MACROECONOMIC AND FISCAL FRAMEWORK FOR THE WEST BANK AND GAZA: SEVENTH REVIEW OF PROGRESS[1]

STAFF REPORT FOR THE MEETING OF THE AD HOC LIAISON COMMITTEE

Brussels, April 13, 2011

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EXECUTIVE SUMMARY

The economic recovery continued in the West Bank and Gaza (WBG) in 2010, with real GDP growth estimated at 9 percent in 2010. However, the recovery cannot be sustained without a further easing of Gaza's blockade and of restrictions on movement and access in the West Bank. Gaza's recovery represents mostly a "catch up" from a very low base following the tightening of restrictions in 2006. Despite the surge in Gaza's output by 15 percent in 2010, driven by the easing of import controls, its level is lower today than in 2005 by about 20 percent, and the unemployment rate remains high at about 38 percent. The West Bank's strong performance since 2008 has been enabled by PM Fayyad government's sound economic management and reforms supported by donor aid, as well as some easing of Israeli internal barriers. Nevertheless, the West Bank's growth, which is estimated at 8 percent in 2010, is also bound to wane, especially with the Palestinian Authority (PA)'s continued fiscal retrenchment and declining aid, without a strong stimulus from a further easing of Israeli restrictions.

The PA has pursued a tight fiscal stance in 2010, and continued to undertake structural reforms in line with the vision toward statehood presented in the Program of the Thirteenth Government. The PA's fiscal performance has been broadly as envisaged in the 2010 budget, with a marked reduction in the recurrent deficit from 26 to 16 percent of GDP. Lower-than-expected donor aid for both recurrent spending and development projects has led to a buildup of expenditure arrears and borrowing from commercial banks. Progress in structural reforms in 2010 included applying the social safety net to target social assistance to the truly needy; the transfer of electricity distribution from several West Bank municipalities to commercial companies to reduce implicit electricity subsidies; and steps toward comprehensive pension reform.

IMF staff considers that the PA is now able to conduct the sound economic policies expected of a future well-functioning Palestinian state, given its solid track record in reforms and institution-building in the public finance and financial areas. Steady reforms in the public finance management system have enabled the PA to tightly control expenditures, apply rigorous budget preparation and execution practices, and establish fiscal transparency and accountability in line with international standards. These reforms, along with a prudent fiscal policy, have contributed to a rise in the quality of spending and a sharp reduction in donor aid for recurrent spending, from $1.8 billion in 2008 to $1.2 billion in 2010, with a view to a further reduction to less than $1 billion in 2011. The Palestine Monetary Authority (PMA)'s institutional reforms have enabled it to fulfill core functions of a central bank. These functions include the application of a rigorous banking supervision and regulatory framework, providing a strong credit and payment infrastructure, and monitoring compliance with a governance code and an anti-money laundering law.

The PA has made major strides since 2008 in raising the quality, transparency and timeliness of the WBG's economic and financial statistics. The Palestinian Central Bureau of Statistics (PCBS) is expected to meet all the requirements of the IMF's Special Data Dissemination Standard (SDDS) in 2011, reflecting the best practices applied by the PCBS as well as by the ministries and agencies that provide the source data. The quality, transparency and timeliness of the data produced today by the PCBS, Ministry of Finance, and the PMA compare favorably with those of IMF member countries that maintain high data management and dissemination standards.

The draft Palestinian National Plan (PNP) for 2011–13 envisages a steady reduction in the recurrent budget deficit to about 4 percent of GDP by 2013. The draft PNP is ambitious but achievable given the PA's strong track record in implementing the equally challenging Palestinian Reform and Development Plan for 2008–10 presented at the Paris Donors' Conference in December 2007. To further raise public sector efficiency, phase out reliance on aid for the recurrent budget, and sustain private sector confidence, it is essential for the PA to step up the implementation of structural reforms, including electricity sector, pension, and civil service reforms. For 2011, it is particularly important for the PA to abide by the expenditure ceilings set in the 2011 budget to achieve the targeted reduction in the recurrent deficit from 16 to 13 percent of GDP, especially given the highly uncertain global environment and prospects for donor aid. While expenditure arrears and domestic bank borrowing cannot be fully prevented in case of continued shortfalls in donor aid, the PA should do its utmost to minimize these by continuing with cost-saving measures, prioritization of operational expenditures, postponement of lower priority projects, and by making effective use of the Financial Management Information System to better match expenditure commitments with cash availability.

To sustain the solid economic growth and reduce unemployment, prompt action needs to be taken by the Government of Israel (GoI) to ease restrictions on economic activity. The measures envisaged in the agreement between the Quartet Representative and the GoI in February 2011 are prime examples of initial practical steps that could be implemented despite political challenges. To ensure sustained and broad-based growth, it is important to implement these measures as scheduled and build on them by phasing out remaining restrictions on economic activity, in particular the restrictions on trade between the WBG and Israel, on internal barriers on movement in the West Bank, and on access by the private sector to about 60 percent of the West Bank's territory (Area C).

A key component of the agreement between the Quartet Representative and the GoI is the decision by the GoI to engage in discussions with the PA to agree on new measures to enhance the collection of clearance revenue. These discussions have started in March 2011, with the aim of settling outstanding issues by June 2011. One key objective should be to agree on practical steps to minimize clearance revenue leakages, including through: (i) enhanced monitoring by the PA officials of imports at border crossings to raise the collection of invoices for VAT and other taxes and fees; and (ii) an assessment of potential revenue on the basis of comprehensive data compiled by the GoI on imports from Israel into the WBG.

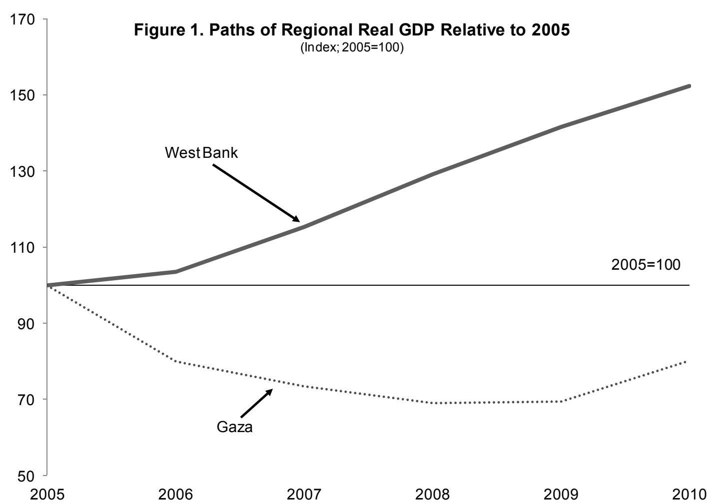
It is essential that adequate aid to support the PA's reforms be pledged as soon as possible and disbursed in a timely manner. For 2011, there is an urgent need to secure donor assistance to cover the recurrent financing requirements of $967 million. About $0.7 billion was disbursed or indicated by donors during the first quarter of 2011, leaving a financing gap of about $0.3 billion in the remainder of the year.

I. Recent Economic Developments

1. **The macroeconomic situation in the West Bank and Gaza (WBG) has improved in 2010, with overall real GDP growth estimated at 9 percent.**[2] In Gaza, the strong recovery was driven by the steady easing by the Government of Israel (GoI) since mid-2010 of restrictions on imports of consumer goods and inputs for public investment projects, following the tightening of controls in 2006.[3] In the West Bank, growth continued to benefit from higher private sector confidence underpinned by good management and reforms by the Palestinian Authority (PA) supported by donor aid. It also benefited from measures to ease restrictions in early 2010, including the removal of internal obstacles and enhancing the capacity of crossing points with Israel.[4]

2. **To sustain the strong growth performance, it is essential to further ease Gaza's blockade and restrictions in the West Bank**:

- While Gaza's growth in 2010 may appear impressive, much of it represents a "catch up" of real GDP following its contraction by a cumulative 30 percent during 2006–09 due to the blockade (Figure 1). In 2010, even following the surge in output, Gaza's real GDP was 20 percent below its 2005 level. Given Gaza's separation from the West Bank, sustaining Gaza's recovery will require the lifting of the ban on exports to Israel and imports of private investment inputs. As a first step, it is important to promptly implement and build upon the measures agreed between the Quartet Representative and the GoI in February 2011 (see Box 1).



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[2] Real GDP growth in 2010 is estimated at 8 percent in the West Bank and 15 percent in Gaza.

[3] The monthly average number of truckloads of imports rose from 2,470 in January–June 2010 to an average of 4,174 in July–December 2010. Nevertheless, the new level is still well below the 2005 monthly average of about 11,200, before the onset of Gaza's blockade, due primarily to remaining restrictions on imports of private investment inputs.

[4] 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 at end-2009 to 505 obstacles at end-March 2010, but remained at about that level in the remainder of 2010. In addition, during 2010 the GoI, with support from USAID, expanded the capacity of several crossing points between the West Bank and Israel to facilitate the flow of merchandise trade.

Box 1. Economic Measures Agreed Between the Quartet Representative and the Government of Israel

On February 4, 2011, the Quartet Representative and the Government of Israel (GoI) agreed on a series of initial, practical steps that need to be taken promptly. To expand Palestinian private sector activity and raise revenue to the Palestinian Authority (PA) in a sustainable manner, it is essential to build on those steps by lifting the remaining restrictions on movement and access.

I. Relaxing Gaza's export restrictions

Pre-agreement situation: Since the onset of the blockade in 2006, the GoI imposed a general ban on exports from Gaza. The GoI occasionally permitted the export of limited quantities of flowers and strawberries destined to EU markets.

Agreed measures:

- *Starting on April 1, 2011*, the GoI will permit the export of textiles, furniture, and agricultural products from Gaza to international markets (but not to Israel or the West Bank). As of mid-March 2011, the GoI has permitted the export to EU markets of limited quantities of cherry tomatoes and sweet peppers, in addition to flowers and strawberries.
- *By end-April 2011*, the GoI will decide on whether to allow PA-approved Gazan producers to transfer textiles and furniture to pre-approved West Bank purchasers.
- *Once a merchandise security scanner is installed*, *expected by mid-2011*, the GoI will increase the quantities, and potentially the range, of goods exported to all markets except Israel and the West Bank.
- *The GoI has agreed to consider, in due course, further relaxation of export restrictions.*

II. Relaxing Gaza's import restrictions

Pre-agreement situation: From 2006 to mid-2010, the GoI allowed into Gaza mostly humanitarian goods and limited quantities of consumer goods on a "positive list". Since mid-2010, it has applied a "negative" or "controlled goods" list, which in effect lifts restrictions on imports of consumer goods, as well as on inputs destined to pre-approved, internationally-supervised investment and construction projects. However, the policy has maintained import restrictions on a broad range of investment inputs for the private sector, including construction inputs, as well as machinery and equipment considered to have dual military/civilian use.

