Economic Monitoring Report to the Ad Hoc Liaison Committee

May 10th, 2022

WORLD BANK GROUP
THE WORLD BANK IBRD • IDA | IFC International Finance Corporation | MIGA Multilateral Investment Guarantee Agency

Table of Contents

BOXES

ACRONYMS

AHLC	**Ad Hoc Liaison Committee**
AML/CFT	**Anti-Money Laundering and Combating Financing of Terrorism**
CBRs	**Correspondent Banking Relationships**
CCS	**Commitment control system**
DSL	**Digital Subscriber Line**
FATF	**Financial Action Task Force**
FCV	**Fragility, Conflict and Violence**
GDP	**Gross Domestic Product**
GoI	**Government of Israel**
GNI	**Gross National Income**
GRM	**Gaza Reconstruction Mechanism**
HCPPP	**High Council for Public Procurement Policies**
IFMIS	**Integrated Financial Management Information System**
IMF	**International Monetary Fund**
LGUs	**Local Government Units**
LWSC	**Land Water Settlement Commission**
MENA	**Middle East and North Africa**
MENAFATF	**Middle East and North Africa Financial Action Task Force**
MoF	**Ministry of Finance**
NPL	**Non-Performing Loans**
OMR	**Outside medical referrals**
PA	**Palestinian Authority**
PCBS	**Palestinian Central Bureau of Statistics**
PEFA	**Public Expenditure and Financial Accountability**
PFM	**Public Financial Management**
PLA	**Palestinian Land Authority**
PMA	**Palestine Monetary Authority**
SMEs	**Small and Medium Enterprises**
TFP	**Total Factor Productivity**
VAT	**Value Added Tax**

Executive Summary

i. **Despite confronting significant challenges, in 2021 the Palestinian economy started to recover from the severe impact of the COVID-19 pandemic.** The economy grew by 7.1 percent in 2021, as measures to confront the pandemic remained significantly eased, and was mainly driven by a healthy growth rate of 7.8 percent in the West Bank due to higher consumption as a result of the ease of COVID-related measures and an increase in the number of Palestinians working in Israel and the settlements, from 125,000 in 2020 to 153,000 in Q4 2021. In Gaza, the May 2021 conflict slowed the Strip's recovery resulting in a growth rate of 3.4 percent. While poverty rates slightly decreased to 27.3 percent in 2021, representing a population of about 1.5 million people, the unemployment rate increased to 24.2 percent in Q4 2021 in the Palestinian territories – up from 23.4 percent in Q4 2020, mainly due to a 3.2 percentage point rise in the labor market participation rate. Significant differences in unemployment rates between the West Bank and the Gaza Strip—13.2 percent and 44.7 percent, respectively—reflect the divergent development patterns.

ii. **In 2021, the management of fiscal policies remained the single most important economic challenge confronted by the Palestinian Authority (PA).** The recovery of the Palestinian economy had a positive impact on fiscal revenues. Domestic tax collections grew by 28 percent, and clearance revenue increased by 12 percent, despite higher unilateral deductions by the Government of Israel (GoI) which reached NIS338 million (US$104 million) in 2021. Expenditure growth was limited to 2 percent as increases in the wage bill were offset by lower transfers. However, aid received was only US$317 million. In fact, as a share of GDP, aid to the budget fell from 27 percent in 2008 to 1.8 percent in 2021. Consequently, the PA faced a large financing need of US$940 million in 2021. An advance payment on clearance revenues in the amount of US$153 million (NIS500 million) provided by the GoI in September 2021 provided some relief. Nevertheless, the needs remained large and to address this, the PA relied on arrears to the private sector, the pension fund, and domestic borrowing. The PA has also been paying partial salaries since November 2021, accumulating arrears to public employees. The stock of arrears accumulated to the private sector is around US$975 million, according to the Ministry of Finance, while arrears to the pension fund are estimated at US$3 billion, as of end-2021. The large stock of arrears causes a growing risk to the stability of the economy.

iii. **Against this fiscal backdrop, the banking system has remained relatively stable largely due to sound financial regulations, which confirms the importance of safeguarding the banking system against economic shocks.** The PA has significantly increased its borrowing from domestic banks, increasing the exposure of the banking system through domestic public debt. Domestic public debt reached US$2.5 billion by December 2021 (23 percent of total direct credit) and exceeded the Palestine Monetary Authority (PMA) exposure limits by 15 percent. In addition to direct borrowing by the PA, bank loans to PA employees (backed by future salaries) also represent an indirect channel of exposure to the public sector, along with the expanded usage of promissory notes. Overall, the PA and public employees account for about US$4.3 billion, or 40 percent of total banking sector credits. In this regard, the PA's decision to pay partial salaries has gradually deteriorated the quality of loan portfolios across the banking and microfinance sectors, which compounded the risk to bank profitability, and further deterioration is likely. In the current context, the independence of the PMA, as a supervisor and prudential regulator of the banking system, should be safeguarded. In addition, a more stable arrangement for cross-border payments, the correspondent banking relationship, is being developed by the PMA and the Bank of Israel, but progress in the establishment of, and transition to the proposed arrangement has been slow, and efforts should be accelerated to reduce these risks.

iv. **The size of the deficit is expected to remain large in 2022, reaching 5.1 percent of GDP (before aid).** Since additional domestic financing is no longer possible, and aid has been on a declining trend, proceeding with priority reforms is crucial. Otherwise, the continual provision of quality public services will be constrained. This report provides concrete recommendations on what can be done to build a medium-term sustainable macroeconomic framework. These are key for further strengthening the fiscal position, and thus warrant continual efforts by the PA and support from the international community. Additionally, cooperation by the GoI is essential to ensure the reforms reach their potential. On the expenditure side, this report identifies several reform areas that the PA could undertake to address the fiscal situation. First, deep reforms are needed to improve sustainability of the wage bill, including (a) development of a more performance-based civil service staff assessment, (b) alignment of the security sector staffing and skill-set with the actual needs, and (c) reduction of education sector staff to student ratio, as well doctor to patient ratio, closer to comparator countries. Second, the pension system could be reformed to (a) increase the retirement age, (b) tighten the criteria for disability and survivorship pensions, and (c) bring the pension level in line with international practices to make it affordable. Third, reforms in the health sector need to (a) strengthen prevention, (b) increase hospital capacity to improve investments in physical and human resources, and (c) reform the health financing system and institutions. Finally, net lending has resulted in unplanned subsidies of more than US$370 million per year (2 percent of GDP) to the Local Government Units (LGUs). Reform should, first, increase LGU revenues, second, strengthen governance of the electricity and water distribution services, and finally, reform the intergovernmental fiscal transfers system.

v. **There is also scope to further enhance revenue generation.** The general PA revenues (before grants) as a share of GDP in the Palestinian territories stood at around 23 percent in 2021, which compares well to other fragile countries at the same level of development. However, more can still be done. In addition to internal efforts to widen the tax base and improve administration, there is scope for cooperation between the GoI and PA to increase revenues. For example, granting Palestinian businesses access to Area C could potentially increase the PA's revenues by 6 percentage points of GDP, according to World Bank estimates. In addition, the Israeli civil administration, which already collects revenues from businesses operating in Area C, could transfer these funds to the PA. The PA's share of Allenby Bridge exit fees, which according to the Paris Protocol should be transferred monthly, could be enhanced and regularized. Renegotiating down the 3 percent handling fee charged by the GoI to handle Palestinian imports is also a priority. The recent implementation of a pilot for an e-VAT system on March 9, whereby traders are granted the option to voluntarily issue transaction receipts digitally, is an important step in the right direction for cooperation on fiscal matters. However, more is needed to further develop and consolidate the pilot so that both interfaces are linked in real-time.

vi. **These proposed reforms, while necessary and urgent, are not sufficient to allow the economy to reach its potential if the policy context under which the Palestinian economy operates does not improve significantly.** Growth in the Palestinian territories is projected to slow to 3.7 percent in 2022, returning to the growth performance of the pre-pandemic years. Economic growth matters not only for job creation, poverty reduction, and economic development, but it is one of the main ingredients to ensure a medium-term sustainable fiscal framework. In addition, given the importance of fiscal policy as the main macroeconomic policy for the Palestinian economy, support to maintain an adequate macroeconomic framework remains fundamental. The growth and development of the Palestinian economy is constrained by Israeli restrictions. Restrictions on movement and access by the GoI, including in Area C, affect Palestinian economic growth and depress the PA's revenue potential. External trade is controlled by Israel and subject to a range of costly non-tariff barriers that have reduced the competitiveness of Palestinian exports—one of the key potential drivers of growth—and contributed to a large external trade deficit. Israel's movement and access restrictions on Gaza has resulted in an almost closed economy, stifling the development of the Strip. In the short term, greater efforts from the international community to provide budget support are needed to manage the transition toward a more sustainable macroeconomic framework.

vii. **The PA's fiscal situation needs to be placed on a more sustainable path, as this will eventually result in a better and more efficient allocation of resources, positively affecting social**

conditions which have worsened due to the pandemic. In this AHLC report, a deep analysis of the impact of the COVID-19 pandemic on poverty in the West Bank and Gaza is conducted. The report shows that the pandemic had a severe impact on Palestinian livelihoods and the Palestinian economy. The effects have been aggravated by an already weak economy, which faced persistent fiscal deficits, high unemployment, rising poverty levels in Gaza, and declining levels of international support even before the pandemic. The report concludes that at the peak of the lockdown around 110,000 Palestinians entered poverty because of the pandemic. Most of those live in the West Bank, resulting in the emergence of newly poor Palestinians. Their characteristics differ significantly from the population that was poor before the pandemic in that they are more concentrated in the West Bank, are in rural areas, are more likely to have tertiary education, and are more likely to be living in female-headed households. In terms of employment, 2 in 10 previously employed main income earners lost their jobs, and income fell in more than 60 percent of Palestinian households. The report also shows that there is a broad vulnerability to food insecurity, which was a feature of the pandemic, even in relatively better-off households in the West Bank. Finally, children in the poorest households faced the biggest difficulties in accessing education during lockdowns, mainly because of a lack of internet connectivity.

viii. **Understanding where the most prevalent vulnerabilities lie, and how different groups are impacted by the pandemic, helps to identify how to build more resilient lives and livelihoods for Palestinians.** It is expected that in the future there will be more shocks to households, which may be the result of the next waves of a pandemic, the effects of climate change, or periods of conflict, including wars with global economic impacts such as the current Ukraine-Russian war. Systemic vulnerability will mean that each shock will meet a new group of households who become poor and food insecure, which is one the main concerns in the context of the current war in Ukraine. Consequently, to build more resilient lives and to better protect people and livelihoods, one critical element will be resuscitating economic activity to unlock the potential of a young workforce, with a focus on a more conducive environment for the private sector and entrepreneurship. In the medium to long term, policies will need to build resilience through boosting the productivity of the Palestinian economy, building a social protection system that is flexible and can target the most vulnerable, and setting up data and registration systems that are high quality and transparent. Finally, continuing to improve both the digital infrastructure and access to digital services, including the internet, remains an important contributor to resilience.

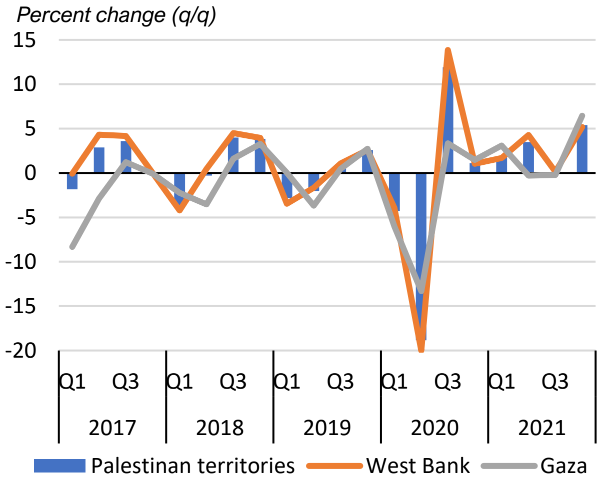
ix. **The main body of the report is organized in two chapters and one supporting annex.** Chapter I focuses on recent economic developments in the real, fiscal, and banking sectors while providing a near-term outlook that highlights critical challenges facing the Palestinian economy, in particular, the required fiscal reform. Chapter II outlines some of the key areas in which Palestinian lives have been impacted by the pandemic and its associated restrictions. It begins by describing the impact on money-metric poverty before taking a broader lens to focus on job losses, food insecurity, and access to education. It presents recommendations on how to use the crisis to address systemic vulnerabilities and help to build more resilient lives and livelihoods for Palestinians living in the West Bank and Gaza.

