Economic Monitoring Report

to the Ad Hoc Liaison Committee

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List of Acronyms

AHLC	Ad Hoc Liaison Committee
AML/CFT	Anti-Money Laundering and Combating Financing of Terrorism
CBR	Correspondent Banking Relationships
DNA	Detailed Needs Assessment
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoI	Government of Israel
GRM	Gaza Reconstruction Mechanism
HS	Harmonized System
IEC	Israel Electric Corporation
IMF	International Monetary Fund
IPP	Independent Power Producers
IT	Information Technology
LTU	Large Taxpayers Unit
MENAFATF	Middle East and North Africa Financial Action Task Force
MFN	Most Favored Nation
NCTP	National Cash Transfer Program
NIS	New Israeli Shekel
NORG	National Office for the Reconstruction of Gaza
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics
PETL	Palestine Electricity Transmission Company Ltd.
PFM	Public Financial Management
PLO	Palestine Liberation Organization
PMA	Palestine Monetary Authority
PPA	Power Purchase Agreement
SME	Small and Medium Enterprise
VAT	Value Added Tax
WA	Wassenaar Arrangement
WDR	World Development Report
WGI	World Governance Indicators
WTO	World Trade Organization

Executive Summary

1. **Despite its potential, the Palestinian economy is currently heavily distorted and failing to generate the jobs and incomes needed to improve living standards.** Restrictions[1] on trade and the access to resources, along with a decade long blockade of Gaza have hollowed out the productive base. The share of manufacturing in the economy has halved in the last twenty-five years, while agriculture is only one third its previous size. The economy is import dependent with imports over three times the size of exports and a trade deficit close to 40 percent of GDP (one of the highest in the world), while trade is overly concentrated with Israel. Investment rates have been low with the bulk channeled into relatively unproductive activities that generate insufficient employment. As a result, growth, which has mainly been driven by consumption, has run out of steam. With a sharp decline because of the 2014 Gaza war and a drop in aid levels, growth in real Gross Domestic Product (GDP) slowed to 2 percent on average between 2013 and 2016, and dropped to a mere 0.7 percent in early 2017. Unemployment remains close to 30 percent on average, with youth unemployment twice as high in Gaza where the humanitarian situation has significantly worsened in recent months following the electricity crisis which has serious implications on the health, water and sanitation sectors as well as business activity.

2. **The Palestinian Authority's (PA) fiscal position represents an additional risk to the economy, while recent consolidation steps have focused on Gaza.** In recent months, the PA has cut its payroll and net lending expenditure in Gaza where the poverty levels are the highest. Even with the recent Gaza measures and revenue transfers by Israel to offset fiscal leakages, the financing gap in 2017 is projected to be more than USD580 million. A broader consolidation effort is needed that focuses on reducing low priority expenditures and boosting revenues in a fair and sustainable way across both the West Bank and Gaza.

3. **In the absence of change, the stagnant short term outlook will persist with consequent implications for economic and social stability.** Analysis conducted by the Bank using a Computable General Equilibrium (CGE) model[2] as the main tool suggests that by 2025 growth in the West Bank will not exceed 2 percent per annum, meaning a continuous real decline in per capita terms. In Gaza, unemployment could reach 48 percent by 2025. This would foment an already highly combustible social situation and derail achievements up until now.

4. **The Palestinian economy will not be able to reach its full potential without a final political resolution, but urgent action by all parties to implement existing agreements and improve the domestic business environment could significantly improve the economic outlook.** For a small economy, achieving a sustainable growth path depends to a large extent on having a private sector that is able to compete in regional and global markets and increase its exports of goods and services. The private sector is the only sustainable engine for growth, and the focus should be on removing the constraints and creating the right conditions for it to flourish. This report aims to provide input for achieving this vision of increased private sector activity and higher growth. Such a vision requires urgent action by the PA, the Government of Israel (GoI), and the international community to address the external constraints on movement, trade and access to resources, and also the internal constraints to create a better enabling environment for doing business.

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[1] The Government of Israel states that these restrictions are in place to protect the security of Israel and its citizens.

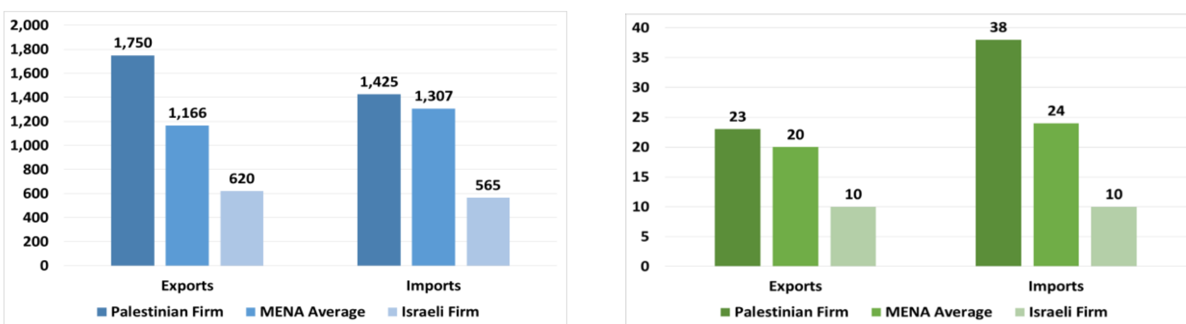
[2] The World Bank has developed a Computable General Equilibrium (CGE) model to capture the broader economic impact of removing the internal and external constraints (see Annex 3 for further details). Consistent with the standard for these models, parameter estimates and closure rules define the Palestinian-specific model. The exogenous variables and key parameters are based on available studies or estimates. The results are thus more illustrative and do not claim to capture the full complexity of the economic effects.

5. **Addressing the external constraints is the most important factor.** Our analysis suggests that the removal of the Israeli restrictions on Area C alone could bring about additional cumulative growth for the West Bank economy equal to 33 percent by 2025. This would not only enable better access to critical scarce resources, notably land and water, but also allow Palestinian businesses to take advantage of Area C's comparative advantages in agriculture, mining and quarrying, and tourism. As for Gaza, lifting the blockade would open it up for critical trade needed to rebuild its infrastructure and economy, and could lead to additional cumulative growth in the range of 32 percent by 2025.

6. **Another important area of focus is reducing the punitive and non-transparent barriers imposed by the GoI on Palestinian trade -- a number of measures could be put in place in the short term in the context of existing agreements.** The Doing Business data show that average trade costs per transaction for a Palestinian firm are nearly three times as high as for an Israeli firm, while the average duration of the import process for a Palestinian firm is nearly four times as long as for an Israeli firm (Figure 1). World Bank analysis shows that relaxing the dual use list alone would bring about additional cumulative growth of 6 percent to the West Bank economy by 2025, with a bigger impact of about 11 percent in Gaza. It is also important to improve the costly procedures for shipping goods across the border and through Israeli ports (including customs clearance and storage fees, back-to-back truck procedures, and cumbersome inspections). **Overall, alleviating external restrictions that were quantified could raise real GDP by some 36 percent in the West Bank and 40 percent in Gaza by 2025**.[3]

Figure 1: Trade costs and duration of trade process in the Palestinian territories compared to MNA and Israel

Average trade costs per transaction (USD) *Average duration of trade process (days)*



Source: World Bank Doing Business database.

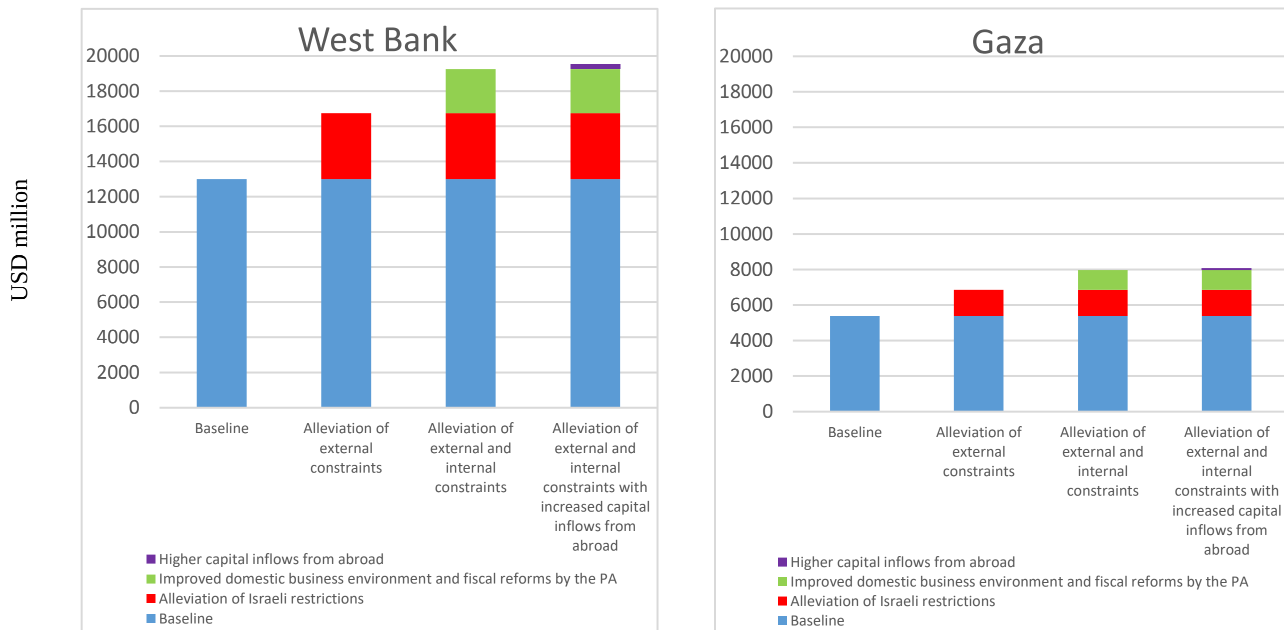
7. **Addressing the internal factors that stifle business activity is also critical to unleash economic development and is largely within the control of the PA.** A general need is to improve the business regulation and licensing arrangements that influence the cost of doing business in the territories. Taking steps to strengthen the enabling environment in sectors where private participation is feasible (such as energy and water) is also a priority as it would allow private sector capital to be tapped for important infrastructure needs. In addition, an increased focus on vocational training to bridge the skill gap in the labor market and accelerating land registration to fully release this factor of production into the economy are key areas that the PA should focus on.

[3] Despite some negative impact from allowing for "normal" movement of labor between the Palestinian territories and Israel which could reduce the effective labor supply in the Palestinian economy in the absence of efforts to enhance labor force participation.

8. **The internal constraints requiring attention go beyond sector issues.** Political reconciliation between the West Bank and Gaza is an utmost priority. Also, strengthening governance and institutions is key for a well-functioning economy. Fiscal reform to create a more stable macroeconomic situation is also needed. Rationalizing employment in the public sector, making tax collection more effective and efficient, and freeing resources to provide adequate infrastructure are all areas requiring attention. **Our analysis suggests that alleviating the internal constraints could achieve cumulative growth by 2025 in the region of 24 percent in the West Bank, and an even higher 30 percent in Gaza due to a lower base effect.**

9. **If progress is made in alleviating the external and internal constraints, then over the medium term the economic and social payoff would be immense.** Our analysis suggests that by 2025 the territories could achieve higher growth rates of perhaps 6 percent per annum in the West Bank and 8 percent in Gaza. This growth would drive a substantial increase in job creation estimated at 50 thousand additional jobs in the West Bank by 2025 relative to a baseline scenario and even higher at close to 60 thousand jobs in Gaza. This will result in a significant reduction in unemployment, and further progress could be expected in the longer term if these efforts were sustained and enhanced.

Figure 2: Projected GDP by 2025 under different scenarios



Source: World Bank staff calculations.

10. **International donors also have a key role to play to support a vision for growth and job creation.** Reversing the major decline in aid in recent years is particularly important to support the needed fiscal adjustment and improve the environment for private savings. It is also important that donors continue supporting the PA in its efforts to conduct sectoral reforms and institutional strengthening as this is key to create the conditions that enable greater private sector activity and job creation. Donors can also help by offering innovative financing instruments that can mitigate risks holding back transformative investments by the private sector – in line with the G20's recent emphasis at Hamburg on maximizing financing for development by leveraging the private sector and optimizing the use of scarce public resources. The Palestinian private sector is starting to look towards its active participation in infrastructure creation, which can help limit public debt and contingent liabilities. In line with this approach, the World Bank Group strategy aims to support reform of public sector institutions to address

policy and regulatory obstacles that stifle business enterprise and innovation. It is also establishing a risk mitigating financing facility to leverage the resources of development partners and catalyze both short-term and long-term financing. Moreover, exploring the potential for the Palestinian entrepreneurship ecosystem to have better linkages to regional ecosystems especially in neighboring Israel and Jordan can also support private sector activity.

11. **A longer-term vision would, of course, also have to consider the future of a Palestinian state with an independent trade regime as part of a broader political agreement with the GoI**. An alternative regime to the current customs union should primarily enable the PA to regain its capacity to conduct economic policy and escape from its stunted development path. To adopt an independent trade policy, the PA should exercise effective control over its customs territory. The PA is encouraged to seek full membership in the World Trade Organization (WTO) and establish a liberal trade regime. It should also negotiate a Free Trade Agreement (FTA) with Israel, which is likely to remain its most important trading partner. To diversify its trade, the Palestinian economy should also deepen and negotiate trade agreements with other trading partners beginning with the Arab countries, the European Union, and the United States.

12. **The main body of the report is organized in two chapters with three supporting annexes.** Chapter I focuses on recent economic developments in the real, fiscal and banking sectors, while providing a near term outlook that highlights critical challenges facing the Palestinian economy. Chapter II provides input on a new vision for growth and job creation, with quantification of the potential gains. It contains critical messages for the GoI, the PA and the international donors on steps to create an environment conducive to the needed private sector investment. Annex 1 assesses the status of the World Bank recommendations to the AHLC meeting over the years – many of which relate to the constraints identified in Chapter II. While there are developments, overall progress from the GoI and the PA has been minimal. Annex 2 provides an update on the disbursement of pledges made at the Cairo conference in October 2014 on reconstructing Gaza. Donor support by mid-July 2017, at 53 percent of Cairo conference pledges, had barely changed from the December 2016 position – and there are limited prospects of further contributions. Most of the gap can be attributed to the larger pledgers at the conference. Finally, Annex 3 provides some methodological notes on the specifications of the CGE model and assumptions used to quantify the external and internal constraints.

