

State of Palestine

Ministry of Finance

**Fiscal Developments & Macroeconomic Performance:
Fourth Quarter and Fiscal Year 2012**

Macro-Fiscal Unit

03/03/2013

Section 1: Palestinian Territory Macroeconomic Performance in 2012:

GDP: According to preliminary estimates published by PCBS¹ (Tables 1A and 1B), Palestinian Territory² real GDP grew by 6.1% in the first three quarters of 2012 compared to 12.0% during the same period of 2011. Palestinian Territory GDP for the 3rd quarter 2012 of USD 1,707.9 million at constant prices declined by 2.7% over Q2 2012 and increased by 5.5% over Q3 2011.

In the West Bank real GDP in the first nine months of 2012 increased by 5.5% compared to the same period in 2011. Real West Bank GDP for the 3rd quarter 2012 was USD 1,256 million, a decline of 2.2% over Q2 2012, and an increase of 5.1% over Q3 2011. The origin of the growth in West Bank is the expansion of the Services by 10.7% in the first 9 months of 2012, while Public Administration, Security and Construction sectors retrenched as a consequence of the financial crisis faced by the PA. The growth of Construction sector in the West Bank is expected to continue its decline in 2013 as a result of a sharp increase in the supply of housing over the past three years and the uncertainty created by delayed payments of salaries and questions raised about PNA sustainability.

In Gaza real GDP in the first nine months of 2012 increased by 7.7% compared to the same period in 2011. GDP for the 3rd quarter 2012 at constant prices was USD 452 million for the Gaza Strip, a decline of 4% over Q2 2012, and an increase of 6.7% over Q3 2011. The construction activity increased by 39% during Jan-Sep 2012 over the same period 2011 reflecting the relaxation of the import restrictions and increasing imports of construction material from Egypt through the tunnels. On the other hand, the Agricultural and forestry output declined by 37%.

Table 1A. Palestinian Territory Real GDP*(USD million).

	Q3 2012	Q3 12 over Q2 12 (%)	Q3 12 over Q3 11 (%)
Gaza	451.8	-4.0%	6.7%
West Bank	1256.1	-2.2%	5.1%
Palestinian Territory	1,707.9	-2.7%	5.5%

*Base Year 2004

Table 1B. Palestinian Territory Real GDP* (USD million).

	Real GDP Q1-Q3 12	Jan-Sep 2012/ Jan-Sep 2011	Jan- Sep 2011/ Jan-Sep 2010	Jan-Sep 2010/ Jan-Sep 2009
Gaza	1336.4	7.7%	18.2%	12.8%
West Bank	3727.7	5.5%	10.0%	8.7%
Palestinian Territory	5064.1	6.1%	12.0%	9.7%

*Base Year 2004

Economic activity in the Palestinian territory has slowed down significantly in the first 9 months of 2012 compared to first 9 months of recent years (Table 1B) as the growth rate decreased by half from double digit growth in 2011 (12%) to 6.1% in 2012. This downward trend can be witnessed in both West Bank and Gaza. Our projections for the full year 2012 reveal further reduction in economic growth in the Palestinian Territory to about 5.5% which is lower than the growth rate which was projected in the budget for 2012 of 6.2%.

¹PCBS, "Press Report, Preliminary Estimates of Quarterly National Accounts (Third Quarter 2012)", December 20, 2012.

²Palestinian Territory*: exclude those parts of Jerusalem which were annexed by Israel in 1967.

The shortfall in donor aid in 2012 and the Israeli withholding of Palestinian clearance revenue, especially following the granting to Palestine of Non-member Observer State status at the United Nations in November 2012, have exacerbated the financial crisis faced by the PA. Israel delayed transferring clearance revenues in Q4 2012 and deducted unilaterally the full amount of November's clearance revenue of NIS 467 million mainly to settle outstanding electricity arrears to Israel Electricity Corporation (IEC) and Jerusalem District Electricity Corporation (JEDCO).

The uncertainty of the financial sustainability of the PA and the uncertainty of the political outlook caused a reduction in the spending behavior of consumers. These factors combined with the persistence of Israeli restrictions imposed on private sector economic activity contributed to the slowdown in economic growth.

