



Palestine Economic Policy Research Institute

Evaluating the Performance of the Palestinian Ministry of Finance

**Omar Abdel-Razeq
Iyad Rammal
Misyeef Misyeef**

June 2004

The Palestine Economic Policy Research Institute (MAS) was founded in 1994 as an independent, non-profit institution to address the socio-economic policy making process through appropriate and relevant applied economic and social policy research.

MAS MISSIONS:

- ♦ Bridging the gap between research output and the policy and decision-making process through applied socio-economic research to assist in the formulation of rational policies and appropriate legislation.
- ♦ Identifying developmental challenges and priorities and enhancing applied research.
- ♦ Providing technical support to PNA bodies (executive and legislative), the private sector, and NGOs to enable them to function more effectively and enhance good governance.
- ♦ Promoting the participation of civil society institutions in socio-economic policy formulation and decision-making.
- ♦ Broadening public debate on socio-economic issues and ensuring oversight of public performance.
- ♦ Disseminating information and enhancing public awareness, transparency, advocacy, and accountability.
- ♦ Strengthening socio-economic policy research capacity and institution building in Palestine.
- ♦ Sponsoring and training young Palestinians in socio-economic applied research by including them in MAS research teams.
- ♦ Attracting expatriate Palestinian, Arab and international economists, social scientists, and experts to contribute to and review MAS research.
- ♦ Promoting links with local, regional and international policy research institutes and academic institutions in economic and social fields.

Board of Trustees:

Ismail Al-Zabri/ Chairman, Ahmad Qurie, Anis F. Kassim, Edmond Asfour, Hani Abu Dayyeh/Deputy, Hassan Abu-Libdeh/ Secretary, Heba Handoussa, Kamal Hassounch/Treasurer, Maher El-Masri, Muneeb Masri, Nabeel I. Kassis, Rima Khalaf, Salam Fayad, Samer Khouri, Taher Kanaan, Samir Abdullah (Director).



Palestine Economic Policy Research Institute

Evaluating the Performance of the Palestinian Ministry of Finance

**Omar Abdel-Razeq
Iyad Ramal
Misyef Misyef**

June 2004

Evaluating the Performance of the Palestinian Ministry of Finance

Researcher: Omar Abdel-Razeq, Research Fellow at MAS, and Associate Professor at Al-Najah National University, Nablus
Iyad Rammal, Ph.D. Public Administration, Administrative Consultant, Palestinian Water Authority.
Misyeef Misyeef, National Project Director/UNCTAD-Esycuda Project, Ministry of Finance

Research Assistants:

Shaker Sarsour
Yousef Adwan
Mohamad Naser
Nasr Atyani

Editorial Assistants: Abed Alruhman Y.Abu Shammaleh (Arabic)
Karen Mann (English)

Layout: Lina Abdallah

Funding: This Study was funded by Friedrich Ebert Stiftung (FES) and the Ford Foundation

Palestine Economic Policy Research Institute (MAS)
Jerusalem and Ramallah

June, 2004

©2004 MAS

Introduction

Effective and transparent management of public finance, which all countries strive to achieve, is generally considered as one of the most important conditions for development and good governance. This applies equally to both poor and rich nations. Indeed, the former are most in need of developing and implementing the type of fiscal policies capable of boosting the economy and laying the foundations for sustainable development as cost-effectively as possible. Governments need to build the capacity of their finance ministries in order to achieve both a high level of competence in revenue collection and the rationalization of expenditure.

In the Palestinian case, fiscal policies are one of the few tools that the Palestinian National Authority (PNA) has at its disposal to influence the economy. The PNA budget has increased in importance, particularly in light of its continuous growth in the period prior to the outbreak of the Intifada in September 2000. Despite the decline of public revenues over the past four years, the PNA's budget remains the most important and influential tool available to impact economic activity.

As a result of current reviews related to institutional building and the general performance of the public sector, in addition to ever-louder calls for reform from many Palestinian sectors, especially the Palestine Legislative Council, MAS assumed the initiative to conduct this study of the Finance Ministry. The aim was to draw conclusions from the Ministry's past experiences at all levels in order to assist in continuing the reform process started in mid-2002. The Ministry welcomed this study that examines all aspects of its work: the drafting and implementation of fiscal policies, institutional building, and the relationship between the Ministry and taxpayers.

MAS is pleased to present this study and points out that the following comments should be taken into consideration:

1. The study was conducted at a time of deterioration in the political situation in general and the implementation of measures of collective punishment. This is reflected in the decline in all aspects of economic and social activity, augmenting the atmosphere of frustration and pessimism, which, in turn, has negatively affected the reform and institutional building agenda.

2. The study took place at a time when the PNA's budget was suffering from a large deficit and accumulated debt to the private sector. The Finance Ministry has therefore focused its efforts on securing adequate funding to cover the basic commitments of PNA ministries and institutions, such as salaries and fees. It is natural that in such a financial crisis a change in priorities might take place, especially in the reform of public finance.
3. The study was conducted at a time when the Finance Ministry was busy addressing a number of serious issues that the research team could not cover comprehensively, in particular:
 - The accrual of all public revenues into a single Palestinian Treasury account.
 - Developing and improving the process of preparing the general budget and presenting it to the Palestine Legislative Council in accordance with the law.
 - Compiling all PNA investments and placing them under the management of the Palestinian Investment Fund (PIF), and incorporating PIF accounts within the PNA budget.
 - Proceeding with payments and settlement of commitments to the private sector, whether for purchases or matters related to tax refunds.
 - Unifying the management of civil servant salary payments and paying all employees, including personnel of security agencies, directly to their bank accounts.