CHAPTER I: RECENT ECONOMIC DEVELOPMENTS

1- Economic Activity

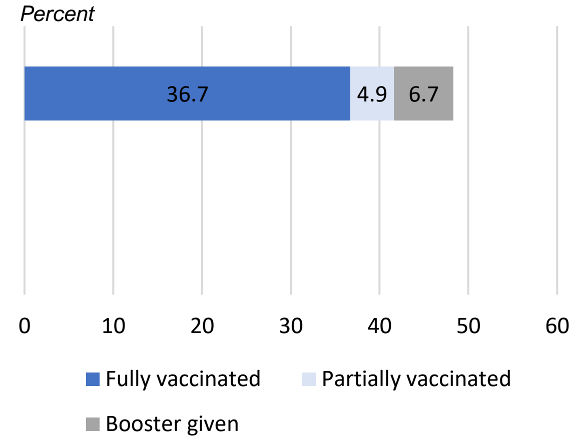
1. **In 2021, the Palestinian economy began recovering from the pandemic. Despite new waves of COVID-19 cases, lockdowns were significantly eased in 2021.** This, combined with the pickup of the vaccination campaign,[1] allowed consumer confidence to slowly improve and business activity to gradually rebound. Official data for 2021 shows that the real Gross Domestic Product (GDP) of the Palestinian economy grew by 7.1 percent, year-on-year (y-o-y), driven by the services and industry sectors (Table 2).

Figure 1: GDP growth in the Palestinian territories



Source: Palestinian Central Bureau of Statistics.

Figure 2: Percentage of vaccinated population, Palestinian territories (as of April 12, 2022)



Source: WHO 2019 Coronavirus Situation Report

2. **The year 2021 witnessed a significant regional disparity in economic activity between the West Bank and Gaza.** In the West Bank, the economy grew by 7.8 percent in 2021, mostly driven by consumption due to the ease of COVID-related measures and an increase in the number of Palestinians working in Israel and the settlements from 125,000 in 2020 to 153,000 in Q4 2021. The average daily wage of these workers is NIS269 - twice the average daily wage in the West Bank, implying a larger impact on demand. In Gaza, the conflict that took place in May 2021 negatively impacted economic activity and is estimated to have destroyed 2 percent of Gaza's capital stock. Gaza's real GDP growth is estimated at 3.4 percent in 2021, driven by an increase in public spending in Gaza, some reconstruction efforts, and the ease of COVID-19 related measures.

3. **Despite strong growth in 2021, the unemployment rate remained high mainly due to an increase in the labor market participation rate.** Even though the lockdowns were eased in 2021, the unemployment rate increased and reached 24.2 percent in Q4 2021 in the Palestinian territories - up from 23.4 percent in Q4 2020. The increase could be explained by a 3.2 percentage point rise in the participation rate between Q4 2020 and Q4 2021 as a higher number of men and women were encouraged to join the labor market with the improvement in economic conditions. The overall rate masks a wide regional divergence whereby unemployment in the West Bank reached 13.2 percent in Q4 2021 while in Gaza it was 44.7 percent, reflecting the effect of the 11-day conflict compounded with difficult COVID-19 conditions and the ongoing Israeli movement and access restrictions on Gaza.

[1] Figure 2 presents the vaccination rate as a share of the *overall* population. The official numbers indicate a higher vaccination rate as those are presented as part of the *eligible* population.

Table 1: Labor Market Statistics, Palestinian territories, Q4 2021

Indicator (%)	West Bank	Gaza	Palestinian territories
Unemployment rate	13.2	44.7	24.2
Labor force participation rate	46.4	40.0	44.0
Youth unemployment (15-29 yrs)	20.1	61.1	34.9
Male	15.6	56.1	29.8
Female	38.6	78.1	54.1

Source: Palestinian Central Bureau of Statistics.

4. **Inflation in the Palestinian territories turned positive in 2021, reflecting a gradual increase in demand and higher food and energy prices.** Growth in consumer prices had been modest before the outbreak of COVID-19, where prices generally moved in the 1-2 percent range. However, in April 2020, growth in prices turned negative and continued this trend throughout the year. In total, prices in 2020 were 0.7 percent lower than in 2019, reflecting weak demand by consumers. Consumer prices gradually increased in 2021, reflecting a pickup in demand as well as rising global food and energy prices. For the full year 2021, the consumer price index (CPI) rose by 1.2 percent, y-o-y. Price increases have continued in 2022 and the latest data for March shows that the CPI rose by 3.6 percent, y-o-y, mainly due to higher food prices.

5. **In line with the economic recovery, poverty is estimated to have slightly dropped in 2021, after peaking in 2020.** Based on the latest available official data, 22 percent of Palestinians lived below the US$5.5 2011 purchasing power parity (PPP) a day poverty line in 2016/17. In the West Bank, poverty rates are lower but sensitive to shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing. Estimates based on GDP per capita growth suggest that in 2020 the poverty rate spiked to 29.7 percent - an increase of nearly 8 percentage points from 2016. As the impact of the pandemic receded, the poverty rate is estimated to have declined to 27.3 percent in 2021. These poverty rates represent a poor population of about 1.5 million people.

Table 2: Palestinian territories macroeconomic indicators 2019-2022, (Annual percent changes unless indicated otherwise)

	2019	2020	2021	2022 f
Real GDP growth, at constant market prices	1.4	-11.3	7.1	3.7
Private Consumption	4.1	-13.1	6.3	4.2
Government Consumption	-3.5	0.3	11.1	-5.5
Gross Fixed Capital Investment	-2.6	-20.9	14.7	10.0
Exports, Goods and Services	2.0	-11.2	18.8	6.0
Imports, Goods and Services	1.4	-14.2	16.6	4.0
Real GDP growth, at constant factor prices	1.3	-12.0	6.2	3.7
Agriculture	0.9	-9.1	-2.3	3.0
Industry	-0.5	-19.4	6.2	3.5
Services	2.0	-10.0	7.2	3.8
Inflation (Consumer Price Index)	1.6	-0.7	1.2	2.8
Current Account Balance (% of GDP)	-10.4	-12.3	-8.2	-8.1
Net Foreign Direct Investment (% of GDP)	1.1	0.9	0.0	0.8

Source: Palestinian Central Bureau of Statistics and World Bank staff calculations.
Note: f: forecast.

Box 1: The impact of the Russia-Ukraine War on the Palestinian territories

While Russia and Ukraine are not significant trading partners for the Palestinian territories, re-exports of Russian and Ukrainian products from Israel are not insignificant. Russia accounts for 0.3 percent of goods imports to the Palestinian territories, while Ukraine accounts for 0.9 percent. Notably, though, one-third of the wheat imported into the West Bank and Gaza comes from Ukraine, along with 37 percent of imports of sunflower oil. Also, the Palestinian territories import 66 percent of wheat and flour from Israel which, in turn, imports 54 percent from Ukraine and Russia. This raises concerns regarding food security. The PA has recently announced, however, that it currently has three months' worth of stock of wheat and that wheat imports from Russia have already been resumed. The PA has also already instructed importers to find alternative sources for wheat.

Part of the impact of the conflict may be felt in the Palestinian territories through the negative commodity supply shock and subsequent inflationary pressures. Food is not subsidized in the Palestinian territories, and it is expected that the increase in commodity prices, especially for wheat, will be passed through to the consumer. To alleviate this effect, the PA announced that all packaged flour sales will be VAT-free for March, April, and May 2022. Slightly higher inflation projected in Israel in 2022 (from 2.8 percent in a pre-conflict scenario to 3 percent) may also be passed on to the Palestinian economy. This will happen at a time when inflation in the Palestinian territories has already started to pick up since January 2022 following the economic recovery and increased demand after the initial COVID-19 shock.

Fuel subsidies limit the pass-through of higher global oil prices to consumers but will add strain to an already tight budget. The PA purchases all its fuel from Israel at market prices and sells it to gas stations at a subsidized price and monitors consumer prices. As a result, the consumer price for fuel is expected to see little or no variation due to the conflict. In 2021, the fuel subsidy amounted to US$77 million, or 0.4 percent of GDP. The Ministry of Finance has recently stated that, given already rising inflation, it plans to continue subsidizing fuel prices amid the Russia-Ukraine war to protect consumer prices. Hence, the government's deficit is expected to widen as the subsidy is raised (see Table 3).

The crisis may have a positive impact on the Palestinian IT sector, while it may delay the recovery of the tourism sector. The Israeli hi-tech sector benefits from outsourcing to Ukraine. The crisis may result in the inability of Ukrainian IT firms to continue providing such services to the Israeli economy. This gap may be filled through outsourcing to Palestinian IT companies, especially as there has been a growing trend among Israeli IT companies in recent years to outsource to the Palestinian territories. With the ease in COVID-19-related measures and lockdowns, the Palestinian tourism sector was expected to rebound in 2022. This rebound, however, may be affected by the lack of Russian tourists, given that they represented the third largest portion of inbound visitors to the West Bank in years before the pandemic. The impact on GDP, however, will be limited as the IT and tourism sectors' combined contribution to GDP does not exceed 5 percent.

6. **The Palestinian economy is expected to continue its recovery in the coming period, albeit at a slower rate.** In 2022, growth for the Palestinian territories is projected to slow down to 3.7 percent as the low base effect weakens and fiscal consolidation continues. The ongoing Omicron variant COVID-19 wave may also pose additional risks. According to estimates, sufficient vaccine doses have either been secured or are in the pipeline, to meet vaccination needs up to mid-2022. Assuming the PA will further expand the vaccination campaign to cover a larger portion of the population, and lockdown measures will continue to be eased, private consumption and investment as primary engines of growth are projected to recover further, supported by improved consumer and business confidence. This will be aided by the increase in the number of Palestinian workers in Israel.[2] Over the medium term, however, sustainable sources of growth remain limited. Under a baseline scenario that assumes a continuation of the restrictions on movement and access, the persistence of the

[2] Recently and for the first time, a quota of 500 permits for Palestinian hi-tech workers was issued. Also, according to the GoI, a resolution was adopted by the Israeli cabinet on March 27, 2022, expanding the quota for workers from Gaza to 20,000 workers (the highest since 2007), of which 12,000 permits are in the construction sector and 8,000 in agriculture.

internal divide between the West Bank and Gaza, and stagnating aid levels, the growth of the Palestinian economy is expected to hover around 3 percent in 2023-2024, resulting in stagnating income levels, especially in Gaza.

7. **Downside risks remain elevated.** The Russia-Ukraine war may affect the outlook through mounting inflationary pressure and a widening of the PA's deficit as the fuel subsidy increases and as the PA has announced a VAT holiday on all packaged flour sales for three months. The inflationary pressure is compounded by extraordinarily high transaction costs and restrictions on access to alternative markets. The pandemic wave may also cause risks to the outlook, especially if no additional vaccines are secured beyond mid-2022. Further, if recent clashes between Palestinians and Israeli forces in the West Bank and Gaza escalate, and restrictions are imposed on the entrance of Palestinian workers to Israel, there is little room left to absorb such shocks.

2. Public Finance

a) Fiscal Performance in 2021

8. **In line with a rebound in economic activity, public revenues witnessed a significant boost in 2021.** According to data published by the Ministry of Finance (MoF), domestic tax collections grew by 28 percent in 2021, y-o-y. The increase was driven by income tax and value-added tax (VAT) collections which grew by 12 and 14 percent, respectively. Domestic customs collected on used cars also increased by 81 percent as consumers that had delayed such purchases in 2020, given the closures and the perceived uncertainty, proceeded in 2021. Also, excise on tobacco increased by 18 percent in 2021, y-o-y, as the closure of the border with Jordan eliminated tobacco smuggling, resulting in higher public revenues. However, non-tax revenues grew by 2 percent only in 2021 due to a decline in investment profits by 98 percent, as the PA barely received any investment profits from the Palestine Investment Fund in 2021, compared to NIS95 million in the same period in 2020. On the other hand, domestic fees and charges increased by 10 percent in 2021 following the receipt of around NIS110 million in license payments from telecoms providers.

