PRDP-TF Review
January – March 2021

Fiscal performance

1. **Despite an ease of COVID-19 related measures, the PA's fiscal situation remained difficult in the first three months of 2021 partly due to a decline in domestic revenues**. According to data provided by the Ministry of Finance (MoF), the performance of domestic taxes was mixed. Income tax and VAT collections both declined by 10 and 2 percent respectively, year-on-year, due to an overall decline in economic activity in January to March 2021 compared to the same period in 2020 when the COVID-19 outbreak had not started yet. On the other hand, domestic customs collected on used cars increased by 14 percent as consumers that had delayed such purchases in 2020, given the perceived uncertainty, have proceeded in Q1 2021. Also, excise on tobacco increased by half in Q1 2021, year-on-year, as the closure of the border with Jordan has eliminated tobacco smuggling, resulting in higher public revenues. Non-tax revenues registered a significant drop of 28 percent as the PA barely received any investment profits from the Palestine Investment Fund in Q1 2021, compared to NIS41 million in the same period in 2020 and also due to a drop in transfers by the Government of Israel (GoI) of health fees and equalization levy collected from Palestinian workers in Israel.[1] In total, domestic revenues dropped by 2 percent in Q1 2021, compared to the first three months of 2020.

2. **Clearance revenue transfers stabilized in Q1 2021 and they increased by 1.3 percent, year-on-year, due to higher customs as collections from all other tax categories declined**. Customs on imports grew by 17 percent in Q1 2021 mostly driven by higher imports of raw tobacco from third countries used by local manufacturers to produce cigarettes to substitute for the loss of smuggled cigarettes from Jordan. Collections from petroleum excise dropped by 5 percent in Q1 2021, year-on-year, due to lower imported quantities especially in February compared to the same period in the previous year. Transfers of income tax collected by the GoI from Palestinian workers in Israel amounted to zero in Q1 2021, compared to NIS27 million in Q1 2020. The increase is customs, however, offset the decline in other tax categories resulting in a small overall increase in clearance revenues.

3. **Public spending increased by 13 percent in Q1 2021, year-on-year, adding to the fiscal stress.** The increase was mainly driven by a 13 percent increase in the wage bill due to the PA's decision to reinstate the wages of more than 30 thousand public employees in Gaza to a 100 percent starting February 2021, up from 70 percent in the last several years. Spending on the use of goods and services also increased by 26 percent in Q1 2021 reflecting additional expenses associated with the relatively regular return of public employees to their duty stations and to normal working hours compared to the first quarter of 2020. Transfers also grew by 12 percent driven by an increase in social transfers paid through the National Cash Transfer Program (NCTP) to needy families affected by the COVID-19 crisis, and due to additional spending on pensions to Gaza employees as those were also reinstated to a 100 percent starting February 2021. Finally, net lending stabilized at its previous year's level, which is a positive indication that payment by consumers is picking up again following a strong deterioration in previous months.

[1] According to the PA MoF data, the GoI transferred in excess of NIS112 million in Q1 2020 in health fees and equalization levy compared to NIS51 million in Q1 2021.

4. **Given the decline in public revenues and the significant increase in spending, the PA's deficit reached US$182 million – compared to US$40 million in the same period in 2020.** Aid received through the budget was less than US$11 million, and it was all channeled towards development projects, while budget support amounted to zero compared to US$70 million in the same period last year. The decline in budget support is mainly attributed to the absence of funding from Saudi Arabia, lack of contributions by donor countries to the World Bank's PRDP TF and a delay in the European Union's contribution which is planned to be disbursed in the second half of 2021 rather than in the first quarter of the year, as in 2020. Given the absence of budget support, the PA faced a large financing gap of US$171 million. The PA relied on arrears to the private sector and the pension fund to finance the gap. It did not, however, resort to additional bank borrowing in Q1 2021. In fact, data by the MoF show that the PA's stock of domestic debt declined from US$2.3 billion as of December 2020 to US$2.2 billion as of March 2021.

