

**Palestinian National Authority**

**Ministry of Finance**

**Fiscal Developments & Macroeconomic Performance:  
First Quarter 2012**

Macro-Fiscal Unit

**14/05/2012**

## Section 1: Macroeconomic performance in WBG 2011:

**Real GDP** in the WBG grew by 9.9% in 2011 compared to the same period of 2010, due to the rapid economic growth in Gaza (Tables 1A, 1B and Charts 1, 2). In the West Bank the real growth rate dropped from a growth rate of 6.8% in 2010 to 5.2% in 2011. In contrast, in Gaza real GDP in 2011 increased by 23% compared to the same period in 2010 due to the increase in construction activities (construction activities contributed to about half of the real GDP growth in Gaza) and services.<sup>1</sup> This unusually high growth of construction was caused by UN projects and some private construction, with working supplies smuggled from Egypt.

**Table 1A. WBG Real GDP\*, 2008-2011, USD million**

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
<b>Gaza</b>	1162	1260	1505	1851
<b>West Bank</b>	3717	3980	4250	4472
<b>West Bank &amp; Gaza</b>	4879	5239	5754	6323

\*Base year 2004

**Table 1B. Real growth rates, 2009-2011, (percent)**

	<u>2009</u>	<u>2010</u>	<u>2011</u>
<b>Gaza</b>	8.4	19.5	23.0
<b>West Bank</b>	7.1	6.8	5.2
<b>West Bank &amp; Gaza</b>	7.4	9.8	9.9

**The Consumer Price Index in Palestinian Territory** for March 2012 shows an increase of 0.25% compared to February 2012 and an increase of 3.12% compared to March 2011.<sup>2</sup>

**Unemployment** in the West Bank reached 20.5% by the end of December 2011, while in Gaza it reached 33.8%. Overall unemployment in WBG was 24.8% for the same period.

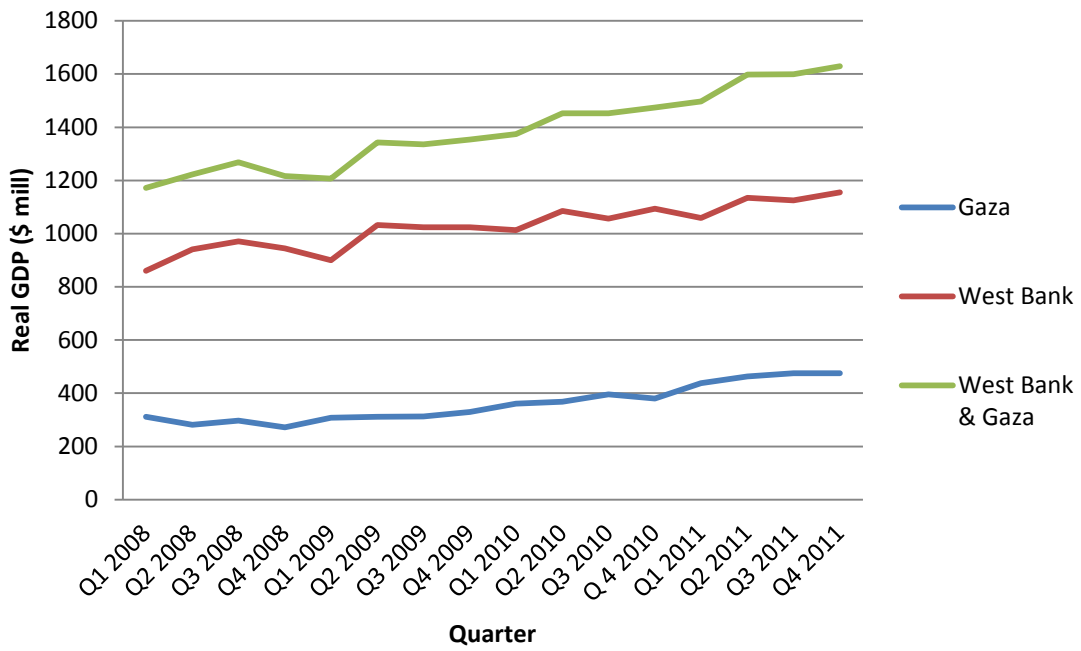
**Table 2. Labor Force and Unemployment by territory, Dec. 2011.**

Region	Total	Unemployment		Employment	
	Number	%	Number	%	Number
<b>West Bank &amp; Gaza</b>	1,167,600	24.8	289,300	75.2	878,300
<b>West Bank</b>	792,600	20.5	162,700	79.5	629,900
<b>Gaza</b>	375,000	33.8	126,600	66.2	248,400

