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Palestine Economic Policy Research Institute

Round Table Discussion (2)

**The Palestinian National Authority's
Budget, 2012**

9 April 2012

The Palestinian National Authority's Budget 2012

Date: 9th April 2012

Background and Rationale:

Since the signing of the Declaration of Principles in Oslo in 1993, the new government has made public general budget of the Palestinian Authority. From then until today, the Palestinian Authority budget lives in chronic crises. The financial crisis of the Palestinian Authority reached bottle neck in 2002. It started to decline from 2007, but still continues currently.

This roundtable seeks to review the financial history of the Palestinian National Authority's budget from 1994 to 2011. It also concentrates on the budget of 2011, which was assigned by the Palestinian president in March 2011, and compares it with the actual budgetary results that occurred during that year. Then it compares the actual results of 2011 with the draft budget of the Palestinian Authority in 2012. The actual financial position of the Palestinian National Authority in 2011 can be summarized as follows:

- ✧ The decline in the net local revenues on the commitment basis through 2011 (7.3 billion NIS in comparison with 7.9 billion NIS as was planned), and the increase in total expenditures (current and development), caused a deficit in the total balance of the budget by 5.9 billion NIS. On the other hand, foreign aid for the current budget was 18% less than the expected amount in the budget. Moreover, the foreign aid for development was 67% less than the expected amount. This means that the current and the development deficit after foreign aid was 2.4 billion NIS. This deficit was financed by borrowing from banks (333 million NIS) and from increasing the net accumulation of arrears by 2 billion NIS.

The policies of the government to adjust the deficit during the year 2011 can be summarized as follows:

- ✧ Set the appointment of new staff, with a net increase in the number of employees in the government sector by 2,010 new employees. This number is less than was planned in the budget, since a ceiling on hiring new employees was set to 3000 new employees. However, it is worth mentioning that the bill of government salaries rose by 6% during the year and that 44% of new employment was in the security sector.
- ✧ Decrease expenditures of net lending to reach 501 million shekels in 2011, compared to 880 million shekels during the year 2010 (reduced by more than 43%).

As for the draft budget for the year 2012, the budget seeks to increase revenue through the following steps:

- ✧ Increase the number of large tax payers from 290 to 460 and improve collection and reduce tax exemptions, especially those that are associated with the program of encouraging investment, and increasing the total tax revenue by 23%.
- ✧ Increase clearing revenues by 15% (by pressing the Israeli government to approve the agreement between the functional commissions to reduce financial leakage).
- ✧ Raise some fees (land registration) to fit the cost of public service.

As for the rationalization of expenditure during the year 2012, the budget is based on:

- ✧ The rationalization of employment (not to increase employment by more than three thousand people and the rationalization of employment contracts).
- ✧ Rationalization of travel expenses and the prohibition of renting or buying real estate.
- ✧ Cut the transfers expenditure by 9.5%, through the reform of the pension fund system and improve the targeting of poor households, without affecting the allocation of ministries of health, education and social affairs (the current allotment of these ministries increased in the budget by 2.4% compared with 2011, note that inflation is expected to reach 3%)

- ✧ Continue reducing net lending (up to 400 million NIS), in a way to cancel this item completely during the next two years.

MAS has decided to shed light on the budgets of the National Authority and its financial performance and ask questions at the roundtable in front of experts and business stakeholders.

Participants

Keynotes speakers:

Dr. Mohamed Nasr: Dean of the Faculty of Commerce and Economics at Birzeit University

Dr. Azmi Shuaibi: Commissioner for Combating Corruption - Coalition for Integrity and Accountability (AMAN). The representative of Palestine in the Transparency international organization.

Engineer Zahi Khouri: Chairman of the Board of Directors of National Beverage representing the private sector.

Key questions for discussion

Questions raised during the roundtable are:

First: How did the Palestinian National Authority deal with the financial crisis during the last year and what are the lessons from its actual financial performance, compared to the budget set at the beginning of 2011?