These issues have somewhat affected the course and results of the study. Nevertheless, MAS is confident that by identifying and addressing weaknesses and shortcomings and highlighting and reinforcing strengths, the study will assist decision-makers at the Ministry and other parties working towards administrative and financial reform.

On the occasion of the publication of this study, we would like to thank H.E. Dr. Salam Fayyad, Minister of Finance, for his support for this initiative and for his good-natured acceptance of the constructive criticism contained therein. We would also like to thank senior officials at the Ministry for their cooperation in making available information as needed by our researchers, participating in interviews, and completing questionnaires. Thanks are also due to the researchers who reviewed and evaluated the study and to the participants at the discussion workshop for their invaluable observations which have contributed towards developing the study and refining its conclusions. We thank the researchers who

prepared the study for their enormous effort and the care they demonstrated in presenting their conclusions and recommendations courageously and faithfully. We also express our sincere gratitude to the Friedrich Ebert Foundation of Germany for supporting this study and for their distinguished contribution towards scientific research in Palestine.

To conclude, MAS would like to stress that the ideas and conclusions put forth in the study do not necessarily express the point of view of the Institute or of any of its bodies. This in no way detracts from the Institute's responsibility towards upholding the integrity and independence of scientific research, nor does it exempt it from striving to present studies and research papers that fulfill the requirements and adhere to the fundamentals of scientific research.

Dr. Samir Abdullah
Director General

Summary

1. This study aims to evaluate the performance of the Palestinian Ministry of Finance (MOF) as a public sector institution and covers economic, administrative and organizational aspects. The study was based on primary data collected from questionnaires and personal interviews conducted during July-August 2003. There were two questionnaires, one targeting MOF directors in a comprehensive survey and the second directed at other Ministry employees in a random sample. Four groups of interviews were conducted: the first with senior MOF officials, the second with a group of taxpayers, the third with members of other public institutions to explore their relationship with the MOF, and the fourth with companies implementing government tenders. These interviews were not meant to be representative but merely to provide indications of the basic issues. There were 183 directors in summer 2003, 38% of them in the West Bank and 62% in the Gaza Strip. The rate of response was about 63% in the West Bank and 71% in the Gaza Strip. According to Ministry records, there were 1,536 Ministry employees; 49% in the West Bank and 51% in the Gaza Strip. Excluding directors, the number of employees falls to 1,353; 56% in the West Bank and 44% in the Gaza Strip. Questionnaires were distributed to 400 employees representing 31% of all employees (excluding directors). The sample covered the West Bank and the Gaza Strip and questionnaires were distributed according to the actual distribution of employees in these areas. The rate of response was about 73% in the West Bank and 98.5% in the Gaza Strip.

Data analysis was conducted during September and October 2003 and the first draft of the study was presented in a workshop at MAS on December 18th 2003.

2. Determinants of MOF Performance:
The distinctive factor in the new Palestinian experience of managing public resources is the fact that the PNA has never controlled Palestinian economic resources, including water and land, nor has it had any control over Palestinian borders or the movement of Palestinians and their merchandize.

In May 1999, the hypothetical end of the transitional period, Israel continued to exert total control over 71% of the West Bank and 30%

of the Gaza Strip. Since September 2000, Israel has tightened its siege of the Palestinian territories and destroyed Palestinian infrastructure and public and private buildings. At the same time, foreign assistance has helped the PNA to develop Palestinian infrastructure and has prevented a total collapse in economic and social conditions. Internally, the MOF has demonstrated an absence of clear economic goals and good governance practices like transparency and accountability, a lack of Palestinian expertise, and poor practices in public recruitment and promotion. Moreover, the overlapping of responsibilities and interference from the political leadership in the public expenditure process combined with uncertainty over the role of the security apparatus and a weak judiciary to bring about undisciplined public expenditures, especially prior to 2003, and to widespread nepotism and political factionalism. As a result, financial and administrative corruption spread through the different structures of the PNA.

3. Palestinian expertise was gained via experience in the PLO administration, in the public sectors of Arab countries, in the Israeli civil administration, from higher education, or through training after the establishment of the PNA. Prior to the PNA, Palestinian expertise was concentrated in implementation but not in planning or decision-making processes.
4. The Oslo Accords and the agreements following it formed the legal basis for the PNA. Autonomous bodies were formed, including the PLC and the Cabinet of Ministers.
5. The structure of the MOF has developed to comprise ten departments dealing with three tasks: policy, implementation, and control. The ten departments are as follows:
 - Revenues
 - Budget
 - Treasury
 - Salaries and retirement
 - Administrative affairs
 - Supplies and tenders
 - Economic research and policies
 - Monitoring and auditing
 - Computers and information
 - Legal affairs

6. According to the MOF, its mission is the management of all public funds.
7. Although the MOF does not provide a list of its goals, these can be deduced to include the guardianship of public funds, development of the Ministry's human resources, application of the principles of good governance (transparency and accountability), and unification of treasury accounts.
8. According to the MOF, its tasks include designing and implementing fiscal policy, collecting public revenues, organizing financial accounts, monitoring expenditure processes, overseeing the various public funds, proposing suitable legislation, designing and developing the various forms needed for the tasks of the MOF, and ensuring public sector procurements.
9. The customs department plays a very important role in light of the complications resulting from the implementation of economic agreements, specially those related to the clearance process with Israel. Its role can be summarized as the collection of local value added taxes and revenues connected with international trade, in addition to participation in the application of international trade agreements.
10. The goals of the customs department are primarily to supply the PNA treasury with local revenues, prevent access to illegal merchandize, provide accurate information about Palestinian international trade, and improve the efficiency of its human resources.
11. The role of the income tax department is summarized in a set of goals and tasks that includes developing tax policies, tax rates and brackets, developing internal structures, ensuring the effectiveness of the auditing process, modernizing tax administration, and the development of human resources.
12. The role of the property tax department is to account for all files relating to the property of residents and absentees, provide proof of ownership for legal and commercial purposes, the establishment of a unified and computerized system for keeping files and information, the follow up of daily cases, and the development of human resources.
13. Economic reform and structural adjustment aimed at achieving a developed economy and effective performance must be carried by efficient management in the government and its institutions. Countries

in which the economic, political, and institutional environment are coordinated have been able to achieve higher economic growth rates and developmental goals compared with countries with inefficient and incompatible political, social, and economic institutions. Prior to introducing any administrative reforms, an evaluation process must be conducted to explore appropriate mechanisms to achieve the intended goals and exploit resources.

