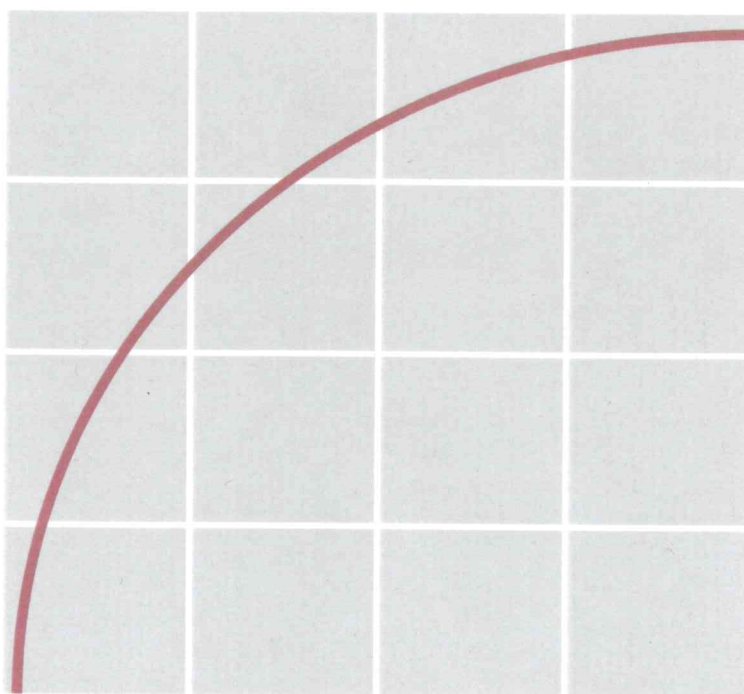


2012

Economic & Social Monitor



Palestine Economic Policy Research Institute (MAS)
Palestinian Central Bureau of Statistics (PCBS)
Palestine Monetary Authority (PMA)



**Palestine Monetary Authority
(PMA)**



**Palestinian Central Bureau of
Statistics (PCBS)**



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October, 2012

FOREWORD

We are pleased to introduce this issue of the *Economic and Social Monitor*, which covers the main developments that occurred in the Palestinian economy during the second quarter of 2012 (April-June 2012). The time-lag between the release date of this publication and the period in review is due to the fact that the preparation of quarterly data is a time consuming process – especially in regards to GDP - gathering, processing and analyzing quarterly data takes a minimum of three months.

This issue of the *Economic and Social Monitor* presents a general statistical review and analysis of the main economic trends in the Palestinian Territory. Among the topics discussed in this issue are: National accounts data, public finance, labor markets, the indicators of economic activity, prices and purchasing power as well as banking sector data during the second quarter of 2012. Also included in this addition, is an analysis of foreign trade figures (the trade balance and balance of payments).

The present issue of the *Monitor* includes nine independent text boxes, each of which addresses a topical issue either directly or indirectly related to the policies and economic situation in the Palestinian Territory. For example, one box discusses olive oil prices in the global as well as in the Palestinian markets. Another box discusses the recent amendments concerning the trade arrangements on clearance mechanisms between the Palestinians and Israelis. Other boxes deal with the economic reasons behind the popular protests that broke out recently against the increase in costs of living and the consequences of setting a minimum wage in the Palestinian Territory.

The statistical and analytical information provided by the quarterly *Economic and Social Monitor* is necessary for decision makers, as well as political and economic analysts. The *Monitor* provides an overview of the evolution of the economy and depicts a picture of the major problems and pressing issues that have surfaced and worried both, citizens and experts, over the past few months.

We hope that this issue further strengthens the role of the *Economic and Social Monitor* as a reliable reference to the regular changes occurring in the Palestinian economy. Finally, we hope that this issue opens the door for necessary debate on the current restrictions and future possibilities of economic growth in the Palestinian Territory.

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Executive Summary

Gross Domestic Product: The Palestinian GDP scored a value of about \$1,722 million in the second quarter of 2012. This represents an increase of 9% compared with the previous quarter and an increase by 7.7% compared with its corresponding quarter in 2011. Conversely, GDP per capita increased by 8.2% in the second quarter of 2012, compared with the previous quarter but increased by 4.6% relative to the corresponding quarter in 2011. On the other hand, expenditure on final consumption amounted to \$2,111.6 m in the second quarter of 2012.

The Labor Market: The number of workers in the occupied Palestinian territory increased from 834,000 in the first quarter to 877,000 in the second quarter of 2012. The number of workers in Q2 2012 increased by 2.9% relative to Q2 2011. The unemployment rate decreased to 20.9% in the second quarter compared with 23.9% in the previous quarter. On the other hand, average daily wage of workers in the Gaza Strip increased by 0.6% to be NIS 64.3 in Q2 2012 compared with NIS 63.9 in previous quarter. The average daily wage of workers in the West Bank increased by 2.3% to NIS 87 in Q2 2012 compared with NIS 85 in Q1 2012. The vacancies advertised in the local newspapers during Q2 were distributed as follows: 49% for the private sector, 39% for the NGOs and 12% for the public sector.

Public Finance: In the second quarter of 2012 the domestic revenues in the PA's budget decreased by 10% compared with the previous quarter (to \$ 501 m). On the other hand, current expenditures increased by 15% (to \$ 777 m) during the same period. Thus the pre-aid current budget deficit increased by 143% (to \$ 280 m), whereas the total deficit (current and developmental) before foreign aid was \$331 m. After aid however, the deficit is \$93.8 m during the second quarter of 2012.

The Banking Sector: Total direct credit facilities were \$ 3,783.6 m in the second quarter of 2012. This is an increase of about 5.3% from the previous quarter (70% of these facilities were loans). On the other hand, the number of checks offered for clearance increased by 2.8% in number to be 1,038,177 checks in the second quarter of 2012.

However, their value decreased by 9% to be \$2,370 million in the same period.

Palestine Exchange: The number of shares traded in the Palestinian Stock Exchange decreased by 15% during the Q2 2012 compared with the previous quarter. The value of shares during Q2 2012 was around \$74 million, a decrease of 22% from the previous quarter. Lastly, the Al-Quds index decreased by 42.71 points at the end of Q2 2012 compared with the previous quarter.

Investment Indicators. The following four variables serve as proxies to indicate the current investment climate in the Palestinian territory:

Company registration: The number of newly registered companies reached 278 in the West Bank in Q2 2012. This represents a decrease by 13% compared with the previous quarter and 25.4% with the corresponding quarter of 2011. The total capital of these companies in Q2 2012 was about JD 37.3 m.

Building Licenses and Cement Imports: The number of building licenses in the West Bank increased by 8.7% during Q2 2012 compared with the corresponding quarter of 2011, and 0.83% compared with the previous quarter. On the other hand, the total space of registered buildings decreased during the second quarter by 11% compared with the previous quarter. The quantity of cement imported into the Gaza Strip was 13.5 thousand tons during Q2 2012 compared with 11.4 thousand tons in the corresponding quarter of 2011. In the West Bank, the quantity of imported cement was 341.9 thousand tons during the same period.

Car Registration: 3,628 new and used cars were registered in the West Bank in Q2 2012. This represents a decrease by 3% compared with the previous quarter, and also a 28% decrease compared with the corresponding quarter of 2011. Most registered cars were used and imported cars from abroad (44%).

Hotels and occupancy: The number of hotels decreased from 102 hotels in the first quarter of 2012 to 98 hotels at the end of the second quarter of 2012. The total number of guests staying in hotels located in the occupied

Palestinian territory was 158,167 in Q2 2012. This is an increase of 37% compared with the previous quarter, and a 20% increase compared with the corresponding quarter of 2011.

Prices and Purchasing Power: The Consumer Price Index (CPI) increased by 0.45% during Q2 2012 compared with the previous quarter. The Wholesale Price Index decreased by 2.15% during the same period. The Construction Price Index for residential and non-residential buildings in the West Bank rose by 0.06% in Q2 2012 compared with the previous quarter. On the other hand, the purchasing power (measured in dollars) increased by 1.77% compared with Q1 2012.

Trade Balance: The total value of commodity imports recorded during Q2 2012 was about \$1,109 million. The share of Israel was 66% of the good's imports. The value of commodity exports recorded during the same period was about \$185m. The share of Israel was \$160 m (88% of the total). Consequently, the commodity trade balance deficit during this period was recorded at \$924 m.

Balance of Payment: The current account deficit during Q2 2012 was \$793.6 m, representing an increase by 14.9% compared with the previous quarter and a 4% increase with Q2 2011. This deficit was funded from the financial and capital accounts, by \$875.2 m.

Box Topics: The current issue of the *Economic and Social Monitor* includes nine boxes addressing various sociopolitical and economic topics of special relevance to the occupied Palestinian territory. A summary of the content of these boxes are provided below:

World olive oil price is increasing while price of Palestinian oil is stagnating: This box discusses the significant rise in the global price of olive oil due to an unsuccessful harvest in Spain, the world leader in olive oil production. The olive oil price in Palestine, however, is not likely to be influenced by this rise, as the olive oil market in Palestine is limited and isolated. However, there is a possibility of price increase in Palestine in the event Israel opens its market for import of Palestine olive oil.

Minimum wage: Legislation vs. Implementation. This box addresses the possible consequences of setting a minimum wage in the Palestinian Territory. The Palestinian Legislation Council (PLC) resolution approved a minimum wage of NIS 1,450 a month, NIS 65 per day, and NIS 8.5 per hour. The box also addresses the varying perspectives addressed regarding the minimum wage debate. One perspective holds that a minimum wage should be based on the cost of living, while another stresses economic variables, such as worker productivity and average wages, for example, as the basis for determining a minimum wage. However, realistically, it is impossible to accept either of the above two arguments in light of the paradox of a high cost of living couple with a low average wage within the Palestinian economy. The box also discusses the various economic consequences of implementing a minimum wage and calls for monitoring indicators that will emerge when this resolution is implemented, such as employment and prices.

320 applicants for a 'receptionist' vacancy!: This box reflects the desperate Palestinian labor market, more particularly the high unemployment rate among young people and recent college graduates. MAS had announced a "receptionist" vacancy for diploma holders, and received 320 applications for this vacancy (8% of whom were male). Most applicants were recent graduates from administrative humanities science colleges, 70% of whom were bachelor holders and 86% were unemployed at the time of application.

An initial understanding on amending clearance revenue arrangements in the Paris Protocol: The box discusses the recent amendments to the Paris Protocol concerning the trade arrangements on clearance mechanisms, which was signed by Palestinian and Israeli representatives. The proposed arrangements aim at reducing financial leakage, facilitating the movement of goods between Israel and the Palestinian Territory and supporting the parties' efforts to reduce illegal trade and tax evasion. The box also includes details on the terms of the agreement regarding calculating customs revenue, purchase taxes and VAT, the establishment of Palestinian customs clearance areas, and

finally constructing a pipeline to transport fuel directly from Israel to the Palestinian Territory.

PEGASE: From a temporary to permanent mechanism? The box aims to introduce the mechanism of "PEGASE," and to explore the programs, through which European aid will be disbursed in the Palestinian Territory. "PEGASE" channeled direct financial assistance to the Palestinian Territory, during the period of 2008-2011, of more than one billion Euros, 65% of which funded staff salaries and pensions of retirees.

The effects of the absence of 10 agora from circulation in the Palestinian Territory: The box examines the consequences of the disappearance of the 10-agora coin from the Palestinian market and its impact on prices. It also attempts to determine the segment of society most affected by the disappearance of the coin. The 10-agora coin vanished 15 years ago, however not as the result of official legislation. The disappearance had a strong influence on the Palestinian consumer for two reasons. First, the bulk of spending goes to frequent small expenditures on food and transportation. Second, the poverty-stricken spend their income in smaller amounts, and more frequently than the affluent. The box provides an overview of the cost and benefit of the use of the agora and its potential impact on prices.

The financial crisis of Jerusalem District Electricity Company: This box discusses the debt crisis that Jerusalem Electricity Company is suffering from. The company recently

received a warning from the Israeli-Qatari company that the electricity supply will be cut unless it pays its accumulated debts. The box outlines the main reasons for the crisis and proposes some solutions.

The soaring cost of living - causes and effects: This box discusses the economic reasons behind the popular protests that broke out recently against the PNA's policies and the deterioration of the standard of living. The box breaks these reasons down into five primary causes: a high unemployment rate, especially among young people; lower real wages; price increases, especially fuel and VAT; frozen salary payments, pensions and transfers; and the impact of the Paris Protocol on prices. The PNA has responded to these protests and the deterioration of the standard of living by cancelling the increase in fuel prices and VAT, as well as announcing price guides for a number of basic food commodities, and finally hastening a decision on a minimum wage.

Four reasons why Israel's economy is strong: This box explores the main factors of the Israeli economy's success during the past decades, which was not influenced by the global financial crisis that recently swept the developed world. Jordan Weissmann, an economist, suggests four main reasons. First, Israel has learned from its bitter past. Second, the economy has benefited from the influx of highly qualified immigrants. Third, the government has intervened in a timely and efficient manner. Finally, Weissmann opines Israel's monetary policy to be innovative.

1. GDP

The second quarter of 2012 achieved a growth of 9% over the previous quarter, mainly spurred by a 21% increase in the share of the construction sector. However, economic activities have a seasonal nature; therefore economists appear in favor of drawing comparisons between corresponding, rather than successive quarters. As such, the growth reported in GDP was only 7.7% when compared to the corresponding quarter of 2011

(with a scant rise of 6% of the share of the construction sector). This growth is real (at constant prices), i.e., the nominal increase minus the impact of price inflation. On the other hand, the per capita GDP was up by 8.2% in Q2 of 2012 compared to the previous quarter, while it grew by 4.6% compared to the corresponding quarter of the previous year (see Table 1-1).

**Table 1-1: GDP in the Palestinian Territory
(constant prices, base year 2004)**

Economic activity	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
GDP (\$ millions)	1,496.4	1,598.2	1,599.0	1,629.4	1,579.7	1,722.0
West Bank*	1,058.3	1,135.0	1,124.5	1,154.6	1,115.5	1,203.0
Gaza	438.1	463.2	474.5	474.8	464.2	519.0
GDP per capita (US \$)	385.3	408.5	405.6	410.2	394.7	427.1
West Bank*	457.2	487.0	479.2	488.7	469.0	502.4
Gaza	279.3	292.8	297.4	295.0	285.9	317.0

Source: Palestinian Central Bureau of Statistics (PCBS) 2012, National Accounts Statistics, 2011-2012 Ramallah - Palestine.

Data of 2011 quarters and first quarter of 2012 are preliminary and subject to further revision.

Data of the second quarter of 2012 are preliminary and subject to revision.

* Data does not include the part of Jerusalem governorate which was forcefully annexed by Israel following its occupation of the West Bank in 1967.

As for the structure of GDP, the following points are in evidence (see Table 1-2):

- ✧ A 20% growth in the agriculture sector contribution compared to the previous quarter; but a decline of 11% compared to the corresponding quarter of 2011.
- ✧ A 1.6% rise in the relative contribution of the industry, electricity and water sector compared to the previous quarter; but a decrease of 4.6% compared to the corresponding quarter of 2011.

- ✧ A 20% increase in the contribution of the construction sector compared to the previous quarter; and a growth of 6% compared with the corresponding quarter of 2011.
- ✧ A 6% decline in the relative contribution of the service sector compared to the previous quarter; but a rise of 4% compared with the corresponding quarter of 2011.

**Table 1.2: Percentage distribution of the shares of economic sectors
in GDP in the OPT * (constant prices, base year 2004)**

Economic Activity	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Agriculture and fishing	5.5	5.4	4.3	6.7	4.0	4.8
Mining, manufacturing, water and electricity	13.1	13.1	12.4	12.0	12.3	12.5
Mining and quarrying	0.4	0.3	0.4	0.4	0.4	0.4
Manufacturing	9.2	9.4	8.4	8.0	8.4	8.7
Electricity, gas, steam and air conditioning	2.9	2.7	2.8	2.8	2.9	2.7

Economic Activity	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Water supply, sanitation activities and waste management & treatment	0.6	0.7	0.8	0.8	0.6	0.7
Construction	10.2	11.8	11.5	11.2	10.3	12.5
Wholesale & retail and repair of vehicles and motorcycles	9.1	9.1	9.6	9.4	9.4	9.2
Transport and storage	2.1	2.0	2.1	2.2	2.3	2.2
Financial and insurance activities	4.9	4.7	4.7	4.6	4.8	4.4
Information and communication	6.3	6.4	6.7	6.3	6.5	6.3
Services	22.2	21.5	21.5	21.8	23.8	22.4
Accommodation and food services	1.1	1.1	1.4	2.1	1.7	2.1
Real Estate and Renting	6.8	6.2	6.2	6.0	7.2	6.2
Professional, scientific and technical activities	1.6	1.5	1.4	1.4	1.6	1.4
Administrative services and support services	0.6	0.6	0.6	0.6	0.7	0.6
Education	7.6	7.6	7.7	7.4	7.8	7.7
Health and social work	2.7	2.7	2.6	2.7	2.9	2.8
Arts, recreation and leisure	0.5	0.5	0.4	0.4	0.5	0.4
Other services	1.3	1.3	1.2	1.2	1.4	1.2
Public administration and defense	14.8	14.0	14.0	13.2	13.6	13.0
Home Services	0.1	0.1	0.1	0.1	0.1	0.1
Less: brokerage and clearing	-4.3	-4.2	-4.1	-4.1	-4.3	-4.0
Plus: custom duties	7.3	6.8	7.0	7.0	6.9	6.2
Plus: Net value added tax on imports	8.7	9.3	10.2	9.6	10.3	10.4
Total (%)	100	100	100	100	100	100.0

Source: Palestinian Central Bureau of Statistics (PCBS) 2012, National Accounts Statistics, 2011-2012 Ramallah - Palestine.

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Table 1-3 shows the value of spending on major items of GDP in 2011 and the first and second quarters of 2012. The table features the basic equation in the national accounts: Private

consumption + investment + government consumption + exports - imports = GDP ($C + I + G + X - M = \text{GDP}$).

Figures for the second quarter 2012 are as follows (\$ millions):

	USD millions
Household Consumption	1,545.5
+ Government consumption	500.5
+ Consumption of not-for-profit organizations that serve households	65.6
+ Investment (capital formation)	366.9
+ Exports	302.9
- Imports	1,059.4
= GDP	1,722

Table 1-3: GDP and its expenditure in the Palestinian Territory
(Constant prices, base year 2004)

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Final consumption expenditure	1,982.2	1,875.3	1,933.6	1,895.1	2,053.5	2,111.6
Household final consumption expenditure	1,529.1	1,423.8	1,494.9	1,433.0	1,576.0	1,545.5
Government final consumption expenditure	396.3	391.8	378.7	390.4	419.9	500.5
Final consumption expenditure of not-for-profit organizations that serve households	56.8	59.7	60.0	71.7	57.6	65.6
Gross capital formation	313.7	378.6	318.9	310.1	282.0	366.9
Gross fixed capital formation	359.1	446.4	384.0	391.1	359.9	480.6
- buildings	289.9	387.5	330.4	338.6	304.8	419.6
- non-buildings	69.2	58.9	53.6	52.5	55.1	61.0
Changes in inventories	-45.4	-67.8	-65.1	-81.0	-77.9	-113.7
Net precious property	0.0	0.0	0.0	0.0	0.0	0.0
Net exports of commodity and services	-799.5	-655.7	-653.5	-575.8	-755.8	-756.5
Exports	249.2	274.9	294.5	320.9	223.7	302.9
- commodity	191.2	216.1	230.6	242.7	145.4	222.1
- services	58.0	58.8	63.9	78.2	78.3	80.8
- Imports	1,048.7	930.6	948.0	896.7	979.5	1,059.4
- commodity	951.5	819.7	817.7	771.4	846.6	916.8
- services	97.2	110.9	130.3	125.3	132.9	142.6
GDP	1,496.4	1,598.2	1,599.0	1,629.4	1,579.7	1,722.0

Source: Palestinian Central Bureau of Statistics (PCBS) 2012, National Accounts Statistics, 2011-2012 Ramallah - Palestine.

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Several points can be concluded from the Table:

- ✧ The final consumption expenditure in the Palestinian Territory during Q2 of 2012 outweighed gross domestic product by 22.6%. This means that the Palestinian economy consumes more than it produces - a deficit that is balanced by import.
- ✧ The distribution of final consumption expenditure was as follows: \$ 1,545.5 billion (73%) for household consumption, \$ 500.5 million (24%) for government final consumption expenditure and \$ 65.6 million (3%) for final consumption expenditure of non-profit organizations that serve households.
- ✧ The final consumption of households declined by 2% compared to the previous quarter. This coincided with an increase of about 19 % in government final consumption expenditure and a rise of 14% in final consumption expenditure of non-profit organizations during the same period.
- ✧ The gross capital formation grew by 30% compared to the previous quarter; but declined by 3% compared to the corresponding quarter of 2011.
- ✧ The exports of goods and services rose by 35.4% compared to the previous quarter. Likewise, imports grew by 8% during the same period.

Textbox 1: Olive Oil Prices: Rising in the global market but declining in Palestine

Spain's production of olives dropped in 2011 due to a severe winter that was followed by a hot, dry summer. As Spain is the largest producer and exporter of olive oil¹, the price of this product saw a remarkable hike. In 2012/2013 the global production of olive oil fell by 19%, driving a 24% hike in the price of this product in the international market. The price of 1 kilogram of olive oil rose from 2.191 Euros (about NIS 11) in September 2011 to 2.943 Euros (NIS 14.6) in September 2012². In Spain, olive oil prices swelled by 39%, standing at 2.59 Euros / 1 kg in the first week of September 2012³.

With the start of the olive harvest in Palestine (mid-October to mid-December), we might need to question the impact of the price rise in the international market on the price of the Palestinian olive oil. Preliminary observations indicate that domestic oil price, unlike in global markets, saw a decline. In an attempt to understand these opposing trends, this textbox reviews the status of the Palestinian olive oil market.

Olive trees in Palestine are rain-fed; hence the fluctuations in the quantity of the yields, there is a regular flux in olive production (relatively abundant in a 'diamond year', followed by meager yields in a 'sterile year'). In the past, the yields of a diamond year were estimated at 33 thousand tons of olive oil, while a sterile year's production was estimated at roughly 7 thousand tons of oil. However, these estimates, according to the Palestinian Olive Council, fell to 22 thousand tons of oil in a diamond year (e.g. 2010) and 5 thousand tons in a sterile year (e.g. 2009).