Second: To what extent does the budget of 2012 succeed in selecting the right areas for savings, economically and socially, and how accurate are predictions in revenue?

Third: What are the features of the economic policy (long-or medium term) that can be recognized from the 2012 draft budget?

Summary of Main Rebuttal

Dr. Numan Kanafani, head of research at MAS institute and the leader of this discussion, presented a summary for the contents of the background paper prepared by the institute for this discussion. He divided the history of the Palestinian National Authority's (PNA) budget into five distinctive parts: the establishment phase (1994 – 1999), Intifada phase (2000 – 2002), start of the financial reform (2003 – 2005), Hamas government and the "Government of National Unity" (2006-2007), and the current phase (2009 – 2011). He then reviewed the reality of the budget at each of the previously mentioned stages, which can be summarized as follows:

I. Establishment Phase (1994 – 1999)

- ✧ The budget was in surplus in 1998 and relatively in equilibrium in the following year.
- ✧ International aid would be directed primarily to developmental expenditure.
- ✧ Public employment reached 98 thousand individuals in 1999.
- ✧ Domestic revenue was raised to 20% of GDP.

II. Intifada Phase (2000 – 2002)

- ✧ Severe drop in the budget's domestic revenues
- ✧ Increase in public employment in 2002 to nearly 124 thousand individuals.
- ✧ Huge increase in international aid directed for the budget's current expenditure.
- ✧ Increase of lending and of unpaid loans to and from local banks.

III. Start of the Financial Reform (2003 – 2005)

- ✧ Repayment of part of the loans to local banks.
- ✧ Public employment has reached 146 thousand workers by the end of 2005.
- ✧ The net lending bill increased to 244 million dollars in 2005.
- ✧ The percentage of public spending in 2005 increased to 49% of GDP.

IV. Hamas government and the “Government of National Unity,” (2006 – 2007).

- ✧ The payment of only 40% on average of public employees.
- ✧ The number of public employees in 2006 reached nearly 159 thousand employees (50% civil and 50% security).
- ✧ The second half of 2007 witnessed the return of clearance revenues and the increase of foreign aid towards the current budget.

V. The Current Phase (2009 – 2011).

- ✧ Increase in net domestic revenues.
- ✧ Control of net lending expenditures.
- ✧ Foreign aid towards the current budget decreased from 1.76 billion in 2008 to 1.13 billion in 2010.
- ✧ Public debt towards local banks reached 1.1 billion by the end of 2011.
- ✧ Increase in net accumulation of arrears.

Afterwards, Kanafani compared the 2011 budget with what has been accomplished on the ground throughout the year, and presented the leading indicators of the 2012 budget.

Summary of Commentator’s Rebuttals

Engineer Zahi Khoury: Khoury attempted in his rebuttal to answer the first question, and started by affirming that paying taxes is a national duty as well the need to enhance the national responsibility of the public in regards to paying taxes. Regarding the mechanism of the government’s handling of the crisis, Khoury said that even in there is no doubt that the public debt has increased, but the main financier of the debt has been the banks and the private sector. In turn, this has led to restricting the growth of the private sector which is the main employer of labor. He also considered that the heavy debt faced by the local banks decreased their ability to lend funds to the private sector and increased the cost of these funds as the government became a main competitor of the private sector for these funds.

With regards to tax collection, Khoury pointed out that companies that faced initial hard phases have started to grow and have increased their profits. In regards to the tax payment policy, clearly the pressure of payment falls largely on the tax payers themselves. It is here that we see around 97% of companies in the Palestinian Territories are small companies under tax evasion. Therefore, large companies have lost their competitive edge in the market. Khoury also complained that the level of bureaucracy present at the present at the Ministry of Finance, in addition to the way they dealt with the private sector have been disastrous, citing the amount of unrecorded debts according to his own estimations at around 500 million NIS.

