



**MACROECONOMIC AND FISCAL FRAMEWORK
FOR THE WEST BANK AND GAZA:
SECOND REVIEW OF PROGRESS¹**

STAFF REPORT FOR THE MEETING OF THE AD-HOC LIAISON COMMITTEE

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¹ This report was prepared by a team comprising Oussama Kanaan, Henry Ma, Joël Toujas-Bernaté, and Roman Zyteck. The macroeconomic and fiscal framework set out in the Palestinian Reform and Development Plan (PRDP) was assessed by IMF staff in “Medium-Term Macroeconomic and Fiscal Framework for the West Bank and Gaza,” which was issued on December 5, 2007. The first review of progress in implementing the framework was issued on May 2, 2008. Both documents were published on the IMF website (www.imf.org/wbg).

EXECUTIVE SUMMARY

The economic and political environment in the West Bank and Gaza has been less favorable than hoped for in the Palestinian Reform and Development Plan (PRDP). The Government of Israel (GoI) has tightened restrictions on movement and access in the West Bank based on security concerns, and Gaza remains isolated, dampening private sector growth. A surge in inflation has further eroded household incomes and raised production costs. Other external factors have also had an adverse impact, including the slowdown in the Israeli economy and the sharp appreciation of the shekel vis-à-vis the dollar. These constraints have offset other positive developments, including significant flows of external budgetary assistance, as well as improved confidence following the deployment of Palestinian security forces in major cities of the West Bank.

Despite the difficult conditions on the ground, the PA has continued with prudent fiscal policies and reforms. A strict government employment policy has been followed, wage rates have been virtually frozen, and a range of measures have been implemented to improve utility bills payment. The Public Financial Management System has been strengthened further, which is helping prioritize and raise the quality of spending. Reflecting higher inflation, some expenditures in the first half of 2008 were higher than anticipated in the budget, and wage arrears were repaid at a faster pace, which helped cushion the erosion of employees' real incomes. Nevertheless, expenditure increases have been below the inflation rate, implying a retrenchment in real terms. The recurrent fiscal deficit (on a commitment basis and excluding one-off revenue items) is projected to decline from 27 percent of GDP in 2007 to about 23 percent in 2008. The 2009 budget currently under preparation envisages continuation of PRDP reforms, which would reduce the deficit further to about 17 percent of GDP.

Donor assistance for the recurrent budget disbursed or identified so far is much higher than pledged at the December 2007 donors' conference in Paris, but still falls short of the amount needed to finance the cash deficit for the whole of 2008. External financing requirements for 2008 are projected at \$1.85 billion, of which \$1.2 billion was disbursed during January to August. This leaves about \$650 million needed in the remainder of the year, of which about \$330 million has been identified. In 2009, external financing requirements are projected to decline to \$1.3 billion, reflecting a reduced deficit and lower repayment of arrears. However, so far only about one third of that amount has been pledged.

Close cooperation among all three parties, the PA, the GoI, and donors, remains critical to the success of reforms and the recovery of the Palestinians' living standards. A collaborative approach has become all the more important given the increasingly difficult global economic conditions, which compound the impact of restrictions on domestic inflation and growth. Perseverance by the PA in the PRDP's implementation is essential for fiscal sustainability. However, there is a risk that its efforts will be hampered by social and political pressures, especially if incomes and employment opportunities remain constrained. That risk would be substantially reduced through a relaxation of Israeli restrictions, a further improvement in the security situation, and the timely disbursement of adequate donor assistance.

I. RECENT ECONOMIC DEVELOPMENTS

1. **The macroeconomic environment in the West Bank and Gaza (WBG) so far in 2008 has been less favorable than earlier envisaged.** The Palestinian Reform and Development Plan (PRDP) presented at the December 2007 donors' conference in Paris envisaged a gradual relaxation of restrictions by the Government of Israel (GoI) to enable a recovery of trade and private investment, and an acceleration of public investment. An improvement in the situation in Gaza was also hoped for. So far, however, the restrictions have been tightened in the West Bank, while Gaza's primary border crossings have remained closed, constraining development projects. Preliminary data from the Palestinian Central Bureau of Statistics (PCBS) indicate a contraction in real GDP in the first quarter of 2008, consistent with other economic indicators (Box 1). On that basis, real GDP appears to have been flat, at best, during the first half of the year. Assuming that restrictions are modestly relaxed in the last quarter of 2008, real GDP could grow by about 1 percent in 2008 as a whole.²

2. **Unemployment and poverty remain high, especially in Gaza.** The unemployment rate in the first quarter of 2008 averaged about 30 percent in Gaza and 19 percent in the West Bank. Based on the Palestinian Expenditure and Consumption Survey (PECS) for 2007, about 79 percent of households in Gaza and 46 percent in the West Bank lived below the poverty line.³ Poverty is likely to have risen to even higher levels since then, given the tightening of the restrictions. The humanitarian situation in Gaza continues to be very difficult as primary crossings allow only imports of basic commodities and are virtually sealed for exports.

3. **In addition to the impact of restrictions, real incomes in the WBG were reduced by the sharp rise in inflation, which reached 12 percent in the year to July 2008** (compared with about 1 percent in mid-2007). The rise was much more pronounced in Gaza (18 percent) than the West Bank (13 percent) and East Jerusalem (7 percent), given the tighter trade restrictions.⁴ Increases in the prices of food and fuel were particularly large, reflecting higher world prices of wheat and petroleum products. The impact of the rise in food prices was much higher than in Israel, given its higher weight in the WBG's consumption basket. The adverse

² The GoI has reported the start of implementation of easing measures that were agreed upon in May 2008 with the Quartet Special Representative, Mr. Tony Blair.

³ See the report by UNWRA, "Prolonged Crisis in the Occupied Palestinian Territory: Socio-Economic Developments in 2007," July 2008. See www.un.org/unrwa/publications/pubs07.html.

⁴ The rate of inflation in East Jerusalem of about 7 percent is much lower than in the West Bank given its greater economic linkages with the Israeli economy.

Box 1. Economic Performance in 2008

Economic activity remained weak in the first half of 2008, as restrictions on movement and access were tightened in the West Bank while Gaza remained isolated.^{1/} The impact on economic activity was compounded by a surge in inflation and appreciation of the shekel. Real GDP in the WBG is estimated by the Palestinian Central Bureau of Statistics to have declined by 0.6 percent in the first quarter of 2008 compared with the average in 2007.

The weak performance is borne out by several indicators of economic activity:

- Reflecting weak private investment, outstanding **credit to the private sector** declined by 32 percent in real terms in the year to May 2008. Banks have high levels of excess liquidity, most of which is placed overseas.
- **Exports** of goods and services from the WBG to Israel are estimated by the Israeli Bureau of Statistics to have declined by about 16 percent (in dollar terms) and by 26 percent (in NIS terms) in the first quarter of 2008 compared with the average in 2007.
- In the year to March 2008, **real wages** in the private sector rose by 1 percent in the West Bank, and declined by 5 percent in Gaza.
- Total gross budgetary **revenues**, excluding tax refunds and one-off transactions, declined by about 1 percent in real terms in the first half of 2008 compared with the first half of 2007. The fall in budgetary revenues was particularly severe in Gaza, with VAT clearance revenues there declining by about 64 percent in real terms.
- **Real GDP growth in Israel**, the WBG's main trading partner and destination for its goods and labor services exports, is projected to slow in 2008 compared with 2007.

Economic activity would have been even weaker were it not for the exceptionally high level of external budgetary support (albeit with reduced purchasing power due to inflation and shekel appreciation), which amounted to \$953 million in the first half of 2008 (14 percent of annual GDP), more than double the amount disbursed in the second half of 2007. There were also other favorable factors in early 2008, including the deployment of PA security forces in some West Bank cities, as well as the Bethlehem investor conference which pointed to considerable investment potential in the WBG under more favorable conditions on movement and access.

There are not enough reliable indicators available to estimate economic growth separately in Gaza and the West Bank, and it is difficult to draw definitive conclusions based only on selected anecdotal evidence. Gaza and the West Bank remain economically linked, including through public expenditure, which makes it appropriate to consider the entire Palestinian territories as one economic entity.

