1,598	1,927	1,124	1,073	1,895	2,155
Gross domestic revenues	585	707	412	413	689	775
Tax revenues	301	377	220	253	424	475
Nontax revenues	284	330	193	160	265	300
Gross clearance revenues	1,103	1,320	770	705	1,280	1,500
Tax refunds	91	100	58	45	74	120
Total recurrent expenditures (commitment basis):	3,190	3,170	1,849	1,797	3,130	3,100
Wage expenditures	1,467	1,550	904	916	1,580	1,643
Non-wage expenditures	1,349	1,370	799	722	1,300	1,258
Net lending	374	250	146	159	250	200
Total recurrent expenditures (cash basis)	2,920	3,170	1,849	1,711	3,130	3,150
of which: non-wage expenditures (cash basis)	1,142	1,370	799	650	1,300	1,308
Recurrent balance (commitment basis)	-1,592	-1,243	-725	-724	-1,235	-945
Recurrent balance (cash basis)	-1,371	-1,243	-725	-628	-1,235	-995
Development projects (commitment basis)	430	670	391	171	450	700
Development projects (cash basis)	400	670	391	145	450	700
Overall balance (cash basis, including development expenditures)	-1,771	-1,913	-1,116	-772	-1,685	-1,695
Financing	1,771	1,913	1,116	772	1,685	1,695
External support for recurrent and development expenditures	1,755	1,913	1,116	576	1,685	1,695
External support for recurrent expenditures	1,355	1,243	725	546	1,235	995
External support for development expenditures	400	670	391	29	450	700
Domestic financing	176	---	---	197	---	---
Net external debt	-4	---	---	---	---	---
Memorandum items:						
GDP	6,117	7,022	7,022	7,022	7,022	7,806
Domestic tax revenue (percent of GDP)	4.9	5.4	3.1	3.6	6.0	6.1
Clearence revenue (percent of GDP)	18.0	18.8	11.0	10.0	18.2	19.2
Wage expenditures (commitment basis), percent of GDP	24.0	22.1	12.9	13.0	22.5	21.0
Net lending (including subsidies; percent of GDP)	6.1	3.6	2.1	2.3	3.6	2.6
External financing for recurrent budget (US$ billion)	1.35	1.24	0.73	0.55	1.23	1.00
Recurrent balance (commitment basis), percent of GDP	-26.0	-17.7	-10.3	-10.3	-17.6	-12.1
Recurrent balance (cash basis), percent of GDP	-22.4	-17.7	-10.3	-8.9	-17.6	-12.7
Net expenditure arrears accumulation (US$ billion)	0.30	---	---	0.12	---	---
of which: non-wage arrears	0.21	---	---	0.07	---	---
Net recurrent expenditure arrears accumulation (percent of GDP)	4.9	---	---	1.7	---	---
Total interest payments (US$ million)	53	55	32	22	55	55
Domestic payments	36	40	23	15	40	40
External payments	17	15	9	7	15	15

Sources: Ministry of Finance; and IMF staff estimates.

10. **The PA has continued to strengthen the Public Finance Management System**, which has helped prioritize and raise the quality of public expenditures. The implementation of measures since mid-2007 to increase transparency and accountability has greatly facilitated the disbursement of donor aid directly to the PA budget. Expenditure management was further enhanced in 2010:

- In May 2010, a commitment control system (CCS) was integrated into the Financial Management Information System (FMIS). The CCS automatically prevents expenditure commitments by line ministries that exceed amounts under "purchase orders" authorized by the MoF's General Accountant Department. While, prior to implementation of the CCS, line ministries tended to make commitments at budgeted levels, the new practice enforces the matching of commitments with cash availability with a view to minimizing arrears accumulation. The MoF is currently strengthening the CCS's operation by ensuring that the purchase orders are determined by monthly cash plans that take into account the likelihood of delays in donor aid.
- The preparation of the 2011 budget is using a special module that has been integrated into the FMIS to allow ministries to prepare their budgets on the basis of their program objectives, taking into account up-to-date information on budget execution in 2010. It also ensures that line ministries' requests for budget allotments are in line with the overall budget ceiling set by the MoF.
- The Chart of Accounts and budget classifications have been revised in line with GFS 2001, with technical assistance from DFID. These revisions have also been integrated into a CAS module, and are currently being employed in the preparation of the 2011 budget.
- The FY 2008 financial statements are currently being reviewed by the Supreme Audit and Administrative Control Bureau (SAAC), with assistance from Deloitte and Touche, with a view to completion by end-September 2010. The FY2009 financial statements are expected to be completed by the MoF and submitted to the SAAC by end-2010.
- Tax administration continued to be strengthened with technical assistance from the Fund and USAID. One important step has been the expansion of property tax collection from 25 to 34 municipalities (out of a total of 107 municipalities in the West Bank), with an additional 15 municipalities expected to be covered by end-2010. In June 2010, the authorities have started the implementation of an action plan for 2010–13 aimed at expanding the tax base and improving compliance, including the establishment of a unified revenue administration with a Large Tax Payers Unit, the computerization of taxpayers records with a "single file" system to reduce tax evasion, and strengthening supervision at border crossings to improve payments of trade-related taxes. Regarding the latter component, an important objective of the MoF for 2010–11 is to strengthen collection of clearance revenue from VAT through close cooperation with the GoI to ensure: (i) enhanced monitoring by PA officials of imports at key crossing points to raise collection of VAT invoices;

and (ii) an assessment of potential VAT revenue on the basis of comprehensive data compiled by the GoI on merchandise imports from Israel into the WBG.

