Palestinian National Authority
Ministry of Finance

Fiscal Developments: Third Quarter 2008

October 29, 2008

A. Budgetary Operations and Financing

1. Summary and overview

Budgetary revenues accruing to the Palestinian National Authority (PNA) have been performing well during the third quarter of 2008, exceeding budgetary expectations.

Excluding one off items, such as license fees and dividends, gross PNA revenues collected in the third quarter of 2008 amounted to $ 410 million, with clearance revenues contributing $ 309 million (Tables 1 and 5). Gross revenues increased by 13% in NIS terms over the third quarter of 2007[1]. This is a robust increase considering that inflation during this period did not exceed 9 % and that there was a sharp decline in Gaza's economic activity. This is an indication of a rise in real consumption, fueled by large external budget support to the PNA, but also of higher production in the West Bank, which benefited from the higher consumption levels.

Measuring this performance against the 2008 budget, with the conservative assumption that fourth quarter revenues in NIS will be the same as in the third quarter, gross revenues would reach $ 1.57 billion, as opposed to $ 1.36 billion in the budget[2] (Table 5).

This $ 200 million overachievement in revenue collection over the budget target is reduced to $ 130 million when looking at net revenues, because actual tax refunds have been running at a $ 130 million annual rate, whereas only $ 20 million were projected in the budget.

[1] In US dollar terms, the increase is of 33 %, reflecting a 15 % depreciation of the US $/NIS exchange rate.
[2] Excluding $ 146 million budgeted as dividends from net revenues and adding tax refunds..

When dividends and license fees are included, total net revenue projections for the full year, would yield $ 1.79 billion, exceeding the 2008 budget target of $ 1.49 billion by $ 300 million (Summary table below).

Wage expenditures in September 2008, on a commitment basis, of $ 368 million during the third quarter of 2008, have been very much in line with previous quarters, and only increased by 2.8 %, in NIS terms, relative to the third quarter of 2007. Because of relatively high inflation this year, (9%), and no general increase in wages, there has been a substantial decline in real wages for PNA employees. When annualized, wage expenditures are expected to be slightly below the 2008 budget target of $ 1.48 billion.

On the other hand, non wage expenditures have risen steadily during the third quarter from about $ 70 million in July to $ 146 million in September. During the first half of the year, both operational expenditures and transfers were running well below budgetary allocations. But if the third quarter level for these expenditures is maintained during the fourth quarter, non wage expenditures for the entire year would exceed the budget target by about $ 100 million (table 2).

Summary table: Budgetary Operations, in millions of US dollars

	Q1	Q2	Q3	Projections Q4	Projections 2008	Budget 2008
Net Revenue	335	572	493	392	1792	1486
--domestic	104	127	104	107	442	304
--clearance	247	291	308	315	1161	1056
--one off	21	197	105	0	323	146
--tax refund	-38	-43	-24	-30	-135	-20
Expenditures	604	742	837	800	2982	2845
--wages	359	370	368	370	1467	1481
--non wage	168	249	330	330	1077	964
--net lending	77	123	138	100	438	400
Rec. Deficit	269	170	343	408	1190	1359

Net lending (tables 1 and 3), which mostly covers electricity payments on behalf of municipalities, increased to $ 138 million during the third quarter, averaging $ 46 million per month. If this level is maintained during the remainder of the year, the budget allocation of $ 400 million will be exceeded by about $ 80 million. This is largely due to fuel price increases, which are expected to decline during the fourth quarter, yielding better results. The Ministry of Finance (MoF) has been trying to enforce electricity payments by municipalities and individuals and it is possible that accounting lags may not reflect real progress achieved in this area. This, coupled with lower fuel prices, should reduce net lending during the fourth quarter to $ 100 million, which would reduce the budget overshooting to $ 30 million (see summary table)

The recurrent deficit, on a commitment basis, during the first nine months of the year of $ 783 million, is expected to be well within the 2008 budget target of $ 1.36 billion. When annualized, the recurrent deficit should be around $ 1.2 billion. (See the summary table below). While recurrent expenditures have been running at about $ 150 million above budget, this excess might be offset by higher recurrent revenues of about the same amount. Overall, budget execution has been in line with the budget targets, but larger one off receipts will lower the projected deficit below its budget target by about $ 150 million.

The cash recurrent deficit has been much higher during the first nine months of the year for two main reasons: i) in September, monthly wages were paid twice, the first payment on September 5 for August salaries, and the second payment on September 25, timed before the Eid holidays, for the September salaries (table 4). However, this should be offset in October when there will be no wage disbursement. ii) repayment of wage arrears of $ 290 million, during the first three quarters. Taking into account the repayment of remaining arrears to PNA employees and the private sector and projecting for the full year, the recurrent cash deficit may be around $ 1.7 billion.