Palestinian olive oil production is projected at 18 thousand tons in 2012, with the six thousand tons from the previous year's inventory, the total available supply of olive oil comes to 24 thousand tons. On the other hand, the local annual consumption of olive oil is about 14 thousand tons (annual per capita consumption is 4.8 kg in the West Bank and 1.2 kg in the Gaza Strip)⁴ - suggesting a surplus of approximately 10 thousand tons.

In October 2012, olive oil was sold for 23 shekels per kilogram in the West Bank. Tareq Abu Laban, member of the Palestinian Olive Oil Council, expects a drop to 18 shekels, though most farmers have stored their oil in anticipation of higher prices. Abu Laban attributes the decline in prices to the weak demand for oil as a result of the closure of the Gaza Strip, which would, otherwise, import large quantities. Obstacles to exporting to Israel and abroad represent another reason for the decline, he said⁵.

Table 1 displays the value of exports and imports of olive oil in the Palestinian Territory (with exports ranging from 12 to 13 million dollars a year)⁶.

Table 1: Value of Palestinian exports and imports of olive oil 2007-2010 (thousand\$)

Year	Exports	Imports
2007	11,475	1
2008	11,493	171
2009	12,481	449
2010	13,806	1,619

Source: Palestinian Central Bureau of Statistics, foreign trade data on goods and services: basic results. Years 2007-2010

Export of Palestinian olive oil to international markets encounters several obstacles, including high volatility and high production costs. Additionally, global markets are still unfamiliar with the Palestinian olive oil⁷. According to the Palestinian Olive Oil Council, the major destinations of the Palestinian oil are Arab Gulf markets (approximately 2,400 tons a year), Jordan (500 tons), Europe (700 tons) and the United States as well as Canada (500 tons). Due to strong competition and because Palestinian olive oil is often unattractive

¹ In 2012, Spain produced about 1.7 million tons of olive (more than 60% of world production). Turkey came in second place.

² <http://www.indexmundi.com/commodities/?commodity=olive-oil&months=60¤cy=eur>

³ International Olive Council. 2012. Market Newsletter <http://www.internationaloliveoil.org/news/view/660-year-2012-news/307-market-newsletter-september-2012>

⁴ Palestinian Olive Oil Council <http://www.pooc.org.ps/pooceng/>

⁵ Interview with Mr. Tareq Abu Laban, a member of the Palestinian Olive Oil Council.

⁶ 2009 Cabinet decision regulated import of olive oil from abroad. Under this decision, a technical committee was formed to regulate the issuance of import licenses. To guarantee the domestic yields are marketed properly, the committee issues licenses only after strict verification.

⁷ Interview with Mr. Ali Ghanem, member of the Anabtawi Group.

in the European markets (due to its acridness), marketing in international markets needs great and focused efforts⁸.

Israel's production of olive oil ranged from 4 to 9 thousand tons during the past five years⁹. The Israeli consumption of olive oil, on the other hand, ranged between 15 and 17 thousand tons during the same period¹⁰. Despite the fact that Israeli consumer prefer the acrid taste of Palestinian olive oil, Israel still primarily imports olive oil from Turkey due to the lower price of Turkish oil.

As such, the price of Palestinian olive oil is governed by domestic supply and demand. Thus, the influence of the global crisis on the price of Palestinian olive oil is limited, most likely due to the product's almost exclusive dependency on the domestic market. The export of olive oil to the global markets is highly competitive, evidently the presence of big producers with a long history and tradition in marketing poses challenges to the export of Palestinian oil in the short term despite the promising prospects in the long run.

However, prices of Palestinian olive oil might still see some improvement if Israel opens its market. The price of one kilo of oil in the international market (as noted earlier) is 2.94 Euros (about 14.6 NIS). When other costs (transport, value added tax, profit margins) are added, the price of imported olive oil from world markets to the Israeli market might become higher than the price of Palestinian oil. This will increase the Israeli demand for t Palestinian olive oil, which will, in turn, increase its price.

2. The Labor Market

2.1 Labor force and participation rate

During the second quarter 2012, participation rate (i.e. the ratio of workers and the unemployed to those of working age) in the West Bank and Gaza Strip stood at 43.6% compared with 43.4% in the previous quarter, rising by one percentage point from the corresponding quarter of 2011. Table 2-1

shows an ongoing disparity between the West Bank and Gaza Strip in the participation rate (45.4% in the West Bank and 40.3% in the Gaza Strip). This disparity is particularly due to the low rate of female participation in Gaza compared to the West Bank (14.9% compared to 18.6%).

**Table 2-1: Percentage of labor force participation for individuals
15 years of age and above in the West Bank and the Gaza Strip
by Region and Sex between 2010 and Q2 2012 (%)**

Region & sex	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
Males and Females								
West Bank	43.7	43.2	45.3	46.2	47.3	45.5	45.4	45.4
Gaza	36.4	37.0	38.1	39.0	39.5	38.4	39.9	40.3
West Bank & Gaza	41.1	41.0	42.7	43.6	44.4	43.0	43.4	43.6
Males								
West Bank	69.5	69.0	71.2	73.1	72.2	71.4	70.8	71.5
Gaza	62.1	62.5	64.0	64.3	64.8	63.9	65.5	65.1
West Bank & Gaza	66.8	66.7	68.6	70.0	69.5	68.7	68.9	69.2
Females								
West Bank	17.2	16.7	18.8	18.6	21.6	19.0	19.3	18.6
Gaza	10.2	11.0	11.6	13.2	13.6	12.4	13.7	14.9
West Bank & Gaza	14.7	14.7	16.2	16.7	18.7	16.6	17.3	17.3

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 2012.

⁸ According to Tareq Abu Laban (member of the Palestinian Olive Oil Council), marketing Palestinian olive oil in Western markets does not go through normal commercial outlets but through 'World Fair Trade Organization'. These outlets were established by anti-globalization activists, and they seek to market the products of the poor throughout the world and to give them a fair price for their products.

⁹ <http://www.indexmundi.com/agriculture/?country=il&commodity=olive-oil&graph=production>

¹⁰ <http://www.internationaloliveoil.org/estaticos/view/131-world-olive-oil-figures>

Table 2-2: Individuals 15 years of age and above, working in the Palestinian Territory-By Place of Work 2010 – Q2 2012

Place of Work	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
Manpower (in thousands)	2,376	2,432	2,455	2,477	2,500	2,465	2,523	2,546
Workforce	976	997	1,048	1,108	1,111	591,0	1,095	1,109
No. of workers (in thousands)	744	780	852	839	878	838	834	877
West Bank (%)	63.5	61.2	60.7	59.7	62.1	61.4	60.9	60.5
Gaza Strip (%)	26.0	28.8	29.4	29.9	28.3	28.8	29.9	30.3
Israel & the Settlements (%)	10.5	10.0	9.9	10.4	9.6	9.8	9.2	9.2

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 2012.

Quarterly data shows a 5% growth in the number of workers in the West Bank and the Gaza Strip – from 834 thousand in the first quarter of 2012 to 877 thousand in the second quarter of 2012. There was also an increase of 3% in the employment rate compared to the corresponding quarter of the previous year.

Nevertheless, this increase was mainly due to a rise in the number of unpaid family members (see Table 2-4). Distribution of workers in the first quarter of 2012 by place of work was as follows: 61% in the West Bank, 30% in Gaza and 9% in Israel and the settlements (see Table 2-2).

Table 2-3: Percentage of workers 15 years of age and above in the Palestinian Territory- By Region and Sector 2010 – Q2 2012 (%)

Sector	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
oPt								
Public sector	23.6	22.9	21.6	22.8	22.6	22.2	23.1	21.9
Private sector	62.4	63.3	64.8	63.1	64.8	64.5	64.2	65.6
Other sectors	3.6	3.8	3.7	3.7	3.0	3.5	3.5	3.3
Israel & the settlements	10.4	10.0	9.9	10.4	9.6	9.8	9.2	9.2
Total	100	100	100	100	100	100	100	100
West Bank								
Public sector	15.9	15.4	14.5	15.9	15.9	15.2	16.3	14.9
Private sector	67.7	68.2	69.1	67.0	68.9	68.9	68.5	70.0
Other sectors	2.5	2.4	2.4	2.3	1.8	2.1	2.0	2.0
Israel & the settlements	13.9	14	14.0	14.8	13.4	13.8	13.2	13.1
Total	100	100	100	100	100	100	100	100
Gaza								
Public sector	46.1	48.0	41.7	38.6	38.8	39.4	39.1	37.9
Private sector	46.7	44.3	51.3	54.6	54.1	53.8	54.0	55.7
Other sectors	7.2	7.7	7.0	6.8	7.1	6.8	6.9	6.4
Israel & the settlements	100	100	100	100	100	100	100	100

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 2012.

Table 2-3 reveals that the private sector was the main employer of the Palestinian labor force in the West Bank during Q2 2012 - absorbing 70% of the total employees. In the same period, the public sector's share was barely 15%. In Gaza, the main employer was the public sector - absorbing more than one

third of workers. However, the number of workers in the public sector in Gaza fell from 41.7% during the second quarter 2011 to 37.9% in the second quarter 2012. On the other hand, the number of Gaza's private sector workers increased by 8.5% compared to the corresponding quarter of 2011.

With regard to the employment status of workers, the data shows an increase in the share of unpaid family members in the second quarter 2012 compared to the previous quarter. This share also rose by 2 percentage points

from the corresponding quarter of the previous year (see Table 2-4). In Gaza, the share of self-employed fell to 15.5%; down from 16.5% in the previous quarter and 20.3% in the corresponding quarter of the year 2011.

Table 2-4: Percentage distribution of workers in the Palestinian Territory – by Employment Status and Region (quarters of 2010 - Q2 2012) %

Employment Status and Region	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
West Bank								
Employer	7.1	8.0	7.6	7.4	6.5	7.4	7.6	7.2
Self-employed	20.3	18.9	19.0	18.8	18.8	18.9	19.7	19.0
Wage earner	63.6	66.7	64.7	64.0	61.3	64.1	63.2	63.1
Unpaid family member	9.0	6.4	8.7	9.8	13.4	9.6	9.5	10.7
Total	100	100	100	100	100	100	100	100
Gaza								
Employer	4.2	3.0	3.0	5.7	3.7	3.9	2.9	3.2
Self-employed	14.3	18.7	20.3	15.8	16.3	17.7	16.5	15.5
Wage earner	78.9	73.9	70.3	71.8	75.1	72.7	74.4	74.2
Unpaid family member	2.6	4.4	6.4	6.7	4.9	5.7	6.2	7.1
Total	100	100	100	100	100	100	100	100
oPt								
Employer	6.4	6.6	6.3	6.9	5.7	6.4	6.2	6.0
Self-employed	18.8	18.8	19.4	17.9	18.1	18.6	18.8	18.0
Wage earner	67.6	68.8	66.4	66.4	65.2	66.6	66.5	66.5
Unpaid family member	7.2	5.8	7.9	8.8	11.0	8.4	8.5	9.5
Total	100	100	100	100	100	100	100	100

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 2012.

According to quarterly data, during Q2 2012, there was a significant change in the distribution of workers by economic activity compared to the previous quarter; however the rates remained almost unchanged compared to the corresponding quarter of the previous year (see Table 2-5). The construction sector, for example, maintained almost the same number of workers compared to the corresponding quarter 2011 though the number of workers rose slightly compared with the first quarter of 2012. On the other hand, there was a decline in the number of workers in the service sector in the Palestinian Territory (from 37.1% in the first quarter 2012 to 34.9% in the second quarter of the same year). Contrarily, the number of workers in the agriculture sector

grew from 10.5% to 12.7% during the comparison period.

2.2 Unemployment

The unemployment rate in Q2 2012 stood at 20.9% (17.1% in the West Bank and 28.4% in the Gaza Strip) – down by 3 percentage points from the previous quarter, but up by 2 percentage points from the corresponding quarter of 2011. This relative low rate resulted from a drop in the unemployment rate in the West Bank and Gaza by about 3 percent compared to the previous quarter (see Table 2-6).

**Table 2-5: Percentage distribution of workers in the Palestinian Territory
by Economic Activity and Region 2010 – Q2 2012 (%)**

Region & Economic Activity	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
oPt								
Agriculture, fishing and forestry	11.8	10.6	11.5	10.9	14.4	11.9	10.5	12.7
Quarries and manufacturing	11.4	11.5	12.3	12.1	11.3	11.8	12.2	11.7
Building and construction	13.2	13.8	14.5	13.9	13.3	13.9	13.5	14.7
Trade, restaurants and hotels	19.3	20.0	20.4	21.0	19.6	20.3	20.1	19.7
Transport, storage and communications	6.0	6.4	6.1	6.0	6.0	6.1	6.6	6.3
Services and others	38.3	37.7	35.2	36.1	35.4	36.0	37.1	34.9
Total	100	100	100	100	100	100	100	100
West Bank								
Agriculture, fishing and forestry	13.3	10.6	12.3	11.5	16.4	12.8	11.4	14.4
Quarries and manufacturing	13.7	14.1	15.0	14.7	13.6	14.4	14.9	14.4
Building and construction	16.8	17.4	18.0	17.3	15.8	17.1	16.4	17.4
Trade, restaurants and hotels	19.9	21.3	20.9	21.9	20.1	21.0	21.4	20.4
Transport, storage and communications	5.7	5.9	5.6	5.4	5.2	5.5	5.6	5.9
Services and others	30.6	30.7	28.2	29.2	28.9	29.2	30.3	27.5
Total	100	100	100	100	100	100	100	100
Gaza								
Agriculture, fishing and forestry	7.7	10.5	9.5	9.3	9.1	9.6	8.4	8.9
Quarries and manufacturing	4.8	5.0	5.7	5.8	5.5	5.5	5.9	5.4
Building and construction	3.0	4.9	6.2	6.0	6.8	6.0	6.7	8.7
Trade, restaurants and hotels	17.3	16.8	19.4	18.8	18.5	18.4	16.9	18.1
Transport, storage and communications	6.6	7.6	7.2	7.3	8.1	7.6	8.9	7.3
Services and others	60.6	55.2	52.0	52.8	52.0	52.9	53.2	51.6
Total	100	100	100	100	100	100	100	100

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 of 2012.

**Table 2-6: Unemployment rate among individuals participating in the labor
force (15 years of age and above) in the Palestinian Territory –
by Region and Sex: 2010 – Q2 2012 (%)**

Region & Sex	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
oPt								
Males	23.1	20.5	16.4	20.5	19.3	19.2	22.0	18.8
Females	26.8	27.3	28.6	30.5	27.2	28.4	31.5	29.5
Total	23.7	21.7	18.7	22.4	21.0	20.9	23.9	20.9
West Bank								
Males	16.6	16.3	13.4	18.3	15.5	15.9	18.6	16.1
Females	19.7	21.8	23.3	25.3	20.3	22.6	25.5	21.4
Total	17.2	17.4	15.4	19.7	16.6	17.3	20.1	17.1
Gaza								
Males	36.2	28.9	22.4	24.9	27.0	25.8	28.4	24.1
Females	47.8	42.1	43.6	43.4	46.4	44.0	46.5	47.2
Total	37.8	30.8	25.6	28.0	30.3	28.7	31.5	28.4

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 of 2012.

Features of unemployment in Palestinian Territory during Q2 of 2012

- ✧ Unemployment in the oPt is high among young people: with 34.3% among young people aged 15-24 years (56.1% among young females and 30.5% among young

males). This suggests that a large proportion of the unemployed are new entrants to the labor market (see Table 2-7). By comparison, the employment rate among young people was 30.3% during the corresponding quarter of last year.

Table 2-7: Unemployment rate among individuals participating in the labor force (15 years of age and over) in the Palestinian Territory – by Sex and Age Group: 2010 – Q2 2012 (%)

Age Group	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
Males & Females								
15-24	38.8	38.2	30.3	37.9	36.4	35.7	40.4	34.3
25-34	24.2	22.5	20.6	22.5	21.5	21.7	24.8	23.9
35-44	15.1	12.2	10.2	14.2	11.2	12.0	13.7	10.5
45-54	16.4	13.6	12.1	12.8	13.3	13.0	14.5	12.2
55+	14.1	10.0	9.8	8.1	8.2	8.9	10.9	7.7
Total	23.7	21.7	18.7	22.4	21.0	20.9	23.9	20.9
Males								
15-24	36.8	35.3	26.4	34.0	32.8	32.3	36.9	30.5
25-34	21.7	19.6	16.0	17.7	17.0	17.5	20.2	18.9
35-44	15.5	12.3	9.6	14.8	11.9	12.2	13.9	10.5
45-54	19.0	15.6	13.3	14.6	16.1	14.9	16.0	13.7
55+	16.3	10.9	11.3	9.6	9.7	10.4	13.2	9.5
Total	23.1	20.5	16.4	20.5	19.3	19.2	22.0	18.8
Females								
15-24	49.6	53.8	51.0	58.1	51.5	53.5	58.1	56.1
25-34	34.0	33.8	37.3	40.0	36.7	37.0	40.2	41.0
35-44	13.2	11.9	12.9	11.4	8.6	11.0	12.8	10.6
45-54	3.5	3.1	6.9	5.1	2.0	4.2	7.1	5.7
55+	2.1	4.5	3.0	0.9	1.4	2.3	0.7	1.3
Total	26.8	27.3	28.6	30.5	27.2	28.4	31.5	29.5

Source: PCBS 2012: Database of Labor Force Survey: 2010, 2011 and Q2 of 2012.

- ✧ It is concentrated among the most educated females: the unemployment rate among females with 13 years of schooling and over was 42.6% (up from 39.2% in the corresponding quarter 2011) during the second quarter 2012 compared to a very low unemployment rate among the uneducated female population who recently entered the labor market. The picture is completely reversed for males: the higher the number of years of education, the lower the unemployment rate.

2.3 Unemployment among graduates of universities and institutes

Table 2-9 sheds light on the rate of unemployment among individuals with intermediate diploma and higher– by major. The second quarter 2012 saw a 13% increase in unemployment rates among degree holders compared to the corresponding quarter of 2011. The table indicates that, with 11.9%, the unemployment rate among those who obtained a degree in architecture and civil engineering was the lowest (i.e. for every one hundred graduates, there were 12 without a job). On the other hand, the unemployment rate among those who obtained a degree in press and media was the highest (about 71.2% during the second quarter of 2012).

Table 2-8: Unemployment rate among individuals participating in the labor force (15 years of age and over) in the Palestinian Territory – by Sex and Years of Schooling 2010 – Q2 2012 (%)

Years of schooling	2010	Q1 2011	Q2 2011	Q3 2011	Q4 2011	2011	Q1 2012	Q2 2012
Males & Females								
0	13.8	15.5	11.9	10.4	10.4	11.8	4.6	7.9
1-6	25.7	23.1	16.5	20.3	19.1	19.8	24.8	18.5
7-9	24.8	22.6	17.8	21.5	20.0	20.4	23.1	19.6
10-12	23.2	20.5	16.1	20.4	19.8	19.2	22.1	18.2
13+	23.1	22.1	22.8	26.0	23.7	23.7	26.2	25.5
Total	23.7	21.7	18.7	22.4	21.0	20.9	23.9	20.9
Males								
0	24.3	23.4	18.5	19.9	20.4	20.6	6.9	17.6
1-6	28.6	25.6	18.4	22.7	22.2	22.2	27.6	21.5
7-9	26.2	23.4	18.6	22.2	21.6	21.5	24.6	20.8
10-12	24.0	20.6	16.4	21.0	20.6	19.7	22.5	18.9
13+	15.7	15.1	13.1	17.2	14.0	14.9	16.6	15.6
Total	23.1	20.5	16.4	20.5	19.3	19.2	22.0	18.8
Females								
0	1.5	4.1	5.1	1.8	-	2.4	2.2	1.3
1-6	5.1	2.2	4.3	3.6	1.5	2.9	4.2	1.9
7-9	7.8	9.9	7.4	12.2	6.1	8.6	6.9	6.9
10-12	13.6	19.5	12.6	14.0	12.9	14.5	19.0	11.4
13+	36.3	34.9	39.2	41.0	39.5	38.8	42.0	42.6
Total	26.8	27.3	28.6	30.5	27.2	28.4	31.5	29.5

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 of 2012.

Table 2.9: Unemployed graduates (with an intermediate diploma and above) by Major: 2011 – Q2 2012 (%)

Major	Q2 2011	Q1 2012	Q2 2012
Educational sciences & preparation of teachers	39.9	38.1	39.3
Humanities	26.4	28.2	29.5
Social and behavioral sciences	20.7	33.6	29.2
Journalism and media	45.2	32.4	41.2
Business and administration	18.9	26.3	25.9
Law	15.2	14.9	22.9
Natural sciences	23.3	23.6	17.5
Math and statistics	28.6	29.0	25.5
Computer	33.1	34.3	29.0
Engineering and engineering professions	15.1	20.1	23.3
Architecture and construction	18.2	20.9	11.9
Health	16.7	18.5	19.7
Personal services	7.8	26.9	17.3
Others	27.7	31.1	24.9
Total	24.0	27.9	27.2

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 of 2012.

2.4 Wages and working hours

The average daily wage of West Bank workers saw a slight rise in Q2 compared Q1 of 2012. Likewise, the average wage of Gaza's workers and those working in Israel and the settlements saw a growth of 0.6% and 0.7%, respectively. In comparison with the corresponding quarter of the previous year, the average wage in the West Bank, the Gaza Strip and Israel & the settlements grew by 3%, 4% and 2%, respectively.

The gap between average wages in the West Bank and Gaza is still relatively large (the average wage of Gaza's workers represents only 73.6% of the average wage in the West Bank). The median daily wage in Gaza (the

pay received by half of the employees) reflects a greater disparity between wages in the Gaza Strip and the West Bank, where the median daily wage in Gaza is only 65% of the average daily wage in the West Bank. This continued disparity mirrors the demand for labor in light of the Israeli blockade placed on Gaza. On the other hand, the weekly working hours during the second quarter 2012 hovered around the rates reported in previous quarters and years. However, there was a rising trend of weekly working hours in the West Bank, the Gaza Strip and Israel & the settlements (see Table 2-10).