Table 1: Budget Support to the Palestinian Authority, US$ million

Budget Support	Jan-March 2020	Jan-March 2021
Arab Donors	**31**	**0**
Saudi Arabia	31	0
Algeria	0	0
Qatar	0	0
Oman	0	0
Egypt	0	0
Kuwait	0	0
International Donors	**39**	**0**
USA	0	0
India	0	0
France	0	0
Turkey	0	0
EU PEGASE	14	0
World Bank PRDP TF	25	0
Total	**70**	**0**

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 "Strengthening Fiscal Stability and Financial Integrity" DPG approved by the Board of directors on May 8, 2020.** This is the tenth 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 operation focuses on three main pillars: 1) strengthening commitment control in line ministries and improving overall public procurement practice, (ii) improving sector governance in water and health service provision, and (iii) strengthening the stability and integrity of the financial sector. The following section lists the main reforms supported by the operation and describes progress on each.

Pillar 1: Strengthen commitment control in line ministries and improve overall public procurement practice.

6. **Prior Action 1: The Ministry of Finance has taken the necessary actions to implement a commitment control system in all line ministries to secure budget allocations prior to the**

signing of a contract with service providers, excluding outside medical referrals. Prior to this action, a budget reservation (in most ministries) has only occurred when an expense is being paid. Implementation of a commitment control system requires line ministries to ask for a budget allocation before an expense is contracted. This reform is being implemented through the Integrated Financial Management Information System (IFMIS) and the associated financial procedures. Expenditures processed under the new commitment control system will initially include wages and transfers, which add up to 70 percent of the PA's total spending. The new commitment control system would enable: (i) reserving budget allocations for specific purposes; (ii) making those allocations unavailable for any other purpose; and (iii) planning for future disbursements. The measure is expected to reduce the generation of arrears for expenditures outside the budget by ensuring that all commitments are within the budget. Due to COVID-19, there has been some delay in rolling out the new system in all line ministries. However, data provided by the MoF show that the PA's spending on wages and semi wages (including transfers and pension payments) is now being processed under the new commitment control system. This adds up to around 66 percent of the PA's recurrent spending, only slightly lower than the 70 percent target set by the DPG.

7. **Prior Action 2**: **The Cabinet has instructed public entities to publish their procurement plans, procurement opportunities and contract award notices on the single portal procurement website which can be accessed on www.shiraa.gov.ps.** The single procurement portal is critical for promoting transparency and for making available necessary information on public procurement to the private sector, the government, and the public. It is the first step towards the adoption of an e-procurement system. The data generated from the portal will help Higher Council for Public Procurement Policies (HCPPP) assess the performance of the procurement system against a set of indicators and to subsequently adjust procurement policies to achieve best value for money. According to latest data, 62 percent of entities at the central level (56 out of 90) and 28 percent of municipalities (33 out of 118) used the portal in 2020. So, the DPG target of 50 percent of entities at the central level was reached while the achievement at the local level was only slightly shy of the 30 percent target.

8. **Prior Action 3: The Cabinet has instructed all public entities at the central and local levels to use Standard Bidding Docs (SBDs) for the procurement of works, goods and consultants' services.** The issuance and mandatory use of SBDs presents a number of advantages for a procurement system, namely: helping standardize and harmonize implementation of procurement proceedings; promoting transparency and predictability in public procurement proceedings, helping mitigate the effects of low levels of procurement capacity in the public sector; facilitating participation by small businesses; and facilitating oversight, and audit of procurement proceedings. Given the COVID-19 breakout, training on the use of SBDs for central and local level entities was interrupted and eventually restarted in October 2020. As a result, data as of March 2021 indicate that the share of procuring entities using the SBDs was 14 percent at the central level and 7 percent of municipalities, lower than the target agreed upon in the DPG which was 50 percent of entities at the central level and 30 percent of municipalities by end-2020. It is important to note that due to COVID-19, the fiscal crisis and the operation on an emergency budget in 2020, the allocation to public procurement and the overall number of public bids has significantly dropped given that the majority of government agencies and municipalities had none, negatively impacting the use of the new SBDs. In fact, considering the number of entities at the central level and municipalities that have used the SBDs as a percentage of those that have published bids, the figures increase to 23 and 18 percent respectively. It is also worth noting that the government agencies that have used the

