

PURSE Review
April-June 2022

Fiscal performance

1. **The first half (H1) of 2022 witnessed a significant boost to public revenues.** Domestic tax collections increased by almost 26 percent year-on-year (y-o-y) driven by a growth in all tax categories, except tobacco excise. Income tax collections grew by 40 percent while VAT and domestic customs grew by 27 and 22 percent, respectively. This y-o-y growth was driven by an improvement in economic activity as real GDP growth is estimated to have reached 5.7 percent in Q1 2022, y-o-y, (latest available data). Collections from excise on tobacco dropped by 3 percent as the re-opening of the bridge with Jordan and the resumption of commercial travel through it may have allowed for some tobacco smuggling. But it seems like this practice remains limited given that monthly collections continue to be higher than the pre-COVID-19 era. Non-tax revenues increased by 27 percent in H1 2022 driven by an increase in domestic fees and charges, and also in the equalization levy collected by Israel from Palestinian workers and transferred to the Palestinian Authority (PA).¹ Investment profits received by the PA from the Palestine Investment Fund also increased and reached NIS15 million. Tax refunds, a negative tax item under which the fuel subsidy is classified, increased given a 250 percent growth in the subsidy following the PA's decision to continue subsidizing fuel despite the increase in global prices. The increase in tax refunds was offset by a growth in revenue collections, as mentioned above, resulting in an overall increase in public revenue.

2. **Clearance revenues also performed well in H1 2022, increasing by 13 percent, y-o-y.** Their good performance is mainly attributed to higher customs and VAT collections which increased due to a rise in imports.² Petroleum excise also increased by 30 percent due to higher imported quantities compared to the same period in the previous year and the rise in the global prices of fuel. Also, the appreciation of the NIS encouraged higher imports from abroad, in line with the rebound in economic activity. Notably, income tax collected by Israel from Palestinian workers reached NIS71 million in H1 2022, up from NIS30 million in the same period last year.³ Deductions by Israel from clearance revenues to account for some of the payments made by the PA to Palestinian prisoners in Israeli prisons, ex-prisoners, and families of those deceased as a result of violence were reduced to NIS50 million per month in 2022, down from NIS100 million since August 2021.

3. **Recurrent public spending was maintained at last year's level as increases in certain spending items were offset by a strong drop in transfers.** Government transfers declined by 19 percent as the PA did not provide any payments to poor beneficiaries through the National Cash Transfer Program (NCTP) in H1 2022, given the delay in the disbursement of the European Union's contribution to the program. The strong decline in transfers offset the increase in other spending items. Mainly, the wage bill rose by about 5 percent, on a commitment basis, in H1 2022, y-o-y, due to the implementation of the yearly step increase and the cost-of-living allowance. On a cash basis, the PA has been paying around 80 percent of the salaries of public employees, while protecting the lowest earners, since November 2021. Spending on goods and

¹ Palestinians employed in Israel are only entitled to basic insurance benefits, 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.

² PCBS trade data show that imports between January-May 2022 (latest available data) increased by 36 percent compared to the same period in 2021.

³ According to the PCBS, the number of Palestinian working in Israel and the settlements increased from 138 thousand in Q1 2021 to 204 thousand in Q1 2022 (latest available data).

services increased by 2 percent, reflecting higher expenses mainly related to outside medical referrals and also vaccines and medical supplies. Net lending, reflecting unplanned subsidies to Local Government Units (LGUs) covering utility bills to Israeli suppliers, increased by 1.2 percent in H1 2022, y-o-y, compared to its high base during the same period in 2021 following the COVID-19 shock. This highlights the need to expedite reforms in this area.

