

# *Economic Monitoring Report*

## *to the Ad Hoc Liaison Committee*

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## List of Acronyms

AML/CFT	Anti-Money Laundering and Combating Financing of Terrorism
BoI	Bank of Israel
CoLA	Cost of Living Allowance
GDP	Gross Domestic Product
GoI	Government of Israel
HS	Harmonized System
IEC	Israel Electric Corporation
IMF	International Monetary Fund
JEC	Joint Economic Committee
LTU	Large Taxpayer Unit
MENA	Middle East and North Africa
MoF	Ministry of Finance
MoH	Ministry of Health
NIS	New Israeli Sheqel
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics
PIA	Population and Immigration Authority
PMA	Palestine Monetary Authority
SMEs	Small-Medium Enterprises
VAT	Value Added Tax

## I. Executive Summary

- 1. The Palestinian economy is not growing enough to raise living standards and reduce high unemployment.** The economy has witnessed a sharp deceleration in economic growth, from over 8 percent during 2007-11 to 3 percent during 2012-15. The sharp decline in growth has stifled the economy's ability to create jobs for a growing youth population. Successful reform efforts and strong economic growth helped bring the relative size of the Palestinian overall fiscal deficit down from 24.6 percent of GDP in 2008 to 13 percent in 2010. However, despite these efforts at fiscal consolidation, the deficit to GDP ratio has remained stuck in the 10 - 13 percent range since 2010 -- on the back of a large wage bill and weak revenue performance. The economy has long suffered from the restrictions<sup>1</sup> and political instability that continue to constrain private sector activity. In addition, the decline in donor funding from 32 percent of GDP in 2008 to 6 percent in 2015 has significantly contributed to the recent economic weakening. The internal divide between the West Bank and Gaza, which has created a dual regulatory framework, has also negatively impacted economic activity and the tax base.
- 2. In 2015, the economy bounced back from the 2014 recession but economic growth was barely enough to keep up with population growth.** The 2014 Gaza war pushed the Palestinian economy into recession due to the devastating impact it had on economic activity and the livelihood of Gazans. From a very low base, economic growth was 6.8 percent in Gaza in 2015 – with the reconstruction, wholesale and retail trade sectors being the main drivers. While it is positive that Gaza returned to economic growth, with the current pace of reconstruction, and with a lingering internal divide between Gaza and the West Bank, the Gaza economy is not expected to rebound to prewar levels before 2018. Overall growth in the Palestinian economy was limited to 3.5 percent due to a growth slowdown in the West Bank from 5.3 percent in 2014 to an anemic 2.5 percent in 2015 in the face of a significant decline in foreign aid and the liquidity squeeze caused by the Israeli decision to suspend the transfer of the Palestinian Authority's (PA) taxes during the first four months of 2015. Given that population growth in the Palestinian territories is around 3 percent, economic growth witnessed in 2015 was not enough to increase per capita incomes.
- 3. Even though only a political resolution would allow the Palestinian economy to reach its full potential, easing the restrictions and implementing existing agreements could significantly improve the economic outlook.** In general, granting Palestinians access to production inputs and external markets and enabling unimpeded movement of goods, labor and capital, as anticipated in the political agreements, would drastically improve growth prospects of the Palestinian economy. For example, the Oslo Accords envisioned a gradual transfer of Area C to the PA's control. This hasn't happened yet, and the World Bank estimates that granting Palestinian businesses access to Area C would increase Palestinian GDP by a third. Also, the Paris Protocol allows for the expansion of the quota of goods that the PA can apply its own import and customs policy to and import from third countries, depending on the Palestinian market's needs. These quotas, however, have not been revised since 1994 even though Palestinian needs have significantly increased over the years, resulting in supply shortages. The blockade imposed on Gaza since 2007 continues to weigh on the economy. Also, the closure of the Rafah crossing has further exacerbated the situation. Israeli measures to allow more goods out of Gaza have expanded since the last AHLC meeting and are a step in the right direction. However, more needs to be done as only 11 percent of what left Gaza prior to the blockade is currently

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<sup>1</sup> According to the Government of Israel these restrictions are imposed to protect the security of Israeli citizens.

being allowed out. Freeing up movement of people and goods in a way that meets legitimate security concerns of neighboring countries is essential to improve Gaza's growth prospects.

- 4. The PA suffers from substantial revenue losses under the current revenue sharing arrangements outlined by the Paris Protocol and other subsequent agreements.** The agreements defined specific arrangements through which the Government of Israel (GoI) collects VAT, import duties and other income, or the so called clearance revenues, on behalf of the PA and shares it with the latter on a monthly basis. Some of these arrangements have become outdated and others have not been implemented as envisaged by the agreements, resulting in fiscal losses for the PA. The quantified annual loss (excluding revenues collected by the GoI in Area C that could not be quantified due to data constraints) amounts to USD285 million, or 2.2 percent of Palestinian GDP. The majority of the quantified loss from incomplete implementation of the Paris Protocol results from tax leakages on bilateral trade with Israel in addition to undervaluation of Palestinian imports from third countries. In addition to costs related to incomplete implementation of the Paris Protocol, some of the measures need to be updated. For instance, while the three percent handling fee charged by the GoI may have been appropriate at the time the agreement was signed, the current amount significantly outstrips costs incurred by the GoI to handle Palestinian imports.
- 5. In addition to the annual losses, considerable revenues owed to the PA and to Palestinian workers are not remitted.** The stock of revenues currently retained by the GoI is estimated at USD669 million, or 5.3 percent of Palestinian GDP. This amount mainly includes pension contributions collected over the years from Palestinians working in Israel and their employers. Under the agreement, it was anticipated that these contributions would be transferred to a dedicated pension fund that is yet to be established by the PA, and are to be used to pay pension allowances for these workers once they retire. The overall amount also includes deductions made by the GoI from the salaries of Palestinian workers in Israel over the years. These deductions were expected to have been transferred to the PA on a monthly basis to finance health services and social benefits for these workers and their families. Finally, revenues retained by the GoI include Allenby Bridge exit fees that have not been shared with the PA as intended under the original agreed upon sharing formula.
- 6. Resolving outstanding issues related to the revenue sharing arrangements will significantly ease the PA's fiscal stress, improve the economic outlook, and might facilitate progress on the political front.** The Israeli and Palestinian Ministers of Finance have recently met and it was agreed that the GoI will transfer to the PA about USD128 million to offset some of the PA's losses accumulated over the years. This recent agreement is highly encouraging as a first step. The revival of the Joint Economic Committee (JEC) that was established in 1994 with the objective of following up on the implementation of the Paris Protocol would help in resolving outstanding issues.
- 7. Closing the fiscal gap will also require sustained action by the PA and the donors.** The PA ought to carry on with its efforts to enhance public revenues as they continue to be lower than potential. On the domestic front, low tax collection in Gaza is an important reason behind suboptimal revenues, as it shaves 3-4 percentage points off the PA's revenues as a share of GDP. Weak compliance in the West Bank and generous tax holidays also reduce revenues by about 4 percentage points. Reforms by the PA to enhance revenues and rationalize expenditures ought to continue, even under the challenging economic and political conditions. The World Bank's report to the AHLC in September 2015 provided recommendations on how to rationalize public spending and improve its quality. With such continued fiscal reforms by the PA, donors need to do their share and support the reforms through budget support based on progress by the PA on key measures such as those found in the European Union's results framework for budget support, the IMF's recommendations and the World Bank's budget support framework.

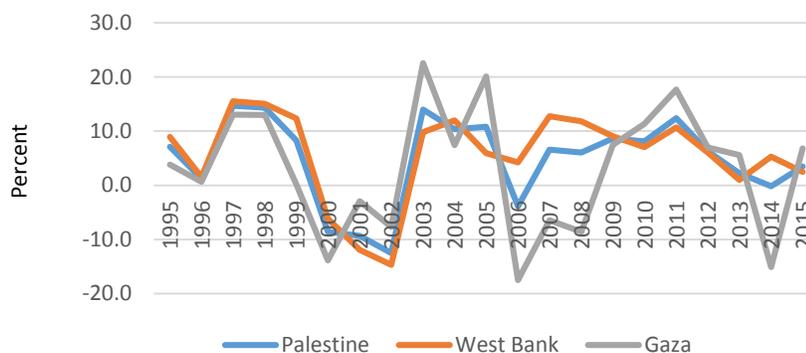
- 8. Slower than expected aid continues to hamper Gaza reconstruction, but as additional pledges materialize, the current import mechanism will also need to be adjusted.** Out of the USD3.5 billion pledged at the Cairo conference for Gaza reconstruction, USD1.4 billion has so far been disbursed, which puts the disbursement ratio at 40 percent. Since the September 2015 AHLC report, disbursements have increased by USD179 million: USD159 million in additional disbursements and USD20 million as a result of updating figures. Funds already disbursed are USD1.3 billion less than originally planned mainly because payments by some of the largest donors remain lower than anticipated. At the current pace, pledges will fully materialize by mid-2019; almost two years behind schedule. As donor pledges materialize and as larger recovery projects start to advance, the import mechanism will need to be adjusted to enable the entrance of the required materials and accelerate approval procedures, while taking into account legitimate Israeli security concerns. Despite recent progress, construction material imported into Gaza continues to be lower than needed. At the current import rate, it will take about two years to import materials needed to rebuild and repair all housing units impacted by the war. As a result of lower than needed funding and construction materials, only 9 percent of totally damaged houses and 45 percent of partially damaged houses have so far been rebuilt, and 14,800 families continue to be displaced.
- 9. The main body of the report is organized in four chapters and an annex.** Chapter II focuses on recent economic developments and provides a near term macroeconomic outlook. Chapter III discusses the PA's finances in 2015 and 2016. Chapter IV reviews money and banking, while Chapter V takes a comprehensive look at the implementation of the revenue sharing arrangements between the PA and the GoI. Finally, an annex summarizes the status of donor pledges from the Cairo conference on Gaza reconstruction.

## II. Recent Economic Developments

**10. Economic recovery is underway following the 2014 recession, but income levels continue to be stagnant.** In 2014, the Palestinian economy contracted by 0.2 percent due to the devastating impact of the Gaza war on economic activity. Recovery has started and the economy is estimated to have grown by 3.5 percent in 2015, in real terms.<sup>2</sup> Given that population growth in the Palestinian territories is high at around 3 percent, real GDP per capita is estimated to have remained almost stagnant in 2015.

**11. Reconstruction efforts have supported economic recovery in Gaza, but a full rebound to prewar levels requires further time.** The Gaza economy is estimated to have expanded by 6.8 percent in 2015, in real terms. The recovery has mainly been driven by a very strong rebound in construction activity and, to a lesser extent, wholesale and retail trade. Despite some progress, the reconstruction efforts have been slower than expected. At this pace, the Gaza economy is not expected to rebound to its pre-war level until 2018. The GoI has been allowing shipments of certain products from Gaza to the West Bank and some agricultural produce to Israel. However, the monthly flow of goods out of Gaza is reported to be well below what it used to be before the blockade was imposed in 2007.<sup>3</sup>

**Figure 1: Real GDP Growth, 1995-2015**



Source: Palestinian Central Bureau of Statistics

**12. Meanwhile, growth in the West Bank slowed in 2015.** Real growth in the West Bank is estimated at 2.5 percent in 2015, which is a 2.8 percentage point drop from the previous year's level. Growth was mainly concentrated in wholesale and retail trade in addition to services, while agriculture and manufacturing both contracted in 2015. The slowdown is mainly attributed to a significant decline in foreign aid in addition to the Israeli decision to suspend the transfer of PA taxes in early 2015, resulting in a severe liquidity squeeze.