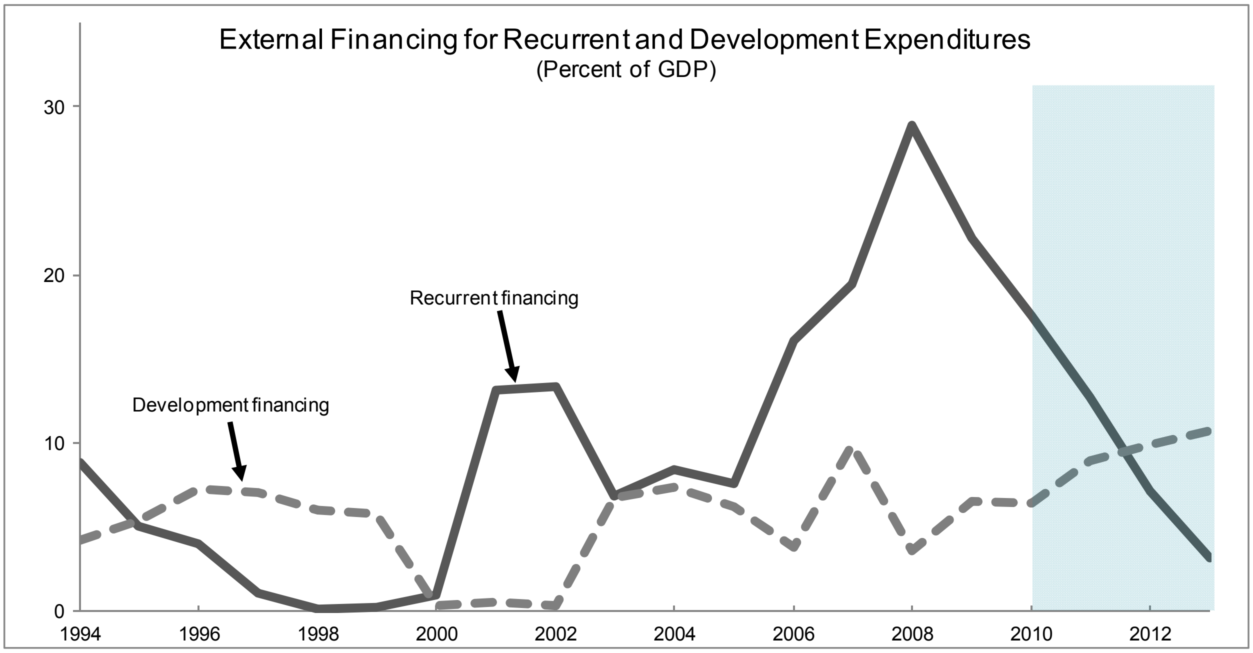
11. **The PA is considering a gradual approach toward the issuance of Treasury Bills.** Development of a Treasury Bills market would have a number of benefits including promoting the money and interbank markets, fulfilling the need for collateral in the new Real Gross Time Settlement System (RTGS, see Box 1), and can potentially lower the cost of funding for the PA. The authorities recognize that current conditions are not appropriate for a full scale issuance program, given the need for further progress toward fiscal sustainability. A recent IMF technical assistance mission has recommended a gradual approach, starting with a program to enhance the institutional and operational aspects of a Treasury Bills market, including through training and capacity building. Follow-up IMF missions will assist in such training, and assess the practicality of securitizing small amounts of existing nonbank debt into short-term marketable debt. The option of a broader issuance of securities should await further reductions in the government's financing requirements. A stable and predictable issuance policy is required for the success of even a small scale Treasury Bills market. Timely disbursements by donors are also essential to ensure that liquidity conditions can be accurately forecast.

III. Macroeconomic Outlook

12. **The revised macroeconomic framework continues to assume that all parties (PA, the GoI, and donors) pro-actively push the peace process forward and take measures to support the WBG's economic development.** In particular, it assumes that the easing of restrictions on movement and access that has continued in 2010 will accelerate. In Gaza, the further easing of the blockade will allow steadily rising imports of the investment inputs required by the private sector and relaxation of the ban on exports. In the West Bank, lifting of remaining internal restrictions will be complemented by removal of obstacles on external trade, in particular on exports to Israel, as well as on access of private investors to "Area C". The PA will continue a prudent fiscal policy and structural reforms to enable a sustained reduction in the recurrent budget deficit. Donors will disburse aid on time to cover both the narrowing budget deficit and expanded public investment and reconstruction needs.

13. **Given the above assumptions and policy expectations, growth—led by the private sector—would rise significantly, while under a pessimistic scenario it would significantly slow down.** Under the baseline scenario, the expansion of private sector activity and external trade enabled by continued easing of restrictions would support a rise of real GDP growth from 8 percent in 2010–11 to about 10–12 percent by 2012–13. The recurrent deficit would decline to a sustainable rate of 3 percent of GDP, with a shift in the composition of spending from wages and subsidies to public investment. This in turn would allow a shift in the composition of donor aid from recurrent budget financing to development projects, gradually moving back to the situation which prevailed in the mid-1990s when the bulk of the budgetary aid went to finance development expenditures (see Figure 2). This scenario is subject to the risk that the peace process would stall and that

Figure 2. Reliance on external aid for budgetary financing is projected to decline, with a shift in its composition toward development projects



Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates and projections.

West Bank and Gaza: Comparison of Baseline and Pessimistic Scenarios

	2009	2010	2011	2012	2013	2010	2011	2012	2013
		Baseline Scenario				Pessimistic Scenario			
Output and Investment									
Real GDP (percentage change)	6.8	8.0	8.0	10.0	12.0	5.5	4.0	4.3	4.4
West Bank	7.2	8.0	7.7	9.4	12.0	5.5	4.3	4.6	4.7
Gaza	5.4	8.0	9.0	12.1	12.2	5.5	3.0	3.2	3.2
Real GDP per capita (percentage change)	3.8	5.0	5.0	6.9	8.9	2.6	1.1	1.4	1.5
West Bank	4.4	5.2	4.7	6.3	8.8	2.8	1.4	1.7	1.8
Gaza	2.1	4.6	5.9	8.9	9.0	2.2	0.1	0.3	0.3
Gross capital formation (in percent of GDP)	30.7	30.7	33.5	34.7	36.0	24.6	26.8	27.3	27.3
Of which: public investment (in percent of GDP)	7.1	6.9	9.5	10.3	11.1	4.1	6.6	7.6	7.9
				(In percent of GDP)					
Public finances 1/									
Revenues	26.1	27.0	27.6	29.7	29.8	26.5	24.9	25.2	25.6
Recurrent expenditures and net lending	52.1	44.6	39.7	36.3	32.5	46.5	46.0	42.8	39.9
Recurrent balance (before external support)	-26.0	-17.6	-12.1	-6.6	-2.7	-20.0	-21.1	-17.7	-14.3
Recurrent balance, on a cash basis (before external support)	-22.4	-17.6	-12.7	-7.1	-3.2	-18.0	-13.1	-8.2	-4.3
Expenditure arrears accumulation	4.4	0.0	-0.6	-0.6	-0.5	1.9	8.0	9.5	10.0
Capital expenditures	6.5	6.4	9.0	9.9	10.7	3.6	6.1	7.1	7.4
(In millions of U.S. dollars)	400	450	700	873	1,095	250	457	575	650
External recurrent budgetary support (in billions of U.S. dollars)	1.4	1.2	1.0	0.6	0.3	1.2	1.0	0.6	0.3
Total external support, including capital expenditures	28.7	24.0	21.7	17.0	13.9	21.5	19.3	14.8	11.1
(In billions of U.S. dollars)	1.8	1.7	1.7	1.5	1.4	1.5	1.5	1.2	1.0
				(In percent of GDP)					
External sector									
Exports of goods and nonfactor services	12.7	13.5	16.0	20.0	21.4	11.6	12.2	12.7	13.6
Import of goods and nonfactor services	68.8	74.4	79.3	80.0	79.0	66.7	68.7	65.9	64.8
Current account balance (excluding official transfers)	-27.5	-33.5	-34.1	-31.1	-28.9	-24.2	-23.5	-19.9	-16.4
Current account balance (including official transfers)	1.2	-9.5	-12.3	-14.1	-15.1	-2.7	-4.2	-5.1	-5.3
Memorandum items:									
Unemployment rate (average in percent of labor force)	25	22	19	17	15	22	20	20	20