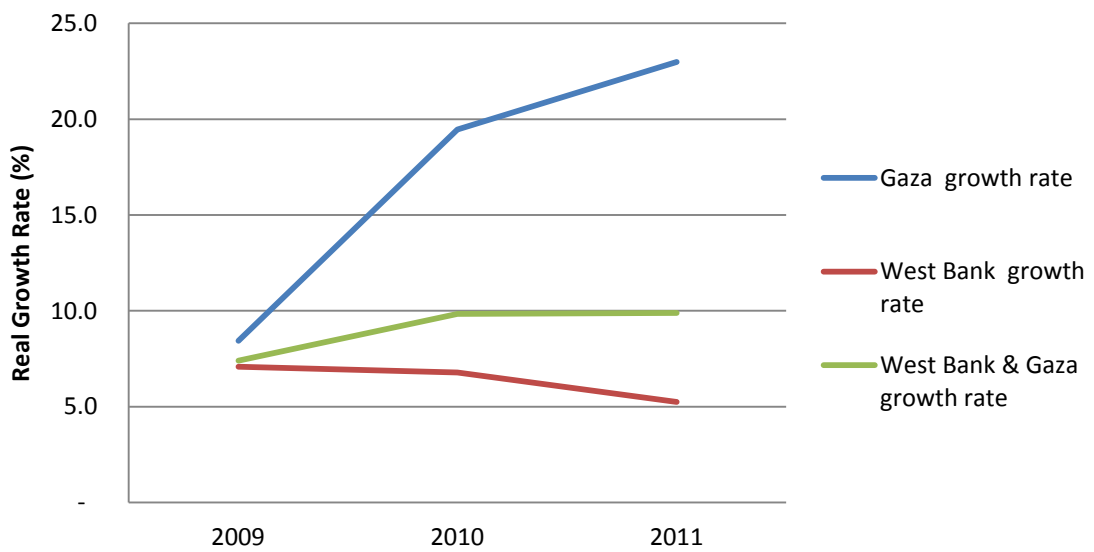
<sup>1</sup> Source Palestinian Central Bureau of Statistics, (PCBS)

<sup>2</sup> Source Palestinian Central Bureau of Statistics, (PCBS), WBG inflation does not include East Jerusalem.

**Chart 1. WBG: Real GDP 2008-2011, quarterly (USD million)**



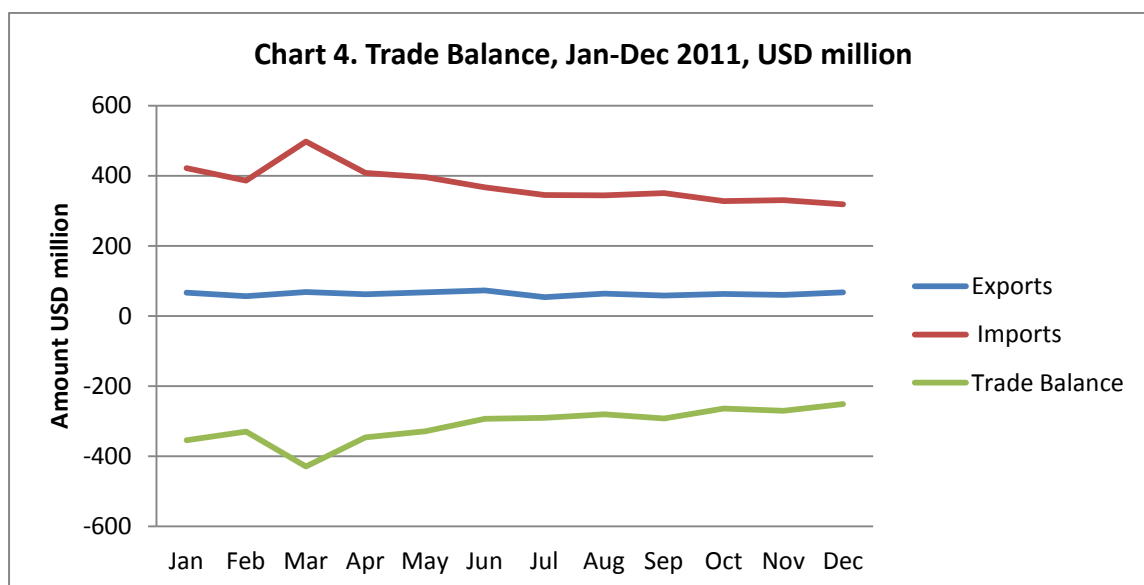
**Chart 2. WBG: Real GDP growth rate, 2009-2011, (%)**



**External Trade:** Exports for 2011 amounted to USD 759 million with a monthly average of USD 63 million, ranging between USD 73 million and USD 54 million. Exports to Israel represent almost 93% of total exports. On the other hand, imports in the same period amounted to USD 4.49 billion with a monthly average of USD 374 million, ranging between USD 497 million and USD 318 million. Trade deficit reached its peak of USD 429 million in March for a total of USD 3.73 billion in 2011.

**Table 3. External Trade, Jan-Dec 2011, USD million.**

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
<b>Total Trade</b>	489	443	565	470	464	440	399	407	408	391	390	385	5250
<b>Exports</b>	67	57	68	62	68	73	54	63	58	63	60	67	759
<b>Imports</b>	422	386	497	408	396	367	345	344	350	328	330	318	4491
<b>Trade Balance</b>	-355	-330	-429	-347	-329	-294	-291	-281	-292	-265	-270	-251	-3732