9. **Clearance revenue transfers[3] stabilized, and increased by 12 percent in 2021, y-o-y, despite higher deductions by the GoI.** The GoI increased monthly deductions from NIS42 million to NIS50 million from April 2021 to account for some of the payments made by the PA to Palestinian prisoners in Israeli prisons, ex-prisoners, and families of those deceased as a result of violence. Deductions were further increased to NIS100 million in August 2021 to offset payments made by the PA in 2020 that were not deducted by the GoI at the time.[4] The monthly deductions were subsequently reduced back to NIS50 million in 2022. Despite the additional unilateral deductions in 2021, clearance revenues' growth in 2021 remained strong. It was mainly attributed to higher customs collections due to Palestinian importers purchasing three months' worth of stock of raw tobacco from third countries in May, to avoid any future import delays related to the GoI changing its tobacco packaging laws. Petroleum excise also increased due to higher imported quantities compared to the same period in the previous year in line with the rebound in economic activity. Notably, income tax collected by the GoI from Palestinian workers in Israel and the settlements increased by 241 percent y-o-y and amounted to NIS260 million in 2021, reflecting a decision by the GoI to increase the number of work permits granted to Palestinians.

10. **Growth in recurrent public spending was limited to 2 percent in 2021, y-o-y, as increases in certain spending items were offset by a strong drop in transfers.** Government transfers declined by 25 percent as the PA disbursed fewer payments through the National Cash Transfer Program

[3] Clearance revenues are mostly VAT and import duties collected by the GoI on behalf of the PA and should be transferred on a monthly basis, according to the Paris Protocol.
[4] To clarify, the GoI stopped (or paused) making deductions from PA clearance revenues in 2020, and then the GoI doubled the deduction amount in mid-2021 to compensate for that lack of deductions in 2020.

(NCTP) in 2021 compared to the previous year. The strong decline in transfers offset the increase in other spending items. Mainly, the wage bill rose by 13 percent in 2021, y-o-y, due to the PA's decision to reinstate the wages of public employees in Gaza to 100 percent since March 2021, up from 70 percent in the past several years. Spending on goods and services increased by 15 percent in 2021, reflecting additional expenses associated with the return of public employees to their duty stations and to normal working hours compared to 2020, in addition to higher spending on vaccines and medical supplies. Also, net lending reflecting unplanned subsidies to Local Government Units (LGUs) covering utility bills to Israeli suppliers increased by 4 percent in 2021.

11. **Given strong revenues and low expenditure growth, the PA's deficit declined significantly in 2021, but financing remained very tight due to low aid.** The total deficit (before grants) amounted to US$1.26 billion in 2021 – a 28 percent decrease relative to a peak in 2021 due to COVID-19.[5] Donor financing was US$317 million (US$186 million in budget support and US$131 million for investment projects). Budget support was only half of what was received in 2020. This drop is attributed to the absence of funding from Gulf Cooperation Council (GCC) countries, lower contributions by donor countries to the World Bank's Multi-Donor Trust Fund, and a delay in the European Union's contribution, which is now expected to be disbursed in 2022. Given the decline in external financing, the PA faced a large financing need of US$940 million in 2021. Despite an advance payment on clearance revenues of US$153 million (NIS500 million) from the GoI in September 2021, which provided some relief, the financing need remained large. The PA, therefore, had to reduce salary payments by 20-25 percent in November and December 2021, while protecting the lowest earners, accruing arrears to public employees. Further, the PA relied on arrears to the private sector, the pension fund, and on domestic borrowing to make ends meet. Even though comprehensive data on arrears is not available, data from the MoF suggest that the stock of arrears accumulated to the private sector over the years is around US$975 million, while arrears to the pension fund are estimated at about US$3 billion as of end-2021. The large stock of arrears causes a risk to the macroeconomic stability as it pulls out liquidity from the market and can eventually also negatively impact the banking sector. The stock of debt from the domestic banking sector increased from US$2.3 billion as of December 2020, to US$2.5 billion as of December 2021.

b) 2022 Budget

12. **According to the PA's 2022 budget, the size of the financing gap will decline.** The budget projects a 13 percent increase in revenues due to an improvement in domestic and clearance revenues. On the expenditure side, the PA's budget assumes a 2.4 percent decline in 2022 mostly due to a steep drop of 21 percent in net lending. The recurrent deficit is projected to reach US$352 million, while development expenditures are expected to total US$763 million, leading to a total deficit of US$1.12 billion. The budget assumes that aid will amount to US$550 million (US$250 million in budget support and US$300 million in development financing), resulting in a financing gap of US$565 million. Notably, the budget assumes that the net accumulation of arrears in 2022 will be zero.

13. **World Bank estimates indicate a larger financing gap.** Revenue growth in the budget may be too optimistic and the Bank expects the fuel subsidy (a negative revenue item) to widen in 2022 given the PA's announcement to continue subsidizing fuel during the Ukraine/Russia war. On the expenditure side, the World Bank estimates the wage bill to decline (on a cash basis) given the PA's decision to pay partial salaries in 2022. Most other spending categories including goods and services, transfers and net lending are expected to grow. Hence, the World Bank estimates the PA's spending to slightly increase, y-o-y, in 2022. Based on previous years' trends, development spending may be lower than assumed by the budget. Put together, this will result in a deficit of US$984 million (5.1 percent of GDP). Aid inflows are projected to reach US$345 million (US$214

[5] The increase is calculated in NIS terms to avoid the impact of the USD/NIS exchange rate.

million in budget support and US$131 million in development financing) - lower than expected by the PA, resulting in a financing gap of US$639 million. Unilateral deductions by the GoI from clearance revenues are expected to reach US$292 million in 2022, further widening the gap to US$931 million.

Table 3: Palestinian territories Fiscal Operations, 2021 – 2022

US$ million		Budget	WB Est.
	2021	2022	
Net revenues	4,234	4,771	4,568
Gross revenues	4,417	4,954	4,772
Tax refunds	-183	-183	-204
Recurrent expenditure	5,250	5,123	5,312
Wage bill1/	2,636	2,553	2,445
Goods and services	805	739	848
Transfers	1,138	1,166	1,323
Interest	124	150	131
Minor capital	33	67	34
Earmarked spending	141	152	157
Net lending	373	295	373
Recurrent balance	-1,016	-352	-743
Development expenditure	241	763	241
Total balance	-1,257	-1,115	-984
Financing	1,257	1,115	984
Budget support	186	250	214
Development financing	131	300	131
Clearance revenue deductions	-104	__	-292
Other	1045		
Gap	0	565	931

Note: 1/ World Bank 2022 estimation of the wage bill is cash based.

c) The Road to Sustainability

14. **The PA has managed an impressive degree of fiscal consolidation over the years despite the challenging environment.** While the multi-layered system of restrictions imposed by the GoI and the internal divide have clearly been the most significant impediments for the PA to boost economic growth and achieve fiscal sustainability, the PA has pressed on with efforts within its control to strengthen its fiscal position. Between 2006 and 2021, the relative size of the PA's total fiscal deficit (before grants) fell from 21 percent of GDP to around 7 percent—an impressive achievement.

15. **However, the size of the deficit has remained large and since the options for additional domestic financing are no longer possible, and aid has been on a declining trend, pressing on with priority reforms is crucial.** Otherwise, the continual provision of quality public services will be constrained. The reform measures briefly described in this section focus on the fiscal sector. Other reforms by the PA, including to improve the business environment and to strengthen transparency and accountability, are also key but are not the focus of this report. Reforms included here are considered important for further strengthening the PA's fiscal position, and thus warrant continual efforts by the PA and support from the international community. Additionally, cooperation by the GoI is essential to ensure that the reforms reach their potential.

Expected Increases in Revenues

16. **Despite the PA's efforts over recent years to increase revenues, amounts generated continue to be lower than their potential.** The central government revenues (before grants) as a share of GDP in the Palestinian territories stood at around 23 percent of GDP in 2021, which compares well to other fragile countries at the same level of development. However, more can be done. The lower-than-potential collections are partly related to the internal divide, which prohibits the PA from

collecting taxes in Gaza. Also, reforms are needed to widen the tax base as only 30 percent of those that need to pay taxes do. The PA has already intensified efforts to increase the number of registered taxpayers in the West Bank, which is a highly commendable step. However, more needs to be done to cover high earning professionals such as doctors, lawyers, engineers, etc. Tax enforcement should be improved through capacity building of the Large Taxpayer Unit (LTU) to strengthen targeted audit activity and dispute management capacity. Furthermore, legislation must be strengthened to penalize non-payers. Another important area of reform is the very small amount of revenues collected by local governments. Inadequate municipal revenues contribute to the PA's deficit by increasing the need to finance local government operations through transfers. Encouragingly, the MoF has recently prepared a three-year revenue strategy (2022-2024) that focuses on tax administration and improving compliance. Progress has also been made on updating public fees and charges with a notable decision to increase the license fee for petrol stations.

17. **Cooperation by the GoI could provide a significant boost to the PA's revenues.** Lack of Palestinian access to Area C contributes to the PA's lower-than-potential revenue. The World Bank estimates that granting Palestinian businesses access to Area C would boost the Palestinian economy by about a third and increase the PA's revenues by 6 percentage points of GDP.[6] Aside from access to Area C, the 1995 interim agreement states that the Israeli civil administration is expected to collect revenues from businesses operating in Area C and remit them to the PA.[7] The PA and GoI disagree over Israel's transfer of these collected revenues to the PA, and Israel's retention of Allenby Bridge [8] exit fees that would be transferred to the PA, according to the Paris Protocol.[9] Recent news about the parties reaching an understanding to implement an e-VAT system and moving ahead with a pilot on March 9, whereby traders on both sides are granted the option to voluntarily issue transaction receipts digitally, is encouraging. This could be a first step toward eventually fully linking the interfaces of both authorities to exchange real-time information on all purchases being made as this will significantly reduce VAT leakage. Furthermore, renegotiating down the 3 percent handling fee charged by the GoI to handle Palestinian imports, and removing this fee on fuel imports, could further mitigate the PA's trade-related fiscal losses. The 3 percent fee, as was set out in the Paris Protocol, has proven to finance a larger part of the Israeli customs and VAT department's total budget compared to the share of Palestinian imports out of total imports handled by this department.[10]

Improving Expenditure Efficiency

18. **On the expenditure side, the fairness, effectiveness, and efficiency of public spending needs to be improved in the following areas:**

    a) ***The Wage Bill.*** The relative size of the wage bill stood at 14.9 percent of GDP in 2021. The wage bill represents more than half of the PA's spending and consumes 60 percent of its revenues. Once semi-wages (including pension and social assistance payments) are added, both wages and semi-wages represent almost 100 percent of the PA's revenues. Deep reforms are needed to put this spending category on a more sustainable path. The PA implements an annual mandatory step increase of 1.25 percent, in addition to about 3-4 percent in other automatic increases. This implies a regular increase in the wage bill at an unsustainable rate. Because of automatic promotions, the PA has ended up with a top-heavy grading structure, with more staff

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[6] Area C and the Future of The Palestinian Economy. The World Bank, 2014.

[7] See Annex III, Appendix I, Article 8, Paragraph 2 (a), 2(b) and Article 18, Paragraph (4) of the Interim Agreement on the West Bank and the Gaza Strip, Washington, D.C., September 28, 1995 (the Interim Agreement).

[8] Allenby Bridge is a crossing that crosses the Jordan River near the city of Jericho and connects the West Bank with Jordan.

[9] See Section G of Appendix 5 to Annex I of the Interim Agreement.