Regarding the involvement of the Israeli side in the issue of taxation, Khoury views the attempts of the Palestinian negation to be unsuccessful. Israelis usually attempt to evade payment and there is no representative of the private sector in this regard, which holds large consequences. With regards to setting the 2012 budget, Khoury sees that there are contradictions between the proposed and actual budgets. Such contradictions include statements that unemployment will decrease and that growth will decrease.

Dr. Azmi Shuaibi: Shuaibi said that it seems that it has become a habit to present the budget in this manner, 4 months late in the new year, especially that the law states that the budget needs to be ready for implementation from the beginning of the year, and is only permitted delay under special and urgent circumstances due to discussions regarding the content of the budget inside the legislative bodies concerned. On the other, Shuaibi confirmed the need to refrain from discussion the budget in isolation of the public, and of the pinpointing the relevant priorities.

Shuaibi divided the Palestinian fiscal policy to two stages: Before and after Salam Fayyad. The first stage was characterized by three main indicators: First, pleasing the citizens through absorbing them into public employment and decreasing unemployment after the ceasing of work in

Israel. Second, a dependency on donors' development projects. Third, allowing for the stagnation of the same laws regarding fees in the same state that they have been at tens of years ago. This policy has resulted in increasing the wage bill and other items such as pensions and raises and privileges obtained by public sector employees.

As for the period after Fayyad, Shuaibi divided it into two phases: first, the period of fiscal reform, as the government had a unified accounting base and clear financial data. The second period comprised of spending a period of time under the banner of being prepared of preparing for state-building and independence. In this stage, according to Shuaibi, there were no changes in the major challenges as the primary focus was instilled on curbing the deficit. Fayyad's policy to combat the deficit, and not the main challenges, was to increase revenue and streamlining expenditure. Therefore, the topic of fixing the budget and the deficit needs to involve a restructuring of the budget in light of the national reality and on light of the important challenges we are facing including the deficit. This is a national responsibility than needs to be placed on the discussion agenda in order to determine the primary direction that we as Palestinian people will head in in 2012.

Regarding revenue, reconsidering the policy on income tax is right direction in principle, according to the Shuaibi. But, this reconsideration needs to be done not in order to inflate revenues, but to redistribute the burden among citizens more fairly. The main problem with income tax is not with tax payers, but with those who evade the tax. The government also needs to rely on a more horizontal structure in order to decrease chances of tax evasion, as this would include wide sectors that one would need to track.

As pertaining to expenditures, the amount of money paid to cover the wage bill will not benefit from the reductions proposed here. There is need not only to streamline expenses but also to control them. Shuaibi also sees that it is necessary to rehabilitate the cadres that receive wages but produce little work instead of hiring new personnel. Moreover, the real and accurate numbers for the security employees need to be revealed. Shuaibi also noted that we need to pay attention to worker in certain embassies that travel along with their families to other countries but who practically do not really work in these embassies. Also, there is a need to review public employees receiving wages in the district of Jerusalem. As to the subject of arrears, Shuaibi sees that is necessary to pay it from the Investment Fund, especially that the 2012 budget ignored the existence of the arrears problem.

Dr. Mohammad Naser: in an attempt to answer the third question, Naser indicated that the two main tools available for the government in its practice of fiscal policy are increasing revenues and streamlining expenditure. He also indicated that there are many goals that countries attempt to achieve throughout their budget, which include: achieving growth levels, encouraging investment, fighting unemployment, prime use of resources and achieving social justice. Usually a contradiction is present between the goals and the priorities, where the budget attempts to reflect these priorities so that there is a trade-off between goals.

The main objective of the budget year 2012 is to reduce the deficit. This goal, according to Naser is important heavily and relates to financial stability. The importance of this goal has increased now that many countries suffer from disability, such as Greece. It could be argued that plugging the deficit is one of the most important goals of any major country and this has increased the importance of this goal at the present time. Naser noted the presence of many goals in the budget of 2012 that could or should be attached under the heading of social justice and also that there are other targets that are not represented, which include: encouraging investment and reducing unemployment. There are also some assumptions in the budget, such as: unemployment is expected to fall from 21% to 18%, investment will reach 20%, and that inflation is 3%, all without the presence of a policy in the budget which enables us to reach these assumptions.