## Section 2: Fiscal Operations Q1-2012

### A. Budget execution highlights:

- **Total budget deficit** for Q1 2012 amounted to NIS 1.25 billion and is on track with the budget target. The recurrent budget deficit amounted to NIS 1.03 billion which is above the quarterly budget target<sup>3</sup> by NIS 126 million.
- **Total net revenues** in Q1 2012 were below the quarterly budget target by NIS 127 million from shortfalls in non tax and clearance revenues by NIS 54 million and NIS 122 million respectively and increase in domestic tax revenue by NIS 39 million.
- **Domestic tax revenue** increase came mainly from increases in income tax, VAT, and property tax while excises and customs revenues declined.
- **The wage bill** in Q1 2012 amounted to NIS 1.65 billion and was below the quarterly budget target by NIS 56 million due to delay in disbursements in wage indexation increases while the 2012 budget was being approved.
- **Nonwage expenditures** in Q1 2012 amounted to NIS 1.23 billion were on track with the budget target. Operational expenditures and minor capital were below their budget by NIS 18 million and NIS 16 million respectively. Transfers were above the budget target by NIS 41 million.
- **Net Lending** amounted to NIS 148 million and was largely above the budget target by NIS 48 million reaching 37% of the annual budget target.
- **Budget support** disbursement was 19.4% of the amount budgeted to finance the recurrent quarterly budget deficit target while the **development projects financing** was only 4.7% of the quarterly budget target. The total **financing gap** for Q1 2012 amounted to NIS 452 million.
- **Domestic debt stock** level fell to NIS 4.09 billion as the Treasury managed to decrease its **domestic debt** by NIS 54 million during Q1 2012.
- **Total net accumulation of arrears** during Q1 2012 reached NIS 632 million including development expenditures arrears of NIS 54 million and tax refund arrears of NIS 103 million. Arrears to the private sector including the tax refunds arrears came to NIS 342 million. Arrears to the private sector continue to undermine PA credibility and budget execution control.
- **2012 Budget** was approved on 31<sup>st</sup> of March 2012.

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<sup>3</sup> Quarterly budget target is 25% of the approved annual budget.

Table 4. Consolidated Fiscal Operation Analysis of Q1 2012 ( Commitment Basis)

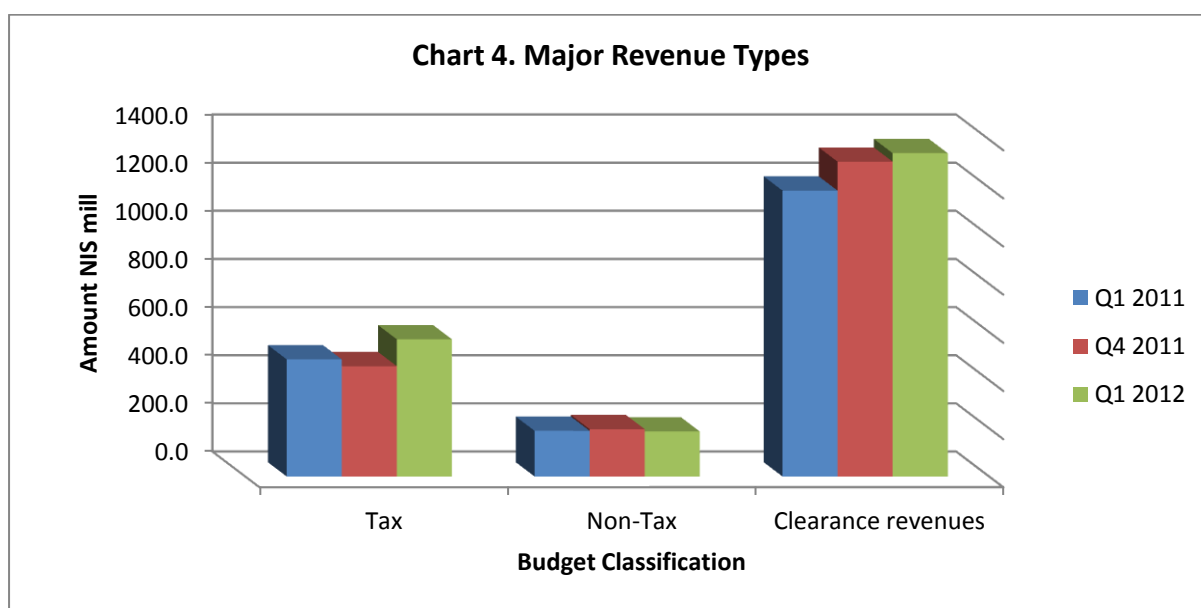
	Q1 2012	Change from Q4 2011	Change from Q1 2011	2012 Approved Budget	share of approved 2012 Budget	25% of 2012 Approved Budget	Deviation from the 25% of the approved 2012 Budget