GDP per Capita: According to PCBS, Palestinian Territory* GDP per capita during Q3 2012 was USD 421, an increase of 2.4% over Q3 2011, and a decline of 3.4% when compared to Q2 2012. In the West Bank, GDP per capita in Q3 2012 was USD 521 an increase of 2.2% over Q3 2011, and a decrease of 2.8% when compared to Q2 2012. While for Gaza GDP per capita was USD 274 during Q3 2012, an increase of 3.1% over Q3 2011, and a decline of 4.8% when compared to Q2 2012.

The Consumer Price Index for 2012 shows an increase of 4.08% in the West Bank and an increase of 0.48% in Gaza compared to 2011. Overall prices in the Palestinian Territory increased in 2012 by 2.78% compared to 2011.³

The overall change in Consumer Price Index (CPI) for the year 2012 is mainly attributable to changes in prices of the following expenditure sub groups compared to the previous year: Fresh Vegetables (+15.03%), Fresh Poultry (+8.91%), Cigarettes (+7.42%), Fuel for transportation (+5.81%), Education (+5.47%), Fuel and electricity (+3.67%), Medical Care (+3.06%), and Fresh fruit (+2.17%).

The population of the Palestinian Territory at the end of 2012 is about 4.4 million, 2.7 million in the West Bank and 1.7 million in Gaza. Refugees constitute about 44.2% of the population of the Palestinian Territory: 41.4 % in the West Bank and 58.6 % in the Gaza Strip. The average household size in the Palestinian Territory is 5.6 persons in 2012, (5.3 persons in the West Bank and 6.1 persons in Gaza Strip) compared with 6.4 in 1997.⁴

The unemployment rate⁵ during Q4 2012 reached 22.9% in the Palestinian Territory compared to 24.3% during Q3 2012 and 21% during Q4 2011. Unemployment in WB reached 18.3% during Q4 2012 compared to 20.4% during Q3 2012 and 16.6% during Q4 2011. In Gaza, unemployment reached 32.2% during Q4 2012 compared to 31.9% during Q3 2012 and 30.3% during Q4 2011.

The highest unemployment rates in the West Bank governorates were experienced in Tulkarm and Hebron registering 24.3% in each case. In Gaza Strip, the highest unemployment rate was 36.4% in North Gaza governorate.

The services sector was the biggest employer in the local market with 32.6% in the West Bank and 54.3% in Gaza Strip. The public sector employed 22.8% of those in employment: 40.1% in Gaza Strip

³PCBS, "The Consumer Price Index during 2012", January 14, 2013.

⁴PCBS, "The Palestinians at the end of the year, 2012" December 31, 2012.

⁵PCBS, "The Labor Force Survey Results Fourth Quarter (October- December, 2012) Round (Q4/2012)", February 21, 2013.

and 15.7% in the West Bank. The average daily wage for wage earners in the West Bank was NIS 88.0 compared with NIS 63.1 in Gaza Strip.

Table 2. Labor Force Component, Q4 2012.

Region	Labor Force	Unemployment		Employment	
	Number	Percentage	Number	Percentage	Number
Palestinian Territory	1,137,300	22.9%	260,400	77.1%	876,900
West Bank	761,500	18.3%	139,400	81.7%	622,100
Gaza	375,800	32.2%	121,000	67.8%	254,800

External Trade⁶: Palestinian exports of goods for the period (Jan-Nov) 2012 amounted to USD 676.8 million with a monthly average of USD 61.5 million, compared to USD 692 million for the same period 2011, decreasing by 2.2%. On the other hand, imports during Jan-Nov amounted to USD 3.85 billion with a monthly average of USD 350 million, compared to USD 4.17 billion for the same period in 2011, declining by 7.7%. The trade deficit reached USD 246 million in November 2012 for a total trade deficit for Jan-Nov 2012 of USD 3.17 billion. When compared to the same period 2011, the total trade deficit declined by 8.8%. The decline in Palestinian total trade reflects the slowdown in economic growth in the first nine months of 2012 compared to the same period 2011. There is also a small deficit in the service sector in Q1/12-Q3/12 (\$271 million), a small increase over same period 2011 (\$217 million).