14. The evaluation of performance is vital for development and improvement, the rational use of public resources, and to contribute to the process of general policy formation in which public responsibilities are determined through an integrated system of planning, control, evaluation, and follow up.
15. Poor performance in many developing countries has been due to backwardness in elements of the administrative process. This includes unqualified human resources, massive organizational structures, and routine procedures dependent on centralized mechanisms with mixed roles and unclear goals. In these countries, there is generally an absence of the rule of law and the spread of inequality, often giving rise to the exploitation of public jobs and funds and the spread of bribery and embezzlement. All these are obstacles to good governance.
16. Efforts to build an efficient and organized administrative system providing good services face obstacles that include lack of vision, lack of human, technical and material resources, the absence of efficient organization, and random growth in public institutions resulting from political, economic or social pressures. This leads to the duplication of responsibilities, inability to plan, complicated procedures, unclear channels of communication, and the spread of bribery and embezzlement. In addition, management will be unable to conduct their tasks and employees will be dissatisfied.
17. To remove such obstacles, an evaluation process is necessary. Performance evaluation is one of the basic tenets of modern administration which seeks to provide superior performance whilst working towards goals despite constraints. Evaluation has become one of the most important administrative processes contributing to the development of economic, political, administrative, social, and environmental conditions. Performance evaluation is closely connected with other administrative processes, especially planning and monitoring.

18. The elements of organization form the scientific framework for the evaluation process. These elements are goals, inputs, processes, outputs, feedback, and environment. This system represents the base for the evaluation of the MOF's performance. Focus is on elements of the administrative process, the degree of Ministry commitment to them, and their application in a suitable manner in line with general administrative requirements that include planning, organization, direction, and control.
19. Indicators and criteria
The following criteria were applied for the evaluation process:

1. Plan

- ✧ Existence of a written and understandable vision.
- ✧ Uniform vision among management personnel.
- ✧ Existence of a written and understandable mission.
- ✧ Existence of written and understandable goals.
- ✧ Existence of a written and understandable policy.
- ✧ Existence of a written and understandable strategy.
- ✧ Do plans take into account the aforementioned items (1-6)?
- ✧ Consistency of the aforementioned elements and their interrelationships.
- ✧ Existence of determinants, including time, quantitative and financial criteria, in the plan.
- ✧ Deviations in the implementation of the plan.

2. Organization

- ✧ Existence of an approved organizational structure.
- ✧ Adoption of an organizational structure and its link with the goals and tasks required from the Ministry.
- ✧ Clarification of responsibilities and powers within the organizational structure and extent to which these are consistent with jobs within the structure.
- ✧ Effective flow of information in the organizational structure.
- ✧ The organizational structure allows decision-making to be decentralized.
- ✧ Clear written goals and tasks for each department and division.
- ✧ Written job description and job requirements for each position in the organizational structure.
- ✧ Job requirements and description match the responsibilities and powers assigned to each employee.

- ✧ Clear policy, instructions, and mechanism for recruitment.
- ✧ All available jobs are advertised within the organizational structure.
- ✧ Effective communication with other institutions.

3. Direction

- ✧ Clarity and determination of written responsibilities.
- ✧ Delegation of powers in writing.
- ✧ Adopted method of leadership.
- ✧ Clarity of instructions from management.
- ✧ Clarity and ease of communication between different administrative levels.
- ✧ Cooperation between departments and divisions.
- ✧ Presence of an incentive system for employees.
- ✧ Training courses for employees.
- ✧ Suitability of training courses to specializations and tasks.
- ✧ Adequacy of training courses.
- ✧ Extent of relationship between training courses and incentives.
- ✧ Evaluation of training courses, trainees and trainers.
- ✧ Identification of training needs for all employees and effectiveness of their application.

4. Control

- ✧ Writing of periodic reports by employees to higher levels in the pyramid structure.
- ✧ Implementation or application of feedback by management on reports and information coming from lower levels in the pyramid structure.
- ✧ Periodic evaluation of implemented plans and accomplishments.
- ✧ Annual evaluation of employees.
- ✧ Efficiency of forms and their suitability for recruitment.
- ✧ Existence and efficiency of an internal control system and extent of its development.
- ✧ Existence of written regulations explaining sequence of operations.
- ✧ Existence of internal control unit and its position in the hierarchy.
- ✧ Clarity of instructions to the internal control unit and extent of interest in its reports.
- ✧ Existence of administrative and financial controls.

5. Economy

- ✧ Role of the Finance Ministry in drafting economic policies.
- ✧ Role of the Ministry in the administration of the public budget.
- ✧ Palestinian fiscal policy.

6. Criteria for budget evaluation

From international experiences, budget preparation is conducted against several basic criteria directly related to economic and administrative reform. These criteria include:

- ✧ Accountability.
- ✧ Principle of transparency and ease of access to adequate available data.
- ✧ Presence of and respect for a general legal framework.
- ✧ Equality and continuity in providing services for all.
- ✧ Principle of competition and quality.