Sources: Palestinian authorities and IMF staff estimates.
1/ Commitment basis, unless otherwise stated.

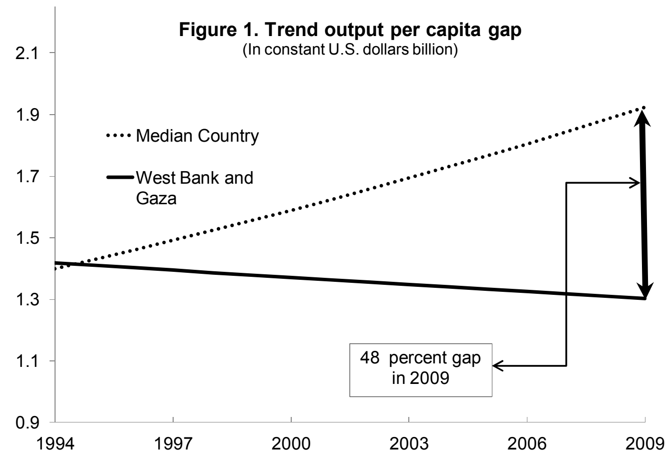
the easing of restrictions would slow. In the pessimistic scenario, real GDP growth would wane to an average of about 4 percent over the medium-term. Budgetary revenue would be lower, while emergency spending and arrears accumulation would be high, thus slowing the pace of fiscal adjustment, with the deficit remaining above 14 percent of GDP by 2013.

14. **The regional paths of real GDP per capita and unemployment are projected to start converging over the medium term**:

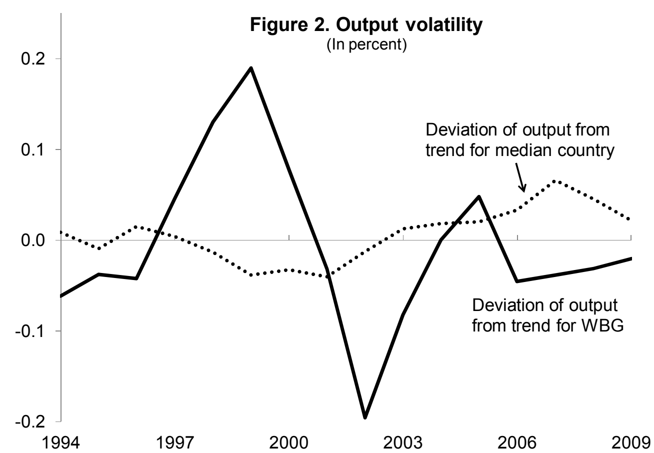
- The West Bank and Gaza's real GDP per capita has fluctuated widely since 1994. From 1994 to 1999, the early years following the Oslo agreement, the rising GDP per capita trend reflected the increased private sector confidence and institution-building as the PA took over key administrative responsibilities from the GoI, with open borders between Palestinian areas and Israel. From 2000 to 2002, real per capita GDP declined sharply with the unfolding of the second Intifada and sharp intensification of trade restrictions. From 2003 to 2005, it recovered to the 1994 level, in response to the limited relaxation of restrictions. Real GDP per capita then dipped again reflecting the onset of Gaza's blockade, before recovering in 2007 following the advent of Prime Minister Fayyad's government. By 2009, the WBG's real GDP per capita had fully recovered to its 1994 level. The WBG's overall growth performance, as reflected in trend output growth as well as output fluctuations, has been significantly worse than for other countries which had a comparable real GDP per capita in 1994 (Box 2).
- The movement of overall real GDP per capita reflects a wide divergence in regional output paths. The West Bank's real GDP per capita has grown steadily since 2007, reflecting the factors discussed in Section I, and is projected to be about 60 percent above its 1994 level by 2013. In contrast, Gaza's real GDP per capita has been on a downward trend since the blockade in 2006, with its recovery starting only in 2009. In the baseline scenario, Gaza's real GDP will be about 20 percent below its 1994 level by 2013, while in the pessimistic scenario it will be about 40 percent below that level (see Figure 3).
- The early years following the Oslo accords witnessed a steady fall in the West Bank's and in Gaza's unemployment rates to 10 percent and 17 percent. However, since the second Intifada, Gaza's rate has remained exceptionally high at an average of about 35 percent, while the West Bank's rate has been on a broadly declining trend. This divergence reflects the tighter restrictions in Gaza on external trade and on the employment of workers in Israel, the higher sensitivity of its output to such restrictions given its small domestic market, higher uncertainty faced by the private sector due to more frequent hostilities, as well as the degradation of public institutions and infrastructure since 2006. In the baseline scenario, the West Bank's unemployment rate is projected to decline to 11 percent by 2013, while that in Gaza would decline to 22 percent. In the pessimistic scenario, unemployment rates would remain high, at 15 percent in the West Bank and 29 percent in Gaza by 2013.

