PRDP-TF: Quarterly Review
April – June 2017

1. **The PA's revenues have so far performed well in 2017.** Between January and June 2017, domestic taxes grew by 13 percent year-on-year following a strong pick up in income tax receipts (by 19 percent) due to higher collections from local tax offices as well as the Large Taxpayers Unit (LTU) following enhanced tax administration efforts by the PA. Collections from domestic customs on cars also grew by an impressive 23 percent due to a rate hike implemented in mid-2016. Revenues from excise on tobacco increased by close to 5 percent due to additional collections following the establishment of a new local tobacco company in 2017.[1] Clearance revenues[2] also performed well growing by 6 percent[3] in the first half of 2017 driven by an increase in customs, VAT and petroleum excise – in line with an increase in Palestinian imports, as reported by the PCBS. Notably, the GoI transferred to the PA in March a lump sum payment of NIS131 million covering income tax collected from Palestinians working in Israel over a period of several months, in addition to NIS107 million in health fees and equalization levies transferred in June, which also helped boost the PA's revenues.

2. **On the expenditure side, PA spending declined by close to 3 percent in the first half of 2017, year-on-year**. This is mainly due to a significant drop in transfers as only half of the first quarter payment of the National Cash Transfer Program (NCTP) was disbursed while the remainder is yet to be paid to poor households. Also, spending by line ministries on the use of goods and services in early 2017 was much lower than in the previous year as expenditure plans were delayed due to delays in approving the 2017 budget. Net lending[4] increased by 8 percent due to water related costs, while electricity-related net lending was contained – though still high. The wage bill grew by 1.7 percent mainly reflecting the annual step increase that is mandatory by law.

3. **The PA's total deficit declined by about 16 percent in the first half of 2017, nonetheless, the fiscal situation remained tight**. The PA's total deficit amounted to USD490 million between January and June 2017. Aid received amounted to USD323 million (USD254 in budget support and USD69 million for development financing), resulting in a financing gap of USD167 million. Notably, aid received was 19 percent lower than in 2016 mainly due to a drop in budget support while development financing actually increased. Despite the reduction in the deficit and as a result of the drop in budget support, the PA accumulated additional payment arrears in the amount of USD263 million in the first six months of 2017 and slightly increased its net domestic bank financing by USD42 million. However, an advance payment on clearance revenues by the GoI enabled the PA to repay some of its arrears from previous years, pumping some highly-needed liquidity into the market.

4. **The PA adopted a number of measures in mid-2017 to control its spending, particularly in Gaza**. For instance, starting April 2017, the PA eliminated all allowances for Gaza employees which resulted

[1] A new local tobacco company was licensed by the PA and established in 2017. The company is in charge of buying all local rolling tobacco produced in the West Bank and selling it to the local market. Prior to the establishment of the company, rolling tobacco was produced in the West Bank and sold in the black market, hence the PA was not collecting any taxes on it.
[2] Clearance revenues are VAT and import duties collected by the GoI on Palestinian imports and then transferred to the PA on a monthly basis.
[3] This year-on-year growth figure is calculated after adjusting for transfers by the GoI to offset fiscal leakages under the revenue sharing arrangements between the two parties in 2016 and 2017 in order to get a better idea of the underlying growth without these one-off transfers.
[4] Net lending represents deductions by the GoI from clearance revenues to offset utility bills owed by Palestinian Local Government units (LGU) to Israeli suppliers.

in a 30 percent cut, on average, in the salaries of public employees in Gaza. In July, the PA also referred around 7000 civil employees in Gaza to early retirement to be followed by an additional 5000 security employees. Further, the PA took steps to reduce the supply of electricity to Gaza by more than 30 percent resulting in savings in net lending.

5. **Despite these measures, the financing need for 2017 is expected to remain large.** The PA's total deficit for 2017 is expected to reach USD1.2 billion or 8.4 percent of GDP. Aid inflows are projected at USD661 million. After accounting for external debt repayment, the size of the financing gap could thus exceed USD580 million (4 percent of GDP). Notably, this projection has high downside risks associated with it particularly if some of the planned measures do not materialize or if donor aid ends up being even lower than expected.

6. **While the PA needs to further accelerate reforms that align its spending and revenue capacity, in the short-term actions by the PA alone will not be enough to close the financing gap.** In addition to the above-mentioned measures for Gaza in 2017, the PA should implement reforms in the West Bank to control the wage bill and fully constrain non-priority spending. It also needs to avoid new hiring to replace those that were referred to early retirement, unless really needed. The results, however, will not be enough to close the 2017 financing gap. Some financing may be available through borrowing from domestic banks as the PA still has some space before reaching the limit set by the Palestine Monetary Authority (PMA), but this will also not be sufficient to close the gap and will further increase the banks' credit exposure to the PA.

7. **Therefore, in the short term, there is no feasible alternative to budget support as a key source of financing.** Donor support during these critical times is essential to sustain reforms and enable provision of services to the Palestinian population. Additional actions by the GoI to systematically eliminate the PA's fiscal losses under the revenue sharing arrangement instituted by the Paris Protocol will also have significant fiscal benefits. Long term fiscal sustainability, however, cannot be achieved without a prudent and stringent fiscal consolidation program by the PA. This program needs to address reform areas such as the pension system, civil service reform, health referrals and untargeted transfers. Consolidation efforts will also help create fiscal space for additional public investment in areas not viable for the private sector and through which the PA can create a better environment for doing business.