20. Examination of the role and tasks of finance ministries in several countries found much in common between them and the Palestinian Ministry of Finance. These can be summarized in the following:

- ✧ Important and effective role in building, implementing and reviewing economic, fiscal, and tax policies. This includes the drafting of economic and development plans, drafting and implementation of fiscal policies, management of the country's public debt, and assistance in coordinating public employment policies and passing tax laws and regulations.
- ✧ Preparation of the public budget and its discussion with government bodies for implementation.
- ✧ Control and supervision of the entire budget process.
- ✧ Acting as national representative in international and regional financial and economic institutions and developing relations with them.
- ✧ Contribution to the preparation of draft financial, tax, and customs laws.
- ✧ Providing basic information in services areas like data, statistics, and procedures to private and public sectors to facilitate study and planning processes, the decision-making process, and effective assessment preparation.

21. A finance ministry in any country requires a clear vision and mission supported by values and principles.

21.1 This vision can be summed up in two basic points:

First, the ministry is a responsible and effective public institution as well as a model for leadership, open to all individuals and sectors of society.

Second, the ministry's tasks are run efficiently and effectively and it is subject to open scrutiny by the people and their representatives.

21.2 Mission

1. Working towards the development of a financial plan that matches modern financial developments.
2. Wise and cautious management of public resources for the government.
3. Drafting general policies and an organizational framework for rules, regulations, procedures, and bylaws that help to create an economic base that supports and strengthens economic activities.
4. Coordination with other public institutions to facilitate trade.

21.3 Values

Finance ministries in many countries share common values:

1. Responsibility and accountability towards the needs of citizens and the various economic sectors. This value can be seen in the following practices:

- ✧ Evaluating performance and submitting reports to all government levels.
- ✧ Benefiting from successful experiences in work and learning from mistakes.
- ✧ Supporting regulations pertinent to the management of risks and encouraging enhanced performance and work efficiency.

2. Analysis of economic resources and directing human resources towards activities brings about the best results and opportunities to avoid financial and economic risks.

Innovation focuses on the following:

- ✧ Discovering new international partners and ideas on how to conduct business activities.
- ✧ Keeping abreast of technological developments and exploring new opportunities in the field of high-technology.
- ✧ Establishing investment strategies that focus on available resources.

3. Honesty and Respect
 - ✧ Encourage teamwork, respect for the opinions of others, and reliability of information.
 4. Confidence and Trust
 - ✧ Maintain openness and transparency in activities and the results of work.
 - ✧ Responsive to the reaction of the public and other institutions.
 - ✧ Ensuring the presence of open channels of communication between all parties.
22. The Israeli occupation left various distortions in all sectors of the Palestinian economy. These distortions are apparent in the structural role of the various economic sectors, in the generation of Palestinian income and dependence on foreign sources, especially Israel, in the geographical distribution of Palestinian foreign trade, and in public resources due to the clearance mechanism with the Israeli economy.
- These distortions should have shaped the general goals of Palestinian economic policy and those of the MOF in particular. Palestinian economic independence will never be realized without eliminating these distortions but in the absence of proper Palestinian development plans, the MOF holds responsibility for managing public resources in a manner that achieves the majority of goals.
23. Managing the Public Budget:
- The management process of the public budget is composed of procedures that direct and allocate public resources for different purposes. Distortions in any part of the process affect economic performance and therefore, the process should be conducted efficiently in both revenues and expenditures to achieve economic and financial goals. The budget is an important document that summarizes how to exploit available financial resources to the fullest extent with approval by the highest legislative and executive levels. The budget also serves the various goals which together make up the organizational plan of economic and social activities of the government.
24. In addition, the budget preparation process must be subject to accountability and questioning on the basis of government obligations, the link between the budget and government priorities, and through the continuous evaluation and monitoring of basic performance indicators.

25. The Palestinian budget is prepared through three mechanisms: legal steps, revenues, and expenditures:

25.1 According to the basic budget law, articles 48, 81, and others related to the budget preparation, the legal process is summarized as follows:

- ✧ PNA institutions are to present their budgets to the MOF no later than the second of September in the given year.
- ✧ The MOF discusses the sub-budgets with the related institution and then present a consolidated public budget to the Council of Ministers no later than the fifteenth of October of that year.
- ✧ The Council of Ministers discusses, amends, and approves the proposed budget and presents it to the PLC no later than October 31st of that year.
- ✧ The PLC discusses, amends, and approves the budget as law no later than the last day of the year.
- ✧ If the PLC fails to approve the budget before the end of the year, allocations are automatically made on a monthly basis using figures from the previous year's budget.

25.2 The Palestinian MOF distributes the 'proposed budget declaration' to the various financial institutions of the PNA. The declaration contains four basic elements, including a timetable and general rules, in addition to:

- A. General instructions consisting of written administrative principles related to expenditures and revenues:
 - A.1. All financial institutions must classify their current, capital, and development budgets and proposed new job appointments according to the official forms provided by the MOF.
 - A.2. To restrain public expenditure to as low as possible and provide services, the following guidelines are made:
 - ✧ No requests for new staff except where absolutely necessary.
 - ✧ No rental of new office space without the written approval of the minister.
 - ✧ Reduction of operating expenses, including electricity, water, communications, travel, and fuel.
 - ✧ No requests for new cars.

- A.3. Deposit of all public revenues, including local and foreign, in a general treasury account for allocation according to the law.
 - A.4. Implementation of development projects in cooperation with the related ministry. The MOF is responsible for allocation procedures, monitoring and auditing, while the related ministry is responsible for technical aspects.
 - A.5. Departments must make all possible efforts to increase revenues through improved collection procedures and limiting tax evasion.
 - A.6. Fund appropriation ends on December 31st. Any remaining funds are returned to the MOF to be used in the next budget.
 - A.7 Any additional requests for public resources after the approval of the budget must be passed by the PLC.
- B. Detailed instructions relating to public revenues:
- ✧ Each institution estimates its revenues on the basis of actual revenues for the previous year and the first six months of the current year, assuming a 10% growth in current GDP.
 - ✧ Each institution should prepare a proposed plan to increase revenues and improve collection methods, estimating anticipated grants and donations to be included in the budget. They should also conduct studies to determine fees are in line with the cost of services.
 - ✧ Each institution must provide a statement of local and foreign loans for the current and forthcoming year with estimates of anticipated installments and interest payments.