[10] Previous analysis by the World Bank concluded that the 3 percent fee could be reduced to 0.6 percent to become commensurate with the share of Palestinian imports in total imports handled by the Israeli customs and VAT department.

at senior levels than in other countries. The evaluation system of civil servants is not well regarded by staff as it does not reward performance, and promotion is largely based on seniority. Therefore, the PA may proceed with the development and roll-out of a more performance-based annual staff assessment. The PA's security sector is very large by global standards (at almost 10 personnel per 1,000 inhabitants, compared with a global average of some 4.5/1,000). Aligning staff numbers and skills to the security needs of the Palestinian territories would allow these needs to be met at much lower cost. In addition, both the health and education sectors have larger numbers of staff than other countries in the region, and other lower middle-income countries. Schools run by the United Nations Relief and Works Agency (UNRWA) employ fewer teachers per pupil and have significantly larger class sizes but outperform PA schools on standardized tests.[11] Both the West Bank and Gaza have higher doctor-patient ratios than comparator countries across the region. Again, the outcome is much higher costs for the health and education services delivered. Given this, the PA may undertake a functional review of the overall machinery of government to better align mandates, structures, and staffing. Actions required to improve the civil service system are extensive and wide ranging. Therefore, strong leadership and dedicated management over a number of years are warranted if it is to succeed.

b) ***The Public Pension System.*** Public pension expenditures in the Palestinian territories are considered high, at 3 percent of GDP, given the territories' demographic profile. The transfers required to service the system confront the PA with an enormous fiscal burden, which it is failing to meet, forcing it to accumulate large arrears to the pension fund. The system provides extremely generous benefit formulae, with payment rates of up to 100 percent of final salary, especially in the security sector. The combination of high benefits and low coverage raises important equity concerns. The system is expected to cease to pay for itself in several years if present management practice continues. Restoring the Palestinian pension system's sustainability requires adjustments to consolidate the currently fragmented pension system and make the system not only, *de facto*, pay-as-you go, but also, *de jure*, by changing the pension law to: i) increase the retirement age; ii) tighten the criteria for disability and survivorship pensions; and iii) bring the pension level in line with international practices to make it affordable. According to preliminary Bank estimates dating back several years, the proposed measures may lead to accumulated savings of around NIS130 million in the first three years of implementation. Estimates also indicate that the reduction in expenditure will be even higher in the following years. Such a reduction in pension liabilities will reduce the burden on the public budget and release funds that can be used to support social programs with a high redistributive impact.

c) ***The Health Sector.*** Public health spending has been on the rise, and it stood at 4 percent of GDP in 2021. At the same time, the quality of public healthcare has not substantially improved. Almost 90 percent of the government's health budget is devoted to curative care, leaving primary and preventive care underfunded. Almost 60 percent of the Ministry of Health's budget is spent on salaries and around 90 percent of the non-salary recurrent expenditure goes to outside medical referrals (OMRs) and pharmaceuticals. The total spent on OMRs grew from US$179 million to US$255 million between 2013 and 2019. However, the annual growth rate decreased from 11.7 percent in 2013 to 5.4 percent in 2019, marking a containment in the growth of OMR expenditures. Nevertheless, this category of spending continues to pose a burden on the PA's finances. A World Bank study on OMRs showed the need for standardization of clinical guidelines, prices, and medicine lists and contracts across referral receiving hospitals, along with a phased implementation of an OMR localization plan. It is also important to reform the extremely generous Government Health Insurance (GHI) system, as it remains the main source of hemorrhage. The financial sustainability of the GHI scheme is a

[11] Public Expenditure Review of the Palestinian Authority: Towards Enhanced Public Finance Management and Improved Fiscal Sustainability. World Bank, 2016.

key challenge; it operates at loss and only leverages around 10 percent of total health expenditures, resulting in significant budget gaps and huge arrears. Additionally, COVID-19 continues to pose a high risk of morbidity and mortality, not only through its direct effects but also through the indirect effects of the burden imposed on the health system. The financial and service delivery challenges faced by the health system are interlinked, and attributable to the fragmented and inefficient manner in which chronic diseases are controlled. A system-wide reform is needed across three pillars: i) strengthening family health, to provide comprehensive, continuous, cooperative, and personal services for the family, which would focus on prevention and management of cases at the primary level, therefore reducing costs and improving quality; ii) strengthening hospital capacity to improve investments in physical and human resources, with the intention of reducing future costs per patient and improving the quality of care; and iii) reforming the health financing system and institutions, both specifically for OMR through standardizing processes and guidelines, as well as for strengthening revenue raising, pooling, purchasing, and benefits package arrangements.

d) ***Net lending*****.** Net lending has resulted in unplanned subsidies that have become one of the thorniest fiscal issues facing the PA. To a significant extent, LGUs finance their operating budgets by selling electricity, water, and other utility services provided to them by Israeli companies, leaving the PA to repay some or all of the costs, as those are then deducted by Israel from revenues it collects on behalf of the PA (clearance revenues). As a result, the PA is providing unplanned subsidies of more than US$370 million per year (2 percent of GDP) to the LGUs. Reducing this drain on the PA budget will require steps in two directions: first, reforms that will increase own-source LGU revenues, and second, the commercialization of electricity and water distribution services as utility management requires skills and governance structures not generally found in local governments. Resolving the net lending problem will also need to include a reform of the intergovernmental fiscal transfers system. Cooperation by the GoI on better transparency regarding deductions made from clearance revenues to offset dues owed by Palestinian LGUs to Israeli service providers is also important.

19. Pressing on with reforms both on the revenue and expenditure sides is crucial for the sustainability of the fiscal position but needs to be carried out gradually to avoid social implications. Given the importance of fiscal multipliers in the Palestinian context and the role that public spending plays in driving the economy, implementing fiscal reforms needs to be paced gradually and in a way that does not adversely affect growth nor social conditions, especially in the post-pandemic context. For example, revenue reforms should initially focus on high earners, including professionals and large taxpayers, that are not paying their dues fully. On the expenditure side, some of the savings made from rationalizing spending on the wage bill, for instance, could be redirected toward social spending, especially as social conditions have worsened following the pandemic (see chapter 2). Fiscal reforms are eventually expected to result in a better and more efficient allocation of resources, benefiting the poor.

20. It is important to note that efforts by the PA are necessary to improve the fiscal position, but they are not sufficient to put the Palestinian territories on a sustainable development path. The reforms explained above will help reduce the size of the fiscal deficit. Even with PA measures to improve the business environment and transparency, those will not allow the economy to reach its potential. Previous work by the World Bank[12] has shown that restrictions on movement and access in the West Bank and Gaza continue to be the main impediments to growth and private sector development. Hence, without progress on alleviating these challenges, the economy of the Palestinian territories will continue to operate below potential.

[12] Prospects for Growth and Jobs in the Palestinian Economy: A General Equilibrium Analysis, 2017.

3. Money and Banking

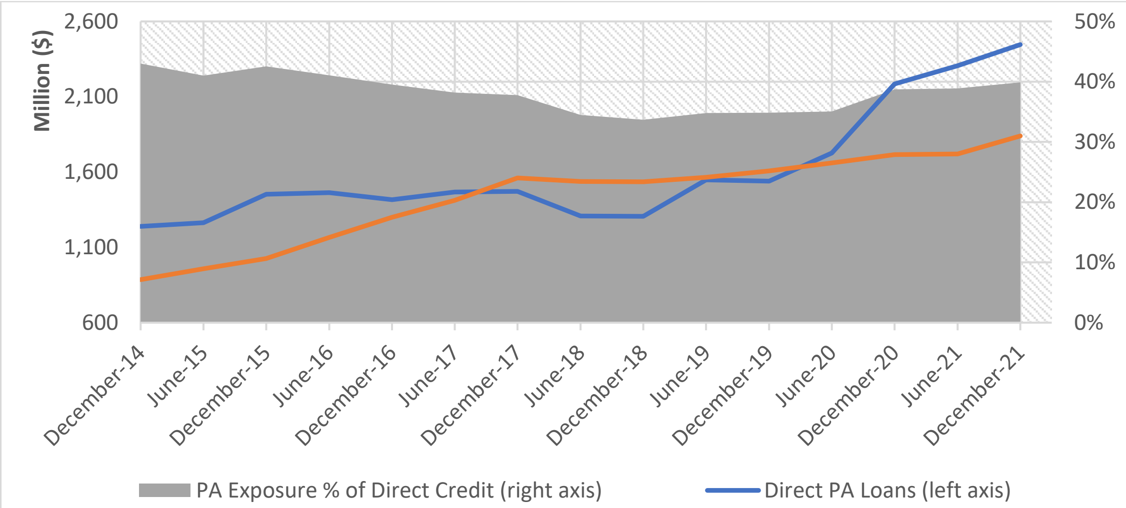
21. **The financial sector in the West Bank and Gaza is relatively young and remains dominated by banking activities.** It is regulated by the PMA and the Palestine Capital Markets Authority. A large proportion of transactions are made in cash, but regulators have prioritized digital finance in recent years, resulting in the introduction of new market players and the emergence of a small but growing market for digital financial services. Properly and proactively managing the balance of financial stability, integrity, and inclusion is critical given the context of instability and fragility.

22. **Despite growing risks and some deterioration in performance indicators, the banking system remains relatively stable against the backdrop of a declining macro-fiscal performance.** But to avoid further destabilization, financial sector regulators should emphasize the importance of safeguarding the banking system against emerging and protracted economic shocks. All banks are well capitalized and are compliant with the basic Capital Adequacy Requirements set by the PMA (in line with Basel III). The capital adequacy for all banks stands at 16.1%. According to preliminary reporting by the PMA through December 2021, total banking system assets exceeded US$20 billion during the reporting period. After a decline during 2020, banking sector profitability continued to recover by the end of 2021. Return on equity rebounded to 15.1 percent, an improvement compared to 2020 levels (9.4 percent) and in line with pre-COVID levels of 12.8 (2019) and 15.3 percent (2018). Return on assets registered a similar trend, reaching 1.2 percent in 2021, an improvement compared to 0.9 percent (2020), and approaching pre-COVID levels, 1.25 (2019) and 1.55 percent (2018). The growth in deposits during 2021 exceeded growth in credit when compared to the same reporting period in 2020, resulting in a continued decline in the overall credit-to-deposit ratio, down to 65 percent in 2021, compared to 70 percent in Q2 2020.

23. **With declining financing and rising fiscal imbalances, the PA has significantly increased borrowing from domestic banks, potentially generating new stability risks for the banking system, and raising concerns regarding the PMA's operational independence.** Following a few years of relative stability in the level of domestic public debt (about US$1.3-1.4 billion), the banking system's exposure to the public sector (through domestic public debt) increased steadily in 2020, reaching US$2.5 billion by December 2021 (23 percent of total direct credit), and exceeding PMA exposure limits by 15 percent. In addition to direct borrowing by the PA, bank loans to PA employees (backed by future salaries) also represent an indirect channel of exposure to the public sector, along with the expanded usage of promissory notes. When combined, PA and public employees account for about US$4.3 billion, or 40 percent of total banking sector credits. To avoid further destabilization, financial sector regulators should emphasize the importance of safeguarding the banking system against emerging and protracted economic shocks. This growing PA reliance on domestic bank borrowing raises concerns about the operational independence of the PMA, especially on matters pertaining to prudential supervision.

24. **Given the sustained fiscal imbalances and limited donor assistance, Palestinian policymakers should carefully balance fiscal, monetary, and financial considerations and interrelations.** The independence of the PMA, as supervisor and prudential regulator of the banking system, should be respected and upheld. This principle is especially critical during times of economic distress, where the financial system is critical in mitigating the impact of this shock, but if not managed effectively, could also create an additional source of instability - if the current accumulation of risks is not effectively managed. In light of the growing fiscal challenges faced by the PA over the past decade, the banking system's rising direct and indirect exposure to the public sector continues to be a cause of unease and needs to be actively managed to maintain depositor confidence.

Figure 3: Direct and Indirect Exposure to the PA (US$ million)

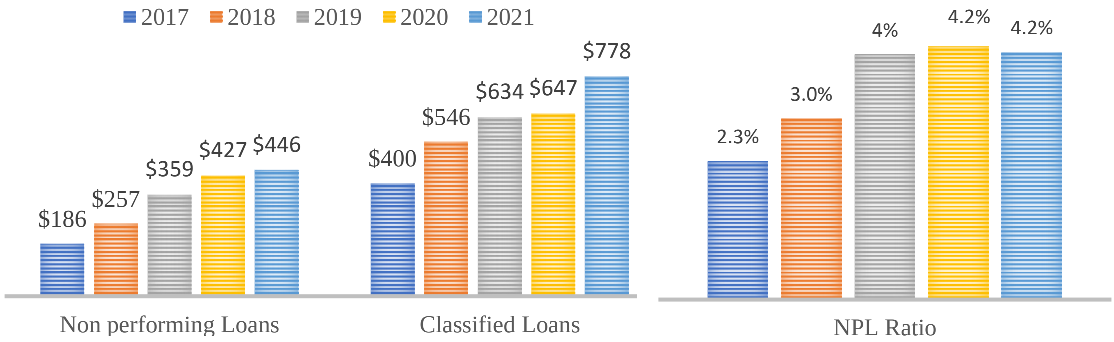


Source: Palestine Monetary Authority.