Table 2-10: Average weekly working hours, monthly working days and daily wages (in NIS) of known-wage workers in the oPt – by Place of work: 2011 – Q2 2012 (%)

Place of work	Average weekly hours	Average monthly working days	Average daily wage	Median daily wage
Q1 2011				
West Bank	42.6	22.0	85.0	76.9
Gaza Strip	39.2	23.3	64.6	50.0
Israel and settlements	39.8	20.9	164.0	153.8
Total	41.3	22.2	92.4	76.9
Q2 2011				
West Bank	42.8	22.5	84.8	76.9
Gaza Strip	37.5	23.7	61.8	48.1
Israel and settlements	38.9	20.6	160.5	153.8
Total	40.9	22.5	90.8	76.9
Q3 2011				
West Bank	43.4	22.6	84.3	76.9
Gaza Strip	38.2	23.4	59.3	46.2
Israel and settlements	38.8	21.2	164.5	153.8
Total	41.2	22.5	92.6	76.9
Q4 2011				
West Bank	43.7	22.5	85.7	76.9
Gaza Strip	36.9	23.3	60.6	50.0
Israel and settlements	40.1	21.3	159.6	153.8
Total	41.4	22.5	91.1	76.9
Q1 2012				
West Bank	43.0	22.4	85.4	76.9
Gaza Strip	36.9	23.5	63.9	50.0
Israel and settlements	41.2	20.7	162.0	153.8
Total	41.1	22.4	90.9	76.9
Q2 2012				
West Bank	43.8	22.3	87.4	76.9
Gaza Strip	37.8	23.6	64.3	50.0
Israel and settlements	41.8	20.3	163.2	153.8
Total	41.9	22.3	92.1	76.9

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, 2010-2011 and Q2 2012

2.5 Vacancy announcements¹¹

The number of vacancies posted in the second quarter of 2012 was about 1083, a 22% rise from the previous quarter, and a 27% increase from the corresponding quarter of 2011 (see Table 2-11). It is worth noting that in the second quarter of 2012, there were 60 announcements with no specific number of vacant posts. In addition, the posted vacancies do not necessarily cover all available job opportunities, though all government jobs, as per law, must be advertised¹².

With 533 vacancy announcements, the private sector accounted for the largest share of job vacancies advertised in this quarter (49%). The shares of the NGO sector and the public sector were 39% (422 jobs) and 12% (128

jobs), respectively. The shares of the private sector and the public sector in the total vacancies advertised grew by 24% and 21%, respectively, while that of the NGO sector declined by 23% compared with the first quarter of the same year (see table 2-11).

With respect to the distribution of posted vacancies by region, data shows that the central West Bank accounted for the majority of vacancies advertised (65%). The shares of both Northern and Southern West Bank governorates were 15% and 11%, respectively. The Gaza Strip's contribution was only 9%. As for the distribution of vacancies by the required degree, the BA degree was the most needed (64%) (see Table 2-11).

Table 2-11: Number of vacancies advertised in daily newspapers in the oPt during Q1 & Q2 2012, and Q2 2011

	Q2 2011	Q1 2012	Q2 2012			
			April	May	June	Total
By sector						
Private sector	445	354	177	203	153	533
Public sector	140	87	17	25	86	128
NGOs	266	449	124	173	125	422
By region						
Northern West Bank	102	88	62	43	55	160
Central West Bank	645	640	198	273	232	703
Southern West Bank	88	90	29	54	42	125
Gaza Strip	16	72	29	31	35	95
By degree						
MA and above	77	61	15	45	47	107
BA	544	632	189	259	250	698
Intermediate Diploma	105	71	45	28	15	88
Below Diploma	125	126	69	69	52	190
Total						
	851	890	318	401	364	1,083

Source: MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hayah) as well as from the website www.jobs.ps

With a segment of 35%, the demand for administrative and economic sciences had the largest share of advertised vacancies. Meanwhile, the demand for humanities and social sciences; applied sciences; other

specializations and professions; and medical sciences posted 20%, 18%, 18% and 9%, respectively. The NGO sector claimed the majority (91%) of vacancies advertised in the Gaza Strip (see Table 2-12).

¹¹ MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hyah) as well as from the website www.jobs.ps

¹² Article (19) of the Civil Service Law No. (4) of 1998 states that the government departments shall announce job vacancies in which appointment is made by the competent authority within two weeks of vacancy in at least two daily newspapers. The announcement shall contain detailed information about the job and conditions to be met.

Table 2-12: Number of vacancies advertised in daily newspapers in the oPt- by Major, Sector and Region— Q2 2012

Major	West Bank			Gaza			Total
	Public sector	Private sector	Civil sector	Public sector	Private sector	Civil sector	
Medical sciences	10	49	33	0	0	8	100
Humanities and social sciences	36	50	111	1	2	18	218
Applied sciences	25	94	49	0	3	22	193
Administrative and economic sciences	35	178	132	1	2	29	377
Other (craftsmen, maintenance, secretarial work, etc.)	20	155	11	0	0	9	195
Total	126	526	336	2	7	86	1,083

Source: MAS collected job advertisements from daily newspapers (Al-Quds, Al-ayyam and Al-Hayah) as well as from the website www.jobs.ps

Textbox 2: Minimum Wage: Legislation and Practice

MAS Institute holds a series of interactive roundtable sessions where some hot issues are debated and recommendations for decision-maker are evoked. On October 21st, the Institute held a session to debate the consequences of the minimum wage decision in the Palestinian territory. Keynote speakers included the Palestinian Labor Minister and representatives of employers and trade unions. The Institute prepared a background paper for discussion. Below is a synopsis of the main points raised:

Theme of the Dialogue

On October 9, 2012, the Palestinian Cabinet ratified a recommendation brought forth by the "National Wage Committee" on the minimum wage in the Palestinian territory; thus putting one of the items of the labor law (which was released in 2000) into effect. The committee was comprised of five ministries representing the government, employers and trade unions (Palestine General Federation of Trade Unions, General Union of Palestine Workers, Federation of Independent & Democratic Trade Unions & Workers' Committees and Union of Universities Staff).

The meetings, which were held for almost an entire year between employers and workers, did not, however, settle the dispute. Worker representatives insisted on a monthly minimum wage of 1,750 shekels while employers insisted on only 1,250 shekels. Consequently, the Minister of Labor made a compromising proposal: 1,450 shekels a month, 65 shekels a day and 8.5 shekels an hour.

Thirteen members (out of fifteen) in the "National Wage Committee" consented to the recommendations of the Minister, provided it comes into effect in January 2013, so that the companies can assess their positions. Protesting against the decision, the Palestine General Federation of Trade Unions observed a sit-in outside the Cabinet headquarters. Headed by the Secretary-General of the Federation and all the members of its executive committee, the demonstration involved hundreds of workers and unemployed young people from different governorates of the West Bank.

Two models of setting a minimum wage

With regards to setting a minimum wage, there are two main schools: the first advocates setting a minimum wage based on the cost of essential necessities of life; the second promotes setting it according to economic variables, such as labor productivity, wage levels and real incomes in the economy.

Opting for only one of these two methods in the Palestinian territory, in light of the persisting structural distortions, is inappropriate and inefficient. The structures of production, employment and productivity in the Palestinian economy are underdeveloped, while the structure and level of cost of living resemble those reported in developed economies. Thus, any proposed wage level would be low in relation to the cost of living and high in relation to productivity.

The first model: minimum wage is established in relation to sustainability of life

This model establishes the minimum wage in relation to the minimum income where the life of the individual is sustained or in accordance with the national poverty lines. In Israel, for example, the monthly poverty line per capita is 2,268 shekels (50% of median disposable income). The monthly poverty line for a family of 4 members is 5,807 shekels. As such, the minimum wage necessary to ensure that the family is not below the national poverty line is 30 shekels / h ($5,807 / 192$)¹³. It is important to note, however, that the actual minimum wage in Israel is only NIS 4,300 / month or 22 shekels / h.

In the Palestinian territory, the threshold of extreme poverty for a household is 1,832 shekels a month. This means that the minimum wage of extreme poverty is 9.5 shekels /h ($1832/192$) - assuming that only one person per family is employed, and works for 192 hours a month.

The second model: minimum wage is calculated in relation to the economic variables

Proponents of this model believe that the first model (which builds on actual costs of living) confuses social policy with economic policy, turning a blind eye to the adverse effects on production and employment: Can an economy afford a minimum wage? The alternative, according to this model, is to depend on real wages in the market; i.e. labor productivity.

In most, or even all, countries around the world, the average wage is always higher than the median wage¹⁴. According to the International Labor Organization, most of the world's countries (75 countries) set the minimum wage at 40-50% of the nominal average wage or at 55% of the median wage (for example, in England the minimum wage is 52% of the median wage, and in France it is 61%). Again, in Israel the average wage is 8,563 shekels a month- suggesting that the minimum wage in Israel represents 50% of the average nominal wage ($4,300 / 8,563$).

In the Palestinian territory, the average daily wage is NIS 79.7 (87.4 in the West Bank and 64.3 in Gaza or NIS 11.9 / h in the West Bank and NIS 10.2 / h in Gaza), while the median daily wage is NIS 63.4 (77 / h in the West Bank and 50 / h in Gaza). As such, the minimum daily wage in the Palestinian territory, according to this approach, is between 35 shekels (55% of the median wage) and 32 shekels (40% of the average wage). Obviously, this is a very low wage and is socially and politically unacceptable.

Minimum Wage Law in Palestine

The Palestinian minimum wage law has set the minimum wage at 1,450 shekels a month, 65 shekels a day and 8.5 shekels an hour. If we assume that the number of wage earners in a family is 1.6, then the minimum wage will secure the family a monthly sum of 2320 shekels (1450×1.6). This is higher than the level of extreme poverty (projected at 1832 shekels) for the family (2 adults and 3 children). Indeed, this wage is even higher than the average poverty threshold (2293 shekels). However, if the number of income earners in a household fell to less than 1.2, then the minimum monthly wage would not be enough to ensure an income higher than the extreme poverty level. Likewise, if the number of income earners in a household fell to less than 1.5, then the income would be lower than the normal level of poverty.

Table 1: Number of employees who receive a monthly wage less than 1,450 shekels (Q2 of 2012)

Sector	West Bank	Gaza Strip	oPt
Agriculture, hunting, forestry and fishing	6,800	10,300	17,100
Mining, quarrying and manufacturing	19,700	8,100	27,800
Construction	4,800	14,200	19,000
Trade, restaurants and hotels	21,000	18,100	39,100
Transport, storage and communications	2,700	8,100	10,800
Services and related activities	16,400	20,200	36,600
Total	71,400	79,000	150,400

Source: Palestinian Central Bureau of Statistics 2012, Labor Force Survey, Q2 2012, Ramallah, Palestine

¹³ These figures assume that there are 192 working hours a month: 8 hours a day multiplied by 6 days a week in 4 weeks. The example also assumes that there is only one income earner for each household.

¹⁴ The average wage = total wages / number of workers. The median wage is the wage earned by most workers.

The minimum daily income (NIS 65) in the oPt is 75% of the average daily wage in the West Bank (NIS 87.4 in 2012) and almost 100% of the average daily wage in Gaza. This minimum income is nearly equal to the median daily wage in the Palestinian territory. These rates are extremely high compared to international averages which sets the minimum wage at only 40% of the average wage.

Figures of the census reveal that more than 150 thousand people in the Palestinian territory receive a monthly income of less than 1,450 shekels. These are the prospective beneficiaries of the minimum wage law- representing 20% of the total number of workers in the Palestinian territory (excluding those working in Israel and the settlements). Forty-seven percent of these prospective beneficiaries are West Bankers, and more than half of them work in trade, restaurants and services (see Table 1). The median wage of those who receive less than the minimum wage is about 1,083 shekels, suggesting that the median wage for this group will increase by 34% once the new minimum is applied (see Table 2).

Table 2: Average & Median daily wage of workers receiving less than 1,450 shekels a month (Q2 2012)

	West Bank	Gaza	oPt
Average monthly wage	1,039.8	819.9	925.7
Median monthly wage	1,083.3	800.0	1,000.0

Source: PCBS 2012: Database of Labor Force Survey: Q2 of 2012, Ramallah, Palestine

In case that wage workers who are making less than NIS 1.450 a month will increase their average wage (currently standing at NIS 925.7) to the proposed minimum wage, then the new law will swell the wage bill by nearly 945 million shekels a year, 37% of this amount will be in the West Bank (see Table 3). This rise in the wage bill can be offset through 3 channels: less profit (income redistribution), and / or higher prices, and / or an increase in labor productivity.

Table 3: Expected increase in the wage bill when Minimum Wage Law is applied

Increase in wage bill (million shekels)	West Bank	Gaza	oPt
Monthly	29.3	49.8	79.1
Yearly	351.6	597.6	949.2

Source: The Monitor calculations are based on data obtained from the Palestinian Central Bureau of Statistics, 2012: Database of Labor Force Survey: Q2 2012, Ramallah

Three important indicators could be examined in the future to check the effectiveness/ineffectiveness of the minimum wage law in the Palestinian territory:

1. The ambit of commitment to the application of the law.
2. Impact of increasing minimum wage on employment.
3. Impact of increasing minimum wage on prices and inflation.

Textbox 3: 320 Applicants for one "Receptionist" Vacancy

In July 2012, the Palestine Economic Policy Research Institute (MAS) posted a vacancy announcement for a 'receptionist' position. The vacancy announcement stipulated that applicants should have obtained an intermediate diploma with a working knowledge of English and knowledge of basic computer applications. The Institute received 320 applications, which, upon sorting out, revealed the miserable conditions of the Palestinian labor market.

Table 1: Distribution of applicants for a 'receptionist' vacancy by Degree

	BA	Intermediate Diploma
Administrative and economic sciences	100	71
Humanitarian and social sciences	92	2
Applied sciences	32	14
Medical and health sciences	1	2
Total	225	89*

* Six of the applicants have only obtained a high school diploma.

The Table reveals that:

- ✧ 70% of applicants were BA holders.
- ✧ Most of those with a BA degree had their majors in Administrative Sciences and Humanities, while 32 BA applicants held a degree in applied sciences.
- ✧ About 69% of BA holders have recently graduated from Universities (2010-2012), while 30% graduated before 2010. By contrast, most of the intermediate diploma holders (64%) graduated before 2010.
- ✧ 8% of applicants were males.
- ✧ 86% of applicants were unemployed, while 14% were employed but wanted to seek another job.

These results bring to light the dismal status of young people in labor market and the rampant unemployment among Palestinian university graduates (with intermediate diploma and above) - standing at 27.2% in Q2 2012, eventually driving them to look for any opportunity to work even if it is not in their major or requires less academic qualification. Besides, the results suggest a change in social norms: 26 males applied for what is considered traditionally a female-type of work!

3. Public finance¹⁵

Financial data indicate a decline in the financial position of the Palestinian Authority during Q2 of 2012. The most prominent developments in this quarter compared with Q1 are:

- ✧ The current deficit soared to about 11% of GDP (\$ 280.7 million) compared to 4.8% in Q1.
- ✧ The total public revenues and grants (net) declined by 4.7% (to 734.5 million dollars) as a result of a decline in net domestic revenues.

The total public expenditure grew significantly by 15.4% (to 828.3 million dollars) due to an increase in non-wage expenditures.

- ✧ The public debt outstanding balance saw a significant increase of 5% (standing at 2,339.4 billion dollars).

However, when compared to the corresponding quarter of the previous year, the total domestic revenue had declined 7%. Likewise, public expenditure fell by approximately 7%. The 60% growth in grants and international aid between the corresponding quarters reduced the budget deficit by 54% (about \$ 94 million).

These figures reflect the budget on the cash basis versus the accrual basis; i.e., the cash

¹⁵ Data for financial operations are in NIS. The NIS monthly exchange rate was taken from the source. The shekels were converted to dollars, then the monthly totals for each quarter were calculated accordingly. Data for the second quarter of 2012 are preliminary, issued by the Palestinian Ministry of Finance and are subject to updates and revision. Figures in brackets are of a negative value.

Table 3-1 summarizes the financial developments in the PNA budget in accordance with the cash basis during Q2 of 2012.

basis figures do not take into account the unpaid obligations accumulated by the PNA (see section 3.4 of this chapter).

Table 3-1: Summary of the financial position of the PNA: Q2 2102

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Public revenues and grants (net)	796.9	683.4	1,005.0	668.3	770.8	734.5
Total domestic revenues (net)	580.6	536.1	545.2	514.2	559.6	496.8
Domestic revenues	591.5	538.7	545.2	514.2	559.8	501.3
Tax revenues	134.8	121.6	102.5	123.3	153.5	99.8
Non-tax revenues	44.4	68.4	66.1	41.2	48.6	48.2
Clearing revenues	412.3	348.8	376.6	349.7	357.7	353.2
Tax returns	10.9	2.6	-	-	0.2	4.5
External revenues (grants and aid)	216.3	147.3	459.8	154.1	211.2	237.7
For budget support	191.1	122.0	362.9	132.6	197.0	204.5
To support developmental projects	25.2	25.2	96.9	21.5	14.2	33.2
Total public expenditure	793.5	889.5	764.6	809.2	717.7	828.3
Current expenditure, including:	730.4	780.0	715.5	734.8	675.3	777.5
Wages and salaries	427.2	448.8	409.4	393.6	403.0	420.4
Non-wage expenses	270.1	301.5	277.8	293.4	233.0	324.3
Net lending	33.1	29.8	28.3	47.9	39.3	32.9
Development expenses	63.2	109.4	49.1	74.4	42.4	50.8
Treasury-funded	38.0	84.2	(47.7)	52.9	28.1	17.6
Donor-funded	25.2	25.2	96.9	21.5	14.2	33.2
Current deficit / surplus	(149.8)	(243.9)	(170.3)	(220.6)	(115.7)	(280.7)
Total deficit / surplus (before grants and aid)	(213.0)	(353.4)	(219.4)	(295.0)	(158.1)	(331.5)
Total deficit / surplus (after grants and aid)	3.3	(206.1)	240.4	(140.9)	53.1	(93.8)
Financing	(3.3)	206.1	(240.4)	140.9	(53.1)	93.8
Net financing from local banks	13.1	183.4	(229.7)	134.2	(56.7)	94.8
The remaining balance	(16.5)	22.8	(10.6)	6.7	3.6	(1.0)

Source: Data available in the financial reports published by the Palestinian Ministry of Finance (cash basis), Table 3.

3.1 Analysis of income and grants

During Q2 of 2012, public revenues and grants fell by 4.7% from the previous quarter (to \$ 734.5 million) due to a decline in net domestic revenues. Contrarily, grants and foreign aid grew by 12% during the same period. With respect to the components of the total domestic revenues, data indicates that clearance revenues accounted for the lion's share (70.5%), followed by tax revenues (20%) and then non-tax revenues (9.5%). These three sources retained the position they enjoyed during the previous quarters.

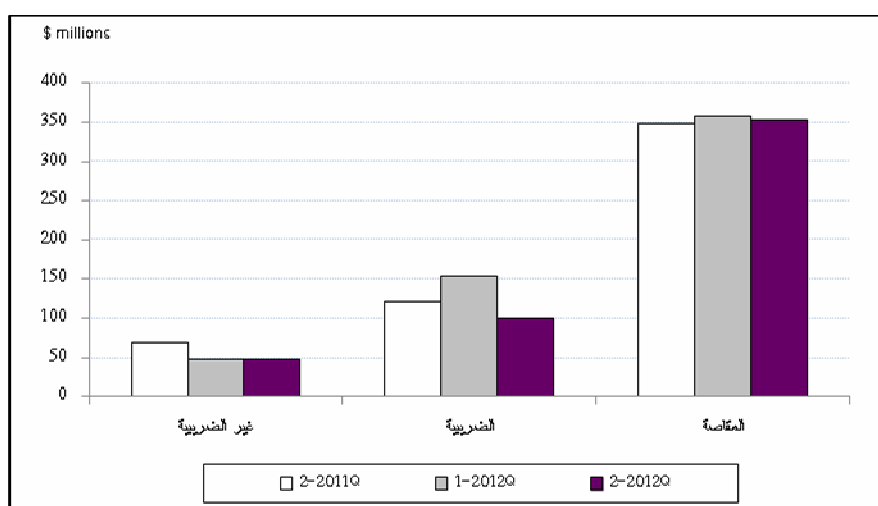
Clearance revenues saw a 1.2% drop during Q2 of 2012 compared to the previous quarter, totaling \$353.2 million. However, these revenues were 1.3% higher than the corresponding quarter of 2011¹⁶. In general, the share of clearance revenues in net domestic revenues has been growing since 2010. During

¹⁶ Clearance revenues are collected in NIS, and therefore the nominal value of the item calculated in dollars is significantly affected by fluctuations in the exchange rate of the dollar against the shekel. When considering the developments on the clearance revenues collected in NIS, the change is higher than the figures listed above (the real change stands at 12.3%).

the first half of 2012, the monthly clearing revenues stood at \$105-121 million on average. Tax revenue declined to \$99.8 million, down by 35% from the previous quarter. This regression occurred due to the absence of income and property taxes that are due only in the first quarter, making its values higher than the values of other quarters of the

year¹⁷. Still, Q2 of 2012's tax revenues fell by 18% from the corresponding quarter of 2011. This is a matter of concern especially in light of government policies aimed at increasing domestic funding sources to plug the budget deficit. During Q2 of 2012, non-tax revenues totaled \$48.2 million, down by 1% from the previous quarter.

Figure 3-1: Structure of domestic revenues



Source: Data available in the financial reports published by the Palestinian Ministry of Finance

On the other hand, with about \$237.7 million, international donations increased by 12.5% of the total grants and assistance to the Palestinian Authority to support budget and development projects. The growth was a result

of the sizable assistance from Arab countries and the rise in subsidized development projects. This aid was 61.4% higher than in Q2 of 2011.