4. **Given strong revenues and the maintenance of public spending, the PA's deficit significantly dropped in H1 2022, y-o-y.** The total deficit (before grants) reached US\$153 million, almost 70 percent less than in the same period last year.⁴ Donor financing was US\$80 million (US\$44 million in budget support and US\$36 million in development financing). After accounting for deductions made by the GoI from clearance revenues, the PA ended with a financing gap of US\$164 million. The PA relied on arrears to the private sector, the pension fund, and to public employees to make ends meet. Even though comprehensive data on arrears is not available, the current stock of arrears to the private sector is estimated at about US\$950 million while arrears to the pension fund are around US\$2 billion, only for civil schemes while data is unavailable for the security schemes. The PA has paid down its debt from the domestic banking sector to US\$2.2 billion as of June 2022, down from US\$2.5 billion as of December 2021.

Reform progress

5. **The assessment in this section is based on progress made by the PA in achieving the targets set in the World Bank's "Supporting Transparency, Inclusiveness and the Green Economy" Development Policy Grant (DPG) approved by the Board of directors on June 7, 2022.** This is the twelfth budget support operation that the World Bank has prepared for the benefit of the Palestinian territories, and it is in the amount of US\$30 million. The development objectives of the operation are to: (i) improve public resource management and support inclusiveness, and (ii) strengthen governance in the water sector and accelerate the greening of the economy. The following section lists the main reforms supported by the operation. Reporting on reform progress will commence in the Q3 PURSE report to give the authorities some time for implementation following Board approval.

Pillar 1: improve public resource management and support inclusiveness

6. **Prior Action 1: The Recipient through its Cabinet has increased efficiency and transparency by instituting electronic government procurement (e-GP) and automating the public procurement process, as evidenced by Cabinet decision No. (1,م/و,م/18/155/01) dated April 4, 2022, approving the e-GP strategy which defines the objectives, functionality, roadmap for implementation and institutional arrangements to automate all steps of the public procurement process.** Building on actions included in previous DPGs and to improve public resource management and transparency, this prior action supports the development and implementation of an end-to-end e-GP system. E-GP is a key step in public procurement reform as it facilitates streamlining and automating all aspects of the government procurement process, from planning to tendering, contract monitoring and eventually payment, while applying stronger controls over spending. The introduction of an e-GP system is a vehicle to enhance service delivery, transparency, and citizen satisfaction. The indicator agreed upon with the PA for this prior action is that eight high spending procuring entities targeted in phase 1 of e-GP start executing procurement transactions through the electronic system, by December 2023. These entities include the MoF- General Supplies Department, Ministry of Public Works and Housing- Central Tendering Department, Ministry of Health, Ministry of Education, Ministry of Telecommunications, Palestinian Water Authority, Palestinian

⁴ The year-on-year comparison is made using NIS figures to avoid the impact of the exchange rate fluctuation.

Natural Resources and Energy Authority and the Ministry of Local Government. The share of these entities in total public spending is 34 percent.

7. **Prior Action 2: The recipient, through the Palestine Monetary Authority, has prioritized financial inclusion by revising modalities and specifications for financial inclusion accounts canceling the proof of work requirement and requesting a zero minimum balance aiming to reach financially excluded and unbanked populations with a range of financial services suited to their needs, as evidenced by PMA’s Regulations No. 13, dated June 10, 2021.** Over the last decade, the PMA has focused on financial inclusion as a key priority to develop strong and efficient financial infrastructure. Given that owning a bank account is considered the first step towards financial inclusion, the PMA has prioritized efforts to regulate financial inclusion accounts. In 2012, the PMA issued regulations governing the creation of financial inclusion accounts, also known as no-frill accounts. Those, however, were never really operationalized due to difficult requirements, mainly proof of work, which most of the target population including free lancers, small female-owned businesses, and Palestinian workers in Israel could not provide. In 2021, the PMA revised the old instructions in an effort to better serve the unbanked population through this product. The revision cancelled the proof of work requirement and requested banks operating in the Palestinian territories to introduce this type of account to their management information systems. The financial inclusion accounts require a zero minimum balance and allow users to store money and send and receive bank transfers, receive cheques and use debit cards, all at a zero fee. The indicator agreed upon with the PMA for this prior action is that 10,080 financial inclusion accounts are issued by December 2023.