**13. A quarter of the Palestinian labor force remains unemployed.** After skyrocketing to more than 47 percent during the 2014 war, unemployment in Gaza declined to 38 percent by the end of 2015, as the reconstruction process started to pick up and private firms were beginning to rebuild their capacity. Unemployment in Gaza was twice as high as that in the West Bank. The Palestine Central Bureau of Statistics (PCBS) labor force data indicates that unemployment amongst Palestinian youth was very

<sup>2</sup> GDP growth rates for 2015 are based on preliminary data by the Palestine Central Bureau of Statistics.

<sup>3</sup> <http://gisha.org/reports-and-data/the-gaza-cheat-sheet>

high in 2015, particularly in Gaza where more than half of those aged between 15 and 29 were out of work. In addition to low labor demand, females continue to face challenges to join the labor force and therefore, female participation rate in the labor market is very low at around 19 percent, with a high unemployment rate of almost 40 percent.

- 14. Inflation remains low and stable, but with regional differences.** Average inflation in the Palestinian territories in 2015 was 1.4 percent: 1.3 percent in the West Bank and 1.8 percent in Gaza. Prices in Gaza started to rise following the crackdown on smuggling through tunnels with Egypt in the summer of 2013, as access to the cheaper Egyptian fuel, construction materials, and other commercial goods significantly deteriorated.
- 15. The current account deficit (excluding official transfers) is estimated to have declined to 11.1 percent of GDP in 2015 due to a narrowing of the trade deficit.** Preliminary estimates indicate that the trade deficit as a share of GDP amounted to 35.9 percent in 2015, which is about 4 percentage points lower than its 2014 level. This was driven by a decline in imports from Israel, the Palestinian territories' main trading partner. Imports from Israel were lower due to slower growth in the West Bank, lower fuel prices, and a growing trend among Palestinian consumers to substitute products imported from Israel by those from other countries. As a result, non-Israeli imports were up 22 percent in 2015. The size of exports in the economy remained low and stagnant at 17 percent in 2015 due to the ongoing Israeli restrictions, which have eroded the productive capacity of Palestinian agriculture and industry.
- 16. The economic outlook continues to be highly uncertain.** Assuming that the current restrictions remain in place and that the recent surge in violence does not further escalate, the real GDP growth rate of the Palestinian economy is projected to hover around 3.5 percent in the medium term.<sup>4</sup> This sluggish growth implies a stagnation in real per capita income and an increase in unemployment. Notably, downside risks remain significant. First, the pace of reconstruction and recovery in Gaza has been slower than anticipated and despite some acceleration in recent months, additional setbacks are possible. Second, the outcome in the West Bank may be worse than expected if tensions continue to escalate. This will result in elevated security risks that may eventually weaken consumer and investor confidence, and hence, negatively impact economic activity.

### III. Public Finance in 2015 and 2016

#### Fiscal Developments in 2015

- 17. In 2015, the PA managed to reduce the overall fiscal deficit as a percentage of GDP, but a steep decline in donor aid resulted in an increase in domestic borrowing and arrears accumulation.** Expenditure growth was high in 2015, exceeding 6 percent (in nominal NIS terms), mainly driven by spending on transfers and goods and services. However, it was offset by strong revenue growth of 9 percent. As a result, the overall fiscal deficit (before grants) declined relative to its 2014 level and reached 11.4 percent of GDP. Aid in 2015 dropped by almost 30 percent relative to the previous year and it was lower than needed to cover the deficit, leading to a USD650 million financing gap. The PA resorted to arrear accumulation and domestic borrowing to cover the gap.
- 18. The PA's revenue grew in 2015, continuing a trend that started in 2014.** The revenue to GDP ratio increased by 0.1 percentage point to reach 21.7 percent in 2015, after increasing by 3 percentage points in 2014. The PA's efforts to settle tax violations and collect advance payments led to a 10 percent year-

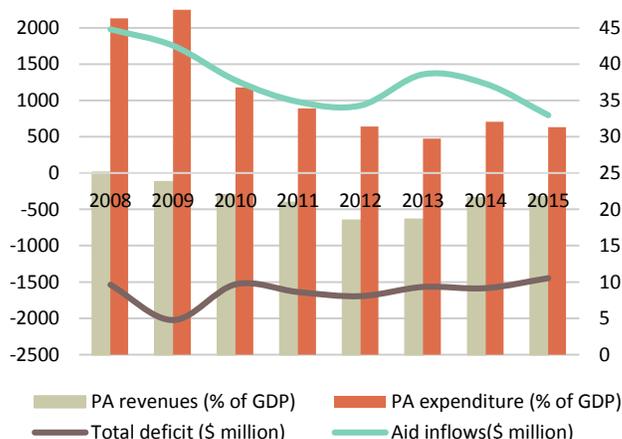
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<sup>4</sup> GDP projections were produced by the IMF.

on-year growth in domestic tax collections in 2015. The PA’s efforts also focused on widening the tax base through adding 8,920 new taxpayers to the system. Clearance revenues also performed well in 2015 growing by 9 percent. Their growth was mainly driven by an increase in customs that are collected on non-Israeli imports according to the Paris Protocol. Growth in customs is explained by two factors: Firstly, following the elimination of the subsidy on local tobacco in March 2014, consumers have been shifting to imported brands as the price of local and imported cigarettes has become very close. Secondly, there has been a general trend among Palestinian consumers, since the 2014 Gaza war, to shift towards products from third countries. Growth in clearance revenues in 2015 is also attributed to an increase in collections from petroleum excise due to increased imports of Israeli fuel into Gaza.

**19. Public expenditure growth was high in 2015.** It exceeded 6 percent and it was driven by an increase in transfers and spending on goods and services. Transfers grew by 16 percent mainly due to higher spending in Gaza and repayment of pension arrears from 2014. As for spending on goods and services, it grew by about 9 percent in 2015 due to an increase in the cost of medical referrals outside the public system. The Ministry of Health (MoH) has already implemented measures to control referral costs such as signing Memoranda of Understanding with three Israeli hospitals to regulate the contractual terms of the referral process, including pricing arrangements. As a result, the cost of referrals to Israeli hospitals dropped by 31 percent in 2015, year-on-year. Nevertheless, the cost of referrals to private Palestinian hospitals in the West Bank and East Jerusalem continues to rise. The MoH states that it plans to expand measures already implemented to control referrals to Israeli hospitals to cover Palestinian hospitals as well.

**Figure 2: The Palestinian Authority’s Finances, 2008-2015**



Source: PA MoF

**20. Growth in the wage bill was contained at 1 percent in 2015, on a cash basis, but unfunded commitments threaten to increase the wage bill in 2016.** The PA maintained a zero net hiring policy in 2015 as end of year employment figures show that the number of public employees decreased by 11, on a net basis, compared to end-2014.<sup>5</sup> The increase in the wage bill in 2015 was well below the 3.8 percent assumed by the budget because the PA did not pay the Cost of Living Allowance (CoLA) and

<sup>5</sup> 823 employees were hired in the West Bank while 933 departed from the labor force in Gaza. The number of employees outside the Palestinian territories increased by 99. Net employment in the security and education sectors increased by 219 and 63, respectively, while it was reduced by 138 in the health sector.

the increases for teachers that were called for in the 2015 budget. These increases are obligations that the Ministry of Finance (MoF) will eventually pay, and hence, they pose a contingent liability.

- 21. Net lending showed a slight decline in 2015 compared to the previous year.** The PA took some measures to control net lending in early 2015, including entering into MoUs with three Palestinian electricity providers. By signing the MoUs, the electricity providers commit themselves to paying 90 percent of what they collect from customers to the Israel Electric Corporation (IEC) which is the main supplier. The remaining 10 percent is used to cover operational costs. As a result, net lending showed a strong decline in the second quarter of 2015. Nevertheless, the monthly net lending amount started to increase again later in the year as some electricity distributors reverted to the practice of not transferring dues to the IEC.<sup>6</sup> As a result, net lending ended the year only 1 percent less than in 2014.<sup>7</sup>
- 22. Lower than needed aid resulted in an increase in the PA's domestic borrowing and the accumulation of further arrears.** The PA's total deficit amounted to USD1.45 billion in 2015. Aid received was USD798 million: USD709 million in budget support and USD89 million in development financing. Notably, aid received was 30 percent lower than in 2014 and a staggering 58 percent below budget. As a result, the PA ended up with a financing gap of about USD650 million. To finance the gap, the PA resorted to borrowing from local banks. It, therefore, increased its net domestic bank financing by USD163 million, leading to a total stock of debt of USD1.5 billion, as of December 2015 – almost reaching the limit permitted by the Palestine Monetary Authority (PMA). Although the PA has been clearing its old arrears, new arrears were generated in 2015, and hence, net accumulation amounted to USD491 million.<sup>8</sup> In an attempt to reduce the flow of arrears, the MoF plans to introduce a promissory notes program whereby legally enforceable notes will be issued to PA suppliers. (See Box 1).

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<sup>6</sup> According to the GoI, the total amount of electricity debt owed to the IEC stood at NIS1.7 billion, as of end-2015. However, the PA disputes this amount and requests that an audit is carried out to verify it. Also, the PA states that about NIS1.3 billion of the debt is owed by the Jerusalem District Electricity Company (JDECO) which is 75 percent privately owned, and hence, the PA should not be accountable for it.

<sup>7</sup> Figures reported here on net lending are different from those reported by the PA because they were adjusted to neutralize the effect of the extraordinary deduction of NIS237 million made by the GoI from Clearance revenues in February.

<sup>8</sup> About 41 percent of arrears accumulated in 2015 is to private suppliers while the majority of the rest is to the pension fund.

### Box 1: PA Promissory Notes

In an attempt to contain the impact of arrear accumulation on private sector liquidity, the PA is currently exploring the introduction of a promissory notes program. Under the envisaged program, legally binding promissory notes would be issued to PA suppliers on specific terms and conditions, detailing the PA's debt obligation and future repayment schedule. Suppliers may opt to cash-in their debt instrument at one of the participating banks, in doing so transferring the PA's debt obligation from the supplier to the bank, in exchange for a discounted cash payment.

While the details of the program are still being worked out, such notes could provide cash flow relief for cash-strapped suppliers, and enforce a more transparent debt repayment and expenditure management process. However, such a program needs to address the following concerns: First, given the banking sector's high credit exposure to the PA, transferring additional debt to the banks through the PA's suppliers raises exposure risks. Second, one of the key success factors in the proposed promissory notes program is the PA's ability to fulfill its debt obligation in accordance with the specified terms and repayment schedule. In light of the recent decline in external budget support, and with over two thirds of public revenues consisting of clearance revenues that are subject to unplanned disruptions, this is very risky.

#### Assessment of the PA's 2016 Budget

- 23. According to the 2016 budget, the financing need will remain large.** The budget projects a 4 percent increase in revenues and a 2 percent decline in expenditures due to a drop in net lending and in the spending on goods and services by 27 and 19 percent, respectively.<sup>9</sup> The wage bill is expected to grow by 3 percent in 2016 despite a decision to maintain the zero net hiring policy. The increase will be driven by a 1.25 step increase that is mandatory by law, a 1.5 percent CoLA, in addition to yearly promotions. The recurrent deficit is projected at about USD1.03 billion, or 7.8 percent of GDP. Development expenditures are expected to total USD350 million leading to a total deficit of USD1.38 billion, or 10.5 percent of GDP – 0.9 percentage point less than in 2015. The budget assumes that aid will amount to USD1 billion (USD750 million in budget support and USD250 million in development financing), leading to a financing gap of about USD380 million.
- 24. Bank staff estimates a larger financing gap than assumed by the budget.** The budget revenue target is seen as achievable, but the expected decline in expenditures appears optimistic, particularly for net lending and the use of goods and services. Also, Bank staff projects development spending to be lower than budgeted based on past trends. Put together, staff projects the 2016 total deficit to be USD1.43 billion, or 10.9 percent of GDP. Aid inflows are expected to reach a maximum of USD900 million, resulting in a financing gap of USD0.5 billion. Notably, this projection does not take into account any increases to the salaries of teachers in 2016, as it is unclear whether they will be implemented this year.