Agreed measures:

- The GoI has agreed to discuss with the United Nations the implementation of a pilot arrangement, *to start on April 1, 2011*, to allow PA-approved Gaza businesses to import limited quantities of construction inputs.
- *In progress since February 2011*: The GoI has agreed to pre-approve 20 new internationally-supervised construction projects in Gaza including in the health, housing, infrastructure, and environmental areas. The funders of these projects are preparing to implement them in coordination with the GoI.

III. Enhancing energy supply to the West Bank and Gaza

Pre-agreement situation: Since 2006, Gaza has depended for its energy mostly on an inefficient oil-based power station with obsolete equipment. Power outages have been frequent. Prior to September 2010, the plant was dependent on the provision of fuel purchased by the PA, but the subsidy was gradually phased out as payment of electricity bills by Gazan consumers improved.

Agreed measures:

- *By June 2011*: The GoI agreed to conclude preliminary discussions with the PA on the development of the Gaza Marine offshore gas field. The development of this gas field will provide energy to both the Gaza Strip and the West Bank.
- The GoI has agreed to approve the upgrading of the existing power station and the construction of a second one following the submission of the PA plans. It has also agreed to the use of the gas from the Gaza Marine (once developed) by the two plants, and to review requests to provide electricity to Gaza from Israeli sources.

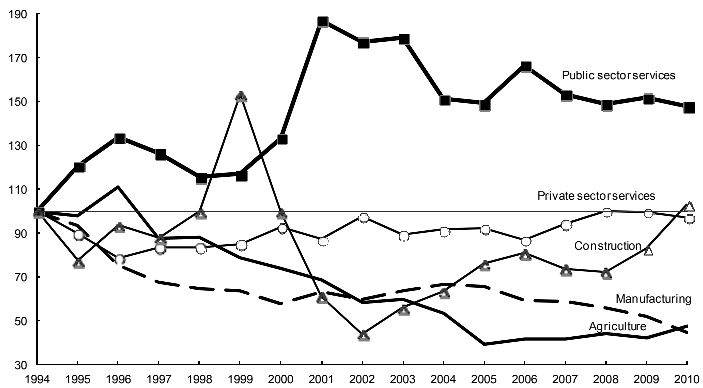
IV. Improving the collection of clearance revenue

A key fiscal objective of the PA has been to raise clearance revenue toward its full potential through joint steps with the GoI, including enhanced information-sharing and monitoring by PA officials of imports at crossing points/gateways. The GoI agreed to schedule regular meetings with the PA to identify and agree on measures to raise and streamline the transfer of revenue to the PA. Meetings between officials from the Palestinian and Israeli ministries of finance began in March 2011.

➢ In the West Bank, the removal during 2009–10 of a large number of roadblocks and other barriers to internal movement, as well as the expansion of capacity at crossing points with Israel in 2010, have provided a limited impetus to growth. To sustain the growth momentum, it is essential to continue lifting restrictions on movement and remove other core constraints on private sector expansion. First, restrictions on exports and "dual use" imports—which were tightened with the construction of the separation barrier in 2009–10—should be eased to allow the West Bank to benefit from trade complementarities with the much larger Israeli market and from its traditionally strong ties with East Jerusalem. Second, restrictions on private investment in "Area C", which represents 60 percent of the West Bank, should be promptly removed.

- The impact of the long-standing trade restrictions in the WBG is reflected in the downward trend since 2008 in the WBG's exports to Israel, despite an uptick in 2010.[5] In 2010, exports of goods and services from the WBG to Israel are estimated to have risen by 5 percent in real terms, reflecting the expansion of capacity of the West Bank's crossing points with Israel. However, the latter rise follows a sharp contraction in these exports during 2008–09 by 30 percent due to the construction of the separation barrier. The decline in imports from Israel, by a cumulative 10 percent in real terms during 2008–09, with an uptick of 3 percent in 2010, was less pronounced than that of exports, reflecting the much tighter Israeli restrictions in the West Bank on exports than on imports. In fact, since 1994, when trade between the WBG and Israel was largely unhindered, sectoral shares of the two core sectors producing tradable goods, manufacturing and agriculture, have shrunk substantially from 33 percent in 1994 to 19 percent in 2010 (Figure 2). In contrast, the sectors producing services and non-tradables, notably public and private services, and the construction sector, have fared better. This suggests that the WBG's pattern of production continues to be distorted and reflects persisting restrictions on external trade rather than the WBG's comparative advantage. This distortion has been accentuated by the small size of the domestic market and the absence of a local seaport or airport. Overall, the cumulative impact on economic growth of the restrictions since 1994 has been substantial (Box 2).

Figure 2. Shares in GDP of Sectoral Output Relative to 1994
(Index; 1994=100)



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

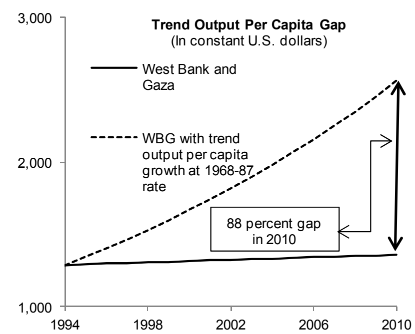
Note: In 1994, the shares as percent of GDP were as follows: 9 for public sector services, 46 for private sector services, 9 for construction, 20 for manufacturing, and 13 for agriculture.

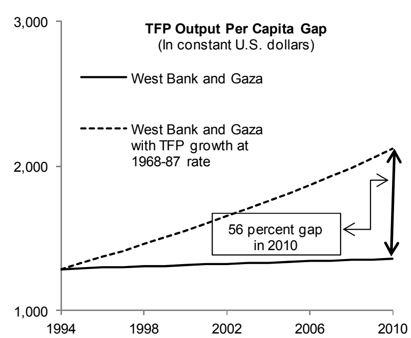
[5] Quarterly data on trade between the WBG and Israel are produced by Israel's Central Bureau of Statistics.

Box 2. Appraising Economic Growth Since 1994

The low trend output growth and wide fluctuations experienced since 1994 suggest that, had there been no restrictions since 1994, the West Bank and Gaza's (WBG) output per capita in 1994 would have been significantly higher than it actually was. To estimate the extent of this "growth performance gap", we compare the output path of the WBG to output paths, simulated using the neoclassical growth model, on the basis of: (i) the WBG's performance during 1968–87, a period with more open borders with Israel; and (ii) the performance of a group of countries which had a real GDP per capita comparable to that of the WBG in 1994. The results, presented below, indicate sizable growth performance gaps and thus ample potential for high growth in case of continued easing of restrictions.

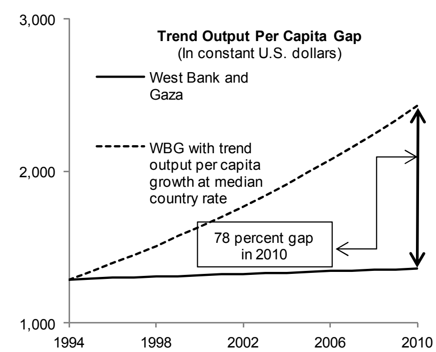
The WBG's per capita output from 1968 to 1987, a period without conflict or restrictions, was decomposed into trend output per capita, and deviations from that trend. Trend output per capita grew at 4.4 percent per year during 1968–87, while it is estimated at -0.6 percent for the 1994–2010. Had the WBG since 1994 had the same trend output growth as during 1968–87, real GDP per capita in 2010 would have been 88 percent higher than it actually was.

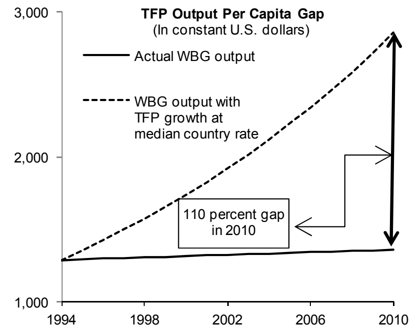




The standard growth accounting framework was applied to decompose the WBG's output into contributions from capital, labor, and Total Factor Productivity (TFP). The WBG's average TFP growth per year during 1968–87 is estimated at 1.8 percent, while for 1994–2010 it is -0.5 percent. Had the WBG since 1994 had the same TFP growth as during 1968–87, real GDP per capita in 2010 would have been 56 higher than it actually was.

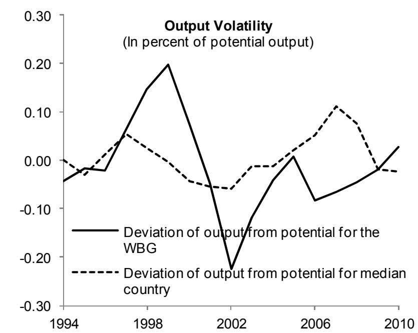
Next, the WBG's performance was evaluated against countries whose PPP-adjusted real GDP per capita was comparable to that of the WBG in 1994, i.e., at about 20 percent above or below that of the WBG. [1]The countries were then ranked by the yearly growth of trend real GDP per capita since 1994. The WBG ranked second lowest in the group, with growth of trend output per capita of -0.6 percent. The median country's trend growth rate was 4.0 percent. Had the WBG since 1994 had the same trend output growth as the median country, real GDP per capita in 2010 would have been 78 percent higher than it was.

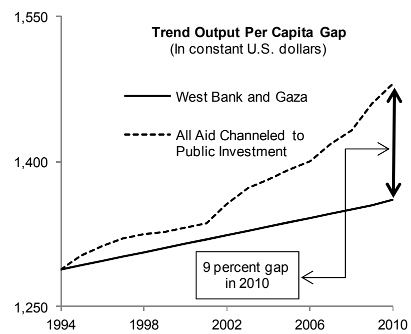




The standard growth accounting framework was applied to decompose each country's output growth into contributions from capital, labor, and TFP. The WBG's average TFP growth per year since 1994, at -0.5 percent, was the second lowest in the group. Had the WBG since 1994 had the median TFP growth of 3.0 percent, the WBG's real GDP per capita in 2010 would have been 110 percent higher than it actually was.

Countries were next ranked by the volatility of their output as measured by the standard deviation of output from trend. The WBG has the second highest volatility in the group, with a standard deviation of 9.5 percent, compared to the median standard deviation of 4.7 percent.