25. **The protracted crises and the PA's decision to only pay partial salaries have gradually deteriorated the quality of loan portfolios across the banking and microfinance sectors, and further deterioration is likely.** Both non-performing loans (NPLs) and classified loans have maintained an upward trajectory since 2018.[13] The NPL ratio (which represents the percentage of NPLs out of all direct loans and is a lagging indicator) stands at about 4.2 percent as of December 2021. While this appears manageable given the context, discussions with several local banks indicated that NPLs are concentrated in critical portfolios (e.g., SMEs), and that aggregate NPL indicators are likely underestimated as a result of regulatory forbearance measures applied in recent years. The expected further deterioration in the quality of SME, consumer, and Gaza loan portfolios could translate into higher NPLs, particularly in banks with substantial exposure to Gaza, SMEs, and PA employees.

[13] It is worth noting that some of the banking sector indicators have been impacted by the adoption of IFRS9.

Figure 4: Growth in non-performing and classified loans (US$ million & % of gross loans)



Source: Palestine Monetary Authority.

26. **Recognizing that the two economies are highly interlinked, the stability of cross-border payments remains a cause for concern due to the potential negative impact of de-risking by Israeli banks.** Payment activity between Israel and the West Bank and Gaza has an estimated yearly value of more than NIS44 billion. In recent years, Israeli banks have signaled plans to limit or terminate correspondent banking services to Palestinian banks citing money-laundering and financing of terrorism concerns. Termination of correspondent banking relationships (CBRs) is likely to have significant economic impact on the Palestinian economy, due to Israel being its primary trade partner, and the reliance on the Israeli Shekel as the primary currency in the cash-based Palestinian economy. An example of this is the current complexity associated with the repatriation of NIS cash from Palestinian banks to Israel, contributing to the accumulation of excess NIS liquidity in Palestinian banks.[14] The first external evaluation of the AML/CFT regime is currently scheduled to take place during August 2022 by the regional Financial Action Task Force (MENAFATF). This AML/CFT "mutual evaluation" is a standard condition for membership and was initially planned for 2020 but postponed due to the pandemic. In 2017, the GoI approved a temporary indemnity and immunity package for Israeli banks working with Palestinian banks, thereby taking on part of the risks, to alleviate the potential for immediate disruptions to CBRs between the two banking systems. The GoI repeatedly extended this temporary package, most recently until July 2022, while a more stable arrangement for cross-border payments is developing by the PMA and the Bank of Israel, but progress has been slow and should be accelerated.

27. **The PMA has been taking steps toward advancing financial inclusion, digital payments, and upgrading financial infrastructure:**

- As part of its effort to modernize its financial infrastructure, the PMA recently operationalized the Electronic Cheque Clearance system (ECC), replacing traditional physical movement of paper cheques with an image-based cheque settlement and clearing system, reducing time required to clear cheques from three-four days to one day. Additionally, the PMA recently conducted an upgrade to the National Payment Switch and started to use it to process Point-of-Sale (PoS) domestic transactions using debit and prepaid cards (along with the existing ATM transactions processing) thereby reducing fees for merchants when accepting card payments. Furthermore, the PMA is making progress toward implementation of the Fast Payment System (FPS), which includes technical features such as the instant crediting of the payee account, the 24/7/365 availability, and other overlay services that will further help the transition to digital payments across different use cases.

[14] Banks in the West Bank and Gaza are having to manage large amounts of excess cash due to limits on the amount of cash which can be shipped to Israel.

- Five recently established payment service providers are now offering payment services in Palestine, primarily through e-wallet-based payment services. As of December 2021, a total of 234,083 e-wallets have been issued with a stored value of US$2.5 million. About 26 percent of these have been issued to women.
- Eight microfinance institutions currently deliver microlending services to 65,000 clients, 35 percent of which are women. The size of the microfinance sector - both in terms of number of borrowers and outstanding portfolio - has been shrinking due to repeated economic shocks in recent years. The size of the sector is currently reported at US$247 million (across 65,000 borrowers) compared to US$270 million (across 90,000 borrowers) in 2018.

Chapter II: The Impact of the COVID-19 Pandemic on Poverty: Toward a More Resilient Future

28. **The COVID-19 pandemic has had a severe impact on Palestinian livelihoods, and on the Palestinian economy.** The effects have been aggravated by an already weak economy, which faced persistent fiscal deficits, high unemployment, rising poverty levels in Gaza, and declining levels of international support even before the pandemic. Against this backdrop, chapter 1 provided recommendations that could place the fiscal position on a more sustainable path, resulting in a better allocation of resources, including on social spending. In this context, this chapter focuses on how people and households in the West Bank and Gaza have been impacted by the pandemic, especially in terms of income and employment, as this is critical to design and adopt policies that can help build more resilient Palestinian lives and livelihoods.

Box 2: How were the pandemic's impacts on poverty simulated?

To assess how COVID-19, the economic downturn, and lockdowns have affected the welfare of households in the West Bank and Gaza the analysis relies mostly on microdata collected before and after the pandemic. The simulations take advantage of two recent sources of information on employment and wage income: the quarterly labor force survey collected by the Palestinian Central Bureau of Statistics (PCBS), and the rapid assessment phone survey conducted by PCBS, the World Bank, the United Nations Development Programme of Assistance to the Palestinian People, and other UN agencies (UN Women, United Nations Population Fund, United Nations Children's Fund, the World Health Organization, and the World Food Programme). It draws on behavioral models that predict households' likelihood of experiencing income and employment shocks. It also accounts not only for government and nongovernment responses to the economic downturn but also estimated remittance flows. These changes are simulated onto the PECS 2016/17 to estimate the change in income, consumption, poverty rate, and inequality. A fuller description of the model and the techniques used can be found in Gansey et al. (2021).

a) The Impact of the Pandemic on Poverty[15]

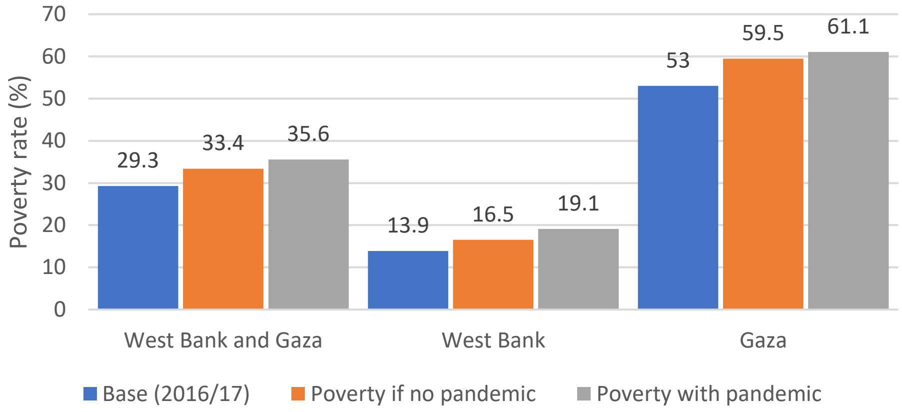
29. **The disruption caused by the pandemic has come at a time when living conditions, particularly for those living in Gaza, have been declining.** The latest poverty figures in the Palestinian Expenditure and Consumption Survey (PECS 2016/17) showed 29.3 percent of the population living on the national poverty line. However, the national number masks the diverging situation between the West Bank and Gaza, where poverty rates stood at 13.9 percent and 53.0 percent, respectively. The situation is worse for refugee-headed households and those living in refugee camps. Moreover, in 2019, the West Bank and Gaza had very low labor force participation rates (about 37 percent) and low employment rates (about 28 percent of the working-age population), with a large youth population badly in need of jobs.

30. **Simulations of the impact of the pandemic suggest that the increase in poverty was as large a change as 33.4 percent to 35.6 percent of the population.** This took place in a very short time and represents pushing more than 110,000 Palestinians into poverty as a result of COVID-19 alone. As shown in the figure below, even before the pandemic, poverty had increased between 2016 and

[15] The analysis and discussion presented in this chapter are largely based on Gansey, R., Aghajanian, A., & Al-Saleh, J. (2021), and Becerra, P., Malasquez, E., & Al-Saleh. J. (2021), both of which appear as chapters in Hoogeveen, H. & Lopez-Acevedo (2021). Distributional Impacts of COVID-19 in the Middle East and North Africa Region. MENA Development Report;. Washington, DC: World Bank. © World Bank. https://openknowledge.worldbank.org/handle/10986/36618 License: CC BY 3.0 IGO.

2019, with simulated poverty rates for the West Bank and Gaza rising from 29.3 to 33.4 percent. Gaza experienced a sharper increase in poverty (from 53.0 to 59.4 percent) than the West Bank (from 13.9 to 16.4 percent) before the onset of the pandemic. The simulated poverty impact of the pandemic shows that since its onset, the poverty rate in the West Bank and Gaza rose by 2.2 percentage points to reach 35.6 percent, the equivalent of more than 110,000 newly poor Palestinians. The increase is apparent in both the West Bank (from 16.4 to 19.1 percent) and in Gaza (from 59.4 to 61.1 percent).

Figure 5: Poverty rates by location with simulations for impact of the pandemic



Source: World Bank calculations and simulations based on PECS (2016/2017) and Labor Force Surveys (2016, 2019, 2020).

Box 3: The West Bank and Gaza in regional context: The effects of the pandemic on poverty and inequality

	Tunisia	West Bank and Gaza	Lebanon
Survey year	2015	2016/17	2015/16
Baseline poverty	15.2%	29.3%	27.4%
Poverty impacts of pandemic	Projected to rise by 7.3 percentage points, to 22.5 percent (optimistic scenario), and by 11.9 points, to 27.1 percent (pessimistic scenario).	Projected to rise to 34.9 percent. For Gaza the change is from 53 percent to 59.2 percent. For the West Bank the change is from 13.9 percent to 19.2 percent.	For nationals, poverty is projected to increase by 18 percentage points. The increase for refugees is even larger than this.
Inequality impacts of the pandemic	Gini index rises from 37 to 29 (optimistic) and to 41.4 (pessimistic).	Gini index rises from 33 to 34.	Not available.

Source: Reproduced from Table 0.1 in Hoogeveen and Lopez-Acevedo (2021).

b) The Newly Poor

31. **The analysis of data from the West Bank and Gaza suggests that rather than only reinforcing previous vulnerabilities, the pandemic has led to the emergence of a substantial number of newly poor Palestinians, and that these people are predominantly located in the West Bank.** The new poor appear to be different from the traditionally poor in several ways, as shown in the table below. The first column of the table gives the population shares for different characteristics such as location, level of education, and whether the household is headed by a male or female. The second column shows the share of the poor population for these characteristics before the pandemic. So, for example, before the pandemic 60.7 percent of the population lived in the West Bank, but only 28.7 percent of the poor lived in the West Bank. Finally, the third column shows the proportion of the newly poor in each category. The analysis shows that although the poverty rate in Gaza was far higher than in the West Bank before the pandemic, the majority of those who became poor during the pandemic live in the West Bank rather than in Gaza. The newly poor are also much more likely to live in rural areas than in camps. They appear to mostly come from either end of the distribution of education; in other words, they are more likely to hold either no education or secondary or tertiary education.

32. **The newly poor are more likely to live in a female-headed household.** Only a small percentage of households in the West Bank and Gaza are headed by a woman, and even before the pandemic these households were more likely to be poor than male-headed households. Even though female-headed households make up only 6.1 percent of households in the West Bank and Gaza, they make up around 10.6 percent of the newly poor. At the height of the pandemic around 6 in 10 households which had a woman as the main income earner had seen a reduction of cessation in wage income.