Most of the deficit in goods and services is offset by Palestinian workers remittances from work in Israel (about \$ 1.1 billion estimated for 2012), from current transfers from abroad (donor support to the PA budget and UN agencies (about \$ 1.6 billion estimated for 2012) and capital inflows such as development financing from donors and foreign direct investment (about \$ 700 million)

Table 3. External Trade 2012, USD million.

	Jan- Nov 2012	Jan- Nov 2011	% change
Exports	676.8	691.8	-2.2%
Imports	3851.6	4172.8	-7.7%
Trade Balance	-3174.8	-3481.0	-8.8%

Exchange Rate: While the 2012 budget exchange rate was projected at US \$ 1 = NIS 3.8, the NIS has depreciated slightly against the US dollar during 2012 bringing the average exchange rate up to the end of the year to US \$ 1 = NIS 3.85

⁶ PCBS, Palestinian Registered* External Trade in Goods, November 2012.

Section 2: Fiscal Operations Full Year 2012

A. Budget execution highlights:

While the 2012 original budget had a recurrent budget deficit target of NIS 3.62 billion, the actual 2012 recurrent budget deficit amounted to NIS 5.6 billion. Consequently, the Cabinet approved a supplementary budget of NIS 950 million (\$250 million) financed through domestic bank borrowing to cover additional expenditures, of which around NIS 510 million were actually allocated. The allocation of the supplementary budget by economic classification was as follows: NIS 18 million for wages and salaries, NIS 389 million for operational expenditures, mainly to cover arrears to the health sector, and NIS 103 million for transfer expenditures. (Check table 4)

- The **Total Budget Deficit** for the year 2012 amounted to NIS 6.54 billion (USD 1.698 billion) which was above the budget target⁷ by NIS 1.08 billion. The recurrent budget deficit amounted to NIS 5.6 billion (approximately USD 1.45 billion) which was above the budget target by NIS 1.47 billion. The **recurrent budget deficit** is reduced to **NIS 5.14 billion (approximately USD 1.33 billion)** if **NIS 468 million of debt repayment under** Net lending is excluded. This debt repayment was incurred as a result of the unilateral action by Israel to deduct payments of the advances provided to the PA during the year (NIS 35 million and NIS 55 million), in addition to allocating NIS 437 million of November's clearance revenue to JEDCO and IEC to repay previous electricity debt.
- **Gross Revenues** in the year 2012 amounted to around NIS 8.42 billion, which was below the budget target by NIS 524 million (6%), mainly due to shortfalls in domestic tax and clearance revenues by NIS 272 million (13%) and NIS 242 million (4%) respectively.
- **Total Expenditures and Net Lending** in the year 2012 amounted to around NIS 13.6 billion, which is above the budget target by NIS 969 million (8%). When we exclude NIS 468 million from net lending mentioned earlier, total expenditure and net lending would exceed the budget target by NIS 501 million.
- **The Wage Bill** in 2012 amounted to NIS 6.81 billion which was on track with the budget target. Since this is the largest expenditure item, the PA pursued a tight budgetary policy to keep it within budgetary appropriations.
- **Non-wage Expenditures** of NIS 5.7 billion were above the budget target by NIS 316 million. While operational expenditures and minor capital spending fell short from their budget targets by NIS 91 million and NIS 52 million respectively, transfers exceeded the budget target by NIS 459 million due to the inclusion of pension liabilities to security retirees which were not originally budgeted.
- **Net Lending** amounted to NIS 1.07 billion and was substantially above the budget target by NIS 672 million, mainly due to Israeli deductions from clearance advances and full deduction of November's clearance revenues (NIS 467 million) to repay previous electricity debt. When these deductions are excluded from the calculation, net lending is reduced to NIS 604 million which is about NIS 200 million above the budget target. Higher electricity prices and the increased monthly Israeli electricity deductions from clearance revenue also contributed to increasing net

⁷ Budget target is the 2012 approved annual budget.

lending in 2012. In fact, progress in bill collection is greater than what is reflected by Net Lending data.