<b>Budget Classification</b>	NIS mill.	%	%	NIS mill.	%	NIS mill.	NIS mill.
<b>Gross Revenues</b>	2099.8	7.0	12.7	8947.0	23.5	2236.8	-137.0
<b>Total Net Revenue</b>	1996.1	7.7	12.8	8493.0	23.5	2123.3	-127.1
<b>Domestic Tax</b>	569.8	24.4	17.1	2124.0	26.8	531	38.8
Income Tax	286.2	215.8	52.9	-----	-----	-----	-----
Value Added Tax	157.8	-30.6	19.4	-----	-----	-----	-----
Customs	60.4	-4.5	-22.4	-----	-----	-----	-----
Excises on tobacco	57.4	-23.1	-30.2	-----	-----	-----	-----
Excises on beverage	0.8	-26.7	-3.4	-----	-----	-----	-----
Property Tax	7.3	430.5	11.7	-----	-----	-----	-----
<b>Nontax</b>	186.8	-5.0	-1.5	963.0	19.4	240.8	-54.0
Civil Registration Fees	14.5	14.8	-4.3	-----	-----	-----	-----
Health Insurance	45.4	15.7	5.1	-----	-----	-----	-----
Transportation	25.0	19.7	-15.7	-----	-----	-----	-----
Licenses	20.3	-67.1	-60.1	-----	-----	-----	-----
Other charges and fees	81.6	31.7	60.9	-----	-----	-----	-----
Investment Profits	0.0	-----	-----	-----	-----	-----	-----
<b>Clearance Revenue</b>	1343.2	2.7	13.1	5859.0	22.9	1464.8	-121.5
Customs	465.8	-0.8	11.6	-----	-----	-----	-----
Value Added Tax	449.5	7.9	19.9	-----	-----	-----	-----
Petroleum Excises	420.9	0.2	6.3	-----	-----	-----	-----
Purchase Tax	0.0	-----	-----	-----	-----	-----	-----
Income Tax	2.4	19.0	20.0	-----	-----	-----	-----
Other	4.6	-983.5	-270.7	-----	-----	-----	-----
<b>Tax refunds (-)</b>	103.6	-4.5	9.8	454.0	22.8	113.5	-9.9
<b>Total Expenditure and Net Lending</b>	3027.5	-2.7	4.2	12114.0	25.0	3028.5	-1.0
<b>Wage Expenditure</b>	1647.6	3.4	6.1	6813.0	24.2	1703.3	-55.7
<b>Nonwage Expenditure</b>	1232.0	-8.1	-0.1	4901.0	25.1	1225.3	6.7
Operational Expenditure	472.0	10.3	-4.1	1959.4	24.1	489.8	-17.8
Transfers	756.5	-15.7	2.7	2863.7	26.4	715.9	40.6
Minor Capital	3.4	-77.6	-28.4	78.0	4.4	19.5	-16.1
<b>Net Lending</b>	148.0	-17.0	24.2	400.0	37.0	100	48.0
<b>Current Balance</b>	-1031.4	-18.1	-9.2	-3621.0	28.5	-905.3	-126.2
<b>Development Expenditure</b>	214.0	-37.7	-24.2	1330.0	16.1	332.5	-118.5
<b>Balance</b>	-1245.4	-22.3	-12.2	-4951.0	25.2	-1237.8	-7.7
<b>Financing</b>	1245.4	-22.3	-12.2	4951.0	25.2	1237.8	7.7
Budget Support	739.3	49.4	7.8	3811.0	19.4	952.8	-213.4
Development Financing	53.5	-33.3	-41.0	1140.0	4.7	285.0	-231.5
Net Domestic Bank Financing	-205.5	-141.6	-578.8	0.0	-----	-----	-----
Expenditure arrears net accumulation	529.2	18.8	59.8	-----	-----	-----	-----
Net Clearance <sup>(1)</sup>	-0.8	-69.2	-99.7	-----	-----	-----	-----
Tax Refunds (Arrears)	103.0	-5.1	87.2	-----	-----	-----	-----
Nontax Refund <sup>(2)</sup>	0.0	N/A	N/A	-----	-----	-----	-----
Residual	24.7	-0.3	-140.8	-----	-----	-----	-----