25.3 Public expenditure instructions:

- ✧ Current expenditures are to be estimated on the basis of minimum needs. Wages and salaries should be determined based on actual figures (previous year) with an annual growth rate set by law.
- ✧ No requests for funds for new items of expenditure.
- ✧ No overtime work except in exceptional cases.
- ✧ Limit rewards and travel expenses to within legal boundaries.
- ✧ No rental of new buildings without the written approval of the minister.

- ✧ Halt international phone calls except for a limited number of people and impose a maximum limit on phone bills.
- ✧ Effective monitoring of the use of public cars and limit the travel of official delegations to a maximum of three members, except with the approval of the President or Council of Ministers.
- ✧ Reduce expenditure related to guests, parties, advertisements, and other operating expenses by at least 10% from previous levels.
- ✧ No new furniture, cars, or computers allowed during the current year if they were approved the previous year.
- ✧ In capital expenditure, priority is given to on-going projects and new ones of utmost necessity. Focus should be on productive and labor-intensive infrastructure projects.
- ✧ Priority should be given to projects that contribute to sustained growth and facilitate the movement of exports and imports.
- ✧ Capital expenditures include basic social projects related to education, health, and social rehabilitation and development centers. The detailed costs of such projects must be attached.

26. Despite membership in committees and special councils formed for development planning or public investment management, and despite its role as director of the whole budget process, the role of the MOF in economic policies and development planning was marginal or nonexistent. In investigating the reasons it was found that:

- ✧ The economic committees that were formed have been ineffective.
- ✧ Public administration of the Palestinian public sector has not been linked to a clear strategy.
- ✧ The main goal of development and economic plans has been the presentation of reports to donor countries requesting financial support for public investment projects.
- ✧ The MOF has not been prepared for effective participation in making developmental plans and economic policies. The Ministry has been developing mechanisms for public revenue collection and development in the knowledge that public expenditure decisions have remained the authority of various parties.
- ✧ The generally unstable environment due to Israeli measures has been used to justify widespread administrative instability and inefficiency at the PNA and the MOF.

27. The process of preparing fiscal policy is composed of many stages, starting with agreement on a clear and general strategy regarding issues like the economic system, the role of government, foreign economic relations, and the various systems that govern internal and external development issues. This strategy leads to the determination of quantitative goals within a pre-set time frame for comprehensive development (economic, political and social) and then the mechanisms to achieve the goals are set and the tools for short and long term mechanisms chosen. The tools are tied to the goals in a scientific and analytical way. The legislative process results in the approval of legislation to change the volume and structure of fiscal policy tools in agreement with detailed plans. The implementation process of fiscal policy consists of monitoring economic and social indicators and applying the needed adjustments. As such, it can be concluded that Palestinian fiscal policy has been non-existent, in particular prior to 2003 and, as a result, the public budget became nothing more than a financial statement of government financial transactions.
28. The MOF has carried out several important achievements, especially during the last two years. These include unifying treasury accounts, enhancing budget transparency, keeping expenditures within the budget, paying all public salaries (including those of security personnel) through banks, unifying managerial and accounting systems in the two parts of the Ministry (the West Bank and Gaza Strip), initiating the control and auditing process (both internal and external), and grouping all public investments into the Palestinian public investment fund.
29. The Paris Economic Protocol signed between the PLO and Israel in April 1994, which was annexed to the political (Oslo) agreement of September 1995, has been the main determinant of PNA management of the Palestinian economy, not only in regard to foreign trade relations but also in economic policies (both fiscal and monetary). A review of the Protocol found that permitted tools for Palestinian fiscal policy include:
- ✧ **Expenditure tools:**
Expenditure tools include current government consumption of goods and services, current government transfers, and investment (development) expenditures, in addition to the structure of current expenditures. The Paris Protocol did not address the subject of public expenditures and the PNA is therefore free to use any expenditure tools.

✧ **Tax tools :**

These include all kinds of taxes, their rates and structures. Article 5 dealt with direct taxes relating to profits and incomes generated in the local economy and gave the PNA complete powers over direct taxes. Article 3 and part of Article 6 dealt with the details of customs taxes and indirect taxes on local production. The PNA agreed to adopt Israeli customs taxes, structure, and rates on imported goods to the Palestinian Territories with some exceptions. Indirect taxes on local production are accounted for by value added taxes. The PNA also agreed to apply Israeli VAT on Palestinian production with the possibility of reducing it by no more than two percentage points.

30. The PNA issued legislation directly related to fiscal policy and also indirectly related to it: The Organic Budget Law, Income Tax Law, and the Encouragement of Investment Law.

30.1 The Organic Budget Law

The law was approved and issued in 1998. It organizes the administrative procedures for the preparation of the public budget within a set time frame.

30.2 The Income Tax Law

The PNA approved major changes to the income tax law, including reforming tax brackets and reducing tax rates according to IMF recommendations (IMF,1998). The PNA presented the draft income tax law to the PLC in October 1998. After intensive discussion and amendments, the PLC approved it and sent it to the President in May 2001 for issuance.

The new law reduces the number of tax brackets and income tax rates in line with international trends. However, the law adopts the traditional exemption and deduction system tied to social expenditures including education, health care, and the cost of living. Some reviewers of the law fear that the tax system may not be progressive.