- **Budget Support** disbursement for the full year 2012 was 78% of the amount budgeted to finance the recurrent budget deficit target and amounted to USD 761 million, while **development projects financing** of NIS 601 million was below the 2012 budget target by NIS 539 million, reaching only 53% of the budget target.
- **Domestic Debt Stock** level by end 2012 reached NIS 5.14 billion, as the Treasury increased its **domestic debt** by NIS 996 million as a result of additional borrowing from commercial banks during the year 2012.
- **Total Net Accumulation of Arrears** for the year 2012 reached NIS 2.23 billion, including development expenditures arrears of NIS 124 million and tax refund arrears of NIS 239 million. Arrears to the private sector have accumulated to NIS 741 million.

Table 4. Consolidated Fiscal Operation Analysis of Q4 2012 and FY 2012 on Commitment Basis.

	Q4 2012	Q4 12 over Q3 12	Q4 12 over Q4 11	FY 2012	2012 over 2011	Budget 2012*	Share of 2012 approved Budget
	NIS mill	%	%	NIS mill	%	NIS mill	%
Gross Revenues	2063	-6%	5%	8423.4	8.9%	8947	94%
Total Revenue	1910	-10%	3%	7989.4	9.1%	8493	94%
Tax	464.7	9%	1%	1852.0	7.3%	2124	87%
Income Tax	114.1	-14%	26%	661.7	39.5%	-----	
Value Added Tax	199.6	25%	-13%	675.5	-0.3%	-----	
Customs	35.5	2%	-44%	158.7	-36.7%	-----	
Excises on tobacco	113.1	19%	52%	337.2	8.5%	-----	
Excises on beverage	1.4	-76%	24%	8.6	155.9%	-----	
Property Tax	1.0	1%	-22%	10.3	1.9%	-----	
Nontax	184.8	-43%	-6%	954.4	4.3%	963	99%
Civil Registration Fees	5.9	-31%	-54%	43.6	-35.9%	-----	
Health Insurance	39.5	-4%	1%	169.7	4.5%	-----	
Transportation	19.5	-10%	-7%	90.2	-1.0%	-----	
Licenses	40.8	-15%	-34%	189.9	-8.6%	-----	
Other charges and fees	78.1	-6%	25%	341.1	51.0%	-----	
Investment Profits	1.0			119.9	-25.1%	-----	
Clearance Revenue	1413.6	-2%	8%	5617.0	10.2%	5859	96%
Customs	512	-2%	9%	1974.0	9.5%	-----	
Value Added Tax	469	3%	13%	1861.0	14.9%	-----	
Petroleum Excises	421	-10%	0%	1758.1	7.5%	-----	
Purchase Tax	7.7			15.0		-----	
Income Tax	3.3			8.8	-70.1%	-----	
Other	0.0			0.0		-----	
Tax refunds (-)	153.5	92%	41%	434.0	4.2%	454	96%
Total Expenditure and Net	3819	15%	22%	13593.0	14.3%	12624	108%
Wage Expenditure	1678.5	-4%	6%	6812.1	6.8%	6831	100%
Nonwage Expenditure	1593	13%	11%	5709.0	13.8%	5393	106%
Operational Expenditure	659.7	8%	28%	2257.4	26.0%	2349	96%
Transfers	925.0	16%	4%	3425.6	8.2%	2966	115%
Minor Capital	8.5	11%	-49%	25.9	-55.3%	78	33%
Net Lending	547.5	178%	238%	1072.0	114.0%	400	268%
Current Balance	-1910	59%	49%	-5603.7	22.4%	-4131	136%
Development Expenditure	288.9	15%	-13%	937.0	-29.3%	1330	70%
Balance	-2199	52%	36%	-6540.7	10.8%	-5461.2	120%
Financing	2199	52%	36%	6540.7	10.8%	5461	120%
Budget Support	751.3	4%	52%	2985.5	2.4%	3811	78%
Development Financing	211.8	1%	164%	601.1	-0.6%	1140	53%
Net Domestic Bank	913.1			489.8	46.6%	511	
Expenditure Arrears (Net	713.9			1987.0		-----	
Net Clearance	217.7			-479.2		-----	
Tax Refunds (Arrears)	88.1			239.4		-----	
Nontax Refund	0.0			-59.3		-----	
Residual	-261.8			-182.1		-----	

Budget 2012* including the supplementary budget

B. Revenues

Gross PNA revenues for the full year 2012 amounted to NIS 8.42 billion growing by 8.9% over 2011. While in Q4 2012, Gross revenues amounted to around NIS 2.06 billion, decreasing compared to Q3 2012 by 6% while increasing compared to Q4 2011 by 5%. Gross revenues for 2012 were below their budget target by around 6% (NIS 524 million).