1. Withheld (+) or transferred from past collections (-).

2. Nontax refund is repayment to Jawwal and Zain telecommunication companies the advanced money the PA received from them in 2009.

## B. Revenue

**Gross PA revenues** in Q1 2012 amounted to NIS 2.1 billion growing by 7% and 12.7% over Q4 2011 and Q1 2012 respectively. **Total net revenue** was NIS 2.0 billion in Q1 2012 increasing by 7.7% and 12.8% compared to Q4 2011 and Q1 2012 respectively. Total net revenues obtained in Q1 2012 by the PA are below the quarterly budget target by NIS 127 million due to the shortfall of clearance revenues and the non-tax revenues by NIS 54 million and NIS 122 million respectively. Domestic tax revenues were above the budget target by NIS 39 million.

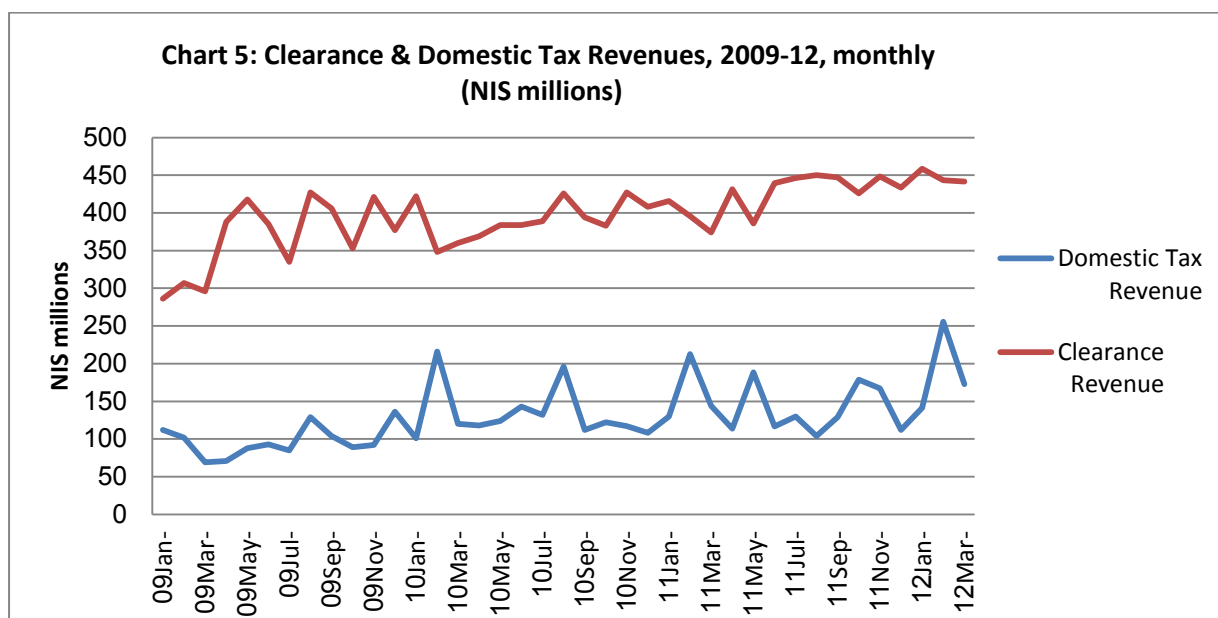


**Domestic tax revenue** of NIS 570 million during Q1 2012 increased by 17% over domestic tax revenue collected in Q1 2011 and 24% over Q4 2011 (Fiscal Table 5 and Charts 1&2). Substantial revenue collection efforts were deployed by the income tax and VAT departments. Efforts at raising income tax revenues focused on broadening the tax base, adding in the new income tax law a new tax bracket of 20% for large income earners, enforcing collection of arrears, and systematically reviewing tax liabilities by the 100 largest corporations. Moreover, two of the largest companies gave up the advantages of income tax waiver under the investment promotion law for a period of 2 years as part of the negotiations with the private sector.

In Q1 2012, income taxes amounted to NIS 286 million, substantially higher than Q4 2011 and Q1 2011 by 216% and 53% respectively. Much more income tax and property tax payments are made during the first quarter of the year because there are strong incentives

for early payments. Property tax in Q1 2012 was NIS 7.3 million an increase of 430% and 11.7% over Q4 2011 and Q1 2011 respectively. Greater controls by custom officers have also raised VAT revenues. Domestic VAT amounted to NIS 158 million an increase of 19% compared to Q1 2011. Excises on tobacco decreased by 23% over Q4 2011 due to cancelation of the increase in the excise that occurred in Q4 2011 (Fiscal Table 5).

**Nontax revenue** of NIS 187 million during Q1 2012 decreased over Q4 2011 and Q1 2011 by 5% and 1.5% respectively. Overall, nontax receipts were below the quarterly budget target by NIS 54 million which were overestimated by high expectations of license fees and investment profits. The PA is planning to review the license fees and domestic charges for potential to raise more revenues.



**Clearance revenues**, which account for two thirds of total PA revenues, amounted to NIS 1.34 billion in Q1 2012, an increase of 2.7% and 13.1% over Q4 2011 and Q1 2011 respectively. However, the clearance revenues for Q1 2012 are still below the quarterly budget target by NIS 122 million. The increases in the two main categories in clearance revenues, VAT and customs, in Q1 2012 compared to Q1 2011, were 20% and 12% respectively. The PA in Q1 2012 started collecting VAT invoices for all products coming from Karim Abu Salem crossing which will generate between NIS 8-15 million each month more VAT revenues.



The petrol tax appears to be holding up in Q1 2012 despite the rate reduction of the BLOW and the decrease in the supplies to Gaza. This is the result of the large increase in the quantities of petrol supplied to the West Bank.

**Tax refunds** in Q1 2012 on a commitment basis amounted to NIS 104 million. However, on a cash basis, only NIS 0.6 million was disbursed by the decision of MoF to prioritize spending and payments on wages and recurrent expenditures due to the large shortfall in external budget support. This decision contributed to arrears accumulation of NIS 103 million. Tax refunds in Q1 2012 increased by 10% over Q1 2011 even though it was below the quarterly budget target by NIS 10 million.

### C. Expenditure and Net Lending

Total expenditure and net lending in Q1 2012 were largely on track with the budget target. During Q1 2012 total expenditures and net lending amounted to NIS 3.03 billion, on a commitment basis, a decrease of 2.7% from the expenditure level in Q4 2011 and an increase of 4.2% from the expenditure level in Q1 2011.

**Table 6. Sector recurrent expenditure budget execution, Jan-Mar 2012 , thousand NIS**

Sectors	Recurrent Total Expenditures	2012 Sector Budget	% of Sector Budget
Central Administration	201,512	812,800	25%
Security and Public Order	974,198	3,711,028	26%
Financial Affairs	264,445	1,082,165	24%
Foreign Affairs	62,972	234,304	27%
Economic Development	54,076	329,670	16%
Social Services	1,097,216	5,219,221	21%
Cultural and Information Services	41,567	232,064	18%
Transport and Communication Services	20,588	92,500	22%
<b>Total</b>	<b>2,716,573</b>	<b>11,713,756</b>	<b>23%</b>

The recurrent expenditures execution over which the PA has control over is kept within budget targets with total recurrent expenditures reaching 23% of the budget target in Q1 2012. Total recurrent expenditures in 2012 budget are aimed to remain within their level in 2011 at about 12 billion as part of restrained spending policies.

In our attempt to protect the social services provided to the population, particularly education and health, and to improve the quality of expenditure, recurrent allocations for ministries of Education, Health, and Social Affairs have been increased in the 2012 budget by 2.4% over 2011. This reflects the government's priorities to achieve greater income equality and social justice. The PA managed to keep the share of the three ministries in recurrent expenditures in 2012 at 41%, as in 2011.