¹ See "An Analysis of Economic Developments and Prospects in Palestine in 2008," published on the PA's ministry of finance website.

impact of inflation on incomes was compounded by the sharp appreciation of the shekel vis-à-vis the U.S. dollar, given the importance of dollar-denominated sources of income in the WBG, including part of remittances and donor assistance.⁵

4. **Bank deposit growth was sluggish and credit contracted**, reflecting subdued economic activity and investment. Deposits were virtually flat (in NIS terms) and contracted by about 10 percent in real terms in the year to May 2008. Private sector credit continued to decline, with its share in private deposits falling to 27 percent by May 2008 (compared with 39 percent at end-2006 and 30 percent at end-2007). After increasing in 2006–07, the share of nonperforming loans to total loans (net of provisions) remained stable at about 12 percent in the first quarter of 2008. Some risks to banks' balance sheets persist, due in particular to Gaza's continued isolation and its likely adverse impact of asset quality. In addition, the banking situation in Gaza has been complicated by Israeli restrictions on the transfer of cash from West Bank branches into Gaza. This has led to a significant drop in the stock of cash liquidity in Gaza during 2008, posing a risk that Gaza banks would be unable to satisfy all cash demand from their customers.

5. **The Palestine Monetary Authority (PMA) has continued institutional reforms** (Box 2). The PMA has made considerable progress in internal reform and capacity building, including in strengthening the supervisory framework and governance. Efforts are ongoing, in coordination with the Bank of Israel, to ensure that Israeli banks continue to act as clearing institutions (in NIS) for Palestinian banks engaged in financial relations between Israel and the WBG.

⁵ The shekel appreciated by 13 percent, from an average of NIS 4.07 per U.S. dollar in the second half of 2007 to NIS 3.53 per U.S. dollar in the first half of 2008.

Box 2. Reforms by the Palestine Monetary Authority

The Palestine Monetary Authority (PMA) has continued in 2008 with a plan to transform its organization and operations, with the medium-term objective of becoming a full-fledged central bank. The transformation, supported by IMF technical assistance, has been broad-based, focusing on three main areas:

- The **supervisory framework** is being strengthened, including through the creation of a macroprudential division at the PMA, and steps to establish an early warning system. In early 2008, the PMA issued a circular to banks tightening the provisioning requirements for nonperforming loans. Another circular is being drafted to set limits for client credit concentration. Unified bank performance reports have been introduced and new manuals for onsite and offsite monitoring are being drafted. Since December 2007, banks have been preparing annual audited financial reports based on modernized and unified requirements. The regulatory framework has been expanded to cover money changers; regulations for nonbank financial institutions will soon be submitted to the PA for approval. To regularize cross-border supervision, the PMA has signed a memorandum of understanding with the Central Bank of Jordan on joint supervision of Jordanian commercial bank branches operating in WBG. To strengthen commercial banks' capital base and improve their regional competitiveness, the PMA has raised minimum capital requirements to \$35 million (from \$20 million) and plans further increases in several stages to \$100 million.
- On **other operational issues**, the new credit registry, which became fully operational in April 2008, is allowing banks to better evaluate risks, and is expected to reduce collateral requirements and improve credit flow. The PMA expects to see a formal borrower scoring system in place by end-2009 and an expansion of the credit registry's database to include information on utility bills and rents by end-2010. Given the absence of credit rating agencies, the PMA is planning to develop the use of the credit registry for rating purposes, with a view to eventual adoption of Basel II standards. In addition, as part of efforts to set up an electronic payment system for all banks by July 2009, the PMA has requested tenders for the Automated Transfer System and has formed a National Payments Council to look at suitable business models for the payments system.
- The PMA is taking steps to establish a sound **financial sector legal framework**. An Anti Money Laundering Law has been in force since 2007. A new banking law is expected to be enacted by end-2008, and a Central Bank Law in 2009.

II. FISCAL DEVELOPMENTS IN JANUARY-JUNE 2008

6. **In the first half of 2008, the PA maintained a tight expenditure stance, despite the surge in inflation, while regular budgetary revenues have been weaker than expected, reflecting sluggish economic activity:**

- Total net revenues, excluding one-off items, were about 3 percent lower than budgeted. The impact of inflation on the revenue level was offset by the weaker-than-expected economic activity. In real terms, net revenues declined by about 5 percent compared with the first half of 2007. There were, however, one-off items not foreseen in the budget: (i) the PA received NIS 653 million in dividends from the Palestine Investment Fund (PIF), which were entirely used to settle part of the PA's debt to the PIF;⁶ and (ii) the GoI remitted NIS 76 million as interest for past withheld clearance revenue. At the same time, the PA has repaid about NIS 125 million in tax refunds to the private sector.⁷
- On a commitment basis (in NIS), the wage bill was 4 percent lower than budgeted for the first half of the year due to lower-than-expected PA employment.⁸ However, on a cash basis wage expenditures were higher than budgeted, reflecting the frontloading of wage arrears repayment. While the PRDP envisaged the repayment of about NIS 1.1 billion in arrears owed to public sector employees in a phased manner during 2008-10, the PA now intends to fully repay these arrears in 2008 as part of an agreement with public sector trade unions reached in April 2008.⁹ This has also helped cushion the impact of the higher inflation on real incomes of PA employees.
- A tight stance has also been applied to nonwage expenditure commitments, which turned out 16 percent lower than the budgeted amount. While the PA repaid significant nonwage arrears, it continued to accumulate arrears on contributions to the pension fund, which now functions like a pay-as-you-go system with monthly transfers from the budget.

⁶ This transaction was in effect a bookkeeping operation to settle part of the PA's debt to the PIF, with no cash paid.

⁷ The 2008 budget did not project any tax refund payments. The budget does however project the payment of other arrears to the private sector.

⁸ PA employment averaged 142,000 during the first half of 2008, compared with 150,000–153,000 expected in the budget.

⁹ The agreement stipulates, *inter alia*, that all wage arrears should be repaid within 6 months, and envisages an increase in transportation allowances by 50 percent, and a study by a committee of inflation's impact.

- Net lending (including payments by the central government for utility bills due by consumers, and tax rebates or losses related to the marketing of petroleum products) was 20 percent higher than the prorated budgeted amount, but 30 percent lower than in the first half of 2007. This reflected the rise in inflation, especially fuel prices,¹⁰ as well as the temporary suspension of some measures to improve utility bill collection. These measures have now been fully restored, including (i) the implementation of the system of certificates of payments;¹¹ (ii) a new incentive system for municipalities to ensure that consumers' utility payments are passed on to the electricity companies, in addition to a close monitoring of municipalities' bank accounts;¹² and (iii) installation of prepaid meters in West Bank refugee camps.
- On a commitment basis, the recurrent deficit, before external support (and excluding one-off items) for the first half of 2008, is estimated at NIS 2.3 billion. This is lower by about NIS 140 million (\$40 million) than the prorated budget deficit, as the lower-than-budgeted nonwage expenditure commitments have more than offset higher net lending. However, on a cash basis, the deficit (excluding the one-off items) is estimated at NIS 3.1 billion, higher than budgeted by NIS 300 million (\$85 million), reflecting the higher arrears repayment.

7. **The PA continues to strengthen the Public Finance Management System**, with a focus on prioritizing spending and minimizing arrears accumulation. The Ministry of Finance (MoF) is building on the recent establishment of the General Accountant Department (GAD) and the installation of a new computerized accounting system which now links 10 ministries to the MoF. The MoF is preparing a design paper for the system's processes and procedures, and plans to set up a cash management planning unit in the GAD. This will facilitate the MoF's efforts to prioritize spending and minimize arrears accumulation. Fiscal transparency has been enhanced by the regular posting, on the MoF website, of fiscal reports 15 days after the end of each month. Further improvements in public expenditure management are envisaged for the remainder of 2008 and 2009, including a strengthening of commitment controls, cash management and planning, and budget execution.

¹⁰ In particular, higher international petroleum prices have contributed to larger payments of fuel for the Gaza power plant.

¹¹ The system of certificates was suspended by the courts in March 2008. However, the PA won its appeal in June 2008, and the system has been implemented since then.

¹² According to the new incentive system, municipalities that do not fully cover their utility bills are blocked from receiving funds for development projects, while municipalities that pay their bills in full receive transfers equivalent to a certain percentage of the value of these bills.

