PURSE REVIEW
January - March 2024

Fiscal Performance

1. **The negative impact of the Middle East conflict, centered in Gaza, has been severe on the Palestinian Authority's (PA) ability to generate revenues in 2024.** According to data by the Palestinian Ministry of Finance (MoF), domestic tax revenues declined by 34 percent in the first quarter (Q1) of 2024, year-on-year (y/y), due to a drop in all tax categories. The decline in nontax revenue was lower, at 8 percent, over the same period due to significantly higher investment profits from the Palestine Investment fund (PIF) in Q1 2024 compared to the same period in 2023.[1] This partly offset the steep decline in the other component of nontax revenue, collections from domestic fees and charges, which dropped by 36 percent. The deterioration in domestic fees and charges is mainly due to a strong drop in the transfers of income tax collected by Israel from Palestinian workers which amounted to NIS28.5 million in Q1 2024 compared to NIS112.2 million in Q1 2023, reflecting the Israeli decision to restrict access of Palestinian workers to the Israeli labor market. The overall decline in public revenue is commensurate with the decline in economic activity in the West Bank, where the absolute majority of public revenues are generated, which contracted by 25 percent in Q1 2024, year-on-year, according to the Palestinian Central Bureau of Statistics (PCBS).

2. **Increased deductions by the Government of Israel (GoI) exacted a very large toll on clearance revenues, the PA's main source of income.** On a commitment basis, clearance revenues declined by 23 percent in Q1 2024, y/y. However, on a cash basis monthly Israeli deductions from clearance revenues surged to around NIS500 million since October 2023, up from an average of NIS200 million prior. This increase was intended to account for the PA's unchanged spending in Gaza and offset some of the debt owed by the Jerusalem District Electricity Company (JDECO) to the Israeli Electricity Company (IEC).[2] As a result, net transfers of clearance revenue by Israel were significantly reduced and the PA felt politically compelled to reject most of them in the fourth quarter (Q4) of 2023. On January 22, 2024, the Israeli Cabinet approved a decision to transfer already withheld funds as well as future funds that, according to the GoI, are "earmarked for Gaza" to Norway to be held by a third party until the GoI eventually approves their transfer to the PA once robust vetting of all PA Gaza employees is carried out. This has prompted the PA to resume the acceptance of these revenues in Q1 2024. However, in May 2024, the Israeli Minister of Finance took a decision to withhold all clearance revenue transfers to the PA in response to several countries recognizing "the state of Palestine" and the PA's actions in international forums. Even though this decision was reversed on July 1, it had kept the PA without its main source of income for a couple of months, crippling its ability to provide services and pay public salaries.[3] Israeli transfers of clearance revenues to Norway have also stopped since the latter recognized "the state of Palestine" on May 28, 2024.

[1] In Q1 2024, the Palestinian Authority received NIS112 million in investment profits from the PIF compared to NIS0.4 million in Q1 2023.
[2] The PA states that since JDECO is mostly owned by private investors, PA (public) funds should not be used to repay its debt.
[3] In June 2024, The Israeli minister of Finance deducted NIS130 million form the PA's frozen clearance revenues to compensate 28 Israeli families that have won lawsuits raised against the PA in Israeli courts. This was the first time this type of deduction from clearance revenues is implemented.

3. **Recurrent public spending, on a commitment basis, decreased by 3 percent in Q1 2024, y/y**. This decrease was propelled by a decline in most spending categories including on goods and services, transfers, the fuel subsidy and the wage bill, reflecting the PA's decision to significantly rationalize spending. It's important to underline that on a cash basis, the PA paid, on average, 65 percent of the salaries of its public employees in Q1 2024, while protecting the lowest earners.[4] Net lending was the only spending category that experienced an increase in Q1 2024, by 33 percent, y/y, reflecting additional unplanned subsidies to Local Government Units (LGUs) covering accumulated utility bills to the Israeli suppliers due to a worsening of the economic situation.