Total net revenue amounted to NIS 7.99 billion in 2012, an increase of 9.1% compared to 2011. Total net revenues mobilized during Q4 2012, of NIS 1.91 billion decreased by 10% compared to Q3 2012, but showed an increase of 3% over Q4 2011. Total net revenues obtained in 2012, were below the budget target by 6% due to the shortfall of tax revenues, non-tax revenues, and clearance revenues by 13%, 1% and 4% respectively, below their budget targets.

Gross revenue performance during 2012 was in line with economic growth. Given that nominal GDP growth in the West Bank, which is the source of most of PNA's revenues, is projected to reach about 8% during the same period (5% real growth and 3% price increases). Despite the good performance of **gross revenues** and **net revenues**, both were below their budget targets.

Gross revenues fell short of the budget target by NIS 524 million and grew by 8.9% compared to 15.6% growth set as the budget target. This target assumed there would be an increase in VAT revenues after reaching an agreement with the Israeli authorities which, however, did not materialize. Moreover, the economic growth in the West Bank, which generates most of PNA's revenues, is expected to slow down by the end of the year, given the withdrawal of fiscal stimulus through fiscal retrenchment and the uncertainty about the financial sustainability of the PA which inhibits private sector activity and causes households to reduce their spending. The delay in paying November and December 2012 salaries to PA employees also caused a decline in household consumption during Q4 2012 which is expected to slow down economic growth in West Bank GDP in 2013.

Domestic tax revenue of NIS 465 million during Q4 2012 increased by 9% and 1% over domestic tax revenue collected in Q3 2012 and Q4 2011 respectively. The increase in domestic tax in Q4 2012 over Q3 2012 can be mainly attributed to the increase in domestic VAT collection efforts and the increase in the excise on tobacco during the fourth quarter. For the full year, domestic tax revenues amounted to NIS 1.85 billion, an increase of 7.3% over the year 2011, but slightly less than nominal GDP growth in West Bank which is projected at 8% for 2012.

In 2012, the PA continued its institutional reform efforts aimed to raise domestic tax revenue through unifying the customs and VAT departments and undergoing improvements in the Large Taxpayer Unit (LTU) staffing and management, as well as the establishment of the Palestinian Revenue Council in the second half of 2012. The Revenue Council developed a comprehensive action plan to reform tax administration that has subsequently been approved early in 2013.

A breakdown of the four major domestic tax categories reveals the following rates of increase during 2012: Income tax: 39.5%, Value added tax: -0.3%, Customs: -36.7%, Excises on tobacco: 8.5%

Income tax which contributed about 36% of domestic tax and around 8% of gross revenues in 2012, increased by 39.5% over the year 2011 reaching NIS 662 million in 2012. This is partly due to advances paid by the taxpayers on the new tax bracket of 20% for individual and corporate income exceeding NIS 125,000 annually introduced on January 1st 2012. In addition to income tax payments,

15 companies suspended their income tax exemptions under the investment promotion law for two years (2012-2013) and contributed about NIS 50 million in 2012. Excluding the suspension of tax exemption, income tax receipts increased by around 29% in 2012 reflecting improved tax compliance and efforts of settling tax cases with companies falling under the LTU.

In Q4 2012, income tax revenue amounted to NIS 114 million, a decrease of 14% over Q3 2012 based on the yearly trend of income tax, and an increase of 26% over Q4 2011.