Box 2. Economic Growth Performance: A Comparison with Other Countries

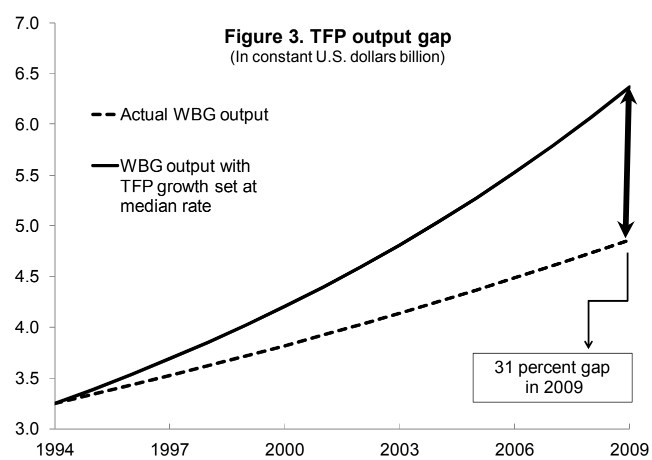
The Palestinian economy's growth performance since 1994, as discussed in Section III, has been adversely affected both by general restrictions on movement and access as well as the recurrence of episodes of conflict and intensified trade controls. These factors lowered the trend of output growth and induced substantial output fluctuations. Here we evaluate the WBG's performance against 13 countries that in 1994 had a "comparable" GDP per capita, i.e., at about 20 percent above or 20 percent below that of the WBG.[1] The following results provide an indication of the WBG's "growth performance gap" relative to the above comparator countries, given each country's path of real output per capita recorded since 1994.



- Each country's per capita output was decomposed into trend output and deviations from that trend. The countries were then ranked by the yearly growth of trend real output per capita for the period 1994 to 2009. The WBG ranked lowest in the group, with a growth rate of -0.6 percent. The median growth rate was 2.1 percent. By 2009, the trend output GDP per capita for the country with median growth was about 48 percent higher than that of the WBG (Figure 1).



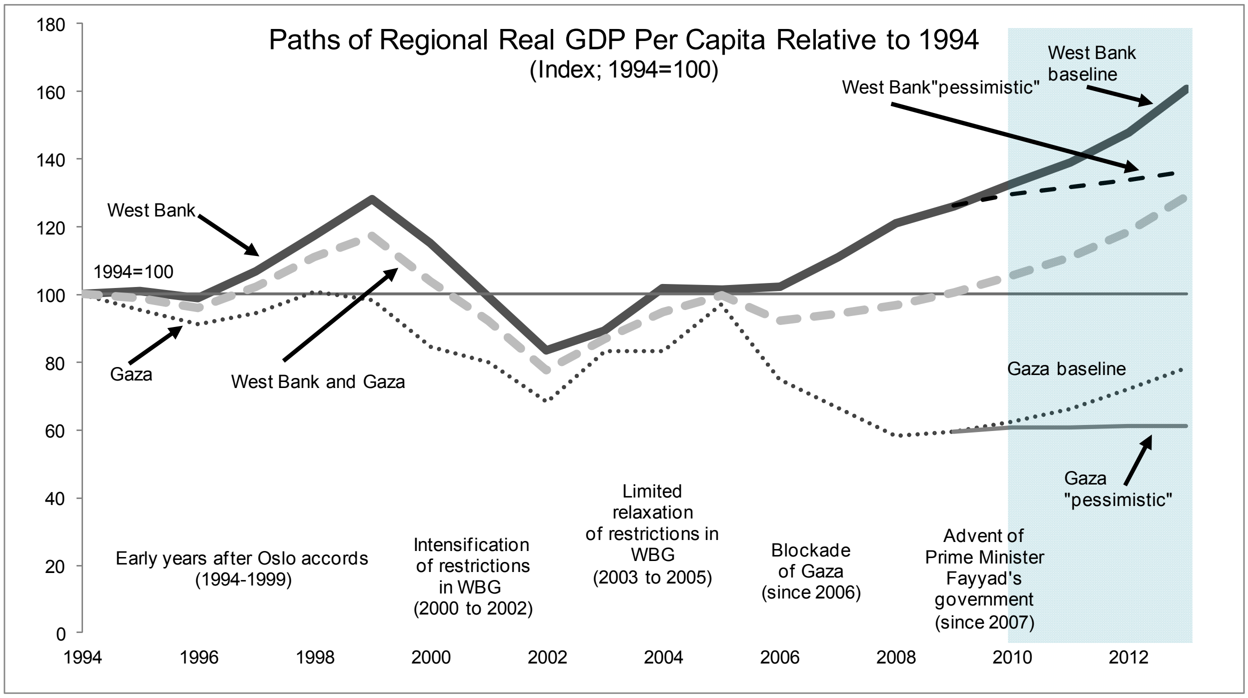
- Countries were then ranked by the volatility of their output as measured by the standard deviation of the output from trend. The WBG's output has the highest volatility in the sample, with a standard deviation of 10.2 percent, compared to the median standard deviation of 2.9 percent (Figure 2).