Table 3-2: Indicators of public revenue and grants — Q2 of 2012

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Total domestic revenues (net) in million dollars	580.6	536.1	545.2	514.2	559.6	496.8
As % of total revenues and grants	72.9	78.5	54.2	76.9	72.6	67.6
As % of current expenditure	79.5	68.7	76.2	70.0	82.9	63.9
As % of GDP	24.8	20.6	21.5	20.5	23.1	19.3
External revenues (grants and aid) in million dollars	216.3	147.3	459.8	154.1	211.2	237.7
As % of total revenues and grants	27.1	21.5	45.8	23.1	27.4	32.4
As % of current expenditure	29.6	18.9	64.3	21	31.3	30.6
As % of GDP	9.3	5.7	18.2	6.1	8.7	9.3
GDP (million dollars)*	2,337.6	2,601.8	2,530.9	2,511.8	2,421.8	2567.9

Source: Table (3-1)

Data source: PCBS

¹⁷ Per accrual basis, tax income in Q2 of 2012 totaled 121.4 million shekels: a decline of 58.4% from the previous quarter. At the same time, customs revenue fell from about NIS 60.4 million during the first quarter to NIS 28.1 million in Q2 of 2012. Property tax revenue also declined from about NIS 7.3 million to approximately NIS 1.1 million during the same period.

On the other hand, most of international aid (86%) was allocated to support the budget. These grants increased by 3.8% from Q1 2012 and by 67.6% from the corresponding quarter 2011. The aid was a contribution from the Palestinian European mechanism PEGASE

(\$42 million), the World Bank (\$81.4 million), Algeria (about \$69.4 million) and France (\$11.8 million). The developmental support in Q2 2012 totaled \$33.2 million (14% of the total grants and assistance) (see Table 3-3).

Table 3-3: Grants and foreign aid to the Palestinian Authority– Q2 of 2012 (million dollars)

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Budget support	191.1	122.0	362.9	132.6	197.0	204.5
Grants from Arab countries	52.9	26.0	207.3	0.0	30.1	69.4
International aid	138.1	96.1	155.6	132.6	166.9	135.1
Developmental financing	25.1	25.2	96.9	21.4	14.3	33.2
Total external financing	216.2	147.3	459.8	154.1	211.3	237.7

Source: Table 7 - Table of external support

Obviously, the share of foreign aid in the total revenues and grants has been declining steadily (from 61% in Q1 2008 to about 32% in Q2 2012). In parallel, the share of local taxes has increased from 39% to 68% during the same period, signaling that the PNA has started to depend on its local resources to finance public spending and reduce dependence on external aid.

3.2 Analyzing items of public expenditure

During Q2 2012, public expenditure (current and development) stood at \$ 828.3 million (32.3% of GDP), swelling by 15.4% from the previous quarter due to an increase in current

expenditure, particularly non-wage payments. The rise was occasioned by an increase in transfer and operational expenses, such that expenditure on departments inflated and transfers to retirees and social services increased.

The PNA's current expenditure in Q2 2012 totaled \$ 777.5 million, a 15% increase over Q1, particularly spurred by an increase in spending on transfer and operational expenses, as well as on wages. With 54%, wages and salaries accounted for the largest share of current expenditures. The wage bill grew by 4.3% from the previous quarter as a result of new employments.

Table 3-4: Indicators of public expenditure- Q2, 2012

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Current expenditure (million dollars)	730.4	780.0	715.5	734.8	675.3	777.5
As % of total public expenditure	92.0	87.7	93.6	90.8	94.1	93.9
As % of GDP	31.2	30.0	28.3	29.3	27.9	30.3
Development expenses (million dollars)	63.2	109.4	49.1	74.4	42.4	50.8
As % of total public expenditure	8.0	12.3	6.4	9.2	5.9	6.1
As % of GDP	2.7	4.2	1.9	3.0	1.8	2.0

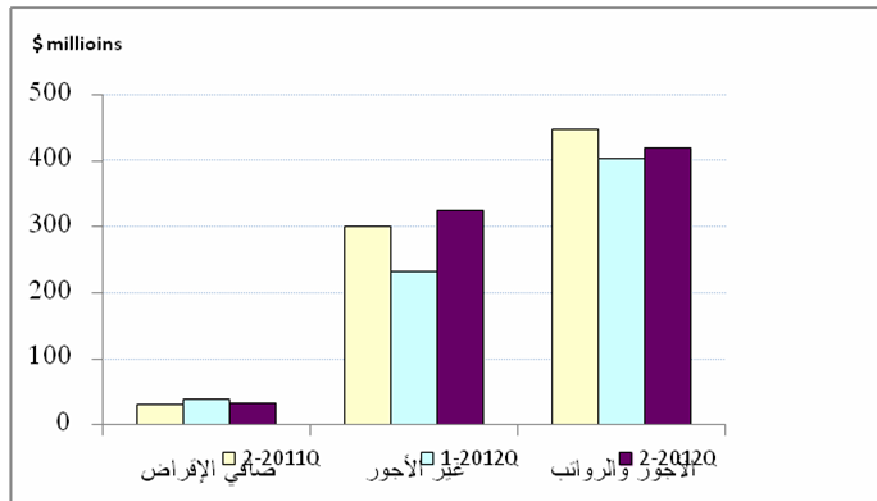
Source: Table 3-1

The monetary value of the wage bill (actually paid) in Q2 of 2012 was \$ 420 million, \$38 million below the amount due, and this deficit was, to a large degree, identical to that observed in the previous quarter. This

underpayment is a result of the financial crunch and poor liquidity available to the treasury¹⁸.

¹⁸ The actual wage bill cash deficit was \$ 26.6 million in average for each quarter of 2011.

Figure 3-2: Structure of current expenditure



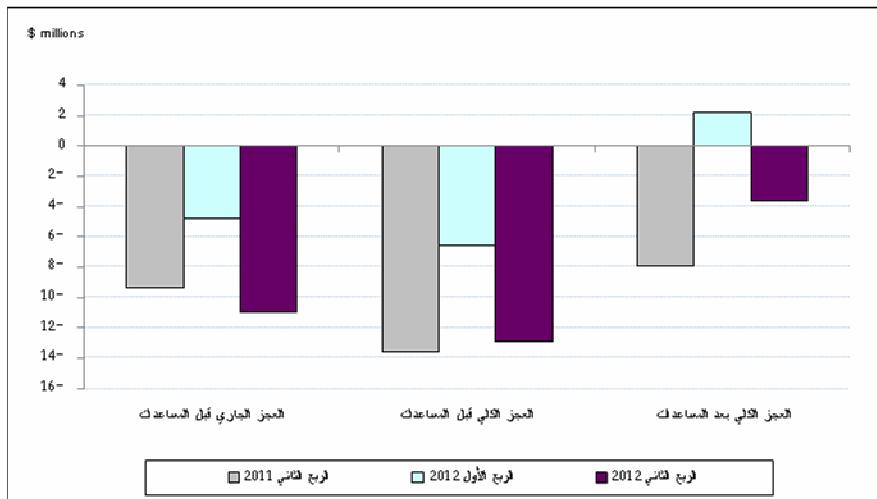
Source: Data published in the financial reports of the Palestinian Ministry of Finance

3.3 Financial Surplus / Deficit

The rise in current expenditures and the decline in the total domestic revenues (net) led to an increase in the current deficit during this quarter to \$ 280.7 million, compared with \$ 115.7 million in the previous quarter and \$ 244 million in the corresponding quarter of the previous year. This deficit represented about 11% of GDP compared with 4.8% in Q1 of 2012.

Spending on net lending in Q2 of 2012 totaled \$32.9 million, down by 16.4% from the previous quarter. The share of net lending of current expenditure has seen a steady declining trend since 2008 (from 13% to 5%). Developmental expenses also rose to \$50.8 million compared with \$42.4 million during the previous quarter, though grants and foreign aid allocated to developmental expenditure were only \$ 33.2 million.

Figure 3-3: Indicators of the fiscal deficit as % of nominal GDP



Source: Table 3-1

The total deficit (current and developmental) before grants and aid was about \$ 331.5 million (13% of GDP compared with 6.5% in the previous quarter). On the other hand, the budget balance (after grants and aid) posted a

deficit of about 93.8 million in the second quarter 2012, compared with a surplus of \$ 53.1 million in Q1 and a deficit of 206.1 million dollars in Q2 of 2011.

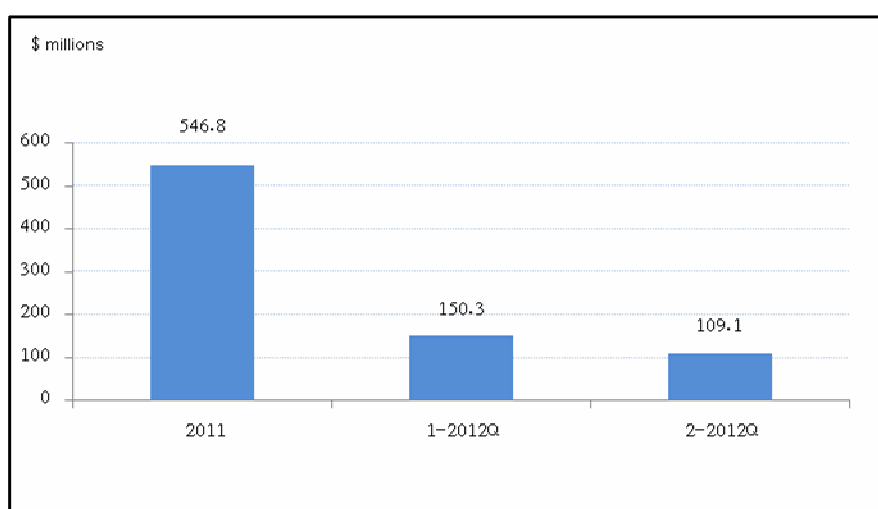
3.4 Net accumulation of arrears and the surplus / deficit: cash basis vs. accrual basis

The PNA's net accumulation of arrears in Q2 2012 totaled \$131.4 million¹⁹. This item involved the PNA's liabilities as tax returns (\$21 million)²⁰. Arrears to the private sector stood at 62.7 million dollars, while arrears of wages and salaries were \$38 million, and amounts owed as developmental expenses totaled \$9.7 million. On the other hand, liabilities owed to the PNA totaled \$22.3 million, cutting the net accumulation of

arrears to \$109 million during Q2 2012. Adding the net accumulation of arrears (\$109 million) to the current deficit on a cash basis (\$281 million), the balance of the current deficit in accordance with the accrual basis becomes \$390 million.

The accumulation of arrears suggests that without international aid, the PNA will endure further pressures in bridging the funding gap. This will eventually curtail the PNA's ability to reduce its public debt or obtain other sources of funding due to the high risks and costs.

Figure 3-4: Quarterly developments in the net accumulation of arrears²¹



Source: Data published in the annual reports of the Palestinian Ministry of Finance

3.5 Clearing Revenue

Table 3-5 outlines quarterly developments in the clearance revenues according to the accrual basis. The table indicates that the revenues in Q2 2012 were nearly \$ 369.7 million, up by 3.5% from the previous quarter and by a scant 1.2% from the corresponding quarter. It is worth noting that Israel's cash transfers of clearing dues were \$ 16 million below amounts pledged. Regarding clearance components, we can see that the main item behind the increase in clearing revenues is the VAT which was responsible for an increase of 6.6%.

The three major components in the clearance revenues (VAT, customs and fuel) have equal shares (almost one third each). Clearance revenues in Q2 2012 contributed 74.2% to the total domestic revenues (on accrual basis), up from 63.8% in Q1 2012. Incorporating foreign aid into the budget, the share of clearance revenues drops 50.2% in Q2 and 46.3% in Q1. The Table also reveals that clearance revenues represented 14.4% of GDP during the second quarter 2012.

¹⁹ Net accumulation of arrears = liabilities due for the PNA minus arrears owed by the PNA. This represents the liquidity status of the PNA, whereby a lower value indicates improved liquidity status and vice versa.

²⁰ PNA's Treasury failure to pay the tax returns started as early as the beginning of 2011.

²¹ The reason why the estimates of this item differ from the figures of the previous quarters is that the Ministry of Finance has fully updated the data of the previous quarters.

Table 3-5: Clearance revenues* (\$ millions)

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Clearing revenue	329.6	365.4	379.0	351.3	357.2	369.7
Customs	115.9	130.0	132.6	126.2	123.8	124.0
Value added	104.1	118.0	119.2	112.0	119.6	127.5
Fuel	109.9	115.6	119.2	112.7	112.0	117.8
Purchase tax	0	0	0	0	0	0.0
Income tax	0.6	0	7.0	0.5	0.6	0.8
Other	-0.8	1.8	1.1	-0.1	1.2	-0.5
Clearance revenues as % of net domestic revenues	56.8	68.2	69.5	68.3	63.8	74.4
Clearance revenues as % of total public revenues and grants (net)	41.4	53.5	37.7	52.6	46.3	50.2
Clearance revenues as % of GDP*	14.1	14.0	15.0	14.0	14.8	14.4

Source: Tables of financial operations, details of revenue, expenditure and funding sources (accrual basis), Ministry of Finance.

* Accrual basis is used as the data in the tables are the only data that contains all components of clearing.

3.6 Public Debt

Public debt in the oPt saw a remarkable increase in Q2 of 2012, rising by 5% from the previous quarter, bringing the figure up to \$2.3 billion. External debt represented 48%, while domestic debt constituted 52% of total public debt. Arab financial institutions claimed 56% of external debt, international and regional institutions accounted for 30%, while the

bilateral loans represented 14%. On the other hand, about 14.5% of the total domestic debt owed to the banking system was in the form of liabilities owed by the Petroleum Authority (see Table 3-6). The public debt service totaled \$4.9 million compared to \$4.3 million in the previous quarter.

Table 3-6: Public Debt - Q2 2012

Item	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
a. Domestic debt	907.3	1,123.7	827.7	1,098.5	1,101.7	1,213.4
Bank loans	402.6	433.4	376.9	506.1	481.4	546.1
short term	0	0	167.0	168.5	162.8	320.2
long term	0	0	209.9	337.6	318.6	225.9
Bank facilities	362.2	529.9	302.7	441.0	448.0	482.6
short term	0	0	302.7	441.0	448.0	482.6
Petroleum Authority loans	133.2	150.8	139.3	142.8	164.1	176.4
short term	0	0	139.3	142.8	164.1	176.4
Other public institutions' loans	9.2	9.6	8.7	8.6	8.2	8.3
short term	0	0	8.7	8.6	8.2	8.3
b. External debt	1,045.6	1,046.9	1,116.2	1,114.3	1,126.7	1,126.0
Arab financial institutions	539.2	539.8	617.3	617.2	630.7	629.1
Al-Aqsa Fund	444.1	444.1	522.7	522.4	522.4	522.5
Arab Fund for Economic and Social Development	42.1	42.2	42.4	43.3	56.3	56.4
Islamic Development Bank	53.0	53.5	52.2	51.5	52.0	50.2
International and regional institutions	346.6	346.2	342.4	341.9	338.1	341.2
World Bank	301.0	300.0	298.0	297.0	295.0	293.5
European Investment Bank	23.4	23.9	22.1	22.6	20.7	25.3
International Fund for Agricultural Development	3.5	3.5	3.4	3.3	3.3	3.2
OPEC	18.7	18.8	18.9	19.0	19.1	19.2
Bilateral loans	159.8	160.9	156.5	155.2	157.9	155.7
Total public debt	1,952.9	2,170.6	1,943.9	2,212.8	2,228.4	2,339.4

Source: Data published in the annual reports of the Palestinian Ministry of Finance

Textbox 4: Preliminary agreement to amend clearing arrangements in the Paris Protocol

Since concluding the Paris Protocol in 1994 between Israel and the PLO, the Palestinian side has often complained of detriments inflicted as a result of fiscal leakage, a situation in which money exits the Palestinian economy in the form of tariffs on imports, indirect taxes or purchase tax. Such amounts are collected by Israel, yet the PNA cannot recover them. The Palestinian National Authority has frequently asked the Israeli side to put this issue on the table through the Joint Economic Committee, but to no avail²². However, in late June 2012, an important breakthrough occurred when the Palestinian Prime Minister and the Palestinian Finance Minister held a meeting with the Israeli Finance Minister. Both sides agreed on a number of procedures that can reduce the fiscal leakage.

Clearing revenues totaled about \$1.5 billion in 2011, rising by 20% from the previous year. These revenues constituted about 65-70% of the total budgetary domestic revenues. These figures demonstrate how critical clearing revenues are in the public budget, and the Palestinian economy in general.

Value and forms of fiscal leakage²³

The Palestinian side incurs significant financial losses since it does not recover all indirect taxes paid by Palestinians in the West Bank and Gaza Strip on goods they consume. For example, the PNA does not recover the purchase tax that is paid on goods purchased from Israel (except for fuel). Similarly, the PNA does not receive customs paid on foreign goods imported first to Israel and then re-exported to the West Bank and the Gaza Strip; let alone the loss of various taxes levied on direct purchases from Israel, which are not, of course, documented properly.

The set of value added taxes and other indirect taxes imposed on Palestinian purchases from Israel only makes things worse. Palestinian businesses and petty middlemen do often not provide the Palestinian Ministry of Finance with the necessary invoices or import documents. Further, it is now not unusual that some Palestinian businesses engage in indirect imports via Israeli intermediaries to avoid shipment clearing delays or other complications imposed by Israeli customs officers. Often, these imports are reportedly destined to Israel rather than the pPt. This way, customs, VAT and purchase tax, which are all borne by the Palestinian consumer, go to the Israeli government.

Another factor that drives Palestinian importers to either underreport the value of their imports or engage in indirect import activities is the desire to reduce their income tax paid to the PNA. Such illegal acts have evidently doubled the adverse effects on the PNA's tax revenue collection.

Several Palestinian and international research centers conducted theoretical studies to detect the drawbacks of the clearing mechanism provided for in the Paris Protocol. There are also many reports that provided estimates of the volume of financial leakage of indirect taxes paid by Palestinian consumers and withheld by Israel. In an EU study, Dumas (1999) concluded that the lost revenue amounted to 90-140 million dollars in 1997 (equivalent to between 2.6% and 4.2% of GDP)²⁴. According to the World Bank (2002), annual tax revenue losses on indirect imports amount to \$ 133 million, or 3.2 percent of GDP²⁵. Both of these studies, however, failed to notice the losses on direct purchases (without bills) by consumers and merchants in the West Bank and Gaza Strip.

New/proposed amendments to the clearing mechanism

It is no secret that the severe financial crisis of the PNA has driven the PNA to seek mechanisms that might reduce the financial leakage. According to the IMF's report, an increase of clearance transfers by 5% would decrease the Palestinian budget deficit in 2012 by \$75 million. The report pointed out that the Palestinian and Israeli technical committees had, in 2011, reached an agreement that would fill the gaps in the process of calculating clearance transfers. This agreement was referred to the Israeli government for approval, but the government has not yet responded. To pressure the PNA, Israel replied that its approval is linked to a return to the negotiation table²⁶.

The agreement that was concluded by the Palestinian Finance Minister Nabeel Kassis and the Finance Minister of Israel Yuval Steinitz in the presence of the Palestinian Prime Minister Salam Fayyad has never been disclosed, and the full text of the agreement has not been released. All that is available, is a press

²² The Joint Economic Committee was established to follow up the implementation of the Paris Protocol. Ever since the outbreak of the second intifada, JEC suspended its meetings, holding only one meeting in September 2009. Palestinian demands in that meeting focused on increasing Lists A1 and A2 quotas, but without achieving significant results.

²³ For further information on the "fiscal leakage", see *Economic and Social Monitor*, Volume 25.

²⁴ Dumas, J (1999). Fiscal Leakage in the West Bank and Gaza Strip. MEDA Program of the EU.

²⁵ World Bank (2002). Long Term Policy Options for the Palestinian Economy. West Bank and Gaza Office.

²⁶ IMF (March, 2012): Recent Experience and Prospects of the Economy of the West Bank and Gaza. Staff report prepared for the meeting of the Ad Hoc Liaison Committee.

release given by the Finance Minister of Israel and a brief news report by the Palestinian government spokesman.

The Israeli press release states that the objective of the arrangements is to introduce mechanisms that better facilitate the movement of goods between Israel and the Palestinian Authority, and both parties' efforts are needed and given to reduce illegal trade and tax evasion.

We were able to collect some information about the terms of the agreement, particularly the following three elements:

1. Calculating customs clearing, purchase tax and VAT

As of January 2013, taxes that Israel collects on behalf of the PNA will be calculated based on the *actual* rather than the *reported* transfer of goods. This will be achieved through an increase of information sharing by tax authorities on both sides.

Specifically, Palestinian officials from The Ministry of Finance will be granted access to a computerized database in order to identify Palestinian traders, who clear their imports via Israeli trading companies. In addition, other measures will also be taken to curb smuggling and tax evasion on transferring goods to the Palestinian Territory, including technology utilization, such as electronic tagging and sealing containers, destined to the Palestinian market, with electronic locks.

2. Palestinian bonded areas

Palestinians face many difficulties when their customs are cleared in the Israeli bonded areas. They have to endure rough treatment, high costs and deliberate delays. The new agreement allows the PNA to establish Palestinian bonded areas at crossings between Israel and the West Bank. This might facilitate imports from abroad and reduce costs and, thus, prices.

3. Laying a fuel pipeline

The two sides agreed to establish a fuel pipeline from Israel straight to the area administrated by the PNA. This is to stop the current practice of using trucks to transport fuel into the oPt. In addition to its environmental benefits, pipelining would reduce costs of trucking and storage and, thus, import costs. Karim Nashashibi, a former IMF economist and economic adviser to Salam Fayyad, says a conservative estimate of the tax leakage put the losses at about \$200 m. Another estimate, by the Palestinian Economic Council for Development and Reconstruction (PECDAR), says the annual shortfall could be up to \$450m²⁷.

On September 27, MAS held a round table meeting to discuss the recent amendments to the trade arrangements in the Paris Protocol. One of the keynote speakers was Mr. Yousef Zomar, Chairman of the Board of Tax Revenue in the Palestinian Ministry of Finance. Mr. Zomar remarked that, contrary to the Israeli statement, the alleged amendments are merely letters of understanding exchanged between the Israeli and Palestinian sides rather than an actual agreement. Things still need considerable debate and tough negotiations, he said.

Textbox 5: PEGASE: From a Temporary Program to a Permanent Mechanism?

This textbox aims to introduce the mechanism of PEGASE and examine the programs through which European aid is channeled to the Palestinian territories. PEGASE (a French acronym for *Mécanisme Palestino-Européen de Gestion de l'Aide Socio-Economique*: the Palestinian-European mechanism to manage social and economic assistance) was established by the European Union in 2008 as a three-year program, but it has continued working till the present.