Returning to the tools available for the government, the government increased revenues by increasing the tax on large taxpayers, the postponement of tax concessions to the private sector,

achieving reform in the revenue collection of clearances, and by the review and increase in some fees on the registration of private land. Naser also believes that such policies may have a payoff in the short term, but long-term policies such as these will affect investment, as any investor would hesitate to invest in the Palestinian territories (where the risk factor is very high) when you raise taxes and abolish exemptions and privileges. On the other hand, the volume of the total income tax revenue the government holds is relatively small (about 7%) and thus the impact of income tax policy is limited.

As for the policies of rationalization/streamlining of expenditure, the aims are clear: limiting the growth of public employment, the rationalization of employment contracts, reducing manufacturing costs, reducing net lending, and devaluing development expenses. Naser believes that these policies will not lead to a reduction in the level of government spending because the structure of expenditures does not allow for it. This is because half of all public expenditure constitutes salaries, while the other half can only be reduced very slightly, as it touches on important sectors such as health, education and social affairs. The side of the expenditure that can be cut is that which the budget has called “reform of the pension system.” This is because there is talk that the government will transfer 26 thousand people to the retirement system. While this will reduce the budget deficit, it will also have a negative impact associated with high unemployment; the private sector is unable to accommodate these figures. And thus, this will add 26 thousand people to the list of retirees and the unemployed. On the other hand, there is an advantage in development expenses section of the budget, as that is an expense that is possible to postpone. What all of this shows, is that the budget is working to accommodate the short-term but not long-term problems.

Two final points that Naser stressed are: First, from an economic standpoint, it is difficult to talk about austerity in light of the economic recession and high unemployment; in fact, there is a need for expansionary policies. Naser pointed out that the government has over the past years adopted expansionary policies, but were not correct in doing so, as it was simply a way for the expansion of government spending which did not give incentives to the private sector. The second point emphasized by Naser is the limited space available to the Palestinian Authority to make any policies, as well as his view that what the government is doing currently is not the development of financial policies, but simply crises management.

Summary of the Discussion

The participants were actively involved in the discussion through the rebuttals of experts, where the atmosphere was that of intimacy and good humor in spite of the degree of professionalism and specialization in which it presided in. Here we present a condensed summary for the most poignant of the points raised in the rebuttals:

Dr. Said Haifa, Department of Economics at the faculty of Commerce and Economics at Birzeit University: indicated that an increase in the public debt owed to the local banks leads to competing with the local sector for funds, which is what economists call crowding out. He also turned to the structural problems plaguing the budget, which are: high expenditure and uncertain revenue streams which Israel controls more than 70% of.

Dr. Atef Alawneh, author of the book: Reform of Pension Systems in Palestine: handled a disregarded issue in the budget, which entails the benefits entitled to the “Palestinian Retirement Authority”, which is not mentioned in the budget or in local and foreign debts. Alawneh expects their benefits to reach 4.9 billion Shekels (for civil and security personnel). Therefore, the government owes at least 6.5 billion Shekels.

Dr. Akel Abu-Kar’, lecturer at Birzeit University: raised some questions regarding the social dimension of the budget under the rationalization of expenditure, especially since a quarter of Palestinians are under the poverty line, in addition to the high levels of unemployment rate.

Amal Al-Masri, Business Women Forum: stated that the international community should also take responsibility for the debts. We are still an occupied people with an inability to solve our own economic problems. Moreover, there is a need to increase developmental projects instead decreasing them. Finally, she insisted on the necessity of prosecuting tax evaders.

Samer Alameh, Ministry of Labor: is of the view that the Israeli occupation should also be held responsible, and not just the international community, otherwise the international community will become a source of financing for the occupation. His second point emphasized the need to not omit social goals under the guise of streamlining/rationalizing expenditure.