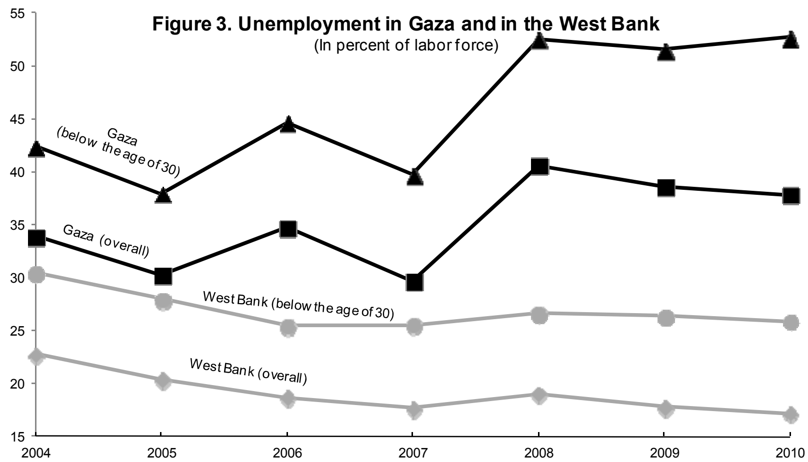


The conflict and restrictions have raised external financing requirements for emergency and social spending. Given limited overall aid from donors, this has led to a diversion of aid from development projects to recurrent spending. Had all aid disbursed since 1994 been channeled to public investment, ceteris paribus, real GDP per capita would have been 9 percent higher in 2010 than it actually was.

[1] The countries are: Angola, Armenia, Bhutan, Cameroon, Cape Verde, China, P.R.: Mainland, Côte d'Ivoire, Equatorial Guinea, Georgia, Guyana, Kiribati, Mauritania, Moldova, Mongolia, Nicaragua, Nigeria, Pakistan, Uzbekistan.

3. **The unemployment rate has declined very slowly in both Gaza and the West Bank, and remains very high among the young.** During 2008–10, unemployment in the West Bank declined from 19 percent to 17 percent, and from 41 percent to 38 percent in Gaza. Employment prospects for people below the age of 30 appear especially bleak in Gaza. While youth unemployment declined during 2008–10 from 27 to 26 percent in the West Bank, in Gaza it remained unchanged at 53 percent (Figure 3). The weak response of employment to higher growth suggests that the recovery, especially in Gaza, has taken place through a better utilization of already employed resources, without a commensurate rise in business investment and hiring. The recovery has thus benefited largely those who had been underemployed or with some work experience rather than new, mostly young entrants to the labor force.[6] For the unemployment rate to decline faster, the private sector needs confidence in steady access to outside markets, which requires removing controls on exports and imports of investment inputs.

Figure 3. Unemployment in Gaza and in the West Bank
(In percent of labor force)



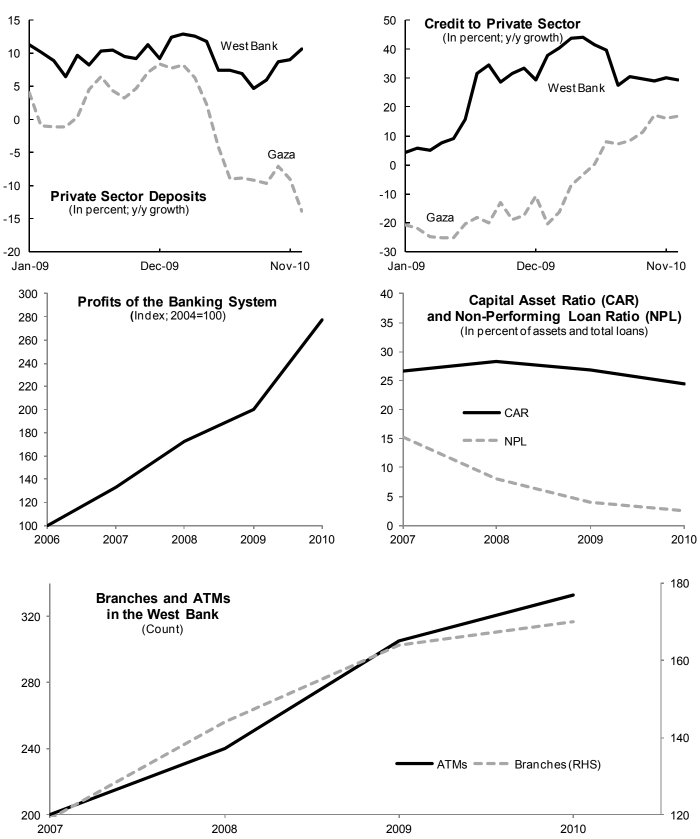
Source: Palestinian Central Bureau of Statistics.

4. **The decline in inflation during 2010 was aided by the easing of Gaza's blockade.** The WBG's year-on-year CPI inflation rate (in NIS) fell from 5 percent to 3 percent during 2010, reflecting lower inflation in Israel and the easing of import restrictions in Gaza. While Gaza's inflation had risen sharply above that of the West Bank due to the blockade, it has been on a declining trend since 2009 following the end of the Gaza war. By December 2010, inflation was significantly lower in Gaza (1 percent) than in the West Bank (3 percent), and East Jerusalem (4 percent), reflecting the relaxation of the blockade on imports of consumer goods and foodstuffs, as well as food's higher weight in Gaza's consumption basket compared to the West Bank. Inflation in the WBG is projected to rise to 4 percent in 2011 in response to increasing world food and fuel prices.

[6] Another factor contributing to high unemployment stems from persisting restrictions on the number of Palestinian workers allowed into Israel. While the number of West Bank workers allowed into Israel has been rising, from an average of 48,479 in 2001–06 to 78,275 in 2010, as a share of the labor force it has increased only slightly to 12 percent from the 2001–06 average of 10 percent. In contrast, in 2000 the share of the West Bank labor force employed in Israel was 19 percent. While 13 percent of Gaza's labor force was allowed into Israel in 1999, since 2001 the number has been negligible.

5. **Commercial banks continue to perform well, with very limited exposure to global markets and conservative lending practices** (Figure 4)**.** The share of non-performing loans in total loans continued its downward trend, from 4 percent at end-2009 to about 2 percent at end-2010. Bank credit to the public sector, as a share of total assets, has declined from 10.4 to 9.7 percent in 2010, and is projected to fall steadily with the envisaged fiscal adjustment by the PA. The banking sector continues to have adequate liquidity and is well capitalized.[7] In the West Bank, private deposits in U.S. dollar terms rose by 11 percent in the year to December 2010, reflecting strong private income growth. In Gaza, private deposits in U.S. dollar terms declined by 14 percent, as cash was withdrawn to satisfy pent up demand for consumer goods following the relaxation of import controls. Gazan banks' prospects have improved due to the easing of restrictions by the GoI on the entry of consumer goods and bank notes. While the restrictions on the entry of Jordanian dinars and U.S. dollars are still formally in place, their impact has been limited since mid-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.

Figure 4. Banking Sector Indicators



Source: PMA; and IMF staff calculations.

[7] The ratio of the banking system's capital to risk-weighted assets is estimated at 25 percent at end-December 2010.

6. **In 2010, the Palestine Monetary Authority (PMA) has made impressive progress in institutional reforms** (Box 3). The rise in private bank credit in the WBG in 2010 stems from significant improvements in financial market infrastructure since 2009, including the establishment of a credit registry which allows a better assessment of borrowers' creditworthiness. Credit to the private sector in the West Bank rose by 29 percent, without excessive concentration in any particular sector.[8] The improved conditions in Gaza led to a rise in private credit by 17 percent, reversing a declining trend since end-2007. The rise in domestic credit opportunities has contributed to the steady decline in the share of bank deposits placed abroad from 56 percent at end-2008, to 51 percent in 2009 and 48 percent in 2010. Given this decline and the improved domestic credit conditions, the PMA will be reviewing in 2011 the necessity of retaining the ceiling of 55 percent for the share of deposits placed abroad.[9] In Fund staff's view, the ceiling should be lifted and replaced with prudential regulations that ensure sufficient diversification of banks' portfolios between domestic credit and outside placements.

7. **The PMA and the Bank of Israel (BoI) have continued 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 cash deposits on concerns about legal implications. That problem was addressed in July 2010 through a special arrangement whereby the excess shekel cash is regularly deposited at Israeli banks' accounts with the BoI. The PMA and the BoI are currently working on devising practical ways to ensure the timely and regular transfer into Gaza of cash amounts adequate to cover fully commercial banks' needs, without pre-set limits on the amount of U.S. dollars or Jordanian Dinars.[10] The close cooperation has already allowed the transfer into Gaza, since July 2010, of cash amounts beyond the usual limit of NIS 50 million per month. Discussions are also underway on the prospects of reestablishing relations between Gazan and Israeli banks.

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[8] Sectoral credit allocation has been stable since 2009. In particular, bank credit to the real estate and construction sector has remained unchanged at about 10 percent of total credit.

[9] Prior to 2008, banks were required to satisfy a floor of 40 percent for the ratio of domestic loans to deposits. In December 2008, that floor was eliminated and replaced with a ceiling of 55 percent for the share deposits placed abroad.

[10] An informal agreement was reached in 2009 between the PA and Israeli authorities to allow the passage of 50 million shekels per month. While that limit has been relaxed since then, the process of approving cash shipments is lengthy and highly cumbersome. The agreement does not cover the entry of Jordanian Dinars or U.S. dollars.

Box 3. Reforms by the Palestine Monetary Authority

Following steady institutional reforms since 2007, the Palestine Monetary Authority (PMA) is now in a position to carry out the functions of a central bank. These reforms, with IMF technical assistance, have enabled the application to all banks in the West Bank and Gaza (WBG) of a rigorous supervision and regulatory framework through regular on-site and off-site supervision. The PMA uses a broad range of prudential instruments, including required reserves ratios, minimum capital requirements, minimum liquidity ratios, and limits on credit concentration, outside placements, and currency exposure. Since 2008, it has been monitoring banks' compliance with a Basel committee compliant corporate governance code. The PMA's reforms, along with improved economic conditions, have supported the well-performing banking system. In 2010, the PMA advanced reforms on several fronts:

The PMA has further strengthened the supervision and regulatory framework and advanced towards the implementation of Basel II standards. Full implementation of these standards is expected by mid-2012. In January 2010, a unit was established in the Supervision Department to implement the Fair Lending Regulations and conduct financial literacy campaigns. In May 2010, the PMA issued Basel II compliant regulations governing the disclosure of information by financial institutions. It also prepared regulations, for approval by June 2011, for licensing and supervision of Specialized Lending and Financial Companies, including microfinance institutions. In August 2010, the PMA adopted regulations governing mergers and acquisitions in line with best practices. These regulations have already been applied to bank mergers. The PMA has also applied Basel standards and procedures when liquidating two banks in 2010 (one insolvent bank and one OFAC-listed bank). To further strengthen the banking system's capital base, the PMA introduced two measures in December 2010: (i) an increase in the minimum capital requirement to $50 million (from $35 million); and (ii) new "counter-cyclical" reserve requirements according to which banks should add 15 percent of their net (after tax) income to their Tier I capital as an additional "bad times" buffer.

A modern system to track bounced-checks, in operation since 2009, has contributed to the decline in bounced checks by an estimated 25 percent. The **credit scoring system**, which was integrated into the credit registry in July 2010, is reported by banks to have been an important contributor to the rise in the WBG's bank credit to the private sector. A bank deposit insurance scheme is being developed with World Bank assistance, and is expected to be ready in early 2012.