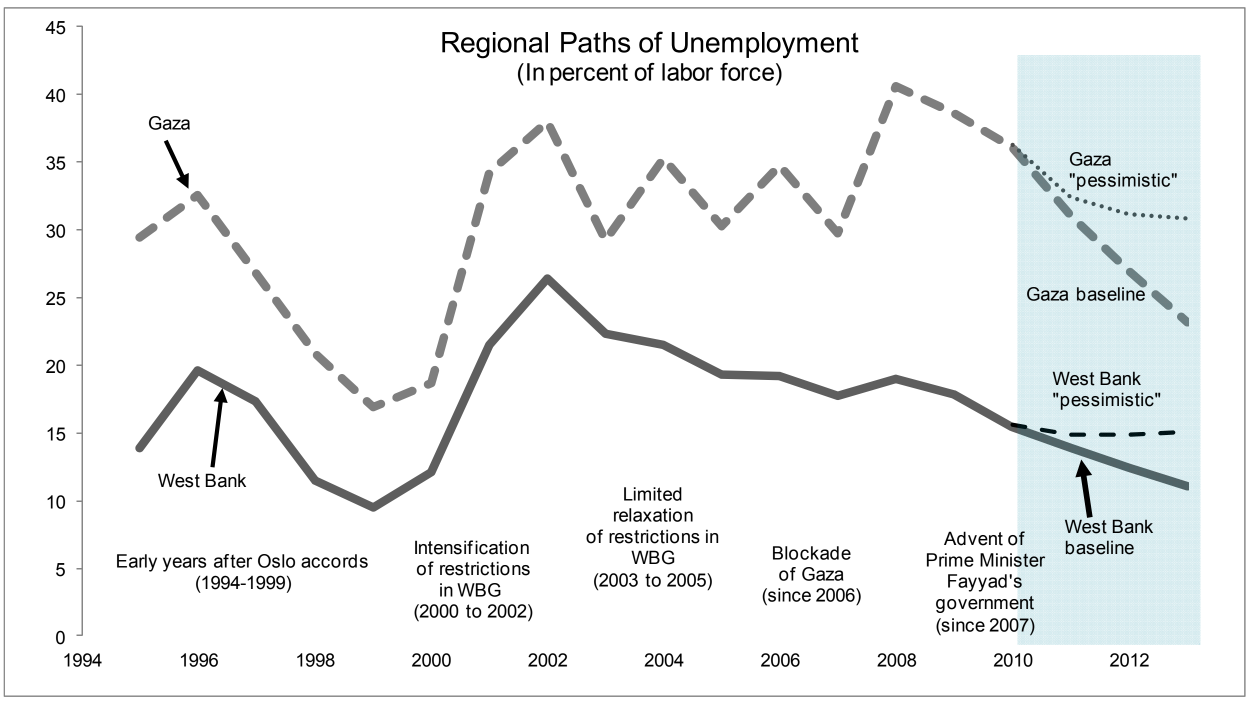


- A standard growth accounting framework was applied to decompose each country's output growth into contributions from capital, labor, and Total Factor Productivity (TFP). The WBG's average TFP growth per year during 1994–2009, at -0.4 percent, was the lowest in the group. Had the WBG had the median TFP growth of 1.3 percent, the WBG's real GDP per capita would have been about 31 percent higher in 2009 than it actually was (Figure 3).

1/ The set of countries consists of: Algeria, Cape Verde, El Salvador, Guatemala, Islamic Republic of Iran, Jordan, Lithuania, Maldives, Morocco, Papua New Guinea, Paraguay, Romania, and Syrian Arab Republic.

Figure 3. Regional Real GDP Per Capita and Unemployment Rates are Projected to Converge in the Baseline Scenario





Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates and projections.

15. **Key structural reforms will need to be stepped up in the remainder of 2010 to ensure steady progress toward fiscal sustainability and reduced reliance on recurrent budgetary aid, in line with the vision toward statehood presented in the "Program of the Thirteenth Government" and elaborated in the 2010–11 plan "Homestretch to Freedom":**[15]

- **Further streamline and better target social assistance.** In early 2010, several cash assistance programs in the West Bank have been merged into one central program with a single payment modality, based on a Proxy Means Test that more accurately identifies vulnerable households. Key measures to be implemented by end-2010 include: (i) revising the database of targeted households to ensure that only those below the poverty line receive assistance; and (ii) implementing a "lifeline electricity tariff", for households in the latter database, at which a "lifeline" amount of household electricity consumption is billed only at cost. The latter measure is especially important given the increase in prices as electricity distribution is commercialized. The above measures will ensure that transfers from the Ministry of Social Affairs are contained at about 4 percent of total non-wage spending over the medium term while ensuring adequate protection for the needy.
- **Phase out electricity subsidies, by completing the transfer of electricity supply and distribution from municipalities to commercial companies.** An important step taken in early 2010 was a transfer of electricity distribution from the municipality of Nablus to the Northern Electricity Distribution Company (NEDCO), and the installation of about 170,000 pre-paid meters to improve bills payment. A key objective to be achieved before end-2010 is the completion of the transfer of distribution from the remaining local governments in the northern West Bank region to NEDCO. The transfer of distribution in the remainder of the West Bank is expected to be completed by end-2011. The electricity reform measures are essential to halve the subsidies in 2010–11 (from 6–7 percent of GDP in 2008–09).
- **Reform the public pension system**: An important step taken in July 2010 was the adoption of a comprehensive public pension reform action plan for 2010–12. The plan aims at restoring the viability of the pension system in several phases during 2010–12. The first phase, to be completed by end-2010, consists of the elimination of early retirement and ensuring that pensions are paid only to those who have reached the minimum age and served the minimum number of years required by law. The remaining steps for 2011–12 include raising the retirement age and elimination of lump sum payments at retirement.[16]

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[15] The documents are published on the PA's Ministry of Planning website http://www.mop-gov.ps/new/index.php?langid=2.

[16] The staff of the IMF and World Bank, on the basis of the macroeconomic framework in this report, have jointly produced preliminary estimates of the impact of the different components of pension reform on the

(continued)

- **Initiate civil service reform aimed at a steady decline in the wage bill and greater public sector efficiency**. So far, the authorities have relied on controls on wage rates and new employment to contain the growth of the wage bill. While this approach has yielded substantial budgetary savings, it will need to be complemented by additional measures to ensure long-run sustainability and increased efficiency in the delivery of public sector services, especially in view of the continued real erosion of average government wage rates.[17] One important measure that could be implemented in the remainder of 2010 is a careful review of personnel needs in key sectors, including health and education, to fine-tune the current "blanket ceiling" of 3,000 new employees that is automatically placed in annual budgets. In parallel, a comprehensive review and audit of employees' qualifications and performance could be undertaken to pave the way for a new incentive structure with a wider salary scale.

- **While restrictions on movement and access are the main constraint on private sector development, the PA could still do a great deal to improve the investment climate for the private sector, in particular by enhancing the legal and regulatory framework.** The PA has been collaborating closely with the World Bank in the preparation of laws that ensure that incentives and regulations facing private investors are in line with best international practice. These laws, which have been approved by the Cabinet but are still awaiting the President's signature, should be enacted promptly.[18] It is also important to implement effectively the 2009 telecommunications law that requires the establishment of an independent regulator for that sector. As stressed by World Bank staff, the establishment of the regulator is essential to ensure a level-playing field for investors in the telecommunications sector.[19]

"implicit pension debt" defined as the present value of the pension system's projected liabilities to current and future pensioners. Assuming constant government real wages, the elimination of the early retirement option (for both the civil service and security schemes) yields an implicit pension debt of 28 percent of GDP, compared to 61 percent of GDP in the no-reform scenario. The increase in the retirement age yields an implicit pension debt of 32 percent of GDP, compared to 69 percent in the no-reform scenario. Under the assumption of declining government real wages, pension debt declines by even greater amounts.