III. MACROECONOMIC AND FISCAL OUTLOOK

8. **The PRDP's macroeconomic framework continues to be premised on all parties (the PA, Israel, and donors) working together constructively to foster sustainable growth in the WBG.** Progress hitherto made by each side can be summarized as follows:

- The PA has made substantial progress in establishing security in several Palestinian cities in the West Bank by deploying police and security forces. This has brought about a large measure of stability and business confidence. As noted above, the PA has continued with fiscal consolidation, underpinned mainly by a strict government employment policy and a virtual wage rate freeze, as well as measures to reestablish payment discipline for utilities. The sharp rise in inflation, not envisaged in the budget, has contributed to higher-than-expected net lending and a faster pace of arrears repayment. However, the PA intends to continue to contain expenditure commitments to the budgeted levels, implying a significant retrenchment in real terms.
- The PRDP envisaged a gradual relaxation of the GoI's restrictions on movement and access during 2008, to enable a recovery of trade and private investment, and an acceleration in public investment. Thus far the restrictions have been tightened.
- There is an urgent need to secure additional financing from donors to finance the recurrent deficit for 2008. The financing needs are significantly larger than the amount pledged at the December 2007 Paris conference, mainly reflecting the following factors: (i) the amount pledged at the conference was below the 2008 budget financing needs as presented in the PRDP; (ii) the PA has been repaying wage arrears more rapidly than envisaged, and its net lending has been higher than budgeted; and (iii) the financing gap in U.S. dollar terms increased due to the marked appreciation of the NIS vis-à-vis the U.S. dollar.

9. **The updated macroeconomic framework takes into account the tightening of Israeli restrictions on movement and access, as well as the surge in inflation and NIS appreciation.** It is assumed that the restrictions will be modestly relaxed only in the fourth quarter of 2008, and that inflation will moderate in the second half of 2008. The implementation of the public investment program will likely be much slower than expected, especially in Gaza. On that basis, real GDP growth is projected at about 1 percent in 2008, lower than projected in the PRDP (3.5 percent), and average inflation at 11.5 percent (compared with 3.2 percent in the PRDP). Assuming continued modest relaxation of Israeli restrictions, real GDP growth is projected to rise to 3.7 percent in 2009, and inflation would decline to 4 percent.

10. **The projected recovery is subject to downside risk, and would not be sufficient to significantly raise living standards and lower unemployment.** With population and the labor force both growing by about 4 percent per year, real income per capita is estimated to

have declined by about 3 percent in each of 2007 and 2008. Even with the assumed modest relaxation of Israeli restrictions starting in late 2008, real income per capita would rise by only about 1½ percent per year over 2009–11, while unemployment would remain high, at over 18 percent.

11. The fiscal outlook for 2008 differs in several respects from the budget:

- Total net revenues are projected to be about 12 percent higher than budgeted, due to several one-off items (i.e., PIF dividends, GoI interest payments, and telecommunications license fees¹³). Excluding these one-off items, regular revenues are projected to be slightly lower than budgeted, with the impact of higher inflation offset by lower-than-expected growth.
- On a commitment basis, wage expenditures would remain in line with the budget,¹⁴ while nonwage expenditures would be about 6 percent lower, implying a marked decline in real terms. However, reflecting the frontloading of repayment of wage and nonwage arrears, total cash outlays for wage and nonwage expenditures will be larger than budgeted by about NIS 300 million.
- Net lending is projected to be higher than budgeted by about NIS 200 million, but still lower than in 2007, as the impact of stricter enforcement of utility payments is partly offset by higher fuel costs.¹⁵
- The projected recurrent budget deficit for 2008, on a commitment basis and excluding the one-off items, is higher than budgeted by about NIS 333 million, mainly reflecting higher net lending. On a cash basis, the projected deficit is higher than the budget projection by about NIS 830 million on account of the frontloaded arrears repayment. If the one-off items are included, the budget deficit is significantly lower than the budget projection on both a commitment as well as cash basis.

12. External budgetary financing requirements for the year as a whole are now projected at \$1.85 billion, compared with \$1.6 billion in the budget. Additional financing

¹³ The Wataniya telecommunications company paid about NIS 270 million in license fees to the PA in August 2008.

¹⁴ The projected wage bill takes into account the expected increase in the number of teachers for the new school year, as envisaged in the budget.

¹⁵ As noted above, higher fuel prices would affect the cost of operating the Gaza Power Plant. While the tax refunds for petroleum products are in effect fuel subsidies, the PA has kept the wedge between WBG and world fuel prices broadly constant, implying minimal impact of higher fuel prices on the fiscal position. As for food prices, there is no government intervention in marketing or provision of price-dependent transfers.

will be urgently needed for the remainder of 2008. About \$1.2 billion in donor support was disbursed during January–August 2008. This is already above the amount pledged at the December 2007 donors' conference in Paris for the entire 2008 recurrent budget, and higher than past yearly amounts. Of the \$650 million needed during the remainder of the year, about \$330 million has been identified, leaving a gap of about \$320 million.^{16 17}

Fiscal Indicators for 2007-08
(In millions of NIS, unless otherwise indicated)

| | 2007 | 2008 | | |
|--|--------|--------|--------|--------------------|
| | | PRDP | Budget | Current Projection |
| Total net revenues | 4,894 | 5,349 | 5,349 | 6,014 |
| of which (one-off items for 2008): | | | | |
| PIF dividends used to repay debt | 0 | 0 | 0 | 653 |
| Wataniya licensing fee | 0 | 0 | 0 | 266 |
| Late interest on clearance revenue withheld | 0 | 0 | 0 | 76 |
| Total recurrent expenditure (commitment) | 10,430 | 10,462 | 10,244 | 10,247 |
| Total recurrent expenditure (cash) | 10,526 | 10,981 | 11,025 | 11,524 |
| of which: repayment of wage and nonwage arrears | 96 | 519 | 781 | 1,277 |
| Recurrent deficit (commitment basis) | -5,535 | -5,113 | -4,895 | -4,233 |
| excluding one-off items | -5,535 | -5,113 | -4,895 | -5,228 |
| Recurrent deficit (cash basis) | -3,901 | -5,632 | -5,676 | -5,510 |
| excluding one-off items | -3,901 | -5,632 | -5,676 | -6,505 |
| Financing | 3,927 | 5,632 | 5,676 | 5,510 |
| External recurrent budget support required | 4,149 | 5,648 | 5,881 | 6,368 |
| Domestic bank financing | -542 | 0 | -180 | -180 |
| PIF financing | 320 | 0 | 0 | -653 |
| Net external debt | 0 | -16 | -25 | -25 |
| <i>Memorandum items:</i> | | | | |
| GDP | 20,737 | 21,465 | 21,918 | 22,910 |
| Exchange rate | 4.10 | 4.15 | 3.60 | ... |
| External budget support required (in U.S. dollars) | 1,012 | 1,361 | 1,634 | 1,846 |
| Deficit excluding one-off items (commitment basis), % of GDP | -26.7 | -23.8 | -22.3 | -22.8 |
| Deficit excluding one-off items (cash basis), % of GDP | -18.8 | -26.2 | -25.9 | -28.4 |

Sources: Ministry of Finance, and IMF staff estimates.

¹⁶ Projections assume an average exchange rate of NIS 3.45 per U.S. dollar, versus NIS 3.60 per U.S. dollar assumed in the 2008 Budget and NIS 4.10 per U.S. dollar in the PRDP.

¹⁷ Identified disbursements during September to December 2008 include projected disbursements of about \$210 million from the European Commission's disbursement mechanism PEGASE, with contributions, among others, from the European Commission, Germany, Belgium and Sweden, as well as disbursements of about \$120 million from the PRDP Trust Fund, with contributions from Kuwait, the UK, and Canada.

13. Fiscal adjustment in 2009 is predicated on a further fall in recurrent expenditures by about 3 percentage points of GDP, based on the following measures:

- Strict control on the wage rate and on new employment (except for a net addition of 3,000 health and education workers) will continue, despite the erosion in real incomes due to recent inflation. This implies a continued fall in the share of PA employment in the total labor force from about 17 percent in 2008 to 15 percent in 2009.
- Nonwage expenditures will largely be held constant in real terms. Continued strengthening of cash management and spending commitment controls would allow higher quality spending and better prioritization, and help prevent arrears accumulation.
- Net lending is projected to decline by about 1 percentage point of GDP, reflecting implementation of measures to improve the incentives to municipalities and households to pay their electricity bills.
- The repayment of all wage arrears in 2008 will reduce the arrears repayment burden on the 2009 budget. About NIS 211 million in private sector arrears are expected to be paid in 2009.
- The revenue-to-GDP ratio, excluding one-off items, is projected to recover toward more typical past levels,¹⁸ reflecting (i) a significant recovery in real income for the first time in two years; (ii) improved compliance resulting from both the higher income, the more stable political and security situation, as well as the settlement of arrears on wages and to the private sector; and (iii) ongoing strengthening in tax administration.¹⁹
- The recurrent budget deficit on a commitment basis (excluding one-off items) is projected to decline from about 23 percent of GDP in 2008 to 17 percent in 2009. Reflecting a lower deficit and lower arrears repayments, external financing needs for recurrent expenditure would decline to about \$1.3 billion in 2009.

