

PRDP-TF: Quarterly Review
October- December 2009

Despite recent economic growth, the PA continues to face a difficult fiscal position and in 2009 increased its reliance on external budget support. The recurrent budget deficit on a commitment basis was nearly \$1.6 billion; up from \$1.3 billion in 2008 and almost \$143 million more than projected in the revised 2009 budget. Most of this can be attributed to the emergency situation in Gaza, which forced the PA to add \$300 million to the budget mid-year. In addition, there were large arrears brought forward from 2008 and incorporated into 2009 commitments. However, some of it was also due to increased spending on wages. During 2009 the PA continues to implement its reform agenda but at a slower pace.

Though final figures are not yet available, it appears that real growth in the WBG is on track to reach the PA's 2009 projection of at least 5.5%. Given the continuing closure of Gaza, most of this growth was undoubtedly in the West Bank, where it might have reached as high as 7-8%. Despite the resumption of growth, even if the projected GDP levels are reached, the PA's recurrent budget deficit on a commitment basis will have increased from about 20.1% of GDP in 2008 to about 24.8% in 2009. Of course much of this is due to the additional costs arising from PA's need to address the humanitarian needs of the population in Gaza. Removing the \$300 million (NIS 12,000 million) added to the budget for emergency relief there puts the deficit at just over 20% of GDP, similar to 2008. The actual recurrent deficit was NIS6,263 million, nearly 8% more than the revised budget.

The original 2009 budget called for donor support of \$1.15 billion to fund the recurrent deficit and another \$500 million for the development budget. It was hoped that there would be an increase in the quality of the budget compared to previous years by beginning to shift donor funding from recurrent costs to development expenditures. In September the need for support to the recurrent budget was raised to \$1.45 billion to respond to the needs in Gaza. However at the end of the year the recurrent deficit was nearly \$1.6 billion and the overall deficit was more than \$1.8 billion. Only about \$1.35 billion in budget support and \$45 million in development financing materialized. Consequently, the PA was forced to turn to borrowing from local banks and accumulating arrears of \$299.8 million. In addition, development expenditures on a commitment basis were only \$215 million compared to \$191 million in 2008.¹ Thus, because of the emergency in Gaza, in 2009 there was no significant shift of external resources from recurrent to development expenditures.

¹ The MoF tables report only \$45 million in development financing and \$215 million in development expenditures. The MoF reports that \$10 million in community development projects were financed from the Central Treasury Account. The remaining expenditures were financed from aid received in previous years but not recognized in those years because previously the MoF only recognized development financing when it was spent. In 2009, the MoF changed to a practice of recognizing development financing when it is received.

Tax revenues remained high in the fourth quarter but net revenues still ended the year more than 4% less than projected in the budget. Despite the increased economic activity, clearance revenues in 2009 were lower than projected due to the complete closure of Gaza and restrictions on fuel imports in the first quarter of the year. They quickly recovered and were nearly a third higher in both the third and fourth quarters than in the first. However, they still ended the year about 3.5% below the budget target. Non-tax revenues also lagged. They missed projections by nearly 22% because the PA received fewer dividends and one off fees, such as telecommunications licenses, than hoped for. Non-tax revenues fell by 21% in the fourth quarter compared to their high in the third quarter. Tax revenues for the year exceeded projections by more than 8%. This was driven by increased collections efforts starting in the third quarter and continuing through the fourth. Tax refunds remained steady at about NIS270 million in the fourth quarter. For the year, tax refunds were some 24% less than budgeted. But they are expected to jump in the first part of 2010 because of the delay in enterprises submitting for refunds.

In the fourth quarter total expenditures and net lending continued to climb; ending the year at NIS12,521 million on a commitment basis and exceeding the revised budget by NIS200.7 million. However, the PA reports that \$141 million, or about NIS550 million, in commitments reported in 2009 were actually incurred in 2008. At the end of 2008, the PA reported that it had settled all arrears. However in the process of preparing its 2008 accounts for the external auditor and introducing better commitment controls, the MoF discovered these large arrears. Consequently, the PA now reports that actual commitments incurred in 2009 were nearly 3% below the revised budget. There could still be some commitments from 2009 that have not yet been recognized and that will have to be carried over to 2010. However, with the help of the IMF and World Bank, in 2009 the MoF improved its commitment controls and does not expect these arrears to be large. The PA reports NIS814 million dollars in non-wage arrears, however NIS 555 million, were brought forward from 2008, it implies that in 2009 the PA incurred only NIS259 million in non-wage arrears.

The PRDP commits the PA to increasing employment by no more than 3000 net employees each year with the majority of them in health and education. In addition, the PA pledged to keep overall employment below 153,000 in 2009. At the end of the fourth quarter the PA payroll included 147,726 employees, well below the ceiling. However, in 2009 there was a net increase of 4,789 and much of the new employment was in the security sector. Net employment in Gaza dropped by 531 and rose in the West bank by 5,309. Employment in the security sector and the education sector grew the most; 2,229 and 1,263 respectively. The Ministry of Health lost 49 employees and the Ministry of Interior shrank by 528. Wage expenditures on a commitment basis for the year were nearly NIS121 million more than budgeted. In the fourth quarter they jumped by nearly 7% compared to the third quarter and ended the year 2.1% above the budget. Overall, wage expenditure commitments in 2009 were nearly 12% higher in NIS terms than they were in 2008.