[17] The average public real wage rate is estimated to have declined by a cumulative 9 percent during 2008–09, and is projected to decline by a further 1 percent in 2010.

[18] These laws include the New Companies Law, that removes the bureaucratic red tape faced by new companies; the New Investment Law and the New Industry Law, both of which ensure a fair treatment of private companies independently of the sector of operation; and the Movable Assets Law which facilitates access to bank finance by enabling the use of movable assets as collateral.

[19] For details of the measures needed to improve the legal and regulatory environment for the private sector, see the World Bank Economic Monitoring Report to the Ad Hoc Liaison Committee, September 21, 2010, "The Underpinnings of the Future Palestinian State: Sustainable Growth and Institutions."

16. **The preparation of the 2011 budget is underway taking into account the baseline macroeconomic outlook and structural reforms, as described above, with a view to its submission to the Cabinet by mid-November 2011**. In July 2010, the MoF received feedback from line ministries to guide the MoF's allocation of the overall expenditure envelope, including detailed inputs on: (i) ministries' core objectives for 2011–12, with a focus on 2011; and (ii) the financial resources required for the fulfillment of those objective. Preliminary work has started on setting targets for the budget's broad line items:

- Strict control on the wage rate (limited to the 1.25 percent automatic yearly increase) and on new employment (net addition of 3,000 employees) will continue. This implies a continued fall of the share of PA employees in the labor force.
- Nonwage expenditures will be held at about the same level in dollar terms as in 2010. Continued strengthening of the Public Finance Management System will allow the elimination of lower priority spending, while tighter commitment controls and cash management will allow higher quality spending, and will help prevent arrears accumulation.
- Net lending is projected to decline by about 1 percentage point of GDP, reflecting continued commercialization of electricity distribution and measures to improve the incentives to municipalities and households to pay their electricity bills.
- The revenue-to-GDP ratio is conservatively projected to increase by about one percentage point, reflecting continued tax administration measures to improve enforcement and compliance.
- The recurrent budget deficit on a commitment basis is projected to decline from about 18 percent of GDP in 2010 to 12 percent in 2011, a substantial fiscal adjustment. Reflecting the lower deficit, external financing needs for recurrent expenditure would decline to about $1 billion in 2011.

IV. Assessment

17. **IMF staff considers that the PA has successfully implemented core institution-building and public finance reforms set out in its Palestinian Reform and Development Plan (PRDP) for 2008–10**. These reforms, supported by generous donor aid, have supported the revival of private sector activity and recovery of economic growth. Investor confidence has been reinforced by the PA's track record of establishing security in the West Bank, and its sound economic management including restraint on the public sector wage bill, reduced utility subsidies, prioritized public expenditures, transparent government finances, and enhanced tax administration. These reforms have also enabled a major stride toward fiscal sustainability despite recurrent delays in aid disbursements. It is essential for the PA to sustain this solid track record by accelerating key structural measures, including enhancing the social safety net to better target assistance to the poor, commercialization of

electricity distribution to phase out subsidies, implementation of the plan to restore the viability of the public pension system, and steps toward civil service reform.

18. **Concerted actions by the PA, the GoI, and donors are essential to stem substantial risks to the hitherto strong economic performance:**

- Removing remaining restrictions on movement and access is essential to maintain the growth momentum, rebalance the composition of output, and reduce regional disparities. In Gaza, where living standards lag far behind those in the West Bank, a lasting recovery in private sector investment and employment will require a removal of the ban on exports and private sector imports of capital goods and raw materials. Tapping the West Bank's full growth potential will require complementing the relaxation of restrictions on internal movement with a lifting of restrictions on exports to Israel, imports of machinery and equipment, and allowing greater access by the private sector to "Area C".

- The PA should continue to implement cost-saving measures and prioritize expenditures, including through the postponement of lower-priority projects, to meet the shortfalls in aid. While expenditure arrears cannot be fully prevented, these can be minimized though the effective use of the computerized accounting system to tighten commitment controls and enhance cash management, as well as by stepping up efforts to raise domestic tax collection. Given the uncertainty regarding availability of financing for 2011, it is particularly important to avoid raising spending commitments for 2011, such as increases in wage rates or new employment beyond the PRDP ceilings.

- The wage bill's share of GDP, at about 23 percent, is still much higher than the 10–15 percent that is typical of countries at a similar stage of development. Bold measures are needed toward a comprehensive civil service reform to reduce the wage bill while improving public sector efficiency. It will become increasingly difficult to reduce the wage bill by relying on a "blanket" restraint on wage rates and new employment, especially as the average public sector wage rate has already declined significantly in real terms since end-2007. With regard to public investment projects, the widening of the government's responsibility for their management is a welcome step—especially as these now include grassroots-driven "community projects"—but should continue to be done in close coordination with donors to ensure that the projects are fully financed before their implementation starts.

- The successful implementation of the PRDP since 2008 would not have been possible without the sustained aid for recurrent budget support from the donor community, which totaled about $4 billion since end-2007. The effectiveness of that aid has been reflected both in the strong economic recovery since then, as well as in the steady reduction in the recurrent deficit. The prudent fiscal policy enabled an impressive reduction in the amount of aid needed to finance the budget gap, from $1.8 billion in 2008 to $1.2 billion expected in 2010. However, the delays in disbursements have imposed a significant cost on the PA in terms of interest payments and additional premia required by private suppliers of goods and services as they face increased risk of payment delays. Timely disbursement of aid, in particular to cover the $0.3 billion financing gap for 2010, is essential to sustain reforms and orderly adjustment, and ensure early self-reliance by the PA.

Table 1. West Bank and Gaza: Selected Economic Indicators, 2008–13

(Population: 3.9 million; 2009 est.)
(Per capita GDP: $1,554; 2009)
(Poverty rate: 57 percent, of which 46 percent in the West Bank and 79 percent in Gaza Strip; 2007 est.)