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<sup>9</sup> Year-on-year changes are in nominal NIS terms.

**Table 1: The Palestinian Authority's Fiscal Operations, 2013-2016**

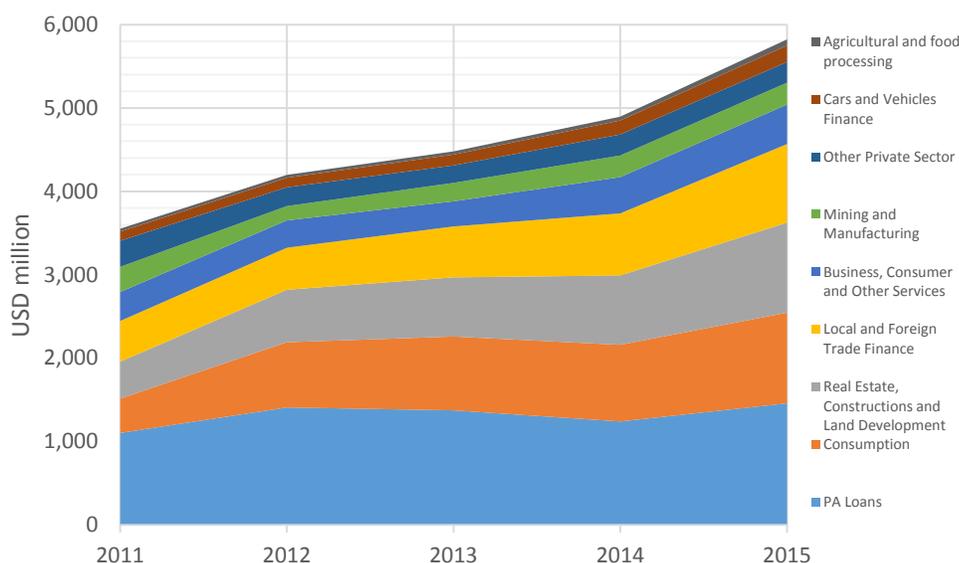
	2013	2014	2015	Budget	World Bank Projections
				2016	
<b>USD million</b>					
<b>Total revenues</b>	2311	2744	2754	2869	2867
<b>Total expenditure</b>	3693	4068	3973	3901	4066
Wage expenditure	1919	2050	1912	1965	1965
Nonwage	1564	1732	1816	1718	1842
Net lending	210	286	301	218	260
<b>Recurrent deficit</b>	-1382	-1324	-1219	-1032	-1199
<b>Development expenditure</b>	187	262	230	350	230
<b>total deficit</b>	-1569	-1586	-1449	-1382	-1429
<b>Financing</b>	1569	1586	1449	1382	1429
Budgetary support	1255	1027	709	750	767
Development financing	106	203	89	250	130
Net domestic bank borrowing	-248	-142	163	250	250
Domestic arrears	462	504	491	-250	-250
Residual	-6	-6	-3	382	532
<b>In percent of GDP</b>					
<b>Total revenues</b>	18.6	21.6	21.7	21.8	21.8
<b>Total expenditure</b>	29.7	32.0	31.3	29.6	30.9
Wage expenditure	15.5	16.1	15.1	14.9	14.9
Nonwage	12.6	13.6	14.3	13.0	14.0
Net lending	1.7	2.3	2.4	1.7	2.0
<b>Current balance</b>	-11.1	-10.4	-9.6	-7.8	-9.2
<b>Development expenditure</b>	1.5	2.1	1.8	2.7	1.7
<b>Total deficit</b>	-12.6	-12.5	-11.4	-10.5	-10.9

*Sources: PA MoF and staff estimates*

## IV. Money and Banking

**25. The Palestinian banking sector maintained a stable performance in 2015, despite a slight decline in profitability.** PMA data for 2015 indicates a 6.5 percent increase in net assets across the Banking sector. Direct credit increased by 19 percent over the past year, but the banking sector remains highly liquid with a loans-to-deposits ratio of 60 percent. Given the high political uncertainty permeating the Palestinian economy, the Banking sector maintains a fairly risk-averse position. However, over recent years, the private credit-to-deposits ratio has grown from 28 percent in 2011 to 41 percent in 2015. A closer look at bank lending reveals significant concentration, with approximately 50 percent of all private lending going to construction and consumer loans. While this ratio did not fluctuate severely over recent years, potential concentration risks should be closely monitored. Encouragingly, nonperforming loans declined in 2015 compared to 2014, reaching 2.1 percent by year end.

**Figure 3: Distribution of Credit Facilities by Economic Sector**



Source: Palestine Monetary Authority

**26. The banking sector’s credit exposure to the public sector is at its highest level in recent years.**

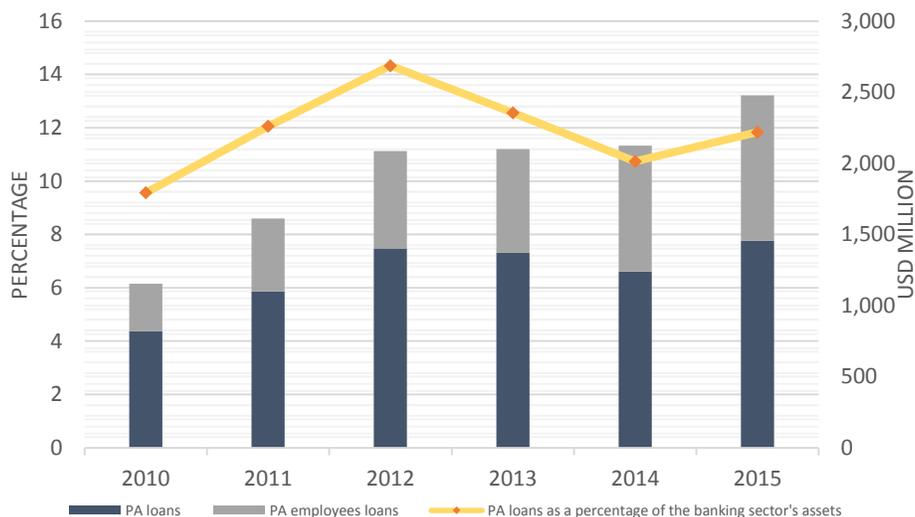
PMA records for 2015 indicate a total of USD1.5 billion in credit facilities to the PA -- a 17.5 percent increase compared to 2014. Credit to the PA represents 12 percent of the banking sector’s total assets and approximately 100 percent of the sector’s equity. When considering concentration risks, monitoring exposure to the PA must go hand-in-hand with exposure to public sector employees. PMA records show that credit to public sector employees, as of December 2015, exceeded the USD1 billion mark and in doing so, maintained an upward trend since 2010. Credit to the PA and its employees combined represent about 43 percent of the total banking sector credit facilities. In light of the PA’s systemic fiscal instability, this high credit concentration risk carries significant ramifications on the viability of the banking sector as a whole. To ensure the resilience of the Palestinian banking system against potential shocks, the PMA regularly conducts stress testing in line with the Basel II principles. According to the latest available data (June 2015) the PMA reports that the banking system is well capitalized and able to withstand a wide range of shocks.

**27. A persistent cause for concern among Palestinian banks over the past several years has been accumulation of excess NIS liquidity.**

Palestinian banks<sup>10</sup> have long faced difficulties in managing NIS liquidity with Israeli banks who cite concerns over money-laundering and financing of terrorism as the main reasons undermining correspondent banking relationships. Given that the Palestinian economy is cash based, a fragile relationship between Palestinians banks and their Israeli correspondents may severely undermine the payment system and affect economic transactions.

<sup>10</sup> NIS cash transfer difficulties are currently only faced by Palestinian banks and not by foreign banks operating in the Palestinian territories.

**Figure 4: Following a decline since 2012, PA debt increased again in 2015 after the suspension of clearance revenue while credit to PA employees has been on the rise all along**



Source: Palestine Monetary Authority

**28. The PMA has been making steady progress towards greater regulatory efficiency and effectiveness.** Among recent actions by the PMA to strengthen the resilience and stability of the banking system, it approved liquidation and merger deals resulting in the forthcoming reduction of licensed banks from 16 to 14. Furthermore, the PMA has taken concrete steps towards enhancing the efficiency and effectiveness of its supervisory process, with technical support from the IMF and the World Bank. The steps include the preparation of Basel II guidelines and a Risk Based Supervision Manual. Such steps towards risk based supervision will enhance the regulator’s efficiency and effectiveness by focusing on risky banking activities, with minimal burden on the overall banking system.

**29. Efforts to enhance the regulatory framework and expand the credit bureau are also expected to have a positive potential impact on the financial sector.** The proposed Central Bank Law is expected to provide greater independence for the PMA in conducting monetary policy, and would form the legal basis for the potential establishment of a central bank in the future. Following a series of consultations with stakeholders to discuss the draft law, the PMA is currently in the process of incorporating feedback received, with a goal of finalizing the Central Bank Law over the coming few months. Further to recent developments on the proposed Central Bank Law, the President recently approved a new Anti-Money Laundering and Combating Financing of Terrorism Law (AML/CFT), establishing a national committee for the implementation of relevant UN Security Council AML/ CFT resolutions. The PMA is also making progress towards greater financial inclusion, including the development of a financial inclusion strategy and expanding the capacity of the credit registry. Concrete steps taken by the PMA include conducting financial inclusion field studies to be reviewed by the relevant working groups ahead of the anticipated official launch in the second half of 2016. Additional achievements include enhancements to the credit registry capacity of the PMA through incorporating financial data from mortgage loans, leasing activities and utility payments.

## V. Enhancing the Palestinian Authority's revenue potential: A focus on clearance revenues

- 30. Despite commendable fiscal consolidation efforts during 2008-15, the PA's finances remain fragile.** Successful reform efforts and strong economic growth helped bring the relative size of the PA's overall fiscal deficit down from 24.6 percent of GDP in 2008 to 11.4 percent in 2015. Nevertheless, the deficit still stood large, at USD1.45 billion in 2015. Inflows of donor aid have been a major source of financing for the deficit, but those have significantly declined in recent years and have been insufficient to cover the overall financing need. As a result, the PA has accumulated large arrears to private suppliers and to the pension fund, estimated at 20 percent of GDP by the end of 2015. This, in addition to large borrowing from the domestic banking sector has undermined the PA's debt sustainability.
- 31. Low tax effectiveness in Gaza takes off about 3-4 percentage points of the PA's revenue to GDP ratio, according to Bank estimates.** The internal divide between the West Bank and Gaza, since 2007, has significantly affected the PA's ability to collect taxes in the Strip. In fact, only about 12 percent of the PA's current revenues come from Gaza even though the share of its economy is close to 30 percent of the overall Palestinian economy. Revenues collected from Gaza mainly include taxes on the income of PA employees working in the Strip in addition to taxes on fuel imports from Israel.
- 32. Stronger compliance and less generous tax holidays could increase domestic revenue generation.** Tax avoidance is prevalent in the Palestinian territories as a large number of individuals and companies are not registered to pay taxes. According to the MoF, only 30 percent of the tax base is covered. The PA has already intensified efforts to increase the number of registered taxpayers, which is a highly commendable step. However, more needs to be done. In particular, tax enforcement should be improved through capacity building of the Large Taxpayer Unit (LTU) in order to strengthen targeted audit activity and dispute management capacity. Furthermore, legislation ought to be strengthened to penalize non-payers and eliminate excessive tax exemptions such as those offered by the investment promotion law. Also, nontax revenues could be significantly increased by revising some government fees and charges such as those paid for medical examinations and agricultural services, particularly since most have not been adjusted in over twenty years. Such actions could increase domestic revenues by as much as 3.7 percentage points of GDP, according to the IMF.<sup>11</sup>
- 33. Allowing the PA to mobilize tax revenue in Area C and securing a tighter implementation of the revenue sharing arrangements between the GoI and the PA can significantly improve the PA's fiscal situation.** Area C constitutes about 61 percent of the West Bank. Access to this area has been severely limited for Palestinians for most kinds of economic activity. World Bank estimates show that granting Palestinian businesses access to Area C (excluding the areas subject to final status negotiations) would boost the Palestinian economy by about a third and increase the PA's revenues by USD800 million, or 6 percentage points of GDP. Clearance revenues – i.e. VAT, import duties and other income collected by the GoI on behalf of the PA and transferred to the latter on a monthly basis -- represent the majority of the PA's revenues, specifically, 73 percent in 2015. Nevertheless, the implementation of some of the revenue sharing arrangements has been less than optimal from the PA's perspective. Moreover, the PA is of the view that they are outdated and updating them would enhance its fiscal revenues.
- 34. Some welcome progress has been made recently but a lot more revenues could be secured if the Palestinian and Israeli sides reach deeper cooperation on revenue sharing and related**

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<sup>11</sup> See Annex IV of the IMF's May 2015 report to the AHLIC.