In November 2010, the PMA completed the installation of **an electronic payment system**, including a Real Time Gross Settlement system (RTGS). The system will be augmented with a Clearance House which will be ready for use by May 2011 following user acceptance testing. The payment system has significantly raised bank payments' efficiency and reduced liquidity risk. The PMA estimates that, from November 2010 to March 2011, the system has processed financial transactions worth about $14.4 billion.

A new Banking Law to strengthen the financial sector's **legal framework** was enacted in November 2010. A new Central Bank Law, which guarantees the independence of the PMA, is expected to be submitted to the new Cabinet for approval by mid-2011, and approved by the President by September 2011. 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.

Looking forward, the PMA is preparing its **Monetary Operations Department** for open market operations and the issuance of government securities and PMA Certificates of Deposits, with technical assistance from the Fund starting in the second half 2011.

8. **The Palestine Capital Market Authority (PCMA) has further strengthened the legal and regulatory framework for the financial non-banking sector.** In mid-2010, the PCMA completed a self-assessment which concluded that its legal framework and capacity to regulate the securities market are in line with best international practice. On that basis, it applied for membership to the International Organization of Securities Commission (IOSCO), of which it expects to become an ordinary member by mid-2011. In the insurance sector, the PCMA completed an assessment of the viability of all insurance companies in the WBG, with a view to recommending remedial actions to the companies by May 2011. Progress was also made in enhancing the regulatory framework for the leasing, mortgage, and private pension areas, including the completion of laws and regulations to supervise and license private pension funds.

9. **The PA has made major strides since 2008 in raising the quality, transparency and timeliness of the WBG's economic and financial statistics.** The Palestinian Central Bureau of Statistics (PCBS) is expected to meet all the requirements of the IMF's Special Data Dissemination Standard (SDDS) in 2011, reflecting the best practices applied by the PCBS as well as by the ministries and agencies that provide the source data. The quality, transparency and timeliness of the data produced today by the PCBS, Ministry of Finance, and the PMA compare favorably with those of IMF member countries that maintain high data management and dissemination standards.

II. Fiscal Developments in 2010

10. **The PA's fiscal performance during 2010 was broadly as envisaged in the budget—with the recurrent deficit on a commitment basis at 15.5 percent of GDP compared to the budgeted 16.8 percent of GDP—but delays in donor aid, including for development projects, contributed to domestic payment arrears and borrowing from commercial banks** (Tables D, 2a, and 2b):

- Budgetary revenue, excluding one-off items such as dividend payments and license fees, was in line with the budget. Gaza's clearance revenue from taxes on fuel and other petroleum products was lower than expected in 2010 due to the decline in the quantity of fuel and other petroleum products imported into Gaza, reflecting the increased substitution of fuel from Israel with cheaper fuel from Egypt. The shortfall in clearance revenue was offset by the strong pick-up in the West Bank's domestic tax revenue due to improved tax compliance, and repayment of income tax arrears owed since 2007.[11] One-off items, classified under "non-tax revenue", were lower than budgeted due to lower license fees and dividend payments.

[11] About $50 million in income tax arrears had been owed to the PA by large enterprises since 2007.

Table A. Clearance Revenues

	2008			2009			2010		
	Jan.-Jul.	Aug.-Dec.	Year	Jan.-Jul.	Aug.-Dec.	Year	Jan.-Jul.	Aug.-Dec.	Year
					(In millions of shekels)				
Total clearance revenue	2,217	1,700	3,918	2,393	1,979	4,372	2,702	2,091	4,793
West Bank	1,992	1,522	3,514	2,216	1,804	4,020	2,510	1,926	4,436
Gaza	225	178	404	177	175	352	192	165	357

Source: Ministry of Finance.

- The 2010 wage bill was about 4 percent higher than budgeted (or by about $63 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 these adjustments, the rise in the wage bill was limited to the budgeted increase of 4 percent in the general wage rate. The number of public sector employees rose by 3,317 in 2010 (of which 452 in health, 1,762 in education, 362 in security, and 741 in other sectors). The average yearly increase in net employment during 2008–10 was 2,221 (consisting of an average increase in the West Bank by 3,676 employees, and by an average reduction of 1,503 employees in Gaza). The MoF intends henceforth to abide strictly by the 3,000 yearly limit, especially given the higher-than-targeted increases in new employment in the West Bank.

- Facing aid shortfalls for both recurrent spending and development projects, 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 budgeted amounts by about $143 million in 2010 (Table B).

Table B. Non-Wage Expenditure in 2010

	Total	Operational Expenditure	Transfers	Minor Capital Expenditure
		(Commitment basis; in millions of U. S. dollars)		
Budget	**1,370**	513	813	43
Outturn	**1,227**	493	705	29

Source: Ministry of Finance.

- 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 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 2010 recurrent budget was lower than envisaged, with \$1,147 million disbursed compared to \$1,243 million anticipated in the budget. In addition, aid for development projects was lower than planned by about \$168 million, out of which \$144 million was covered in cash by the treasury in anticipation of external aid disbursements, while the remaining \$24 million accumulated as arrears.

- Shortfalls in aid, uncertainty regarding aid prospects during the year, and the use of recurrent aid for development projects as noted above, led to cash recurrent spending well below commitments.[12] This compression contributed to the accumulation of a total of \$116 million in payment arrears including to the pension fund, private sector suppliers, and development projects (Table C). The liquidity difficulties also led to an increase in net domestic bank financing in 2010 by about \$84 million, including gross borrowing of \$200 million, yielding a stock of debt to banks of about \$0.8 billion as of end-2010. This stock constitutes a significant burden on the budget in interest payments (about \$32 million in domestic interest payments were made in 2010, or about 3 percent of non-wage expenditures), which ultimately will be reflected in increased external financing requirements for the budget.

Table C. Composition of Net Arrears Accumulation 2009–10

	2009	2010
(In millions of U.S. dollars)		
Contributions to the pension fund:		
of which: employee's share 1/	43	50
government's share 2/	90	46
Private sector suppliers 2/	117	25
Net lending	20	-28
Development projects 3/	30	24
Total	**299**	**116**

Source: Ministry of Finance.
1/ Item classified under "wage expenditures".
2 Items classified under "non-wage expenditures".
3/ Item classified under "development projects".

[12] In 2010, donor aid for the recurrent deficit, at \$1.15 billion, was about equal to the actual recurrent deficit on a commitment basis, but below the budgeted amount by \$96 million. The recurrent spending commitments were compressed below the budget levels in anticipation of the donor aid shortfalls. Cash recurrent spending was in turn compressed below commitment levels, generating a source of financing to cover shortfalls in aid for development projects.

- Development spending in 2010 was well below the budgeted amount, reflecting the restrictions on the import of investment inputs into Gaza, as well as the shortfalls in development aid. The implementation of public investment projects is expected to accelerate in 2011, reflecting the relaxation of controls on imports of inputs destined to Gaza's donor-financed projects.

11. **The PA has continued to strengthen the Public Financial Management System (PFM),** 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 (Box 4). Expenditure management was markedly enhanced in 2010 through the integration of the Commitment Control System (CCS) 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. Another important step was the completion of the review of the FY 2008 financial statements by the Supreme Audit and Administrative Control Bureau (SAACB). The FY2009 draft financial statements were sent in January 2011 to the SAACB for review.

Table D. Fiscal Indicators for 2009–11

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

	2009	2010		2011
		Budget	Outturn	Proj.
Total net revenues	1,598	1,927	1,927	2,145
Gross domestic revenues	585	707	745	810
Tax revenues	301	377	474	512
Nontax revenues	284	330	271	298
Gross clearance revenues	1,103	1,320	1,259	1,442
Tax refunds	91	100	76	107
Total recurrent expenditures (commitment basis):	3,190	3,170	3,076	3,228
Wage expenditures	1,467	1,550	1,613	1,710
Non-wage expenditures	1,349	1,370	1,227	1,358
Net lending	374	250	236	160
Total recurrent expenditures (cash basis)	2,920	3,170	2,956	3,228
of which: non-wage expenditures (cash basis)	1,142	1,370	1,156	1,358
Recurrent balance (commitment basis)	-1,592	-1,243	-1,149	-1,083
Recurrent balance (cash basis)	-1,371	-1,243	-1,083	-967
Development projects (commitment basis)	430	670	299	500
Development projects (cash basis)	400	670	275	500
Overall balance (cash basis, including development expenditures)	-1,771	-1,913	-1,358	-1,467
Financing	1,771	1,913	1,358	1,467
External support for recurrent and development expenditures	1,755	1,913	1,277	1,467
External support for recurrent expenditures	1,355	1,243	1,147	967
External support for development expenditures	400	670	131	500
Domestic financing	176	---	84	---
Net external debt	-4	---	---	---
Residual	-156	---	-4	---
Memorandum items:				
GDP	6,158	7,395	7,395	8,450
Domestic tax revenue (percent of GDP)	4.9	5.1	6.4	6.1
Clearence revenue (percent of GDP)	17.9	17.9	17.0	17.1
Wage expenditures (commitment basis), percent of GDP	23.8	21.0	21.8	20.2
Net lending (including subsidies; percent of GDP)	6.1	3.4	3.2	1.9
External financing for recurrent budget (US$ billion)	1.35	1.24	1.15	0.97
Recurrent balance (commitment basis), percent of GDP	-25.9	-16.8	-15.5	-12.8
Recurrent balance (cash basis), percent of GDP	-22.3	-16.8	-14.6	-11.4
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	---	---	---
Total interest payments (US$ million)	53	42	42	42
Domestic payments	36	32	32	32
External payments	17	10	10	10

Sources: Ministry of Finance; and IMF staff estimates.

Box 4. Reforms in Public Financial Management

Since the advent of Prime Minister Fayyad's government in mid-2007, the Palestinian Authority (PA) has made wide-ranging reforms to its Public Financial Management (PFM) system. Today the PFM system is ready to support the functions of a state, and is a prime model to follow for developing countries in need of PFM reforms. The reforms have allowed the PA to tightly control expenditures, apply rigorous budget preparation and execution practices, and establish fiscal transparency and accountability in line with international standards. They also enabled a sharp reduction in the PA's reliance on donor aid for recurrent spending.

In mid-2007, the PA was faced with a PFM system that had been severely degraded by sanctions and mismanagement. The Ministry of Finance (MoF) had to tackle a number of exceptional challenges, including aid inflows that bypassed it, fragmented banking arrangements, weak budget procedures, and lack of fiscal reporting. The government took prompt steps to establish a Central Treasury Account which centralized all expenditure, revenue, and recurrent aid inflows under the MoF's control. By early 2008 all budget procedures were restored, expenditure controls and cash management were strengthened, and fiscal accounts were developed in line with best practice. These measures allowed the preparation of an emergency budget that was the basis for generous donor support in 2008–09.