		Est.	Projections			
	2008	2009	2010	2011	2012	2013
Output and prices			(Annual percentage change)			
Real GDP (2004 market prices)	5.9	6.8	8.0	8.0	10.0	12.0
CPI inflation rate (end-of-period)	7.0	4.3	3.0	3.0	3.0	3.0
CPI inflation rate (period average)	9.9	2.8	3.0	3.0	3.0	3.0
Investment and saving			(In percent of GDP)			
Gross capital formation, *of which:*	26.9	30.7	30.7	33.5	34.7	36.0
Public	4.1	7.1	6.9	9.5	10.3	11.1
Private	22.8	23.7	23.8	24.1	24.4	24.9
Gross national savings, *of which:*	35.7	32.0	21.2	21.2	20.6	20.9
Public	10.8	7.6	6.4	9.6	10.4	11.2
Private	24.8	24.4	14.8	11.6	10.2	9.7
Saving-investment balance	8.7	1.2	-9.5	-12.3	-14.1	-15.1
Public finances 1/			(In percent of GDP)			
Revenues	25.7	26.1	27.0	27.6	29.7	29.8
Recurrent expenditures and net lending	47.2	52.1	44.6	39.7	36.3	32.5
Wage expenditures	23.8	24.0	22.5	21.0	19.3	17.4
Nonwage expenditures	16.1	22.1	18.5	16.1	14.9	13.6
Net lending	7.3	6.1	3.6	2.6	2.1	1.5
Recurrent balance (commitment, before external support)	-21.6	-26.0	-17.6	-12.1	-6.6	-2.7
Recurrent balance, cash (before external support)	-27.7	-22.4	-17.6	-12.7	-7.1	-3.2
Development expenditures	3.5	6.5	6.4	9.0	9.9	10.7
(In millions of U.S. dollars)	215	400	450	700	873	1,095
Overall balance (before external support)	-25.1	-32.6	-24.0	-21.1	-16.4	-13.4
External recurrent budgetary support (in billions of U.S. dollars)	1.76	1.35	1.23	1.00	0.63	0.32
Total external support, including for development expenditures	32.4	28.7	24.0	21.7	17.0	13.9
(In billions of U.S. dollars)	1.98	1.75	1.68	1.70	1.50	1.42
Monetary sector 2/			(Annual percentage change)			
Credit to the private sector	-3.4	22.9	29.5	24.2	25.4	28.4
Private sector deposits	14.0	5.7	16.8	15.7	17.9	21.4
External sector			(In percent of GDP)			
Exports of goods and nonfactor services	14.4	12.7	13.5	16.0	20.0	21.4
Import of goods and nonfactor services	67.2	68.8	74.4	79.3	80.0	79.0
Net factor income	9.8	9.4	8.1	7.6	6.9	6.3
Net current transfers	51.7	47.9	43.3	43.3	39.0	36.3
Official transfers	32.4	28.7	24.0	21.7	17.0	13.9
Current account balance (excluding official transfers)	-23.6	-27.5	-33.5	-34.1	-31.1	-28.9
Current account balance (including official transfers)	8.7	1.2	-9.5	-12.3	-14.1	-15.1
Memorandum items:						
Nominal GDP (in millions of U.S. dollars)	6,108	6,117	7,022	7,806	8,855	10,221
Per capita nominal GDP (U.S. dollars)	1,597	1,554	1,735	1,874	2,066	2,317
Unemployment rate (average in percent of labor force)	26	25	22	19	17	15
Al Quds stock market index (annual percentage change)	-16.2	11.6	…	…	…	…

Sources: Palestinian authorities; and IMF staff estimates.

1/ Commitment basis.
2/ End-of-period; in U.S. dollar terms.

Table 2a. West Bank and Gaza: Central Government Fiscal Operations, 2008–13

	2008	2009	Budget 2010	Projections 2010	2011	2012	2013
	(In millions of U.S. dollars, unless otherwise stated)						
Total net revenues	**1,568**	**1,598**	**1,927**	**1,895**	**2,155**	**2,632**	**3,049**
Gross domestic revenues	562	585	707	689	775	1,083	1,310
Tax revenues	273	301	377	424	475	533	610
Nontax revenues	289	284	330	265	300	550	700
Clearance revenues (accrued)	1,122	1,103	1,320	1,280	1,500	1,683	1,887
Clearance revenues (cash)	1,137	1,090	1,320	1,280	1,500	1,683	1,887
Clearance revenues (net arrears)	-15	13	---	---	---	---	---
Tax refunds	116	91	100	74	120	133	148
Total recurrent expenditures and net lending (commitment)	**2,886**	**3,190**	**3,170**	**3,130**	**3,100**	**3,213**	**3,321**
Wage expenditures (commitment)	1,453	1,467	1,550	1,580	1,643	1,709	1,777
Wage expenditures (cash)	1,771	1,423	1,550	1,580	1,643	1,709	1,777
Wage expenditures (net arrears)	-317	43	---	---	---	---	---
Nonwage expenditures (commitment)	985	1,349	1,370	1,300	1,258	1,320	1,386
Nonwage expenditures (cash)	1,055	1,142	1,370	1,300	1,308	1,370	1,436
Nonwage expenditures (net arrears)	-70	207	---	---	-50	-50	-50
Net lending	447	374	250	250	200	184	158
Recurrent balance (commitment, before external support)	**-1,317**	**-1,592**	**-1,243**	**-1,235**	**-945**	**-581**	**-273**
add: expenditure arrears (net)	-387	270	---	---	-50	-50	-50
subtract: net clearance due (+) or repaid (-)	-15	13	---	---	---	---	---
add: arrears on tax refunds	---	-36	---	---	---	---	---
Recurrent balance (cash, before external support)	**-1,690**	**-1,371**	**-1,243**	**-1,235**	**-995**	**-631**	**-323**
Development expenditures (cash)	**215**	**400**	**670**	**450**	**700**	**873**	**1,095**
Overall balance (cash, including development expenditures)	**-1,905**	**-1,771**	**-1,913**	**-1,685**	**-1,695**	**-1,504**	**-1,418**
Total financing	**1,905**	**1,771**	**1,913**	**1,685**	**1,695**	**1,504**	**1,418**
Net domestic bank financing	-29	176	---	---	---	---	---
Other domestic financing	---	---	---	---	---	---	---
External financing for recurrent expenditures	1,764	1,355	1,243	1,235	995	631	323
External financing for development expenditures	215	400	670	450	700	873	1,095
Net external debt	-4	-4	---	---	---	---	---
Residual	-40	-156	---	---	---	---	---
Memorandum items:	(In percent of GDP; unless otherwise stated)						
Revenues	25.7	26.1	27.8	27.0	27.6	29.7	29.8
Recurrent expenditures and net lending	47.2	52.1	45.7	44.6	39.7	36.3	32.5
Wage expenditures	23.8	24.0	22.3	22.5	21.0	19.3	17.4
Nonwage expenditures	16.1	22.1	19.7	18.5	16.1	14.9	13.6
Net lending	7.3	6.1	3.6	3.6	2.6	2.1	1.5
Recurrent balance (commitment) before external support:	-21.6	-26.0	-17.9	-17.6	-12.1	-6.6	-2.7
Recurrent balance (cash) before external support	-27.7	-22.4	-17.9	-17.6	-12.7	-7.1	-3.2
External support (recurrent)	28.9	22.1	17.9	17.6	12.7	7.1	3.2
in millions of U.S. dollars	1,764	1,354.9	1,243	1,235	995	631	323
Development expenditures	3.5	6.5	9.7	6.4	9.0	9.9	10.7
Overall balance (cash)	-31.2	-29.0	-27.6	-24.0	-21.7	-17.0	-13.9
Total external support (in millions of U.S. dollars)	1,979	1,755	1,913	1,685	1,695	1,504	1,418
Nominal exchange rate (NIS per US dollar)	3.6	3.9	3.8	...	...	...	...
Nominal GDP (in millions of U.S. dollars)	6,108	6,117	6,940	7,022	7,806	8,855	10,221