Table 4: Characteristics of the newly poor

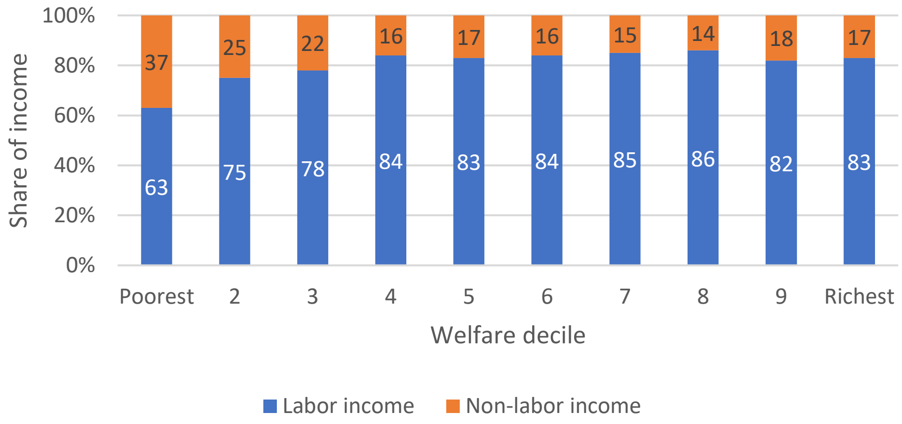
Location	**Share of population**	**Share of poor pre-pandemic**	**Share of newly poor**
West Bank	60.7	28.7	64.8
Gaza	39.3	71.3	35.2
Rural	16.8	10.8	16.7
Urban	73.0	73.4	72.8
Camp	10.2	15.8	10.5
Education			
No education	2.9	4.3	4.4
Primary	17.8	24.2	18.5
Secondary	57.4	60.2	52.1
Tertiary	21.9	11.3	25.0
Gender of household head			
Male	93.9	93.6	89.4
Female	6.1	6.4	10.6

Source: World Bank calculations and poverty projections.
Note: A full discussion of these results and other characteristics associated with newly poor households and individuals in the West Bank and Gaza can be found in Becerra et al. (2021).

c) The Impact on Income and Jobs

33. **The impact of the pandemic on households may vary greatly depending on the shares of labor income and non-labor income in total household income.** In the West Bank and Gaza, the poorest deciles are more likely to be affected by changes in non-labor income (in the form of governmental and nongovernmental aid). This can be seen in the figure below. The bottom three deciles (that is, the poorest 30 percent of the population) rely on non-labor income to make up 37, 25, and 22 percent of their total income, respectively. Labor income in the form of wages makes up the majority of household income sources, and this increases as a percentage of total income as households become richer.

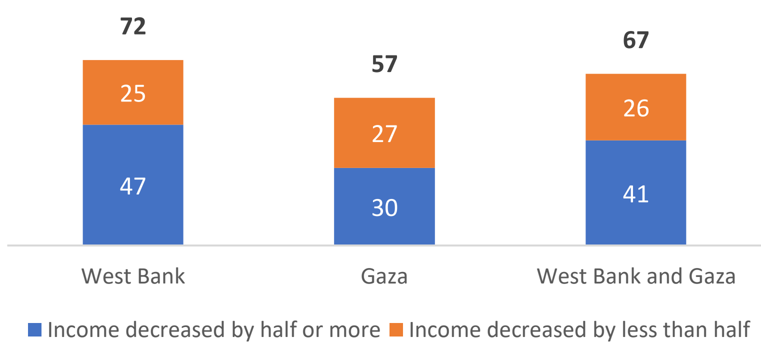
Figure 6: Composition of household income by welfare decile



Source: Palestinian Expenditure and Consumption Survey (PECS) 2016/2017.

34. **The impact of the pandemic and associated mitigation measures on household incomes was widespread.** During the early stages of the pandemic, as shown in the figure below, two out of three households in the West Bank and Gaza suffered income losses. In the West Bank, the share was 72 percent of households, and in Gaza, 57 percent. Moreover, the negative impact on income was not only widespread but also severe. Among households that reported these income drops, 41 percent said that their incomes decreased by half or more, a severity that is observed both in the West Bank (47 percent) and in Gaza (30 percent).

Figure 7: Share of households in which income decreased during pandemic restrictions (%)



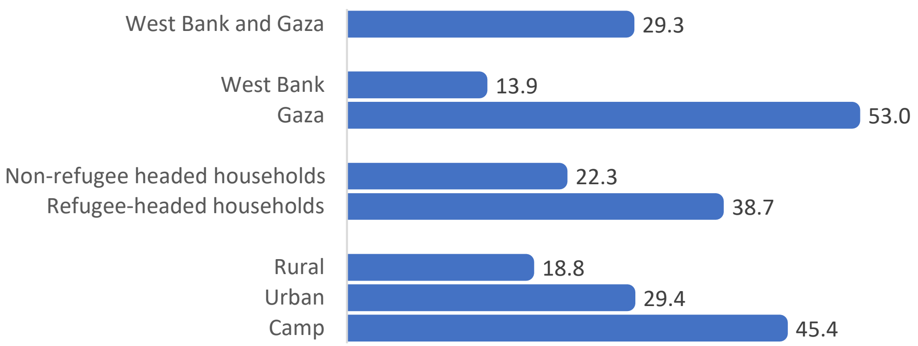
Source: World Bank calculations in Becerra et al. (2021).

35. **Many household income dynamics during the pandemic can be explained by the main income earners' capacity to engage in work activities.** A very high 93 percent of households whose main income earner lost their job during the lockdown faced lower incomes. In contrast, less than half (42 percent) of the households where the main income earner continued working full-time experienced an income reduction. Even when the main income earner continued working full-time, 50 percent of households in Gaza faced lower household incomes versus 35 percent in the West Bank. This suggests that either the labor incomes among workers in Gaza were more likely to fall than in the West Bank, or that other sources of household income (besides the labor income of the main earner) had been affected during the pandemic.

Box 4: What has the impact of the pandemic been on refugees in the West Bank and Gaza?

Individuals living in refugee camps, and people living in refugee-headed households were already in a more vulnerable position before the start of the pandemic. In the analysis, refugee status includes both registered and unregistered individuals. As shown in the figure below, although the overall poverty rate in the West Bank and Gaza stood at 29.3 percent, the rate in refugee camps was 45.4 percent. Similarly, poverty in refugee-headed households was more than 16 percentage points higher than in households headed by a non-refugee.

Figure 8: Poverty rates before the start of the pandemic



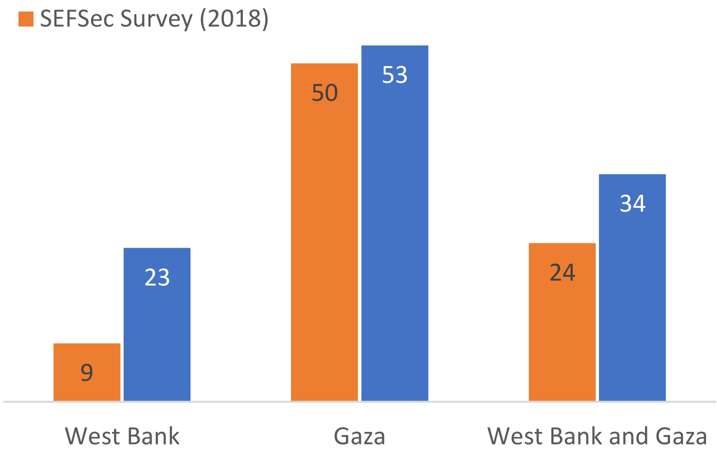
Source: World Bank Calculations in Becerra et al. (2021)

Simulations of the poverty impact at the height of pandemic restrictions suggest that the poverty rate in refugee-headed households rose from 38.7 percent to as much as 45.8 percent. The changes in employment status for refugees living in Gaza generally mirrored the situation in the West Bank. At the height of the pandemic there was a contraction of 25 percent in employment in restaurants, hotels, and tourism in Gaza – the sector that was also most severely affected in the West Bank. Similarly, the only sector that saw a substantial increase in employment for refugees in Gaza was health and social work, which saw a rise of 14 percent during the pandemic.

d) Linking Changes in Income and Employment to Increases in Food Insecurity[16]

36. Evidence from before the pandemic had suggested that a large share of households in the West Bank were particularly vulnerable to welfare shocks (Atamanov and Palaniswamy, 2018). This vulnerability was realized during the pandemic, with the share of food insecure households in the West Bank increasing from 9 percent to 23 percent in the period before and during the pandemic. Prior to the pandemic, levels of food insecurity in Gaza were multiple times higher than in the West Bank, but even so, there was an increase from 50 percent to 53 percent, as shown in the figure below.

Figure 9: Share of households that faced food insecurity (%)

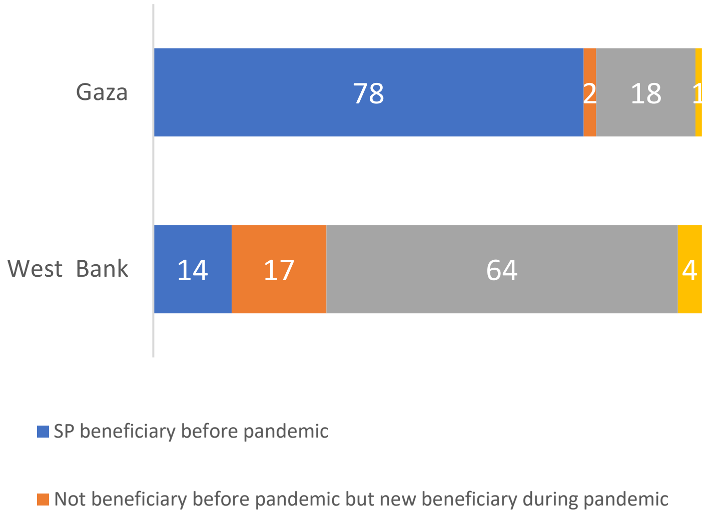


Source: World Bank calculations in Becerra et al. (2021).

37. The sudden jump in food insecurity shows that the early response to expand the social protection network to households in the West Bank was necessary. While almost 80 percent of households in Gaza were already beneficiaries of the social protection system before the lockdown, only 14 percent of those in the West Bank were covered. The temporary and rapid expansion of the social safety net in the West Bank was much needed. The figure below shows that in the early stages of the pandemic the number of beneficiary households in the West Bank more than doubled. Overall, after the social protection expansion during the initial lockdown, 30 percent of households in the West Bank were beneficiaries of some type of program, while in Gaza it was 80 percent.

[16] Food insecurity is defined using the Food Insecurity Experience Scale (FIES), a metric developed by the UN Food and Agriculture Organization (FAO), to assess the adequacy of people's access to food by asking them directly about their experiences. The construction of the FIES in the West Bank and Gaza has been calibrated to a global standard for comparability.

Figure 10: Distribution of households reporting receiving social protection benefits before and during the pandemic



Source: World Bank calculations in Becerra et al. (2021).

38. **The pandemic has shown that even the better-off households were vulnerable to food insecurity after a negative shock to incomes.** It is clear that self-reported income loss is closely correlated with higher food insecurity during the pandemic. The increase in food insecurity during the pandemic is related to income losses across the whole expenditure distribution, even among households in the highest quintiles. Households across all expenditure levels saw their food insecurity increase in 2020 if their income decreased during the lockdown, including the richest households.

39. **Increases in food insecurity were worse among those households whose main income earners were not able to work their usual number of hours.** Conversely, food insecurity in the West Bank and in Gaza was lower among households where the main income earner was able to work as usual. In the West Bank, the worse-off households were those where the main income earner (a) was not working before the lockdown, (b) lost their job, or (c) kept their job but was not able to work. In Gaza, the worse-off households were those where the main income earner lost their job; 78 percent of households in this group were food insecure in 2020.

40. **The war in Ukraine will lead to additional difficulties for an already highly food insecure population.** Around one-third of the wheat imported into the West Bank and Gaza comes from Ukraine, along with 37 percent of imports of sunflower oil. A lack of availability of these food items, together with a sharp rise in the cost of fuel, has already led to a sharp rise in the food price index. The current stock of wheat flour is expected to last around two to three months, after which there is a very concerning outlook for an already vulnerable population, particularly in Gaza.