**Wage expenditure** of NIS 1.65 billion in Q1 2012 (Table 4) fell by NIS 56 million of the budget target since the payment of the annual and cost of living allowances were delayed until the budget was approved and will be paid retroactively in March payroll to be recorded in April 2012. Wage expenditure increased by 6.1% over the wage bill in Q1 11. This increase reflects the yearly wage adjustment, wage drift, and a limited increase in net PA employment, not exceeding 3,000 employees. The cost of living allowance and the annual increase, agreed to with the civil service union, became effective on January 1<sup>st</sup> 2012, will be disbursed in March payroll.

**Table 8. Budget Execution Jan- Mar 2012, Wages and Salaries by Sector, thousand NIS.**

Sectors	Wages and Salaries	2012 Sector Budget	% of Sector Budget
Central Administration	90,037	349,041	26%
Security and Public Order	735,238	3,021,144	24%
Financial Affairs	55,354	230,311	24%
Foreign Affairs	33,860	123,616	27%
Economic Development	44,693	192,455	23%
Social Services	641,713	2,704,666	24%
Cultural and Information Services	28,733	120,963	24%
Transport and Communication Services	16,669	70,500	24%
<b>Total</b>	<b>1,646,297</b>	<b>6,812,695</b>	<b>24%</b>

Wage expenditure on a cash basis was NIS 1.51 billion (Fiscal Table 3). Arrears of NIS 133 million were incurred on the employee contributions to the Pension Fund as well as for other items, all due to shortfalls in external budget support and resulting from liquidity shortages.

**Nonwage expenditures** of NIS 1.23 billion in Q1 2012 were lower than in Q4 2011 in almost every category except in operational expenditures. In comparison with Q1 2011, Q1 2012 nonwage expenditures decreased slightly (-0.1%). Operational and minor capital expenditures were curtailed in order to increase slightly the transfer expenditures.

Because of liquidity shortages, due to much lower external budget support received than was committed by the donors, about NIS 342 million in nonwage arrears were incurred in Q1 2012 (Fiscal Table 4).

**Operational expenditures** of NIS 472 million during Q1 2012 (Table 4) increased by 10.3% over Q4 2011 but decreased by 4.1% over Q1 2011.

Operational expenditures for 2012 budget was increased by 9.3% from the level attained in 2011 to achieve greater efficiency while attempting to improve the quality of services delivered, since operational expenditures are related to the services provided to a growing population, particularly in the education and health sectors.

<b>Sectors</b>	<b>Operational Expenditure</b>	<b>2012 Sector Budget</b>	<b>% of Sector Budget</b>
<b>Central Administration</b>	74,432	319,353	23%
<b>Security and Public Order</b>	45,072	306,432	15%
<b>Financial Affairs</b>	43,482	229,627	19%
<b>Foreign Affairs</b>	25,466	89,773	28%
<b>Economic Development</b>	5,391	45,922	12%
<b>Social Services</b>	134,943	860,921	16%
<b>Cultural and Information Services</b>	9,553	91,941	10%
<b>Transport and Communication Services</b>	2,311	15,390	15%
<b>Total</b>	<b>340,650</b>	<b>1,959,359</b>	<b>17%</b>

(1) Table 9 is on a cash basis. It does not include the accumulation of arrears to suppliers.

Table 9 shows that Foreign Affairs sector is slightly above operational expenditure budget target. But since most ministries are under spending, total operational expenditures were kept below budget targets.

**Transfers** of NIS 756.5 million in Q1 2012 were lower than in Q4 2011 by 15.7% and higher than Q1 2011 by 2.7% reaching 26.4% of its budget target (NIS 2863.7 million). Transfers which include government share for each sector were above the budget target by NIS 41 million.

**Minor capital expenditures** amounted to NIS 3.4 million, decreased by 77.6% and 28.4% compared to Q4 2011 and Q1 2011 respectively. This amount reached to only 4.4% of its 2012 budget target at the end of the first quarter. The MoF decided to prioritize its spending

on wages and other recurrent expenditures by delaying minor capital spending during the period of approval of the 2012 budget.

**Table 10. Budget Execution Jan- Mar 2012, Transfer Expenditures by Sector, thousand NIS**

Sectors	Transfer Expenditure	2012 Sector Budget	% of Sector Budget
Central Administration	35,918	138,500	26%
Security and Public Order	193,735	358,143	54%
Financial Affairs	165,405	617,928	27%
Foreign Affairs	3,645	15,716	23%
Economic Development	3,991	87,193	5%
Social Services	320,200	1,630,135	20%
Cultural and Information Services	2,445	9,831	25%
Transport and Communication Services	1,608	6,260	26%
<b>Total</b>	<b>726,946</b>	<b>2,863,705</b>	<b>25%</b>

**Net lending** amounted to NIS 148 million in Q1 2012 (Fiscal Tables 1 and 2), a decrease of 17% over Q4 2011 and an increase of 24.2% over Q1 2011.

Net lending was above the quarterly budget target of NIS 100 million by NIS 48 million or by 48%. This is due to the recent increases (in Q4-2011 and Q1-2012) in Israeli deductions of electricity bills from monthly clearance revenues and the decline in payments from municipalities for electricity to the PA.