**information sharing.** The Israeli and Palestinian Ministers of Finance have recently met to resolve some issues related to the revenue sharing arrangements, and it was agreed that the GoI will transfer to the PA about USD128 million to offset some of the PA's losses over the years. This recent agreement is highly encouraging, but it is only a first step. The remainder of the report will take a comprehensive look at the revenue sharing arrangements between the GoI and the PA, and discuss factors contributing to fiscal losses to the Palestinian side.

## **I. Description of the revenue sharing arrangements between the PA and the GoI**

### **35. Revenue sharing arrangements between the GoI and the PA were instituted by the Paris Protocol.**

The Protocol was signed on April 29, 1994<sup>12</sup> and it regulates economic relations between the GoI and the PA. It established a quasi-customs union<sup>13</sup> between Israel and the West Bank and Gaza whereby the two parties apply the same import policy on trade with third countries<sup>14</sup> and maintain free trade in all goods between them.<sup>15</sup> Given that the PA's customs officials are not present at the points of entry, the Protocol defined specific arrangements through which the GoI collects import taxes on Palestinian trade with third countries and shares them with the PA. The Protocol also sets up a mechanism for the clearance of indirect taxes (VAT) on bilateral trade between the PA and the GoI. The protocol provides that both parties shall maintain a normal movement of labor between them and it therefore introduced provisions to regulate the transfer of fees collected by the GoI from Palestinian workers in Israel.

### **36. Subsequent agreements signed by the parties after the Protocol introduced additional revenue sharing arrangements.**

For instance, the Interim Agreement regulates the transfer of taxes collected by the GoI from individuals and businesses operating in Area C to the PA. It also covers arrangements for sharing passenger exit fees through the Allenby Bridge.<sup>16</sup> In 1995, the Parties also agreed that Israel would deduct a 3 percent handling fee from import taxes and VAT it remits to the PA to cover its administrative costs.<sup>17</sup>

### **37. Some of these revenue arrangements have become outdated and others have not been implemented as envisaged by the agreement, resulting in fiscal losses for the PA and the GoI.**

The Paris Protocol was intended to serve for a short interim period of five years, starting in 1994, during which the PA could form its institutions and build capacity to manage its economic affairs. It was anticipated that by the end of the interim period, a permanent status agreement that guarantees Palestinian political and economic independence would be reached.<sup>18</sup> However, the failure of the permanent status negotiations between the parties led to the *de facto* extension of the Protocol far beyond the period it was designed for. As a result, certain aspects of it have become outdated, and hence, unable to serve the interests of the parties. Also, the deterioration in the parties' relationship, especially after the outbreak of the second Intifada in September 2000, has resulted in the suspension of coordination and implementation of some of the Protocol's arrangements.

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<sup>12</sup> In 1995, the Protocol was slightly amended and incorporated as Annex V to the 1995 Interim Agreement on the West Bank and the Gaza Strip.

<sup>13</sup> The GoI refers to it as a customs "envelope".

<sup>14</sup> An exception to this general rule applies to goods on the A1 and A2 lists for which the PA can define an independent import policy (including the rate of import taxes, standards, licensing and other regulations) and to the goods on list B for which the PA can define the rate of import taxes.

<sup>15</sup> The Protocol also enabled free trade in some services including banking (Art IV), tourism (Art X) and insurance (Art XI).

<sup>16</sup> And the Rafah crossing which remained under Israeli control until September 2005. See Section G of Appendix 5 to Annex I of the Interim Agreement.

<sup>17</sup> See Paragraph 4 of the Supplement to the Protocol.

<sup>18</sup> See Paragraph (5) in the preamble to the 1995 Interim Agreement.

## II. The PA's revenue losses under the existing revenue arrangements<sup>19</sup>

### II.1 Revenue losses due to inadequate implementation of current arrangements and misreporting by businesses

#### A. Indirect imports and undervaluation of direct imports

**38. Under the Paris Protocol, taxes collected on imports from third countries are cleared between Israel and the PA based on the principle of final destination.**<sup>20</sup> Given that the PA's officials are not present at the points of entry, Palestinian imports from third countries are cleared by Israeli customs, and taxes collected are transferred to the PA. As with importing arrangements around the world, Palestinian and Israeli importers need to submit a detailed import declaration when they import from third countries, specifying the classification of the goods according to the Harmonized System (HS) and their value. If the declaration states that the final destination is the Palestinian territories, then the GoI is expected to transfer to the PA all import taxes and other levies it collects on the imports including VAT, customs and purchase tax.

**39. Due to difficulties faced by Palestinian importers to directly import goods from third countries, they often resort to indirect importing through Israel, which results in fiscal leakages for the PA.** According to the Palestine Central Bureau of Statistics (PCBS), direct imports from third countries represent less than a third of overall Palestinian imports. The rest is purchased from Israel. Palestinian businesses state that they are hesitant to directly import goods from third countries due to difficulties and delays they face in getting their goods cleared at the Israeli points of entry. For example, imports destined to the Palestinian territories go through additional security checks that Israeli bound goods are not subject to. Also, Palestinian importers need to apply for an import license every time they import merchandise while Israeli importers are granted a one year license. The same applies for standards licensing. This could result in favoring Israeli importers who can clear their goods faster and cheaper. Palestinian businesses also report that regulations governing direct importing are revised often by the Israeli authorities and are only available in Hebrew which makes it difficult for Palestinian importers to meet them. Therefore, they often end up not fulfilling import requirements, which results in delaying the clearance of their imported goods and raises storage and transaction costs. Therefore, a large number of Palestinian businesses use Israeli middlemen to import goods from third countries because procedures are seen as simpler and less time consuming relative to those applied to direct imports. The Protocol specifies that in such cases, the PA is eligible to receive import taxes *only* if the Israeli importer explicitly states in the import declaration that the goods are destined to the Palestinian territories. In practice, however, goods that originate from third countries are imported to Israel as the final destination and then re-sold to Palestinian traders as Israeli goods. This is enabled by the fact that Israeli importers, unlike Palestinian importers, are not required by law to sign a declaration stating that the imported goods will only be sold in their area. As a result, indirect imports enter the Palestinian market as Israeli goods, which makes the PA only eligible for VAT collected on them according to the Paris Protocol. Other import duties collected on these goods are retained by the GoI, resulting in a fiscal loss for the PA.

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<sup>19</sup> The GoI did not share data with the World Bank for this analysis, so quantification of the fiscal losses is based on data provided by the PA and various estimation methods.

<sup>20</sup> Article III, paragraph 15 of the Paris Protocol.

- 40. Estimating the leakage on indirect imports is challenging mainly because these imports are registered in both Israeli and Palestinian trade data as part of the bilateral trade with Israel, not disaggregated in a separate category.**<sup>21</sup> To estimate the value of indirect imports, the team compared the registered value of Palestinian imports from Israel as reported by the PCBS to a predicted value produced by a gravity model.<sup>22</sup> The difference between both amounted to USD726 million in 2014, which implies that 35 percent of Palestinian imports from Israel (excluding water, electricity, and fuel) are actually from third countries. Applying the average import tariff to the value of indirect imports results in USD30.6 million in an annual leakage for the PA in customs and purchase tax.<sup>23</sup>
- 41. Moreover, the PA suffers from tax leakages on direct imports due to widespread undervaluation by Palestinian importers as the PA’s customs officials cannot inspect at the points of entry.** Goods bound to the Palestinian territories are inspected by Israeli officials, and the GoI has been sharing data collected on these imports with the PA on a daily basis since 2014. Trade data confirms that declarations by Palestinian importers are 32 percent lower, on average, than those submitted by trading partners. On the other hand, data indicates that undervaluation of Israeli goods is lower at 23 percent.<sup>24</sup> This results in annual fiscal leakages for the PA estimated at USD53 million.<sup>25</sup> Palestinian customs officials report that intercepting goods as they cross into the West Bank remains challenging due to the multiple routes used by importers, including in Area C where the PA has no control. As a result, post clearance audits have only generated around USD9 million per year—less than one percent of the annual value of Palestinian imports, despite the high rate of undervaluation.

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<sup>21</sup> The GoI also mentions that it suffers from leakages related to indirect imports to the Israeli market.

<sup>22</sup> According to the PCBS, registered Palestinian imports of goods from Israel amounted to USD3.958 billion in 2014. Given that the objective is to estimate the value of indirect imports, imports of water, electricity and fuel (USD1.855 billion) were deducted since they are not imported from third countries, resulting in a new value of USD2.104 billion. However, a gravity model developed by the Bank of Israel shows that the expected value of Palestinian imports from Israel should be half the value reported in official trade statistics, resulting in a predicted value of USD1.052 billion (See Bank of Israel’s report “Recent Economic developments 137, October 2013-March 2014” published in June 2014). The gravity model does not take into account the effect of the customs union which enhances trade between its members by 31 percent (See: <http://www.jstor.org/stable/25146520>). Factoring in the marginal effect of the customs union results in an increase in the predicted value to USD1.378 billion. The difference between the latter and the adjusted official figure is USD726 million, and it is our estimate for the value of indirect imports.

<sup>23</sup> Before applying the tariff, the value of indirect imports was converted to the C.I.F. (Cost Insurance Freight) value of the goods using a ratio of 1.52. The ratio was constructed taking into account the average Israeli tariff, 18 percent VAT paid at the point entry, and an average profit margin for the Israeli trader of 20 percent. By applying this ratio, the CIF value of indirect imports is estimated at USD478 million. Finally, to calculate the fiscal leakage, the average Israeli tariff was applied. Notably, the tariff was adjusted to exclude cars since they are imported directly from third countries and *not* through Israel. The tariff was also adjusted to exclude fuel since it was deducted from the original import value.

<sup>24</sup> To estimate the average rate of undervaluation of Palestinian imports from third countries, the annual value of Palestinian imports from a number of countries as reported by the Palestinian territories was divided over the annual value of exports to the Palestinian territories as reported by the trading partners. The average ratio for the Palestinian territories was 68 percent. The same exercise was done for Israel and the ratio was higher at 77 percent.