With respect to development expenditures, partial accountings of actual disbursements, which have gone through the Central Treasury Account, have been mostly related to small community projects: $ 8 million in expenditures carried forward from last year, and $ 37 million of new community projects carried out this year. About 220 of these projects have been fully implemented and another 200 are being executed.

There is no systematic information provided by donors on actual disbursements on large development projects financed by them. The budget has appropriated $ 492 million for development projects pledged at the Paris Conference (December, 2007) and MoF is attempting to take stock of what was actually spent by donors on the ground.

External budget support of $ 476 million during the third quarter (table 7), exceeded external support provided during the second quarter ($ 410 million), bringing total budget support during the first nine months to $ 1.4 billion. This provided the PNA with a cash surplus on recurrent expenditures of about $ 630 million. This made it possible to pay back PNA employees $ 290 million in wage arrears, and the private sector, another $ 61 million (tables 1and 4). PNA exposure to commercial banks was also reduced by $ 214 million. This major reduction in PNA indebtedness to key sectors of the economy provided a measure of stability and strengthened public confidence. Building on this momentum, the MoF intends to settle all payment arrears by the end of the year.

2. Revenues

Revenues in the third quarter were boosted in August by a license fee ($ 79.8 million) from the newly established Telecommunication company, Wataniah, and from a $ 25 million dividend from the Palestinian Investment Fund (PIF) (table 5).

Clearance revenues, which provide three quarters of PNA revenues, have been doing very well, increasing every quarter of this year (table 5). Third quarter revenues of $ 308 million, increased by 6% over the second quarter, and by 8% over the third quarter of 2007 in NIS terms. Comparing the first nine months of 2008 to the same period in 2007, VAT receipts increased by 14 %. This reflects a 25 % increase in the West Bank (from NIS 89 million per month to NIS 112 million) and a 58 % decline in Gaza, from a monthly average of NIS 14 million in 2007 to about NIS 7 million in 2008. .

Domestic tax revenue increased from $ 68 million in the first quarter to $ 81 million in the second quarter, following a major effort at collecting domestic VAT receipts which almost doubled during that quarter to $ 39 million. However, in the third quarter, domestic tax revenue declined to $ 63 million.

VAT revenues were still higher than in the first quarter ($ 30 million vs. $ 21 million) but there was a substantial decline in income tax receipts, from

$ 34 million during the first quarter, to $ 15 million in the third quarter. This is mostly due to the income tax amendment which raised the individual exemption, and which became effective at the beginning of the year, but it may also be related to collection problems.

Domestic fees and charges also declined from $ 46 million in the second quarter to $ 41 million in the third quarter, when we exclude the Wataniah license fee.

Tax refunds have been running at an average of $ 6-7 million per month during the third quarter. Total refunds since January have amounted to $ 105 million. By the end of the year they may reach $ 130 million, as opposed to a $ 20 million budgetary target. Even tough these refunds have been much higher than budgeted, total net revenues are still expected to exceed the budgetary target by the end of the year by about $ 130 million.

3. Expenditures

PNA expenditures, on a commitment basis amounted to $ 315 million in September, a 19 % increase over expenditures in August (table 1). Third quarter spending of $ 837 million registered a 13 % increase over second quarter spending. This increase was not due to the PNA wage bill—rather, it was caused by non-wage expenditures (table 2).

Wage expenditures of NIS 412 million in September have been lower than in August or July due to a reduction in PNA employment by 250 personnel mostly teachers, after the end of the school year. Comparing the third quarter of 2008, to the third quarter in 2007, the PNA wage bill only increased by 2.8%, in NIS terms

PNA employment, which amounted to 144,380 in December 2007, has declined to 140,000 by March 2008 and stabilized at around 141,000 since May. Most of the decline affected security personnel which reached a peak of 64,000 in January 2008 and declined to 59,000 in May, stabilizing at that level thereafter.