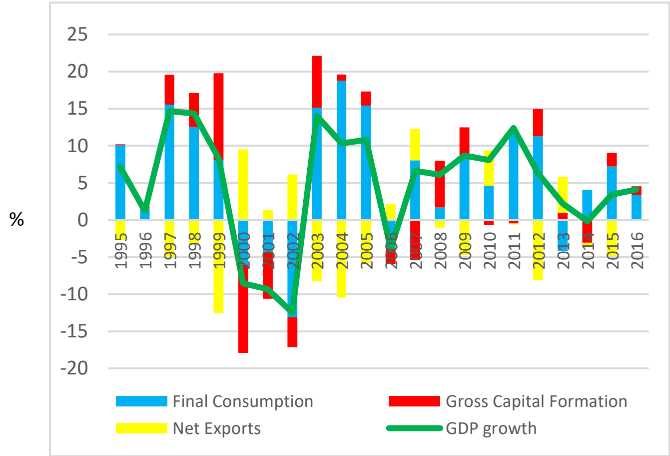
Chapter I: Recent Developments

Economic Growth

13. **The Palestinian economy has been suffering from volatile and spasmodic growth for years.** Following the signing of the Oslo Accords and the establishment of the PA, the Palestinian economy enjoyed strong annual growth averaging 9 percent between 1994 and 1999, enabled by the return of Palestinian refugees, restoration of livelihoods, large inflows of public and private capital and increased private investment. This trend was quickly interrupted after the outbreak of the second Intifada in 2000 when the GoI imposed a multi-layered system of physical, institutional, and administrative restrictions that fragmented the Palestinian territories into small enclaves lacking most forms of economic cohesion, pushing the annual growth rate to minus 9 percent. An initial period of recovery after the end of the Intifada was interrupted by the turmoil surrounding the internal divide in 2006/7 which caused the economy to slip into recession again. In the following years, growth picked up to an annual average of 8 percent between 2008 and 2012 as large amounts of donor funding, equivalent to 32 percent of Palestinian GDP in 2008, in addition to substantial PA reforms and some easing of Israeli restrictions boosted public and private consumption.

14. **The 2014 war in Gaza and a drop in donor aid has led to a severe deterioration in the economic conditions in Palestine in recent years.** The latest war in Gaza had severe social consequences and a devastating impact on private sector activity causing the Palestinian economy to slip into recession in 2014. However, growth had been slowing since before the war due to a significant drop in donor aid. As a result, real GDP growth slowed down to an annual average of 2 percent between 2013 and 2016, and dropped to a mere 0.7 percent in the first quarter of 2017 (0.8 percent in the West Bank and 0.4 percent in Gaza).[4] This drop is a clear sign that the Palestinian economy's growth drivers of the 2007-12 period -- consumption supported by fiscal expansion – have run out of steam and proving unsustainable. In fact, most growth witnessed over the last couple of years has been driven by reconstruction efforts in Gaza and some private consumption financed by bank loans in the West Bank.

Figure 3: Contribution to real GDP growth, 1995-2016



Source: PCBS and author's calculation.

[4] Q1 2017 data is based on preliminary figures by the PCBS subject to revision.

15. **The Palestinian economy has not been able to generate enough jobs to absorb new labor market entrants, resulting in high and stubborn unemployment.** Over the last two decades, the number of Palestinians in the labor force increased by 0.8 million, while only 0.5 million additional jobs were created by the private and public sectors. Hence, the number of unemployed increased by 0.3 million, resulting in an extremely high unemployment rate, fluctuating between 20 and 31 percent over the post Oslo period. Most recent data for the second quarter of 2017 show that the unemployment rate has recently been on the rise in both Gaza and the West Bank reaching an average of 29 percent. In the West Bank, it reached 21 percent by end-June 2017 despite an increase in the number of Palestinians working in Israel and the settlements. In Gaza, it increased to 44 percent mainly due to a deceleration in reconstructions activities.

16. **The Palestinian labor market suffers from structural problems of inclusion particularly for young people and women.** Currently, only 41 percent of those aged between 15 and 29 are active in the labor market, reflecting high pessimism regarding employment prospects. Despite a low participation rate, unemployment amongst this category reached 30 percent in the second quarter of 2017 in the West Bank and a staggering 62 percent in Gaza. Another concern in the Palestinian labor market is related to dramatic differences in labor force participation by gender. Male participation rates reached 72 percent in 2017 (not far from the average in other lower middle income countries), while women have long been underrepresented in the Palestinian labor market with recent participation rates of 19 percent – compared to an average of 39 percent in comparators. Anecdotal evidence indicates that social norms and mobility restrictions play a key a role in keeping women outside the labor market.

17. **The reduction in budget support and the resultant contraction in Palestinian growth have exposed the distorted nature of the Palestinian economy.** For such a small economy, achieving a sustainable growth path depends to a large extent on the capacity of the private sector to compete in regional and global markets and increase its exports of goods and services. The Palestinian economy, however, has been losing this capacity as a result of a poor investment climate mainly driven by externally-imposed restrictions on trade and access to resources in addition to the lack of political stability and weak governance and institutions.

18. **Impeded access of the private sector to trade has truncated the structural transformation of the Palestinian economy.** In fact, the structure of the economy has substantially deteriorated since the 1990's. The manufacturing sector, which is usually one of the key drivers of structural transformation through export-led growth, has largely stagnated and its share in GDP has dropped from 19 percent in 1994 to 11 percent currently. The share of the agriculture sector has also declined from 13 to 4 percent over the same period. The decline in these sectors has not been offset by an increase in high value-added service exports like Information Technology (IT) or tourism. In fact, in relative terms, most growth over the past two decades occurred in public sector services.

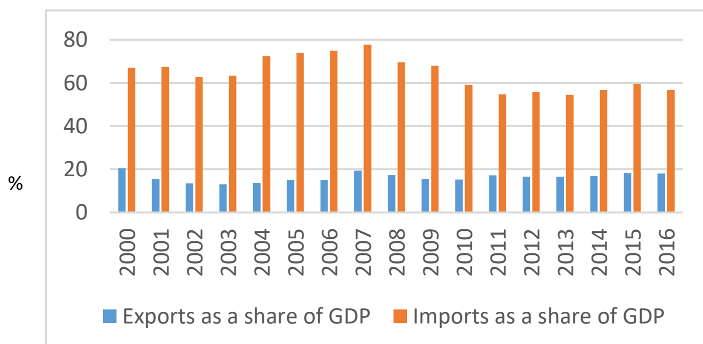
19. **Investment rates have remained low, with the bulk channeled into relatively unproductive activities that generate insufficient employment.** Private investment levels, averaging about 15-16 percent of GDP in recent years, have been low as compared with rates of over 25 percent in fast-growing middle income economies. Foreign Direct Investment (FDI) in the Palestinian territories at a mere 2 percent of GDP, is also very low in comparison to most fast-growing economies. Low investment has not only been a result of a decline in foreign savings but also due to very low domestic private savings. Also, much of the investment has been concentrated in low productivity activities where returns are less affected by political risk, mainly internal trade and real estate development -- neither of which generates significant employment.

20. **Progress in poverty reduction in the Palestinian territories remains a challenge as political shocks and episodes of violent conflict frequently erode welfare gains and increase the risk of the**

vulnerable falling below the poverty line. Economic growth, social assistance and a well targeted cash transfer program run by the PA have helped reduce poverty in the Palestinian territories in the years following the second Intifada. However, political instability and multiple episodes of war in Gaza over the last ten years have significantly eroded these welfare gains. For example, following the 2008/9 war in Gaza, poverty in the Strip increased by 20 percentage points, pushing up the overall poverty rate in the Palestinian territories. The latest available poverty data is for 2011 and shows that poverty levels in Gaza were not able to recover to prewar levels, remaining very high at 38 percent. Poverty in the West Bank, however, was much lower at 18 percent in 2011. This clearly indicates a significant spatial disparity in poverty rates, with a large and widening gap in living standards between the West Bank and Gaza. Poverty rates in Gaza are also more volatile because a large share of Gazans live very close to the poverty line and remains at constant risk of falling into poverty with any economic shock or episode of war. Given that poverty is highly correlated with labor market outcomes, and given that the unemployment rate has been on the rise in recent years, it is anticipated that poverty levels in the Palestinian territories have increased since 2011, especially in Gaza. New household survey data available towards the end of 2017 will provide essential information on the impact of the last 5 years of stagnation and turmoil on poverty and shared prosperity.

21. **The Palestinian economy can be characterized as an import-dependent economy.** In fact, at 57 percent of GDP, the Palestinian territories' imports are almost 3.2 times their exports at 18 percent of GDP in 2016. This implies an external trade deficit of close to 40 percent of GDP -- one of the highest in the world. Such a trade structure is usually associated with protracted violent conflict in failed state contexts, such as Somalia. This trade deficit was partly financed by net factor income (12 percent of GDP) - essentially earnings of Palestinians in Israel, private transfers (10 percent of GDP) - mainly remittances of Palestinian workers in third countries, and official current transfers of about 6 percent of GDP, mainly (declining) government aid from bilateral donors.

Figure 4: Palestinian exports and imports, 2000-2016



Source: PCBS and author's calculation.

22. **Further, the absolute majority of Palestinian trade is concentrated with a single trading partner – Israel.** Although Israel is a medium-sized economy that accounts for only 0.2 percent of the world's GDP,[5] imports from Israel account for 63 percent of Palestinian imports while Israel accounts for 79 percent of Palestinian exports.[6] Israel's comparative advantage at the global level is narrow, and lies principally in very specialized high-tech manufactures and services, chemicals and pharmaceuticals, and polished diamonds. Most of these products do not typically constitute a large share of the imports of a lower-middle-income developing country, such as the Palestinian territories. So, not surprisingly,

[5] According to estimates by the Bank of Israel for 2014.
[6] According to PCBS data.

Israel's large exports to the Palestinian economy do not conform to its comparative advantage at the global level: they consist mainly of fuel, food products, and low and medium-technology manufactures. Moreover, a gravity model of trade between the Palestinian economy and the rest of the world suggests that, based on its size, income and proximity to large markets such as Israel, Europe and the Gulf States, Palestinian exports could be twice their current levels.[7]

23. **The heavy concentration of Palestinian trade with Israel is mainly due to an artificial substitution of imports driven by differential costs of internal and external trade, known commonly as "trade diversion."** In principle, trade diversion can happen in any trade agreement, because the absence of tariffs on trade between partners will somewhat offset more efficient trade with a partner outside the common external tariff. However, in the Palestinian case, trade diversion towards Israel mainly happens because Israeli restrictions make the costs of Palestinian trade with the rest of the world higher than costs associated with trading with Israel. For example, restrictions including dual-use regulations, high transport costs, and cumbersome customs clearance procedures tend to disproportionally impede Palestinians, and make it easier, cheaper, and simpler to buy from an Israeli trader than directly from overseas. Because of these restrictions, it is also often easier to sell to Israel than to sell abroad, and, if selling abroad, to sell through Israeli intermediaries. Another reason leading to the heavy concentration of Palestinian trade with Israel is the fact that Arab countries are reluctant to trade with or through Israel which tends to separate the Palestinian economy from several of its natural trading partners.

24. **Government spending has been a significant factor in economic growth and job creation in previous years, but with the decline in aid and the resultant reduced government capacity to affect consumption, the only way forward for a sustainable economic recovery is through private sector growth.** Tracking the relationship between government spending and growth of the Palestinian economy over the years suggests that increases in government expenditures played an important role in growth by raising public and private consumption levels. With the decline in aid, however, PA spending as a share of GDP has been significantly reduced and this has subdued its impact on final consumption resulting in lower growth. To achieve a sustainable economic recovery in the Palestinian territories, growth and job creation going forward will need to be private sector driven. And for this to happen, improvements in the external and internal environments are key.

25. **Given the stalled peace process and unresolved internal challenges, the near-term economic outlook for the Palestinian territories remains worrying with projected growth levels insufficient to improve living standards.** Under a baseline scenario which assumes that the current Israeli restrictions remain in place and no improvement in the domestic economic and political environment, real GDP growth of the Palestinian economy is projected to reach 3.0 percent in 2017: 2.7 percent in the West Bank and 4.0 percent in Gaza. This growth level implies a near stagnation in real per capita income and an increase in unemployment. Moreover, downside risks remain significant. In Gaza, more setbacks to the reconstruction process are possible. The resumption of armed conflict cannot be ruled out and if this happens, the Gaza economy is expected to slip back into recession. Also, recent fiscal measures by the PA in Gaza to reduce its payroll and electricity related spending may have severe social implications that can lead to unrest. As for the outcome in the West Bank, it may be worse than expected if the decline in donor support exceeds current projections. Also, with the ongoing political tensions, clashes may arise again resulting in elevated security risks that could negatively impact economic activity.

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[7] These estimates should be viewed with caution as gravity models are not designed to analyze sources of financing or the current account.

Public Finance

26. **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.[8] Clearance revenues[9] also performed well growing by 6 percent[10] 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.

27. **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[11] 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.

28. **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.

29. **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 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

[8] 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.

[9] Clearance revenues are VAT and import duties collected by the GoI on Palestinian imports and then transferred to the PA on a monthly basis.

[10] 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.

[11] Net lending represents deductions by the GoI from clearance revenues to offset utility bills owed by Palestinian Local Government units (LGU) to Israeli suppliers.

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.

30. **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.

