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The PNA's FY 2018 Budget – What is New?

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The PNA's FY 2018 Budget[1] - What is New?

1- Background and Rationale

A country's budget is a practical plan that serves the objectives of its development plans, which aims ultimately to achieve economic, financial and social goals. The Ministry of Finance (MoF) of the Palestinian National Authority (PNA), prepares the budget by estimating the different budget items based on assumption and guided by data. The financial instruments in the budget structure which are used as basic variables in the formulation of fiscal policy, are listed under three main rubrics: (i) Public expenditures and related components (goods, services, wages, salaries, non-wage, social services, security, development, investment and current expenditures); (ii) Public revenues and related components (collected from several domestic and foreign sources, and from various types of taxes and non-tax sources, fees and profits); (iii) deficit, how it is financed and net lending. The latter variable ties with revenues, foreign aid, and domestic and external borrowings to cover the financing gap. Usually external budget support is relied upon to cover this gap. However, the downward trend in external support makes it necessary to borrow from domestic banks and to ration payments in settlement of private sector dues.

Given the Palestinian conditions, preparing the FY 2018 Budget takes place within a complex economic and political context. The MoF works diligently to prepare a budget that is in line with the economic and fiscal objectives and that responds to political changes and domestic development, aiming at gradually creating an independent economy capable of generating the needed revenues. These efforts build upon previous efforts that began in 2010[2] and were embodied in the 2014 and 2015 budgets and their new procedural, policy and legal statements. The 2015 assumptions and policies embodied major differences compared with the previously followed approach. Following that year, the process of developing the budget became different, having to go through three main stages; 1) the preliminary stage, which represents the referential basis and the general framework for policies, which involves identifying the economic and political environment and the various related indicators, determining the economic and social targets of the budget; 2) the stage of defining the budget items entailing revenues and expenditures of the different centers of responsibility;3) the stage of implementation and follow-up, which is the direct responsibility of the Ministry of Finance, which ensures compliance with the limits set in the budget.

Many challenges beset these stages, particularly because of the measures imposed by the Israeli occupation. These challenges have to be considered when preparing the budget, most importantly: the uncertainty of revenue forecasts since Israel controls a large proportion of these revenues and might impede implementing policies and meeting targets; the uncertainty in the availability of foreign budget support, depending on political conditions, which has an adverse effect on bridging the financing gap; and commitments arising from the national reconciliation that directly affect the public budget, which necessitates developing fiscal policies to enhance revenues and to cover the additional expenditures. The latter is a new factor, which was embodied for the first time in the FY 2018 Budget, by adding a Gaza-Strip specific expenses and revenues column to the budget

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1 The first PNA budget was developed in 1995 (which was not then based on a budget law). Since it was not built on a technically coherent basis, the first budget was tentative and improvised. Following the first legislative elections in 1996, the Palestinian Legislative Council (PLC) was formed and the Basic Law which (in its Articles 60 and 61) made the development of the public budget mandatory, and Law No (7) of 1998, which regulated the public budget and financial issues, was issued. Afterwards, the PNA process of formulating the budget became part of a comprehensive financial policy. The policy sets the rules and procedures for designing the budget, stipulating compliance with the budget law and requiring the executive authority to submit the budget to the PLC under a law that is ratified at a specific date each year. However, following the 2007 political division which suspended the Legislative Council, the budget law is now presented by the Cabinet to the PNA President for ratification.

2 In 2010 a fundamental change was made to the methodology of preparing the budget; the transition to program-based budget from item-based budget. This was partially introduced in 2012, following the pertinent cabinet decision, to become fully introduced in the system by 2013. The 2014 budget statement defined more specific objectives, and in conjunction with other amendments, constituted the basis for preparing budgets in the coming years linking the budget to the National Development Plan 2014-2016 (for more information see MAS, 2017)

resulting a what has been termed "Unified Budget"[3]. The Budget was presented to the representatives of the PLC factions in a special closed session, and was discussed later with representatives of the private sector and civil society institutions. However, statements about the budget in the media do not show a concurrence in the government's and the private sector's views regarding the policies and targets of the 2018 Budget, especially those related to the new tax amendments.

On 4th March 2018, the President of the State of Palestine ratified the PNA's Public Budget, which does not include the aforementioned additional budget column. The Budget Law, decreed by the President, comprises 19 articles covering: follow-up rules and mechanisms that will be adhered to throughout the year; the stringent spending controls, including restricting employment and allowances; and spending authorization.