<sup>25</sup> To calculate the fiscal leakage on Palestinian imports from third countries, a ratio was computed for the value of undervaluation in Israel over the value of undervaluation in the Palestinian territories. The ratio was then multiplied by the registered value of Palestinian imports from third countries to estimate the *actual* value of these imports. The difference between the registered and *actual* value, which is USD222 million, is our estimate for unvalued annual imports. This value was multiplied by the average tariff and Palestinian VAT rate to calculate potential revenues on these imports, which amounted to USD53 million.

## B. VAT on bilateral trade with Israel

- 42. The Protocol also identifies a mechanism to clear VAT on bilateral trade between Israeli and Palestinian businesses, based on the exchange of invoices.** Under the agreement, goods traded between the two parties are subject to the VAT rate applicable at the selling market. For example, if an Israeli trader purchases goods from a Palestinian business, it will be taxed according to the Palestinian VAT rate. Trade invoices are issued by the tax authorities: (I) invoices are issued by the Israeli tax authority and (P) invoices are issued by the Palestinian tax authority. Each tax authority provides these invoices to its registered dealers, upon request. After each trade transaction, the seller produces an invoice to evidence it. He/she then offers the original invoice to the buyer, sends a copy to his/her respective tax authority, and keeps another copy for internal bookkeeping. These invoices do not include detailed information on the goods such as the HS code or their origin, but a general description of the products and their value, including the amount of VAT paid. According to the Protocol, VAT paid will accrue to the tax administration with which the payer is registered, and VAT revenues are cleared between the PA and the GoI through monthly clearance sessions.
- 43. The Palestinian and Israeli authorities both suffer from fiscal leakages on bilateral trade due to smuggling and fraud, but the relative size of the issue is more significant for the PA since around two thirds of its trade is with Israel, while less than six percent of Israeli exports are to the Palestinian territories.** Fiscal leakages occur because some transactions take place between both parties without the issuance of any official invoices. Given the lack of a physical border, goods are then smuggled to the importer's territory and sold in the black market without declaring income made on the sale. This issue is particularly prevalent on the Palestinian side because goods are brought from Israel to Area C of the West Bank, where the PA has no control. These goods are then gradually moved to Areas A and B where they are sold to wholesale and retail vendors without paying taxes to the PA. The Israeli and Palestinian tax authorities also report that they both suffer from fiscal losses due to fraud. In such cases, the importer and the exporter agree to underestimate the value of the transaction on the issued invoice to reduce the VAT obligation. This report will not aim to quantify fiscal leakages resulting from smuggling and fraud due to data constraints.
- 44. Revenue losses suffered by the PA because of under-reporting by Palestinian businesses of VAT paid to Israel -- either because businesses seek to minimize their tax obligation to the PA or as a result of the PA's inability to obtain invoices from businesses operating in Gaza -- are estimated to be significant.** The clearance procedure requires that the (I) or (P) invoices that were received by the buyer at the time of the transaction be presented during the clearance session in order for the claiming side to receive its VAT revenues. However, Palestinian buyers do not always pass on to the PA the (I) invoice that they receive from the Israeli sellers at the time of the transaction to avoid declaring sales on these goods, and hence, lower their local VAT and income tax obligations. In addition, since the internal divide between the West Bank and Gaza in 2007, the PA has rarely received (I) invoices from businesses in Gaza because its tax officials have not been able to operate there. Consequently, the PA ends up unable to claim VAT recorded in these missing invoices during the clearance sessions, which leads to significant fiscal leakages. The Israeli MoF has information on the missing (I) invoices because the Israeli sellers are required to transfer a copy of these invoices to their tax authority. However, it does not share this information with the PA due to doubts over whether the Israeli goods have actually left Israel, according to the Israeli tax authority. In the absence of information on (I) invoices from the Israeli MoF, estimating the potential magnitude of the PA's leakage remains challenging. The only available comparable data is on Israeli exports to the Palestinian territories published by the Israeli Central Bureau of Statistics. This data is derived from (I) invoices submitted by Israeli traders to their tax authority on sales to the PA. The export value was converted to

tax amounts<sup>26</sup> and then compared to the PA MoF data on what was reported by Palestinian businesses as VAT paid on purchases from Israel. The Israeli data is USD103.7 million higher than that reported by the PA and this difference is our estimate for the annual Palestinian leakage on bilateral trade.<sup>27</sup> The leakage represents about 17 percent of current VAT transfers on bilateral trade to the PA.

### C. Deductions made by the GoI from Palestinian labor salaries

**45. The Protocol provides that the GoI and the PA will attempt to maintain “normality” in the movement of labor between them.**<sup>28</sup> The agreement also grants the parties the right to determine the number of workers allowed into their territory, subject to notifying the other party. The absolute majority of labor movement over the years has been concentrated in unskilled, male Palestinian workers attracted to higher wages in Israel, mainly in the construction sector. The GoI sets yearly employment quotas to regulate Palestinian employment in Israel.<sup>29</sup> In 2014, the number of workers reached 94 thousand, or 7 percent of the Palestinian workforce.<sup>30</sup> Data provided by the GoI indicates that the quota was raised in 2015 and the number of workers reached 136,500.<sup>31</sup>

**46. The GoI is expected under the Protocol to transfer to the PA deductions from the income of Palestinians working in Israel, but this has not happened.** Specifically, the agreement sets out the following deductions:

- The equalization levy: Palestinians employed in Israel are only entitled to basic insurance benefits,<sup>32</sup> and hence their contribution to the Israeli national insurance system is lower than Israeli workers who are fully ensured. To keep the wage costs of Palestinian labor equal to those of Israeli workers and avoid any preference towards cheaper labor from the Palestinian territories, the GoI introduced the so called “equalization levy” to the income of Palestinian workers to offset the difference between their reduced contribution to the national insurance system and the full amount paid by Israeli workers. Under the Protocol, the GoI is expected to transfer the equalization levy to the PA, on a monthly basis, after deducting certain health and administrative costs.<sup>33</sup> Once transferred, the equalization levy is to be used by the PA to finance health services and social benefits for Palestinians employed in Israel and their families. In reality, however, equalization

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<sup>26</sup> Meetings with the Israeli Central Bureau of Statistics (ICBS) confirmed that the methodology used by their staff to convert VAT amounts reported in (I) invoices to export values is through dividing the former by the Israeli VAT rate. So, to convert the export data back to VAT amounts, the Bank team multiplied it by the Israeli VAT rate. However, before that, the import value was adjusted to deduct agricultural sales to the PA, since those are VAT free. The import value was also adjusted to take into consideration that figures for fuel exports in ICBS data are based on the original price of fuel, and not on the final price on which the PA pays taxes.

<sup>27</sup> The estimate is based on 2012 data, which is the latest available since Israeli trade figures for 2013 and 2014 are undergoing revisions.

<sup>28</sup> Article VII, Paragraph 1 of the Paris Protocol.

<sup>29</sup> Notably, there are no quotas for permits in settlements and industrial zones in Area C.

<sup>30</sup> According to the Israeli Population and Immigration Authority, by the end of 2014, 51842 Palestinians worked in Israel and held a permit. According to the PCBS 2014 labor force survey, an additional 27800 worked in Israel without a permit and 14600 were holders of Israeli identity cards or foreign passports.

<sup>31</sup> According to the GoI, the number of Palestinians working in Israel reached 136,500 in 2015, 40 thousand of which did not hold a permit.

<sup>32</sup> The Insurance package provided to Palestinian workers in Israel only covers work related injuries, employer bankruptcy, and the maternity leave allowance.

<sup>33</sup> According to Article VII paragraph 3 (a) of the Paris Protocol, the GoI has the right to deduct from the equalization levy fees for health services provided to workers at the place of employment in addition to two thirds of the administrative costs borne by the Israeli Employment Service when dealing with issues related to Palestinian workers.

funds collected over the years were not transferred to the PA. According to the 2014 report of the Israeli state comptroller,<sup>34</sup> the amount of equalization levy collected between 2006 and 2013 amounted to USD169.2 million, after deductions. The estimated amount for 2014 is about USD19 million.<sup>35 36</sup>

- Health insurance fees: The GoI is entitled by the Protocol to deduct monthly health insurance fees, or the so called “health stamp”, from the salaries of Palestinians working in Israel. Given that these workers do not receive health insurance services in Israel, the agreement provides that these fees should be transferred to the PA, on a monthly basis, to finance their health insurance services in the Palestinian territories.<sup>37</sup> However, sums collected over the years have not been transferred to the PA. According to the 2014 report of the Israeli state comptroller, health stamps collected between 2006 and 2013 totaled USD55.4 million.<sup>38</sup> Estimates suggest that an additional USD16.2 million was collected in 2014.<sup>39 40</sup>
- Income tax: Under the agreement, Palestinians working in Israel are entitled to the same minimum wage applied to Israeli workers and are subject to income tax deductions. The GoI is expected to transfer to the PA 75 percent of income tax collected from Palestinian workers in Israel and 100 percent of income tax paid by Palestinians working in the settlements. However, the earnings of most Palestinians working in Israel and the settlements do not exceed the Israeli minimum wage, which exempts them from paying income tax in Israel.<sup>41</sup> Following the signing of the protocol in 1994, the GoI modified its laws to enable Israeli employers to directly pay Palestinian workers without going through the Israeli Population and Immigration Authority (PIA). The changes reduced official oversight over the process making it extremely difficult for the PIA to verify whether wages paid to Palestinian workers are in line with the Israeli law. In fact, the Israeli state comptroller’s 2014 report suggests that Palestinian workers in Israel are not always paid the minimum wage. Even if some Palestinians make high earnings, lack of official oversight by the PIA enables Israeli employers to underreport wages in the pay slip to reduce tax obligations and other charges. Consequently, income tax transfers by the GoI to the PA have been extremely low, averaging around USD8.4 million in recent years. Underreporting of income also results in reduced equalization fees and other deductions since they are calculated as a share of the salary, resulting in fiscal leakages for the PA.

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<sup>34</sup> The 2014 annual report of the Israeli State Comptroller, 65a, P. 533.

<sup>35</sup> KavLaOved, 2015. “Violations of the Right to Medical Care for Palestinian Workers Employed in Israel”.

<sup>36</sup> Given that the number of Palestinians working in Israel has significantly increased in 2015, the annual amount of equalization levy collected that year is expected to exceed the 2014 estimate.

<sup>37</sup> Article VII paragraph 9 (a) of the Paris Protocol.

<sup>38</sup> The 2014 annual report of the Israeli State Comptroller 65a, 2014 P. 533

<sup>39</sup> Staff calculations based on data provided by the Israeli Population and Immigration Authority. See: [http://www.piba.gov.il/Subject/PalestinianWorkers/Documents/finance\\_allowance\\_plstn\\_2016.pdf](http://www.piba.gov.il/Subject/PalestinianWorkers/Documents/finance_allowance_plstn_2016.pdf)

<sup>40</sup> Given that the number of Palestinians working in Israel has significantly increased in 2015, the annual amount of health stamps collected that year is expected to exceed the 2014 estimate.

<sup>41</sup> The Israeli MoF reports that the GoI has recently introduced a system to reduce the tax free threshold for Palestinian workers in Israel.

D. Taxes collected by the Israeli civil administration<sup>42</sup> in Area C

**47. Under the 1995 interim agreement, the Israeli civil administration is expected to collect revenues in Area C and remit them to the PA, until this area is transferred to Palestinian jurisdiction.** Area C was due to be transferred to the PA by 1997,<sup>43</sup> however, this transfer has not been implemented yet.<sup>44</sup> Hence, the Israeli civil administration continues to be in charge of collecting taxes in Area C. Specifically, the agreement states that it is the responsibility of the Israeli side to collect property tax, income tax and VAT from individuals and businesses operating in Area C, according to the Palestinian tax rate, and remit them to the PA.<sup>45</sup>

**48. Even though the Israeli civil administration collects taxes in Area C, these funds have not been transferred to the PA.** A large number of Israeli businesses operate in Area C in the fields of electricity, telecommunications, tourism, retail trade, and quarrying, among others. Some of the large Israeli industrial zones are also located in Area C. The agreement specifies that the PA is only eligible for taxes collected from businesses located *outside* the settlements and military locations in Area C. However, land designated for settlements and closed military zones has significantly expanded since the agreement was signed in 1994 as it currently encompasses up to 89 percent of Area C.<sup>46</sup> This has continued to squeeze the share of Area C revenues that the PA is eligible for, according to the agreement. Lack of access to relevant Israeli data made it difficult for the team to quantify the size of the PA's leakage from Area C taxes.