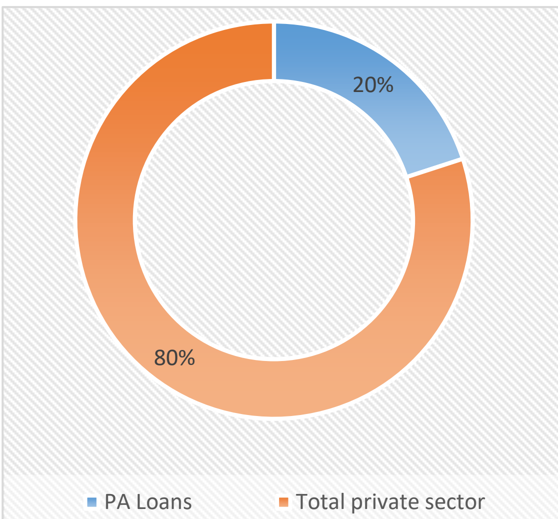
31. **While the PA needs to further accelerate reforms that align its spending and revenue capacity, in the short-term actions by the PA alone will not be enough to close the financing gap.** In addition to the above-mentioned measures for Gaza in 2017, the PA should implement reforms in the West Bank 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.

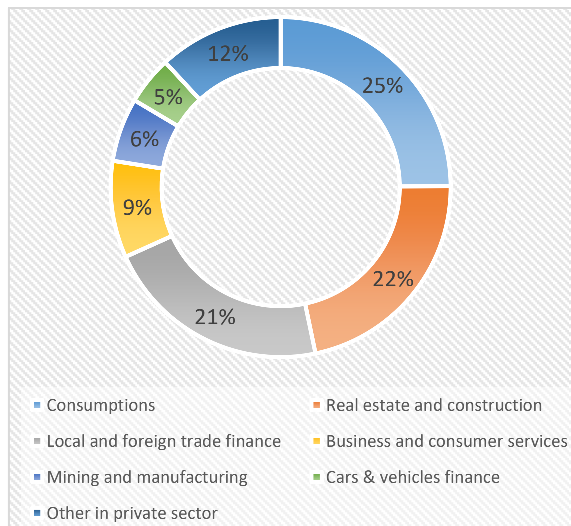
32. **Therefore, in the short term, there is no feasible alternative to budget support as a key source of financing.** Donor support during these critical times is essential to sustain reforms and enable provision of services to the Palestinian population. Additional actions by the GoI to systematically 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.

Money and Banking

33. **During the first half of 2017 the Palestinian financial sector, composed primarily of traditional banking, remained one of the few stable segments of the Palestinian economy with healthy levels of growth.** The Palestine Monetary Authority's (PMA) reporting through June 2017 indicates that the banking system's total assets just exceeded USD15 billion, an increase of 13 percent compared to June 2016. Direct credit maintained a growth trajectory in line with recent years, reaching USD7.5 billion, a growth of USD1.1 billion over the past 12-month period. The overall credit-to-deposit ratio, which had a historical range of 50-60 percent in recent years, further increased from 63 percent in 2016 to 66 percent as of June 2017. Despite the recent and modest uptick in credit-to-deposits, the banking system is still regarded as liquid – confirmed by the latest PMA stress tests. Nonperforming loans were maintained at 2 percent, reflecting the banking system's risk-averse position in light of the continued political volatility. A review of credit exposure to the private sector indicates persistent sectoral concentration, with 50 percent of all private lending going to construction or consumer loans.

Figure 5: Distribution of credit by sector (left) and by economic activity (right)





Source: Palestine Monetary Authority.

34. **The banking system's credit exposure to the public sector continued to moderate in 2017.** Over recent years, the banking sector's credit exposure to the public sector has raised concerns. In the years leading up to 2016, the PA's reliance on financing from the banking sector grew steadily, raising concerns over credit concentration risk. During the past 12-month period, exposure to the PA stabilized at approximately USD 1.4 billion, equivalent to 20 percent of all lending by the banking system. As of June 2017, PA loans accounted for 84 percent of the PMA imposed limit[12] for the Banking system's direct exposure to the PA, a decline compared to 96 percent as of June 2016. While direct lending to the PA has moderated in 2017, it is important to note that the banking sector's exposure to the PA is not limited to direct credits. Borrowing by public employees has been steadily growing since 2014, reaching a total of USD1.4 billion (equivalent in size to total PA loans) as of June 2017. When combined, PA and public employees account for over USD2.8 billion, or 38 percent of total banking sector credits.

[12] The target limit for exposure is equivalent to the banking sector's total owners' equity at the time.

35. **The potential negative impact of de-risking by Israeli banks remains a cause for concern, with the potential to destabilize the Palestinian banking system.** Citing money-laundering and financing of terrorism concerns, key Israeli banks signaled possible steps to limit or terminate correspondent banking services to Palestinian Banks. A deterioration of correspondent banking relationships (CBRs) with Israeli banks could have significant economic impact due to the highly-interlinked structure of the two banking systems, and the use of the New Israeli Shekel as the primary currency in the Palestinian economy. An example of the potential ramifications relates to the complexities associated with the transfer of NIS cash from the Palestinian banking system to the Israeli counterpart – An issue that has contributed to the accumulation of excess NIS liquidity in Palestinian banks, for years. The NIS cash issue was further compounded in 2017 following a decision by Israeli banks to limit incoming cash shipments from foreign banks operating in the West Bank and Gaza[13] in addition to the existing limitation on NIS cash from Palestinian banks. This has put direct CBRs at risk of further deterioration. In January 2017, the GoI assumed part of the financial risk by approving an indemnity and immunity package for Israeli banks working with Palestinian banks to alleviate the potential for further disruptions to CBRs between the two banking systems. The package is yet to be operational, pending finalization by the GoI. The PMA has also been taking steps, with IMF and World Bank support, towards upgrading the Palestinian anti-money laundering and combating financing of terrorism (AML/CFT) system to be more in line with international practices.

36. **With technical assistance (TA) from the World Bank, the PA is conducting its first self-assessment of ML/FT risks.** This TA aims to enhance the ability of relevant AML/CFT stakeholders in the Palestinian territories in identifying, assessing and understanding the money laundering and terrorism financing risks they face. Going forward, the authorities will be able to take appropriate measures to manage and mitigate these risks at national and institutional levels and implement a risk-based strategy for AML/CFT in line with international standards. Such a strategy would allow the authorities to target the allocation of resources in high-risk areas, as well as develop simplified AML/CFT requirements in proven low risk areas, including to promote financial inclusion. The risk assessment is being coordinated by the Financial Follow-up Unit, with involvement from the Ministries of Finance and Planning, Justice, Interior, and Foreign Affairs, and the Public Prosecutor's Office, Customs Services, and other relevant stakeholders. In parallel to the self-assessment process, the PA requested, and has been granted approval for an evaluation of its AML/CFT regime by the regional Financial Action Task Force (MENAFATF). The evaluation, currently scheduled for 2020, in combination with the self-assessment, represent key milestones towards aligning PA's AML/CFT systems with international standards.

[13] Of the 15 banks licensed by the PMA, 8 are foreign owned (Jordanian and Egyptian), while 7 are locally owned.

Chapter II: What Would Happen to the Palestinian Economy If the External and Internal Constraints Were Removed?

37. **Comprehensive development of the Palestinian economy is ultimately forestalled by the stalemate in the peace process.** As a result of this stalemate, Israeli restrictions have remained in place for years now and have imposed severe economic costs for Palestinians. The movement of people and goods into and out of the West Bank and Gaza, and within the West Bank, is severely limited by a multi-layered system of physical, institutional, and administrative impediments. External trade is tightly controlled and subject to a range of costly non-tariff barriers that increase transaction costs and reduce the competitiveness of Palestinian exports. The situation in Gaza is even more severe with a blockade imposed since 2007. Physical barriers are compounded by unpredictable regulatory measures and practices and by limited access to resources including land and water.

38. **In parallel, the stalled peace process makes it more difficult for Palestinians to mobilize the commitment, cooperation, and coordination (using the terminology of the 2017 World Development Report) to implement reforms and provide effective governance.** Progress in institution building has slowed in recent years and in some areas, previous gains have been reversed. Further, significant distortions arise from an economy dominated by the public sector and large utility subsidies provided by the PA. Economic growth is also impeded by issues related to outdated business legislation, inadequate infrastructure, large swathes of unregistered land and skill mismatches in the labor market. The political divide between the West Bank and Gaza since 2007 has created multiple internal challenges when it comes to policy coordination and resulted in two regulatory frameworks. The combined effect of Israeli restrictions and incomplete governance is to fragment the territories spatially and economically, as a set of external constraints (related to GoI restrictions) and internal constraints (linked to deficient governance) undermine growth prospects.

Box 1: The investment climate as experienced and perceived by the Palestinian private sector

The Bank conducted an Investment Climate Assessment (ICA) in the Palestinian territories a few years ago to identify features of the investment climate that matter most for productivity and income growth, and track changes in the investment climate. For that purpose, a large number of firms were surveyed and asked about the biggest challenges in the investment climate and below are some key findings.

1. Political instability. When asked about the obstacles to doing business, the majority of Palestinian businesses surveyed, both formal and informal and regardless of their location, cite political instability as the top obstacle to their business operations. Few other aspects of the investment climate appear to be as binding in light of this overwhelming constraint of unresolved political status and its consequent effects of fragmentation and uncertainty. The absence of a political resolution to the conflict creates an environment which elevates the cost of doing business, raises the risk to business operations, and creates uncertainty with respect to investment returns.

2. A fragmented and complex legal and regulatory environment. For existing Palestinian firms, factors related to business regulation and enforcement account for over 40 percent of the identified top constraints to business. The regulatory environment under which Palestinian businesses operate is complex since laws and regulations enforced in the West Bank differ from those in Gaza and others in East Jerusalem. Further muddying this already complex legal and regulatory environment is the state of legislative paralysis resulting from the lack of a functioning parliament which stands in the way of passing new laws to modernize the current framework.

<u>3. Logistics and access to markets.</u> Palestinian firms report that the movement of goods and labor from the Palestinian territories to Israel is constrained by a collection of non-tariff barriers, security restrictions, and logistics inefficiencies. Beyond the typical trade regulations, trade and transport of goods to and from the West Bank and Gaza is complicated by a layer of commercial crossings, security restrictions, import controls, and associated logistics that have been subject to change in tandem with security and political events. The unpredictability and cost of these regulations and restrictions is a deterrent to new investments and creates uncertainty for existing businesses.

<u>4. Restrictions on factors of production.</u>
Land: Businesses report that the constraint on access to land in Area C for economic purposes is another major issue. Also, even though land within the Palestinian-controlled Areas A and B is ostensibly available for economic use, it suffers from a variety of constraints including the lack of legal reform on land and real estate which complicates using land for business purposes.
Labor: The Palestinian workforce has high levels of educational attainment. However, businesses report that the workforce is not necessarily skilled and trained to fuel growth in the high value-added manufacturing or service sectors.

<u>5. Access to finance</u>. Although 54 percent of firms identify access to finance as a major constraint, only about one in ten formal firms in the West Bank and Gaza identify access to finance as the biggest obstacle to business operations. Most formal firms (69 percent) report financing the majority of their investments and working capital with retained earnings. 77 percent of firms report that they have not applied for a loan because they do not need one, compared to the MENA average of 45 percent, and 38 percent of firms in lower-middle income comparator countries. This seems to indicate that the constraints lie more in identifying profitable opportunities for investment under the current conditions and constraints than in financing these opportunities

<u>6. Infrastructure.</u> Overall, the availability of infrastructure services— including roads, water supply, power, telecommunications, waste treatment and disposal, and industrial parks— is constrained not only by public financial resources, but also by the restrictions on access to Area C in the West Bank. Reliable power supply in the West Bank and Gaza has deteriorated in the past few years, and water supply has not improved. Electricity has become the top binding constraint reported by Palestinian firms in Gaza, second only to political instability. It is important to note that this is the second most cited top constraint only for SMEs in Gaza while West Bank and East Jerusalem firms do not cite electricity as a top constraint. Telecommunication services have improved in terms of better competition in the telecommunications market. However, 3G and 4G services remain unavailable due to the Israeli restrictions.

<u>7. Perceptions of crime and corruption as a business constraint.</u> Since 2006 and particularly in the West Bank a significantly lower percentage of businesses consider crime and petty corruption as major obstacles to businesses. The most striking result from the Survey is the overall low incidence of expected informal payments, or petty bribes.

Source: Investment Climate Assessment, World Bank (2014).

39. **The stagnant short-term outlook discussed earlier will persist well into the medium term – with consequent effects on social sustainability – in the absence of policy changes.** If the status quo persists with no improvement in the external and internal environments, economic conditions in the Palestinian territories are likely to deteriorate further in the medium term, exacerbating economic and social fragility and fueling renewed violent conflict. In fact, our analysis suggests that growth in the West Bank could converge to 2 percent p.a. by 2025 and to 4 percent p.a. in Gaza as reconstruction activity wears off while the blockade hinders trade and investment. Growth in real per capita incomes could reach negative levels in the West Bank by 2025 and a mere 0.5 percent p.a. in Gaza. The economic decline would lead to even higher unemployment, particularly in Gaza where it could reach 48 percent by 2025. Without the ability to conduct purposeful economic activity, the economic space in the

Palestinian territories will remain stunted and inhabited by young Palestinians suffering from a lack of jobs and desperation, which may eventually lead to social unrest or renewed clashes with Israel.

40. **Even though only a political resolution would allow the Palestinian economy to reach its full potential, implementing existing agreements and improving the domestic business environment could significantly improve the economic outlook.** The private sector should be the main engine of growth and job creation. Therefore, efforts must focus on easing constraints that currently stifle private activity and setting the enabling conditions for private investment. The following section lays out the main external and internal constraints facing the private sector. It also quantifies the impact on growth of the removal of the external restrictions (along the lines of the Interim Agreement and the Paris Protocol) as well as the internal constraints. A general equilibrium model was used as the basic tool to capture the broader and dynamic economic impact of removing the external and internal constraints. For more details on the methodology, please see Annex 3.[14]

External Restrictions and the Economic Impact of Their Removal

41. **Restrictions on access to resources, particularly those in Area C,[15] have severely constrained private investment and economic activity in the West Bank and our analysis suggests that removing such constraints would boost the size of the West Bank economy by one-third in 8 years.** Area C represents 61 percent of the West Bank and is under Israeli civil and security control. Hence, Access to Area C for most kinds of economic activity has been severely limited for Palestinians. Also, the continuous growth in the size of land allocated for settlement activity in Area C has significantly reduced land available for use by the Palestinian private sector and leaves highly limited prospects for a contiguous Palestinian state, even if some land does eventually pass to the PA's control. The economic significance of Area C lies in that it is the only contiguous territory in the West Bank, while Areas A and B represent 227 isolated islands. This renders Area C indispensable to the efficient movement of goods and people within the West Bank, and also to connective infrastructure development. **According to our analysis, the removal of the Israeli restrictions on Area C could bring about additional cumulative growth for the West Bank economy equal to 33 percent by 2025**. Such growth would not only be enabled by better access to critical scarce resources, notably land and water, but also other natural resources that would allow Palestinian businesses to take advantage of Area C's comparative advantages in agriculture, mining and quarrying, and tourism.