14. The preparation of the 2009 budget is under way on the basis of the above outlook. It will, for the first time, have an integrated presentation of both recurrent and development budgets by line ministries, linked to the policy objectives stated in the PRDP. To guide the MoF's allocation of the expenditure envelope, each line ministry and agency is

¹⁸ The revenue-to-GDP ratio in 2009, at 25.1 percent, would still be lower than that estimated for 2005 (27.5 percent) and 2006 (25.4 percent), due to the loss of tax revenue from Gaza starting in mid-2007.

¹⁹ The tax administration measures include the creation of a unified revenues administration, with a Large Taxpayer Unit, as well as the computerization of tax administration under the PATACS project.

providing detailed inputs on (i) its core objectives for 2009–11, with a focus on 2009; and (ii) the financial resources required for the fulfillment of those objective. The cabinet is expected to approve the budget by end-October 2008.

Box 3. External Financial Support for 2009-10

External financing needs for 2009-10 are lower than in the PRDP in shekel terms, but about the same in dollar terms, due to the shekel's appreciation. In shekel terms, projected external financing needs for 2009–10 total NIS 12.7 billion, significantly below the PRDP estimate of NIS 15.8 billion, due to the front-loading in 2008 of repayments of arrears. However, in dollar terms, the PRDP and current projections show external financing needs for 2009–10 at \$3.8 billion, consisting of \$2.6 billion for the recurrent deficit, plus \$1.2 billion for development expenditures.

Donor pledges for 2009–10 budgetary financing are insufficient. At the donors' conference in Paris in December 2007, while pledges for development expenditures far exceeded the needs, those for recurrent budgetary financing fell short. Additional pledges for recurrent budgetary support are thus required, possibly by shifting some existing donor pledges from development assistance toward recurrent budget support. The 2009 budget circular projects a recurrent financing requirement of NIS 4.4 billion (about NIS 1.1 billion lower than in the PRDP), or about \$1.3 billion. Pledges for recurrent budgetary support are estimated at NIS 1.6 billion, or about \$0.5 billion. This leaves a shortfall of NIS 2.8 billion. For 2010, the projected financing gap is NIS 2.5 billion.

West Bank and Gaza: External Financial Support, 2009-10 1/

(In millions of NIS)

| | 2009 | | 2010 | | 2009-10 | |
|-----------------------------------|--------------------|---------|--------------------|---------|--------------------|---------|
| | PRDP Projection | Current | PRDP Projection | Current | PRDP Projection | Current |
| Recurrent budget support required | 5,513 | 4,401 | 5,187 | 4,143 | 10,700 | 8,544 |
| identified | 1,961 | 1,583 | 2,020 | 1,631 | 3,981 | 3,214 |
| gap | 3,552 | 2,818 | 3,167 | 2,512 | 6,719 | 5,330 |
| Development assistance required | 2,283 | 1,684 | 2,768 | 2,500 | 5,051 | 4,184 |
| identified | 2,815 | 2,272 | 2,861 | 2,310 | 5,676 | 4,582 |
| gap | -532 | -588 | -93 | 190 | -625 | -398 |

1/ Valued at NIS 4.15 per US dollar for PRDP; and NIS 3.35 per US dollar for current projections.

West Bank and Gaza: External Financial Support, 2009-10 1/

(in millions of U.S. dollars)

| | 2009 | | 2010 | | 2009-10 | |
|-----------------------------------|--------------------|---------|--------------------|---------|--------------------|---------|
| | PRDP Projection | Current | PRDP Projection | Current | PRDP Projection | Current |
| Recurrent budget support required | 1,328 | 1,314 | 1,250 | 1,237 | 2,578 | 2,550 |
| identified | 472 | 472 | 487 | 487 | 959 | 959 |
| gap | 856 | 841 | 763 | 750 | 1,619 | 1,591 |
| Development assistance required | 550 | 503 | 667 | 746 | 1,217 | 1,249 |
| identified | 678 | 678 | 689 | 689 | 1,368 | 1,368 |
| gap | -128 | -176 | -22 | 57 | -151 | -119 |

1/ Valued at NIS 4.15 per US dollar for PRDP; and NIS 3.35 per US dollar for current projections.

IV. ASSESSMENT

15. **IMF staff considers that public finance reforms undertaken by the PA are broadly in line with the PRDP.** The PA has maintained strict controls on government employment and wages, and implemented measures to improve utility payments. The PFMS has been strengthened, which is helping tighten control on nonwage expenditures. The austerity measures are being implemented in a political and economic environment that is bleaker than anticipated in the PRDP. In particular, the overall situation on the ground has not improved as expected, the surge in inflation has eroded living standards, and private sector growth is constrained by restrictions on movement and access.

16. **In order to ensure that fiscal adjustment is sustained, structural reforms set out in the PRDP will need to be stepped up in 2009:**

- It will become increasingly difficult to lower the wage bill as a share of GDP by relying only on restraining new employment and wage rates. A relaxation of Israeli restrictions would raise private sector growth, which would facilitate a comprehensive civil service reform, combining adjustments of salary scales and restructuring. This will be important to achieve the medium-term objectives for the wage bill. Public sector efficiency is already being enhanced by the ongoing reform of the security force. While the staff understands the difficulty of further retrenchment given the current unfavorable macroeconomic conditions, further personnel reductions would be desirable as the private sector expands and inflation falls.
- The impact of fiscal austerity on the poor needs to be eased by streamlined and better targeted social transfers, with World Bank advice, using reliable household data.
- Measures to improve the collection of utility bills should be complemented by a broader reform of the electricity sector and a review of municipal finances.
- A comprehensive reform of the public pension system is needed to restore its viability.

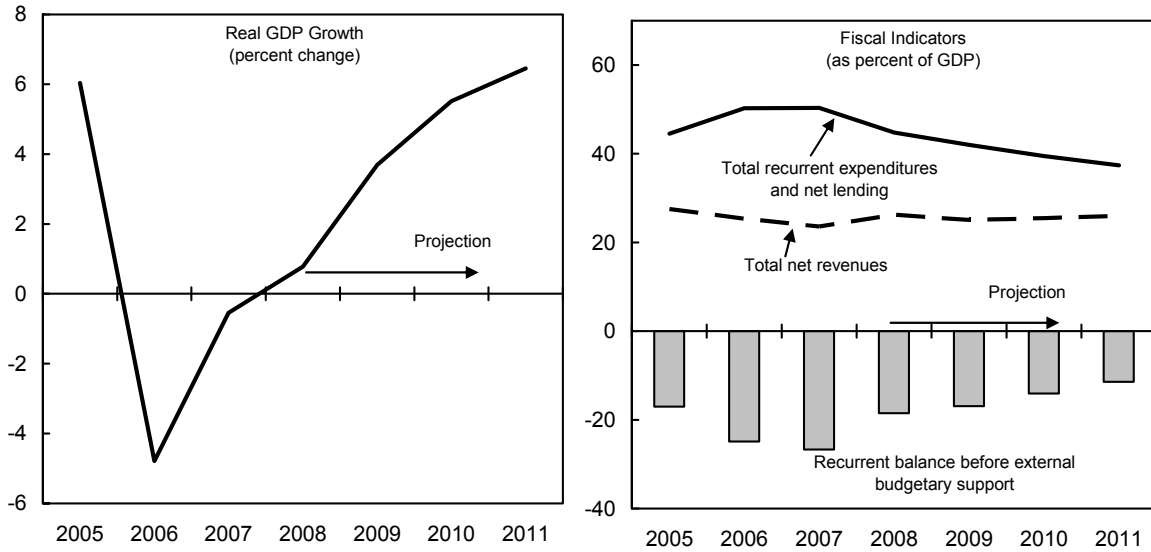
17. **Close cooperation among all three parties (the PA, GoI, and donors) is essential to contain significant risks to the macroeconomic and fiscal outlook:**

- The continuation of Israeli restrictions and lack of progress in the peace process would further delay the recovery anticipated in the PRDP, and compound the impact of high inflation on Palestinians' living standards. This would make it more difficult for the PA to reduce spending and raise collection rates for utilities, leading to a wider budget gap and higher required external assistance. A relaxation of restrictions would ease inflationary pressures and help restrain public sector wages.