Because of its importance, discussion of the budget has become an established tradition at MAS. Each year, the first of the year's series of roundtable meetings discusses the public budget in light of different aspects: comparisons between the actual 2017 vs. the budgeted and defining deviations and their trends; shedding light on developments, new policies, and new assumptions and their implications; and addressing the 2018 Unified Budget with all its components and accompanying policies.

2- FY 2018 Budget in Comparison with Previous Years' Budgets

To assess the 2018 Budget, it is necessary to first review previous budgets' figures, assumptions and policies. This allows for analyzing the overall context of previous budgets' policies and the evolution of revenues and expenditures. Deviations between the actual and the budgeted in the 2017 Budget will be identified, as well as the changes in the 2018 Budget compared with the actual in 2017 Budget**.**

2-1 Previous Budgets– Policies and Assumptions

The 2017 Budget was developed based on the same framework of financial reforms that was adopted in 2014-2015, basically: developing a revised guide of terms and concepts, setting ceilings for the medium-term budgets of the ministries and other public agencies within a framework of program budgeting and expenditure planning, creating projects' ID cards, and introducing a computerized system that integrates budgeting in the financial management system. A new framework was introduced in 2016, which was based on a newly created procedural manual for a medium-term of three years. Starting from 2016, three-year ceilings for budgets are set based on detailed data. Markedly, the 2016 Budget statement focused on developing gender-sensitive budget with more focus on vulnerable groups. The budget, furthermore followed a conservative approach in stating assumptions and expectations about revenues, reducing spending and net lending, and increased dependence on domestic revenues by following the policy of horizontal expansion of the tax base, increasing tax obligation and combating evasion, and enhancing the relationship with the private sector. All these principles were maintained in 2017.

2-2 The FY 2017 Assumptions

First: Revenues Policy:

- Revising trade systems and fees applicable in Palestine, especially those related to tobacco and fuel sectors.
- Identifying new sources of revenues under the Paris Protocol on Economic Relations, and minimizing fiscal leakage estimated at over US$ 300 million a year. These include items

[3] According to media sources and what the MoF presented in its Financial Plan for the Southern Governorates.

such as the 3% administrative fees charged on the clearance revenues; the purchase tax levied on Israeli products; and customs and purchase tax levied on products from the rest of the world imported via the Israeli market.

Second: Expenditures Policy:

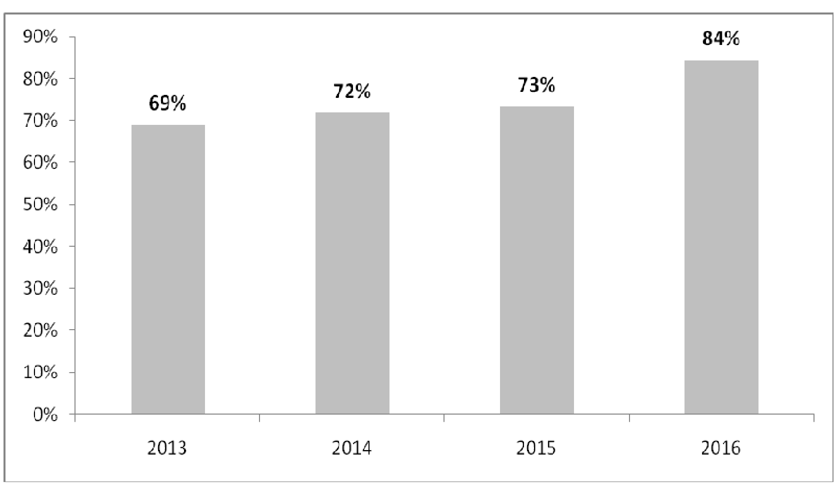
- Issuing promissory notes of NIS 50-70 million per month to expedite repayment of private sector dues and to reduce the accumulating arrears.
- Creating new jobs through allocating NIS 30 million to support small projects, in partnership with the Ministry of Labour (MoL) and banking sector institutions.
- Reforming the health sector and the medical referral system.
- Directing donor agendas to avoid conflicts between the different programs.

These assumptions and policies were designed to strengthen the administration of the "public wealth" reform program, as demonstrated in the following:

- Continue transferring NIS 20 million to the Palestinian Pension Authority and to ensure providing financial means necessary for its sustainability and increasing the cadre of the educational sector.
- Incentives to boost GDP growth through maintaining a low rate of income tax (15%) and reducing the income tax levied on profits of SMEs.
- Supporting the agricultural and the renewable energy sectors, through applying exemptions.
- Avoid crowding-out private sector borrowing from banks, while minimizing borrowing from banks as much as possible.
- Transferring funds on a daily and weekly basis to local government bodies while maintaining a level of NIS 400 million a year.
- Allocating NIS 222 million to support projects in the educational sector in Jerusalem and the marginalized social sectors in Area "C".