Domestic VAT during Q4 2012 was around NIS 200 million, an increase of 27% over Q3 2012 largely as a result of the receipt of NIS 30 millions from Jawwal Telecommunication company. By contrast, VAT in Q4 2012 declined by 12% over Q4 2011. For the full year, domestic VAT reached NIS 676 million, a decline of 0.3% compared to the year 2011. The decline in VAT collection in 2012 can be explained by several factors:

(1) the increase of Domestic VAT applied on September 1st 2012 from 14.5% to 15% following the increase in VAT in Israel (according to Paris Protocol, the difference between VAT rates in Israel and Palestine should not exceed two percentage points). While there has been a half percentage point increase in the VAT rate, merchants' deductions from their VAT liabilities also increased with the widening of the difference between VAT rates in Israel and Palestine from 1.5% to 2%.

(2) The lack of VAT payments compared to 2011 by large corporates in 2012 such as Jawwal Telecommunication company and the Arab Bank.

(3) A number of large companies (falling under the LTU) withheld VAT payments (around NIS 40 million) because they have not been paid by the PNA due to shortages of funds for supplies and services delivered.

Excise tax revenue on tobacco reached NIS 113 million during Q4 2012, a significant increase over Q3 2012 and Q4 2011 of 19% and 52% respectively. Excise taxes on tobacco for the full year 2012 increased by 8.5% over 2011 as a result of MoF's decision to increase excise tax rate on tobacco by 20% in late July, following the Israeli tax increase.

Nontax revenue of NIS 183.8 million (excluding PIF investment profits) during Q4 2012 decreased compared to Q3 2012 and Q4 2011 by 10% and 6% respectively. For the year 2012, nontax revenue (excluding dividends) amounted to NIS 835 million, increasing by 10.5% over 2011.

Investment profits received from PIF in 2012 amounted to NIS 120, exceeding the annual budget target of NIS 95 million, making up for the shortfall in non tax revenues. Overall, by the year end, non-tax receipts were on track with the budget target.

Clearance revenues, which account for two thirds of total PNA revenues, amounted to NIS 1.41 billion in Q4 2012, a decrease of 3% over Q3 2012, and an increase by 8% over Q4 2011. Clearance revenues in 2012 amounted to NIS 5.62 billion (on a commitment basis), an increase of 10.2% over 2011. The three main categories of clearance revenues, namely customs, VAT, and petroleum taxes increased in 2012 by 9.5%, 14.9% and 7.5% respectively, when compared to 2011. Clearance revenues for 2012 fell behind the budget target by 4% or NIS 242 million.

On the issue of reaching an agreement with Israel to reduce clearance leakages and enhance revenue collection by the end of 2012, all technical meetings between the two parties were suspended in mid November 2012 unilaterally by Israel, in retaliation to the Palestinian UN bid for statehood, and no agreement was reached in 2012.

Tax refunds in 2012 on a commitment basis amounted to NIS 434 million, which was below its budget target by NIS 20 million (4%). During Q4 2012, NIS 153.5 million was committed, an increase over Q3 2012 and Q4 2011 by 92% and 41% respectively.

C. Expenditures and Net Lending during Q4 2012 amounted to NIS 3.82 billion, an increase of 12% and 23% over the expenditure level in Q3 2012 and Q4 2011 respectively.

For the full year 2012, total expenditures and net lending reached NIS 13.6 billion (including the payment of NIS 468 for previous electricity debts to IEC and JEDCO by Israel), which were above the 2012 budget target by NIS 969 million (8%), as non-wage expenditures and net lending both exceeded their budget targets. When compared to the previous year 2011, total expenditure and net lending showed an increase of 14.3%.

Table 5. Sector Recurrent expenditure budget execution Jan- Dec 2012, NIS million.

Sectors	Recurrent Total Expenditures	2012 Budget*	% of Sector Budget
Central Administration	804,391	819,943	98%
Security and Public Order	4,201,029	3,812,871	110%
Financial Affairs	1,001,730	1,101,401	91%
Foreign Affairs	234,930	235,517	100%
Economic Development	261,173	330,361	79%
Social Services	5,292,393	5,597,022	95%
Cultural and Information Services	176,681	234,679	75%
Transport and Communication Services	85,016	92,500	92%
Total	11,854,745	12,224,293	99%

*Including the Supplementary Budget.