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[14] Information cited in this section is based on two recent World Bank reports finalized in July 2017. The first one titled "Palestine—Prospects for Growth and Jobs: A general equilibrium analysis" and the second one titled "Unlocking the Trade potential of The Palestinian Economy: Immediate measures and a long-term vision to improve Palestinian trade and economic outcomes".

[15] The Interim Agreement between the PLO and the GoI divided the West Bank into three areas under different jurisdictions: Areas A, B and C. Area A represents 18 percent of the West Bank, covers urban centers, and is under full Palestinian security and civil control. Area B represents 21 percent of the West Bank, covers peri-urban areas and small towns, and is under Palestinian civil control and Israeli security control. Area C represents 61 percent of the West Bank and is defined by the Interim Agreement as "areas of the West Bank, outside Areas A and B, which, except for the issues that will be negotiated in the permanent status negotiations, will be gradually transferred to Palestinian jurisdiction." According to the Interim Agreement, the gradual transfer should have been completed by 1997, but it has not yet been implemented.

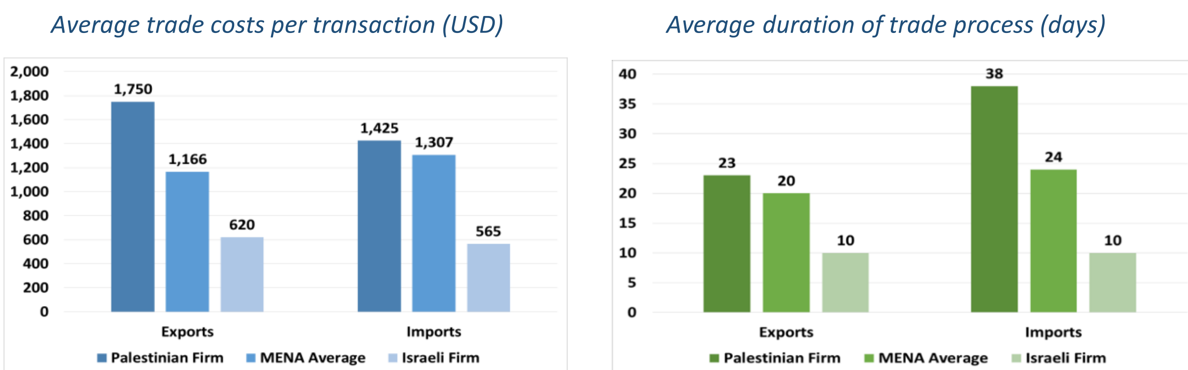
Table 1: Significance of Area C in terms of natural resources

Natural resource	In Area A	In Area B	In Area C	Natural resource in Area C as a percentage of total in West Bank (%)
Nature reserves (dunums[16])	52,300	42,600	607,730	86
Forests (dunums)	7,000	9,000	59,016	91
Wells	223	87	287[17]	48
Springs	70	122	112	37

Source: Applied Research Institute in Jerusalem (ARIJ), 2013.

42. **Restrictions imposed by the GoI also severely hinder Palestinian trade.** The customs union formalized under the 1994 Paris Protocol[18] granted Palestinian and Israeli traders equal trade and economic treatment at Israeli entry/exit points, and allowed Palestinian imports and exports to enter or exit Israel either by sea through the Ashdod and Haifa Ports, via land through the Allenby Bridge into Jordan, or via the Ben Gurion Airport. However, with the onset of the second Intifada, the GoI increased its administrative, logistical and security measures and those have become serious obstacles to Palestinian trade and movement of goods and people. These measures collectively operate as a non-tariff barrier for Palestinian traders, weakening the competitiveness of Palestinian products. A telling example is demonstrated by the Doing Business data which show that average trade costs per transaction for a Palestinian firm are nearly three times as high as for an Israeli firm, while the average duration of the import process for a Palestinian firm is nearly four times as long as for an Israeli firm. As a result, current productivity levels in the Palestinian processed food industry are, for example, 11 percent lower than they would otherwise be, and productivity of agricultural produce is 34–45 percent lower.[19]

Figure 6: Trade costs and duration of trade process in the Palestinian territories compared to MNA and Israel



Source: World Bank Doing Business database.

43. **Since the PA does not have presence at the points of entry/exit, most Palestinian imports and exports pass through Israeli ports, and undergo cumbersome and inefficient logistics,**

[16] 1 dunum is approximately equal to 0.25 acre.
[17] The figure for Area C is relatively low and its value can probably be attributed to Area C restrictions, which preclude the exploration and opening of new wells in Area C. Thus, it is probable that this figure significantly underestimates the true number of wells in the Area.
[18] The Paris Protocol is the agreement that governs economic relations between Israel and the Palestine Liberation Organization (PLO).
[19] Unlocking the Trade potential of The Palestinian Economy: Immediate measures and a long-term vision to improve Palestinian trade and economic outcomes. The World Bank, 2017.

administrative, and security procedures. Over 75 percent of Palestinian trade is shipped through Israeli ports. All goods that transit through Israeli ports must first go through one of four commercial crossings operated by the Israeli Authorities and built along the route of the Israeli – West Bank separation barrier. A survey conducted by the Palestinian Shippers Council notes a long list of technical, procedural and security constraints raising the cost of conducting trade through Israeli ports.[20] For example, the commercial crossings have limited working hours and are unable to efficiently process Palestinian goods leading to long waiting hours and increased costs.[21] Moreover, the Israeli authorities impose a back-to-back system in these crossings whereby all Palestinian goods must be moved from/to a Palestinian truck to/from an Israeli truck.[22] This system in addition to long inspections and pervasive security checks (that are even more stringent for goods coming in and out of Gaza) add significant transaction costs. **It is estimated that incurred security delays can increase costs by an average of USD538 per shipment**, according to the Palestinian Shippers Council (See Box 2 for more details).

Box 2: Challenges faced by Palestinian traders due to Israeli procedures on crossings

Palestinian import and export goods are required to go through a cumbersome "back-to-back" process at crossings as well as lengthy security and clearance procedures. First, all truck drivers need to queue outside the crossing, sometimes for hours, until they are allowed inside. After an initial security check, the Palestinian trucks arriving at the crossing are unloaded in a large, exposed, secured working area without any option of refrigeration. Goods are then subject to security checks on the ground and the customs process for export is completed. At that point, the counterpart truck will be called across and allowed to enter the holding area to load the goods. The Palestinian truck then returns to the West Bank. The reverse process is the same for imports, except that the goods entering the West Bank are put through a pallet-sized scanner during the back-to-back process. In Gaza, the back-to-back aspect of the procedure is even more complicated, as it involves three trucks, one of which operates as a "sterile" vehicle, which always remains within the complex. Israeli trucks transporting goods destined for Gaza are scanned by x-ray, and then transfer their load onto the ground in a walled area or "room" for security and customs checks. Goods are then loaded onto the "sterile" truck inside the terminal, which then proceeds to the other side and unloads into a second fenced-in "room." When that area is full, the gates to the Israeli side are closed and locked, and a third Palestinian truck will enter for each load, and the goods are loaded and delivered to Gaza.

Palestinian shippers complain about limited access to information and resources. Palestinian shippers operating through Israeli-controlled crossings often do not have advance warning about any changes in the procedures and requirements at commercial crossing points by Israeli authorities. This may result in shipments rejected by Israeli officials, payments of fees at the facility or other costly alternatives. Generally, information is not available, not updated, or published in Hebrew only (not in Arabic or English).

[20] Palestinian Shippers' Council. 2012. Capacity Development for Facilitating Palestinian Trade: A Study on the Problems of Palestinian Trade via Israeli Ports (Ashdod and Haifa). Ramallah, Palestinian Territories. April http://psc.ps/files/server/projects/Last%20Study_Problem%20of%20Pal%20Trade%20via%20Israeli%20Ports-Revised.pdf

[21] The Israeli Crossing Points Authority has advised that hours of service at Tarqumiya and Tulkarem crossings will be extended by two hours at the end of the day but it is unclear if the time extension applies to cargo into both directions.

[22] A door to door pilot for outbound trade for trucks leaving the West Bank to Israel was recently implemented at Tarqumiya crossing. But the pilot is limited to companies operating in Area C and its compliance costs for Palestinian traders have been higher than the original back-to-back arrangements.

The Israeli authorities restrict the use of containerized shipments. Containers may be used for some goods at the Green Line crossing points to and from the seaports of Haifa and Ashdod and at the Allenby Bridge, but may not be used at all at Karem Abu Salem (the only crossing point in Gaza used for Palestinian–Israeli trade**)**. The alternative use of palletized shipments with strict packing regulations severely limits the quantity of goods transported in each shipment and increases costs. The back-to-back process on pallets limits the size of goods that can cross, prevents economies of scale, risks damage from the multiple handlings, and rules out transfer of many products that would be damaged by heat, dust, or rain. As a consequence, palletization constitutes a high opportunity cost to Palestinians, as it keeps traders from enjoying much higher gains.

Source: Unlocking the trade potential of the Palestinian Economy, World Bank (2017).

44. **Restrictions on revising the A1, A2 and B lists created by the Paris Protocol of 1994 have limited the PA's ability to benefit from them.** The A1, A2, and B lists were designed as an exception to the custom union's common import policy, granting the PA autonomy to determine its own regime governing the import of specific products originating in Jordan, Egypt, and other Arab and Islamic states. These lists were seen as a first step toward the eventual establishment of an independent Palestinian tariff book. In practice, however, this opportunity for the PA is being undermined by the failure to have the lists updated. The lists impose limitations on the quantity of merchandise imported from Jordan, Egypt, and other Arab and Islamic countries, mainly based on Palestinian market needs as determined more than 20 years ago, when the protocol was signed.[23] This inevitably leads to greater dependence on Israeli products. The PA needs to negotiate with the GoI each time for the inclusion of products not on the lists. Unfortunately, the number of goods specified in Lists A1 and A2 has barely grown since 1994, even though total Palestinian imports have increased more than threefold since then. This results in Palestinian consumers not able to enjoy low prices from open competition between Israel and third-party producers of the same products—restricting Palestinian consumption, especially in goods with high demand price elasticity.

45. **The GoI applies a long list of dual use items whose export/re-export from Israel to the Palestinian territories is highly controlled, prohibiting the development of key economic sectors.** Similar to other advanced countries, Israel controls its exports of goods that have both civilian and military uses, or the so called dual use items. The most common regulatory basis governing the movement of such goods is the 1996 Wassenaar Arrangement (WA).[24] Though not a signatory to the WA, Israel uses the arrangement's lists to license the export of all dual use goods manufactured or assembled in Israel. When it comes to exports/re-exports to the Palestinian territories, the GoI enforces further controls on additional items that it has deemed as "dual use" through the Defense Export Control Law of 2007 and a Military Order passed in 2008 stipulating that all dual use items destined to the Palestinian territories require a special permit and reporting duties.[25] These procedures make it extremely difficult, and oftentimes impossible, to import dual use goods to the Palestinian territories. Currently, the dual use list for the West Bank includes 6 fertilizers, 2 pesticides, and 23 chemicals in their pure form in addition

[23] A significant adjustment to list A1 was agreed in July 2000 by the Ad Hoc Economic Committee that was established as part of the 1997 Wye River Agreement. However, the changes were not implemented.
[24] The Wassenaar Arrangement is an international agreement aimed at increasing global stability through transparency and supervision of dual-use exports. States following the arrangement maintain national export controls on listed items. The lists, including those under the various categories of "Dual-Use Goods & Technology," very narrowly describe items of concern and are updated annually by the WA secretariat. For more info, see http://www.wassenaar.org.
[25] According to the GoI, the law was created as a way of protecting Israelis from attacks using material initially intended for commercial or civilian use.

to 26 types of materials, machinery, and equipment. Gaza has a more extensive dual use list that covers many more items including reinforcing steel, cement, aggregates, insulating panels, timber for furniture manufacture, amongst others. Also, traders report that nearly any item can be deemed as "dual use" at the entry to Gaza, even if it has been imported previously by the same importer with no special controls. Three major macro sectors are particularly affected by the dual-use restrictions—agriculture, manufacturing, and ICT—and, in particular, the subsectors of food processing, beverages, metal fabrication, pharmaceuticals, textiles, leather, paints, detergents, and cosmetics. In Gaza, the situation is very difficult as almost all economic activities are somehow impacted by the dual use list. The enforcement by the GoI of import restrictions on select dual-use goods and material has resulted in a disproportionate fall in wages in dual-use input intensive sectors. **Our analysis suggests that relaxing the dual use list alone would bring about additional cumulative growth of 6 percent to the West Bank economy by 2025, with a bigger impact of about 11 percent in Gaza**.

46. **The decade old blockade on Gaza has had severe consequences on the development of the Strip and its alleviation could boost the size of the Gaza economy by one-third over eight years.** After the takeover of Gaza by Hamas, the GoI imposed a land, air and water blockade on the Strip prohibiting the movement of goods and people from/to it. The blockade had an immediate negative impact on Gaza's economy which shrank by an annual average of 10 percent between 2006 and 2008, while per capita incomes declined by an annual average of 14 percent over the same period. Even though the GoI took some steps to ease the blockade in 2010, exports out of Gaza continue to be extremely low as the monthly average of truckloads leaving Gaza in 2016 represented 17 percent of what it used to be before the blockade.[26] Also, sales to East Jerusalem and the West Bank, which were former lucrative markets for Gaza's businesses, are mostly not allowed. The GoI allows imports of consumer products and some construction material for donor supervised projects, but the inflow of materials remains much below the needs. Gaza has close to 2 million inhabitants that are not allowed to leave the Strip without special exit permits that Israel has been limiting, mostly to humanitarian cases. The isolation of Gazans has been exacerbated by additional constraints imposed by Egypt on the Rafah crossing. Years of blockade have undermined the living conditions in Gaza and fragmented the economic and social fabric of the Palestinian territories. **Lifting the blockade would open Gaza up for critical trade needed to rebuild its infrastructure and economy, and our analysis suggests that it could lead to additional cumulative growth in the range of 32 percent by 2025 for the Strip's economy**.