30.3 Encouragement of Investment Law

The PNA issued this law in the first months after its establishment with the aim of providing the legal environment with incentives to attract foreign investment. The law was approved by the PLC in April 1998 and gave tax exemptions for

limited periods of time for new investments whose invested capital exceeds \$100,000. Some studies proved that these tax exemptions did not provide an incentive to investors.

31. Budget procedures:

- ✧ Official guidelines for preparing the sub-budgets of various ministries and institutions were not followed in either revenues or expenditures. The following comments can be made regarding the mechanism used with the forms:
 1. Revenues are estimated to increase automatically by 10% without any scientific justification.
 2. Expenditures are also estimated randomly without relying on accurate information. Needs are estimated by adding a percentage to the previous year's budget.
- ✧ There are two major reservations:
 - First – The MOF (budget department) does not monitor or audit claims on public resources and therefore does not use such data in calculating revenues and expenditures.
 - Second – Officials of institutions do not feel any obligation to prepare plans that might determine their needs since they know that they are not being monitored or supervised on this issue.

32. The following shortcomings relating to legal aspects of the budget were noted:

- ✧ The PLC has failed to enforce the Organic Budget Law and perform its role supervising the executive. The responsibility for that failure lies with both the PNA and the PLC. The PLC was weak in performing its role while the PNA was reluctant (and delayed) its obligations to the PLC.
- ✧ The MOF did not (prior to 2003) present periodic reports to the PLC.
- ✧ Reports agree on the fact that public expenditures have not been managed effectively due to the lack of qualified experts in budget preparation, especially in areas of planning, monitoring, and auditing. In addition, the process suffered from interference by many parties in public expenditure, increasing the deficit and leading to the spread of favors and nepotism.

33. When subjected to evaluation standards, including those of transparency, accountability, easy access to information, existence of general legal framework, equality of service provision, competition,

quality, and clear transparent tender procedures, it is clear that the Palestinian budget has not adhered to the majority of these principles. This has, up to 2003, led to the spread of financial and administrative corruption and contributed to the deterioration of public resources.

34. Nevertheless, the budget process has made clear progress since the establishment of the PNA in quantitative measures of budget items, although two areas of the budget continue to suffer from lack of special expertise related to planning and forecasting. In addition, the budget process, especially expenditures, lacks a strategic developmental vision, efficient internal auditing, external monitoring, and legislative or judicial accountability.
35. Quantitative Development of Palestinian Budget:
 - ✧ Public expenditures increased at an annual rate of about 14% during 1995-2000. Estimated expenditures for 2001 were 23% higher than 2000 but declined by 13% in 2002.
 - ✧ Current public expenditures accelerated until the end 1998 by about 17% annually, then declined a little in 2000. Israeli measures against Palestinians have caused an increase in PNA current expenditures, especially transfers and emergency work programs.
 - ✧ World Bank reports estimate that donor countries gave Palestinians about US \$929 million in 2001 and US \$1051 million in 2002. The 2003 budget report from the MOF estimated that the PNA needed US \$747 million in donor aid for 2003.
36. Palestinian public current expenditures have been distributed to many uses that can be grouped as follows:
 - ✧ About one third spent on security expenses.
 - ✧ About one third spent on social services (education, health, and social affairs).
 - ✧ The remaining one third spent on other uses, among which the President's office is prominent as taking an average of 7% of the total.
37. Tax revenues grew at an average annual rate of 19% during 1995-2000. The ratio of local revenues to GDP increased from 12.1% in 1995 to 20% in 2000. Israeli closures and devastating aggression of the Palestinian Territories have had a destructive effect on the Palestinian economy, including a decline in tax revenues by 40% in

2001 and 73% in 2002. In addition, non-tax revenues declined by 38% in 2001 and 7% in 2002.

38. Public debt accelerated during 1995-2002 to US \$1227 million. Installment payments are expected to total US \$23.5 million in 2005 and US \$52.6 million in 2010. Interest payments reached US \$12 million in 2000 and US \$16 million in 2001. Most Palestinian public debt is long term, low-cost loans as part of donor assistance to the PNA. The strategy of the MOF towards public debt is to borrow not to finance current expenditures, but for infrastructure projects and public investments. All loans must be through the MOF.
39. In general, there is a lack of integration in elements of the MOF administrative process. There does not appear to be a plan with a clear vision, mission, or goals. The goals of the MOF are not known to many of those working in management and this causes difficulties and obstructions to the design of plans or programs that refer to time and quantitative frames.
40. Organization is unclear. About half of the directors and other employees do not know whether the MOF has an official organizational structure or not. Many of the directors and employees do not have a job description.
41. The organizational structure suffers from complications which might explain the lack of smooth communication and transfer of information, especially between the West Bank and Gaza Strip.
42. The recruitment process is unclear and posts were not usually announced in the press. Most general directors of the MOF believe that the recruitment process is conducted according to instructions. This discrepancy is proof of the absence of a unified vision.
43. Administrative meetings are irregular, unplanned, and do not usually have a pre-set and distributed agenda.
44. Extensive efforts have been put into training but there was inadequate planning. Despite the existence of a plan for 2003, many of the directors were unaware of it. Many employees believed that they had been deprived of participating in training sessions due to the fact that selection sometimes depended on personal connections.