Major strides in PFM reforms have been taken by the PA since 2008, enabling an improvement in the quality of budgetary expenditures and their prioritization, as well as reduced arrears accumulation:

- In 2008 a Financial Management Information System (FMIS) was developed to link the MoF to line ministries. The FMIS, which was rolled out to all line ministries in 2009, gave the ministries increased ownership of financial management and enhanced the quality of budget execution. At the same time a new web-based budget information system was completed by mid-2009, which further enhanced communication between the ministries during annual budget preparations, in particular by facilitating the compilation of budget submissions and preparation of final budget documents. In mid-2010, the FMIS was further enhanced to allow the preparation of budgets on the basis of ministries' program objectives, taking into account up-to-date information on budget execution, and to ensure that line ministries' requests for budget allotments are in line with the overall budget ceiling set by the MoF. In parallel, a new chart of accounts and budget classification consistent with GFSM 2001 were integrated into the FMIS to aid the preparation of the 2011 budget.

- To further raise transparency of public finances and encourage feedback by civil society, in 2008 the MoF established the practice of publishing on its website detailed information on its monthly expenditures, revenue, external aid, and public debt. The data are published fifteen days following the end of each month, along with a quarterly report by MoF staff that appraises budget execution. A macro-fiscal unit was established at the MoF in November 2010 to produce fiscal assessments and projections based on a medium-term macroeconomic framework.

- A major step that stemmed the pace of arrears accumulation has been the integration in 2010 of the Commitment Control System (CCS) into the FMIS. The CCS automatically prevents expenditure commitments by line ministries that exceed amounts under "purchase orders" authorized by the MoF's General Accountant. While, prior to implementation of the CCS, line ministries tended to make commitments at budgeted levels, since early 2011 the MoF has been working to enforce the matching of commitments with cash availability with a view to minimizing arrears accumulation. Toward that end, the operation of the CCS is being strengthened to ensure that the purchase orders are determined by monthly cash plans that take into account the likelihood of delays in donor aid.
- Rigorous procedures were established at the MoF in 2009 to enable regular external audits, in line with best practice, of the MoF's annual financial statements. The 2008 financial statements were reviewed in 2010 by the Supreme Audit and Administrative Control Bureau (SAACB) with assistance from Deloitte and Touche. The draft 2009 financial statements were sent to the SAACB in January 2011, with a view to finalization by September 2011.

III. Fiscal Outlook for 2011

12. **The 2011 budget envisages a decline in the recurrent budget deficit (on a commitment basis) to 13 percent of GDP (from 16 percent of GDP in 2010).** The targets for the budget's broad line items have been set as follows:

- The increase in the wage bill will be limited to: (i) an adjustment of 3.5 percent in wage rates to compensate for 2010 inflation; (ii) the 1.25 percent automatic yearly increase; and (iii) an increase in net employment by 3,000 employees.

- Recurrent nonwage expenditures will decline by 0.5 percent of GDP. Continued strengthening of the PFM system will allow the elimination of lower priority operational spending, while tighter commitment controls and cash management will help prevent arrears accumulation. Operational expenditures are envisaged to decline by 0.7 percent of GDP through cuts in non-essential items such as car use by public servants, while transfers by the Ministry of Social Affairs, largely through the new established social safety net, are envisaged to rise by 0.4 percent of GDP.

- Net lending is projected to decline by about 1.3 percentage points 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 at 25 percent of GDP in 2011, given the uncertainty regarding the revenue impact of the growth in Gaza, and the dividends that will be paid to the budget by the Palestine Investment Fund.[13]

- The budget envisages no net domestic bank borrowing except for short-term loans, and no net arrears accumulation. In line with Fund staff's advice, any higher-than-budgeted revenue or donor aid will be used to repay domestic payment arrears, to reduce the stock of arrears as early as possible. External financing needs for recurrent expenditure would decline to $967 million in 2011.[14]

13. **So far, in 2011, donor aid has fallen short of financing requirements.** During the first quarter of 2011, only about $0.2 billion has been disbursed, and another $0.5 billion was indicated by donors for the remainder of the year. Given the projected financing need of $967 million, this yields a financing gap of about $0.3 billion for 2011. An improved donor coordination framework is essential to help ensure timely disbursements of committed aid, and allow the PA to better prepare for delays in disbursements.

14. **To complement the enhanced PFM system (as described in Box 4 above), the PA has been implementing a comprehensive reform of tax administration with technical assistance from the Fund, DFID, and USAID.** The authorities are implementing an action plan for 2010–13, developed with assistance from the Fund, aimed at expanding the tax base and improving compliance, including the establishment of a unified revenue administration with a Large Tax Payers Unit and the computerization of taxpayers' records to reduce tax evasion. One important step taken in 2010 has been the expansion of property tax collection from 25 to 38 municipalities (out of 107 municipalities in the West Bank), with the aim of covering 53 municipalities by end-2011.

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[13] The projections take into account the repayment to the Palestinian Telecommunications Group of $70 million in license fees following the cancellation of a license agreement. The repayment period is 24 months and started in August 2010.

[14] The recurrent deficit is projected at $1,083 million on a commitment basis, and at $967 million on a cash basis. The difference stems from the payment by the GoI to the PA of $116 million in clearance revenue following the settlement of a court case.

15. **With regard to clearance revenue, an important objective of the MoF for 2011 is to strengthen its collection through closer cooperation with the GoI**. A key component of the agreement between the Quartet Representative and the GoI is the decision by the GoI to engage in discussions with the PA to agree on new measures to enhance the collection of clearance revenue, which is especially important given the PA's pressing financing needs**.** These discussions have started in March 2011, with the aim of settling outstanding issues by June 2011. One key objective should be to agree on practical steps to minimize clearance revenue leakages, including through: (i) enhanced monitoring by PA officials of imports at border crossings to raise collection of invoices for VAT and other taxes and fees; and (ii) an assessment of potential revenue on the basis of comprehensive data compiled by the GoI on imports from Israel into the WBG.[15]

16. **The PA is considering a small issue of Treasury Bills in 2011**, amounting to about $3 million, by securitizing the existing PA debt owed to the PMA. This would be a first step toward the gradual development of a Treasury Bills market which would help promote the money and interbank markets and fulfill the need for collateral in the new Real Time Gross Settlement system (RTGS, see Box 3). It could eventually 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, and they see the initial issue as a demonstration of their institutional readiness to issue bills.

IV. Macroeconomic Framework

17. **The PA's core economic objective is to sustain a high rate of economic growth and steadily reduce unemployment.** The macroeconomic framework, which underpins the Palestinian National Plan for 2011–13, assumes 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 trade and other restrictions, including on foreign direct investment, will accelerate in 2011. This is essential to offset the impact of the PA's fiscal retrenchment on private sector activity and investment. In Gaza, the further easing of the blockade will allow: (i) steadily rising imports of investment inputs required by the private sector; and (ii) a gradual increase in 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 and East Jerusalem, 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 the narrowing budget deficit as well as public investment and reconstruction needs. Fund and PA staff collaborated to develop the draft Palestinian

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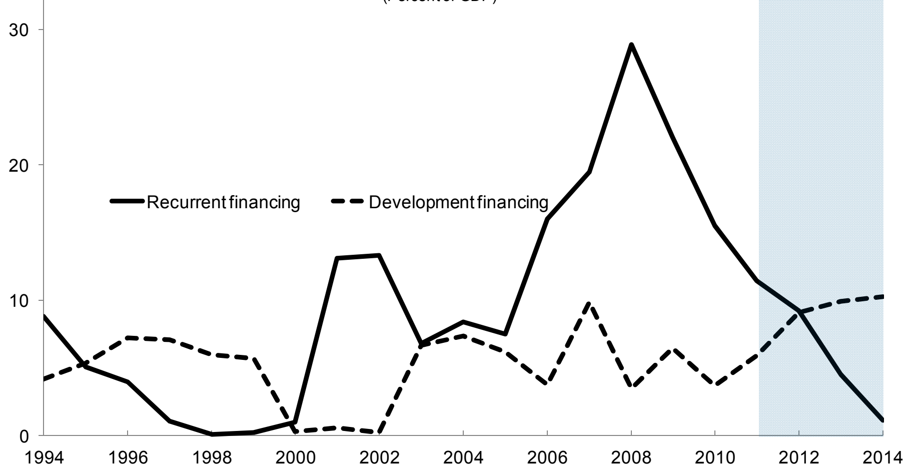
[15] One step currently being discussed is the reduction of VAT leakages by expanding the use of the recently established electronic system—part of the ASYCUDA project—to enable the electronic exchange of information on a daily basis between the two sides. The electronic system currently allows the electronic exchange of customs data on a daily basis, but does not include data on VAT clearance.

National Plan (PNP)'s medium-term macroeconomic framework taking into account these "baseline scenario" assumptions and policy expectations, along with an alternative "low growth" scenario.

18. **The draft PNP's economic outlook envisages a rise in economic growth led by the private sector.** The expansion of private sector activity and external trade, enabled by continued easing of restrictions, would support a rise of real GDP growth from 9 percent in 2010–11 to 10–12 percent by 2012–13, and a decline in the unemployment rate from 24 percent in 2010 to 15 percent by 2013. The recurrent deficit would decline to 4 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 (Figure 5). The fiscal strategy envisages the net repayment of $50 million per year in domestic payment arrears starting in 2012, based on current projections for revenue and aid. Any higher-than-expected revenue or donor aid, from 2011 onwards, will be used to repay domestic payment arrears ahead of schedule.

Figure 5. Composition of Donor Aid
(Percent of GDP)



Source: Ministry of Finance.

19. **In an alternative "low-growth" scenario, the peace process will remain stalled and the easing of Israeli restrictions would slow, inhibiting trade and private investment, and impeding the implementation of development projects.** Real GDP growth would decrease to an average of about 4 percent over the medium-term and the unemployment rate would remain at about 20 percent. Budgetary revenue would be lower, while emergency spending and arrears accumulation would be high, thus slowing the pace of fiscal adjustment, with the deficit at 14 percent of GDP by 2013 (Table E). The low-growth scenario implies a continued divergence of Gaza's path of real GDP per capita and unemployment compared to the West Bank's path (Box 5).