PEGASE emerged as a contemporary mechanism that allows the European Union to continue to provide financial and technical assistance to the Palestinian territory without having to engage with

the Hamas government in Gaza, which came to power in 2006. When the Hamas led government refused EU demands to recognize Israel and renounce violence, the EU suspended its aid and Israel stopped transferring clearing revenues. PEGASE, thus, was set up as an alternative financing mechanism that continues to provide support to the Palestinian territory while bypassing the elected Hamas government.

²⁷ <http://www.ft.com/cms/s/0/95f77d30-6df6-11e1-baa5-00144feab49a.html#axzz26zP>.

According to a press statement issued by the European Commission in January 2008, PEGASE's aim is to "help contribute to the successful recovery of the Palestinian economy and the construction of a Palestinian state based on peace and prosperity." The launch of PEGASE coincided with the "Reform and Development Plan (2008-2010)" and the "National Development Plan (2010-2013)", both developed by the PNA to build institutions that can assume responsibility in the future independent state²⁸.

PEGASE supports a wide array of activities through two broad channels²⁹:

1. Technical support and direct support for projects: This involves large-scale projects to assist the PNA in the reform of public administration. This channel also supports capacity building in the social protection sector. The technical support constitutes training, rehabilitation and development studies³⁰.

2. Direct financial support: This is provided directly through 5 well-defined programs:

- ✧ **Ensuring essential public services:** This program aims to provide fuel deliveries to the Gaza Strip in order to generate electricity. The program has contributed significantly to the supply of electricity to public services (such as hospitals and schools). The funds delivered through this program during 2008-2010 totaled 196.8 million Euros. However, spending on this program stopped in late 2010.
- ✧ **Lifeline for vulnerable families:** This program supports cash transfers supervised by the Ministry of Social Affairs to help the most vulnerable Palestinian families. PEGASE delivers aid to Palestinian families living in extreme poverty on a quarterly basis (every 3 months). Aid delivered through this program (from February 2008 to February 2011) totaled 111.3 million Euros. By the end of 2011, the number of beneficiaries totaled about 93 thousand families. Through this program, the EU provides technical assistance to the Ministry of Social Affairs to modernize and reform the cash transfer program. These reforms involved building a national database on poverty and adopting an outreach method for targeting the poor. Despite expanding the database of target groups, coverage is still limited, and focused on households that live below the extreme poverty line³¹.
- ✧ **Paying the salaries of employees and retirees:** This program contributes to paying the salaries of civil servants (i.e. employees of the ministries) on the one hand, and transfers to retirees, on the other. Between February 2008 and February 2011, 81% of civil servants (74300 people) benefited from this program. The main beneficiary groups involve medical staff and teachers who obtained 15% and 46% of the total payments. In addition, this cash injection benefited 10,250 retirees. The total funds delivered through this program (between February 2008 and February 2011) stood at about 649 million Euros.
- ✧ **Paying the salaries of police and civil defense:** Between February 2008 and February 2011, the EU paid 15.09 million Euros, through PEGASE to ensure proper delivery of civil services.
- ✧ **Eliminating government's debts to the private sector and contributing to the reconstruction of Gaza:** This program was launched in 2009 to provide financial support to businesses that were destroyed or damaged as a result of the Israeli aggression on Gaza. The goal of the program is to pay off the PNA's debts and re-stimulate trade and economic activity in the private sector. The program involves two types of initiatives:
 - ✧ Rehabilitation of the private sector: Since the start of this program until January 2011, 9.6 million Euros were disbursed to businesses affected by the war on Gaza. The assistance involved buying machines, furniture and office equipment, as well as construction materials. This fund targeted all sectors (except for the agricultural sector which was supposed to be financed by others donors). Given its success, the EU decided to use this program as a model to be applied in the agricultural sector in 2012 in Area "C" in the West Bank³².
 - ✧ Paying part of the PNA's debts to the private sector. PEGASE spent 27.63 million Euros on this item between February 2008 and January 2011.

Table 1 summarizes the value of the European aid (direct financial support) to the Palestinian territory provided via PEGASE (2008-2011). The Table shows that more than one billion Euros were transferred as direct financial assistance to the Palestinian territory during 2008-2011 (about 65% of this cash was used to pay staff salaries and pensions of retirees).

²⁸ <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/46&format=HTML&aged=0&language=EN&guiLanguage=en>

²⁹ All figures in this textbox are taken from the recently released report by the European Commission, which assesses the performance of PEGASE during the period 2008-2011. European Commission (2012). External Evaluation of PEGASE 2008-2011 For West Bank and Gaza. Retrieved from http://www.lacs.ps/documentsShow.aspx?ATT_ID=5820

³⁰ <http://www.eurojar.org/en/euomed-projects-actions/pegase-help-building-palestinian-state-promoting-good-governance-and-rule-l>

³¹ Palestine Policy Research Institute (MAS). Social Security in the Palestinian territory: The current status and challenges (exploratory study) (2012).

³² http://ec.europa.eu/europeaid/where/neighbourhood/country-cooperation/occupied_palestinian_territory/occupied-palestinian-territory_en.htm

Table 1: PEGASE direct financial support – 2008-2011
(million Euros)

Sector	Volume of aid received
Support of basic public services	196.82
Support of Palestinian vulnerable households	111.3
Salaries of employees and retirees	649.08
Salaries of Police and Civil Defense Staff	15.09
Paying the PNAs debts to the private sector & the Reconstruction of Gaza	37.23
Total	1,009.52

Source: http://www.lacs.ps/documentsShow.aspx?ATT_ID=5820

4.1 Key developments in the consolidated balance sheet for banks

Table 4-1 summarizes the key items in the consolidated balance sheet for banks operating in the Palestinian Territory.

1. Assets

The net assets of banks declined by \$105.7 million, down by 1.2% from the previous quarter, but up by 2.4% from the corresponding quarter of 2011 (a growth of \$208.2 million). Direct credit facilities grew by 5% compared to the previous quarter (standing at \$189 million. Conversely, deposits held by the Monetary Authority and banks dropped by 9.3% (335.5 million dollars) from the previous quarter. Meanwhile, the cash item saw an increase of 16.3% (standing at \$602.8 million).

In the meantime, portfolio investment declined by \$9.5 million due to a \$9.3 million drop in investment securities portfolio and a \$20,000 drop in trading securities portfolio. Conversely investment item grew by about 2% due to a \$4.3 million increase of investment in sister companies³⁴ and a \$1.6 million drop in the shares of minority stakes. Figure 4-1 displays the distribution of assets of banks at the end of Q2 2012.

³⁴ A sister company, according to the Banking Act, is a company in which a bank acquires 20% -50% of the shares or the voting power; or a company which is, along with a bank, controlled by other people who have a share or a voting power ranging from 20% to less than 50%. These people do not, however, publish financial statements.

4. The Banking Sector³³

In Q2 of 2012, assets / liabilities of banks operating in the Palestinian territory declined by 1.2% from the previous quarter and by 2.47% from the corresponding quarter of 2011. The most significant changes of Q2 were in both assets and liabilities of the consolidated balance sheet for banks as summarized below:

Assets

- ✧ A growth of 16.3% in the cash item.
- ✧ A growth of 5.2% in net direct credit facilities.
- ✧ A decline of 16% in offshore assets of banks.
- ✧ A growth of 4.1% in assets of banks held by the Palestinian Monetary Authority.
- ✧ A growth of 0.7% in assets of banks operating in the oPt.
- ✧ A growth of 1.9% in total net investment.

Liabilities

- ✧ A drop of 0.7% in total holdings.
- ✧ A decline of 1.9% in the public (customers) deposits.
- ✧ A growth of 21.4% in the PMA's assets held by banks.
- ✧ A 1.6% decline in total capital (equity) of banks.

The number of banks operating in the Palestinian territory at the end of Q2 of 2012 remained 18, while one new branch was opened, bringing the number of branches and offices to 227 (163 branches and 64 offices).

³³ The data in this section is preliminary and subject to change.

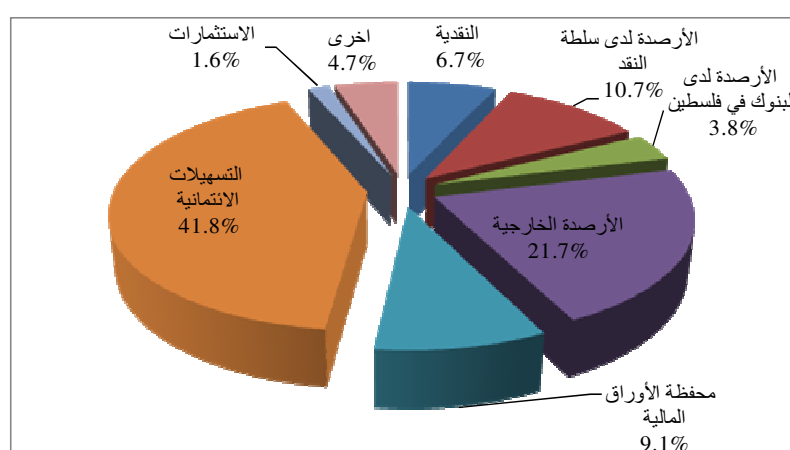
Table 4-1: Consolidated balance sheet for the Palestinian banking system – from Q2 2011 to Q2 2012 (Million dollars)

Item	2011			2012	
Budget Statement	Q2	Q3	Q4	Q1	Q2
Total assets ⁽¹⁾	8,837.2	8,860.5	9,110.3	9,151.1	9,045.4
Direct credit facilities	3,434.8	3,215.2	3,482.8	3,594.5	3,783.6
Deposits of Palestine Monetary Authority & Banks	3,502.2	3,722.2	3,743.7	3,600.3	3,264.8
- Deposits held by PMA	947.6	927.9	940.9	925.3	963.6
- Deposits held by Banks	291.8	259.3	335.3	337.9	340.4
- Banks' offshore deposits	2262.8	2535.0	2467.5	2337.0	1960.9
Portfolio	582.0	629.5	826.3	829.7	820.2
Cash and precious metals	539.6	545.4	496.7	518.5	602.8
Fixed assets	152.9	163.3	171.3	175.1	176.6
Investments	311.5	310.2	137.4	141.4	144.1
Bankers' acceptances	5.4	5.2	5.9	6.1	6.4
Other assets	308.7	269.5	246.2	285.6	246.9
Total liabilities ⁽²⁾	8,837.2	8,860.5	9,110.3	9,151.1	9,045.4
Total deposits of the public	6,950.3	6,820.5	6,972.5	7,045.4	6,911.5
Proprietorship (equity)	1,131.7	1,156.3	1,182.0	1,232.3	1,212.4
Deposits of PMA and Banks	452.8	474.8	646.5	530.5	582.0
Tax benefits & other allocations	167.1	173.8	171.1	186.7	185.6
Other liabilities	117.5	217.4	122.0	141.8	142.3
Executed and existing bankers' acceptances	17.8	17.7	16.2	14.5	11.6

Source: Palestine Monetary Authority – The consolidated balance sheet for banks.

⁽¹⁾ and ⁽²⁾ represent total assets (liabilities) minus allocations.

Figure 4-1: Structure of the assets of banks-- end of Q2 2012



Source: Palestine Monetary Authority – The consolidated balance sheet for banks

✧ Direct credit facilities

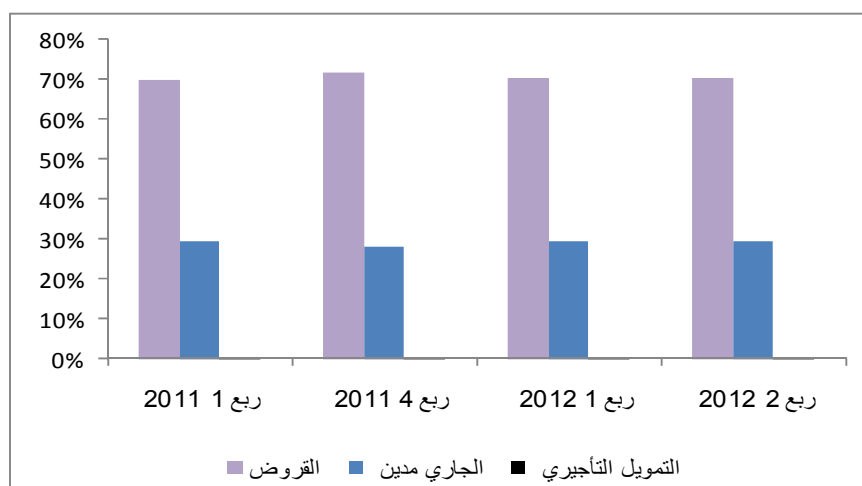
During Q2 of 2012, direct credit facilities continued their rising trend, making up 41.8% of the total assets of banks operating in the Palestinian Territory, coinciding with the PNA's persisting financial crisis. The government's share

rose by 2.5 percentage points from Q1 of 2012 (standing at \$3,783.6). Loans grew by about 70.4%, while overdraft facilities and lease financing saw a growth of 29.4% and 0.2%, respectively (see Figure 4-2).

On the other hand, the share of the Gaza Strip from direct facilities rose by 0.8 percentage points, constituting 9.7% of total net facilities;

thus, the West Bank continued enjoying 90.3% of the facilities (including facilities for the public sector and non-residents).

Figure 4-2: Relative weight of the types of credit facilities



Source: Palestine Monetary Authority – The consolidated balance sheet for banks

Table 4-3: Distribution of direct credit facilities portfolio – from Q1 2011 to Q2 2012

	2011				(million dollars)	
	Q1	Q2	Q3	Q4	Q1	Q2
By Beneficiary						
Public sector	915.7	1,118.1	856.4	1,108.9	1,121.0	1203.4
Resident private sector	2,116.8	2,256.2	2,303.8	2,318.2	2,419.0	2526.2
Non-Resident private sector	61.3	60.5	55.0	55.7	54.5	54.0
By type of facility						
Loans	2,169.7	2,316.2	2,347.1	2,496.0	2,526.1	2665.1
Overdraft	918.2	1,111.1	860.6	978.8	1,060.1	1109.9
Lease financing	6.9	7.5	7.5	8.0	8.2	8.5
By currency						
\$ US	1,873.3	2,011.5	2,009.8	2,206.7	2,209.4	2236.0
JD	320.5	454.0	419.5	404.9	427.8	538.0
NIS	879.8	948.6	764.4	851.2	935.0	985.5
Other currencies	21.2	20.7	21.5	20.0	22.8	24.1

Source: Palestinian Monetary Authority – The consolidated balance sheet of banks.

During this quarter, both the public and the private sectors retained their shares, with 31.8% and 68.2%, respectively (see Table 4-2). In terms of credit facilities currencies, data shows that the credit facilities granted in US dollars held the highest share (59%).

Table 4-3 shows that the real estate and construction sector took the lead of direct credit facilities (21.3%). The trade sector (both

internal and external) came second with a share of 21% (20%), while consumer loans represented 18.8%³⁵

³⁵ Each sector's shares also include allocations, thus the figures shown in Table 4-2 might not match the figures of net credit facilities that appear in Table 4-3.

2. Liabilities

Liabilities of banks operating in the Palestinian Territory mainly involve the total public deposits (76.4%). These involved resident deposits (74%) and non-resident deposits (2.4%). Deposits of the public at the end of Q2 2012 totaled \$ 6.911 billion, down by 1.9% from the previous quarter, and by 0.6% from the corresponding quarter of 2011. Capital came second in terms of relative importance (13.4%) in liabilities. Net equity dropped by 1.6% from the previous quarter to \$1.2124 billion as a result of an increase in dividends. Despite the decline in net equity, the paid-up capital increased by about 2.3% (totaling \$ 890 million).

Foreign liabilities include deposits of non-resident customers, deposits of banks operating outside Palestine and outstanding debts.

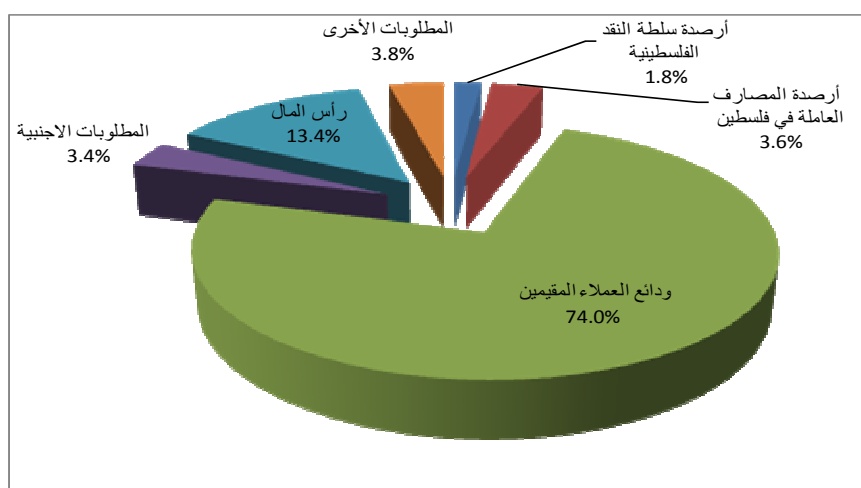
Overseas holdings of banks

With \$1,960.9 billion, overseas holdings of banks represented 21.7% of total assets of banks operating in the Palestinian territory, down by 3.8 percentage points from the previous quarter. This decline coincided with an increase of the ratio of credit facilities to the total assets of banks by about 2.8 percentage points during the same period of comparison.

Assets of banks held by PMA

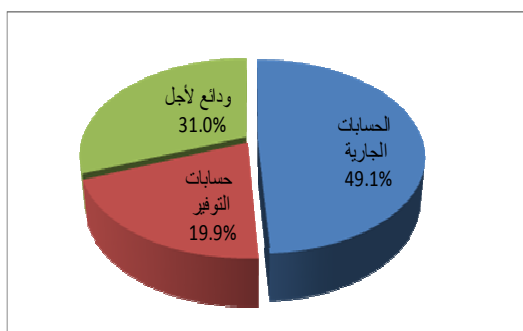
During Q2 2012, the assets of banks held by the PMA represented 10.7% of total assets of banks operating in the Palestinian Territory, totaling \$ 9963.6 million. These holdings were in the form of mandatory reserves (72.7%), current accounts (6.6%) and other accounts (20.7%).

Figure 4-3: Structure of liabilities of banks operating in the Palestinian Territory —end of Q2 2012



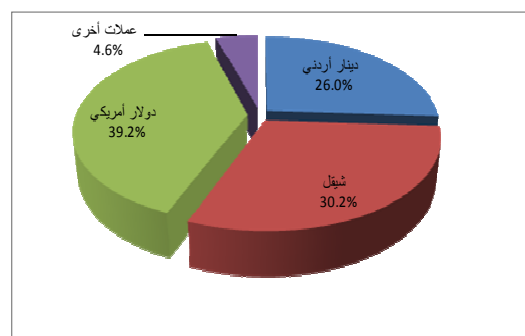
Source: Palestinian Monetary Authority - The consolidated balance sheet for banks.

Figure 4-4: Distribution of public deposits by Type of deposit- as end of Q2 2012



Source: Palestine Monetary Authority –The consolidated balance sheet for banks

Figure 4-5: Distribution of public deposits by Currency - as end of Q2 2012



Current (on-demand) deposits accounted for 49.1% of total public deposits. Time deposits represented 31%, while saving deposits made up 19.9% of the total public deposits (see Figure 4-5). By currency, with 39.2%, the U.S. dollar retained its dominance of public deposits. The Israeli shekel and the Jordanian dinar constituted 30.2% and 26%, respectively.

4.2 Performance indicators of the banking system

The consolidated balance sheet for banks operating in the Palestinian Territory reveals some improvements as well as some volatility

in the key indicators during Q2 2012. The consolidated balance sheet shows that the ratio of credit facilities to non-bank deposits continued its rising trend, to settle at 51%, up from 49.4% in the corresponding quarter of 2011. Likewise, the ratio of credit facilities (granted to the private sector) to the deposits of that sector grew to 40.5%, up from 36.2% in the corresponding quarter. By contrast, the ratio of customer deposits to total assets declined to 76.4%, down from 78.7% during the corresponding quarter 2011. Similarly, the share of overseas assets to total deposits fell to 62.2% compared to 31% in the corresponding quarter 2011.

Table 4-4: Performance indicators of the banking system – from Q1 2011 to Q2 2012

Indicator					(%)	
	2011				2012	
	Q1	Q2	Q3	Q4	Q1	Q2
Credit facilities / Non-bank deposits	44.7	49.4	47.1	50.0	51.0	54.7
Credit facilities of the private sector / private sector deposits	34.9	36.2	37.5	37.3	38.3	40.5
Overseas holdings / total deposits	33.9	31.0	34.8	32.4	33.2	26.2
Customer deposits / total assets	79.4	78.7	77.0	76.5	77.0	76.4

Source: Palestine Monetary Authority – The consolidated balance sheet for banks

✧ Profits of banks operating in the oPt

The net revenues of banks operating in the oPt during Q2 2012 totaled about \$23.3 million, down by \$8.5 million from Q2 2011. The cumulative bank profits in quarters 1 and 2 in 2012 totaled \$61.4 million.

show that in the second quarter 2012, about 1 billion checks (200.604 million dollars) were presented for clearing, down by 2.8% in the number of checks and by 9% in the value of checks compared with the previous quarter. During the comparison period, the number and value of returned checks declined (see Table 4-5), echoing the effective application of the automated system of returned checks, which reduces returned checks through customer rating.

4.3 Clearing Houses Activity

Data from the Palestine Monetary Authority clearing houses in both Ramallah and Gaza

Table 4-5: Number and value of checks presented for clearing & number and value of checks returned from Q1 2011 to Q2 2012

Quarter	Checks presented for clearing		Returned checks		Returned / presented for clearing	
	No. (checks)	Value (\$ millions)	No. (checks)	No. (checks)	Value (\$ millions)	No. (checks)
Q1 2011	981,188	2,882.7	106,141	167.2	10.8	5.8
Q2 2011	1,001,249	3,059.2	115,883	175.6	11.6	5.7
Q3 2011	1,010,402	3,055.7	134,574	213.2	13.3	7.0
Q4 2011	1,055,827	2,870.8	131,518	202.1	12.5	7.0
Q1 2012	1,009,857	2,604.4	119,019	180.3	11.8	6.9
Q2 2012	1,038,177	2,370.1	111,283	161.6	10.7	6.8

Source: PMA, Monthly Statistical Bulletin

4.4 Palestine Stock Exchange

The *Economic and Social Monitor* studies three groups of financial indicators of the Palestine Stock Exchange and its developments:

❖ Indicators of the financial market

Market capitalization³⁶: The share of market capitalization on the Palestine Stock Exchange in 2011 was 32% compared to 29% in 2010.