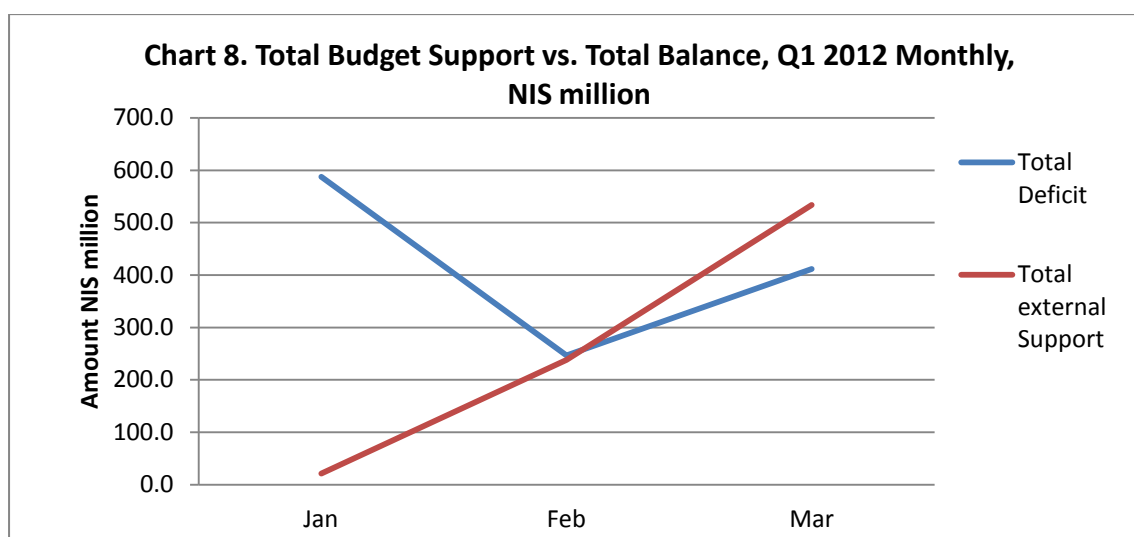
It should be recalled that the budget appropriation for net lending in 2012 has been reduced from NIS 592 million in 2011 to NIS 400 million in 2012, in the context of a policy aimed at eliminating net lending altogether.

**Development expenditures** on a commitment basis channelled through the PA Treasury amounted to NIS 214 million during Q1 2012 (Fiscal Tables 1 and 2). This is lower than the levels attained in Q4 2011 and Q1 2011 by 38% and 24% respectively. However on cash basis only NIS 160 million was disbursed, due to the large shortfall in external financing for development projects.<sup>4</sup> The PA financed NIS 35 million of development expenditures which contributed in the recurrent budget arrears.

<sup>4</sup> Details of development expenditures are now published quarterly along with the fiscal tables with the numbers 9A-9D. The MOF made available for the first time descriptions of the projects in table 9A.