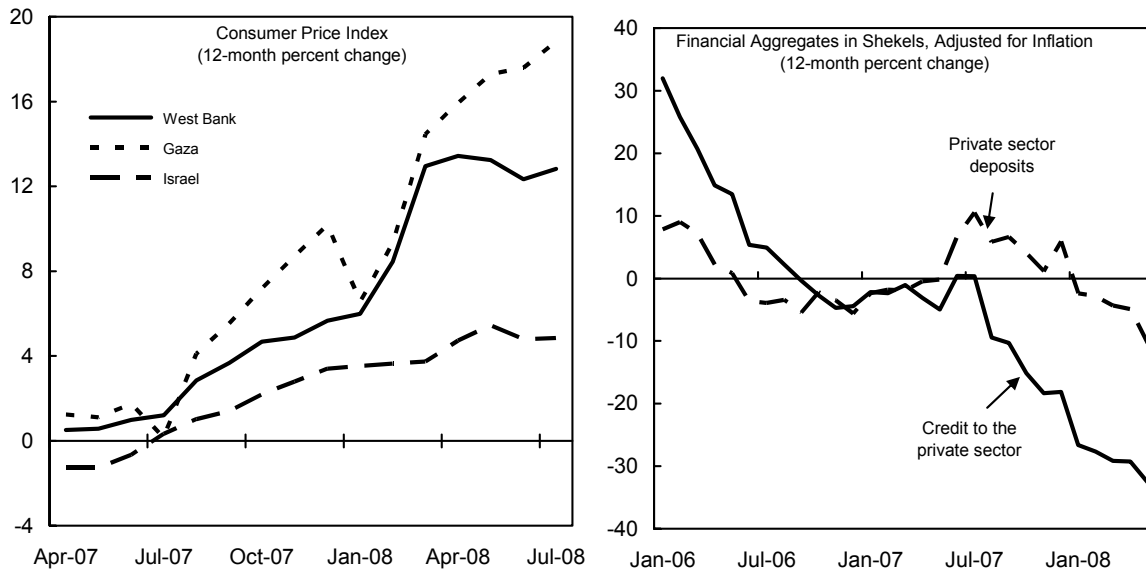
- The PA's reforms will become more difficult to implement without broader political support on the Palestinian side. Important steps have been taken in 2008 to improve public confidence, including the deployment of Palestinian security forces in major cities. The Bethlehem investment conference has also raised investors' confidence and indicated substantial potential for investment in the WBG. Furthermore, the PA's decision to repay all wage arrears in 2008 has stemmed pressures from trade unions to raise wage rates. However, there is a risk of recurrence of such pressures, especially if inflation does not abate and Israeli restrictions are not relaxed.
- Additional donor assistance needs to be secured immediately to fill the recurrent budget gap in 2008 and early 2009. If adequate funds cannot be secured, the PA would need to cut its cash expenditures and likely accumulate new arrears, including on wages. Close coordination among donors, and between donors and the PA, will be essential to ensure adequate and timely disbursements for the recurrent budget. Additional financing assurances should also be provided soon for 2009, to help ensure a smoother and more predictable execution of the budget.
- Uncertainties regarding the situation in Gaza could result in unanticipated emergency and humanitarian spending. This would raise the PA's recurrent deficit and require additional donor financing. Facilitation by the GoI of movement of goods and people across Gaza's borders would reduce this risk and raise its growth potential, including by speeding the implementation of the investment program.

Figure 1. West Bank and Gaza: Macroeconomic and Fiscal Developments

A substantial recovery and fiscal adjustment are envisaged over the medium term, facilitated by a relaxation of restrictions on movement and access.



Inflation has risen significantly, and real bank credit and deposits have contracted.



Sources: Ministry of Finance, Palestinian Central Bureau of Statistics, and IMF staff estimates.

Table 1. West Bank and Gaza: Selected Economic Indicators, 2006–11

(Population: 4 million; 2007, est.)
 (Per capita GDP: \$1,259; 2007, est.)
 (Poverty rate: 58 percent, 2006)

| | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|--|----------------------------|-------|------------|-------|-------|-------|
| | | Est. | Projection | | | |
| Output and prices | | | | | | |
| | (Annual percentage change) | | | | | |
| Real GDP (1997 market prices) | -4.8 | -0.5 | 0.8 | 3.7 | 5.5 | 6.5 |
| CPI inflation rate (end of period) | 3.3 | 6.9 | 7.0 | 4.0 | 4.0 | 4.0 |
| CPI inflation rate (period average) | 3.8 | 2.7 | 11.5 | 4.0 | 4.0 | 4.0 |
| Investment and saving | | | | | | |
| | (In percent of GDP) | | | | | |
| Gross capital formation, of which: | 21.1 | 21.1 | 21.5 | 24.8 | 28.3 | 30.3 |
| Public | 6.4 | 5.5 | 5.4 | 7.8 | 10.5 | 11.5 |
| Private | 14.7 | 15.6 | 16.1 | 17.0 | 17.8 | 18.8 |
| Gross national savings, of which: | 11.2 | 14.2 | 21.8 | 13.3 | 13.8 | 11.6 |
| Public 1/ | -2.3 | -1.7 | 13.9 | 7.7 | 10.4 | 10.0 |
| Private | 13.5 | 15.9 | 7.9 | 5.5 | 3.4 | 1.6 |
| Saving-investment balance | -9.9 | -6.9 | 0.3 | -11.5 | -14.5 | -18.7 |
| Public finances 2/ | | | | | | |
| | (In percent of GDP) | | | | | |
| Revenues 3/ | 25.4 | 23.6 | 26.2 | 25.1 | 25.5 | 26.0 |
| Recurrent expenditures and net lending | 50.2 | 50.3 | 44.7 | 42.0 | 39.5 | 37.4 |
| Wage expenditures | 26.3 | 25.4 | 23.3 | 22.2 | 21.9 | 20.7 |
| Nonwage expenditures (including minor development) | 16.5 | 14.3 | 14.3 | 13.5 | 13.1 | 12.6 |
| Net lending | 7.4 | 10.6 | 7.2 | 6.3 | 4.5 | 4.1 |
| Recurrent balance (before external budgetary support) | -24.9 | -26.7 | -18.5 | -17.0 | -14.0 | -11.4 |
| Externally financed development expenditures | 6.2 | 5.0 | 4.5 | 6.8 | 9.2 | 10.0 |
| (in millions of US dollars) | 281 | 254 | 301 | 503 | 746 | 896 |
| Overall balance (before external budgetary support) | -31.1 | -31.7 | -23.0 | -23.8 | -23.2 | -21.4 |
| Overall balance (after external budgetary support) | -14.7 | -11.7 | 4.8 | -5.9 | -8.0 | -10.0 |
| Overall balance (cash basis, after external support) | -5.1 | -4.9 | -0.8 | -6.8 | -9.1 | -10.0 |
| External support for recurrent budget | 16.3 | 20.0 | 27.8 | 17.9 | 15.2 | 11.4 |
| (in millions of US dollars) | 741 | 1,012 | 1,846 | 1,314 | 1,237 | 1,021 |
| Monetary sector 4/ | | | | | | |
| | (Annual percentage change) | | | | | |
| Credit to the private sector | 7.6 | -5.7 | 21.3 | 10.8 | 14.2 | 14.0 |
| Private sector deposits | 6.2 | 21.9 | 19.3 | 11.8 | 11.4 | 11.2 |
| External sector | | | | | | |
| | (In percent of GDP) | | | | | |
| Exports of goods and nonfactor services | 11.8 | 13.2 | 13.2 | 13.1 | 12.9 | 12.8 |
| Import of goods and nonfactor services | 78.5 | 78.5 | 75.1 | 76.3 | 76.8 | 76.7 |
| Net factor income | 11.8 | 11.4 | 9.3 | 8.8 | 8.4 | 7.9 |
| Net current transfers | 45.0 | 47.1 | 52.9 | 42.9 | 41.0 | 37.3 |
| Official transfers | 22.5 | 25.0 | 32.3 | 24.7 | 24.4 | 21.4 |
| Current account balance (excluding official transfers) | -32.5 | -31.9 | -32.0 | -36.2 | -38.9 | -40.1 |
| Current account balance (including official transfers) | -9.9 | -6.9 | 0.3 | -11.5 | -14.5 | -18.7 |
| Memorandum items: | | | | | | |
| Nominal GDP (millions of US dollars) | 4,533 | 5,058 | 6,641 | 7,354 | 8,118 | 8,944 |
| External public debt (millions of US dollars) | 1,297 | 1,296 | ... | ... | ... | ... |
| Per capita nominal GDP (US dollars) | 1,166 | 1,259 | 1,602 | 1,719 | 1,841 | 1,967 |
| Unemployment rate (average in percent of labor force) | 23.6 | 21.3 | 22.1 | 21.7 | 20.6 | 18.6 |
| New Israeli Shekel per US dollar (period average) | 4.46 | 4.10 | ... | ... | ... | ... |
| Al Quds stock market index (annual percentage change) | -46.4 | -12.8 | ... | ... | ... | ... |

Sources: Palestinian authorities, World Bank, and IMF staff estimates.