E. Exit fees at the Allenby Bridge with Jordan

**49. The 1995 Interim Agreement sets up arrangements for sharing the passenger exit fee collected by the Israeli authorities at the Allenby Bridge with Jordan,<sup>47</sup> but the PA argues that these arrangements have not been properly implemented.** The agreement sets the passenger exit fee at the Allenby Bridge at USD26 per voucher, to be collected by Israeli officials. Income from the first 750 thousand passengers per year should be divided on a 54/46 basis, whereby USD14 of each voucher accrue to the Israeli authorities while USD12 are transferred to the PA. If in any given year the number of passengers exceeds 750 thousand, the PA's share of each voucher increases to USD16. The PA argues that the GoI unilaterally increased the exit fee in 2008 to NIS155 (USD40) for Palestinian passport holders and NIS178 (USD46) for non-Palestinian passport holders, without consulting the PA. This has significantly increased travel costs for Palestinians, particularly West Bankers whose only point of exit is the Allenby Bridge. The PA also argues that the GoI has only been remitting to it

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<sup>42</sup> The civil administration was established in 1981 as the Israeli governing body in the Palestinian territories. In 1994, most of its functions were transferred to the PA, but it remains largely in charge in Area C.

<sup>43</sup> See Interim Agreement Article XI, para 2(d) according to which the redeployment of the Israeli military forces from the West Bank and Gaza, except for issues that will be negotiated in the permanent status negotiations, should have been completed within 18 months from the date of the inauguration of the Palestinian Legislative Council which took place on 7 March, 1996.

<sup>44</sup> The Wye River Memorandum signed between the Palestinian Liberation Organization and the Government of Israel on October 23, 1998 included further arrangements regarding Israeli redeployment from Area C. However, the implementation of the Memorandum was very limited and only 2 percent of Area C was transferred to the status of Area B.

<sup>45</sup> 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).

<sup>46</sup> The World Bank, 2014. "Area C and the Future of the Palestinian economy."

<sup>47</sup> And the Rafah crossing which remained under Israeli control until September 2005. See Section G of Appendix 5 to Annex I of the Interim Agreement.

USD10.5 per traveler, which is lower than the 46 percent of the fee agreed upon in the agreement for the first 750 thousand passengers and 62 percent for each passenger thereafter. Based on the sharing arrangement specified in the agreement and taking into consideration the increase in the fee, revenues transferred to the PA were expected to amount to USD20.1 million in 2014. However, actual amounts received by the PA were USD7.9 million resulting in an annual leakage of USD12.2 million.<sup>48</sup> Furthermore, the total stock of exit fees withheld by the GoI since 2008 are estimated at USD67 million.<sup>49</sup>

## **II.2 Forgone revenue due to an outdated calculation of the handling fee**

**50. In addition to the abovementioned losses, the PA's revenues suffer from a high handling fee charged by the GoI.** In 1995, the parties agreed that for the GoI to cover its administrative costs in collecting import taxes and VAT on Palestinian trade, and handling matters related to them, it will deduct 3 percent from these revenues before it transfers them to the PA.<sup>50</sup> Given the size of Palestinian trade in 1995, the fee may have been considered acceptable for both parties. However, with the significant increase in the size of Palestinian imports over the years, the fee has become outdated. Handling fees collected by the GoI in 2014 amounted to USD63 million and they financed close to a third of the Israeli customs and VAT department's total budget, even though the share of Palestinian imports out of total imports handled by this department is a mere 6 percent.<sup>51</sup> Based on the Bank's estimates, the 3 percent fee should 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.<sup>52</sup> Using the estimated fee of 0.6 percent, deductions made by the GoI would have totaled USD13 million in 2014 rather than USD63 million actually charged, resulting in foregone revenues of USD50 million.

**51. Furthermore, The PA argues that the handling fee was not intended to apply to taxes on fuel, which does not require any handling.** According to the Protocol, fuel imported by the PA should be of specific standards that are not met by fuel produced by regional countries. As a result, the PA purchases all its fuel from Israeli companies to whom it pays all applicable taxes. These taxes are eventually remitted back to the PA after the GoI deducts 3 percent in handling fees. In 2014, handling fees on fuel amounted to USD30 million. The PA argues that this fee should not be applied to taxes on

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<sup>48</sup> The estimate is based on actual data provided by the PA on the number of passengers and transfers by the GoI in 2014 and staff calculations on the amount that should have been transferred according to the agreement. Total number of passengers was 918,126 (730,138 Palestinian passport holders and 187,988 non-Palestinian passport holders). It was assumed that 46 percent of the fee should have been transferred to the PA for the first 750 thousand passengers, taking into account that the fee in 2009 dollars was USD43 for Palestinian passport holders and USD50 for non-Palestinian passport holders. As for each passenger after the first 750 thousand, 62 percent of the fee should have been transferred to the PA.

<sup>49</sup> Following the recent discussions between the Israeli and Palestinian ministers of Finance, the GoI agreed to transfer to the PA part of the stock of exit fees that have been retained by the GoI.

<sup>50</sup> Paragraph 4 of the supplement to the Protocol on Economic relations, Annex V of the Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip signed on September 28, 1995.

<sup>51</sup> The budget of the Israeli customs and VAT department at the MoF was NIS765.7 million in 2014 (See: <http://www.ag.mof.gov.il/AccountantGeneral/BudgetExecution/BudgetExecutionTopNav/BEHistoryDataHistory/BEHistoryData/default.htm>). The 3 percent administrative fee collected by the GoI from PA revenues amounted to NIS225 million during that year, which covers 29 percent of the budget.

<sup>52</sup> The share of Palestinian imports to total imports handled by the Israeli customs and VAT department (including both Israeli and Palestinian imports) is 5.9 percent. The budget of the Israeli customs and VAT department was NIS765.7 million in 2014. Budget allocated to handle Palestinian imports out of the overall Israeli MoF budget should be commensurate with this share. Therefore, the cost allocated to Palestinian imports should be NIS45 million (5.9%\*NIS765.7 million), which constitutes 0.6 percent of tax transfers to the PA in 2014.

fuel since the GoI does not incur any administrative cost in handling fuel or transporting it to the Palestinian territories. In fact, the GoI did not initially deduct the 3 percent fee from fuel taxes until 2000, when the second intifada broke out.

### II.3 Estimate of overall revenue loss

**52. In total, the PA’s annual quantified fiscal loss resulting from the current revenue arrangements is estimated at USD285 million, or 2.2 percent of GDP.** This loss is underestimated because it does not include revenues collected by the GoI from businesses in Area C nor losses from smuggling and fraud as those were not quantified due to data constraints. The quantified amount could reduce the current deficit for 2016 to below USD1 billion, narrowing the expected financing gap by more than 50 percent.

**Table 2: The PA’s Annual Fiscal Loss under the Current Revenue Arrangements**

<b>Annual fiscal losses</b>	<b>USD million</b>
<b>Revenue losses under category II.1: inadequate implementation of current arrangements and misreporting by businesses</b>	<b>234.8</b>
VAT on bilateral trade with Israel	103.7
Undervaluation of Palestinian imports from third countries	53.0
Tax losses on indirect imports	30.6
Annual equalization fees collected from Palestinian workers in Israel	19.0
Annual health stamps collected from Palestinian workers in Israel	16.2
Leakage on the PA's share in exit fees collected at the Allenby Bridge	12.2
<b>Revenue losses under category II.2: outdated handling fee</b>	<b>50.4</b>
<b>Total</b>	<b>285.2</b>

*Sources:* World Bank staff calculations, PA MoF and the 2014 report of the Israeli state comptroller.

**53. In addition, the GoI currently retains USD669 million,<sup>53</sup> or 5.3 percent of GDP, in revenues owed to the PA and to Palestinians working in Israel.** This amount mainly reflects pension contributions collected over the years by the GoI from Palestinians working in Israel and their employers. The agreement specifies that these pension contributions need to be transferred, on a monthly basis, to a dedicated pension fund established by the PA.<sup>54</sup> The PA has not yet created this fund, and hence, the GoI has not made any pension transfers to the PA. Some Palestinian workers have withdrawn their pension contributions over the years. Nonetheless, amounts retained by the GoI are considerable and are estimated at USD377.7 million, as of December 2013, according to the Israeli state comptroller.<sup>55</sup> In addition to pension contributions, the overall amount of retained revenues also includes deductions

<sup>53</sup> This amount is underestimated because it only includes equalization fees and health stamps that were collected between 2006 and 2013, while revenues collected before this period are not covered due to the lack of data. The amount also excludes taxes collected over the years from Area C which the team could not quantify due to data constraints.

<sup>54</sup> Please see Article VII paragraph 4 of the PP. The Article also specifies that the GoI has the right to deduct two thirds of the administrative costs endured by the Israeli Employment Service while collecting the pension contributions, before transferring them to the PA.

<sup>55</sup> The 2014 annual report of the Israeli State Comptroller, 65a, P. 533

made by the GoI from the salaries of Palestinian workers in Israel between 2006 and 2013, including the equalization levy and the health stamps. These deductions were expected to have been transferred to the PA on a monthly basis to finance health services and social benefits for these workers and their families. Finally, revenues retained by the GoI include Allenby Bridge exit fees that have not been shared with the PA.

**Table 3: Total Stock of Revenues Retained by the GoI over the Years**

Stock of revenues retained by the GoI	USD million
Pensions for Palestinians working in Israel	377.7
Equalization funds collected between 2006 and 2013	169.2
Health stamps collected between 2006 and 2013	55.4
Total stock of exit fees not transferred since 2008	67.0
<b>Total</b>	<b>669.3</b>

*Sources:* World Bank staff calculations, PA MoF and the 2014 report of the Israeli state comptroller.

## Recommendations

- 54. More than twenty years since the signing of the Paris Protocol, some of its elements are still inadequately implemented while others have become outdated.** The GoI and the PA would mutually gain from redoubling their efforts to implement the Protocol. The recent agreement by the GoI to transfer USD128 million to the PA in withheld revenues is a highly commendable first step. Some potential measures are discussed below.
- 55. Revive the Israeli-Palestinian Joint Economic Committee (JEC).** The JEC was established by the Protocol, in 1994, with the objective of following up on its implementation and resolving related issues arising between the parties. In reality, the JEC only met in an interrupted manner over the years, with the last meeting held in September 2009. Reviving the JEC and enabling it to conduct its envisaged role could significantly enhance cooperation between the parties on economic and fiscal issues.
- 56. Implementing the Protocol’s provisions regarding information sharing could significantly reduce tax leakages on bilateral trade.** The GoI and the PA would start exchanging full information on the (I) and (P) invoices submitted to them by registered businesses. In fact, the protocol clearly states that “Each side will provide the other side, upon demand, with invoices for verification purposes.”<sup>56</sup> This exchange of information will inform each tax authority about the actual amount of VAT paid by its registered businesses rather than what was reported to it. It will also enable tax officials to go after businesses that do not report their purchases and take legal action against them. Notably, the parties have already implemented a similar arrangement for sharing information on Palestinian imports cleared through Israeli ports, which has helped Palestinian customs combat undervaluation of Palestinian imports from third countries. Expanding the already-existing arrangement to include data on bilateral trade could generate similar benefits for both parties.
- 57. VAT on bilateral trade with Gaza would be transferred to the PA.** The PA rarely receives information on purchases made by Gaza businesses from Israel because its tax officials have not operated in the Strip since the internal divide. Hence, the PA has been unable to claim VAT on the majority of these imports, since 2007. Given that the GoI can keep track of all Israeli goods that actually enter Gaza (the Israeli border with Gaza is completely sealed and there is only one crossing controlled

<sup>56</sup> Article VI (6) and (10) of the Paris Protocol on information sharing.

by Israeli officials), it may be in a position to estimate and transfer to the PA VAT collected on bilateral trade with Gaza.

