2016 fiscal performance

Despite strong revenues, a significant drop in budget support in 2016 resulted in extremely tight financing conditions and further arrears accumulation. Expenditure growth was high in 2016, but it was offset by strong revenues resulting in a 26 percent year-on-year decline in the PA’s total deficit. At the same time, donor aid to the PA’s budget continued its declining trend in 2016 resulting in a large financing gap filled through arrears to the private sector and the pension fund.

In 2016, public revenue increased by close to 25 percent mainly due to one-off transfers by the GoI and advance telecom license payments. Following the Israeli-Palestinian ministerial level discussions in early 2016, the GoI transferred to the PA a total of NIS1.2 billion to offset fiscal leakages accumulated over the years under the existing revenue sharing arrangements between the two parties. The PA also received NIS558 million from Paltel, a telecom operator, as part of the company’s license fees for the next twenty years. These one-off payments in addition to higher petroleum excise from Gaza were the main contributors to public revenue growth in 2016, while collections from most domestic tax categories witnessed a decline. For example, income tax and domestic VAT receipts each fell by 8 percent in 2016, and excise on tobacco declined by 6 percent. The key role that one-off payments played in driving revenue growth in 2016 raises sustainability issues. In fact, if one-off payments are excluded, other PA revenues have actually declined by 8 percent in 2016 year-on-year, which highlights the need for revenue reform.

Public expenditure growth was high reaching 5 percent mainly due to unanticipated wage increases. The wage bill, which is the largest spending item, grew by 5 percent in 2016 due to a 1.25 percent annual increase implemented across the board and additional salary increases for teachers, engineers and security personnel, in addition to a net increase in the number of public employees. Data provided by the Ministry of Finance and Planning (MoFP) show that public employees increased by 1,047 in 2016, on a net basis, due to additional recruitments in the West Bank (mainly in the education sector) while net employment in Gaza actually decreased last year. Expenditure growth was also driven by a 7 percent rise in transfers following an increase in social spending in Gaza. Net lending grew by 3 percent as Palestinian utility distributors continue to accrue dues to the Israeli suppliers, particularly for water and sewage, while the share of electricity net lending has been maintained at the 2015 level.

Despite a strong decline in the PA’s deficit year-on-year, fiscal stress continued to be high in 2016 due to a major drop in budget support. Strong revenue growth offset the increase in spending and led to a 26 percent decline in the deficit in 2016, which amounted to USD1.09 billion. Aid received reached USD 761 million: USD607 in budget support and USD154 million in development financing. Notably, financing

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1 The first Israeli transfer was made in early 2016 and amounted to NIS580 million covering some VAT receipts collected on imports to Gaza in addition to a refund on the 3 percent fee charged to handle Palestinian imports. The second transfer was made in September and it covered accumulated Allenby bridge exit fees (NIS58 million) and equalization and health fees collected from Palestinian workers in Israel over the years (NIS593 million), as part of the electricity deal signed between the PA and the GoI.

2 According to the PA’s employment numbers for 2016, 1,965 employees were hired in the West Bank while 926 departed from the labor force in Gaza, on a net basis. The number of employees abroad increased by 8. Net employment in the health and education sectors increased by 302 and 1,146, respectively, while it was reduced by 244 in the security sector.

3 Net lending represents deductions by the GoI from clearance revenues it collects on behalf of the PA for unpaid utility bills by Palestinian public utilities and local governments.
received for the PA’s development spending in 2016 exceeded its 2015 level by more than two-thirds. Receipts for budget support, however, were 16 percent lower year-on-year mainly due to a fall in aid from both Arab and international donors. As a result, the PA ended up with a financing gap of about USD330 million and resorted to arrear accumulation to finance it.

2017 budget

According to the 2017 budget, the financing need will remain large. The budget projects a 14 percent increase in revenues compared to 2016 (after discounting one-off transfers) mainly due to additional receipts from tobacco taxation from Gaza estimated at USD167 million. In addition, the PA plans to increase some of the government fees it charges such as licenses for gas stations, and this is expected to generate an additional USD50 million in revenues. Also, installments from the recently signed telecom deal with Paltel are expected to reach USD75 million in 2016. As for PA expenditure, it is budgeted to decline by 2 percent as a result of a drop in operational spending and net lending by 20 and 8 percent, respectively. The wage bill is expected to grow by 3 percent in 2017 despite a decision to maintain a zero net hiring policy. The increase will be driven by a 1.25 step increase that is mandatory by law, retroactive Cost of Living Adjustments for 2015 and 2016, in addition to yearly promotions. The recurrent deficit is projected to reach USD691 million. Development expenditures are expected to total USD420 million, leading to a total deficit of USD1.11 billion. The budget assumes that aid will amount to USD640 million (USD500 million in budget support and USD140 million in development financing), leading to a financing gap of about USD470 million. The budget also assumes that the PA’s stock of arrears will be reduced by USD300 million, further widening the financing gap to USD770 million.

Bank staff agree with the PA’s projections on the overall size of the financing gap but not on its contributors. The budget revenue target is seen as too high particularly as Bank staff project additional receipts from tobacco taxation to be only half the budgeted amount. On the expenditure side, the budgeted decline appears to be optimistic particularly for operational spending and net lending. Therefore, staff project the 2017 deficit to be higher than assumed by the budget at USD1.35 billion. Staff agree with the above-mentioned budget projection on aid inflows, and hence, expect the size of the financing gap to reach USD707 million, before any arrears repayment. Notably, this projection has high risks associated with it particularly if some of the planned revenue and expenditure measures do not materialize or donor aid ends up being even lower than budgeted.