4. **After factoring in aid and accounting for the Israeli deductions from clearance revenues, the PA recorded a large deficit in Q1 2024 forcing it to accrue more arrears and to increase its borrowing from domestic banks**. The total deficit (before grants) amounted to US$135 million in Q1 2024. Donor financing reached US$106 million (US$85 million allocated for budget support and US$21 million for development financing), resulting in a modest deficit of US$29 million. However, after considering Israel's deductions from clearance revenues, the PA faced a financing gap of US$165 million. As in previous years, the financing gap was covered through the accumulation of arrears and borrowing from domestic banks. The total stock of arrears owed to the private sector stands at US$1.2 billion and arrears to public employees is US$1.28 billion. The PA's total public debt increased from US$3.78 billion in December 2023 to US$3.82 billion as of March 2024.

Reform Progress

5. **The assessment in this section is based on progress made by the PA in achieving the targets set in the World Bank's Development Policy Grant (DPG) 13 approved by the Board of directors on March 17, 2023.** This is the thirteenth budget support operation that the World Bank has prepared for the benefit of the Palestinian people, and it is in the amount of US$30 million. The development objectives of the operation are to: (i) improve the structural fiscal balance and strengthen the effectiveness of public procurement, and (ii) strengthen the integrity of the financial sector and pursue digital transformation. It is important to note that the targets set in the DPG assumed the continuation of a pre-conflict status quo that would allow the PA to maintain efforts to achieve the targets within the set timeline. However, the exceptional circumstances created by the conflict, the worsening fiscal crisis and increased access and mobility restrictions in the West Bank have played a key role in hampering the PA's ability to achieve some of the DPG targets. The following table summarizes implementation progress while the section describes progress to date.

Table 1: DPG 13 Implementation Progress

Prior Action	Implementation Progress
Pillar 1	
Prior Action 1	On track
Prior Action 2	On track in civil sectors Off track in security sector

[4] January 2024 salaries were paid at a rate of 65 percent on March 7, 2024. February 2024 salaries were paid at a rate of 70 percent on April 30, 2024. March 2024 salaries were paid at a rate of 60 percent on May 5, 2024.

Prior Action 3	Off track
Pillar 2	
Prior Action 4	On track
Prior Action 5	On track
Prior Action 6	Off track

Pillar 1: improve the structural fiscal balance and strengthen the effectiveness of public procurement

6. **Prior Action 1: To improve revenue mobilization and reduce tax evasion, the Recipient, through its revenue directorate at the Ministry of Finance, will strengthen cross checks on VAT invoices by mandating businesses to use an online portal to submit their monthly VAT invoices for purchases and sales to be reconciled with those submitted by other businesses, as evidenced by instructions by the Director General of revenues issued on October 30, 2022.** Building on initiatives outlined in previous DPGs and to further enhance public revenues, this prior action supports the PA's ongoing efforts to combat tax evasion. The MoF has introduced an online portal mandating businesses to submit their domestic VAT invoices for both sales and purchases. The system automatically cross-checks these submissions to ensure alignment between the information reported by selling businesses and that provided by buyers. The agreed-upon target with the MoF for this prior action is to increase the share of domestic VAT collections to domestic tax revenues from 37 percent (as of December 2022) to 39 percent by December 2024. In the first seven months of 2023, the monthly average of domestic VAT collections to domestic tax revenues was 33.1 percent, falling below the target. The MoF attributes this to technical issues related to data transfer to the portal, which impeded their efforts in the initial seven months of 2023. However, as these technical issues were resolved, the ratio gradually improved, reaching an average of 41 percent between August and December 2023. The MoF emphasizes its full commitment to the reform, conducting regular audits and follow-ups in cases where cross-checks reveal discrepancies to address potential tax evasion. This commitment is expected to sustain a high collection rate in the coming period, especially after the conflict ends.