SBDs so far are the high spending agencies and their procurement constitute a major share of public procurement in the PA. Those are: Ministry of Health, Ministry of Education, Ministry of Public Works, General Supplies Department in MoF, Palestinian Water Authority, Ministry of Interior, and the Bureau of Statistics.

Pillar 2: Improve sector governance in water and health service provision.

9. **Prior Action 4: The Ministry of Health (MoH) has instructed the General Director of its Education in Health department to ensure that all human resource planning and policies related to post-graduate medical training in the sector, including the establishment of medical residencies, are based solely on periodic data generated by the human resources observatory.** The prior action supports the use of the results of the mapping exercise that was carried out by the Palestinian National Institute of Public Health, in close coordination with the MoH, to develop an observatory of human resources to design policies. Specifically, the prior action requires that human resource policies related to post-graduate specialized care in the health sector are based on hard data that analyze supply and demand trends in addition to the medium to long-term needs of the population. The human resources observatory has identified a lack of local skills in four highly specialized medical services, including oncology (0.4 physician per 100,000 population), hematology (0.1 physician per 100,000 population), pathology (0.2 physician per 100,000 population), and neurology (1 physician per 100,000 population). These four areas account for the largest share of the medical referral cases posing a significant fiscal burden on the PA. To deal with this issue, it was agreed with the authorities as part of the DPG that certified local medical residencies are established by the Palestine Medical Council in the abovementioned fields to start producing local talent. By end-March 2021, the number of enrollments in the newly established residencies were as follows:

Table 2: Number of enrollments in newly established local residencies

Specialty	Number of local enrollments
Oncology	9
Hematology	2
Pathology	10
Neurology	21

10. **Prior Action 5: The Recipient's President has taken the necessary steps to strengthen the role of the Water Sector Regulatory Council (WSRC) in performance monitoring of service providers.** The PA passed a Water Law in 2014 as part of reform efforts to improve transparency, performance, and quality of services. Based on the law, the WSRC was established as the body in charge of monitoring the performance of service providers including production, transportation, distribution, consumption, and wastewater management. Despite its mandate, the operation of the WSRC remained limited, partly due to insufficient budget allocations. To strengthen the WSRC, in 2019, the President signed amendments to the 2014 Water Law specifying WSRC's funding base to enable it to carry out its regulatory role and further specify its role in performance monitoring of service providers. Information published in the WSRC performance report for 2019 shows that the

council was able to expand its monitoring activities to cover 98 service providers serving 85 percent of the population, slightly lower than the target set by the DPG which is 115 service providers, serving 90 percent of the population. Movement restrictions due to COVID-19 and infections amongst staff of the WSRC and staff of multiple service providers have resulted in long closures in these institutions and have affected the WSRC's ability to reach the DPG target.

11. **Prior Action 6: The Cabinet has instructed the Palestine Water Authority (PWA) to reduce the stock of debt owed by service providers that have installed prepaid meters for households under their constituency in the same amount paid to install the prepaid meters.** In 2018, the Palestinian Cabinet adopted a decree instructing the PWA to encourage LGUs to install prepaid meters to reduce non-payments amongst consumers, as this is considered a main challenge towards the financial viability of the sector. To convince LGUs to join the prepaid meter program, as part of the Memorandum of Understanding (MoU) signed between each of them and the PWA, it is agreed that the stock of debt owed by the LGUs to the PWA will be reduced by the same amount it costs to install the prepaid meters. To date, 15 LGUs joined the prepaid meters program, improving collection rates and hence, their financial performance. The PWA states that MoUs with additional LGUs are in the pipeline. Given the internal divide, this reform is only being implemented in the West Bank. Data by the end of March 2021 show that the average collection rate amongst consumers served by the 15 service providers has reached 83 percent, slightly lower than the 85 percent target specified by the DPG for end-2020.