Sources: Ministry of Finance; and IMF staff estimates.

Table 2b. West Bank and Gaza: Central Government Fiscal Operations, 2008–13

	2008	2009	Budget 2010	Proj. 2010	2011	2012	2013
	(In millions of shekels, unless otherwise stated)						
Total net revenues	**5,627**	**6,282**	**7,323**	**7,203**	**8,189**	**10,001**	**11,585**
Gross domestic revenues	2,017	2,300	2,687	2,620	2,945	4,115	4,977
Tax revenues	979	1,185	1,433	1,613	1,805	2,025	2,317
Nontax revenues	1,038	1,115	1,254	1,007	1,140	2,090	2,660
Clearance revenues (accrued)	4,027	4,338	5,016	4,864	5,700	6,394	7,172
Clearance revenues (cash)	4,080	4,286	5,016	4,864	5,700	6,394	7,172
Clearance revenues (net arrears)	-52	52	---	---	---	---	---
Tax refunds	417	357	380	281	456	507	564
Total recurrent expenditures and net lending (commitment)	**10,354**	**12,543**	**12,046**	**11,894**	**11,780**	**12,211**	**12,621**
Wage expenditures (commitment)	5,215	5,768	5,890	6,004	6,243	6,493	6,753
Wage expenditures (cash)	6,354	5,596	5,890	6,004	6,243	6,493	6,753
Wage expenditures (net arrears)	-1,139	171	---	---	---	---	---
Nonwage expenditures (commitment)	3,535	5,304	5,206	4,940	4,779	5,017	5,268
Nonwage expenditures (cash)	3,785	4,490	5,206	4,940	4,969	5,207	5,458
Nonwage expenditures (net arrears)	-250	815	---	---	-190	-190	-190
Net lending	1,604	1,471	950	950	758	700	600
Recurrent balance (commitment, before external support)	**-4,727**	**-6,261**	**-4,723**	**-4,691**	**-3,591**	**-2,209**	**-1,036**
Add: expenditure arrears (net)	-1,389	1,063	---	---	-190	-190	-190
Subtract: net clearance due (+) or repaid (-)	-52	52	---	---	---	---	---
add: arrears on tax refunds	---	-141	---	---	---	---	---
Recurrent balance (cash, before external support)	**-6,063**	**-5,391**	**-4,723**	**-4,691**	**-3,781**	**-2,399**	**-1,226**
Development expenditures	**771**	**1,573**	**2,546**	**1,710**	**2,660**	**3,317**	**4,161**
Overall balance (cash, including development expenditures)	**-6,835**	**-6,964**	**-7,269**	**-6,401**	**-6,441**	**-5,717**	**-5,387**
Total financing	**6,835**	**6,964**	**7,269**	**6,401**	**6,441**	**5,717**	**5,387**
Net domestic bank financing	-106	691	---	---	---	---	---
Other domestic financing	---	---	---	---	---	---	---
External financing for recurrent expenditures	6,328	5,328	4,723	4,691	3,781	2,399	1,226
External financing for development expenditures	771	1,573	2,546	1,710	2,660	3,317	4,161
Net external debt	-16	-16	---	---	---	---	---
Residual	-71	-612	---	---	---	---	---
Memorandum items:	(In percent of GDP; unless otherwise stated)						
Revenues	25.7	26.1	27.8	27.0	27.6	29.7	29.8
Recurrent expenditures and net lending	47.2	52.1	45.7	44.6	39.7	36.3	32.5
Wage expenditures	23.8	24.0	22.3	22.5	21.0	19.3	17.4
Nonwage expenditures	16.1	22.1	19.7	18.5	16.1	14.9	13.6
Net lending	7.3	6.1	3.6	3.6	2.6	2.1	1.5
Recurrent balance (commitment) before external support:	-21.6	-26.0	-17.9	-17.6	-12.1	-6.6	-2.7
Recurrent balance (cash) before external support	-27.7	-22.4	-17.9	-17.6	-12.7	-7.1	-3.2
External support (recurrent)	28.9	22.1	17.9	17.6	12.7	7.1	3.2
in millions of U.S. dollars	1,764	1,355	1,243	1,235	995	631	323
Development expenditures	3.5	6.5	9.7	6.4	9.0	9.9	10.7
Overall balance (cash)	-31.2	-29.0	-27.6	-24.0	-21.7	-17.0	-13.9
Total external support (in millions of shekels)	7,099	6,901	7,269	6,401	6,441	5,717	5,387
Nominal exchange rate (NIS per US dollar)	3.6	3.9	3.8	...	...	...	...
Nominal GDP (in millions of shekels)	21,916	24,055	26,372	26,684	29,664	33,650	38,839

Sources: Ministry of Finance; and IMF staff estimates.