47. **Although physical restrictions are the most visible, non-transparent and highly unpredictable measures and practices by the GoI also have profound economic impact on the Palestinian economy**. For instance, while the Paris Protocol of 1994 stipulated free movement of labor between Israel and the PA, a tight quota has been imposed on Palestinian workers in Israel.[27] Obtaining visas for foreign investors to enter the Palestinian territories is controlled by the GoI, which has been sparing in issuing such travel permits. Lack of easy access to investments discourages potential foreign investors from exploring business opportunities in the Palestinian territories. Also, the high level of uncertainty linked to the political environment makes Palestinian firms highly reluctant to make further investments or upgrade their product lines. Further, the tight restrictions on access to resources such as water and the electromagnetic spectrum are other examples hindering the growth and development of the Palestinian private sector. **Overall, our analysis suggests that alleviating the external**

[26] GISHA - Legal Center for Freedom of Movement, The Gaza Cheat Sheet, accessed on May 3, 2017 and available at: http://gisha.org/reports-and-data/the-gaza-cheat-sheet

[27] The Paris Protocol states that labor should be allowed to move freely under "normal circumstances".

restrictions that were quantified could raise real GDP by some 36 percent in the West Bank and 40 percent in Gaza by 2025.[28]

Internal Constraints and the Economic Impact of Their Removal

48. **Important inter-related internal constraints create obstacles that stifle business activity and hold back the potential to take full advantage of any alleviation of external constraints**. The political division and strife between the West Bank and Gaza since 2007 has prevented policy coordination and resulted in two parallel regulatory frameworks thus further fragmenting the already limited economic space. The Palestinian parliament has not been operational since the internal divide creating a state of legislative paralysis, particularly since the President is hesitant to pass new laws under the emergency powers granted to him. Presidential and parliamentary terms ended in 2009 and 2010 without new elections. Despite a gradual but continuous improvement in institution building and governance between 2003 and 2010, the Palestinian territories' performance has worsened in key areas since such as the rule of law, government effectiveness, control of corruption, and regulatory quality based on the Worldwide Governance Indicators (WGI).

49. **Distortions and underinvestment arise from an economy dominated by consumption of public services, a large and ineffective civil service, an unsustainable public sector wage bill, and lack of transparency and accountability**. This manifests itself through labor market distortions (public sector salaries are much higher than private sector wages at the lower end of the scale), public finances that are neither adequately oriented to growth and inclusion nor financially sustainable despite substantial donor support, and the inability to pay for essential services (e.g. non-payment by Palestinian distribution companies and municipalities for electricity purchased from the Israel Electric Corporation (IEC), causing cuts in power supplies and frequent power outages). Inadequate public investment in infrastructure also constrains private investment and social progress. Current Public Financial Management (PFM) systems do not provide enough assurances on the quality of spending and the PA's latest audited financial statements date back to 2011.

50. **Productive investments are inhibited by a patchwork regulatory climate which has been vulnerable to capture by vested interests.** While PA efforts to create supportive conditions for private sector development have begun, more is needed. First, the current collection of legislation governing business is archaic as it stems from different periods of Palestinian history.[29] Some legal differences also exist between the West Bank and Gaza as a result of different legislation enacted by the PA and Hamas since 2007, creating many internal inconsistencies. Several pending regulations that can significantly improve the business climate also need to be passed including the New Companies Law and the Competition Law as limited competition and contestability of markets further renders the state susceptible to capture by vested interests.

51. **Given the severe land constraints, limited land registration and unclear property rights even within Palestinian-controlled areas are a major challenge for urban/housing and business development**. Currently only 30 percent of land in Areas A and B is registered with a clear title. Even though a dedicated government agency does exist to manage land registration, at the current rate it would take approximately 80 years to completely register all unregistered land. A more streamlined and less costly process for land surveying, dispute resolution, and registration would release significant

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[28] Despite some negative impact from allowing for "normal" movement of labor between the Palestinian territories and Israel which could reduce the effective labor supply in the Palestinian economy in the absence of efforts to enhance labor force participation.

[29] Business laws consist of layers of Ottoman, British Mandate, Jordanian, Egyptian, and Palestinian laws as well as Israeli Military Orders.

assets and resources into the economic space, with related benefits to the financial sector through collateralized lending. Currently, land management is entangled with the financing of municipalities and rent-seeking, undercutting its role as an enabler of investment.

52. **Even though access to finance is not seen as an impediment for large firms, it continues to be a challenge for Small and Medium Enterprises (SMEs) and informal firms.** Gaps in access to finance for dynamic start-ups further limit the space for the Palestinian territories' well-educated and entrepreneurial population, including in promising services such as tourism, IT and telecommunications. Greater access to finance for these firms should begin with supporting financial inclusion, further developing non-bank financial institutions and addressing their collateral constraints.

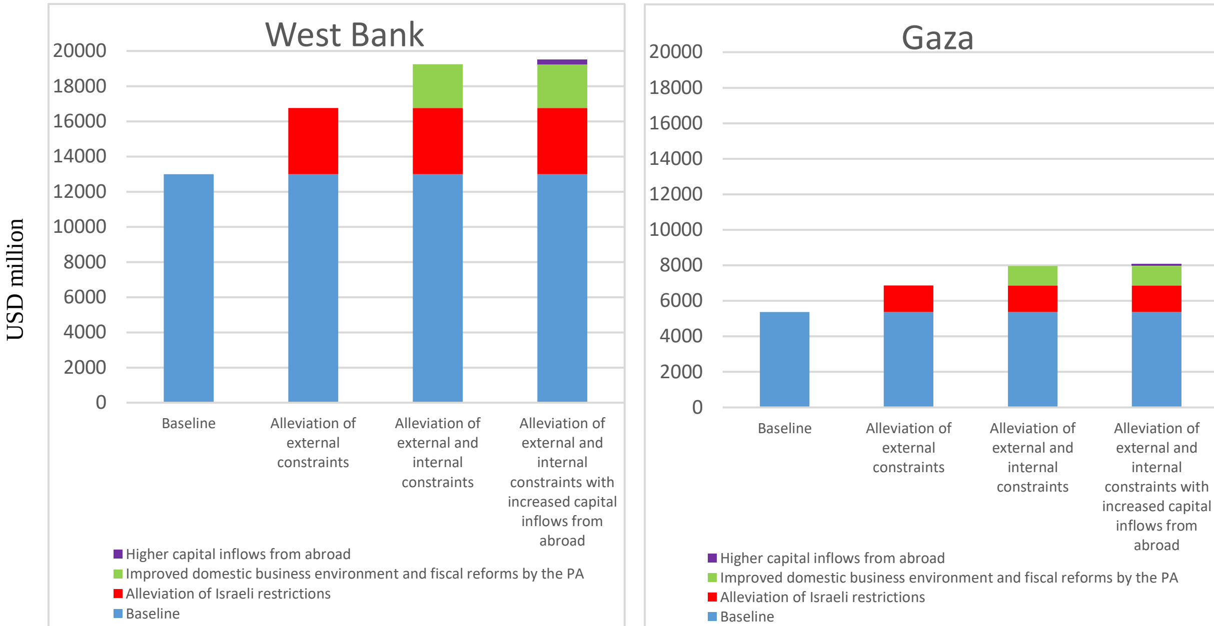
53. **The Palestinian education system is failing to match skills to the needs of the labor market**. Palestinian universities do not produce graduates well equipped with skills required by the private sector including social skills. Also, more efforts need to be focused towards vocational training and attracting additional students to this educational stream as the market currently suffers from a shortage in graduates from this field. Additional investments are also needed to develop skills of the existing workforce as this will be critical for increasing the productivity and competitiveness of Palestinian businesses.

54. **Our analysis shows that PA actions to alleviate the abovementioned constraints would generate significant economic benefits.** In fact, reforms by the PA to improve the internal business and political environment, strengthen its fiscal position and enhance governance and transparency would significantly reinforce the positive impact of an alleviation of Israeli restrictions. **Our analysis suggests that PA reforms could generate additional cumulative growth in the range of 24 percent in the West Bank by 2025, and even higher at 30 percent in Gaza due to a lower base effect.**

55. **If progress in alleviating external and internal constraints were to be made over the medium term, the Palestinian territories could achieve much higher rates of growth—perhaps around 6 percent in the West Bank and 8 percent in Gaza by 2025—and creation of new jobs over and above the rapid population growth.** Real per capita income growth is expected to exceed 3 percent in the West Bank by 2025 and even higher at about 5 percent in Gaza. This growth level would result in an increase in job creation estimated at 50 thousand additional jobs in the West Bank by 2025 relative to a baseline scenario and even higher at close to 60 thousand jobs in Gaza. This will result in a significant reduction in unemployment, while absorbing additional participants in the labor market - not least women. At the same time, such growth levels would dramatically reduce the dependence on foreign aid.

56. **Sustaining such progress in the longer run would require continued efforts.** Such efforts need to focus on enhancing access to productive resources, trade-liberalization and integration, labor mobility within the Palestinian territories and between the West Bank and Gaza and Israel, and improving domestic governance and institutions that affect the business environment.

Figure 7: Projected GDP by 2025 under different scenarios



Source: World Bank staff calculations.

The Path Forward

57. **As discussed above, the Palestinian economy will not reach its full potential without a final status agreement between the PA and the GoI. However, urgent action to implement the existing agreements and improve the domestic business environment can put the economy on a higher growth path and enable greater private sector activity and job creation.** Such vision could only be formulated in a meaningful way with the support of all key stakeholders including the PA, the GoI and the international community. Below are a number of recommendations that could help guide this vision.

58. **Granting Palestinians access to Area C is key for achieving sustainable economic development in the West Bank.** Currently, less than 1 percent of Area C, which is already built up, is designated by the Israeli authorities for Palestinian use, while the remainder is heavily restricted or off-limits to Palestinians. Recent statements by the GoI announcing intentions to allow part of the Tarqoumia industrial zone and the municipal boundaries of Qaliqilya to expand into Area C are encouraging but limited measures, considering the significant economic potential that lies within this area.

59. **Alleviating restrictions on the movement of goods and people to and from Gaza would be the most important action to ease the Strip's economic, social and humanitarian crises**. This would allow critical trade needed to rebuild Gaza's infrastructure and economy following the multiple episodes of war over the recent years. Easing the Gaza blockade should be done while considering the security concerns of neighboring countries.

60. **Refining and revising the dual use list, while ensuring mutually agreed and predictable mechanisms to control and supervise the trade of restricted goods, will support the development of key sectors in the Palestinian economy**. The unilateral and discretionary imposition of dual use

restrictions is resulting in significant economic costs to the Palestinian economy and is in contradiction with the economic underpinning of the customs union established by the Paris Protocol. Refining the list to make it more specific[30] and easily identifiable on the basis of the Harmonized System (HS) will make it much easier for Palestinian traders to access needed inputs and also clarify what goods need special licensing. Further, the GoI should ensure predictable and clear administrative procedures, including a specific timeline in which the dual use screening system would need to issue a response to a licensing request, or otherwise deem it automatically approved. This would maintain the same level of security while reducing the economic risk for Palestinian traders.

61. **The Palestinian Authority should pursue the revision of the A1, A2 and B lists.** Efforts should focus on expanding the products covered by the lists to increase consumer welfare through lower prices and cheaper inputs for the Palestinian productive sectors. Further, quotas specified by the lists need to be eliminated in as many cases as possible, and where kept (for a limited number of products) should include an automatic increase mechanism. The PA should also aim to increase the number of countries/trading blocs covered by the lists based on its trade policy.

62. **Improving and streamlining Israeli procedures at the crossings would significantly reduce transaction costs for Palestinian traders**. For example, enabling a door-to-door solution which allows a truck to travel from the shipment's originating point to its final destination without unloading and reloading is a recommended option to facilitate trade. A door to door pilot for outbound trade for trucks leaving the West Bank to Israel was recently implemented at Tarqumiya crossing. But the pilot is limited to companies operating in Area C and its compliance costs for Palestinian traders have been higher than the original back-to-back arrangements. A better alternative to the back-to-back arrangement would be the introduction of routine containerization and trailer exchange at all crossings and ports by use of special scanners and other standard security processes.[31] This would increase the efficiency of the movement of goods in terms of time and costs and replacing the long and costly back-to-back process and manual inspections; reduce the risk of damage to goods; allow transit of large items such as furniture; and allow for the transportation of refrigerated and perishable items and improved packing of shipments in terms of both diversity and quantity—thereby increasing the ability of Palestinian firms to compete in regional markets. The increased efficiency would also decrease running costs for the GoI and maintain, if not increase, security.

63. **Allowing increased mobility of labor from the Palestinian territories to Israel could help enhance the quality of human capital while increasing private and public incomes through remittances and taxes**. However, this would need to go hand in hand with enhancing labor force participation in the Palestinian territories and strengthening domestic institutions (including in education and health) in order to avoid Dutch disease and an excessive exodus of Palestinian workers from the West Bank and Gaza. In fact, our work shows that without these internal reforms, allowing additional Palestinian workers in Israel could negatively impact economic growth as the Palestinian labor supply is reduced.