Table E. Comparison of Baseline and Low-Growth Scenarios

	2010	2011	2012	2013	2014	2011	2012	2013	2014
		Baseline Scenario				Low-Growth Scenario			
Output and Investment									
Real GDP (percentage change)	9.3	9.0	10.0	12.0	12.0	5.2	4.0	3.7	3.6
West Bank	7.6	6.0	8.0	11.0	11.0	4.0	3.7	3.6	3.5
Gaza	15.2	18.0	16.0	16.0	16.0	9.0	5.0	4.0	4.0
Real GDP per capita (percentage change)	6.2	5.9	6.9	8.9	8.8	2.2	1.1	0.8	0.7
West Bank	4.8	3.2	4.9	7.4	7.4	1.1	0.7	0.7	0.5
Gaza	11.6	14.7	12.7	12.7	12.5	5.9	2.0	1.1	1.1
Gross capital formation (in percent of GDP)	26.9	28.9	32.4	34.0	37.9	28.2	27.2	26.6	26.1
Of which: public investment (in percent of GDP)	4.2	6.4	9.5	10.3	10.6	6.1	7.0	7.4	7.0
				(In percent of GDP)					
Public finances 1/									
Revenues	26.1	25.4	26.5	27.7	28.7	25.3	24.8	24.7	24.7
Recurrent expenditures and net lending	41.6	38.2	35.2	31.8	29.5	41.6	39.2	38.8	38.6
Recurrent balance (before external support)	-15.5	-12.8	-8.7	-4.1	-0.8	-16.3	-14.4	-14.1	-13.9
Recurrent balance, on a cash basis (before external support)	-14.6	-11.4	-9.2	-4.5	-1.2	-13.3	-8.4	-6.1	-6.4
Expenditure arrears accumulation	1.3	0.0	-0.5	-0.5	-0.4	3.0	6.0	8.0	7.4
Capital expenditures	3.7	5.9	9.1	9.9	10.3	5.6	6.6	7.0	6.6
(In millions of U.S. dollars)	275	500	873	1,095	1,295	457	575	650	650
External recurrent budgetary support	15.5	11.4	9.2	4.5	1.2	11.9	10.1	5.4	1.5
(In billions of U.S. dollars)	1.1	1.0	0.9	0.5	0.1	1.0	0.9	0.5	0.1
Total external support, including capital expenditures	17.3	17.4	18.3	14.5	11.4	17.5	16.6	12.3	8.0
(In billions of U.S. dollars)	1.3	1.5	1.8	1.6	1.4	1.4	1.5	1.2	0.8
				(In percent of GDP)					
External sector									
Exports of goods and nonfactor services	13.1	15.4	19.3	20.5	22.0	11.6	12.1	13.0	14.0
Import of goods and nonfactor services	65.4	68.8	72.1	71.4	72.9	65.3	62.9	62.8	63.3
Current account balance (excluding official transfers)	-26.2	-26.3	-26.0	-24.1	-24.2	-22.9	-19.4	-16.8	-16.6
Current account balance (including official transfers)	-8.9	-8.9	-7.7	-9.6	-12.7	-5.4	-2.8	-4.4	-8.6
Memorandum items:									
Unemployment rate (average in percent of labor force)	24	21	18	15	13	22	20	20	20

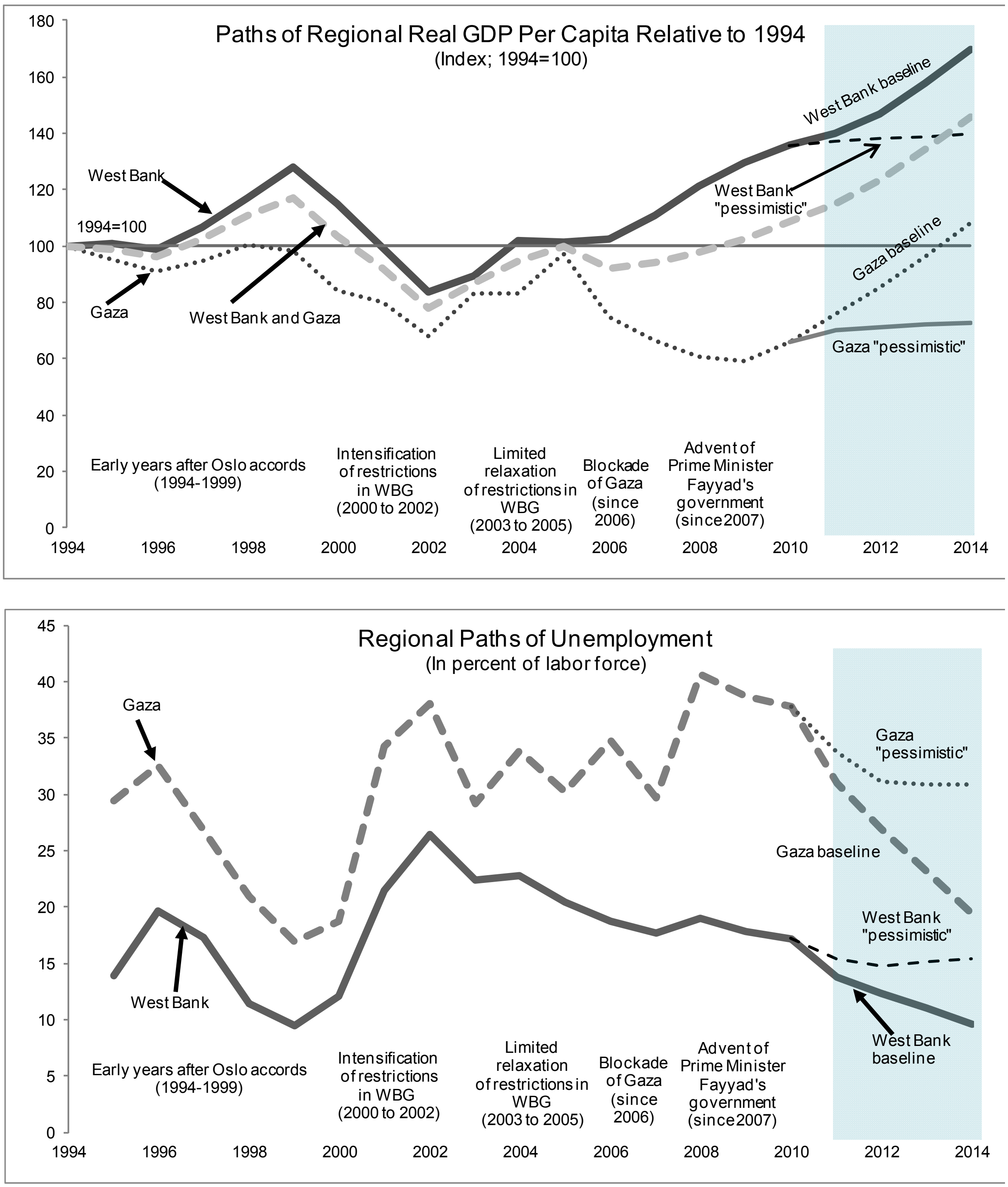
Sources: Palestinian authorities and IMF staff estimates.
1/ Commitment basis, unless otherwise stated.

Box 5. The Economic Paths of the West Bank and Gaza Twenty Years After Oslo (1994 to 2014)

In this Box, we examine the regional paths of real GDP per capita and unemployment in the West Bank and Gaza (WBG) since 1994. While both paths have been severely affected by the conflict and Israeli restrictions, they have broadly diverged since 2006 with the tightening of controls on Gaza. Convergence will depend on the phasing out of the restrictions and reintegration of the two territories.

- The WBG'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 Palestinian Authority (PA) took over key administrative responsibilities from the Government of Israel (GoI). 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, real GDP per capita recovered to the 1994 level, in response to the limited relaxation of restrictions. It 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.
- In addition to the poor overall growth performance in the WBG, the movement of overall real GDP per capita reflects a wide divergence in output paths between the West Bank and Gaza (see Figure 6). The West Bank's real GDP per capita has grown steadily since 2007, and is projected to be about 58 percent above its 1994 level by 2013. In contrast, Gaza's real GDP per capita has been on a downward trend since 2006, with its recovery starting only in 2010 with the easing of the blockade. In the baseline scenario, Gaza's real GDP per capita will be at its 1994 level by 2013, while in the low-growth scenario it will be about 28 percent below the 1994 level.
- 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 (respectively). 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 23 percent. In the low-growth scenario, unemployment rates would remain high, at 15 percent in the West Bank and 31 percent in Gaza by 2013.

Figure 6. 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.

20. **While the assumptions regarding the budgetary revenue and donor aid outlook are appropriately conservative, it is important for the PA to prepare for "downside" as well as "upside" risks:**

- To prepare for lower-than-envisaged revenue or aid, as in the low-growth scenario, it is important for the PA to develop a contingency plan to contain the accumulation of domestic payment arrears or recourse to bank borrowing, although it will be difficult to fully prevent them if the revenue/aid shortfalls persist. The plan would include strict prioritization of expenditures, postponement of non-essential projects, and effectively applying the FMIS to better align commitments with cash availability.

- On the upside, budgetary revenue could be higher than envisaged in the baseline scenario, in particular if political breakthroughs allow the operation in 2012–13 of the Gaza Marine offshore gas field, or a quick pickup in domestic tax revenues from Gaza. Similarly, donor aid could be higher-than-projected in case of a marked improvement in the global and regional outlook. Given the high level of domestic debt, it is important that an alternative expenditure plan is prepared to ensure that higher-than-expected revenue or aid is used for the repayment of domestic payment arrears and bank loans, as opposed to accommodating new spending commitments.

21. **To ensure steady progress toward fiscal sustainability and reduced reliance on recurrent budgetary aid in line with the medium-term fiscal targets, it is essential to step up the implementation of the key structural reforms as set out in the draft PNP:**

- **Further streamline and better target social assistance.** In 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. The Ministry of Social Affairs will be regularly updating the database of targeted households to ensure that only those below the poverty line receive assistance. A key measure to be implemented by mid-2011 is the "lifeline electricity tariff", for households in the latter database, at which a "lifeline" amount of household electricity consumption is billed only at cost.[16] This measure is especially important given the increase in prices as electricity distribution is commercialized.

[16] The Palestinian Electricity Regulatory Commission has developed a methodology for setting a unified tariff structure for the West Bank's distribution companies. This structure includes a lifeline tariff for poor households at which the first 100 kWh of electricity is priced at cost of supply (which is below existing tariff rates).

- **Phase out electricity subsidies (imposed on the MoF due to non-payment by municipalities of their electricity bills) by completing the transfer of electricity distribution from municipalities to commercial companies.** An important step taken in early 2010 was the 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. An action plan was prepared in 2010 to complete the transfer of distribution from the remaining local governments in the northern West Bank region to NEDCO, with the regions of Qalqilya and Tulkarm to be covered by mid-2011. The transfer of distribution in the remainder of the West Bank to other private electricity companies is expected to be completed by end-2011. Progress in electricity sector reform has helped reduce electricity subsidies from 6 to 3 percent of GDP in 2009–10.