## D. Balance and Financing

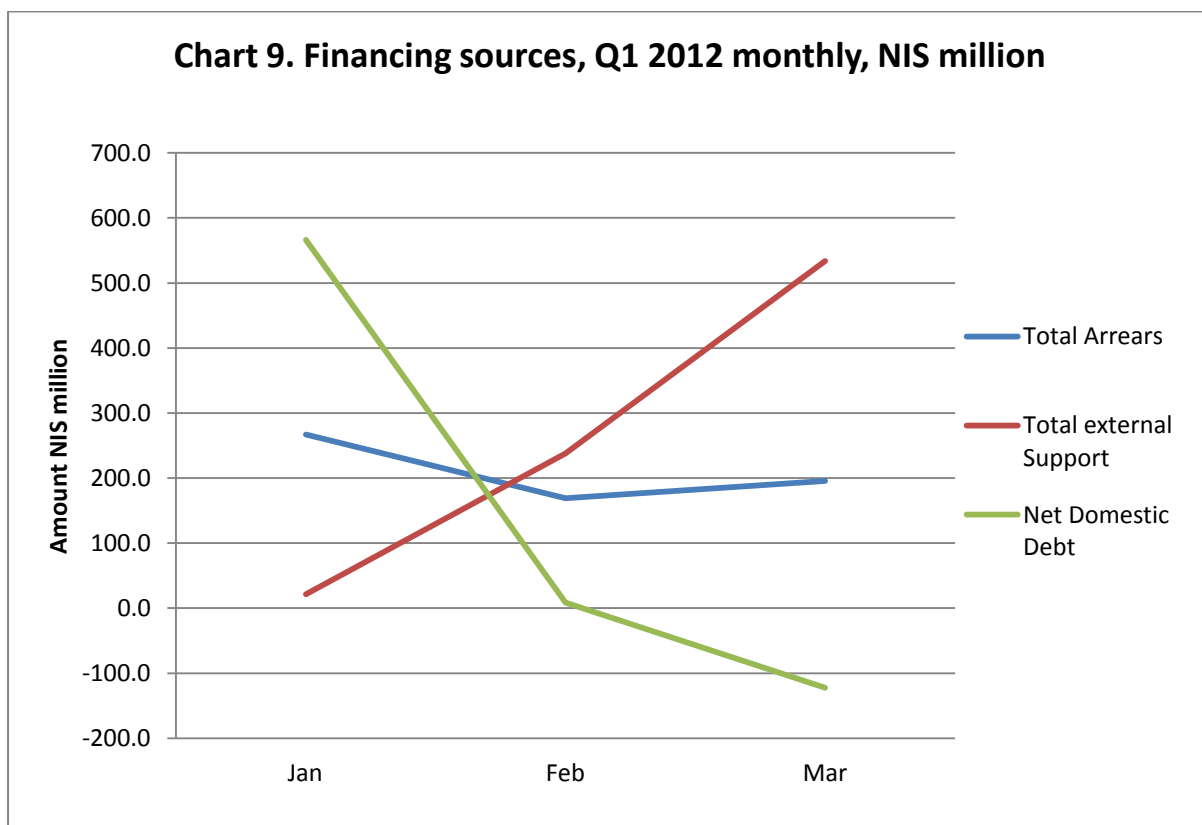
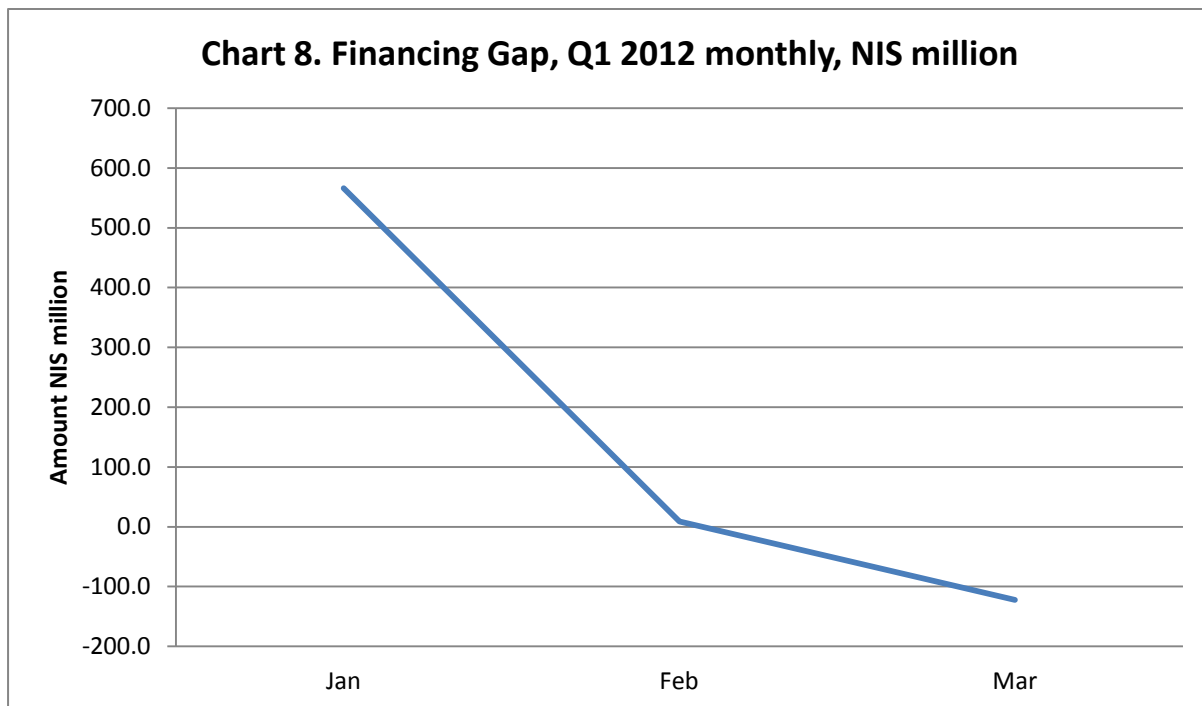
**Balance:** In Q1 2012 the recurrent budget deficit was NIS 1.03 billion exceeding the quarterly budget target by NIS 126 million. This is still lower than the deficit of Q1 2011 by 9.2%. At the same time, the total balance for Q1 2012 amounted to NIS 1.25 billion exceeding the budget target by only NIS 8 billion due to much reduced commitments on development expenditure. This was also a decrease of 22% compared to Q4 2011.



**Financing:** In Q1 2012 the total external budget support amounted to NIS 739 million which does not include the first civil and pensioners PEGASE disbursement for 2012 of NIS 234 million which was received at the end of December 2011 but was disbursed in January 2012. The bulk of the support came from PEGASE (NIS 378 million) followed by the World Bank Trust Fund (NIS 247 million) and regional donors (NIS 114 million). However, the external budget support was substantially short of the total financing requirement for the first quarter 2012 (see Chart 9). Development financing channelled through the Treasury amounted to NIS 54 million or only 5% of the budget target. Development expenditures financed by the PA Treasury as shown in fiscal table 9D amounted to NIS 35 million which makes up the shortfall in external financing for development expenditure. This expenditure by the PA increases the recurrent financing gap by the same amount. The financing gap for Q1 2012 amounted to NIS 452 million. The Treasury managed to decrease its domestic debt by NIS 54 million during Q1 2012<sup>5</sup>, decreasing the domestic debt stock level to NIS 4.09 billion at the end of Q1 2012 (Fiscal Table 8a (NIS)). This constraint on liquidity from running

<sup>5</sup> The difference between net domestic bank financing in fiscal table 1 and the domestic debt repayment is the change in deposits.

down domestic debt stock resulted in Q1 2012 in accumulation of NIS 632 million payment arrears. (See Arrears).



## E. Arrears

Total net accumulation of arrears during the Q1 2012 amounted to NIS 632 million including development expenditures arrears of NIS 54 million and tax refund arrears of NIS 103 million. Payment arrears to the private sector have accumulated to NIS 342 million.

Budget Classifications	NIS mill.	Components	NIS mill.
Wage	132.7	<b>Pensions Arrears</b>	
Nonwage	342.2	Employee contribution	132.7
		Social security, Government share	144.2
Development Expenditures	54.4	Private sector (1)	342.1
Tax refunds	103.0	Other transfers	13.2
<b>Total</b>	<b>632.2</b>		<b>632.2</b>

(1) Payment arrears to suppliers (operational budget and development budget and tax refunds).