1/ The large increase in gross public savings during 2008-10 is due largely to the substantial inflow of donor financing for the recurrent budget and development expenditures.

2/ Commitment basis.

3/ The sharp increase in revenues in 2008 is due to the receipt of dividends from the Palestine Investment Fund, interest on frozen clearance revenues from the Government of Israel, and telecommunication license fees.

4/ End of period; in US dollar terms. In 2008, given the marked appreciation of the shekel vis-à-vis the dollar and higher inflation, the value of deposits and credit are projected to decline in real terms.

Table 2a. West Bank and Gaza: Central Government Fiscal Operations, 2007-11

| | 2007 | 2008 | | 2009 | 2010 | 2011 |
|--|--|---------------|---------------|---------------|---------------|---------------|
| | Est. | Budget | Proj. | Projection | | |
| | (In millions of US dollars, unless otherwise stated) | | | | | |
| Total net revenues | 1,194 | 1,486 | 1,743 | 1,842 | 2,067 | 2,322 |
| Gross domestic revenues | 323 | 419 | 663 | 572 | 653 | 724 |
| Tax revenues | 202 | 253 | 241 | 351 | 401 | 444 |
| Nontax revenues 1/ | 122 | 166 | 422 | 221 | 253 | 280 |
| Clearance revenues (accrued) | 896 | 1,067 | 1,150 | 1,310 | 1,468 | 1,647 |
| Clearance revenues (cash) | 1,318 | 1,067 | 1,150 | 1,310 | 1,468 | 1,647 |
| Clearance revenues (net arrears accumulation) | -422 | 0 | 0 | 0 | 0 | 0 |
| Tax refunds | 25 | 0 | 70 | 40 | 55 | 50 |
| Total recurrent expenditures and net lending (commitment basis) | 2,544 | 2,846 | 2,970 | 3,089 | 3,205 | 3,343 |
| Wage expenditures (commitment) | 1,283 | 1,481 | 1,546 | 1,635 | 1,778 | 1,849 |
| Wage expenditures (cash) | 1,369 | ... | 1,857 | 1,635 | 1,778 | 1,849 |
| Wage expenditures (net arrears accumulation) | -86 | ... | -311 | 0 | 0 | 0 |
| Nonwage expenditures (commitment) 2/ | 725 | 964 | 948 | 992 | 1,060 | 1,130 |
| Nonwage expenditures (cash) | 663 | ... | 1,007 | 1,055 | 1,154 | 1,130 |
| Nonwage expenditures (net arrears accumulation) | 62 | ... | -59 | -63 | -94 | 0 |
| Net lending 3/ | 535 | 400 | 477 | 462 | 366 | 363 |
| Recurrent balance (commitment basis, before external budgetary support) | -1,350 | -1,360 | -1,227 | -1,247 | -1,139 | -1,021 |
| add: expenditure arrears (net accumulation) | -23 | -217 | -370 | -63 | -94 | 0 |
| subtract: net clearance withheld (+) or transferred from past collections (-) | -422 | 0 | 0 | 0 | 0 | 0 |
| Recurrent balance (cash basis, before external budgetary support) | -951 | -1,577 | -1,597 | -1,310 | -1,233 | -1,021 |
| add: external budgetary support | 1,012 | 1,634 | 1,846 | 1,314 | 1,237 | 1,021 |
| of which: external budgetary support yet to be secured | ... | 399 | 316 | 841 | ... | ... |
| Recurrent balance (commitment basis, after external budgetary support) | -338 | 274 | 619 | 67 | 98 | 0 |
| Recurrent balance (cash basis, after external budgetary support) | 61 | 57 | 249 | 4 | 4 | 0 |
| Development expenditures (Public Investment Program) | 254 | 492 | 301 | 503 | 746 | 896 |
| Overall balance (cash basis, including development expenditures) | -193 | -435 | -53 | -499 | -742 | -896 |
| Total other financing | 193 | 435 | 53 | 499 | 742 | 896 |
| Net domestic bank financing | -132 | -50 | -52 | 0 | 0 | 0 |
| Other domestic financing 1/ | 78 | 0 | -197 | 0 | 0 | 0 |
| External financing for development expenditures | 254 | 492 | 301 | 503 | 746 | 896 |
| Net external debt | 0 | -7 | -7 | -4 | -4 | 0 |
| Residual | -6 | 0 | 8 | 0 | 0 | 0 |
| <i>Memorandum items:</i> | (In percent of GDP; unless otherwise stated) | | | | | |
| Revenues 1/ | 23.6 | 24.4 | 26.2 | 25.1 | 25.5 | 26.0 |
| Recurrent expenditures and net lending | 50.3 | 46.7 | 44.7 | 42.0 | 39.5 | 37.4 |
| Wage expenditures | 25.4 | 24.3 | 23.3 | 22.2 | 21.9 | 20.7 |
| Nonwage expenditures 2/ | 14.3 | 15.8 | 14.3 | 13.5 | 13.1 | 12.6 |
| Net lending 3/ | 10.6 | 6.6 | 7.2 | 6.3 | 4.5 | 4.1 |
| Recurrent balance (commitment basis) before external budgetary support | -26.7 | -22.3 | -18.5 | -17.0 | -14.0 | -11.4 |
| External budgetary support (recurrent) | 20.0 | 26.8 | 27.8 | 17.9 | 15.2 | 11.4 |
| Overall balance | -3.8 | -7.1 | -0.8 | -6.8 | -9.1 | -10.0 |
| Total external budgetary support (recurrent & development, millions of US dollars) | 1,266 | 2,126 | 2,147 | 1,816 | 1,983 | 1,917 |
| Nominal GDP (millions of US dollars) | 5,058 | 6,088 | 6,641 | 7,354 | 8,118 | 8,944 |

Sources: Ministry of Finance, and IMF staff estimates.

1/ The sharp increase in nontax revenues in 2008 is due to (i) the receipt of NIS 653 million in dividends from the Palestine Investment Fund (PIF), which were then used to settle part of the Palestinian Authority's debt to the PIF; (ii) the remittance by the Government of Israel of NIS 76 million for interest on past frozen clearance revenues; and (iii) license fees of about NIS 270 million from Wataniya Telecom

2/ Including minor outlays for domestically financed development expenditures.

3/ Including transfers related to the marketing of petroleum products.