45. The top managerial level of the MOF is highly centralized and does not delegate powers. There is competition for responsibilities and lower administrative levels are not given the freedom to develop their internal and external communications.
46. Monitoring in the MOF is continuous and intense yet evaluation results and comments are not usually communicated to those concerned.
47. When comparing the situation in the West Bank with that in the Gaza Strip, the following were noted:
 - 47.1 The vision, mission, and goals of the MOF appear to be clearer to West Bank (WB) directors than to their colleagues in the Gaza Strip (GS). Moreover, written plans are more common in the West Bank.
 - 47.2 Directors in the WB are more convinced that the MOF has an organizational structure and more posts have a job description in the WB.
 - 47.3 More GS employees believe that the organizational structure is complicated compared to WB employees.
 - 47.4 In the WB, powers are better defined and coordination levels higher than in GS. However, it takes about the same time for information to flow from one level to another in both the WB and GS.
 - 47.5 Meetings are organized more frequently in the WB. Training was the same in the two regions but the WB was better at determining training needs. More GS trainees wrote reports than in the WB. The number of trainees who train others was almost the same in the two regions. A higher percentage of WB employees received unsuitable training and the belief that personal connections determine the allocation of training was more common in the WB. However, in GS, the allocation of training was, above all else, completely random.
 - 47.6 The management pattern was almost the same in both the WB and GS and was based on the director's powers. A higher percentage of GS directors felt they needed to check with higher ranking staff before taking decisions.
 - 47.7 Continuous and intensive monitoring is more apparent in the WB than in GS. In the WB, the evaluation of achievements occurs more often and a greater number of employees are asked to write reports. However, feedback in GS is more active.

47.8 Evaluation is more frequent in WB. However, those being evaluated in both the WB and GS are not made aware of the evaluation forms. More WB directors were not given the results of their evaluation, while an equal percentage of evaluated employees in the WB and GS did not know the results.

48. Employee Satisfaction:

- ✧ Incentives System:
In general there is dissatisfaction with the incentive system at the MOF. Employees believed that salaries were insufficient to meet their needs, a common complaint throughout the public sector.
- ✧ Administrative System:
 1. In the majority of cases, promotion within the MOF is not based on performance and the promotion system and practices are inappropriate. Although the classification of jobs and their managerial range should assist in promotion, the permitted range does not satisfy employees' wishes.
 2. Administrative instructions and the general atmosphere do not generally encourage efficient performance and do not satisfy employees.
- ✧ Supporting Services and General Environment:
The level of support services provided to MOF employees does not generally improve efficiency and quality of performance. Most employees believe that their relations with their superiors are deceptive. They believe that the MOF does not appreciate good performance and diligence.
- ✧ MOF Employees feel that they win respect within society as a result of their post at the Ministry.

49. Relations with other Public Bodies:

Relations between the MOF and other public institutions have developed from unsatisfactory to partially satisfactory as a result of various reasons related to the timing of allocations and the budget process.

- ✧ Institutions admit that relations with the MOF have improved since 2003. The MOF conducted training for staff of other public institutions on dealing with budget documents and the special budget preparation forms. Public institutions are pleased with the performance of the MOF in the area of procurements and tenders.

50. Relations with Taxpayers:

The most important results in this regard can be summarized as follows:

The results of evaluation of MOF relations with taxpayers showed some dissatisfaction with the length of time taken to process files and with disinterest by some employees.

Taxpayers complained of the high degree of centralization in resolving issues, most which relate to tax returns and tax estimates. They also believe that tax evasion exceeds 40%.

51. Relations with Companies Providing Tenders:

The results of the study show that companies providing the PNA with procurements are satisfied with the manner in which the MOF applies the relevant legislation. Tender documents are clear and professional. Two complaints are made regarding the procedure:

- ✧ Lowest price is the only standard for tenders. This means that the process neglects quality.
- ✧ Payments take longer than expected, leading to distortions in the process.

52. Recommendations:

The current Palestinian situation cannot withstand delay or neglect. Therefore, reform of the financial and administrative system with serious corrections to the management of public revenues, expenditures and budget, is a necessary and integral part of the future for Palestinians. Technical teams need to be formed to plan and make choices between appropriate mechanisms and tools.

53. Recommendations to Achieve Short Term Goals of Palestinian Fiscal Policy:

- ✧ Employ able and efficient personnel in the planning and forecasting of public revenues.
- ✧ Enact internal and external control to fight corruption and prosecute those involved.
- ✧ Encourage accountability and questioning through cooperation with the PLC and the adoption of measures that allow taxpayers' claims to reach the official and the judicial system.
- ✧ Reduce the value added tax rate on goods imported directly from countries other than Israel.

- ✧ Reduce the share of commercial transactions reported through the unified invoice, which is liable for income tax.
- ✧ Grant second priority (the first being to Palestinian goods) to goods imported directly from countries other than Israel in government purchases.
- ✧ Insist on the transparency of the Palestinian investment fund and on its responsibility for all PNA commercial activities.
- ✧ Allocate the surplus of PNA businesses and its share of profits to finance infrastructure projects, especially those relating to social infrastructure.
- ✧ Unify the public payment mechanism so that it is carried out only by the Ministry of Finance and through the banking system.
- ✧ Halt public employment except in education, health, the judiciary, and areas demanding exceptional expertise.
- ✧ Adopt objective and transparent public employment mechanisms which include procedures for complaints and appeals, including a mechanism of accountability.
- ✧ Make it a requirement that each ministry prepare a short-term development plan justifying its budget and the request of public resources. This plan should include self-revenue and details of current and development expenditures, connecting them with its specific goals.
- ✧ Design and publish standards for the geographic and sectoral distribution of development expenditures. Local government, pseudo-governmental bodies and NGOs should be granted the chance to bid for management of local projects. In addition, control by local and grassroots officials should be initiated.
- ✧ Allocate a proportion of public resources (public tax and non-tax revenues, grants, aid, and internal and foreign loans) for the implementation of development projects that employ those who lost their jobs in Israel. In the short run, focus could be on the construction sector, especially residential and public buildings necessary for the development of social services (schools, clinics, training institutions, orphanages, etc.) to meet the huge social need. Construction projects can absorb large numbers of unemployed, in particular those who used to work in construction in Israel. Some US \$200 million could be allocated each year for such projects. This accounts for only 10% of the investment needs of the residential sector. Tens of thousands of jobs could be created both directly and indirectly. Guarantees could be made available to the private sector for investment in construction.