Pillar 3: Strengthen the stability and integrity of the financial sector.

12. **Prior Action 7: The Palestine Monetary Authority (PMA) has instructed banks operating in West Bank and Gaza to adopt strengthened Anti Money Laundering/ Combating Financing of Terrorism internal controls, in accordance with the AML/CFT strategy adopted by the Palestinian Cabinet on November 2018.** In the context of increasingly volatile cross-border correspondent banking relationships, the authorities have been making steady progress towards upgrading integrity standards across the financial sector. After conducting a self-assessment in early 2018, an AML/CFT strategy was adopted by the PMA later that year. This DPG prior action represents a key milestone towards the implementation of the national strategy, along with other reforms implemented across both the financial and real sectors of the economy. The target for this DPG action is on-site inspections by the PMA of 50 percent of banks operating in the Palestinian territories to ensure compliance with risk-based AML/CFT requirements. Latest available data provided by the PMA show that the target has been achieved.

13. **Prior Action 8**: **The PMA has taken the necessary steps to raise the minimum regulatory capital requirements for all banks licensed by the PMA to carry on banking business in West Bank and Gaza under the strengthened definition of capital.** On the heels of the challenging fiscal crisis and with an increase in non-performing loans (NPLs), the PMA has been undertaking reforms to raise the minimum regulatory capital requirements of banks operating in the West Bank and Gaza from 12 to 13 percent, in order to enhance the banking sector's ability to absorb shocks from economic stress. This reform also carries a risk mitigation element since it enables supervisory intervention at earlier stages if a bank's capital adequacy ratio drops to a level close to or below the new minimum. Based on latest PMA data, all 14 banks operating in the Palestinian territories are

already in compliance with the new regulatory capital requirement, meeting the target set by the DPG.

14. **Prior Action 9: The PMA and the Palestine Capital Markets Authority (PCMA) have jointly reestablished the Central Sharia Supervisory Authority (CSSA) to cover a wide segment of the financial sector, including both bank and non-bank Islamic financial institutions.** The Palestinian financial sector includes a range of banking institutions (governed by the PMA) and non-banking institutions (governed by the PCMA), providing a growing range of Islamic financial instruments. Three licensed Islamic banks offer a range of products including Murabaha, Ijara, and Mudaraba. A range of non-bank Islamic financial institutions offer Ijara (leasing), Takaful (insurance), and microcredit. To standardize the application of sharia-compliant instruments across all financial institutions, the PMA and PCMA reestablished, with an expanded mandate, the CSSA to include all institutions providing Islamic financial products. The CSSA's role includes assessing the compliance of new market entrants and products with Islamic finance standards. It also reviews existing products and institutions to assess the compliance with Islamic financial standards. According to the target set by the DPG, it was agreed that by end-2020, at least two financial instruments should have been reviewed and amended based on the decisions of the CSSA. According to data published on the PMA website, the CCSA has indeed already issued two circulars to amend financial instruments: Circular no. 41/2020 dated Feb 18, 2020, about credit card issuance, and circular no. 60/2020 dated Feb 26, 2020, about the "Tawaroq" product.[2]

[2] The CCSA circulars can be accessed here: https://www.pma.ps/ar/%D8%AD%D9%88%D9%84-%D8%B3%D9%84%D8%B7%D8%A9-%D8%A7%D9%84%D9%86%D9%82%D8%AF/%D8%A7%D9%84%D9%87%D9%8A%D8%A6%D8%A9-%D8%A7%D9%84%D8%B9%D9%84%D9%8A%D8%A7-%D9%84%D9%84%D8%B1%D9%82%D8%A7%D8%A8%D8%A9-%D8%A7%D9%84%D8%B4%D8%B1%D8%B9%D9%8A%D8%A9