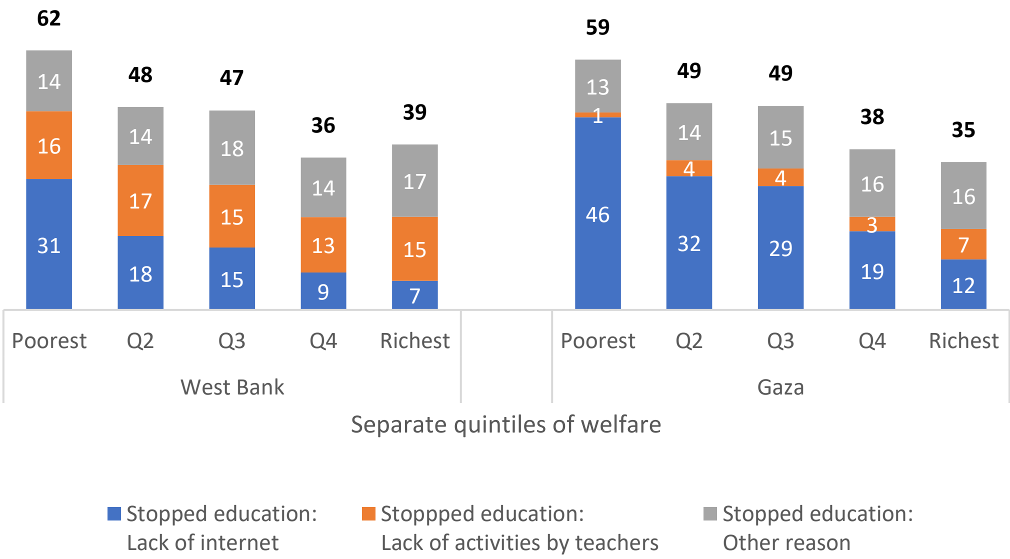
e) The Impact on Education

41. **At times, the pandemic has severely limited Palestinian children's access to education.** In particular, the first lockdown coincided with the last three months of the school year in the West Bank and Gaza. Data from the early stages of the pandemic show that children in half of households were not engaged at all in education activities during the lockdown, with similar shares in the West

Bank and in Gaza. Further, 60 percent of households reported that they were not in contact with their children's teachers during the lockdown (the share being slightly higher in the West Bank than in Gaza).

42. **These setbacks affected Palestinian children of all income levels, especially the poorest.** Children in 60 percent of households in the lowest quintile (in both the West Bank and Gaza) were not engaged in any education activity during lockdowns, while for the highest quintile in the West Bank and in Gaza, the percentage is smaller (39 percent and 35 percent, respectively), although still high. The main obstacle for children in the poorest households was the lack of internet. This is highlighted in the figure below. Another major obstacle was the lack of activities from teachers, as reported by households of all income levels in the West Bank and by households in the top quintile in Gaza.

Figure 11: Reasons why children stopped education during lockdowns in households in which education stopped



Source: World Bank calculations based on Becerra et al. (2021).
Note: Sample is households in which there was at least one child aged between 6 and 18 who was attending school before lockdowns.

f) An Opportunity to Build Resilience

43. **The pandemic has seriously disrupted the livelihoods of Palestinian households through job losses, lower household income, and higher food insecurity.** Analysis of individual and household data has found that the pandemic affected not only the poorest households but also those that were relatively better off before COVID-19 struck. This analysis has yielded three general points that help to understand the impact of the pandemic and may help to guide future interventions.

44. **First, the pandemic has revealed how vulnerable Palestinian households are to food insecurity, even those who were better off prior to the lockdown.** The Food Insecurity Experience Scale (SDG Indicator 2.1.2) shows that 1 in 3 Palestinian households have suffered from moderate or severe food insecurity during the pandemic. This rate increased from about 1 in 4 households in 2018. The West Bank saw the highest increase, with the percentage of moderate or

severe food insecurity of households increasing from 8.7 in 2018 to a peak of 22.8 during the pandemic.

45. **Second, the negative impacts of the pandemic on household incomes have been both prevalent and severe.** They affected households across all expenditure quintiles, although the share of households with self-reported losses of income is slightly higher among the poorest quintiles, both in the West Bank and in Gaza. In the West Bank, the main income earners at all welfare levels experienced job loss or were unable to perform their work, while in Gaza, the main income earners from the poorest households were more likely to lose their job during the lockdown.

46. **Third, although 20 percent of previously employed main income earners lost their job during the early part of the pandemic, employment losses do not fully explain the observed income loss during the lockdown.** Rather, another major factor is at work: changes in the demand for work for workers who had not lost their jobs. This helps explain some of the differences in the impacts of the pandemic on household incomes between the West Bank and Gaza. Among previously employed main income earners, less than half were able to work at least partially, and only a fraction were able to work as usual. In the West Bank, 40 percent of previously employed main income earners reported still having a job but not being able to work. In Gaza, however, a higher share of main income earners who stopped working may have lost their jobs permanently.

47. **In the future, there is likely to be more shocks to Palestinian households, whether this be through the next waves of a pandemic, the effects of climate change, or periods of conflict.** Systemic vulnerability will mean that each shock is met with a new group of households who become poor and food insecure. What is crucial then is to build lives that are more resilient, and create better protection for people and livelihoods. One critical element will be resuscitating economic activity to unlock the potential of a young workforce, with a focus on a more conducive environment for the private sector and entrepreneurship.

48. **Identifying the socioeconomic and welfare impacts of the pandemic on Palestinians leaves policymakers better placed to ensure that future shocks and crises can be mitigated more quickly and effectively.** In the short term this means addressing immediate needs through coordinating a wider vaccination campaign and ensuring that populations in the West Bank and Gaza can be better connected both physically and digitally. In the medium to long term, policies will need to build resilience through boosting the productivity of the Palestinian economy, building a social protection system that is flexible and can target the most vulnerable, and setting up data and registration systems that are high quality and transparent.

49. **The first short-term priority must be to ensure that vaccination supplies and health commodities can move freely between Israeli points of entry, the West Bank, and Gaza.** A lack of supply of vaccines, and the lack of predictability about vaccine rollouts is causing disruption to lives and livelihoods in the West Bank and Gaza. Coordination between the PA and the GoI must be institutionalized and made predictable, as the public good of a more vaccinated population in the West Bank and Gaza will also benefit Israel directly. Increased coordination in movement of commodities is particularly crucial as the PA implements its COVID-19 vaccine deployment plans.

50. **Economic growth and productivity of the Palestinian territories is severely constrained by the movement restrictions imposed by the GoI.** More jobs would be created and retained, and households would be less vulnerable if the impediments to movement, access, and trade were eased. As noted in previous reports to the AHLC, Area C remains key to Palestinian economic development but access to this area remains severely limited.

51. **In the West Bank, job losses have been the main cause of a loss of household income.** This is exacerbated by the high unemployment rates that predate the pandemic. Informal workers, who account for about 60 percent of the workforce, are particularly vulnerable to these shocks, and are

disproportionally concentrated in poor and near-poor households and have no access to formal social protection schemes. Improving the prospects for those in the informal sector by allowing for better integration and easier formalization and access to finance will bolster livelihoods and allow households to have more of a buffer to get through future shocks.

52. **Improving the prospects for those who work in the informal sector goes hand-in-hand with building a social protection system that can respond to crises quickly and is able to target beneficiaries effectively.** This focus is essential to prepare the West Bank and Gaza for future crises. Results from COVID-19 impact surveys across the region have shown that countries with more elaborate registration systems are able to provide better targeted assistance. Similarly, parts of the population that are covered by existing assistance systems have been found to be more protected against shocks caused by COVID-19 than populations at large.

53. **These findings suggest that a clear, secure, and transparent means of digital identification is one way to help people access services in times of need.** Building a comprehensive and inclusive database means focusing on more than just money-metric poverty, and also needs to address disparities across multiple dimensions including gender equality and female empowerment, inequality, financial inclusion, health insurance coverage, and safe movement. Such a system would be particularly helpful in targeting the most vulnerable populations quickly during a crisis, and also allow for a pivot toward programs aimed at building resilience, rather than simply responding to one shock at a time.

54. **The pandemic has brought about disruptions to the education system, and these effects have been felt most severely by children in the poorest households.** The main obstacle reported for the inability to continue learning is the lack of internet. Addressing low and poor digital coverage will help to mitigate this dynamic and is also an obvious way to help improve productivity in the Palestinian economy.

55. **As discussed in the AHLC report of June 2020, overall digital infrastructure is significantly underdeveloped in general, but particularly in Gaza.** The GoI has not yet released mobile broadband internet frequency spectrum bands for use in Gaza. Internet is available and accessible through Wi-Fi hotspots in Gaza, with one-quarter of households still unable to access the internet. In the West Bank, and in Area C specifically, amending the current restrictions on digital connectivity is essential to ensuring that access to infrastructure and transmission sites can facilitate the provision of connectivity services to the Palestinian population, and that households and businesses are able to integrate this basic service into their daily lives and operations more efficiently.

ANNEX I: STOCKTAKING OF WORLD BANK RECOMMENDATIONS TO THE AHLC MEETINGS OVER THE YEARS

1. **The Palestinian economic outlook is worrying, and bold actions are needed from all parties to adjust the Palestinian economy's trajectory.** Several necessary actions have been identified in previous reports by the World Bank to the AHLC meeting, but implementation has been limited. In the World Bank's September 2016 report to the AHLC, a stocktaking 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 expected to 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 stocktaking is updated to show progress since June 2021 using the same three pillars: (1) fiscal sustainability, (2) economic development, and (3) Gaza reconstruction and recovery.

A. Fiscal Sustainability

2. **The ongoing COVID-19 pandemic and tough fiscal situation make it difficult for the PA to embark on challenging expenditure reforms, but once the situation improves the PA must begin addressing several longstanding areas of ineffective expenditure for long-term fiscal sustainability.** In particular, the PA must adopt a comprehensive plan for civil service reform that considers inefficiencies and overstaffing – especially in the West Bank. Parametric reforms are also needed to support the public pension system's sustainability. Progress has been made on steps to control electricity net lending – although the problem is increasing with other utility payments, mainly water and sewerage. The net lending situation for the water sector continues to face challenges: i) net lending for water and sanitation is at NIS30 million per month; ii) Israel charges the Palestinian MoF NIS110 million per year to treat the transboundary wastewater. There is no agreement on accounting principles for these costs; and iii) service providers continue to accumulate debt, which has increased due to COVID-19. Regarding the cost of treating transboundary wastewater, it would be useful for the GoI to provide a detailed breakdown to the PA—and it will be important for the GoI and PA to agree on a solution to the transboundary wastewater issue. All stakeholders need to agree on a new mechanism to ringfence water revenues and increase payments of bulk water purchases from the Israel water utility Mekorot. Outside medical referrals (OMR) also represent an ongoing fiscal burden for the PA, but steps have been taken to control this category of spending, including introducing a digitalized system to monitor OMRs and linking this e-referral system to the MoF's Integrated Financial Management Information System (IFMIS), which will enhance transparency regarding OMRs and allow for better financial planning.

3. **After declining in 2020 due to the COVID-19 crisis, revenues rebounded in 2021 but risks remain high and efforts are still needed to bring revenues close to their potential.** As the PA eased COVID-19 containment measures in 2021, domestic taxes increased by 28 percent. Despite this impressive performance, efforts are still needed by the PA to improve tax administration. For instance, tax avoidance is still widespread, particularly among high earning professionals, and the PA needs to focus efforts on this group of taxpayers. Encouragingly, the MoF has recently prepared a three-year revenue strategy (2021-2024) that focuses on tax administration and improving compliance. Progress has also been made on updating public fees and charges with a notable decision to increase the license fee for petrol stations. Further, the PA and the Government of Jordan have agreed to further cooperation on customs through electronically linking their customs systems, which is expected to significantly reduce smuggling.