64. **Strengthening PA institutions involved in customs, border management and national standards is key for improving the Palestinian territories' trade infrastructure**. Notably, according to the Oslo Accords, operations at the Allenby Bridge should be under joint Palestinian–Israeli control, but this has not been implemented.[32] A targeted program to build Palestinian capacity on all aspects of border management would enable the PA to gradually deploy its staff at the ports. This will facilitate

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[30] See, for example, recommendations from the Middle East Partnership Initiative—Peres Center for Peace (2015).
[31] According to the GoI, plans to enhance infrastructure and technology at some of the commercial crossings do exist.
[32] Upon the agreement's signing, Palestinian customs agents were never employed at the Allenby/King Hussein Bridge. Finally, in the aftermath of the Second Intifada in September 2000, any other Palestinian presence or operation at the bridge was permanently suspended. Since then, Israel has had sole control.

interactions with Palestinian traders and ensure transparent and efficient processes and smooth coordination with the Israeli authorities under the existing customs union. When it comes to Palestinian national standards, as in the case of other modern industrial economies, they need to be compatible with the ones adopted by target markets to enable domestic producers to tap into them. A quality policy and legal framework is being developed and the PA needs to continue these efforts, particularly to finalize the reassigning of the institutional mandates for quality assurance of various agencies in line with international practices. The PA also needs to review and strengthen systems and laws related to the administration of its quality infrastructure.

65. **Efforts by the PA to improve the domestic environment are also key for creating conditions that enable greater private sector activity and job creation.** The utmost priority is political reconciliation between the West Bank and Gaza and holding the long due presidential and parliamentary elections as this is critical for strengthening governance and institutions, which are key for a well-functioning economy. Although the PA has already started implementing reforms to modernize the business regulation, more needs to be done on this front along efforts to accelerate land registration, improve access to finance and reduce the skill mismatch in the labor market.

66. **In addition, efforts by the PA are needed to create supportive conditions for private sector investment in infrastructure**. This mostly requires adopting policy measures in specific sectors to set up the institutional arrangements and offer the right incentives that would encourage the private sector to get involved in infrastructure projects, including for water and electricity.

Box 3: Cooperation by the GoI and reforms by the PA lead to a success story in the energy sector

Recent developments in the energy sector, in particular, the energization of the Jenin high voltage substation and signing of an interim Power Purchase Agreement (PPA) between Israel and the Palestinian Authority, are promising steps towards a financially sustainable energy sector. This interim agreement paves the way for further negotiations towards the main long term PPA and energization of three additional substations. These substations will provide the West Bank with additional electricity allowing supply to keep pace with growing demand. In addition, the PPA will provide reduced tariffs which will enable better cost recovery.

Thanks to this agreement, the Palestinian Electricity Transmission Company Ltd. (PETL) has become operational, receiving 60MW of power through the Jenin substation and selling the energy to electricity distributors in the West Bank. This transaction allows PETL to earn a revenue stream moving it closer to operational sustainability. A reliable cash flow will allow the private sector, in the form of Independent Power Producers (IPPs), to sell generated electricity to PETL and be re-assured that PETL will be able to pay them. This will mobilize private sector players by ensuring them, and their investors, that there is a commercially viable and sustainable flow of funds and that power sales contracts with PETL are bankable. The signing of the interim PPA and energization of the Jenin substation were first steps in this right direction.

Source: World Bank staff.

67. **A sustainable fiscal position for the PA is also a prerequisite for a healthy economy.** More sustained and fundamental reforms are needed to improve the quality of expenditures and revenue collection. Particular attention should be given to making the pay and pension systems for government employees sustainable and fair to the rest of society, as further gains are limited without these far reaching and politically difficult reforms. **Continued efforts by the GoI to fully eliminate fiscal**

leakages under the revenue sharing arrangement between the two parties would also have a significant positive impact on the PA's fiscal situation. [33]

68. **International donors will also have a key role to play through reversing the decline in aid and providing innovative financing mechanisms.** Reversing the major decline in aid in recent years is particularly important over the medium term while the Palestinian territories make progress on increasing fiscal space and improving the environment for private savings. Enhancing public financial management and investment planning while ensuring proper coordination and integration into the budget of donor-funded activities should be a *sine-qua-non* in this regard. Donors can also help through offering innovative financing instruments that can mitigate risks holding back transformative investments by the private sector. For example, as part of its new strategy in the West Bank and Gaza, the World bank plans on establishing a risk mitigating financing facility for the private sector, leveraging the resources of development partners and catalyzing both short-term and long-term financing. The facility will provide partial risk guarantees and first loss components as mechanisms to mitigate payment risks, thus providing comfort to private investors and lenders to infrastructure projects.

69. **Assistance by donors to support public reforms that encourage private sector participation is also important.** As the PA conducts efforts to encourage private sector participation, particularly in infrastructure, the donor community could support such efforts by providing relevant technical support to help guide this important reform.

70. **A longer-term vision would, of course, also have to consider the future of a Palestinian state with an independent trade regime as part of a broader political agreement with the GoI**. An alternative regime to the current customs union should primarily enable the PA to regain its capacity to conduct economic policy and escape from its stunted development path. Such a vision could also help provide a more favorable setting for mutually beneficial economic relations with Israel, as well as enhance the prospects for improved stability and security for both sides. To adopt an independent trade policy, the PA should exercise effective control over its customs territory including placing Palestinian customs officers at the relevant crossing points through which Palestinian imports and exports flow as this would allow it to levy its import taxes directly and set and enforce sanitary and phytosanitary as well as industry standards. The PA is encouraged to seek full membership in the World Trade Organization (WTO) and establish a liberal trade regime consisting of a moderate Most-Favored Nation (MFN) applied tariff. As an integral part of its new trade regime, the PA should also negotiate a Free Trade Agreement (FTA) with Israel, which is likely to remain its most important trading partner in the foreseeable future. To diversify its trade, the Palestinian economy should also engage broadly in "open regionalism," by negotiating new trade agreements or operationalizing and deepening existing agreements with its main trading partners, beginning with the Arab countries, the European Union, and the United States.

[33] For more information on the nature and size of fiscal leakages, please see the World Bank's report to the April 2016 AHLC meeting.

Annex 1: Stock Take of World Bank Recommendations to the AHLC Meetings Over the Years

71. **As mentioned earlier in the report, the Palestinian economic outlook is worrying and bold actions are needed by all parties to get the Palestinian economy out of its deteriorating trajectory.** Most needed actions have been identified in previous reports by the World Bank to the AHLC meeting but implementation has been limited. In our September 2016 report to the AHLC, a stock take of all previous World Bank recommendations to the meeting was conducted. This exercise was intended to provide a baseline for evaluating progress in achieving the Palestinian territories' development priorities. In addition, it was hoped that it would galvanize the reform efforts of all parties to address the immediate need while setting in place reforms that will deliver over time. In this report, the stock take is updated to show progress since September 2017 using the same three pillars 1) fiscal sustainability, 2) economic development and 3) Gaza reconstruction and recovery. The following summarizes main developments in these pillars.

Fiscal Sustainability

72. **While the PA has managed to reduce its spending so far in 2017, more needs to be done on structural reforms that are key to achieving long term fiscal sustainability.** There has been some progress on controlling health referrals with the arrangements earlier developed for Israeli hospitals now extended to six local facilities, with an additional three hospitals in the pipeline. Notably, however, it will not be possible to significantly reduce outside referrals until the main source of hemorrhage, which is a very generous health insurance system, is reformed. progress in referrals will remain Progress has also been made on steps to control electricity net lending – although the problem is now emerging with other utility payments, mainly water. As mentioned earlier in the report, recent measures have been adopted to reduce spending on the wage bill and net lending in Gaza, but there have been no structural changes to control the wage bill in the West Bank nor implement parametric reforms to support the pension systems sustainability.

73. **The PA's revenues have so far performed well in 2017 due to better administration, but more needs to be done.** A geographic decentralization of tax administration offices has significantly helped boost revenue collections in 2017 through facilitating efforts to widen the tax base. In fact, the number of registered taxpayers has exceeded 200,000 - up by more than 20,000 a year ago. Nevertheless, tax avoidance is still widespread, particularly amongst high earning professionals and the PA needs to focus efforts on this group. Strengthening enforcement and audit techniques can also help further expand the tax base. Additional efforts are also warranted on the policy front. For example, the IMF recommends restoring the top income tax bracket of 20 percent, introducing a 10 percent dividend tax, and eliminating some of the generous tax exemptions, such as those offered by the Investment promotion law. Finally, laws should be amended to enable the PA to apply penalties for non-compliance.

74. **The GoI has continued to transfer one off payments to the PA to offset fiscal leakages in 2017, but a more systematic approach to fully eliminate these losses is yet to be adopted.** Efforts should focus on implementing the Paris Protocol's provisions regarding full information sharing on trade that takes place between both parties, including Israeli sales to Gaza. As stipulated by the Protocol, this could be done through setting up an "interconnected computer system" between the Israeli and Palestinian VAT authorities. Immediate focus should also be on revising the high Israeli handling fee, and a systematic transfer of the health and equalization levies, as agreed in the electricity agreement signed between the two parties in 2016. To date, there has not been a positive GoI response to requests in these areas, although proposed senior official talks are a promising development. Talks are also now

underway between the GoI and the PA to initiate the introduction of bonded warehouses for Palestinian imports and the transfer of some customs authority to the PA over the coming years. This is a potentially positive development, although care will be needed in the implementation to ensure that revenues are protected and no additional costs are imposed on the Palestinian private sector.

75. **There has not been any material progress in improving the public financial management (PFM) system in recent months, although the PA has in that period prepared its first comprehensive PFM strategy.** It is intended that this will guide a more active reform agenda in the coming years.

76. **Budget support from donors has continued to decline and this has been a key factor behind the large financing gap.** As a share of GDP, budget support has fallen from 32 percent in 2008 to under 6 percent in 2016. It is expected to further decline to under 5 percent in 2017.

Economic Development

77. **The Israeli constraints on movement, access and trade continue to be a main impediment to economic growth in the Palestinian territories.** In particular, and as indicated earlier in the report, restrictions related to Area C and the blockade on Gaza represent the biggest challenges to growth, and their removal can generate momentous economic benefits. Nonetheless, progress in easing these constraints have not yet materialized. Area C continues to be mostly off limits for Palestinians and the number of master plans approved for this Area has not increased since our last reporting. Also, restrictions on the movement of goods and people in and out of Gaza have not been eased.

78. **At a domestic level, the PA has initiated steps to reduce the cost of doing business and improve the business climate but these have yet to be fully implemented.** A draft Companies Law has recently been submitted to the cabinet, and is expected to be approved by the President during 2017. Similarly, a draft competition law has been prepared although the timing of its implementation is less clear. The abolition of land titling fees has led to an increase in land registration while consideration is also being given to new institutional arrangements to accelerate land registration but no decisions have yet been made.

79. **A recent success in the energy sector is highly encouraging, but more needs to be done.** As mentioned, earlier, the GoI and the PA have recently signed a PPA to energize the Jenin substation which will increase the electricity supply in northern West Bank. Thanks to this agreement, the Palestinian Electricity Transmission Company has moved closer to operational sustainability (see Box 3 for more details). However, more needs to be done. Diversification of electricity supply from other neighboring countries needs to be pursued but it is hindered by problems of land access, security and payment risk. For instance, restrictions of access and construction in Area C are major obstacles to build and upgrade interconnectors with Jordan, and security issues in Sinai reduce the viability of additional electricity from Egypt. Most urgent, though, is the need to increase energy supply to Gaza. The additional 161kV power line from IEC to Gaza would bring much needed relief; however, the question of payment has not been resolved yet.

Gaza Reconstruction and Recovery

80. **Most physical damages after the last Gaza war have been fixed, except for housing, but recovery needs remain large.** Good progress has been made in most sectors, with physical damages repaired. However, the lion share of fully damaged houses is yet to be replaced and recovery needs that go beyond physical destruction remain enormous. Progress remains slow as a result of limited funding, slow material entry, and political divisions between the PA and the *de-facto* authorities. Disbursements after the Cairo conference in October 2014 have reached a plateau at around 50 percent which is causing a

funding shortage that curtails progress particularly in those sectors with the highest financing needs identified in the DNA, e.g., in the housing sector. Good progress has been made in developing a results tracking mechanism to complement the pledge tracking under the leadership of the National Office for the Reconstruction of Gaza (NORG). However, with financial support for NORG ceasing, achievements establishing an institutional structure to support and monitor progress with the Gaza recovery is at risk. Despite some progress in accelerating materials entry through the Gaza Reconstruction Mechanism (GRM), materials remain in short supply and long delays in approval and delivery prevail, particularly for more complex infrastructure projects.

Table 2: Summary of World Bank recommendations to prior AHLC meetings

Actions	Responsible Party	Progress Sept 2016	As of Sept 2017
FISCAL SUSTAINABILITY			
Expenditures			
Control the oversized wage bill	PA		
Control medical referrals to Israel	PA		
Control medical referrals to local facilities	PA		
Implement administrative reforms for the pension system	PA		
Implement parametric reforms to restore the pension system's sustainability	PA		
Reduce the size of net lending	PA		
Revenues			
Enhance the PA's tax effectiveness in Gaza	PA		
Increase the number of registered large taxpayers	PA		
Strengthen legislation to penalize non-compliant taxpayers	PA		
Revise government fees and charges upwards	PA		
Transfer to the PA fiscal losses accumulated over the years	GoI		
Implement institutional measures to reduce fiscal losses on clearance revenues	PA and GoI		
Public Financial Management			
Improve budget preparation procedures	PA		
Align budget execution with available resources	PA		
Clear the backlog of outstanding financial statements 2012-2015	PA		
Develop systems for monitoring and reporting expenditure arrears	PA		
Budget support			
Provide sizeable, predictable and timely support to the PA's budget	Donors		
ECONOMIC DEVELOPMENT			
Area C			
Expand spatial plans for Palestinian villages in Area C	GoI		
Increase number of building permits approved in Area C	GoI		
Grant approval to Palestinian business projects in Area C	GoI		
The Gaza economy			
Allow exports out of Gaza to reach pre-2007 level	GoI		

Actions	Responsible Party	Progress Sept 2016	As of Sept 2017
Significantly reduce items on restricted dual use list for Gaza	GoI		
Create a unified PA in both the West Bank and in Gaza	PA		
The business climate			
Adopt the Secured Transactions Law & establish a movable asset registry	PA		
Adopt the new Companies Law & the Competition Law	PA		
Accelerate land registration in Areas A and B	PA		
Improve access to finance for SMEs	PA		
Reform the education system to bridge gap between graduates' skills and labor market needs	PA		
Securing energy for development			
Sign an interim PPA to energize the Jenin substation	GoI and PA		
PETL operating on commercial basis	PA		
Diversify electricity supply	GoI and PA		
Increase power supply to Gaza	GoI and PA		
GAZA RECONSTRUCTION AND RECOVERY			
Complete a DNA to guide reconstruction and recovery	PA		
Accelerate disbursements of Cairo Conference pledges	Donors		
Establish and monitor time line indicators for review and approval of dual use items	GoI		
Include delivery monitoring in GRM system	GoI and PA		
Set-up results-based tracking program to monitor recovery	PA		
Establish Gaza import mechanism able to handle Gaza's long term recovery needs	GoI and PA		
Strengthen NORG and institutional structure for cross-sector coordination of decentralized recovery planning	PA		