7. **Prior Action 2: To renew the impetus on wage bill reform, the Recipient, through its cabinet, has: (1) adopted an attrition target for net public employment whereby yearly civil and security personnel appointments do not exceed 50 percent of retirement-related and other kinds of departures from the PA during the same year, as evidenced by Cabinet decision No. (18/181/01) dated November 14, 2022, and (2) requested all government agencies to assess their Human Resources (HR) needs and skills, on a yearly basis and submit a list to the Cabinet identifying employee surplus and shortages of skills, with the purposes of reallocating and/or training surplus employees, to enhance efficiency, as evidenced by Cabinet decision No. 18/178/19 dated October 10, 2022.** Over the last decade, the PA's wage bill averaged 14 percent of GDP and 46 percent of central government expenditure – higher than all comparators. In light of escalating fiscal constraints, the PA has recommitted itself to wage bill and public employment reform. One of the initial reforms implemented by the PA in this regard was the decision to set an attrition target for net public employment in 2023. The objective was to ensure that recruitments do not exceed 50 percent of the number of retirement-related and other departures from the PA. This marks a departure from policies observed in recent years,

during which annual net staff increases were witnessed. Data from the MoF's payroll department for 2023 indicates that the ratio of recruitments to exits in the civil sectors was 67 percent. However, when short-term and daily contracts are excluded, and only permanent staff are considered, the ratio drops to 49 percent—slightly below the target agreed upon in the DPG. In the security sector, the ratio of hires to exits reached 132 percent in 2023. The PA explains that efforts to control hiring were not fully extended to this sector, considering the economic downturn, the deteriorating security situation, especially after the outbreak of the conflict, and the PA's role as an employer of last resort while the private sector remains constrained. However, the PA affirms its commitment to this reform and plans to extend efforts to the security sector once the situation on the ground improves.

8. **Prior Action 3: To improve the professional quality of procurement staff in the Palestinian Authority, and enhance the effectiveness of public procurement, the Recipient, through its Cabinet, approved the "Procurement Capacity Building and Professionalization Strategy" which recognizes procurement as a distinct profession in civil service, institutes a permanent procurement training program and establishes an independent certification mechanism for procurement staff, as evidenced by cabinet decision No. (18/186/03) dated December 19, 2022**. Building on reforms outlined in prior DPGs, this initiative reinforces the PA's commitment to advancing public procurement reform. With the aim of improving public resource management and accountability, the PA is placing a high priority on enhancing the professional quality of procurement staff through a certification process based on the PA's 'Procurement Capacity Building and Professionalization Strategy.' This strategy was prepared by the Higher Council for Procurement Policies (HCPPP) with support from the World Bank, in close collaboration with the General Personnel Council (GPC) and other stakeholders. The target for this prior action is that 80 percent of public procurement staff will have completed the training program by December 2024, up from 0 percent in December 2022. The HCPPP has almost completed the selection of a reputable international/regional training firm that will support the development of the procurement training modules and the contract will be signed before end Q3 2024. Some of the training modules that will be integrated into the overall training program have already been developed by the HCPPP and trainees from the PA's central agencies and municipalities have completed some of these modules. The increase in the number of trainees during the first half of 2024 is modest as the HCPPP, in consultation with all relevant stakeholders, has decided to suspend all planned capacity building and training activities until further notice due to the Israeli restrictions on movement within the West Bank and the emergency work attendance requirements adopted by the PA. Hence, the DPG target is not expected to be achieved by the end of 2024 as confirmed by the HCPPP, as a result of the prevailing security conditions and the suspension of all training activities.

Table 2: Public Procurement Trainees (as of June 2024)

Training Topics	No. of Trainees from PA Central Agencies	No. of Trainees from Public Institutions/Municipalities	Total No. of Trainees	% out of the Total Procurement Staff
Public Procurement Law (PPL)	231	218	449	34.9%
Single Procurement Portal (SPP)	219	215	434	33.8%
Standard Bidding Documents (SBDs)	418	312	730	56.8%
Contract Management	76	0	76	5.9%
Procurement Planning	98	77	175	13.6%

Source: HCPPP

Pillar 2: strengthen the integrity of the financial sector and pursue digital transformation