4. **Cooperation by the GoI to offset fiscal leakages remains key as additional deductions from clearance revenues have negatively impacted the fiscal situation.** The GoI has increased monthly deductions from clearance revenues from NIS40 million in previous years to NIS50 million in April 2021 and further up to NIS100 million in August 2021. This has placed large stress on the PA's financing situation. Hence, there is an urgent need to resolve outstanding issues related to the revenue sharing arrangements. Efforts should focus on implementing existing agreements that provide for full information sharing on trade that takes place between both parties, including Israeli sales to Gaza. The parties could also reach an agreement regarding the sharing of Allenby Bridge exit fees. Talks have been under way for some time 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. Even though there were encouraging talks about separating fuel taxes from the clearance process, this did not materialize as these taxes are still collected by the GoI and then transferred to the PA after deducting a 3 percent handling fee. The recently launched pilot to implement an e-VAT system on a voluntary basis is encouraging, but more work is needed to electronically link the interfaces of both parties as this is what will result in a meaningful decline in VAT leakage.

5. **The PA is continuing to make progress on improving the public financial management (PFM) system.** The PA has a comprehensive PFM Strategy (2021-2023), which incorporates the findings of the latest Public Expenditure and Financial Accountability (PEFA) assessment. A World Bank-funded project is providing support with a focus on budget execution, financial accountability, and procurement. Good progress has been achieved through the project on addressing the major delays in the production and audit of financial statements. The 2018 and 2019 audited reports were issued in December 2021 by the State Audit and Administrative Control Bureau and the 2020 audit is expected to be published in 2022. In line with the PFM strategy, support continues on the commitment control system (CCS), which is partially implemented for operating expenditures (including salaries) and will be fully implemented in the second quarter of 2022. The project is also supporting the modernization of financial control, intergovernmental fiscal transfers, and improvement of payroll management. Automated procedures were introduced to ensure that all health referrals are reflected in the financial management information system in a timely manner. Good progress was achieved during 2019-2021 on the implementation of the procurement law with the single procurement portal operational, new standard bidding documents approved by the Council of Ministers, a capacity-building program of the procurement workforce launched, and the operationalization of the complaint mechanism was officially launched in March 2022. Priority actions going forward include enforcing the use of the single portal and Standard Bidding Documents (SBDs) by all procuring entities and equipping HCPPP with the qualified human resources necessary to effectively assume its role in the development of the procurement system, policy-making, and oversight of all public procurement activity. The PA has also prioritized the development and implementation of an e-Government Procurement system and the professionalization of the procurement function. The Bank is preparing a second phase of the PFM Improvement Project to continue working in the same areas in addition to reforms in tax administration and anti-corruption, which should be operational mid-2022. A FCDO-funded PFM project continues to focus on budget management, revenue administration, and improving the policy development/planning processes led from the Prime Minister's Office.

6. **Budget support from donors has significantly declined in recent years and funds remain insufficient to close the large financing gap.** As a share of GDP, aid to the budget fell from 27 percent in 2008 to 1.8 percent in 2021.

B. Economic Development

7. **The constraints on movement, access, and trade continue to be the main impediment to economic growth in the Palestinian territories.** Area C remains key to Palestinian economic development but access to this area remains severely limited. Further progress has been made on

the piloting of door-to-door transport through the West Bank crossings, with the initial Hebron pilot being extended to Nablus and Qalquilia regions, however the current scope of this activity remains limited. Building power networks in the West Bank, particularly for increasing imports from Jordan, unavoidably involves some segments traversing Area C and continues to suffer from approvals being opaquely delayed for years. The long list of dual-use items key for the development of the economy and whose access is restricted has been updated but not significantly eased. With time, and as more incentives are put in place to promote compliance, access to dual-use items should be based on a risk-based criterion rather than a blanket approach. For instance, all Palestinian businesses that have established a strong track record of their ability to safely and securely handle hazardous materials and dual-use goods should be granted access to these goods without the need for cumbersome licensing procedures. Encouragingly, the GoI has recently announced that some restrictions on the movement of goods and people in and out of the Strip will be eased. For example, some 50 Businessman Card (BMC) holders were allowed to exit Gaza in early August. It was also announced that the number of Palestinian workers in Israel will be increased by 15,000.

8. **At a domestic level, the PA has initiated steps to improve the business climate, but these have yet to be fully implemented.** With technical assistance from the World Bank, the Ministry of National Economy finalized a new draft of the Companies Law that was adopted and published on December 30, 2021. The new Companies Law will significantly improve the Palestinian business environment by offering SMEs, entrepreneurs, as well as local and foreign investors a legal framework at international standards, corresponding to a digitalized and fast-paced business world. The new enacted Companies Law provides a more predictable and transparent business environment by introducing new concepts and approaches. Specifically, the new Companies Law: a) enables businesses to register online; b) facilitates the incorporation of businesses by removing unnecessary formalities, minimum capital requirements; c) regulates SMEs only to the extent necessary for the public interest and reduces the compliance cost by removing excessive requirements; d) allows home-based businesses to be registered, to support youth and women entrepreneurs; e) introduces new types of company forms; f) removes restrictions to foreign investment; g) enhances transparency of and accessibility to businesses registration data; h) provides better rules for larger businesses with multiple shareholders; i) introduces tools that the business community was missing, such as mergers, divisions, and transformation; j) promotes women in leadership roles by requesting public companies to have one-third of the Board of Directors women; k) equips shareholding companies with new tools to address the diversity of situations they face in their operation, such as different types of shares, employee stock option plans, and convertible bonds; l) introduces stronger protections for minority investors; and m) enables entrepreneurs to close their businesses faster and through more affordable and predictable procedures for mandatory and voluntary liquidation.

9. **Progress has also been seen in other areas, but more efforts are still needed.** A draft Competition Law was approved by the Cabinet and is now awaiting the President's signature. With support from the World Bank, the PA has also updated the Law of Crafts and Industries of 1953 to facilitate municipal business licensing through simplifying the approval process and reducing the cost. The amendments took effect from January 1, 2019, and the focus has more recently been on removing administrative obstacles to faster processing of municipal business licenses and automating the process. To establish strategic and policy oversight of institutions in land administration, in November 2018 the Cabinet of the previous administration adopted a draft Amendment to the Palestinian Land Authority (PLA) Laws. The amendment calls for the establishment of a Board of Directors that would oversee the operations of the PLA and would facilitate increased transparency in the land sector in line with the ongoing reform process. The legal amendment remains pending for ratification by the executive branch. In 2020, the President's Office sent the PLA Law back to the Council of Ministers with comments in relation to the financial implications of the law. The PLA and LWSC addressed all the comments, and the text of the law was reformulated accordingly and sent back to the Council of Ministers for approval. The draft law was sent to the Presidency again in April 2021 for enactment, but still awaits the President's

signature. Land registration is proceeding in the West Bank under the mandate and direction of the Land Water Settlement Commission (LWSC) in cooperation with local government units (LGUs). However, registration activities continue to be hampered by the pandemic, experiencing delays as a result of the corresponding closures and travel restrictions within the West Bank. In addition to national closures, there have been numerous localized closures at the land agencies due to COVID-19 outbreaks among staff. A new telecommunication law was adopted and published on December 23, 2021. The law, however, remains to be improved to strengthen the independence of the regulatory authority.

10. **Progress in the energy sector continues in the shadow of COVID-19.** The interim Power Purchase Arrangements (PPA) between the GoI and the PA continue to be implemented. Based on these arrangements, the Palestinian Electricity Transmission Company (PETL) has started managing electricity supply from the Israeli Electricity Company (IEC) through the four high-voltage substations in the West Bank. PETL is also providing solar energy, supplied by independent power producers (IPPs) in the northern West Bank and has maintained a good payment record under the interim arrangements and solar PPAs. Increasing supply through the high-voltage substations will contribute to alleviating supply constraints and improving quality across the West Bank. The Palestinian Energy and Natural Resources Authority (PENRA) continues to implement reform measures to improve collection, efficiency, and payment-related performance. The pandemic and economic slowdown continue to cast a shadow in terms of disruption in financial flows across the energy supply chain, which is affecting all energy sector institutions. A Revenue Protection Program, along with updated management information systems, continues to be rolled out to the distribution companies in the West Bank and Gaza. However, improvements in the sector continue to be hampered by a lack of progress in other areas - particularly those related to electricity infrastructure in Area C. Diversification of electricity supply from neighboring countries and distribution grid reinforcements are needed to enable stable supply but are hindered primarily by land access issues. Construction restrictions in Area C continue to pose major obstacles to strengthening the energy supply and sustainability through renewable IPPs and interconnections. In Gaza, the need for a comprehensive energy action plan to enable increased supply, improved operations, and institutional reforms remains urgent. The recently concluded institutional review and audit of energy sector finances in Gaza provides comprehensive recommendations and accelerating their implementation is a priority in addressing the energy crisis and managing the electricity sector's fiscal impact.

C. Gaza Reconstruction and Recovery

1. **The 11-day Gaza conflict in May 2021 resulted in severe damages across all sectors in Gaza.** The immediate humanitarian response started, and efforts are still needed by all parties to ensure this response lays the groundwork for medium and long-term reconstruction and recovery phases. There is a need for action by the PA, GoI, and international community to address the needs and ensure that this reconstruction process paves the way for an efficient recovery and a more sustainable trajectory for Gaza. The PA needs to take on an active approach in leading the reconstruction efforts, building on experience from previous conflicts, namely in 2014. The PA will also need to take prompt actions to ensure sustainability of governance arrangements in Gaza as the current situation of dual administrative systems results in complicated public service arrangements and is not sustainable. While some measures by the GoI to enable material entry have helped, access to materials for reconstruction should be further eased to allow for an efficient and speedy reconstruction, while also addressing legitimate security concerns. Efforts also need to focus on easing constraints that currently stifle private activity and setting the enabling conditions for private investment, as achieving a sustainable growth path for Gaza cannot happen without allowing its economy to connect to the outside world. Finally, sizable and predictable donor support will not only be crucial to implement reconstruction activities, but Gaza's economy will continue to depend critically on donor support for several years to come, until gradually the tradable sectors replace the role of donor aid as the key source of foreign exchange to fuel the economy.

Table A. Summary of World Bank Recommendations to AHLC meetings

Actions	Responsible Party	Progress as of Sep 2016	Progress as of April 2022
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 upward	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	PA		
- 2012-2017			
- 2018-2019			
Develop systems for monitoring and reporting expenditure arrears	PA		
Budget support			
Provide sizable, 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		
Significantly reduce items on restricted dual-use list for Gaza	GoI		
Create a unified legal system in the West Bank and Gaza	PA		
The business climate			
Adopt the Secured Transactions Law and establish a movable asset registry	PA		
Adoption of new Companies Law	PA		
Adoption of Competition Law	PA		

Actions	Responsible Party	Progress as of Sep 2016	Progress as of April 2022
Accelerate land registration in Areas A and B	PA	Red	Amber
Improve access to finance for SMEs	PA	Amber	Amber
Reform the education system to bridge gap between graduates' skills and labor market needs	PA	Amber	Amber
Securing energy for development			
Sign interim PPAs to energize high-voltage substations	GoI and PA	Red	Green
PETL operating on commercial basis	PA	Red	Green
Diversify electricity supply	GoI and PA	Red	Amber
Access to dual-use items			
Make the process to import dual-use goods more transparent	GoI	Red	Amber
Allow access to potent fertilizers in the West Bank	GoI	Red	Red
Facilitate access to machinery in the West Bank	GoI	Red	Red
Adopt a risk-based approach in the West Bank and Gaza to control dual-use items	GoI	Red	Red
Meet international standards for controlling and regulating dual-use goods	GoI and PA	Red	Red
GAZA RECONSTRUCTION AND RECOVERY			
Complete a DNA to guide reconstruction and recovery following May 2021 conflict	PA, donors	Green	Green
Establish and monitor timeline indicators for review and approval of dual-use items	GoI	Red	Red
Include delivery monitoring in GRM system	GoI and PA	Red	Red
Establish Gaza import mechanism able to handle long-term recovery needs	GoI and PA	Red	Red
Gaza Development[17]			
Streamline trade procedures at commercial crossing and expand capacity	GoI	Red	Red
Expand Gaza's fishing zone	GoI	Red	Red
Implement donor-financed labor-intensive projects	PA, GoI, donors	Red	Amber

Legend

Green	On track
Amber	Some progress achieved
Red	No progress

[17] These are additional recommendations that were made in the World Bank's March 2018 report to the AHLC.