Aside from the transportation allowance which was raised in April due to higher fuel costs, there has not been any general wage increase in 2008. There was actually a substantial decline in real wages, given that inflation reached 9% and that there is no cost of living adjustment for PNA salaries

Non wage expenditures, increased by 34 %, in NIS terms, during the third quarter of 2008, over the third quarter of 2007. This increase has been due to both, higher operational expenditures, and transfers (table 2). Operational expenditures rose from $ 83 million in the second quarter to $ 101 million in the third quarter. Transfers to the unemployed, the poor and vulnerable groups rose even more, from $ 163 million in the second quarter to $ 216 million in the third quarter. This was partly due to the increase in the number of poor families which have been audited, (reaching 32,000 by end September, 2008) and which have benefited from these transfers. Both operational and transfer spending were running below budgetary appropriations during the first half of the year, but if third quarter spending levels are maintained during the fourth quarter, budgetary appropriations for these line items will be exceeded by about $ 107 million, or by 11 %. Considering that inflation has been of 9 % during the first nine months of the year and the US dollar depreciated by 2.5 % relative to the NIS/US dollar budget exchange rate, operational and transfer expenditures would be in line with the budgetary appropriation in real terms.

Net lending, reflecting payment of electricity costs on behalf of municipalities as well as fuel costs for the Gaza Electricity Generating Company, has increased from $ 27 million in August to $ 51 million in September. Third quarter spending on this item exceeded the second quarter by 12 %. Most of these increases can be attributed to higher fuel costs and higher electricity charges by Israel Electric Company. With world oil prices declining sharply in October, and government stronger enforcement of electricity bill payments, it is expected that net lending will decline to $ 100 million for the fourth quarter of the year.

Cash expenditures during the third quarter on wages and non wage expenditures of $ 925 million, were much higher than in the second quarter ($685 million), due to two salary payments in September, the second one on September 25 of $122 million, intended to precede the Eid holidays, instead of being paid in October, thereby helping families meet their expenses. This has been partly financed by a second transfer of clearance revenues from the Israeli authorities ($ 66 million). These second payments, will be offset in October, when salary payments will not be disbursed and clearance revenues will be much lower. Overall, the cash deficit in the third quarter of $ 509 million was more than double the deficit in the second quarter ($221 million), but substantial external budget support ($ 477 million), almost financed the entire deficit.

4. Financing

External budget support in September of $ 217.6 million was the second highest in 2008, after March, which yielded $ 313 million (table 7). The largest donor was the World Bank Trust Fund which contributed $ 120 million, mostly from Kuwait ($79.5 million), the UK, ($28.6 million) and Canada, ($11.9 million).

Kuwait's contribution, following the $ 101 million provided by Saudi Arabia, the $ 42 million from the UAE and $ 12 million contributed by Egypt, all disbursed in August 2008, brings the total Arab budget support to the PNA by end September to $ 390 million. This represents 28 % of total budget support to the PNA during the first nine months of 2008. In terms of burden sharing, when measured against relative GDP shares of the various donor countries, the Arab contribution is far larger than that of the OECD and other countries which have contributed to PNA budget support[3].

The European Commission, through its PEGASE mechanism, provided its highest contribution in 2008 of $85.7 million to help out in the payment of double salaries. Russia also contributed $ 10 million, followed by the ESSP mechanism, which provided $ 2 million.

Total budget support during the first nine months of 2008 amounted to
$ 1.4 billion, which, on an annual basis, exceeds the budget support pledged at the Paris Conference in the PRDP ($ 1.634 billion). This has enabled the PNA, during the first nine months of the year) to repay most of its wage arrears to PNA employees ($ 290 million) to the private sector ($ 61 million) and reduce its indebtedness to the banking system ($ 214 million). By the end of 2008, MoF expects all payment arrears to its employees and to the private sector to be settled.

[3] The Euro area, the US, Japan, Russia and Brazil have a combined GDP of $ 32.7 trillion. The entire Middle East GDP is $ 0.9 trillion, of which Saudi Arabia, the UAE, Algeria, Egypt and Kuwait account for $ 0.6 trillion.

B. Institutional developments during the third quarter of 2008

a. Decision by the Council of Ministers in September 18, requesting all ministries and agencies to provide MoF with disbursements on development projects and humanitarian aid received from the donors in 2008, even if the financing was outside the Central Treasury Account.

b. The 2009 budget process has progressed to the point that all ministries and agencies have reported to MoF on their strategic objectives and programs for 2009 and on their requests for funding. MoF will consolidate all these requests in a unified recurrent and development budget, within the overall budgetary ceilings of the Palestinian Development and Reform Program.

c. The Draft Electricity law has been approved by the Council of Ministers which will establish the Palestinian Electricity Regulations Commission (PERC) and the Palestinian Transmission Company. This law will compel all municipalities and village councils to join the electricity distribution companies.

d. Under the new Financial Management System, the Accountant general department has issued guidelines on financial regulations. These will be incorporated in the amendments to the existing regulations which are being drafted.