Table 2b. West Bank and Gaza: Central Government Fiscal Operations, 2007-11

| | 2007 | 2008 | | 2009 | 2010 | 2011 |
|---|---|---------------|---------------|---------------|---------------|---------------|
| | Est. | Budget | Proj. | Projection | | |
| | (In millions of shekels, unless otherwise stated) | | | | | |
| Total net revenues | 4,894 | 5,349 | 6,014 | 6,172 | 6,923 | 7,777 |
| Gross domestic revenues | 1,326 | 1,507 | 2,288 | 1,917 | 2,189 | 2,427 |
| Tax revenues | 827 | 910 | 832 | 1,176 | 1,343 | 1,489 |
| Nontax revenues 1/ | 499 | 597 | 1,457 | 741 | 846 | 938 |
| Clearance revenues (accrued) | 3,673 | 3,842 | 3,968 | 4,389 | 4,918 | 5,518 |
| Clearance revenues (cash) | 5,403 | 3,842 | 3,968 | 4,389 | 4,918 | 5,518 |
| Clearance revenues (net arrears accumulation) | -1,730 | 0 | 0 | 0 | 0 | 0 |
| Tax refunds | 105 | 0 | 243 | 134 | 184 | 168 |
| Total recurrent expenditures and net lending (commitment basis) | 10,430 | 10,244 | 10,247 | 10,348 | 10,737 | 11,199 |
| Wage expenditures (commitment) | 5,262 | 5,333 | 5,333 | 5,478 | 5,957 | 6,196 |
| Wage expenditures (cash) | 5,614 | ... | 6,407 | 5,478 | 5,957 | 6,196 |
| Wage expenditures (net arrears accumulation) | -352 | ... | -1,074 | 0 | 0 | 0 |
| Nonwage expenditures (commitment) 2/ | 2,974 | 3,471 | 3,270 | 3,324 | 3,552 | 3,786 |
| Nonwage expenditures (cash) | 2,718 | ... | 3,473 | 3,536 | 3,867 | 3,786 |
| Nonwage expenditures (net arrears accumulation) | 256 | ... | -203 | -211 | -315 | 0 |
| Net lending 3/ | 2,193 | 1,440 | 1,645 | 1,546 | 1,228 | 1,218 |
| Recurrent balance (commitment basis, before external budgetary support) | -5,535 | -4,895 | -4,233 | -4,176 | -3,814 | -3,421 |
| add: expenditure arrears (net accumulation) | -96 | -781 | -1,277 | -211 | -315 | 0 |
| subtract: net clearance withheld (+) or transferred from past collections (-) | -1,730 | 0 | 0 | 0 | 0 | 0 |
| Recurrent balance (cash basis, before external budgetary support) | -3,901 | -5,676 | -5,510 | -4,388 | -4,129 | -3,421 |
| add: external budgetary support | 4,149 | 5,881 | 6,368 | 4,401 | 4,143 | 3,421 |
| of which: external budgetary support yet to be secured | ... | 1,437 | 1,065 | 2,818 | ... | ... |
| Recurrent balance (commitment basis, after external budgetary support) | -1,386 | 986 | 2,135 | 225 | 329 | 0 |
| Recurrent balance (cash basis, after external budgetary support) | 248 | 205 | 858 | 13 | 13 | 0 |
| Development expenditures (Public Investment Program) | 1,270 | 1,771 | 1,040 | 1,684 | 2,500 | 3,000 |
| Overall balance (cash basis, including development expenditures) | -1,022 | -1,566 | -182 | -1,671 | -2,487 | -3,000 |
| Total other financing | 1,022 | 1,566 | 182 | 1,671 | 2,487 | 3,000 |
| Net domestic bank financing | -542 | -180 | -180 | 0 | 0 | 0 |
| Other domestic financing 1/ | 320 | 0 | -653 | 0 | 0 | 0 |
| External financing for development expenditures | 1,270 | 1,771 | 1,040 | 1,684 | 2,500 | 3,000 |
| Net external debt | 0 | -25 | -25 | -13 | -13 | 0 |
| Residual | -26 | 0 | 0 | 0 | 0 | 0 |
| <i>Memorandum items:</i> | (In percent of GDP; unless otherwise stated) | | | | | |
| Revenues 1/ | 23.6 | 24.4 | 26.2 | 25.1 | 25.5 | 26.0 |
| Recurrent expenditures and net lending | 50.3 | 46.7 | 44.7 | 42.0 | 39.5 | 37.4 |
| Wage expenditures | 25.4 | 24.3 | 23.3 | 22.2 | 21.9 | 20.7 |
| Nonwage expenditures 2/ | 14.3 | 15.8 | 14.3 | 13.5 | 13.1 | 12.6 |
| Net lending 3/ | 10.6 | 6.6 | 7.2 | 6.3 | 4.5 | 4.1 |
| Recurrent balance (commitment basis) before external budgetary support | -26.7 | -22.3 | -18.5 | -17.0 | -14.0 | -11.4 |
| External budgetary support (recurrent) | 20.0 | 26.8 | 27.8 | 17.9 | 15.2 | 11.4 |
| Overall balance | -4.9 | -7.1 | -0.8 | -6.8 | -9.1 | -10.0 |
| Total external budgetary support (recurrent & development, millions of shekels) | 5,419 | 7,652 | 7,408 | 6,085 | 6,643 | 6,421 |
| Nominal GDP (millions of shekels) | 20,737 | 21,918 | 22,910 | 24,637 | 27,194 | 29,963 |

Sources: Ministry of Finance, and IMF staff estimates.

1/ The sharp increase in nontax revenues in 2008 is due to (i) the receipt of NIS 653 million in dividends from the Palestine Investment Fund (PIF), which were then used to settle part of the Palestinian Authority's debt to the PIF; (ii) the remittance by the Government of Israel of NIS 76 million for interest on past frozen clearance revenues; and (iii) license fees of about NIS 270 million from Wataniya Telecom

2/ Including minor outlays for domestically financed development expenditures.

3/ Including transfers related to the marketing of petroleum products.

Table 3a. West Bank and Gaza: Central Government Fiscal Operations, 2007-09

| | 2007 | 2008 | | | | 2009 | |
|---|--|----------------|--------------|---------------|--------------|---------------|---------------|
| | Est. | Year Budget | H1 | H1 Prelim. | H2 Proj. | Year Proj. | Proj. |
| | (In millions of US dollars, unless otherwise stated) | | | | | | |
| Total net revenues | 1,194 | 1,486 | 743 | 939 | 805 | 1,743 | 1,842 |
| Gross domestic revenues | 323 | 419 | 209 | 438 | 226 | 663 | 572 |
| Tax revenues | 202 | 253 | 126 | 149 | 93 | 241 | 351 |
| Nontax revenues 1/ | 122 | 166 | 83 | 289 | 133 | 422 | 221 |
| Clearance revenues (accrued) | 896 | 1,067 | 534 | 536 | 614 | 1,150 | 1,310 |
| Clearance revenues (cash) | 1,318 | 1,067 | 534 | 552 | 598 | 1,150 | 1,310 |
| Clearance revenues (net arrears accumulation) | -422 | 0 | 0 | -16 | 16 | 0 | 0 |
| Tax refunds | 25 | 0 | 0 | 35 | 35 | 70 | 40 |
| Total recurrent expenditures and net lending (commitment basis) | 2,544 | 2,846 | 1,423 | 1,386 | 1,585 | 2,970 | 3,089 |
| Wage expenditures (commitment) | 1,283 | 1,481 | 741 | 728 | 817 | 1,546 | 1,635 |
| Wage expenditures (cash) | 1,369 | ... | 793 | 934 | 923 | 1,857 | 1,635 |
| Wage expenditures (net arrears accumulation) | -86 | ... | -52 | -206 | -105 | -311 | 0 |
| Nonwage expenditures (commitment) 2/ | 725 | 964 | 482 | 412 | 536 | 948 | 992 |
| Nonwage expenditures (cash) | 663 | ... | 539 | 457 | 549 | 1,007 | 1,055 |
| Nonwage expenditures (net arrears accumulation) | 62 | ... | -56 | -45 | -13 | -59 | -63 |
| Net lending 3/ | 535 | 400 | 200 | 245 | 232 | 477 | 462 |
| Recurrent balance (commitment basis, before external budgetary support) | -1,350 | -1,360 | -680 | -447 | -780 | -1,227 | -1,247 |
| add: expenditure arrears (net accumulation) | -23 | -217 | -108 | -251 | -119 | -370 | -63 |
| subtract: net clearance withheld (+) or transferred from past collections (-) | -422 | 0 | 0 | -16 | 16 | 0 | 0 |
| Recurrent balance (cash basis, before external budgetary support) | -951 | -1,577 | -788 | -682 | -915 | -1,597 | -1,310 |
| add: external budgetary support | 1,012 | 1,634 | 1,013 | 953 | 893 | 1,846 | 1,314 |
| of which: external budgetary support yet to be secured | ... | 399 | 196 | ... | 316 | 316 | 841 |
| Recurrent balance (commitment basis, after external budgetary support) | -338 | 274 | 333 | 506 | 113 | -113 | 0 |
| Recurrent balance (cash basis, after external budgetary support) | 61 | 57 | 225 | 270 | -22 | 249 | 4 |
| Development expenditures (Public Investment Program) | 254 | 492 | 246 | 147 | 154 | 301 | 503 |
| Overall balance (cash basis, including development expenditures) | -193 | -435 | -21 | 123 | -176 | -53 | -499 |
| Total other financing | 193 | 435 | 21 | -123 | 176 | 53 | 499 |
| Net domestic bank financing | -132 | -50 | -25 | -42 | -10 | -52 | 0 |
| Other domestic financing 1/ | 78 | 0 | 0 | -197 | 0 | -197 | 0 |
| External financing for development expenditures | 254 | 492 | 246 | 147 | 154 | 302 | 503 |
| Net external debt | 0 | -7 | -3 | 0 | -7 | -7 | -4 |
| Residual | -6 | 0 | -196 | -31 | 39 | 8 | 0 |
| Memorandum items: | (In percent of GDP; unless otherwise stated) | | | | | | |
| Revenues 1/ | 23.6 | 24.4 | 12.2 | 14.1 | 12.1 | 26.2 | 25.1 |
| Recurrent expenditures and net lending | 50.3 | 46.7 | 23.4 | 20.9 | 23.9 | 44.7 | 42.0 |
| Wage expenditures | 25.4 | 24.3 | 12.2 | 11.0 | 12.3 | 23.3 | 22.2 |
| Nonwage expenditures 2/ | 14.3 | 15.8 | 7.9 | 6.2 | 8.1 | 14.3 | 13.5 |
| Net lending 3/ | 10.6 | 6.6 | 3.3 | 3.7 | 3.5 | 7.2 | 6.3 |
| Recurrent balance (commitment basis) before external budgetary support | -26.7 | -22.3 | -11.2 | -6.7 | -11.7 | -18.5 | -17.0 |
| External budgetary support (recurrent) | 20.0 | 26.8 | 16.6 | 14.3 | 13.4 | 27.8 | 17.9 |
| Overall balance | -3.8 | -7.1 | -0.3 | 1.9 | -2.6 | -0.8 | -6.8 |
| Total external budgetary support (recurrent & development, millions of shekels) | 1,266 | 2,126 | 1,259 | 1,100 | 1,047 | 2,147 | 1,816 |
| Nominal GDP (millions of US dollars) | 5,058 | 6,088 | 6,088 | 6,641 | 6,641 | 6,641 | 7,354 |