- **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, in collaboration with the World Bank. The plan aims at restoring the viability of the pension system in several phases during 2010–12. The first phase, to be completed during 2011, consists of indexing pensions to the CPI, raising the retirement age from 60 to 62, 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 2012 include the elimination of lump sum payments at retirement.[17]

- **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.[18] One important measure that should be implemented in 2011 is a careful review of personnel needs in key sectors, including health and education,

[17] The staff of the IMF and World Bank, based on the macroeconomic framework in this report, have jointly produced preliminary estimates of the impact of the different components of pension reform on the "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 about 30 percent of GDP, compared to about 60 percent of GDP in the no-reform scenario. The increase in the retirement age yields an implicit pension debt of about one third of GDP, compared to about 70 percent in the no-reform scenario. Under the assumption of declining government real wages, pension debt declines by even greater amounts.

[18] The average public real wage rate is estimated to have declined by a cumulative 6 percent during 2008–10, and is projected to rise by 1 percent in 2011.

to fine-tune the current “blanket ceiling” of 3,000 new employees that is automatically placed in annual budgets.[19] 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 pickup in private investment envisaged by the PNP will also require the strengthening of the legal and regulatory framework to improve the investment climate for businesses.** 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. While the amended Investment Law was enacted in early 2011, several other laws have been approved by the Cabinet but are still awaiting the President’s signature.[20] These should be enacted promptly. 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. Efforts should also be stepped up to strengthen the public procurement system, including through the enactment of the Procurement Law to ensure efficiency, accountability and transparency in the acquisition of goods and services by the government.

V. Assessment

22. **IMF staff considers that the PA is now able to conduct the sound economic policies expected of a future well-functioning Palestinian state, given its solid track record in reforms and institution-building in the public finance and financial areas**:

- Steady public finance reforms have allowed the PA to: tightly control and prioritize its expenditures; prepare and execute annual budgets; enhance transparency through monthly publication of comprehensive expenditure, revenue, and debt data; and prepare annual financial statements for external audit. These measures have substantially reduced the PA’s reliance on recurrent aid and contributed to economic recovery by bolstering investor confidence. They have also allowed a rise in the

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[19] At the request of the MoF, DFID has funded a study to assess the efficiency of the PA and UNRWA in providing health and education services in the WBG. It will include recommendations on appropriate levels of recruitment for both sectors.

[20] These laws include the New Companies Law, that removes the bureaucratic red tape faced by new companies; 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.

quality of public expenditure and a shift in its composition from wages and subsidies toward growth-enhancing development projects. With regard to public investment projects, the PA has taken increasing responsibility for their management through the implementation of grassroots-driven "community projects".

- Institutional reforms by the PMA have enabled the application to all WBG banks of a rigorous supervision and regulatory framework through regular on-site and off-site supervision, monitoring of compliance with a governance code, and strict application of the anti-money laundering law. These reforms, combined with improved economic conditions, have supported the expansion of the banking system with enhanced performance indicators as reflected in the very low incidence of non-performing loans and a strong capital base for WBG banks. Expansion of private sector credit was supported by the development of a credit registry with a modern credit scoring system and an electronic payment system that has substantially raised bank payments' efficiency.

23. **The fiscal targets for 2011–13 which underpin the draft PNP are ambitious but achievable provided the PA continues to build on its track record of reforms and sound public finance management.** To raise economic efficiency and fully eliminate longer-term reliance on recurrent aid, as envisaged in the draft PNP, it is essential for the PA to step up key structural reforms:

- The social safety net developed with World Bank assistance is an important step to ensure that social assistance reaches the truly vulnerable groups. In 2011, it is important to apply effectively the database of poor households as a basis for all social payments and to better target social assistance and electricity subsidies.

- Electricity subsidies, reflected in the "net lending" component of the budget, have declined substantially due to improved incentives for municipalities and households to pay their electricity bills. To ensure that these subsidies are fully phased out over the medium term, it is essential to abide by the draft PNP's timetable for the commercialization of electricity distribution in the West Bank. To protect vulnerable households, it is important to start promptly the implementation of the "lifeline" electricity tariff billed at cost. This measure is especially important given the anticipated increases in electricity tariffs due to the recent rise in fuel prices.

- Implementing the action plan for reform of the pension system is important to restore its viability and prevent large longer-run costs to the budget. This will require bold measures in 2011, including raising the retirement age.

- A comprehensive civil service reform is essential to sustain the reduction in the wage bill. While the share of the wage bill in GDP has declined in recent years due to limits on increases in wage rates and new employment, at 22 percent it is still significantly 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.

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

- Much of the recent strong growth in the Palestinian territories, especially in Gaza, represents a "catch up" of output from a low base toward the level that would have prevailed today in the absence of recurrent conflict and restrictions on movement and access since 1994. The measures agreed between the Quartet Representative and the GoI in February 2011 are prime examples of initial, practical steps that could be broadened and built upon, to the maximum extent allowed by the security situation, despite the stalemate in the peace process. To maintain the growth momentum, rebalance the composition of output, reduce regional disparities, and accelerate the state-building process, it is essential for the GoI to phase out all restrictions as soon as possible.

- In Gaza, where living standards still 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 investment inputs. In the West Bank, the removal since 2009 of many internal roadblocks and measures to increase capacity at crossing points with Israel have made a significant contribution to economic activity. However, fully tapping the West Bank's potential and sustaining its growth will require complementing these measures with a broad-based removal of barriers on exports to Israel, of imports of machinery and equipment, as well as allowing Palestinian private sector economic activity in "Area C".

- Aid disbursements for the recurrent budget have thus far in 2011 been below financing requirements ($175 million disbursed in the first quarter compared to the $242 million required on average for each quarter in 2011). Given the likelihood of continued shortfalls for the remainder of the year, and the fact that there is little scope for further borrowing from banks beyond short-term bridge loans, it is essential that the PA develops a contingency plan capping expenditure commitments below those in the 2011 budget. This will require strict cost-saving measures and prioritization of 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. The implementation of development and community projects should be aligned as possible be aligned with conservative projections for external project aid to minimize arrears accumulation.

- Given the uncertainty regarding availability of financing for 2011, it is particularly important to avoid further increases in public sector wage rates beyond those given in January 2011. Any compensation for increases in food and energy prices should be targeted to the needy households using the social safety net, and offset by cuts in lower priority expenditure items.

- The success of the PNP for 2011–13 is tied to sustained aid from the donor community, just as the successful implementation of the Palestinian Reform and Development Plan for 2008–10, presented at the Paris Donors' Conference in December 2007, would not have been possible without it. The effectiveness of that aid has been reflected both in the strong economic recovery since 2008, as well as in the steady reduction in the recurrent deficit. The prudent fiscal policy enabled an impressive reduction of aid needed to finance the budget deficit, from \$1.8 billion in 2008 to \$1.2 billion in 2010, with a view to a further reduction to below \$1 billion in 2011. However, the shortfalls and 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. Adequate and timely disbursement of aid is essential to sustain orderly reforms and fiscal adjustment. Sustained reforms and adjustment will in turn allow early self-reliance by the PA for its recurrent spending, with donor aid increasingly focused on growth-enhancing development projects.

Table 1. West Bank and Gaza: Selected Economic Indicators, 2008–14

(Population: 4 million; 2010 est.)
(Per capita GDP: $1,827; 2010)
(Poverty rate: 16 percent in the West Bank and 33 percent in Gaza Strip; 2009 est.)

				Projections			
	2008	2009	2010	2011	2012	2013	2014
Output and prices			(Annual percentage change)				
Real GDP (2004 market prices)	7.1	7.4	9.3	9.0	10.0	12.0	12.0
West Bank	12.0	9.5	7.6	6.0	8.0	11.0	11.0
Gaza	-6.1	0.7	15.2	18.0	16.0	16.0	16.0
CPI inflation rate (end-of-period)	7.0	4.3	2.8	3.8	2.7	2.3	2.5
CPI inflation rate (period average)	9.9	2.8	3.7	4.0	3.1	2.3	2.4
Investment and saving			(In percent of GDP)				
Gross capital formation, *of which:*	26.9	30.3	26.9	28.9	32.4	34.0	37.9
Public	4.1	7.0	4.2	6.4	9.5	10.3	10.6
Private	22.8	23.2	22.7	22.5	22.9	23.6	27.2
Gross national savings, *of which:*	35.7	32.1	18.0	20.0	24.8	24.4	25.1
Public	10.8	10.4	4.4	4.5	9.1	9.9	10.3
Private	24.8	21.8	13.5	15.4	15.6	14.4	14.9
Saving-investment balance	8.7	1.9	-8.9	-8.9	-7.7	-9.6	-12.7
Public finances 1/			(In percent of GDP)				
Revenues	25.7	25.9	26.1	25.4	26.5	27.7	28.7
Recurrent expenditures and net lending	47.2	51.8	41.6	38.2	35.2	31.8	29.5
Wage expenditures	23.8	23.8	21.8	20.2	18.7	17.1	15.7
Nonwage expenditures	16.1	21.9	16.6	16.1	14.9	13.6	13.1
Net lending	7.3	6.1	3.2	1.9	1.5	1.1	0.7
Recurrent balance (commitment, before external support)	-21.6	-25.9	-15.5	-12.8	-8.7	-4.1	-0.8
Recurrent balance, cash (before external support)	-27.7	-22.3	-14.6	-11.4	-9.2	-4.5	-1.2
Development expenditures	3.5	6.5	3.7	5.9	9.1	9.9	10.3
(In millions of U.S. dollars)	215	400	275	500	873	1,095	1,295
Overall balance (before external support)	-25.1	-32.4	-19.3	-18.7	-17.8	-14.0	-11.0
External recurrent budgetary support (in billions of U.S. dollars)	1.8	1.4	1.1	1.0	0.9	0.5	0.1
Total external support, including for development expenditures	32.4	28.5	17.3	17.4	18.3	14.5	11.4
(In billions of U.S. dollars)	2.0	1.8	1.3	1.5	1.8	1.6	1.4
Monetary sector 2/			(Annual percentage change)				
Credit to the private sector	-3.4	22.9	34.8	27.3	25.4	27.9	27.5
Private sector deposits	14.0	5.7	22.1	18.8	17.9	20.9	20.5
External sector			(In percent of GDP)				
Exports of goods and nonfactor services	14.4	12.5	13.1	15.4	19.3	20.5	22.0
Import of goods and nonfactor services	67.2	67.5	65.4	68.8	72.1	71.4	72.9
Net factor income	9.8	9.4	7.8	7.1	6.5	5.9	5.4
Net current transfers	51.7	47.6	35.6	37.3	38.6	35.3	32.9
Official transfers	32.4	28.5	17.3	17.4	18.3	14.5	11.4
Current account balance (excluding official transfers)	-23.6	-26.6	-26.2	-26.3	-26.0	-24.1	-24.2
Current account balance (including official transfers)	8.7	1.9	-8.9	-8.9	-7.7	-9.6	-12.7
Memorandum items:							
Nominal GDP (in millions of U.S. dollars)	6,108	6,158	7,395	8,450	9,584	11,016	12,615
Per capita nominal GDP (U.S. dollars)	1,597	1,565	1,827	2,028	2,236	2,497	2,779
Unemployment rate (average in percent of labor force)	26	25	24	21	18	15	13
Al Quds stock market index (annual percentage change)	-16.2	11.6	-0.7	…	…	…	…

Sources: Palestinian authorities; and IMF staff estimates.