**58. Consider the introduction in the Palestinian territories of a tax on the income of Palestinian workers in Israel whose wages are too low to be taxed in Israel but sufficiently high to be taxed in the Palestinian territories.** The earnings of most Palestinians working in Israel do not exceed Israeli minimum wage, which makes them exempt from paying income tax in Israel. Nevertheless, this income level is considered high for the Palestinian market.<sup>57</sup> The Protocol allows each party to impose additional taxes on its residents (individuals and corporations) who conduct economic activities in areas under the tax responsibility of the other side. Therefore, the PA should consider taxing the income of Palestinian labor in Israel. Estimates show that additional revenues generated would amount to USD22.4 million per year.<sup>58</sup> Information on the names of Palestinian workers in Israel, their addresses, wages and bank accounts could be accessed through the GoI since it requests such details when issuing work permits.

**59. Prohibit Israeli importers from reselling to the Palestinian market goods that have been declared to Israel as the final destination.** Since 2000, the GoI has enforced such arrangements on Palestinian importers, as it requires them to sign a binding declaration prohibiting them from reselling goods imported to the Palestinian territories in the Israeli market. Israeli importers may be required to sign an equivalent binding declaration. As for businesses that import in bulk for both markets, they may be required to store imported goods in bonded warehouses and release them only after issuing an import declaration specifying their final destination. This arrangement is being successfully applied to some Israeli importers and it could be further expanded.

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<sup>57</sup> Israeli minimum wage is NIS5100 per month in the construction sector and NIS4650 in other sectors, which is much higher than the Palestinian minimum wage of NIS1450.

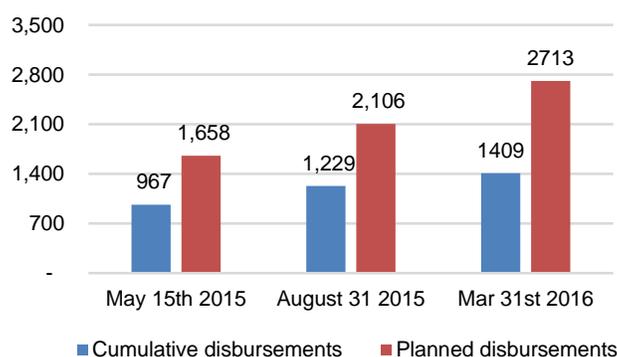
<sup>58</sup> Calculations do not include Palestinians working in settlements or without permits because it is assumed that it would be difficult for the PA to impose income tax on their income since the GoI will not be able to provide any data on their numbers or wages due to the lack of official oversight.

## Annex I: An overview of disbursement and implementation of pledges made at the Cairo Conference on Palestine “Reconstructing Gaza”, Cairo 12th October, 2014

Total pledges at Cairo (USD million)	Total Disbursed (USD million) as of March 31 <sup>st</sup> 2016	Disbursement ratio
3,507	1,409	40%

- 1. As of March 31<sup>st</sup>, 2016, USD1.409 billion of support to Gaza announced at the Cairo Conference was disbursed.**<sup>59</sup> More than a year and a half after the 2014 war, total disbursement of pledges to support Gaza is estimated at USD1.409 billion,<sup>60</sup> and hence, the overall disbursement ratio of support to Gaza announced at the Cairo Conference reached 40 percent. Since the September 2015 AHLC report, disbursements have increased by USD179 million. This mainly reflects additional disbursements of USD159 million, an increase of 15 percent over the past 6 months, and additional information and amendments of previous figures (USD20 million).
- 2. Actual Disbursements fall short of planned disbursements by around USD1.3 billion, and hence, donors are urged to accelerate the disbursement of funds.** While USD1.409 billion has been disbursed, this is almost USD1.3 billion less than the amount projected by donors when indicating the timing of their disbursements at Cairo. Figure 1 illustrates cumulative disbursements of support to Gaza until March 31<sup>st</sup>, 2016 and cumulative delayed funding based on information provided at the conference. If donor funding continues to be disbursed at the current pace, pledges are estimated to be fully disbursed by mid-2019; almost two years behind schedule. The Bank will work closely with the Palestinian Authority to include information on actual expenditure in future updates once the standard reporting and monitoring system for Gaza recovery and reconstruction, developed by the National Office for Reconstructing Gaza (NORG), is finalized.

**Figure 5: Cumulative Actual and Planned Disbursements of Support to Gaza (USD million)**

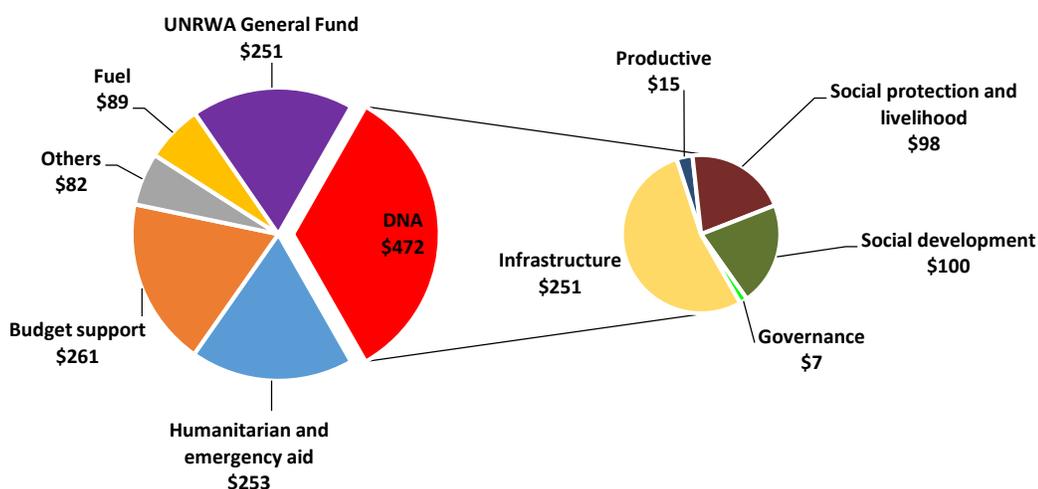


<sup>59</sup> This estimate may change once further data is collected from donors who have not yet provided information about disbursements and allocations of pledges.

<sup>60</sup> Support to Gaza figure refers to pledges made at Cairo Conference and therefore does not reflect all support spent in Gaza after 2014 war.

3. **Out of the USD1.409 billion that has been disbursed, USD472 million was allocated to priority interventions outlined in the Gaza DNA and Recovery Framework, which covered 12 percent of total recovery needs.**<sup>61</sup> By analyzing donors' interventions in Gaza financed through pledges announced at the Cairo Conference, the World Bank in a joint effort with the NORG concluded that only USD472 million of actual disbursements as of March 31<sup>st</sup>, 2016 are attributed to the recovery framework outlined in the DNA across five sectors impacted by the 2014 war as shown in figure 2. The increase in the financing of DNA interventions since the September AHLC report (previously reported at USD227 million) is mainly attributed to the inclusion of UNRWA funding related to Gaza recovery and reconstruction into DNA which was previously reported under a separate category.

**Figure 6: Actual disbursements of Cairo Conference support to Gaza by category (USD million)**



4. **Donors are urged to accelerate disbursement of pledges committed at the Cairo Conference to support reconstruction and rehabilitation of the housing subsector, as outlined in the DNA.** A breakdown of funds disbursed towards interventions in the infrastructure sector shows that total funding received by the housing and shelter subsector amounted to USD147 million.<sup>62</sup> As a result, only 9 percent of totally damaged houses and 45 percent of partially damaged houses have been repaired<sup>63</sup> and over 14,800 families continue to be displaced. Construction material imported into Gaza continues to be lower than needed. At the current import rate of construction materials, it will take an additional two years to import materials needed to reconstruct and repair all housing units impacted by the war.
5. **The PA needs to work with donors to mobilize the remaining USD1.48 billion that was pledged at the Cairo Conference but not yet been disbursed or allocated towards interventions outlined in the recovery framework.** Out of the USD3.5 billion of funds announced at the Cairo Conference, USD1.409 billion has been disbursed so far and another USD615 million of undisbursed pledges are allocated to specific projects and programs leaving USD1.48 billion to still be allocated.<sup>64</sup> It is key that the PA works with donors to direct these funds towards to priority areas outlined in the DNA.

<sup>61</sup> Total recovery needs in Gaza DNA and Recovery Framework are estimated at USD3.875 billion.

<sup>62</sup> This figure reflects contributions by donors to the housing subsector out of pledges made at Cairo Conference only.

<sup>63</sup> Shelter Cluster Palestine Fact sheet, March 2016.

<sup>64</sup> Based on data collected from donors.

**Table 4: Disbursement Status by Donor of Support to Gaza Pledged at Cairo Conference on Palestine "Reconstructing Gaza" in USD Million (as of March 31<sup>st</sup>, 2016)**

<b>Donor</b>	<b>Support to Gaza</b>	<b>Disbursement of Support to Gaza</b>	<b>Disbursement Ratio of Support to Gaza</b>
<b>Qatar*</b>	<b>1000</b>	<b>152</b>	<b>15%</b>
<b>Saudi Arabia*</b>	<b>500</b>	<b>51</b>	<b>10%</b>
<b>European Union<sup>1</sup></b>	<b>348</b>	<b>250</b>	<b>72%</b>
<b>USA</b>	<b>277</b>	<b>277</b>	<b>100%</b>
<b>Kuwait</b>	<b>200</b>	<b>0</b>	<b>0%</b>
<b>Turkey</b>	<b>200</b>	<b>64</b>	<b>32%</b>
<b>UAE</b>	<b>200</b>	<b>29</b>	<b>15%</b>
<b>Norway<sup>2</sup></b>	<b>145</b>	<b>121</b>	<b>83%</b>
<b>Switzerland</b>	<b>70.4</b>	<b>58</b>	<b>82%</b>
<b>European Investment Bank<sup>3</sup></b>	<b>70</b>	<b>N/A</b>	<b>N/A</b>
<b>Germany</b>	<b>63.3</b>	<b>56</b>	<b>88%</b>
<b>World Bank</b>	<b>62</b>	<b>62</b>	<b>100%</b>
<b>Algeria</b>	<b>61.4</b>	<b>61.4</b>	<b>100%</b>
<b>Japan<sup>4</sup></b>	<b>61</b>	<b>61</b>	<b>100%</b>
<b>UK</b>	<b>32.2</b>	<b>30.8</b>	<b>96%</b>
<b>Italy<sup>5</sup></b>	<b>23.7</b>	<b>4.7</b>	<b>20%</b>
<b>Spain</b>	<b>22.8</b>	<b>5.22</b>	<b>23%</b>
<b>Sudan<sup>6</sup></b>	<b>20</b>	<b>N/A</b>	<b>N/A</b>
<b>The Netherlands</b>	<b>15.3</b>	<b>15.3</b>	<b>100%</b>
<b>Canada</b>	<b>14.7</b>	<b>14.7</b>	<b>100%</b>
<b>Denmark</b>	<b>14.5</b>	<b>14.5</b>	<b>100%</b>
<b>Australia</b>	<b>13.2</b>	<b>13.2</b>	<b>100%</b>
<b>France<sup>7</sup></b>	<b>10.1</b>	<b>10.1</b>	<b>100%</b>
<b>Russia</b>	<b>8.7</b>	<b>8.7</b>	<b>100%</b>
<b>Sweden</b>	<b>10</b>	<b>11.4</b>	<b>114%</b>
<b>Finland</b>	<b>9.3</b>	<b>9.3</b>	<b>100%</b>
<b>Luxembourg</b>	<b>9.0</b>	<b>N/A</b>	<b>N/A</b>
<b>Belgium<sup>8</sup></b>	<b>7.9</b>	<b>7.9</b>	<b>100%</b>
<b>Bahrain*</b>	<b>6.5</b>	<b>0.75</b>	<b>12%</b>
<b>Austria<sup>9</sup></b>	<b>5.2</b>	<b>5.2</b>	<b>100%</b>
<b>Brazil<sup>10</sup></b>	<b>5.0</b>	<b>2.4</b>	<b>48%</b>
<b>India</b>	<b>4</b>	<b>4</b>	<b>100%</b>
<b>Ireland</b>	<b>3.17</b>	<b>2.53</b>	<b>80%</b>
<b>Argentina<sup>11</sup></b>	<b>2</b>	<b>N/A</b>	<b>N/A</b>
<b>South Korea</b>	<b>2</b>	<b>2</b>	<b>100%</b>