9. **Prior Action 4: To modernize the Anti-Money Laundering and Combating Financing of Terrorism legal framework, and to align it with international best practices, the Recipient, upon recommendation of the Council of Ministers on July 4, 2022 and through its President, enacted a new AML/CFT law No. 39 published in the official gazette No. 193 on August 14, 2022, and AML/CFT instructions for financial institutions licensed to operate in the Palestinian territories, as evidenced by Instructions No. 2, issued by the National Committee for AML/CFT and published in the official gazette No. 192 of June 30, 2022.** The Palestine Monetary Authority (PMA) and the Financial Follow-up Unit have been actively working to enhance the Palestinian Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime to align it more closely with international practices. In 2018, the local authorities conducted their initial self-assessment to strengthen the capabilities of relevant AML/CFT stakeholders in identifying, assessing, understanding, and mitigating money laundering and terrorism financing risks. The assessment received official endorsement from the Palestinian Cabinet in October 2018, followed by the Cabinet's adoption of the national AML/CFT strategy in November 2018. In 2022, with technical assistance from the International Monetary Fund (IMF), the authorities enacted a new AML/CFT law (No. 39/2022) and issued instructions (No. 2/2022). These defined "beneficial ownership transparency" for account holders and established systematic procedures for financial institutions to collect, verify, and maintain beneficial ownership information. The agreed-upon target for this prior action is for the PMA to conduct on-site inspections of licensed banks, accounting for 85 percent of total bank assets, to ensure compliance with the new procedures on beneficial ownership information by December 2024. As of June 2024, on-site inspections have covered a total of 7 out of 13 banks, collectively representing 60.4 percent of the total assets in the banking sector. The PMA remains committed to this reform, and efforts are expected to continue to encompass all banks within the required DPG timeline.

10. **Prior Action 5: The Recipient, through the Palestine Monetary Authority, further advanced the digital transformation agenda in the financial sector and enhanced public confidence in electronic transactions by enacting a national payments law regulating the use of e-money and strengthening the PMA's authority over entities providing e-money services, as evidenced by presidential decree No. 41 dated August 8, 2022, published in the official gazette No. 193 on August 14, 2022.** This DPG supports the PMA's initiatives to advance the digital finance legal framework through the adoption and implementation of a new national payments law. The purpose of this new payments law is to bridge the gap between banks and non-bank market players, while also strengthening the PMA's licensing and supervisory authority over entities providing e-money products and cashless payment services. Additionally, it aims to establish a level playing field in the retail payments market, ultimately benefiting end-users through increased competition and innovation. This, in turn, facilitates market entry and the deployment of various e-money-based services and products, addressing the needs of vulnerable and financially excluded population segments. The target for this prior action is to achieve a 150 percent increase in the number of cashless transactions by December 2024, compared to a baseline of 2,059,229 cashless transactions in June 2022. According to the latest data from the PMA, cashless transactions have already increased by 122 percent, with a total volume reaching 4,570,990 transactions. Efforts are anticipated to continue at the same pace, which should ensure the achievement of the target within the required timeline.

11. **Prior Action 6: To support women empowerment through financial inclusion, the Recipient, through the Palestine Monetary Authority, issued circular No. 201/2022 dated September 6, 2022, adopting a single definition for female-owned enterprises applicable to all Microfinance Institutions, and introducing the obligation to disclose the number and size of financing provided to these businesses on a regular basis, in order to strengthen the role of MFIs in supporting women.** This DPG supports the development of the data infrastructure needed to advance the financial inclusion of women through targeted gender outreach and evidence-based programming. These efforts aim to encourage financial institutions to increase the share of women-owned businesses in their respective portfolios. The target for this prior action is that 1,500 women-owned businesses, according to the new definition, have access to microfinance by December 2024. According to the latest data from the PMA, 910 women-owned businesses accessed microfinance institutions as of June 2024. The PMA reports that the pace of progress on this indicator has slowed down since the outbreak of the conflict and it is questionable as to whether the DPG target will be achieved in time.

12. **To conclude, 3.5 out of 6 prior actions remain on track, while the achievement of 2.5 prior actions remains questionable.** The exceptional circumstances created by the conflict, the worsening fiscal crisis and increased access and mobility restrictions in the West Bank have played a key role in hampering the PA's ability to achieve some of the DPG targets. Hence, achieving all the targets within the set timeline may be questionable as long as the conflict continues and the knock-on effects in the West Bank persist.