Generally speaking, until the end of 2017 remarkable progress was made in increasing revenues which surpassed the increase in expenditures. The increase in expenditures across all items was 6.3%, while the increase in net revenues was 18.5%. This is shown in Figure 1, which also shows that revenues have increasingly achieved higher ratios against expenditures over the last four years, signaling a diminishing gap between the two from 31% in 2013 to 16% only in 2016.

Figure (1): Development of Revenues (coverage) to Expenditures, 2013-2016



Source: MoF.

In respect to previous budgets (2014 -2017), the following points are noteworthy:

- Volatile financial sustainability:4 The budget deficit indicator shows a bypass of the conventional standard, as the public debt indicator has reached the maximum allowed ceiling. Although under Palestinian circumstances this is considered somewhat acceptable, other current expenditures and net lending (excluding salaries) constituted around 40% of total public expenditures, pointing to potential volatility threatening sustainability. Development expenditures constituted less than 6% in 2016, although ranging between 10%-20% in previous years.
- There is a correlation between the size of import revenues (from Israel and third countries) and economic growth, whereby the positive impact of economic growth on the size of imports translates into an increase in revenues. A slow growth is on the horizon, which means that this growth will not exceed current levels and cannot be expected to increase above that level. Therefore, the expected growth in revenues depends mainly on domestic revenues through improving tax collection and ensuring the private sector's tax obligation, even though domestic revenues contribute only 22% of total revenues. This situation calls for reconsideration of the applied tax policies, tax justice, and how to promote wider tax obligation in a complex context like the Palestinian economy.
- The increase in domestic revenues, the decline in external revenues (foreign grants and aid), and the increase in expenditures cutting, are all indicators that the PNA is more capable of controlling and cutting expenditures than controlling revenues, giving that expenditures are controlled internally, contrary to external revenues which are dependent on donors or are channeled through Israel.
- The rise in the ratio of revenues to expenditures from 69% to 84% indicates good progress during these years, due to improved collection and rationalization of expenditures.

2-3 2017 Budget Deviations: Estimated vs. Actual

Even though the 2017 Budget estimates followed a conservative approach, and adopted austerity measures and expenditures cuts, there was a significant variance between the actual and the estimated figures. This is best illustrated through drawing comparison between the actual and the estimated deviations of the 2017 Budget items as follows:

- Deviations in Revenues
  Data show that actual revenues were NIS 943 million, less (7.3%) than estimated, which is a significant negative deviation. This has mainly resulted from the deviation of actual domestic revenues, which were NIS 884 million less (21.3%) than the estimated, while actual clearance revenues were less by NIS 8 million. Therefore, it is imperative to reassess the basis of estimation and assumptions, or to revise domestic tax policies, and to investigate the reasons for not reaching the targets. On the other hand, contrary to estimates, external financing estimates showed a positive deviation, reaching NIS 2576 million, compared with an estimate of NIS 1326 million (more than 48.5%), which reduced the financing gap by 62% compared with estimates. This highlights the huge impact that external financing has on the financial sustainability and on bridging the financing gap.

- Deviations in Tax Refunds
  Tax refunds followed the same negative trend, as actual tax refunds were NIS 109 million less than estimates (41.8% less). This can be interpreted as a lack of commitment by the government to honoring private sector entitlements that also undermines the policy of enhancing the public-private sector partnership. This was one of the 2017 Budget assumptions, and remains a primary assumption in the statement of the current budget.
- Deviations in Expenditures

[4] Financial sustainability is also affected by political factors, especially donor countries support to the budget.

Even though current expenditures were high (NIS 263 million), actual expenditures were NIS 418 million less than estimates (2.7%), ascribed to cutting expenditures, especially salaries and wages. This confirms the observation that the PNA's ability to control and forecast expenditures is much better than its control and forecast of revenues.

- Deviation in Development Expenditures and Net Lending
  One of the assumptions in the Budget statement was related to enhancing development expenditures in order to stimulate economic development. Within this framework, the developmental spending ceiling was raised in the 2017 Budget to NIS 1639 million. This budgetary item is partially dependent on external aid (estimated at 33% in the Budget), and on allocations from the PNA's revenues. The actual external financing was 3% higher than estimates, yet actual development allocations was significantly less (24%) than the budget estimates, i.e. actual development expenditures declined to NIS 1321 million, some NIS 318 million less than budgeted.