Progress in achieving DPG VII targets

DPG VII was disbursed in May 2016 after the PA had taken eight prior actions aimed at strengthening its fiscal stance, improving transparency of public finances and facilitating the land registration process. The following is an assessment of results of implementing actions supported by the DPG.

Prior action 1: The Council of Ministers has agreed upon and referred draft amendments to the Income Tax Law to the President for issuance in order to improve income tax collection by allowing income tax payment violations to be settled through the PA’s execution court system.
Comments: The Council has indeed referred the draft amendments to the President. However, the amendments are yet to be signed by the President, and hence, remain ineffective.

Prior action 2: The Ministry of Finance has issued an instruction to merge its existing value-added tax collection department and the income tax collection department into a single collection department to improve operational efficiency.
Comments: The instruction was issued and the collection departments of both VAT and income tax have been merged. However, in practice, not all aspects of the work of both departments have been unified and more effort is still needed to create a fully integrated unit.

Expected result: The stock of income tax debt estimated based upon official income tax filings that have been verified through MoFP audits is 15 percent lower in 2016 than it was in October 2015.

Comments: The MoFP has so far not provided data on the stock of income tax debt by the end of 2016. However, even if the stock is lower than its 2015 level, the reduction cannot be fully attributed to the prior actions since amendments to the income tax law are yet to be implemented while merging the work of the collection departments of VAT and income tax still needs to be further enhanced.

Prior action 3: The Palestinian Energy and Natural Resources Authority has entered into and commenced the implementation of the memoranda of understanding with at least two (2) electricity distribution companies and at least one (1) municipality in order to coordinate and facilitate the payment of electricity bills to the Israel Electric Corporation by electricity distribution companies and municipalities.

Comments: MoUs have been signed with a much larger number of DISCOs and municipalities.

Expected result: The ratio of annual wholesale electricity bill payments to the Israel Electric Corporation made by JDECO, NEDCO, SELCO, HEPCO and TEDCO electricity distribution companies to amount collected by these DISCOs from end customers in the West Bank amounts to at least 80 percent in 2016.

Comments: The result was achieved as the ratio stood at 90 percent in 2016.

Prior action 4: The Ministry of Health has entered into and commenced the implementation of the memorandum of understanding with at least three (3) Israeli hospitals to facilitate the health referral process between the Ministry of Health and Israeli hospitals.

Comments: The MoH has since entered into MoUs with all major Israeli hospitals, six East Jerusalem hospitals and three West Bank hospitals.

Prior action 5: The Minister of Health has issued an instruction mandating the health referral committees within the Ministry of Health to use a new Referral Manual for patient referrals outside the public health system.

Comments: The instruction was issued and all referral committees have been using the new referral manual for referring patients.

Expected result: The cost of health referrals to health service providers outside of the Palestinian public healthcare system is lower than 1.2 percent of GDP in 2016.

Comments: The 2015 baseline of 1.2 percent has changed as GDP figures were updated. Based on new data, the cost of referrals to health service providers outside of the Palestinian public healthcare system stood at 1.67 percent in 2015 and the PA managed to reduce it to 1.30 percent in 2016.

Prior action 6: The Ministry of Finance and Planning has issued an instruction mandating its relevant units to produce yearly reports that include information on: (i) the amount of transportation taxes collected by the Ministry of Finance and Planning on behalf of each local government unit; (b) the amount of service fees charged by the Ministry of Finance and Planning and deducted from the transportation taxes collected on behalf of each local government unit; (c) the amount of any other deductions or intercepts on transportation taxes collected by the Ministry of Finance and Planning on behalf of each local government unit; and (d) the amount of transportation taxes transferred by the Ministry of Finance and Planning to each local government unit.

Comments: The instruction was issued, and hence the action was implemented.
**Expected result:** Annual information is available online on the amount of: (1) the transportation tax collected by the MoFP on behalf of each LGU; (2) the service fees charged; (3) any deductions/intercepts for each LGU specifically; and (4) the transportation tax paid to each LGU in the first quarter of 2016.

**Comments:** The MoFP has started the practice of publishing reports on transportation tax. So far, however, only one report for 2014 is online, while 2015 data is not available. Also, the published report does not include all information specified in the prior action. For example, a breakdown of deductions made from the amount of transportation tax collected by the Ministry of Finance on behalf of LGUs is missing.

**Prior action 7:** The Ministry of Finance has issued an instruction mandating the ministries responsible for health, transportation, interior, public works and local government to implement a Commitment Recording System.

**Comments:** The instruction was issued.

**Expected result:** Starting January 2016, access to information on commitments in the pipeline is provided by the Ministry of Health, Ministry of Transportation, Ministry of Interior, Ministry of Public Works and the Ministry of Local Government in the IFMIS at the time a commitment is made.

**Comments:** Information on commitments in the pipeline has been available since January 2016 for all ministries covered by the Prior Action, except for the Ministry of Health, which is yet to implement a Commitment Recording System.

**Prior action 8:** The Cabinet of Ministers has approved a waiver for land titling registration fees and charges for first time land purchasers.

**Comments:** The waiver was approved.

**Expected Result:** The number of land titles picked up in 2016 in the pilot area (monitored through data obtained from the Palestinian Land Authority) is at least 100 percent higher than it was in October 2015 (i.e. at least 376 land titles have been picked up by December 31, 2016).

**Comments:** The result was achieved and the number of land titles picked up in 2016 reached 2,950.