Dr. Mamdouh Al-Aker, Commissioner of the Independent Commission for Human Rights: wondered whether there are items in the budget which are not being transcribed with enough detail. He also emphasized the need to disclose and explain everything related to security in the light of the fact that 44% of new public employment during the year 2011 was in the security sector.

Mr. Adnan Abu-Alhumus, Padico Consultant: is of the view that there are no fundamental differences between the 2012 budget and those of previous years, there is just a chronic problem of deficit. He also sees that increasing revenues through tax policy is not a sound direction to take; instead, there is a need to prosecute tax evaders.

Naser Tahboub, Consultant: it is time to evaluate the privatization of the government share of the corporation, and if this privatization is fair or not. Tahboub thinks this privatization is one of the most important resources available to the government.

Dr. Samir abu Aysha, Former Minister of Planning, and professor at An-Najah University: Some of the assumptions concluded in the budget may not reflect the real yield for the deficit. For example, the assumption that the depreciation of the shekel from 3.60 in 2011 to 3.80 during 2012 means that 5.5% of the deficit will be covered as a result, this is not accurate and not based on facts.

Dr. Samir Abdullah, Director General of Palestine Economic Policy Research Institute (MAS): He emphasized the adoption of programs approach in preparing the budget. He was afraid that this approach has been neglected during the financial crisis.

Dr. Ali Jerbawi, Minister of Planning and Administrative Development: Emphasized that the budget is a political and policy document, and not just financial accounts.

Key Recommendations

- ✧ The necessity of submitting the budget on its legal time.
- ✧ Reconsider the expenditures assigned to the security sector, and assuring that all security employees do have actual jobs.
- ✧ Reconsider the income tax law from the perspective of social justice, rather than just raising revenues.
- ✧ Making the budget according to obvious objectives that suit the general policy of the Palestinian Authority.
- ✧ Setting actual programs to pay arrears to the private sector, because of its bad impact on private sector working.
- ✧ Put greater pressure on the international community to shoulder its responsibilities towards the Palestinian people, in terms of their obligation to pay the pledges of budget support.
- ✧ Specifying the unrecorded public debt to the private sector.
- ✧ Reduce bureaucracy with respect to the tax refunds.
- ✧ Specifying clearly the pension entitlements in the budget.
- ✧ Emphasize the necessity of preparing the budget by programs approach.

**Attendance Record for Round Table Session No. (2)
PNA Budget 2012: Review and Evaluation**

Name	Organization
Mohammed Sameh Qalalwah	PCBS
Amal Al Masri	Business Women Forum
Atef Al Awna	Bank Of Palestine
Azmi Al shuaybi	AMAN
Jawad Al Naje	Office of the Prime Minister
Mohammed Qarash	Economists Association
Saeed Haifa	Bir Zeit University
Samer Salama	Ministry of Labour
Aqel Abu Qaree	Bir Zeit University
Mohammed Al Mbyad	International youth Foundation
Zahi Khoury	National Beverage Company Coca-Cola
Azmi Alatrash	Al-Qouds University
Mohammed Khlifah	MAS
Sam Bahor	AIM
Ibrahim Hantash	MAS
Hani Al Masri	Masarat
Mamdoh Al Aker	
Izat Shuaybi	
Alaa	Association of Banks
Naser Tahbob	Ministry of Finance
Ali Al Jarbawi	Minister of Higher Education
Mohannad Al Jaoni	U.S. Consulate
Adnan Abu Al-Homos	PADICO
Waleed Al Ahmad	AL Qouds Company
Amal Daraghmh Al Masri	Business Women Forum
Remah Mousa	Arab Islamic Bank
Jameel Al Taher	Palestinian Investment Fund
Jihad Al Wazir	PMA
Farid Ghannam	Ministry of Finance
Shhada Hussain	PMA
Samer Abu Aysha	AL Najah University
Nayl Mousa	AL Najah University