  Regarding net lending, despite the strenuous efforts and the adopted policies it was not possible to reach the set target, which was reducing net lending to NIS 950 million. Actual net lending witnessed an increase of NIS 10 million, and as such, revising applied measures and adopting new ones is crucial.

- Variances in the FY 2018 Baseline Scenario Compared with the Actual FY 2017 Budget Performance

  Revenue estimates for FY 2018 are only 7% higher than actual FY 2017 figures, which is a very conservative estimate compared with estimates in previous years. Budgeted tax refunds are 28% less than FY 2017 actual refunds. Total current expenditures and net lending are forecast to increase by only 2.7% in line with the austerity and rationalization policies. The financing gap estimate for FY 2018 is 6.5% less than the actual gap in FY 2017, assuming an 8.3% increase in external financing. On the other hand, development expenditures are budgeted 41.8% above actual expenditures in FY 2017 (Table 1).

3-1 The FY 2018 Budget: Assumptions and Developments

The General Environment and Main Economic Indicators
The FY 2018 Budget came within political conditions and expectations that are different from previous ones.[5] This changing environment pertains to recent developments in the Palestinian reconciliation file, in addition to the deteriorating political situation following the USA new position on Jerusalem. These have together impacted expectations regarding Palestinian-Israeli trade relations, especially the possible instability in clearance revenues. In addition, international aid is forecast to decline, another indicator that the Palestinian economy is expected to shrink. Therefore, the Budget's scenario was built flexibly enough to accommodate the possibility of reconciliation and to serve its goals. For this purpose it was structured differently. In addition to the Baseline Budget, which includes the expenditures of the southern governorates (Gaza Strip), it included the additional budgetary needs of Gaza of accommodating the salaries of 20,000 public servants and other additional expenditures, presented under the "Unified Budget".

The budget estimates were based on the following PCBS data and economic indicators for 2017:

- By the end of 2017 the GDP growth rate was 3.9%.
- The consumer price index (CPI) rose by 0.21% as a result of the increase in fuel prices and electricity tariffs.
- The unemployment rate in the West Bank and Gaza was 29.2%.

[5] FY 2018 Budget Assumptions and Policies- MoF.

- The trade balance deficit rose to USD 5281 million in 2017 (USD 7816 in imports, USD 2535 in exports).
- The ratio of public debt to GDP was 18%.

3-2 Key Policies and Principles of the FY 2018 Budget

The FY 2018 Budget included a package of new policies and measures designed to strengthen the PNA's financial position and to reduce dependence on foreign aid. The FY 2018 Budget statement focused on the following policies:

- Reducing tax burden on individuals and start-ups and small enterprises, with the aim of achieving greater equity, while taking into consideration economic discrepancies between southern and northern governorates.
- Introducing corporate tax policies that aim at absorbing fresh graduates and encouraging banks and financial institutions to finance start-ups and small enterprises.
- Incorporating the reconciliation's costs and additional budgetary needs and implementing new development projects in the Gaza Strip.
- Enhancing financial sustainability through expenditures rationing and cutting unnecessary expenditures, curbing borrowing as much as possible and directing it to development projects rather than to consumption or current expenditures, while ensuring debt servicing capacity.
- Continue reducing arrears as part of the FY 2018 Budget policies through issuing "promissory notes"[6], provided that an 80% cash reserve is secured. The issuance ceiling during FY 2018 will be NIS 600 million.
- Continue supporting the Palestinian Pension Authority, through raising the allocated funds from NIS 20 million (in 2017) to NIS 25 million.

In addition, the Unified Budget addressed possible new financial burdens based on the following policies:

- Continue enforcing and expanding the tax system and ensuring that administrative development is pursued, in addition to enacting new amendments to the income tax brackets for corporates and individuals.
- Introducing smart incentives and exemptions related to training programs targeting graduates.
- Establishing a long-term lending fund administrated by the MoF, for implementing renewable energy projects, in which the government and the Palestine Monetary Authority (PMA) contribute each USD 10 million, to reach a capital of USD 40 million.
- Revising the Law on Landlords and Tenants, and standardizing applicable government fees in many sectors, including oil, courts and land sectors.
- Reducing net lending by 20%, and adopting strict austerity policy including cutting or freezing public sector employees' allowances, as well as reforming the medical referral system and increased local provision of medical services.
- Increasing pressure on Israel to demand for Palestinian financial rights, such as border crossing fees and collection fees (3%) Israel deducts from revenues transferred to the PNA.