Wage expenditure amounted to NIS 1.68 billion during Q4 2012, a decrease of 4% when compared with Q3 2012, and an increase of 5% when compared to Q4 2011. The wage bill during 2012 remained within the budget target, and amounted to NIS 6812 million, which is an increase of 6.8% over the year 2011. This increase reflects the annual mandated increase of 1.25% and the cost of living allowance that were paid in early 2012. In addition, it reflected the net increase in employment of 1,165 employees which is less than 3,000 employees budgeted in 2012. The reduction in PA's employment compared to the target followed the presidential decree of freezing all hiring and promotions on August 25th 2012.

Table 6. Budget Execution Jan- Dec 2012, Wages and Salaries by Sector, NIS million.

Sectors	Wages and Salaries	2012 Budget*	% of Sector Budget
Central Administration	372,852	349,041	107%
Security and Public Order	3,089,202	3,037,340	102%
Financial Affairs	223,842	230,311	97%
Foreign Affairs	134,137	123,616	109%
Economic Development	181,704	192,455	94%
Social Services	2,623,601	2,704,666	97%
Cultural and Information Services	118,817	122,947	97%
Transport and Communication Services	67,899	70,500	96%

Total	6,812,055	6,830,876	100%
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*Including the Supplementary Budget.

Nonwage expenditures during Q4 2012 reached NIS 1.59 billion, an increase over Q3 2012 and Q4 2011 by 14% and 19%, respectively. For the year 2012, it amounted to NIS 5.7 billion, an increase of 13.8% over the year 2011. Nonwage expenditures were above the budget target by 6% (NIS 316 million), due to the increase in transfer expenditures as a result of the unbudgeted pension payments to security sector retirees.

Operational expenditures amounted to NIS 660 million during Q4 2012, an increase over Q3 2012 and Q4 2011 by 14% and 54% respectively. In the year 2012, operational expenditures reached NIS 2.26 billion, which is below the 2012 budget target by 4% (NIS 91 million). When compared to the year 2011, operational expenditure showed an increase of 26%. The supplementary budget in 2012, of NIS 389 million, in operational expenditures covered arrears to the health sector suppliers.

Table 7. Budget Execution Jan- Dec 2012, Operational Expenditures by Sector, NIS million.

Sectors	Operational Expenditure	2012 Budget*	% of Sector Budget
Central Administration	281,173	319,385	88%
Security and Public Order	292,928	338,296	87%
Financial Affairs	231,524	248,862	93%
Foreign Affairs	83,713	89,773	93%
Economic Development	27,501	46,612	59%
Social Services	892,668	1,198,721	74%
Cultural and Information Services	43,613	91,941	47%
Transport and Communication Services	10,280	15,390	67%
Total	1,863,400	2,348,980	79%

*Including the Supplementary Budget.

Transfers of NIS 925 million in Q4 2012 were higher than Q3 2012 and Q4 2011 by 13% and 3% respectively. For the year 2012 transfers amounted to NIS 3.43 billion, which was above the budget target by NIS 459 million (around 15%), due to unbudgeted pension payments to security sector retirees, and transfer payments to those affected by the latest Israeli offensive on Gaza.

Table 8. Budget Execution Jan- Dec 2012, Transfer Expenditures by Sector, NIS million.

Sectors	Transfer Expenditure	2012 Budget*	% of Sector Budget
Central Administration	147,645	145,611	101%
Security and Public Order	815,350	411,925	198%
Financial Affairs	545,782	617,928	88%
Foreign Affairs	13,620	16,928	80%
Economic Development	51,499	87,193	59%
Social Services	1,770,842	1,670,135	106%
Cultural and Information Services	10,992	10,461	105%
Transport and Communication Services	6,566	6,260	105%
Total	3,362,295	2,966,441	113%

*Including the Supplementary Budget.

Minor capital expenditures amounted to NIS 8.5 million during Q4 2012, an increase of 23% over Q3 2012 and a decrease of 44% over Q4 2011. For the full year 2012, minor capital spending amounted to NIS 26 million, a 55% decline over 2011. Minor capital expenditures were 67% below the 2012 budget target by NIS 56 million, as the PNA delayed capital spending due to shortage of funds and liquidity.