Number of listed companies: The number of companies listed on the Palestine Stock Exchange at the end of Q2 of 2012 was 47: 9 companies working in banking and financial services (one company added in this quarter); 11 manufacturing companies; 7 insurance companies; 8 investment companies; and 12 firms working in the service sector.

❖ Liquidity Indicators

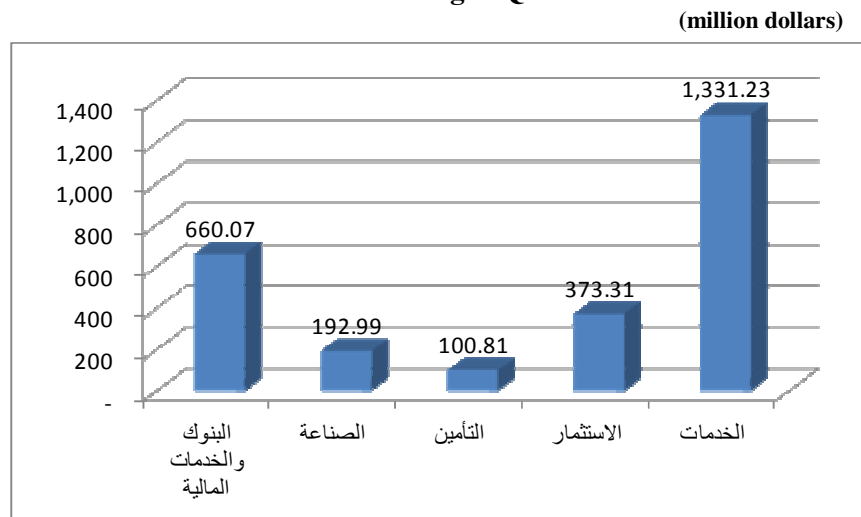
Ratio of traded shares to GDP: In Q2 of 2012, this ratio was 4.3% compared to 6.1% during the previous quarter.

Turnover³⁷: In Q2 of 2012, this indicator declined to 2.8%, down from 3.4% in the previous quarter. By sector, the turnover of the investment sector was 4.7%; the banking and financial service sector stood at 4.3%; the investment sector at 2.9%; the service sector at 2.1%; and the industry sector at 1.2%.

Degree of Concentration³⁸: The five largest companies on the Palestine Stock Exchange held 80% of the total value of shares traded in Q2 of 2012. These companies are: Palestinian Telecommunications Group (34%); Bank of Palestine (21%); Palestine Development and Investment (12%); Palestine Islamic Bank (7%); and Palestine Housing Finance Corporation (6%).

The market value of shares of companies listed on the Palestine Stock Exchange at the end of Q2 of 2012 totaled \$2.7 billion, down by 6% from the previous quarter. By sector, the service sector accounted for the largest share of the total market value (50%). The banking and financial services sector came second with 25% of total value (see Figure 4-6).

Figure 4-6: Value of shares listed on Palestine Stock Exchange - Q1 2012



Source: Palestine Stock Exchange www.pse.com

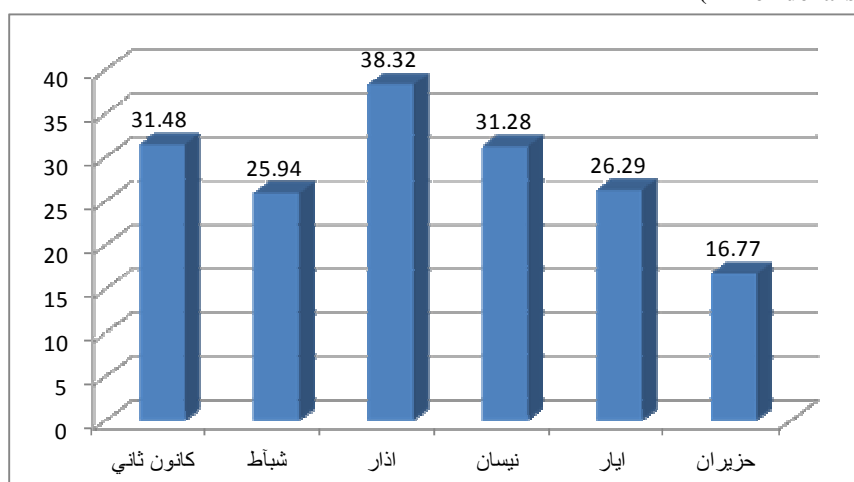
³⁶ This indicator is used to measure the importance and role of the financial market in an economy. It is calculated by dividing the market value of shares listed on the market to GDP at current prices. This indicator is calculated for the entire year rather than quarters.

³⁷ This indicator calculates the volume or value of shares traded on a stock exchange during a day, month or year.

³⁸ This indicator is used to measure the influence of some large companies on changes in stock market indices, especially the stock prices. The influence is measured by calculating the contribution of the top five or ten companies to the value of shares traded on the stock market.

Figure 4-7: Value of shares traded on Palestine Stock Exchange – first and second quarters of 2012

(million dollars)



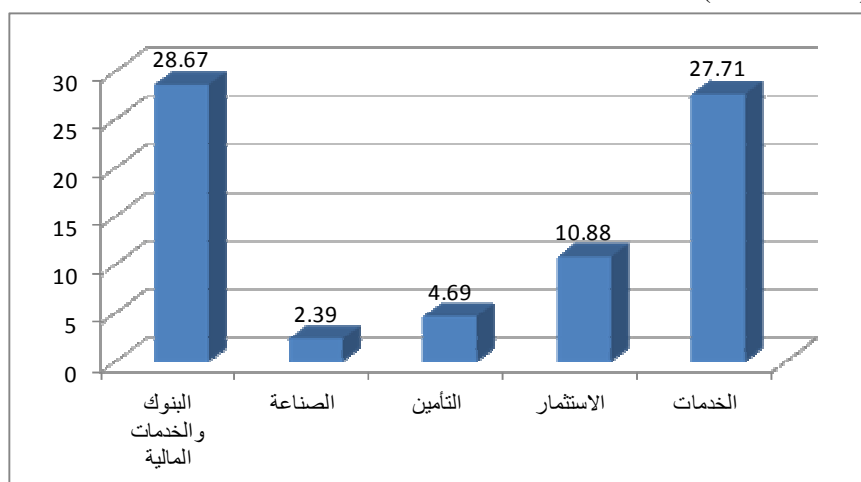
Source: Palestine Stock Exchange www.pse.com

The number of shares traded on the Palestine Stock Exchange in Q2 of 2012 totaled about 40.14 million, down by 15% from the previous quarter. At the same time, the value of shares traded stood at \$74.34 million, down by 22% from the previous quarter (see Figure 4-7).

Regarding the value of shares traded by sector, the banking and financial services sector retained its leading position with 39% of total value of shares traded, while the service sector held 37% of total value of this item (see Figure 4-8).

Figure 4-8: Value of shares traded on PSE by Sector – Q1 2012

(million dollars)



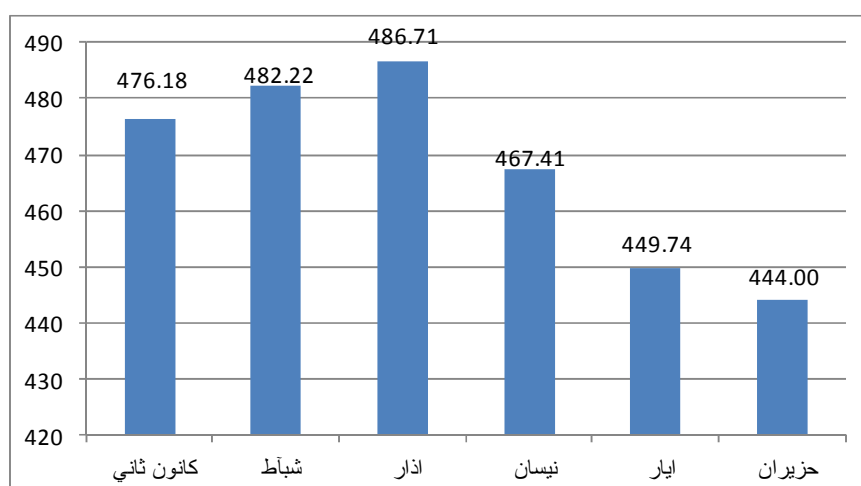
Source: Palestine Stock Exchange www.pse.com

Al-Quds Index

At the end of Q2 2012, Al Quds Index closed at 444.00 points, down by 42.71 points from the previous quarter (see Figure 4-9). The decline was an offshoot of the drop in indices and exchange values which was triggered by a

deterioration in the economic and political situation in the Palestinian Territory, in addition to the PNA's financial crisis, eventually leading to the refrain of business investment in the Palestinian Territory.

Figure 4-9: Al-Quds Index - Qs 1 and 2 2012



Source: Palestine Stock Exchange www.pse.com

Textbox 6: Consequences of the disappearance of the 10 agora unit from the Palestinian market

What are the consequences of the disappearance of the 10 agora unit from the Palestinian market? Does this disappearance impact cash prices? Does this absence affect different groups of people evenly?

These questions are particularly important given the current circumstances in the Palestinian territory which were reflected in the protests against high prices and low standards of living. This textbox tries to answer these questions.

The tenagora is the smallest unit of the Israeli currency, representing 1/10 of the Israeli shekel. Back in 2008, the Bank of Israel recalled the five agora unit (though it remained in circulation until 2011). According to the Bank of Israel, recalling the 5 agora came as a result of a questionnaire conducted by the Bank. 80% of respondents supported recalling this unit from the market. In addition, the costs of coining this unit (16 agora) was well beyond its market value³⁹.

The ten agora unit is the most circulated unit in Israel: the number of coins of this unit constitutes more than half of the entire number of other coins traded. The ten agora is mainly used in public transport⁴⁰. This unit had disappeared from the Palestinian market around 15 years ago. Since then, the smallest category of cash available for trading is the 50agora unit.

Small currency units are important for ensuring fair pricing of goods and services. The smaller the unit, the more accurate the price. However, the cost of minting might exceed the value of the unit; thus the central bank must strike a balance between the impact of the availability of small units on the effectiveness of pricing, on the one hand, and the cost of minting, on the other.

The Palestine Monetary Authority does not, of course, bear the cost of coining the 10agora. However, it still bears the costs of transporting large quantities of this unit from the Bank of Israel to the Palestinian territory, as well as the cost of returning them if they are superfluous or when they need to be substituted. Transportation costs may be relatively high with such a small unit. On the other hand, the Bank of Israel, which bears the cost of minting, receives seigniorage, which the PMA does not receive. However, given the little value of this unit, the Palestinian economy does not lose that much. Besides, the loss of seigniorage in the oPt is a feature of all units and of all traded currencies.

³⁹ <http://www.bankisrael.gov.il/press/eng/070716/070716e.htm>

⁴⁰ <http://www.boi.org.il/he/Currency/DocLib/skira10e.pdf>

The absence of small units often triggers an increase in prices. For example, if the cost of producing a commodity is 2.70 shekels and if a merchant chooses a margin profit of 50 agora, then the price of this commodity becomes 3.20 shekels. However, this price is not possible for the absence of the ten agora. In this case, the price is rounded up to 3.50 shekels (where the 50 agora is the smallest unit available). This represents a 9% increase in the price. In case that this commodity is essential (e.g. needed by the consumer thirty times a month), the availability of the 10 agora can save 9 shekels a month (which is not meager for poor households). On the other hand, small units could allow stronger competition, such that a retailer might be willing to lose 20 or 30 agora of profit for the benefit of the consumer, but unwilling to lose half a shekel.

During the last thirty years, several countries (such as France, Britain and Australia) disposed of their smallest units of currency. However, the value of these units was less than half a U.S. penny⁴¹. In the United States, the penny coin, which represents 1/100 of the U.S. dollar (less than 5 agora), is still in circulation.

Many studies in the United States were conducted to examine the impact of removing the penny from circulation. One of these studies found that such a move would result in a loss of hundreds of millions of dollars⁴². Another study, conducted in Pennsylvania, concluded that, due to the low value of their purchases in every visit to the supermarket (\$ 5 or less), low-income earners will be the most affected when prices are rounded up in case of removing the penny from circulation⁴³.

Studies are also available on the implications on the European markets when prices were rounded up to the nearest unit of the Euro in 2002⁴⁴. The European Commission's Department of Statistical Services found that rounding up led to a rise in prices in general, and that the increase in prices was higher in the service sector and in the basket of cheap goods that are purchased frequently⁴⁵.

It should be noted that the cost of minting one US nickel (a five-cent coin) was 7 cents in 2006. Still, its positive impact on pricing justifies its circulation⁴⁶.

It is very bizarre that Israel, which has a per capita income of NIS 107 thousand, still uses the ten agora coin while this unit is not available in the Palestinian territory where the per capita income is barely 8 thousand shekels.

The disappearance of the 10 agora in the Palestinian territory was not the result of a deliberate decision of removing it from circulation. Now, however, it seems that there is a need for justifications that allow its recirculation.

Undoubtedly, the Palestinian consumer, to some degree, is negatively affected by the absence of small units as prices are usually rounded up rather than down. Even if the price is, for example, 220 agora, it is rounded up to 250 agora rather than rounding it down to 200 agora.

The relatively strong influence on the Palestinian consumer is attributed to two reasons:

First, the bulk of the cash expenditure of the Palestinian consumer goes to food (34% in the West Bank and 40% in Gaza) and transport (12%). These expenses are frequent and they involve small payments.

Second, the purchases of the poor households are more frequent and they involve smaller accounts compared to the purchases of rich households. These two factors lead to raising the cost of rounding up for citizens in general and the poorer echelons of society in particular.

Reintroducing the 10-agora unit in the Palestinian market requires a meticulous examination of the economic feasibility. This entails drawing a comparison between the cost of reintroducing this unit, on the one hand, and the benefit of reducing prices and improving the pricing process, on the other. Given the present analysis and evidence, it turns out that the benefits can substantially outweigh the detriments.

⁴¹ Based on a study by Raymond Ombra http://college.holycross.edu/eej/Volume27/V27N4P433_442.pdf regarding the removing of the penny from U.S. currency system, the value of the units in the examples were equal to half a U.S. penny.

⁴² http://college.holycross.edu/eej/Volume27/V27N4P433_442.pdf

⁴³ http://college.holycross.edu/RePEc/eej/Archive/Volume33/V33N1P147_152.pdf

⁴⁴ It is important to note that the impact of removing a small unit from circulation, and the associated process of rounding up prices, can affect prices only once without having a permanent impact. It does not affect the rate of inflation. This is probably the reason why economists do not pay much attention to it.

⁴⁵ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2003:036:0002:0017:EN:PDF>

⁴⁶ http://college.holycross.edu/RePEc/eej/Archive/Volume33/V33N1P147_152.pdf

5. Investment Indicators

5.1 Company Registration

The Ministry of National Economy registers companies in the occupied Palestinian territory under two different laws in effect in the West Bank and the Gaza Strip⁴⁷. This volume of the *Monitor* reviews the new companies registered in Q2 of 2012 in the West Bank only, because the Ministry of

Economy in Ramallah does not have any data on the registration of companies in the Gaza Strip. The number of registered companies in the West Bank in this quarter was 278, down by 13% from the previous quarter, and down by 25% from the corresponding quarter of the previous year (see Table 5-1).

Table 5-1: Development of the number of new companies registered in the West Bank during the years 2008-2012

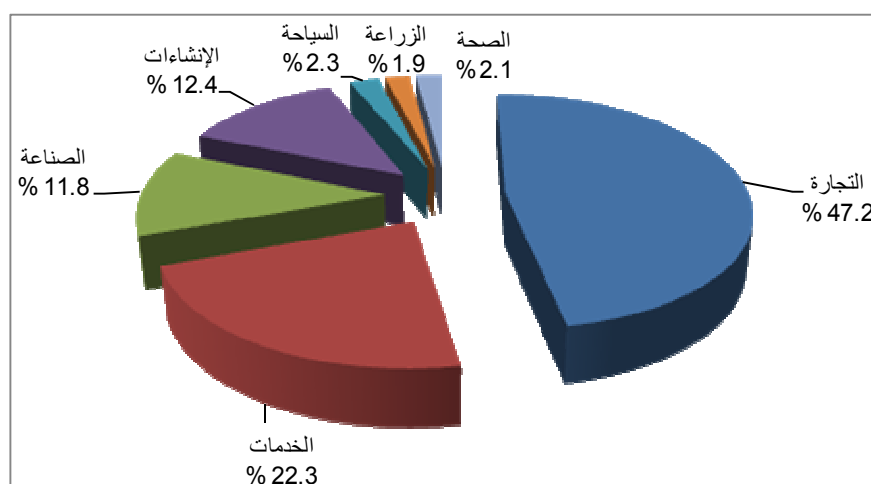
Quarter	2008	2009	2010	2011	2012
1	247	454	334	389	319
2	334	412	428	373	278
3	315	349	164	287	
4	287	438	290	337	
Total	1,183	1,653	1,216	1,386	

Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2012.

The capital of newly-registered companies in the West Bank in Q2 of 2012 totaled 37.3 million Jordanian dinars⁴⁸, down by 57% from the previous quarter⁴⁹. With respect to the distribution of the capital by sector, data available shows that with a share of 47% (JD 17.6 million), the trade sector was the largest

contributor of the capital of newly-registered companies. The services sector ranked second with a share of 22% (JD 8.3 million). The construction sector and the industry sector came third and fourth, with 12.4% and 11.8% (4.6 and 4.4 million dinars), respectively (see Figure 5-1).

Figure 5-1: Percentage distribution of the capital of new companies registered in the West Bank- by Economic Activity, Q2 2012



Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2012.

⁴⁷ Jordanian Companies Law No. (12) of 1964 is applied in the West Bank, while the Companies Law No. (18) of 1929 is applied in the Gaza Strip.

⁴⁸ In 2011, companies were registered in three currencies: the Jordanian dinar, the U.S. dollar and the euro. The following exchange rate are used: US dollar/JD 0.70644, Euro/JD 0.90759)

⁴⁹ The significant rise in the value of capital in this quarter relative to the previous quarter is attributed to the registering of a new company with a capital of \$ 30 million (JD 21.2 million): Reach for Investment and Development (Reach Holding) in the first quarter of 2012

Concerning the legal form of companies registered in Q2 of 2012, data indicates that 120 companies took the form of public ordinary companies, 153 were private joint stock companies, and 5 foreign joint private stock companies. Each of the public ordinary

companies and the joint private stock companies acquired 47% of the total capital of the newly-registered companies, while foreign joint private stock companies acquired only 6% (see Table 5-2).

Table 5-2: Distribution of the value of capital of companies registered in the West Bank- by Legal Form: 2011 and Qs 1 & 2 2012
(JD millions)

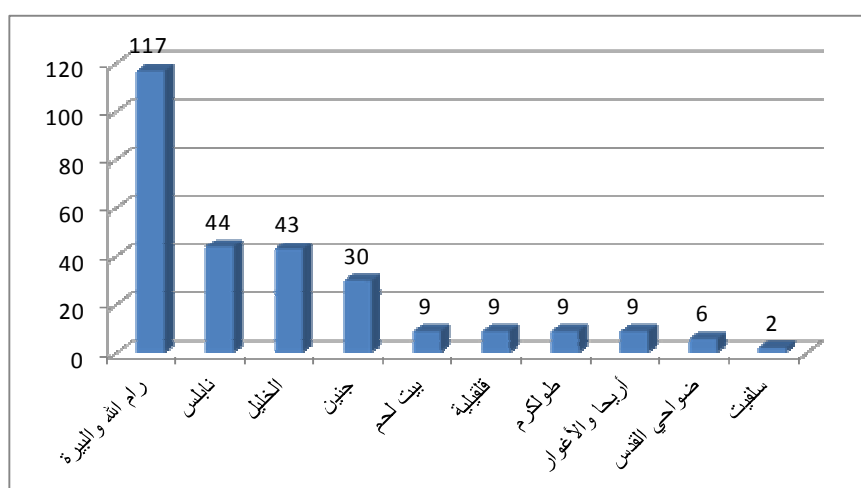
Year	Legal form				Total
	Public Ordinary	Private Shareholding	Public Shareholding	Foreign Private Shareholding	
Q1 2011	19.505	61.200	0	0.070	80.775
Q2 2011	20.306	32.259	0	0.920	53.486
Q3 2011	17.936	20.610	0	0.360	38.906
Q4 2011	16.402	21.176	0	9.496	47.074
2011	74.149	135.254	0	10.846	220.249
Q1 2012	15.514	35.488	5.000	30.110	86.112
Q2 2012	17.580	17.594	0	2.123	37.296

Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2012.

With regard to the distribution of these companies by governorate, the 2012 second quarter data show that the largest contributor was the governorate of Ramallah (42%), while Hebron and Nablus ranked second, with 16% each (see Figure 5-2).

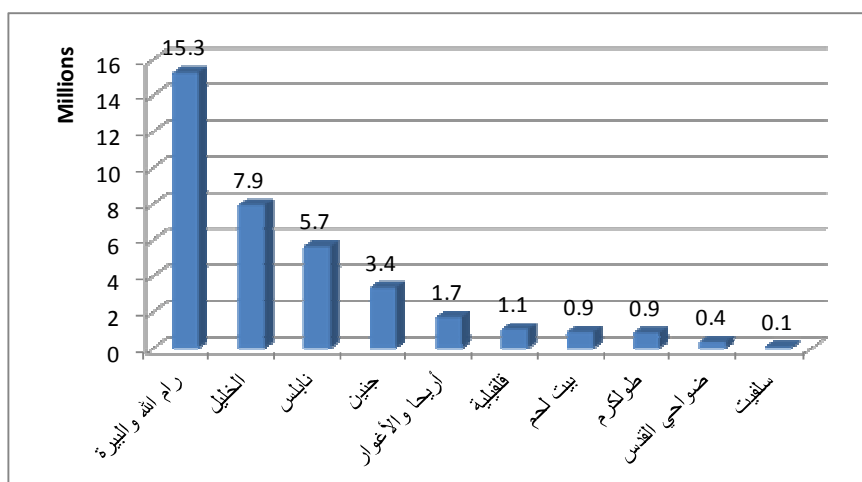
Regarding the distribution of the capital of newly-registered companies by governorate, data demonstrates that Ramallah held the major share (41% of total capital). The second largest contributor was Hebron (21%). Nablus and Jenin came third and fourth, with 15% and 9%, respectively (see Figure 5-3).