Legend

On track

Some progress achieved

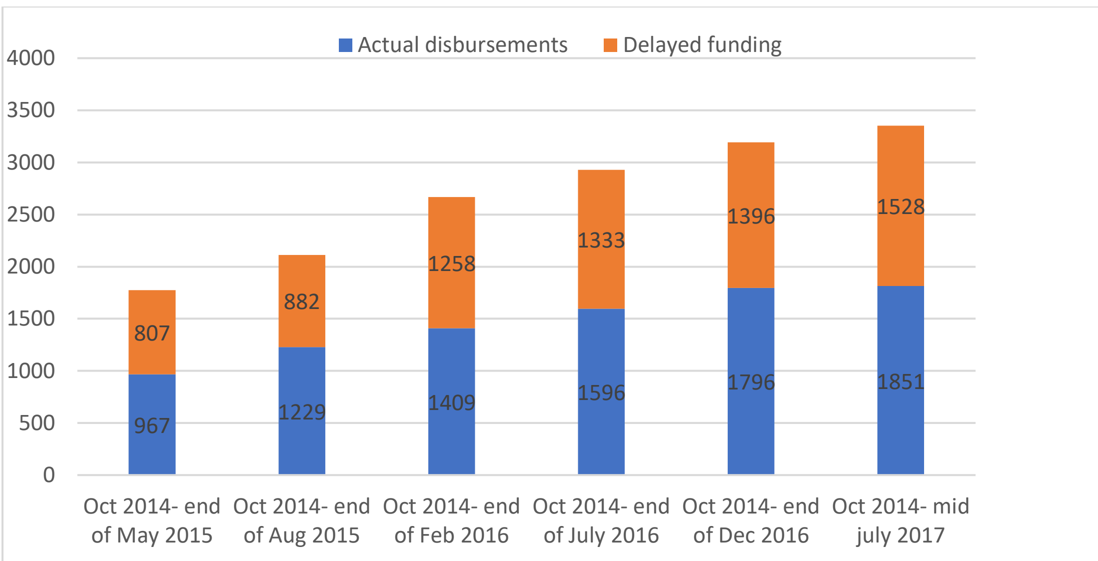
No progress

Annex 2: An Overview of Disbursement of Pledges Made at the Cairo Conference on Palestine "Reconstructing Gaza", Cairo: October 12, 2014.[34]

81. **By end of July 2017, almost three years post the 2014 Gaza war, total disbursement of pledges to support Gaza is estimated at USD1.851 billion,[35] and the overall disbursement ratio reached 53 percent.** Based on available data, 32 participants, out of the total 53 participants, have already fully delivered their original pledge at Cairo Conference to support Gaza.

82. **Actual disbursements, as of July 2017, fell short of planned disbursements by USD1.5 billion.** Figure 8 below shows the actual and expected flow of funding of Support to Gaza over the period 2014-2017. The actual disbursements were supposed to reach 97 percent as opposed to the actual disbursement ratio of 53 percent by July 2017.

Figure 8: Planned disbursements of Cairo Conference Pledges (2014-2017) in USD million



Source: World Bank staff calculations.

83. **If donor funding continues to be paid at the current pace, pledges are estimated to be fully disbursed by the end of 2020.** Since the last data collection in December 2016 (reflected in the May 2017 AHLC report), disbursements have increased by USD55 million.

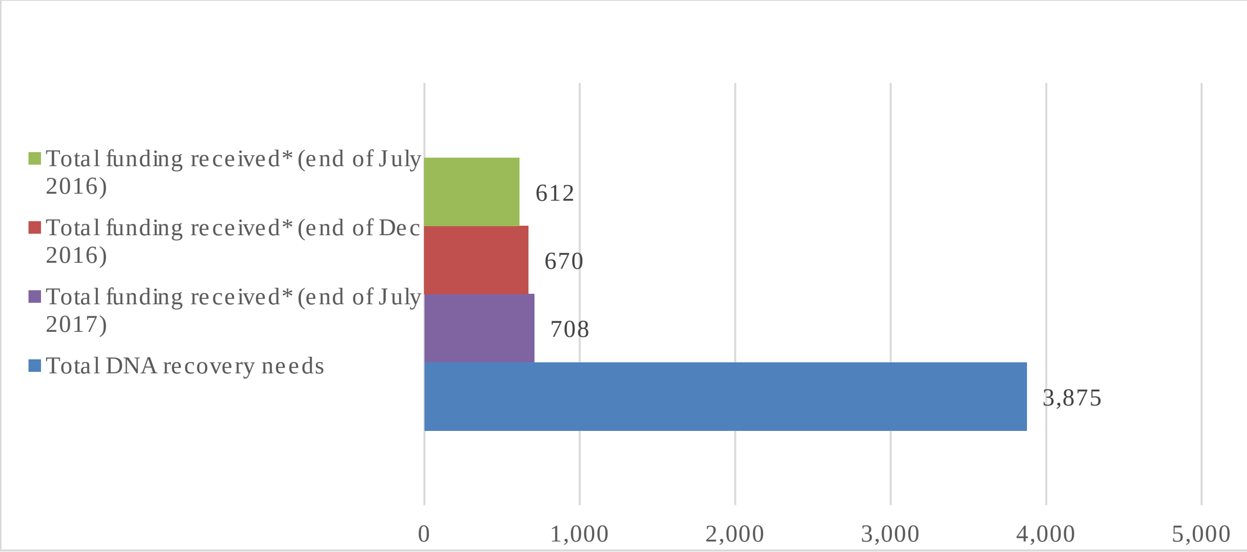
84. **As of today, 18 percent of the total recovery needs have been addressed.** Out of the USD1.851 billion that has been disbursed, USD708 million is directly attributed towards priority interventions outlined in the Gaza DNA and Recovery Framework, which is an increase of USD38 million from the

[34] Following the 2014 Cairo Conference, the World Bank received a request from the PA and Norway to monitor disbursement of donor pledges made at the Conference for Gaza reconstruction. Given that the scheduled end date of contributions is October 2017, this will be the last reporting by the Bank.

[35] Disbursement figure may change once further data is collected from donors who have not yet provided information about disbursements and allocation of pledges. Support to Gaza figure refers to pledges made at the Cairo Conference and therefore does not reflect all support spent in Gaza after the 2014 war.

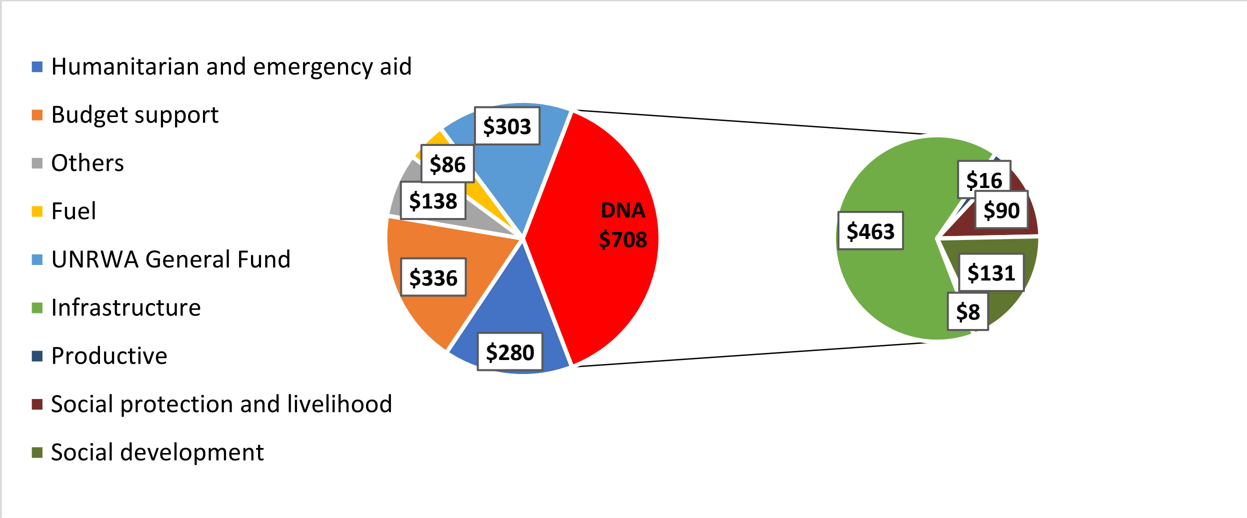
latest data collection in December 2016. The USD708 million covers 18 percent of total recovery needs.[36] The infrastructure sector attracted the largest portion of funds with actual disbursements estimated at USD463 million.

Figure 9: Financing of DNA recovery needs from Cairo Conference pledges (USD million)



Source: World Bank staff calculations.

Figure 10: Actual disbursements of Cairo Conference support to Gaza by category as of July, 2017 (USD million)



Source: World Bank staff calculations.

[36] Total recovery needs, identified in the DNA and Recovery Framework, are estimated at USD3.875 billion to cover the economic / human costs of the conflict and finance interventions to help Gaza recover and build back better.

Table 3: Disbursement status by donor of support to Gaza pledged at Cairo Conference on Palestine "Reconstructing Gaza" in USD Million (July 2017)

Donor	Support to Gaza	Disbursement of Support to Gaza
Qatar*	1000.00	216.06
Saudi Arabia*	500.00	107.80
European Union[1]	348.28	312.28
USA	277.00	277.00
Kuwait*	200.00	62.63
Turkey[2]	200.00	139.48
UAE	200.00	59.08
Norway[3]	144.98	173.91
European Investment Bank[4]	70.00	N/A
Switzerland[5]	65.28	66.96
Germany	63.32	61.70
World Bank	62.00	62.00
Algeria*	61.40	61.40
Japan[6]	61.00	61.00
UK	32.16	32.16
Italy[7]	23.68	11.53
Spain	22.80	14.6
Sudan[8]	20.00	N/A
The Netherlands	15.31	15.31
Canada	14.66	14.66
Denmark	14.46	14.46
Australia	13.18	13.18
France[9]	10.13	10.13
Sweden	10.00	11.37
Finland	9.31	9.31
Luxembourg	8.97	N/A
Russia	8.74	8.74
Belgium[10]	7.92	7.92
Bahrain*	6.50	5.15
Austria[11]	5.22	5.22
India	4.00	4.00

Ireland	**3.17**	**3.17**
Brazil[12]	**2.46**	**2.46**
Argentina[*13]	**2.14**	**N/A**
South Korea	**2.00**	**2.00**
China	**1.60**	**N/A**
Estonia	**1.27**	**0.95**
Greece	**1.27**	**0.63**
Mexico	**1.10**	**1.10**
Indonesia	**1.00**	**N/A**
South Africa	**1.00**	**0.00**
Croatia	**0.40**	**0.35**
Chile	**0.25**	**0.25**
Slovenia	**0.190**	**0.190**
Hungary	**0.16**	**0.16**
Poland	**0.10**	**0.10**
Malaysia	**0.10**	**0.10**
Singapore	**0.10**	**0.10**
Bulgaria	**0.06**	**0.06**
Slovakia	**0.05**	**0.05**
Romania	**0.05**	**0.05**
Serbia	**0.05**	**0.00**
Portugal	**0.03**	**0.03**
TOTAL**	**3,499**	**1,851**

**** The figure of total support to Gaza was slightly revised based on updated information from donors of previous estimates.**
[1] European Union contribution includes contribution to UNRWA General Fund pro-rata Gaza for 2014-2015.
[2] Turkey's figure does not reflect TIKA's disbursements for 2017 of USD7.62 million
[3] Norway did not specify the allocation of its total support between West Bank and Gaza. The amount to Support Gaza is an estimate.
[4] European Investment Bank contribution is in the form of a loan.
[5] Switzerland did not specify the allocation of its total support between West Bank and Gaza. The amount to Support Gaza is an estimate.
[6] Japan pledged USD200 million for Palestinian territories. No specific-pledged amount for Gaza reconstruction. So far, about USD199 million was disbursed of which USD61 million for projects in Gaza, 106 for West Bank and Gaza, 28 million for West Bank and 4.2 million for others.
[7] Italy's contribution includes a soft loan to the Palestinian National Authority of EUR15 million.
[8] Sudan's contribution is in the form of in kind assistance (100 thousand tons of cement and USD3 million of medical supplies).
[9] France's contribution includes total aid for Palestinian territories for the year 2014 only.
[10] Belgium's contribution is its 2014 General Fund contribution to UNRWA.
[11] Austria's contribution of USD8.8 million is programmed for the benefit- with some minor exceptions- of people living in Gaza.
[12] Brazil's contribution is in the form of In-Kind (6000 tons of rice).
[13] Argentina's contribution is in the form of technical assistance agreement to support Gaza which was signed with MOPAD.
*** Data provided by UNRWA and/or the Palestinian Authority.**

Annex 3: Methodology Used for Quantifying the Impact of the Constraints

85. **A Computable General Equilibrium (CGE) model was developed as the basic tool for analysis in order to capture the broader and dynamic economic impact of the removal of the external and internal constraints.** A Social Accounting Matrix (SAM) for 2014 (in transaction prices) was constructed based on the latest available 2004 Input-Output table covering 16 activities. Accounts were divided between the West Bank and Gaza using the available national accounts for each in order to be able to analyze the two regions separately.[37] A key constraint was the absence of national income accounts; in particular, data were not available on the functional income distribution between labor and capital and had to be based on sector surveys used for the 2001 SAM for Palestine applying the same ratios to each sector in the West Bank and Gaza. Further, we did not have detailed information on labor, including between skilled and unskilled labor, which is an important shortcoming in particular as the impact of potentially more free movement of labor from Palestine to Israel likely would affect mainly unskilled workers.[38] Official data also does not distinguish land from other capital, which would be particularly useful for analyzing the Palestinian situation given the restrictions on access to land.[39] Finally, trade prices are generally not available as external trade is only recorded in value terms making it difficult to analyze detailed trade policy regimes.