Net lending amounted to NIS 547 million in Q4 2012, marking a significant increase over the levels reached in Q3 2012 and over Q4 2011 by 117% and 207%. For the year 2012, net lending reached NIS 1.07 billion, an increase of 114% over the year 2011, and being above the 2012 budget target by NIS 672 million. The increase in net lending during 2012 can be partly attributed to increases in the Israeli electricity rates which were only passed on to Palestinian households with a lag. Also, some municipalities did not join NEDCO yet, thus these municipalities did not pass along the increases in the electricity rates to consumers.

Net lending is reduced to NIS 604 million, which is about NIS 200 million above the budget target when **NIS 468 million** of debt repayment for electricity is excluded. This amount was incurred as a result of the unilateral action by Israel to deduct payments of the advances provided to the PA during the year (NIS 35 million and NIS 55 million), in addition to allocating all November's clearance revenue of NIS 467 million to JEDCO and IEC to repay previous electricity debt.

Development expenditures channeled through the PNA Treasury amounted to NIS 937 million during 2012, which is below the budget target by NIS 393 million, and a decline over the levels of 2011 by 29%. Despite this decline, there was a shortage of external development financing by NIS 539 million prompting the Treasury to finance this amount from its own scarce resources. Development expenditures amounted to NIS 289 million during Q4 2012, which is an increase over Q3 2012 by 17% and a decrease over Q4 2011 by 16%.

D. Balance and Financing

Balance: Due to the shortfall of revenues and the increase of expenditures in 2012, the recurrent budget deficit exceeded the budget target by 36% or NIS 1.47 billion, reaching NIS 5.6 billion (including the NIS 468 payment of electricity debts). The 2012 recurrent deficit was higher than last year's deficit by 22.4%. For Q4 2012, the recurrent deficit amounted to NIS 1.9 billion, an increase of 48% and 52% over Q3 2012 and Q4 2011, respectively. Nevertheless, the total balance for 2012 amounted to NIS 6.54 billion, which exceeded the 2012 budget target by 20%, and was larger than the 2011 total balance by 10.8%. The total balance, including development expenditures, was NIS 2.2 billion during Q4 2012, an increase over Q3 2012 and Q4 2011 by 43% and 37%, respectively.

The **recurrent budget deficit** is reduced to **NIS 5.14 billion (approximately USD 1.33 billion)** if **NIS 468 million** of Net lending is excluded as explained above. Therefore, the recurrent budget deficit in 2012 increased over the year 2011 by 12.2% (13.1% of GDP in 2011 and 13.5% of GDP in 2012).

Financing: In 2012, the PA witnessed further reduction in Budget Support, when donor aid dropped below USD 1 billion. When compared to the budget target, 2012 **budget support** was lower by 22%, around NIS 826 million. **Development projects financing** of NIS 601 million was below the 2012 budget target by NIS 539 million reaching only 53% of the budget target. As mentioned earlier, the external financing fell below actual expenditures which forced the Treasury to draw on its own

resources to finance the gap. The continued decline in total external support worsened the fiscal situation causing delays in paying salaries to public employees which led to employee strikes, which interrupted PA service delivery, and to further accumulation of arrears particularly to the private sector and pension fund, and to increase in domestic bank debt.

E. Arrears: Total net accumulation of arrears during the FY 2012 reached around NIS 2.23 billion including development expenditures arrears of NIS 124 million and tax refund arrears of NIS 239 million. Payment arrears to the private sector have accumulated to NIS 741 million.

The PA incurred NIS 272 in arrears for wages as it was not able to fully cover November’s wage bill in 2012. Nevertheless, at the beginning of 2013 the Treasury was able to settle all wage and salary payments for 2012 excluding pension obligations.

Budget Classifications	NIS mill	Components	NIS mill
Wage	816.4	Employee contribution	544.4
Non wage	1046.3	Social security, Government share	607.7
Development	124.3	Private sector ⁽¹⁾	740.5
Tax refund	239.4	Other transfers	333.8
Total	2226.4		2226.4

(1) Payment arrears to suppliers (operational, minor capital and development expenditure and tax refunds.)