Figure 5-2: Distribution of newly-registered companies in the West Bank by Governorate- Q2 2012



Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2012.

Figure 5-3: Percentage distribution of capital of newly-registered companies in the West Bank– by Governorate, Q2 2012 (JD millions)



Source: Ministry of National Economy- Ramallah, Department of Company Registration, 2012.

5.2 Building License

The number of building licenses issued during a given period may be taken as a significant indicator of investment activity in general and investment in the housing sector, in particular. The number of building licenses changes seasonally- increasing in the second and third quarters (during summer), while declining in the first and fourth quarters. Besides, the number of licenses issued in the oPt does not include all building activities in the construction sector, since part of the construction activities, especially in rural areas, is not registered or licensed.

Data of building licenses shows an increase of 0.8% in the number of building permits in the West Bank during Q2 2012 compared to the previous quarter and a growth of 8.7% over the corresponding quarter of 2011. The total area licensed during the first quarter of 2012 was 870 thousand square meters, down by about 11% from the previous quarter, but up by 0.3% from the corresponding quarter of 2011. The number of licensed residential units (both new and existing) totaled 3649, compared to 3848 in the previous quarter and 3718 in the corresponding quarter 2011.

Table 5-3: Number of building licenses issued in the oPt: 2011-2012

Indicator	2011	2012	
	Q2	Q1	Q2
Total licenses issued	2,015	2,172	2,190
Residential buildings	1,816	1,904	1,930
Non-residential buildings	199	268	260
Total licensed areas (1000 Sq. m)	867.3	976.8	870.1
No. of new units	2,972	3,317	3,006
Area of new units (1000 Sq. m)	525.7	618.2	518.6
No. of existing units	746	526	643
Area of existing units (1000 Sq. m)	128.0	109.0	106.3

Source: Palestinian Central Bureau of Statistics (2012): Building Licenses Statistics, Ramallah - Palestine.

5.3 Cement Import

The Q2 of 2012 saw a 7% increase in the quantity of cement that had been allowed into Gaza compared to the previous quarter. This quantity represents a 18.4% increase over Q2 2011. In the West Bank, the quantity of

cement imported grew by 34.5% over the previous quarter, but declined by 10.4% compared to the corresponding quarter of 2011 (see Table 5-4).

Table 5-4: West Bank and Gaza's Imports of Cement: 2009-2012 (thousand tons)

Period	West Bank	Gaza	oPt
2009	1,230	0	1,230
Q1/2010	301.6	0	301.6
Q2/2010	381.5	0.6	382.1
Q3/2010	312.9	1.0	313.9
Q4/2010	344.1	2.7	346.8
2010	1,340.1	4.3	1,344.4
Q1/2011	296.8	2.6	299.4
Q2/2011	381.4	11.4	392.8
Q3/2011	294.7	15.3	310.0
Q4/2011	308.8	15.3	324.1
2011	1,281.7	44.6	1,326.3
Q1/2012	254.3	12.6	266.9
Q2/2012	341.9	13.5	355.4

Source: Palestinian Central Bureau of Statistics:
Administrative records, 2012. Ramallah, Palestine.

5.4 Car Registration

This section tallies the number of cars (new or used) registered for the first time in the West Bank and imported from abroad. This indicator can mirror the economic situation of the population, on the one hand, and the degree of reliability and optimism about the future economic conditions, on the other. Because cars are expensive, they are often purchased through borrowing from banks. This indicator thus reflects the confidence of both people and banks in the sustainability of employment and the ability to pay obligations.

During Q2 of 2012, 3,628 new and used cars were registered in the West Bank, down by 3% from the previous quarter and by 28% from the corresponding quarter of 2011. Forty-four percent of cars registered in the West Bank during this quarter were used cars imported from abroad, while 37% were new cars imported from abroad, and the rest (16%) were used cars purchased from the Israeli market.

Table 5-5: No. of new and used cars newly-registered in the West Bank

	Cars from international market (new)	Cars from international market (used)	Car from the Israeli market (used)	Total
Q2 2011	1,505	2,980	575	5,060
Q1 2012	1,050	2,080	612	3,742
April	333	466	265	1,064
May	622	295	188	1,105
June	404	827	228	1,459
Q2 2012	1,359	1,588	681	3,628

Source: Department of Customs and Excise, unpublished data.

5.5 Hotel activity

The total number of hotels fell to 98 at the end of Q2 2012, down from 102 during the previous quarter. In this period, the number of guests totaled 158,167: 16.5% were Palestinians and 32.7% came from the European Union countries. The number of guests was up by 20.1% from the previous quarter and by 37% from the corresponding quarter of the previous year (see Table 5-6).

During this quarter, the number of nights spent in hotels totaled 373,071, including 14.4% occupied by Palestinians, 35.8% by European Union nationals, and 8.3% by United States and Canadian nationals. This is a 10.2%

growth over the corresponding quarter and 28.8% over the previous quarter. The average length of stay was 2.4 nights per guest, while the highest average was 4 nights per guest in June 2012 in the hotels of Gaza.

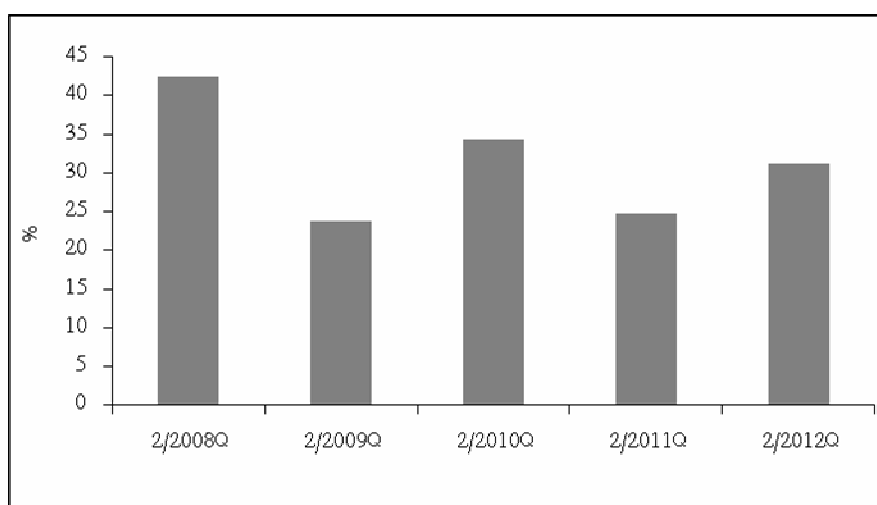
The average room occupancy was 1,778.9 rooms per day (i.e. 31.2% of total available rooms during the second quarter 2012) (see Figure 5-4). With a percentage of 45.4%, hotels of southern West Bank governorates accommodated the largest number of guests; and those of Jerusalem, central West Bank, northern West Bank and Gaza accommodated 34%, 16%, 16%, 4.2% and 0.7%, respectively.

Table 5-6: Key Hotel Indicators in the oPt – Qs 1 & 2 2012 and Q2 2011

Indicator	Q2 2012	Q1 2012	Q2 2011
No. of operating hotels/ end of Q	98	102	98
Average no. of employees/ during Q	2,672	2,535	2,215
No. of guests	158,167	115,433	131,659
No. of nights stayed	373,071	289,683	338,639
Average room occupancy	1,778.9	1,260.8	1,335.9
Average bed occupancy	4,099.7	3,183.3	3,721.3
Room occupancy %	31.2	22.4	24.8
Bed occupancy %	32.1	25.5	33.2

Source: PCBS, 2012: Hotel Activity in the oPt

Figure 5-4: Hotel Room Occupancy Rates, second quarters of 2008, 2009, 2010, 2011 and 2012



Source: PCBS, 2012: Hotel Activity in the oPt

Textbox 7: Crisis of the Jerusalem District Electricity Company

Jerusalem District Electricity Company is one of the most important Palestinian institutions that has survived the Israeli occupation. The company was founded in 1914 during the Ottoman rule and continued providing its services during the British Mandate. The Israeli occupation would pressure the company to stop generating electricity. These pressures involved denying the import of spare parts, constraining licenses needed to run the generators and litigating it under the pretext of polluting the environment. These arbitrary, forced the company to stop producing electricity, limiting its activities to distributing electricity. The company currently buys 95% of its electricity from Israel, and the remainder is purchased from Jordan⁵⁰. The company's coverage involves 25% of the area of the West Bank, including Jerusalem, Ramallah, Jericho and Bethlehem, in addition to Israeli-controlled areas (C) located around these cities. JDEC provides services for more than 220 thousand subscribers⁵¹.

DEC has high debts, a problem triggered by the lack of full commitment of subscribers to pay electricity bills in due time; thefts; and the failure of a large number of residents of villages and camps to pay their dues. This ultimately leads to the accumulation of debts and interests owed to the Israeli Electricity Company⁵².

On August 6, 2012, JDEC received a written warning from the Israeli Electricity Company to the effect that the latter would intermittently cut the power off as a first step to recuperate debts followed by actions to foreclose JDEC's assets and bank deposits if the JDEC didn't pay its dues (a sum of 423-430 million shekels)⁵³.

There are several factors that lead to this debt problem:

- ✧ The inability of the Palestinian National Authority to pay its debts to the JDEC, which totaled 120 million shekels⁵⁴. The PNA has also failed to pay the accumulated debts of the refugee camps (250 million shekels) and its failure to pay the tariff variance in Jericho (where the PNA decided to reduce electricity tariff by 40% promising that the PNA itself will pay the difference to the JDEC)⁵⁵.
- ✧ Electricity theft by some villagers and residents of refugee camps in the company's concession areas, the value of thefts totaling 10 million shekels a month⁵⁶. By governorate, the rate of thefts in 2011 was distributed as follows: Jerusalem 34%, Ramallah 24%, Bethlehem 24% and Jericho 23%⁵⁷. The ongoing attacks on the networks represent another source of drain.
- ✧ Technical electricity loss which occurs as a result of wearing out in networks and transformers. The rate of loss is estimated at 10% of the power that is being purchased⁵⁸.

Several meetings between competent authorities (such as the Prime Minister, the Ministry of Finance, the Energy Authority, the Ministry of the Interior, and others) to discuss the debt crisis were concluded with recommendations, including:

- ✧ JDEC, in coordination with the Energy Authority, would launch a promotional campaign targeting defaulters, allowing them debt rescheduling with long-term installments, in addition to granting incentives to subscribers who pay their obligations in due time.
- ✧ Amending the Electricity Act, such that theft and vandalism are punished as crimes with a prison sentence or fines⁵⁹. The recently issued presidential decree was meant to launch a campaign to collect accumulated debts backed by security services⁶⁰.
- ✧ Both JDEC and the Ministry of Finance agreed on debt repayment mechanism that involves monthly payments. In August 2012, the PNA has transferred 20 million shekels to the Company; however, it failed to pay its dues in September, which threatens to revive the debt crisis⁶¹.

⁵⁰ <http://www.jdeco.ps/Ar/CompanyHistory.aspx>

⁵¹ <http://www.alquds.com/news/article/view/id/378640>

⁵² <http://www.thisweekinpalestine.com/details.php?id=1661&ed=113&edid=113>

⁵³ <http://www.alhayat-j.com/newsite/details.php?opt=7&id=181869&cid=2688>

⁵⁴ <http://www.jpost.com/Sci-Tech/Article.aspx?id=281267>

⁵⁵ <http://www.al-ayyam.com/pdfs/21-6-2011/p19.pdf>

⁵⁶ <http://www.alquds.com/pdfs/pdf-viewer/2012/10/9/#/2/zoomed>

⁵⁷ <http://www.jdeco.ps/Ar/NewsPaper.aspx>

⁵⁸ <http://www.alquds.com/news/article/view/id/382676>

⁵⁹ <http://www.maannnews.net/eng/ViewDetails.aspx?ID=513317>

⁶⁰ <http://www.alquds.com/pdfs/pdf-viewer/2012/10/9/#/2/zoomed>

⁶¹ <http://www.maannnews.net/arb/ViewDetails.aspx?ID=524891>

6. Prices and Purchasing Power

6.1 Consumer prices

Indices of consumer prices in the Palestinian Territory in Q2 of 2012 was down by 0.45% from the previous quarter, but up 2.60% from the corresponding quarter of the previous year. The commodity group which had the strongest

influence on indices was the food and soft drinks group, falling by 1.94% from the previous quarter but hiking by 1.99% compared to the corresponding quarter of 2011 (see Table 6-1).

Table 6-1: Average Change in CPI in the Palestinian Territory by Commodity Group (Base Year: 2004 = 100)

Group	Change in Q2 2012 over Q1, 2012	Change in Q2 2012 over Q2 2011
Food Stuff and soft drinks	(1.94)	1.99
Alcohol beverages and Tobacco	0.91	5.09
Textiles, apparels, and footwear	(0.13)	0.99
Housing and related supplies	0.93	4.64
Furniture & home products and appliances	0.14	0.08
Medical care	0.88	3.01
Transportation & travel	0.97	2.14
Telecommunications	(0.08)	0.46
Recreational & cultural goods & services	0.40	0.34
Educational Services	1.41	6.97
Restaurant, Cafe, and Hotel Services	0.12	4.23
Miscellaneous goods and services	0.65	5.62
General CPI	(0.45)	2.60

Source: PCPD.

* Figures in brackets indicate negative values (decline in prices)

Table 6-2: Price movement of main commodity groups— Qs 2 and 1 of 2012

Consumer group	Percentage Change (Q1 2012 – Q2 2012)
Automobiles fuel	3.34
Domestic fuel	1.21
Fresh Vegetables	(7.70)
Fresh Meat	(1.19)
Sugar	(4.76)
Rice	(2.52)
Fresh Chicken	1.42
Flour	(1.81)
Dairy Products & eggs	(1.03)
Fresh Fruit	(2.48)

Source: PCBS.

Prices of basic consumer commodities had undergone various changes during Q2 of 2012. Table 6-2 tallies the movement of prices of some commodity groups in the Palestinian

Territory during the second quarter of 2012 compared to the previous quarter. The prices of fresh vegetables fell by 7.70%, where as the price of carrots showed a significant increase

of 33.73% (the price of Israeli carrots was 2.13 shekels / 1 kg during April 2012). Prices of fresh fruit declined by 2.48%. The price of bananas, in particular, dropped by 14.74% (the price of large Israeli bananas was NIS 3.26 / 1 kg during June). Likewise, there was a 9.89% decline in the prices of olive oil (the price of local olive oil was 27.66 shekels / 1 kg during June). By contrast, the price of fresh chicken increased by 1.42% (the price of one kilo of local skinned fresh chicken was 17.10 shekels during May). Similarly, prices of car fuel edged up by 3.34% (the price of unleaded gasoline 95 octane stood at 7.70 Israeli shekels / 1 liter during April) (see table 6.2).

6.2 Producer Prices and Wholesale Prices

The Wholesale Price Index (the sale price to retailers or to producers, including VAT and freight/shipping costs) dropped by 2.45% during Q2 2012 compared to the previous quarter. This resulted from a 8.38% decline in the prices of agricultural commodities (which constitute 29% of the wholesale price index). In contrast, prices of manufactured goods rose by 0.53% (which represent 70% of the wholesale price index). Likewise prices of mining and quarrying increased by 1.32%, and those of fishing saw a 2.82% increase. On the other hand, the index of wholesale prices dropped by 0.20% from the corresponding quarter of the previous year, while the prices of both imported goods and locally produced goods fell by 0.37% and 4.26%, respectively.

The Producer Price Index (prices received by domestic producers for their output after all taxes are deducted, including VAT and freight/shipping costs) posted an increase of 0.40% during Q2 of 2012 compared to the previous quarter. This rise occurred as a result of: 1) a 0.80 hike in the prices of manufactured goods (which represent 61.66% of the producer price basket); and 2) a 6.06% increase in the prices of fish and shrimp (which constitute 0.20% of the producer price basket). Meanwhile, the prices of agricultural commodities (which constitute 36% of the producer price basket) dropped by 0.30%. At the same time, prices of mining and quarrying (which constitute 2.13% of the product price basket) remained unchanged. The increase in producer prices was a result of an increase in both imported and locally produced goods by 2.35% and 0.21%, respectively.

6.3 Construction and Road Costs Index

The construction cost index measures the changes that occur in the prices of construction materials and services. During Q2 of 2012, the construction cost index (for residential and none-residential units) in the West Bank saw a slight increase of 0.06% over the previous quarter. There is no updated data on the Gaza Strip.

The road cost index detects changes in the prices of materials and services used in the construction of roads in the West Bank. This index rose by 0.91% in the second quarter of 2012 over the previous quarter. Again, there is no updated data on the Gaza Strip (see Table 6-3).

Table 6-3: Average monthly and quarterly percentage changes in the Construction and Road Costs Index (CRCI) in the West Bank

(Base Month: January 2007 = 100)

Period	CRCI		Monthly Percentage Change		Quarterly Percentage Change	
	Construction cost	Road cost	Construction cost	Road cost	Construction cost	Road cost
January 2012	113.35	111.76	0.34	(0.19)		
February 2012	113.52	113.24	0.15	1.32		
March 2012	113.52	113.79	0.00	0.48		
Q1 average	113.46	112.93			0.26	1.01
April 2012	113.46	113.85	(0.05)	0.05		
May 2012	113.76	114.02	0.26	0.15		
June 2012	113.39	114.00	(0.33)	(0.02)		
Q2 average	113.54	113.96			0.06	0.91

Source: PCBS, (2011).

*Figures in brackets indicate negative values.

6.4 Prices and purchasing power⁶²

The index of consumer prices declined by 0.45% in the second quarter of 2012 compared to the previous quarter. At the same time, this quarter saw a growth of 1.31% in the exchange rate of the dollar against the shekel (standing at 3.82 shekels), which improved the

purchasing power of the US dollar and the Jordanian dinar. The dollar denominated purchasing power improved by 1.77% compared to the previous quarter⁶³ (See Table 6-4).

Table 6-4: % Change in Purchasing Power and Exchange Rates of \$ U.S. and JD against NIS

Period	Inflation rate*	\$ US /NIS			JD / NIS			
		Average exchange rate	Change in exchange rate (%)	Change in purchasing power (%)	Average exchange rate	Change in exchange rate (%)	Change in purchasing power (%)	
2011	Q1	0.36	3.60	(0.50)	(0.86)	5.09	(0.20)	(0.56)
	Q2	(0.05)	3.44	(4.52)	(4.48)	4.85	(4.81)	(4.76)
	Q3	0.74	3.55	3.23	2.49	5.01	3.23	2.49
	Q4	1.20	3.65	2.76	1.56	5.14	2.76	1.56
2012	Q1	1.10	3.77	3.42	2.32	5.32	3.42	2.32
	Q2	(0.45)	3.82	1.31	1.77	5.39	1.31	1.76
	April	(0.24)	3.76	0.68	0.92	5.31	0.68	0.92
	May	(0.20)	3.75	(0.52)	(0.32)	5.28	(0.52)	(0.32)
	June	(0.86)	3.83	2.25	3.11	5.40	2.22	3.08

Source: Calculations based on data obtained from the PMA and the PCBS.

* Inflation rate represents the change in the purchasing power of NIS. Figures in brackets indicate negative values.

Compared to the corresponding quarter of 2011, the exchange rate of the dollar and the dinar against the shekel improved by 11.4%. On the other hand, the inflation rate during

2012's second quarter stood at 2.6%, leading to a growth of 8.5% in the purchasing power (as measured in dollars and dinars) assuming fixed incomes.

Textbox 8: Predicament of the cost of living in the Palestinian Territory

September 2012 saw an upsurge of strikes and protests against the Palestinian National Authority and the policies that have led to the deterioration of living standards. What are the reasons behind this wave of protests? This textbox focuses on the economic factors, though economics and politics in the Palestinian context are interrelated and embedded in one another.

The economic factors can be separated into five broad elements:

First: The chronic high unemployment rates, especially among young people

Stupendously, despite the relatively high growth in gross domestic product, the unemployment rate in the West Bank remained unchanged over the past few years (17.5). A recent MAS study (2012) concluded that despite the fact that 108 thousand new jobs were created in the Palestinian Territory between 2006 and 2010, the unemployment rate (in the West Bank and Gaza Strip) remained constant (23.7%). The study found that (during the study period) manpower in the West Bank increased by 3.7% a year, while employment rate grew by 3.1%, suggesting that the unemployment rate was ever-growing⁶⁴.

⁶² The purchasing power is defined as the value of a currency expressed in terms of the amount of goods or services that one unit of money can buy. It is directly dependent on the income of the consumer and inversely on the change in the rate of prices (inflation) and currency exchange rate. The change in the purchasing power (assuming constant income) can be measured as: (rate of change in the exchange rate of the currency against the shekel) minus (the rate of change in the index of consumer prices).

⁶³ Because the Jordanian dinar is pegged to the U.S. dollar, the purchasing power in JD posted a growth of 1.77% during the same period.

⁶⁴ Due to the increase in employment in Israel and the settlements, the unemployment rate in the West Bank decreased by one percentage point between 2006-2010. See MAS' study: Who shared the fruits of growth in the Palestinian economy, 2006-2010?

It is also striking that, with 34% in Q2 of 2012 in the OPT, unemployment among young people (15-24 years old) are significantly higher than the general unemployment rate. Unemployment among educated people is also high (25.5% among individuals who have completed 13 years (or more) of schooling).

Despite their indications, these figures do not accurately mirror the status of unemployment and the labor market, due to the definitions of the terms 'unemployed' and 'workforce' as they are narrow and do therefore not account for large numbers of those who are actually unemployed.