**Table 2: Net Change in Employment in Most Significant Sectors
End-December 2008 - End-December 2009**

Security Forces	2,229
Education	1,263
President's Office	627
Ministry of Social Affairs	248
Religious Affairs and Endowments	186
High Judicial Office	123
Land Administration	120
Health	-49
Ministry of Interior	-528

Source: PA Ministry of Finance Monthly Reports

Non-wage expenditures ended the year 2.6% above the revised budget. However, if the commitments carried over from 2008 are excluded, non-wage expenditures were substantially below budget. The carryover from 2008 includes \$53 million in operational expenditures, \$66 million in transfers and \$22 million in small capital expenditures. The MoF has difficulty specifying exactly what caused transfers to exceed the budget. Gaza expenditures are reported at only about \$142 million, much less than the midyear supplement. However it is likely that some assistance to Gaza is included in other allocations such as to the Ministry of Social Affairs. Minor Capital expenditures were also significantly above budget.

In the fourth quarter of 2009, the PA continued to make efforts to increase utility collection rates and net lending ended the year 3.6% below budget. Part of this drop can be attributed to the fact the fuel shipments to Gaza were cut off during much of the first quarter. They quickly rebounded, yet net lending in 2009 was still some 7% less than in 2008. The Palestinian Energy and Natural Resources Authority (PENRA) reports that by the end of December 156,000 prepaid meters have been installed and PENRA has tendered to procure another 130,000. The MoF continues to deduct money owed to it by delinquent local governments from taxes and other transfers owed to the local governments. In addition, the MoF continues to transfer to local governments that can demonstrate that they have paid their full electricity bill up to 5% of the value of the bill. The PA reports that collection rates across the West Bank are almost 80% and there is little scope to increase these without increasing collections in refugee camps that are currently excluded from having to pay for utilities.

There was little progress made in the fourth quarter towards implementing the new electricity law, without which the net lending issue is unlikely to be completely solved. The law calls for the establishment of a new regulatory agency for the power sector. But the agency was not appointed by the Council of Ministers until December and it was not approved by the President. Consequently, at the end of 2009 the regulator was not in place and could not begin the process of issuing regulations for licenses, setting tariffs or taking other actions required by the law. While a number of local

governments have joined the new distribution companies, most, particularly in the North where the net lending issue is the most severe, have taken no steps towards actually transferring their electricity assets. The main impediment is that the MoF, PENRA and Ministry of Local Government have not taken steps to negotiate with local governments that are dependent on electricity revenues to fund their operations over how they can be supported until other sources of income are developed. Without addressing the issue of municipal financial stability as called for in the Letter of Development Policy, there can be no progress towards shifting electricity distribution to a commercial basis and towards ending net lending.

Public pensions remain one of the PA's largest liabilities and the PA has committed to developing a pension reform plan that will address the lack of funding and put the pension plan on a sustainable footing. The World Bank has provided a paper and other analytical work that suggests options and estimates the cost and benefits of some parametric reforms. As of the end of the fourth quarter, the PA has not presented a draft plan nor reported any formal discussions or consultations on pension.

In February 2009 the Council of Ministers issued a decree to merge all on-going cash assistance programs using the poverty targeting database developed under the World Bank supported Social Safety Net Reform Program (SSNRP) as the main mechanism for targeting assistance. In the fourth quarter the Ministry of Social Affairs (MoSA) finalized its strategy and agreed with donors on its implementation. MoSA produced a 100 day plan to initiate implementation in the first quarter of 2010. In the third quarter of 2009, MoSA reviewed and updated its proxy means test for determining eligibility for payments based on data from the 2007 household census and 2007 household expenditure and consumption survey (PECS). In the fourth quarter, MoSA continued to add households to the data base using the new proxy means test.

The PA continued to make progress on improving its public financial management systems (PFM) in the fourth quarter of 2009. As of the end of 2009 there were 57 line ministries and institutions connected to the Computerized Accounting System. 36 of them were fully implementing the system with the remainder either completing training or connection. The MoF continues to force the closure of non-zero balance bank accounts held by line ministries and by the end of the fourth quarter almost all such accounts that are not mandated by donors have been closed. This has significantly improved the MoF's ability to control commitments. By the end of the fourth quarter the budget law had still not been drafted and submitted to the Council of Ministers. Municipalities continued to make progress in adopting a standardized accounting framework and implementing the new electronic financial system.

The most notable action on public financial management was that the MoF issued the final financial statements for 2008 and prepared them for delivery to the external auditor. This is a major step towards improved transparency. Issuing the statements was delayed because as they were prepared many systemic problems were identified and corrected. It is anticipated that preparation of the 2009 accounts were be much quick and more efficient. The Internal audit department at the MoF continued to

function and in the fourth quarter issued final audit reports on the Ministry of National Economy MoNE, Ministry of Social Affairs MoSA, and Bureau of the Chief Justice. The external auditor, The State Audit & Administrative Control Bureau developed an action plan for 2009 and continues to implement it.

As a key step in strengthening its public financial management system, the PA committed to passing a new public procurement law in mid-2009 but it has not yet done so. A draft law has been prepared and submitted to the council of ministers but it has not yet been accepted. The World Bank provided significant comments on the draft law but does not feel that these comments were included and the Bank has recommended that the PA not adopt the draft law in its current form. Adopting an effective new law is the first step in strengthening the overall public procurement system and without its passage the PA cannot move forward in this area.

The PA continues to implement the PRDP, however progress in 2009 was considerably slower than in 2008. Government expenditures have remained within budget if the commitments brought forward from 2008 are not considered. However, this was only achieved by adding \$300 million to the original budget at mid-year. This was stated to be in response to the crisis in Gaza, however, the PA has not clearly demonstrated that all of these funds went to emergency distributions in Gaza. The public work force is below its ceiling but the largest share of new hiring is in the security services not in health and education as indicated in the PRDP. In addition, the public age bill continues to increase. The MoF is steadily improving its public financial management system and the preparation of the 2008 accounts is an important milestone. However, as of the fourth quarter of 2009, the new electricity law was not being implemented, the public procurement law has not passed and there has little progress to address the issue of pension sustainability.