8. **Prior Action 3: The recipient, through its Ministry of Finance, to ensure that the collection and allocation of public resources is carried out in ways that contribute to advancing gender equality and women's empowerment, has instructed all line ministries to prepare gender responsive budgets, as evidenced by budget preparation instructions for the years 2022-2024 issued by the budget directorate at the MoF in May 2021.** Significant strides have been made in the Palestinian territories to elevate the importance of gender equality and to institutionalize issues of women’s economic empowerment in policies and strategies. Given that the budget is the main tool used by governments to determine how public funds are raised and used and who benefits from them, the PA has instructed all line ministries to prepare gender responsive budgets by end-2024, making the budgeting process more inclusive and contributing to enhanced transparency. Introducing gender responsiveness to the Palestinian budget would result in outcomes that are based on an understanding of gender roles and inequalities. The indicator agreed upon with the MoF for this prior action is that, at a pilot stage, two of the highest spending line ministries will prepare gender responsive budgets by end-2023. Those will be the Ministry of Social Development and the Ministry of Education—both of which comprise 26 percent of total public spending.

Pillar 2: strengthen governance in the water sector and accelerate the greening of the economy

9. **Prior Action 4: The recipient, through its Prime Minister, has improved governance in the water sector by issuing regulation No. 17 dated June 14, 2021, regulating the establishment and licensing of regional water utilities, and identifying their roles, competencies, and the management of their financial resources, as they take charge of service provision of water and wastewater from Local Government Units and Village Councils, enhancing economies of scale in the sector in both Gaza and the West Bank.** The Palestinian territories is a water-scarce area, making efficient service provision a stressing priority. The water sector is currently regulated by the 2014 Water Law, which supports the aggregation of the existing small service providers -water departments at the LGUs- into

Regional Water Utilities (RWUs) to enhance the sustainability of service delivery. Implementation has been slow due to an incomplete legal structure and currently, there are around 300 predominantly small and local service providers for water, resulting in high fragmentation in the sector. Recently, the bylaw that regulates the establishment of RWUs was adopted by the Cabinet, as a key step to operationalize the 2014 law. The bylaw identifies the tasks of the RWUs, their competencies, their structure, the management of their financial resources and all related matters to their functions. The bylaw is supported by the DPG given its importance in improving governance arrangements and creating efficiencies in the water sector. The target agreed upon with the Palestinian Water Authority (PWA) for this prior action is that two RWUs are established in the West Bank and Gaza, by December 2023.

10. **Prior Action 5: The Recipient, through its President, enacted amendments to the 1999 environment protection law to establish a national climate change committee and enhance national capacity to adapt to the negative consequences of climate change, reduce greenhouse gas emissions, and set specified penalties for enterprises not adhering to emissions specifications, as evidenced by the issuance of Presidential Decree no. 2155, dated October 13, 2021.** The PA has taken active steps in recent years to contribute to the climate change agenda. The Palestinian territories submitted its first Nationally Determined Contributions (NDC) to the United Nations Framework Convention on Climate Change (UNFCCC) in 2017 setting its adaptation and mitigation targets. More recently in 2021, the second NDCs were submitted with higher targets related to greenhouse gas (GHG) emissions compared to those in the First NDC. To modernize the regulatory framework in line with these actions, the PA introduced changes to the Palestinian environmental law to: 1) enhance national capacity to adapt to the negative consequences of climate change and reduce GHG emissions, 2) set specifications for air emissions and request all establishments in the Palestinian territories to adhere to these specifications within a maximum period of three years, specifying penalties, jail time, and fines for those who do not comply, and 3) establish a national committee to implement the Paris Agreement on climate change. These amendments are supported by this DPG and the target agreed upon with the Environment Quality Authority (EQA) for this prior action is that a Measurement, Reporting and Verification (MRV) system that is customized according to the Palestinian context and housed at the EQA, is already generating statistical summaries and analytics on GHG emissions, by December 2023.