Second: Decline in real wages

The term 'real wages' refers to wages that have been adjusted for inflation (i.e. nominal pay increment minus the inflation rate). MAS (ibid) found that the daily average real wage in the Palestinian Territory (excluding those working in Israel and the Settlements) declined by 11.4% between 2006 and 2010. This echoed a 5.7% rise in the nominal wage and a 20% increase in the inflation rate during the same period. However, these average figures conceal considerable disparity between the West Bank and Gaza Strip: the decline in daily wage posted 3.3% in the West Bank compared to 30% in Gaza.

Third: Increase of prices (particularly gasoline prices) and VAT

The Consumer Price Index in the West Bank managed an increase of 12.2 percentage points between January 2010 and August 2012. Additionally, the food price index rose by 9 percentage points during the same period. Though this rise in prices was not offset by raising nominal wages, it didn't trigger the protests that erupted in the West Bank. Indeed, the rise in fuel prices and VAT was the spark that ignited those protests.

Fuel prices

At the end of August 2012, prices of oil products hiked in Israel (and therefore also in the Palestinian territory). The prices increased up to NIS 8.26 per liter, a record and a jump of 56 agora. Meanwhile, the Taub Center for Social Policy Studies published a study on the prices of petroleum in Israel⁶⁵. The study found that "the world price of oil in shekel terms is about the same now as in 2008", yet Israelis pay NIS 1.20 more. The study said most of the increases in gas prices are not due to global petroleum prices, rather, they are due to taxes (88 agora), and high profit margins on transportation, refining and distribution (34 agora per liter). The study estimated that the tax on every liter of gasoline now stands at about 490 agora. This means that more than 50% of the price of gasoline in Israel goes to the government as purchase tax and value-added tax.

Of course, prices of petroleum products in Israel influence the prices in the Palestinian territory. The PNA recovers taxes Israel levies on oil sold to the Palestinian territory. In 2011, the PNA collected \$ 457 million as fuel tax recoverable through the clearing mechanism (an increase of 32% from 2008). The National Authority returns a slight amount of these taxes to the Palestinian consumer, thus the prices of petroleum products in the Palestinian territory are a bit lower than in Israel.

The price of a liter of gasoline (95 octane) in the Palestinian territory in early October was 7.60 shekels. For comparison purposes, the price in Jordan was 1.015 dinars (5.54 shekels). Further, unlike in the West Bank, gasoline 90 octane is available in Jordan (with 700 fils / liter: 3.82 shekels). However, the environmental consequences of the use of this type of gasoline has become controversial in the Jordanian media.

Obviously, the prices of oil products in the Palestinian territory are high; still the debate over this rise should be embedded with the meager revenues of the Palestinian budget, in which the fuel tax revenues account for 20%.

VAT

In 2012, driven by a budget deficit of 30 billion shekels (more than 60% of the budget draft projections), Israel raised the value-added tax from 16% to 17%. An increase of one percentage point would result in an additional NIS 4 billion per year to state coffers⁶⁶.

Raising the value-added tax in Israel entails a similar move in the Palestinian territory since the Paris Protocol states that the difference in VAT between Israel and the Palestinian territory should not be more than two percentage points. Since the current VAT in the Palestinian territory is 14.5%, the proposal to raise VAT in Israel to 17% could have led to increasing this tax in the Palestinian territory to 15% or 15.5%.

However, this move would have led to strong social implications, especially since the VAT system levied in the Palestinian territory is regressive (a larger percentage is paid by low-income people rather than by high-

⁶⁵ <http://www.haaretz.com/business/report-israelis-pay-sixth-highest-gas-tax-in-west-1.461583>

⁶⁶ See *Economic and Social Monitor*, Volume 29, page 24.

income people as the poor allocate a higher proportion of their income for consumption). Still, raising the tax from 14.5 to 15.5% (an increase of one percentage point) could generate an additional 160 million shekels / year (or 80 million shekels if the increase was only half a percentage point). This important additional revenue could help decrease the budget deficit, however it has exorbitant social consequences. Both fuel tax and VAT represent more than half of the total domestic revenues of the PNA; hence their importance.

Fourth: Uncertainty – the crisis of salaries, pensions and transfers

Public sector employees (154 thousand at the middle of 2012), public sector retirees and those who receive subsidies from the government, are living under uncertainty with respect to receiving their salaries and transfers. Table 2 presents periods of interruptions and late payments of public servants' salaries. 2006 and the first half of 2007 saw an almost ongoing stoppage. However, during the second half of 2007 and throughout 2008, PEGASE contributed to ensuring the flow of salaries- paying the salaries of basic social services employees, including teachers' salaries.

The period between early 2009 and May 2012 enjoyed stability in the flow of salaries as they were paid in due time. However, the crisis re-emerged when the June salaries were due. The crisis then continued throughout the next three months.

Table 2: Periods of interruptions and late payments of public servants' salaries (2006-2012)

Period	Commitment / lack of commitment to pay salaries
January 2006 - May 2007	Paying the salary of January 2006 in due time. Payments then were intermittent with amounts ranging from 1.000 to 1.500 shekels during the entire period.
June 2007 - May 2011	Salaries paid in due time, and dues accumulated in previous periods had also been fully paid by end of 2008
June 2011	Only 50% of the salary disbursed and the remainder paid on August 25
July 2011 - May 2012	Salaries disbursed in due time.
June 2012	Only 60% of the salary disbursed (on July 12) with a minimum payment of 2,000 shekels, and the remainder paid on July 22
July 2012	Only 70% of the salary disbursed (on August 11) with a minimum payment of 4,000 shekels, and the remainder paid on August 27
August 2012	Only 50% of the salary disbursed (on September 9), with a minimum payment of 2,000 shekels, and on September 16, the rest was disbursed (salaries above NIS 4,000 had a 10% cut and then the full amount was paid on October 2).
September 2012	Not disbursed to date (October 15)

Source: Unpublished information obtained directly from the Ministry of Finance. See detailed schedule of salary payment interruptions on MAS' web page www.mas.ps

Undoubtedly, there are many economic, social and psychological implications due to salary interruptions, not only on government employees and their families, but also on businesses, leaseholders and lenders. Especially as the salaries of government employees constitute a major component of effective demand in the Palestinian territory.

The reason behind payment interruptions in 2006 and 2007 was the withholding of clearing revenues by Israel⁶⁷. The recent failure to pay salaries is provoked by the significant decline in international aid. The mere threat to stop transferring clearing revenues or the expectations about cuts in international aid creates an atmosphere of uncertainty and, thus, negative socioeconomic implications.

Fifth: The impact of the Paris Protocol on prices

The Paris Protocol has direct implications on VAT rates (minimum rate in oPt: two points less than the average in Israel) and the prices of gasoline (minimum rate in oPt: 15% less than the price in Israel). These prices affect all other prices in the economy.

The Paris Protocol has also indirect implications on prices in the Palestinian territory in the sense that the majority of imports of the West Bank are either from the Israeli market or channeled via the Israeli market. These prices are, thus, influenced by high prices of non-tradable services and goods found in developed economies, let alone the impact of the Palestinian relatively high wages that are directly affected by the Israeli labor market. On the other hand, there is an extraordinary increase in prices as a result of Israel's strict specifications on imported goods (the Palestinian side is bound by these specifications). Finally, there is the impact of the various Israeli procedures that obstruct the free flow of goods, which eventually increases prices.

⁶⁷ For more details on dates of freezing the transfer of clearing revenues, please see *The Economic and Social Monitor*, Volume 28 (Textbox 2).

Conflicting impacts of these factors

It is important to point out that the inverse proportion between the previously mentioned factors (the rise in fuel prices and VAT, on the one hand, and the interruptions of salaries, on the other hand) was the main reason behind the popular protests. High oil prices and taxes can increase government revenues and provide funds to pay salaries on time; i.e. the distress of rising prices can initially be concurrent with factors that reduce complaints about salary interruptions.

PNA reactions to protests

The PA dealt in three ways with the popular protests:

- ✧ It canceled its earlier announced price increases of diesel, kerosene and cooking gas, bringing the price at mid September to their levels in August., and reduced limited the increase in VAT to one-half percentage point, bringing it down from 15.5% to 15%.
- ✧ The Ministry of National Economy announced indicative/maximum prices for a number of basic food commodities along with cancelling import contracts and exclusive concessions. The Ministry of National Economy said it has identified prices in consultation with producers, importers, wholesalers and retailers. Some of these, however, strongly protested the prices that have been announced. Nonetheless, the pledge to control prices and the promise to periodically publicize indicative prices has not been achieved.
- ✧ Issuing the minimum wage law: After a thorough examination by a special committee, the minimum wage law fixed the minimum monthly wage at 1,450 shekels a month, 65 shekels a day and 8.5 shekels an hour. However, the Federation of Trade Unions protested, saying that the minimum wage should be set at 1.750 shekels a month.

The steps taken by the PNA couldn't have put an end neither to the hardship nor to future protests that might perilously break out. The ineffectiveness of such strategies may not be an indication of the reluctance of the PNA to solve the problem; rather it signals the inherent inability of the PNA which incontestably lacks the resources to settle this issue once and for all. This inadequacy is a chronic fault primarily engendered by the Israeli occupation and its restrictions, on the one hand, and by the political split between the West Bank and Gaza Strip, on the other.

7. Foreign Trade

7.1 Balance of Trade

The balance of trade is the difference between the monetary value of exports and imports of output in the Palestinian economy. The total value of registered imports during Q2 of 2012 stood at about 1,109 billion dollars. Those coming from Israel comprised 66% of total commodity imports. Table 7-1 shows that the value of registered commodity imports during Q2 of 2012 rose by 8.8% compared to the previous quarter, but fell by 5.3% compared with the corresponding quarter of 2011.

On the other hand, the value of exports totaled about \$185 million. About 88% (\$164 million) had Israel as their destination. During this quarter, exports fell by 8.4% compared to the previous quarter, i.e. the commodity trade deficit, thus, reached \$ 924 million, up by 10.4% from the previous quarter, but down by 4.6% from the corresponding quarter of 2011.

On the other hand, the service imports from Israel totaled \$ 36.4 million, while exports of services to Israel totaled \$ 32.8 million in the second quarter of 2012. As such, the services trade balance with Israel posted a deficit of \$ 3.6 million compared with a deficit of \$ 1.8 million in the previous quarter (see Table 7-1)

7.2 Balance of Payments

According to the PCBS and the PMA, the current account deficit (the balance of trade plus income generated from trade with international markets and offshore current transfers) totaled \$ 793.6 million during Q2 of 2012, up by 14.9% from the previous quarter, and up by 4% from the corresponding quarter of 2011. This deficit represents about 29.5% of GDP at current prices in the same period.

Table 7-1: Imports and Exports of registered goods and services - 2011 and Qs 1 & 2 of 2012 **

(million dollars)							
Period	Q1/2011	Q2/2011	Q3/2011	Q4/2011	2011	Q1/2012	Q2/2012
Commodity imports	1,305.2	1,171.0	1,039.7	975.7	4,491.6	1,019.5	1,109.2
Service imports*	46.7	40.7	33.9	32.0	153.3	33.8	36.4
Commodity exports	191.7	202.2	175.1	189.7	758.7	182.5	185.2
Service exports*	35.6	37.2	31.5	32.2	136.5	32.1	32.8

Source: Registered foreign trade, PCBS (2012).

* Exports and imports of goods and services from and into Israel only.

* Data for 2011 and 2012 are obtained from official sources, and they are subject to change.

The deficit in the trade balance of goods and services totaled \$ 1,328.4 billion, a decline of 1.7% from the previous quarter and an increase of 6.2% over the corresponding quarter of 2011. In contrast, Q2 of 2012 posted a surplus of \$278 million in the balance of revenues, up by 15% from the previous quarter and 0.9% from Q2 of 2011. This was mainly

generated from revenues of Palestinian workers employed abroad (\$ 272.8 million). At the same time, the balance of current transfers posted a surplus of \$ 256.8 million (nearly one-third came from donor aid), down by 38.7% from the previous quarter, but up by 21.4% compared to the corresponding quarter of 2011.

Table 7-2: Palestinian Balance of Payments - Q2, 2011 and Qs 1 & 2, 2012 (\$ millions)

Item	Q2 2011	Q1 2012	Q2 2012
1. Trade balance of goods and services*	1,250.5-	1,351.2-	1,328.4-
Net goods	1,175.3-	1,255.2-	1,237.5-
Net services	75.2-	96.0-	90.9-
2. Balance of income	275.6	241.7	278.0
- Workers' remunerations received from abroad	266.1	250.6	272.8
- Investment income received from abroad	14.4	30.7	30.2
- Income paid abroad	4.9	39.6	25.0
3. Balance of current transfers	211.6	419.0	256.8
- Net transfers to the government	106.7	204.3	117.5
- Net transfers to other sectors	170.1	286.1	211.3
- Transfers paid abroad	65.2	71.4	72.0
4. Balance of current account (1 +2 +3)	763.3-	690.5-	793.6-
5. Net capital and financial account	785.0	708.8	875.2
- Net capital transfers	61.3	80.3	71.1
- Net financial account	723.7	628.5	804.1
◇ Net direct foreign investment	61.3	86.0	48.1
◇ Net portfolio investment	66.2	27.5	8.7-
◇ Other net investment	529.7	625.8	784.4
◇ Change in reserve assets	66.5	110.8-	19.7-
6. Net errors and omissions	21.7-	18.3-	81.5-

Source: Palestinian Central Bureau of Statistics and the PMA, 2012. Preliminary results of the Palestinian Balance of Payments: Q2 of 2012.

* Figures of exports and imports of commodities and services in the balance of payments differ from the figures contained in the trade balance because the latter records only exports and imports that are registered (i.e. recorded in the clearing accounts and billing), while the balance of payments records the total expectations of import and export. In addition, import and export of services from Israel were recorded only in the trade balance, while the balance of payments records services from different sources.

This current account deficit was financed by capital and financial account, which provided \$875.2 million (see Table 7-2). This item (the

capital and financial account) represents a debt on the national economy as long as it has a positive value.

Technically speaking, there should be a perfect balance between the current account deficit, on the one hand, and the surplus of capital and financial account, on the other. This implies that the net value of these two items must be

zero. However, there is often a slight difference between them. This difference is tallied under 'account errors and omissions', the value of which was 81.6 million dollars.

Textbox 9: Israel's Economy: Key Strengths

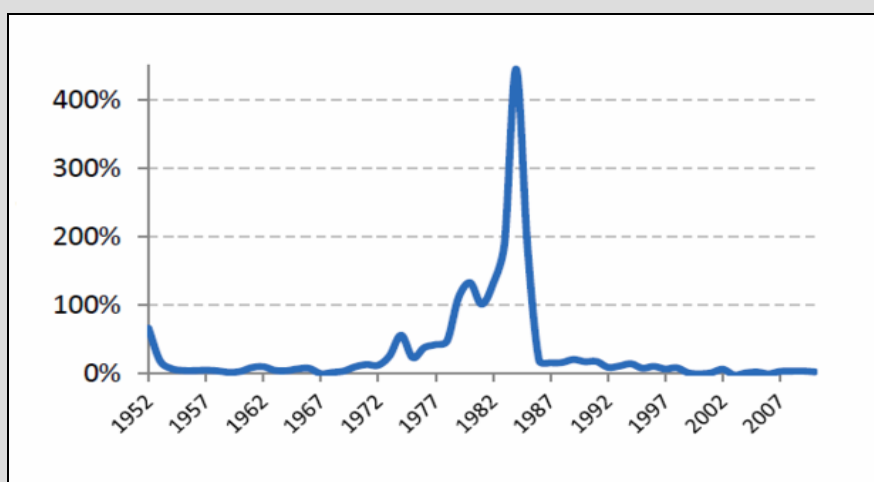
The Republican Party's candidate for the U.S. presidential elections, Mitt Romney, stated during his visit to Israel in July that the reason behind the distinctive economic performance in Israel in the past decades is "culture". Mr. Romney, of course, meant the "Jewish culture" that made the Israelis rich, while Palestinians are quite poor. This statement was praised by some circles who advocate stereotypes, inside and outside Israel.

Apart from the invalidity of this description, Mr. Romney's claim provoked the question about the reasons behind the prosperity of the Israeli economy and its strong immunity against the financial crisis sweeping the developed nations. In a recent article in *The Atlantic*, Jordan Weismann, cites at least four reasons behind this success⁶⁸:

First: Israel learned from disaster

Back in 1984, Israel's story had much more in common with modern-day Zimbabwe, at an average inflation rate of 450% (see Figure 1). This hyperinflation was a result of the massive military buildup that followed the 1973 war.

Figure 1: Consumer Price Index (annual rate of change- end of the period)



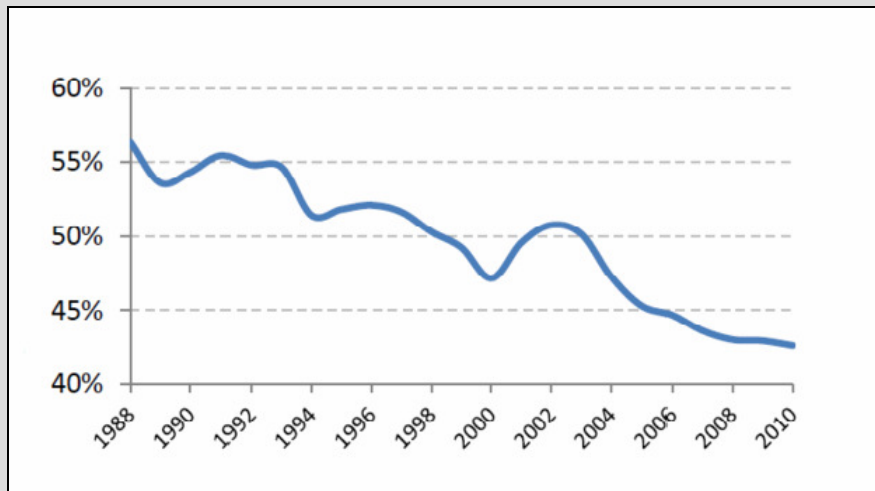
Source: Israel Central Bureau of Statistics

By the end of the 1970s, the government was consuming three quarters of the economy creating huge budget deficits (see Figure 2), which it tried to finance by having the Bank of Israel print money. The fact that Israeli workers' wages rose with the cost of living only made the situation worse, driving an out-of-control inflationary spiral, toppling down competitiveness and forcing investors to evacuate their money from the country.

By then it was unclear if Israel would be able to pay its foreign debts. In 1985, the government crafted a grand bargain that slashed government spending, massively devalued the currency, and severed the tie between wages and prices. It also set new rules for a more independent central bank. This was, in many ways, the beginning of the modern Israeli economy. The government has gradually eased up its role in the economy, while focusing on keeping inflation low and its deficits manageable.

⁶⁸ <http://www.theatlantic.com/business/archive/2012/08/its-not-just-the-culture-stupid-4-reasons-why-israels-economy-is-so-strong/260610/>

Figure 2: Government spending (as % to GDP)



Source: Israel Central Bureau of Statistics

Second: The influx of brilliant immigrants

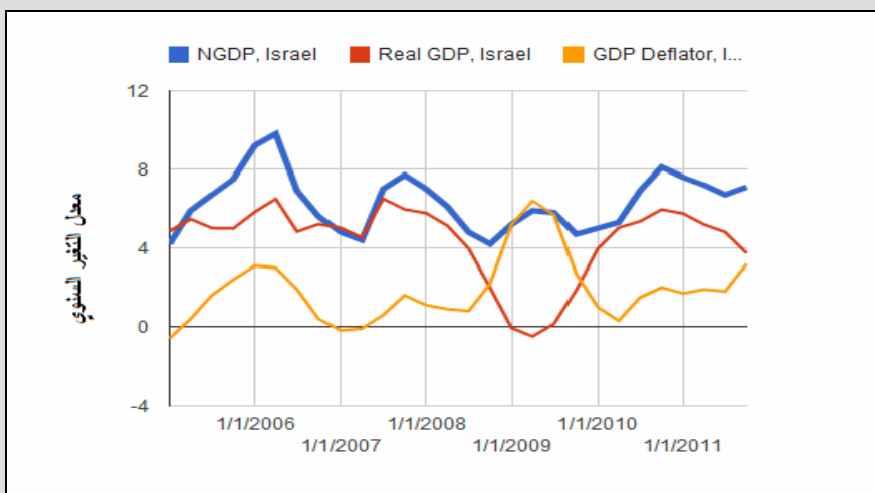
Israel's economy started getting healthy with the influx of immigrants from the Soviet Union. Between 1990 and 1997, more than 710,000 Russian immigrants landed in the country, boosting the working age population by 15%. Around 60 percent of the new arrivals had a college education, versus 35% of the native Israelis. Immigration and the in-flow of a skilled work force, in general, are good for an economy's growth. Immigration increases domestic demand, improves competitiveness and prepares the economy for efficient future leaps in the digital revolution.

Third: Smart government intervention

Israel's government has played a very important role in encouraging and supporting innovative projects in information and communications technologies (digital industries and services). Israel today is the first country in the world (as % to population) in terms of the number of startups. Israel is sometimes referred to as "the start-up nation." The nickname comes from the title of a book written by Romney adviser Dan Senor.

In 1993, the Israeli government developed the Yozma program, a \$100 million state-owned venture capital fund from which some of the money was invested directly in startups. Besides, military needs contributed to developing markets and providing a qualified population. The amendments in taxation convinced foreign venture capitalists to create funds in Israel, thus creating a thriving, independent venture capital market.

Figure 3: Rate of growth in nominal GDP and real GDP



Source: Israel Central Bureau of Statistics

Fourth: Smart monetary policy

The fourth reason behind this success, according to Weismann, is the monetary policy drafted by Stanley Fischer, the head of the Bank of Israel. Fischer is one of the world's most famous economists, former chief economist at the World Bank and deputy managing director at the International Monetary Fund. It is believed that, since Fischer took the helm, the Bank started focusing on a strategy known as "nominal GDP targeting" (versus traditional policies that target the money stock, inflation rates or interest rates), where a central bank picks an annual growth figure, and tries to hit it whether through inflation or real growth (so that the first rises when the second falls and vice versa). Figure 3 shows that

Israel's real GDP and inflation have moved in opposite directions, while its nominal GDP has hovered right around 6.5 percent per year. It is believed that the stability of the nominal growth has ensured stable exchange rates of the shekel against the dollar. This stability has also prevented a rise in the real value of loans and debts, sparing Israel a crash into the financial crises experienced by other developed economies.