<b>China</b>	<b>2</b>	<b>N/A</b>	<b>N/A</b>
<b>Estonia</b>	<b>1.27</b>	<b>0.32</b>	<b>25%</b>
<b>Greece</b>	<b>1.27</b>	<b>0.63</b>	<b>50%</b>
<b>Mexico</b>	<b>1.1</b>	<b>1.1</b>	<b>100%</b>
<b>Indonesia</b>	<b>1</b>	<b>N/A</b>	<b>N/A</b>
<b>South Africa</b>	<b>1</b>	<b>0</b>	<b>0%</b>
<b>Croatia</b>	<b>0.4</b>	<b>0.2</b>	<b>50%</b>
<b>Chile</b>	<b>0.25</b>	<b>0.25</b>	<b>100%</b>
<b>Slovenia</b>	<b>0.19</b>	<b>0.127</b>	<b>67%</b>
<b>Hungary</b>	<b>0.16</b>	<b>0.16</b>	<b>100%</b>
<b>Poland</b>	<b>0.1</b>	<b>0.1</b>	<b>100%</b>
<b>Malaysia</b>	<b>0.1</b>	<b>0.1</b>	<b>100%</b>
<b>Singapore</b>	<b>0.1</b>	<b>0.1</b>	<b>100%</b>
<b>Bulgaria</b>	<b>0.06</b>	<b>0.06</b>	<b>100%</b>
<b>Slovakia</b>	<b>0.05</b>	<b>0.05</b>	<b>100%</b>
<b>Romania</b>	<b>0.05</b>	<b>0.05</b>	<b>100%</b>
<b>Serbia</b>	<b>0.05</b>	<b>0.0</b>	<b>0%</b>
<b>Portugal</b>	<b>0.03</b>	<b>0.03</b>	<b>100%</b>
<b>TOTAL</b>	<b>3,507</b>	<b>1409</b>	<b>40%</b>

<sup>1</sup> European Union contribution includes contribution to UNRWA General Fund pro-rata Gaza for 2014-2015.

<sup>2</sup> Norway did not specify the allocation of its total support between West Bank and Gaza. The amount to Support Gaza is an estimate. Disbursement ratio of total support reached 36 percent.

<sup>3</sup> European Investment Bank contribution is in the form of a loan.

<sup>4</sup> Japan pledged USD 200 million for Palestinian territories. No specific-pledged amount for Gaza reconstruction. So far, about USD 199 million was disbursed of which USD 61 million for projects in Gaza, 106 for West Bank and Gaza, 28 million for West Bank and 4.2 million for others.

<sup>5</sup> Italy's contribution includes a soft loan to the Palestinian National Authority of EUR 15 million.

<sup>6</sup> Sudan's contribution is in the form of in kind assistance (100 thousand tons of cement and USD 3 million of medical supplies).

<sup>7</sup> France's contribution includes total aid for Palestinian territories for the year 2014 only.

<sup>8</sup> Belgium's contribution is its 2014 General Fund contribution to UNRWA.

<sup>9</sup> Austria's contribution of USD 8.8 million is programmed for the benefit- with some minor exceptions- of people living in Gaza.

<sup>10</sup> Brazil's contribution is in the form of In-Kind (6000 tons of rice and 4000 tons of beans).

<sup>11</sup> Argentina's contribution is in the form of technical assistance agreement to support Gaza which was signed with MOPAD.

\* Data provided by UNRWA and/or the Palestinian Authority.

## Glossary:

**The Cairo Conference on Palestine “Reconstructing Gaza” was convened to address urgent needs in Gaza after the 2014 war.** On October 12th 2014, Egypt, Norway and the Palestinian Authority (PA) convened the Cairo Conference on Palestine “Reconstructing Gaza” to respond to the humanitarian needs of the Palestinian people in the aftermath of the Gaza war that took place in July and August 2014, and to enable early recovery and the reconstruction of the Strip.

**The World Bank is leading a stocktaking exercise to track the disbursement of Cairo Conference pledges to support Gaza.** At the request of Norway, as chair of the Ad-Hoc Liaison Committee (AHLC), and the Palestinian Authority (PA), the World Bank has been leading a stocktaking exercise to overview the disbursement and implementation progress of support to Gaza pledged at the conference. The Bank’s findings are updated regularly and presented in the World Bank’s report to the AHLC twice a year.<sup>65</sup>

**Currency:** Total pledges announced at Cairo Conference are in USD million. All original pledges in other currencies were converted into USD using the historical currency exchange rates obtained from ([www.oanda.com](http://www.oanda.com)) dated October 9th 2014. For donors with pledges in currencies other than USD, actual disbursed amounts may slightly differ from figures in table due to fluctuations in exchange rates. Disbursed amounts in other currencies were converted to USD based on historical exchange rate to reflect accurate progress in disbursement.

**Pledges defined:** The output of the pledging exercise in Cairo Conference was a combination of two types of pledges; pledges by donors of total support for the Palestinian territories for the period 2014-2017 and pledges by donors of support to Gaza only over the same period.<sup>66</sup> The difference in pledges reporting by donors at Cairo Conference required a classification of total support figures to better reflect support to Gaza for the period 2014-2017 and to allow tracking disbursement of support to Gaza over that period.

**Support to Gaza:** Funds pledged during the Cairo Conference intended to support Gaza recovery and reconstruction.<sup>67</sup>

### Support to Gaza classification

Total support to Gaza that was announced at Cairo Conference is classified into 4 main categories:

- Humanitarian assistance disbursed during conflict and prior to Cairo Conference that was part of the pledge declared at the conference.
- Existing commitments by donors that were planned and programmed for Gaza for the period 2014-2017 prior to conflict and were part of the pledge.
- Reallocation of existing commitment by donor to support Gaza in response to the conflict.
- New funding announced at Cairo Conference to support Gaza recovery and reconstruction.

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<sup>65</sup> Findings can also be found online at (<http://www.worldbank.org/en/programs/rebuilding-gaza-donor-pledges>)

<sup>66</sup>The pledging exercise at Cairo Conference took two forms; some participant countries declared all their commitments to the Palestinian territories over the period 2014-2017 while other participant countries declared Gaza specific funds only in their pledge.

<sup>67</sup>Support to Gaza figure refers to pledges made at Cairo Conference and therefore does not reflect all support spent on Gaza after 2014 war.

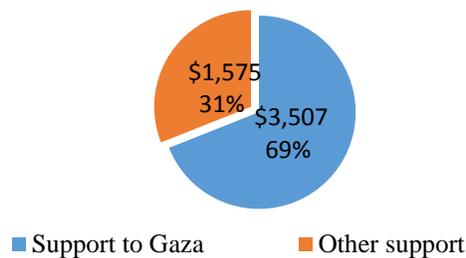
**Disbursement defined:** Disbursement of support to Gaza does not necessarily reflect actual expenditures made on purchasing project-related goods and services but that a donor funds have been made available for use by the relevant implementation agency.<sup>68</sup>

**Disbursement ratio of support to Gaza:** This is the ratio of the amount disbursed of support to Gaza, as per the disbursement definition above, to the amount pledged to support Gaza at the Cairo Conference.

### Pledges of support to Gaza announced at Cairo Conference

**USD3.5 billion was captured as support to Gaza during Cairo Conference, of which USD2.5 billion is new funding.** A review of total pledges captured at the Cairo Conference shows that participant countries and agencies pledged approximately USD5 billion to the Palestinian territories over the period 2014-2017, of which USD3.5 billion is intended to support Gaza over the same period.<sup>69</sup> About 72 percent of the support to Gaza captured at the conference is new funding committed by participants to support Gaza recovery and reconstruction after the 2014 war.<sup>70</sup> The remainder, as shown in figure 7, is reallocation of existing commitments, or assistance that was already disbursed during the war.<sup>71</sup>

**Figure 7: Total Pledges Announced at Cairo Conference (million)**



<sup>68</sup> When a pledge (part of pledge) is disbursed that means that funds were received and secured by implementation agency and donor had fulfilled the pledge committed at Cairo Conference.

<sup>69</sup> Figures for pledges announced at Cairo Conference were revised due to some inaccuracies in recording original pledges and for the use of inflated commodity prices for the valuation of in-kind contributions. Check Glossary for terms and definitions.

<sup>70</sup> Check Glossary for more details about classification of support to Gaza.

<sup>71</sup> Classification of funding may be subject to change in cases where donors have not yet verified their figures.

**Figure 8: Classification of Support to Gaza**

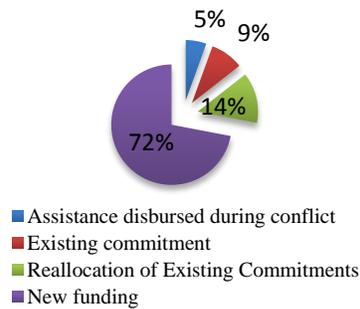
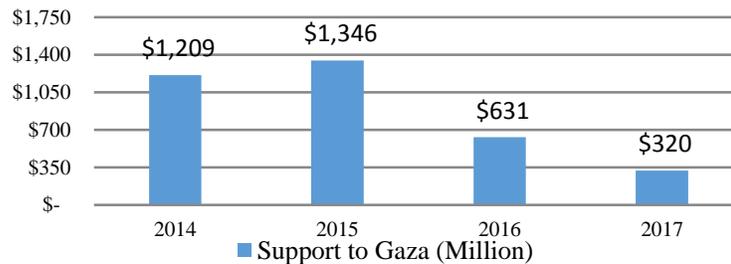


Figure 9 shows the expected flow of funding to Gaza over the period 2014-2017 and more than 70 percent of total support was expected to be disbursed over the period 2014-2015.

**Figure 9: Expected Flow of Support to Gaza**



The Gaza DNA and Recovery Framework lays out the economic and human costs of the conflict and the set of strategies to help Gaza recover. Each recovery framework proposal was identified by the National Consensus Government of the Palestinian territories and has the support of local and international partners that took part in the assessment process. The PA will use these recovery framework interventions to mobilize and direct international support, including the remaining donor funds that were pledged at the Cairo Conference in October 2014 but have not yet been disbursed.<sup>72</sup>

<sup>72</sup> Detailed Needs Assessment and Recovery Framework, Palestine: Gaza, August 2015.

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