Sources: Ministry of Finance, and IMF staff estimates.

1/ In February 2008, the Government of Israel remitted NIS 76 million as interest on past frozen clearance revenues. In May 2008, the Palestinian Investment Fund (PIF) distributed NIS 653 million in dividends, which was then used to settle part of the debt to the PIF.

2/ Including minor outlays for domestically financed development expenditures.

3/ Including transfers related to the marketing of petroleum products. These amounted to NIS 160 million (\$45 million) in January-June 2008.

Table 3b. West Bank and Gaza: Central Government Fiscal Operations, 2007-09

| | 2007 | 2008 | | | | 2009 | |
|---|---|----------------|---------------|---------------|---------------|---------------|---------------|
| | Est. | Year Budget | H1 | H1 Prelim. | H2 Proj. | Year Proj. | Proj. |
| | (In millions of shekels, unless otherwise stated) | | | | | | |
| Total net revenues | 4,894 | 5,349 | 2,675 | 3,313 | 2,701 | 6,014 | 6,172 |
| Gross domestic revenues | 1,326 | 1,507 | 754 | 1,545 | 744 | 2,288 | 1,917 |
| Tax revenues | 827 | 910 | 455 | 524 | 307 | 832 | 1,176 |
| Nontax revenues 1/ | 499 | 597 | 299 | 1,020 | 436 | 1,457 | 741 |
| Clearance revenues (accrued) | 3,673 | 3,842 | 1,921 | 1,893 | 2,075 | 3,968 | 4,389 |
| Clearance revenues (cash) | 5,403 | 3,842 | 1,921 | 1,949 | 2,019 | 3,968 | 4,389 |
| Clearance revenues (net arrears accumulation) | -1,730 | 0 | 0 | -56 | 56 | 0 | 0 |
| Tax refunds | 105 | 0 | 0 | 125 | 118 | 243 | 134 |
| Total recurrent expenditures and net lending (commitment basis) | 10,430 | 10,244 | 5,122 | 4,891 | 5,356 | 10,247 | 10,348 |
| Wage expenditures (commitment) | 5,262 | 5,333 | 2,666 | 2,571 | 2,761 | 5,333 | 5,478 |
| Wage expenditures (cash) | 5,614 | ... | 2,854 | 3,298 | 3,109 | 6,407 | 5,478 |
| Wage expenditures (net arrears accumulation) | -352 | ... | -188 | -727 | -347 | -1,074 | 0 |
| Nonwage expenditures (commitment) 2/ | 2,974 | 3,471 | 1,736 | 1,454 | 1,815 | 3,270 | 3,324 |
| Nonwage expenditures (cash) | 2,718 | ... | 1,939 | 1,615 | 1,858 | 3,473 | 3,536 |
| Nonwage expenditures (net arrears accumulation) | 256 | ... | -203 | -160 | -43 | -203 | -211 |
| Net lending 3/ | 2,193 | 1,440 | 720 | 865 | 779 | 1,645 | 1,546 |
| Recurrent balance (commitment basis, before external budgetary support) | -5,535 | -4,895 | -2,448 | -1,578 | -2,655 | -4,233 | -4,176 |
| add: expenditure arrears (net accumulation) | -96 | -781 | -391 | -887 | -390 | -1,277 | -211 |
| subtract: net clearance withheld (+) or transferred from past collections (-) | -1,730 | 0 | 0 | -56 | 56 | 0 | 0 |
| Recurrent balance (cash basis, before external budgetary support) | -3,901 | -5,676 | -2,838 | -2,409 | -3,101 | -5,510 | -4,388 |
| add: external budgetary support | 4,149 | 5,881 | 2,941 | 3,363 | 3,005 | 6,368 | 4,401 |
| of which: external budgetary support yet to be secured | ... | 1,437 | 707 | 0 | 1,065 | 1,065 | 2,818 |
| Recurrent balance (commitment basis, after external budgetary support) | -1,386 | 986 | 493 | 1,785 | 350 | 2,135 | 225 |
| Recurrent balance (cash basis, after external budgetary support) | 248 | 205 | 103 | 954 | -96 | 858 | 13 |
| Development expenditures (Public Investment Program) | 1,270 | 1,771 | 886 | 520 | 520 | 1,040 | 1,684 |
| Overall balance (cash basis, including development expenditures) | -1,022 | -1,566 | -783 | 434 | -616 | -182 | -1,671 |
| Total other financing | 1,022 | 1,566 | 783 | -434 | 616 | 182 | 1,671 |
| Net domestic bank financing | -542 | -180 | -90 | -148 | -32 | -180 | 0 |
| Other domestic financing 1/ | 320 | 0 | 0 | -653 | 0 | -653 | 0 |
| External financing for development expenditures | 1,270 | 1,771 | 886 | 520 | 520 | 1,040 | 1,684 |
| Net external debt | 0 | -25 | -13 | 0 | -25 | -25 | -13 |
| Residual | -26 | 0 | 0 | -153 | 153 | 0 | 0 |
| <i>Memorandum items:</i> | (In percent of GDP; unless otherwise stated) | | | | | | |
| Revenues 1/ | 23.6 | 24.4 | 12.2 | 14.5 | 11.8 | 26.2 | 25.1 |
| Recurrent expenditures and net lending | 50.3 | 46.7 | 23.4 | 21.3 | 23.4 | 44.7 | 42.0 |
| Wage expenditures | 25.4 | 24.3 | 12.2 | 11.2 | 12.1 | 23.3 | 22.2 |
| Nonwage expenditures 2/ | 14.3 | 15.8 | 7.9 | 6.3 | 7.9 | 14.3 | 13.5 |
| Net lending 3/ | 10.6 | 6.6 | 3.3 | 3.8 | 3.4 | 7.2 | 6.3 |
| Recurrent balance (commitment basis) before external budgetary support | -26.7 | -22.3 | -11.2 | -6.9 | -11.6 | -18.5 | -17.0 |
| External budgetary support (recurrent) | 20.0 | 26.8 | 13.4 | 14.7 | 13.1 | 27.8 | 17.9 |
| Overall balance | -4.9 | -7.1 | -3.6 | 1.9 | -2.7 | -0.8 | -6.8 |
| Total external budgetary support (recurrent & development, millions of shekels) | 5,419 | 7,652 | 3,826 | 3,883 | 3,525 | 7,408 | 6,085 |
| Nominal GDP (millions of shekels) | 20,737 | 21,918 | 21,918 | 22,910 | 22,910 | 22,910 | 24,637 |
| Nominal exchange rate (NIS per US dollar) | 4.10 | 3.60 | 3.60 | 3.53 | 3.37 | 3.45 | 3.35 |

Sources: Ministry of Finance, and IMF staff estimates.

1/ In February 2008, the Government of Israel remitted NIS 76 million as interest on past frozen clearance revenues. In May 2008, the Palestinian Investment Fund (PIF) distributed NIS 653 million in dividends, which was then used to settle part of the debt to the PIF.

2/ Including minor outlays for domestically financed development expenditures.

3/ Including transfers related to the marketing of petroleum products. These amounted to NIS 160 million (\$45 million) in January-June 2008.