86. **The CGE model broadly follows the standard for these models, with parameter estimates and closure rules defining the Palestinian territories-specific model**. CGE models are by nature focused on the real sector, with details on fiscal operations and external current account transactions added as available and needed for the analysis at hand. They normally do not include a monetary and financial sector, including assumptions about budget and current account financing and analysis of debt dynamics, and with the focus of our analysis on growth and jobs, we have also not attempted to do that in our model. Further, in line with common practice, investment behavior is not modeled but rather determined by the overall level of savings with no distinction between public and private investment. In the case of the Palestinian territories, this is somewhat of a mute-point as only some 20 percent of public investment is captured by the budget (according to the Ministry of Finance).

87. **In order to analyze the impact of non-tariff trade barriers, restrictions on mobility and access to land and other natural resources, and other distortions arising from the domestic policy and institutional environment, we estimate trade-related and nontrade-related tariff equivalents (TEs).** While Doing Business indicators may provide some useful information on the severity of Non Trade Barriers (NTBs), they are not in economic terms and cannot be used in our model. We estimate the TEs based on the 2014 industrial survey of cost structure in 45 sectors. Trade-related TEs are estimated in two steps: (i) estimation of the average cost of storage, transportation, and border crossing (based on our own surveys); (ii) application of this cost to the share of traded-inputs in production. Nontrade-related ("capital") TEs are estimated as the residual operating surplus, adjusted for the "normal" rate of return. The TEs are then aggregated to the 16 sectors in the SAM. We find that trade-related TEs are around 2-3 percent, as expected highest in sectors that rely more on traded inputs. Capital TEs are very high in some sectors such as construction and international trade & repair (as well

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[37] PCBS publishes sector production, trade, and consumption data for each region. Government and external income and transfers (net of remittances) were allocated to each region based on population size, and the I/O table imposed on each region balancing the SAM using the standard entropy technique.

[38] Parallel work underway has collected more detailed labor market data that could be incorporated into the CGE framework in the future.

[39] The Ministry of Finance finds that land values are grossly underestimated based on actual property tax collections.

as real estate in the West Bank and agriculture in Gaza) due to the combined impact of external restrictions and domestic distortions. It is generally not possible to distinguish the impact from one versus the other, though in some sectors such as real estate it is plausible that the major impact comes from the external restrictions on access to land.

88. **In our CGE model, both trade- and capital TEs work through the price system as ad-valorem taxes.** The trade-TEs are applied to import prices and the revenue of the tax (equivalent) accrues to foreign agents (export-related TEs act as a tax on exports paid by households and again accruing to foreign agents but these are already reflected in FOB export prices and any reduction would be reflected in higher export prices). The capital TEs work as an indirect tax and applies to domestic producer prices. Unlike the indirect tax, the revenue from the capital TEs (excess rents) accrue to households rather than the government (households own the factors and are getting the both the normal and the excess return). Regretfully, we only have one household type in the model; distributional impacts would be very interesting to trace in a multiple household model (capital versus labor income-based households).

89. **A number of scenarios related to alleviation of external and internal constraints were explored.** The general political assumptions underlying the scenario analysis are: full implementation of the Paris Protocol; access to Area C as required by the Interim Agreement; lifting of the blockade on Gaza; and political reconciliation between the West Bank and Gaza. In addition to a baseline scenario that assumes no significant changes in recent trends or in prevailing constraints, we explore five main scenarios: (i) Full access to Area C (West Bank only); (ii) Improved trade conditions (including lifting the blockade on Gaza) and labor mobility between Palestine and Israel; (iii) Reduced fiscal leakages from Palestine to Israel; (iv) An improved domestic business environment and fiscal reforms by the PA; and (v) Increased foreign capital inflows at a presumed rate of around 0.5 percent of GDP per year. We do this in a sequential, linear/additive way, starting with alleviation of externally-imposed constraints and moving towards alleviation of internal constraints. Each scenario thus builds on the previous, but without any interaction between assumptions or parameters. Exogenous variables and key parameter estimates are based on recent trends, other studies, evidence from other countries, and in some cases our own judgement. The results are thus more illustrative than meant to capture the full complexity of linkages between external and internal constraints and real projections of the economy under different external and internal environments. As our focus is on the medium term, our simulation period is 2017-2025. The assumptions related to each of these scenarios are described in the following tables.

West Bank

Percentage Change from Previous Year **PARAMETERS**		**Baseline:** 2017	**Baseline:** 2018 - 2025	**Scenario 1** 2017	**Scenario 1** 2018 - 2025	**Scenario 2** 2017	**Scenario 2** 2018 - 2025	**Scenario 3** 2017	**Scenario 3** 2018 - 2025	**Scenario 4** 2017	**Scenario 4** 2018 - 2025	**Scenario 5** 2017	**Scenario 5** 2018 - 2025
Factor productivities													
TFP_{Labour}	*Index*	0.4%	0.4%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.9%	1.9%	1.9%	1.9%
$TFP_{Capital}$													
Manufacturing, Construction, and other	*Index*	0.4%	0.4%	2.4%	2.4%	2.7%	2.7%	2.7%	2.7%	3.0%	3.0%	3.0%	3.0%
Electricity	*Index*	3.0%	3.0%	3.00%	3.00%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Agriculture	*Index*	0.4%	0.4%	13.4%	17.4%	13.7%	17.7%	13.7%	17.7%	14.0%	18.0%	14.0%	18.0%
Mining	*Index*	0.4%	0.4%	10.9%	19.9%	11.2%	20.2%	11.2%	20.2%	11.5%	20.5%	11.5%	20.5%
Water	*Index*	0.4%	0.4%	10.9%	19.9%	11.2%	20.2%	11.2%	20.2%	11.5%	20.5%	11.5%	20.5%
Hotels & Resturants	*Index*	0.4%	0.4%	10.9%	19.9%	11.2%	20.2%	11.2%	20.2%	11.5%	20.5%	11.5%	20.5%
Percentage Change from Previous Year ***VARIABLES***	***Units***												
HOUSEHOLDS													
Labour force	*Individuals*	2.0%	2.0%	2.0%	2.0%	1.1%	1.1%	1.1%	1.1%	1.6%	1.6%	1.6%	1.6%
Household saving rate	*Percentage*	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	0.3%	4.3%	4.3%	4.3%	4.3%
Non-tax revenue	*Nominal US$*	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	6.4%	5.0%	13.9%	12.5%	13.9%	12.5%
External transfers (debit)	*Nominal US$*	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
GOVERNMENT													
Real Government consumption:	*Real US$*	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.8%	2.5%	2.5%	2.5%	2.5%
Effective Import Tariff Rates:	*Percentage*	0.0%	0.0%	0.0%	0.0%	-2.0%	0.0%	3.3%	0.0%	3.3%	0.0%	3.3%	0.0%
Effective Other Indirect taxes rates:	*Percentage*	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.3%	0.0%	6.5%	1.2%	6.5%	1.2%
Direct tax rates (Personal)	*Percentage*	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Direct tax rates (corporate)	*Percentage*	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Transfers to households:	*Nominal US$*	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
External government transfers (debit)	*Nominal US$*	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Water Prices	*Nominal US$*	0.0%	0.0%										
Water Subsidy rates	*Percentage*	-	-	-25.0%	-25.0%	-25.0%	-25.0%	-25.0%	-25.0%	-50.0%	-50.0%	-50.0%	-50.0%
Electricity Prices	*Nominal US$*	-	-										
Electricity Subsidy rates	*Percentage*	0.00%	0.00%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
TARIFF EQUIVALENT													
Trade tariff equivalent rates:	*Percentage*	0.0%	0.0%	-5.0%	-5.0%	-15.0%	-15.0%	-15.0%	-15.0%	-15.0%	-15.0%	-15.0%	-15.0%
Capital tariff equivalent rates:	*Percentage*	0.0%	0.0%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%	-5.0%	-9.0%	-9.0%	-9.0%	-9.0%
EXTERNAL SECTOR													
Official transfers (credit)	*Nominal US$*	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	1.6%	1.6%	1.6%	1.6%	1.6%	1.6%
Private transfers (Credit Remittances, etc)	*Nominal US$*	3.8%	3.8%	3.8%	3.8%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%	12.5%
Nominal exchange rate:	*Index*	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Current account deficit (external savings):	*Nominal US$*	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	4.5%	8.00%	8.00%
Export prices													
General		2.0%	2.0%	2.0%	2.0%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%	3.1%
Import prices													
General	Nominal US$	2.0%	2.0%	2.0%	2.0%	-8.0%	2.0%	-8.0%	2.0%	-8.0%	2.0%	-8.0%	2.0%
Electricity	Nominal US$	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Petroleum products	Nominal US$	1.5%	1.5%	1.5%	1.5%	-8.5%	1.5%	-8.5%	1.5%	-8.5%	1.5%	-8.5%	1.5%

Capital Depreciation rate		2.5%	2.5%
Income elasticities			
General:		1.00	1.00
Electricity:		1.50	1.50
Agriculture:		Residual	Residual

Gaza

Percentage Change from Previous Year **PARAMETERS**		**Baseline:** 2017	2018 - 2025	**Scenario 1** *Not Applicable*	**Scenario 2** 2017	2018 - 2025	**Scenario 3** 2017	2018 - 2025	**Scenario 4** 2017	2018 - 2025	**Scenario 5** 2017	2018 - 2025
Factor productivities												
TFP Labour	*Index*	2.5%	2.0%		2.5%	2.0%	2.5%	2.0%	3.1%	2.6%	3.1%	2.6%
TFP Capital												
Manufacturing, Construction, and other	*Index*	4.5%	2.3%		8.2%	6.0%	8.2%	6.0%	8.5%	6.3%	8.5%	6.3%
Electricity	*Index*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Agriculture	*Index*	4.5%	2.3%		8.2%	6.0%	8.2%	6.0%	8.5%	6.3%	8.5%	6.3%
Mining	*Index*	4.5%	2.3%		8.2%	6.0%	8.2%	6.0%	8.5%	6.3%	8.5%	6.3%
Water	*Index*	4.5%	2.3%		8.2%	6.0%	8.2%	6.0%	8.5%	6.3%	8.5%	6.3%
Hotels & Resturants	*Index*	4.5%	2.3%		8.2%	6.0%	8.2%	6.0%	8.5%	6.3%	8.5%	6.3%
Percentage Change from Previous Year ***VARIABLES***	***Units***											
HOUSEHOLDS												
Labour force	*Individuals*	3.2%	3.2%		2.0%	2.0%	2.0%	2.0%	2.5%	2.5%	2.5%	2.5%
Household saving rate	*Percentage*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	2.5%	2.5%	2.5%	2.5%
Non-tax revenue	*Nominal US$*	10.0%	10.0%		10.0%	10.0%	11.4%	10.0%	18.9%	17.5%	18.9%	17.5%
External transfers (debit)	*Nominal US$*	5.0%	5.0%		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
GOVERNMENT												
Real Government consumption:	*Real US$*	5.0%	5.0%		5.0%	5.0%	5.0%	5.0%	4.7%	4.7%	4.7%	4.7%
Effective Import Tariff Rates:	*Percentage*	0.0%	0.0%		-2.0%	0.0%	3.3%	0.0%	3.3%	0.0%	3.3%	0.0%
Effective Other Indirect taxes rates:	*Percentage*	0.0%	0.0%		0.0%	0.0%	5.3%	0.0%	6.5%	1.2%	6.5%	1.2%
Direct tax rates (Personal)	*Percentage*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Direct tax rates (corporate)	*Percentage*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Transfers to households:	*Nominal US$*	5.0%	5.0%		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
External government transfers (debit)	*Nominal US$*	5.0%	5.0%		5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%	5.0%
Water Prices	*Nominal US$*	0.0%	0.0%									
Water Subsidy rates	*Percentage*	-	-		-	-	-	-	-0.125	-12.5%	-12.5%	-12.5%
Electricity Prices	*Nominal US$*	0.0%	0.0%									
Electricity Subsidy rates	*Percentage*	-	-		-	-	-	-	-0.125%	-12.5%	-0.125%	-12.500%
TARIFF EQUIVALENT												
Trade tariff equivalent rates:	*Percentage*	0.0%	0.0%		-10.0%	-10.0%	-10.0%	-10.0%	-10.0%	-10.0%	-10.0%	-10.0%
Capital tariff equivalent rates:	*Percentage*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	-3.0%	-3.0%	-3.0%	-3.0%
EXTERNAL SECTOR												
Official transfers (credit)	*Nominal US$*	5.0%	5.0%		5.0%	5.0%	6.1%	6.1%	6.1%	6.1%	6.1%	6.1%
Private transfers (Credit Remittances, etc)	*Nominal US$*	5.0%	5.0%		24.4%	24.4%	24.4%	24.4%	24.4%	24.4%	24.4%	24.4%
Exports of goods and services	*Real US$*	5.0%	5.0%		13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%	13.0%
Nominal exchange rate:	*Index*	0.0%	0.0%		0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Current account deficit (external savings):	*Nominal US$*	6.0%	6.0%		6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	18.50%	18.50%
Export prices												
General	Nominal US$	2.0%	2.0%		4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%	4.0%
Import prices												
General	Nominal US$	2.0%	2.0%		-16.0%	2.0%	-16.0%	2.0%	-16.0%	2.0%	-16.0%	2.0%
Electricity	Nominal US$	1.5%	1.5%		1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Petroleum products	Nominal US$	1.5%	1.5%		-16.5%	1.5%	-16.5%	1.5%	-16.5%	1.5%	-16.5%	1.5%
Capital Depreciation rate		2.5%	2.5%									
Income elasticities												
General:		1.00	1.00		1.00	1.00	1.00	1.00	1.00	1.00	1.00	1.00
Electricity:		1.50	1.50		1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Labour		0.85	0.85		0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35
Agriculture:		Residual	Residual		Residual	Residual	Residual	Residual	Residual	Residual	Residual	Residual