Table 2a. West Bank and Gaza: Central Government Fiscal Operations, 2008–14

	2008	2009	2010		Projections			
			Budget	Outturn	2011	2012	2013	2014
	(In millions of U.S. dollars, unless otherwise stated)							
Total net revenues	**1,568**	**1,598**	**1,927**	**1,927**	**2,145**	**2,538**	**3,051**	**3,620**
Gross domestic revenues	562	585	707	745	810	1,010	1,303	1,620
Tax revenues	273	301	377	474	512	585	728	845
Nontax revenues	289	284	330	271	298	425	575	775
Clearance revenues (accrued)	1,122	1,103	1,320	1,259	1,442	1,649	1,885	2,156
Clearance revenues (cash)	1,137	1,090	1,320	1,243	1,558	1,649	1,885	2,156
Clearance revenues (net arrears)	-15	13	---	16	-116	---	---	---
Tax refunds	116	91	100	76	107	121	137	156
Total recurrent expenditures and net lending (commitment)	**2,886**	**3,190**	**3,170**	**3,076**	**3,228**	**3,369**	**3,502**	**3,716**
Wage expenditures (commitment)	1,453	1,467	1,550	1,613	1,710	1,796	1,885	1,980
Wage expenditures (cash)	1,771	1,423	1,550	1,564	1,710	1,796	1,885	1,980
Wage expenditures (net arrears)	-317	43	---	50	---	---	---	---
Nonwage expenditures (commitment)	985	1,349	1,370	1,227	1,358	1,426	1,497	1,647
Nonwage expenditures (cash)	1,055	1,142	1,370	1,156	1,358	1,476	1,547	1,697
Nonwage expenditures (net arrears)	-70	207	---	71	---	-50	-50	-50
Net lending (commitment)	447	374	250	236	160	148	120	90
Net lending (cash)	447	355	250	264	160	148	120	90
Net lending (net arrears)	---	20	0	-28	---	---	---	---
Recurrent balance (commitment, before external support)	**-1,317**	**-1,592**	**-1,243**	**-1,149**	**-1,083**	**-831**	**-451**	**-97**
add: expenditure arrears (net)	-387	270	---	93	---	-50	-50	-50
subtract: net clearance due (+) or repaid (-)	-15	13	---	16	-116	---	---	---
add: arrears on tax refunds	---	-36	---	-11	---	---	---	---
Recurrent balance (cash, before external support)	**-1,690**	**-1,371**	**-1,243**	**-1,083**	**-967**	**-881**	**-501**	**-147**
Development expenditures (commitment)	**215**	**430**	**670**	**299**	**500**	**873**	**1,095**	**1,295**
Development expenditures (cash)	**215**	**400**	**670**	**275**	**500**	**873**	**1,095**	**1,295**
Development expenditures (arrears)	**---**	**30**	**---**	**24**	**---**	**---**	**---**	**---**
Overall balance (cash, including development expenditures)	**-1,905**	**-1,771**	**-1,913**	**-1,358**	**-1,467**	**-1,754**	**-1,596**	**-1,442**
Total financing	**1,905**	**1,771**	**1,913**	**1,358**	**1,467**	**1,754**	**1,596**	**1,442**
Net domestic bank financing	-29	176	---	84	---	---	---	---
Other domestic financing	---	---	---	---	---	---	---	---
External financing for recurrent expenditures	1,764	1,355	1,243	1,147	967	881	501	147
External financing for development expenditures	215	400	670	131	500	873	1,095	1,295
Net external debt	-4	-4	---	---	---	---	---	---
Residual	-40	-156	---	-4	---	---	---	---
Memorandum items:	(In percent of GDP; unless otherwise stated)							
Revenues	25.7	25.9	26.1	26.1	25.4	26.5	27.7	28.7
Recurrent expenditures and net lending	47.2	51.8	42.9	41.6	38.2	35.2	31.8	29.5
Wage expenditures	23.8	23.8	21.0	21.8	20.2	18.7	17.1	15.7
Nonwage expenditures	16.1	21.9	18.5	16.6	16.1	14.9	13.6	13.1
Net lending	7.3	6.1	3.4	3.2	1.9	1.5	1.1	0.7
Recurrent balance (commitment) before external support:	-21.6	-25.9	-16.8	-15.5	-12.8	-8.7	-4.1	-0.8
Recurrent balance (cash) before external support	-27.7	-22.3	-16.8	-14.6	-11.4	-9.2	-4.5	-1.2
External support (recurrent)	28.9	22.0	16.8	15.5	11.4	9.2	4.5	1.2
in millions of U.S. dollars	1,764	1,354.9	1,243	999	967	881	501	147
Development expenditures	3.5	6.5	9.1	3.7	5.9	9.1	9.9	10.3
Overall balance (cash)	-31.2	-28.8	-25.9	-18.4	-17.4	-18.3	-14.5	-11.4
Total external support (in millions of U.S. dollars)	1,979	1,755	1,913	1,277	1,467	1,754	1,596	1,442
Nominal exchange rate (average; NIS per US dollar)	3.6	3.9	3.7	3.7	3.7	...	...	...
Nominal GDP (in millions of U.S. dollars)	6,108	6,158	7,395	7,395	8,450	9,584	11,016	12,615

Sources: Ministry of Finance; and IMF staff estimates.

Table 2b. West Bank and Gaza: Central Government Fiscal Operations, 2008–14

	2008	2009	2010		Projections			
			Budget	Outturn	2011	2012	2013	2014
	(In millions of shekels, unless otherwise stated)							
Total net revenues	**5,627**	**6,282**	**7,188**	**7,188**	**7,937**	**9,391**	**11,290**	**13,393**
Gross domestic revenues	2,017	2,300	2,637	2,777	2,997	3,739	4,823	5,992
Tax revenues	979	1,185	1,406	1,768	1,894	2,166	2,695	3,125
Nontax revenues	1,038	1,115	1,231	1,009	1,103	1,573	2,128	2,868
Clearance revenues (accrued)	4,027	4,338	4,924	4,695	5,335	6,101	6,976	7,977
Clearance revenues (cash)	4,080	4,286	4,924	4,635	5,765	6,101	6,976	7,977
Clearance revenues (net arrears)	-52	52	---	---	-429	---	---	---
Tax refunds	417	357	373	284	396	449	509	577
Total recurrent expenditures and net lending (commitment)	**10,354**	**12,543**	**11,824**	**11,473**	**11,944**	**12,467**	**12,959**	**13,751**
Wage expenditures (commitment)	5,215	5,768	5,782	6,017	6,327	6,643	6,976	7,324
Wage expenditures (cash)	6,354	5,596	5,782	5,833	6,327	6,643	6,976	7,324
Wage expenditures (net arrears)	-1,139	171	---	185	---	---	---	---
Nonwage expenditures (commitment)	3,535	5,304	5,110	4,576	5,025	5,276	5,540	6,094
Nonwage expenditures (cash)	3,785	4,490	5,110	4,312	5,025	5,461	5,725	6,279
Nonwage expenditures (net arrears)	-250	815	---	264	---	-185	-185	-185
Net lending (commitment)	1,604	1,471	933	880	592	548	444	333
Net lending (cash)	1,604	1,395	933	983	592	548	444	333
Net lending (net arrears)	0	77	0	-103	0	0	0	0
Recurrent balance (commitment, before external support)	**-4,727**	**-6,261**	**-4,636**	**-4,285**	**-4,007**	**-3,076**	**-1,669**	**-358**
Add: expenditure arrears (net)	-1,389	1,063	---	448	---	-185	-185	-185
Subtract: net clearance due (+) or repaid (-)	-52	52	---	60	-429	---	---	---
add: arrears on tax refunds	---	-141	---	-42	---	---	---	---
Recurrent balance (cash, before external support)	**-6,063**	**-5,391**	**-4,636**	**-4,039**	**-3,578**	**-3,261**	**-1,854**	**-542**
Development expenditures (commitment)	**771**	**1,691**	**2,499**	**1,116**	**1,850**	**3,230**	**4,052**	**4,792**
Development expenditures (cash)	**771**	**1,573**	**2,499**	**1,026**	**1,850**	**3,230**	**4,052**	**4,792**
Development expenditures (arrears)	**---**	**118**	**---**	**90**	**---**	**---**	**---**	**---**
Overall balance (cash, including development expenditures)	**-6,835**	**-6,964**	**-7,135**	**-5,065**	**-5,428**	**-6,491**	**-5,905**	**-5,333**
Total financing	**6,835**	**6,964**	**7,135**	**5,065**	**5,428**	**6,491**	**5,905**	**5,333**
Net domestic bank financing	-106	691	---	312	---	---	---	---
Other domestic financing	---	---	---	---	---	---	---	---
External financing for recurrent expenditures	6,328	5,328	4,636	4,276	3,578	3,261	1,854	543
External financing for development expenditures	771	1,573	2,499	487	1,850	3,230	4,052	4,792
Net external debt	-16	-16	---	---	---	---	---	---
Residual	-71	-612	---	-14	---	---	---	---
Memorandum items:	(In percent of GDP; unless otherwise stated)							
Revenues	25.7	25.9	26.1	26.1	25.4	26.5	27.7	28.7
Recurrent expenditures and net lending	47.2	51.8	42.9	41.6	38.2	35.2	31.8	29.5
Wage expenditures	23.8	23.8	21.0	21.8	20.2	18.7	17.1	15.7
Nonwage expenditures	16.1	21.9	18.5	16.6	16.1	14.9	13.6	13.1
Net lending	7.3	6.1	3.4	3.2	1.9	1.5	1.1	0.7
Recurrent balance (commitment) before external support:	-21.6	-25.9	-16.8	-15.5	-12.8	-8.7	-4.1	-0.8
Recurrent balance (cash) before external support	-27.7	-22.3	-16.8	-14.6	-11.4	-9.2	-4.5	-1.2
External support (recurrent)	28.9	22.0	16.8	15.5	11.4	9.2	4.5	1.2
in millions of U.S. dollars	1,764	1,355	1,243	999	967	881	501	147
Development expenditures	3.5	6.5	9.1	3.7	5.9	9.1	9.9	10.3
Overall balance (cash)	-31.2	-28.8	-25.9	-18.4	-17.4	-18.3	-14.5	-11.4
Total external support (in millions of shekels)	7,099	6,901	7,135	4,763	5,428	6,491	5,905	5,334
Nominal exchange rate (NIS per US dollar)	3.6	3.9	3.7	3.7	3.7	...	...	...
Nominal GDP (in millions of shekels)	21,916	24,215	27,582	27,582	31,264	35,461	40,758	46,675

Sources: Ministry of Finance; and IMF staff estimates.