- ✧ Provide loan guarantees to private sector businesses to re-open firms that were successful prior to the Intifada but were forced to close or contract.
- ✧ Subsidize social services provided by the private sector and NGOs in competition with the public sector.
- ✧ Reduce fuel prices to cut transport costs and the cost of fuel used in the production process.

54. Recommendations to Achieve Long-Term Goals of Palestinian Fiscal Policy:

- ✧ Ensure the Palestinian tax system is progressive and, if not, reform various taxes (income, VAT, and property taxes) to ensure the entire system becomes progressive.
- ✧ The tax system will need structural reforms to become suitable for Palestinian development. It is anticipated that VAT and customs tariff rates will need to be reduced and property taxes increased. This needs to be determined through technical and scientific research.
- ✧ Reduce allocations to security and restructure public employment in favor of social services.
- ✧ Increase allocations to pre-university education and health care.
- ✧ Increase the share of development expenditure in the budget, especially that financed from the PNA treasury.
- ✧ Examine the possibility of changing the non-discriminatory fee system that governs public social services to a system that discriminates in favor of the poor. The new system should give the poor equal opportunity to good quality education and health care. This may require an increase in fees and the establishment of special funds to subsidize education and health care for the poor.
- ✧ Continue the short term support to the residential sector because of its importance to the social and political well being of Palestinians.
- ✧ Allocate sufficient resources for the development of the agricultural sector in order to achieve the highest level of nutritional security.
- ✧ Coordinate with the Ministry of Economics and the PLC to make the Encouragement of Investment Law more suited to the Palestinian economy.

55. Recommendations in Administrative Areas:

- ✧ The MOF should design, write, and publish its vision, mission and goals, and make them clear to employees at all levels so that these can be taken into account when drafting plans.

- ✧ The MOF should discuss and approve the plans of various departments and incorporate them into one comprehensive plan.
- ✧ Define policies and strategies to enhance the role of the MOF in developing the national economy.
- ✧ The MOF should re-organize and design a suitable organizational structure that takes into account major and minor departments and defines their goals and tasks clearly. This should ensure ease of communication and cooperation, guarantee clear powers, and include job descriptions of all posts. On this basis, MOF employees should be redistributed according to actual needs using the zero budgeting model.
- ✧ The MOF should design clear instructions for recruitment in a manner consistent with the civil service law. These should include detailed instructions on how to advertise the position in the press, methods of competition, and selection criteria. In addition, evaluation criteria should be set.
- ✧ MOF leaders (the minister, acting minister, and general directors) should initiate regular meetings to discuss plans, achievements, and obstacles. General strategies and policies should be approved by this group.
- ✧ Instructions should be issued to the various departments to adopt decision-making via participation in regular meetings by department leaders. Leaders should take into account employees' opinions in decision-making. The meeting should discuss plans and achievements, solve problems, and deal with any obstacles.
- ✧ Establish a training department for human resource development. It should determine the training needs of the Ministry on a regular basis, make suitable training plans to deal with those needs, including clear instructions on managing the training program, its evaluation, and its effects.
- ✧ Training is required in management and leadership, focusing on means of delegating powers and decision-making. This delegation of powers should be implemented as soon as possible.
- ✧ All MOF managers and directors should initiate a process of feedback between the various levels of the decision-making process.
- ✧ The MOF should review existing evaluation forms and instructions. The new forms and procedures should be made clear to employees and continuously improved. The results and details of evaluations should be made available to all employees, who should have the opportunity to respond and discuss the results with those concerned with the aim of improving performance.

- ✧ Implement the civil service law to improve conditions for employees and thus, improve productivity.
 - ✧ Design an incentive system that encourages good performance and diligence.
 - ✧ Implement the promotion procedures of the civil service law.
 - ✧ Adopt clear and written instructions for operations and tasks and improve the working environment inside the MOF.
 - ✧ Raise the quality of public service provided by employees through specific and clear instructions.
 - ✧ Improve relationships between employees through social programs and activities.
56. Recommendations Related to Relations with Other Public Bodies:
- ✧ Base the discussions of the sub-budgets on scientific and objective standards connected to the development plans of the institution and the aggregate development plan.
 - ✧ Improve adherence to the sub-budgets agreed upon and to the allocations approved by the PLC.
 - ✧ Improve the procedures of the monitoring and auditing department in order to reduce bureaucracy and the time spent on procedures.
 - ✧ Make all possible efforts to apply the Organic Budget Law.
57. Recommendations Related to Relations with Taxpayers:
- ✧ Procedures and mechanisms should be reformed to become simpler and clearer. This would reduce the amount of time needed to deal with files and assist the taxpayer.
 - ✧ Improve methods of communication and increase taxpayers' awareness of procedures.
 - ✧ Rely more on the law and courts to resolve problems between taxpayers and the MOF, reducing the role of other factors (personal connections, favoritism, and illegal intervention). This requires a greater number of tax courts, judges, and lawyers.
 - ✧ Reduce centralism in dealing with taxpayers and delegate authority to the employees directly involved, within a suitable system of control.
 - ✧ Train MOF employees in communication to reduce discriminatory acts and undue influence. This should help to reduce tax evasion and illegal means of resolving problems.
58. Recommendations Related to Relations with Tender Companies:
- ✧ Improve tender standards to include quality indicators besides price.

- ✧ Improve the performance of departments in accounting, monitoring and auditing to allow for faster completion of cases.
- ✧ Tenders should not be requested until the appropriations are available.