[6] Promissory notes of NIS 12 billion were issued in 2016, and NIS 968 million of arrears were paid off (FY 2018 Budget Statement).

3-3 New Policies and Measures in the FY 2018 Budget

The internal political conditions that accompanied the preparation of the FY 2018 Budget were different from previous years, considering the favorable reconciliation horizon at the time. As such, a new budget structure and policies were adopted, most importantly:

First- the Unified Budget Encompassing the Southern Governorates
For the first time, a new separate column was added to the Baseline Budget to incorporate Gaza's budgetary needs, the "Unified Budget". The new budget incorporated revenues from Gaza of an additional NIS 900 million (6% only of net revenues), expenditures of NIS 1744 million (10.7% of total current expenditures and net lending) and development expenditures of NIS 1080 million (57%) higher compared with the Baseline Budget. In summary, total expenditures increased by 18% and revenues by 7%, which negatively impacts the financing gap and the financial sustainability of the budget. The large increase in expenditures is attributed to the inclusion of 20,000 public servants in the "salaries" item in the Budget.

This entails adopting new economic and fiscal policies, referred to in the Budget statement as "the necessary track". This is because implementing part of these policies could necessitate introducing legal amendments to legislations, while the other part can be implemented directly. The aforementioned track is represented in two sub-tracks: the first is related to the Baseline budget, and the other is necessary for the Unified Budget, as shown in tables (A and B) below.

Table (A): The First Sub-track Necessary for the Baseline Scenario (status que)

#	Policy or Measure	Expected Revenues - US$ Million
1	Amending income tax brackets*	60
2	Applying income tax on dividends*	30
3	Fiscal leakage to Israel	120
4	Revising applied fees	50
5	Amending the Law on Tenants and Landlords and Settlement	15
6	Savings resulting from a 20% reduction in net lending	50
	Total	325

Table (B): The Additional Sub-track Necessary for the Unified Budget Scenario

	Policy	Expected Revenues – US$ Million
1	Suspending the Law on the Encouragement of Investment *	80
2	Rationalizing medical referrals by 10%	20
3	Austerity measures including cutting or freezing allowances	30
4	The needed increase in foreign aid	150
	Total	280

Source: MoF- Budget Statement.
*= a legal action is needed to apply this amendment.

According to the MoF, the financing gap in the Baseline Scenario is expected to stand at US$ 158 million compared with US$ 426 million in the Unified Budget, as a result of applying the policies and measures mentioned in the "necessary tracks" above.

Second- Income Tax Amendments:
Amendments to the income tax, affecting individuals and corporates, aim at achieving greater social and tax collection equity especially among low income earners, through applying a progressive tax approach on high income earners by introducing a fourth tax bracket.

Table (2) shows amendments to income tax brackets for individuals, by introducing a fourth tax bracket of 20%, and raising the exemption ceiling for residents from NIS 36,000 to NIS 40,000. Following the amendment, the percentage of exempted individuals becomes 61% of the total number of taxpayers, while 32% are within the 5% tax rate bracket. This means that only 7% of the taxpayers pay between 10% to 20% income tax (specifically 6% pay 10%, 0.8% pay 15%, and 0.2% pay 20%). The newly adopted approach of the progressive system of taxation will reduce financial burdens on low income earners, especially public-sector employees. More than 60% of those employees receive an annual salary of less than NIS 40,000, and so benefit from raising the exemption ceiling for residents and are not affected by adding a fourth tax bracket. However, in Gaza the percentage of public sector employees earning less than NIS 40,000 rises to 90%. Based on the MoF estimates, this policy is expected to expand the tax base by 10%, thus raising taxes collected from individuals by 35%.

On the other hand, Table (3) shows amendments to income tax for corporations. Income tax for small corporates (with an annual income of NIS 3.5 million or less) has been reduced from 15% to 10% in order to increase productivity and employment opportunities they represent. About 8,150 corporations (or 90% of the total number of corporates) benefit from this reduction. At the same time, the amendment included adding a new tax bracket (20% instead of 15%) applicable to high income corporations (NIS 7 million and above), mostly banks and financial institutions. These large institutions number only 52. Applying these amendments will re-categorize corporations as follows: 98.7% are subject to 10% tax, 0.7% to 15%, and 0.6% to 20%. Again, the MoF expects that tax revenues collected from corporations will increase by 50 %.

Third- Smart Incentives
For income tax purposes, 150% of the minimum wage level will be considered as approved expenses deductible from income tax applied to companies employing more than 20 employees (around 900 corporations), with the expectation that 5,000 fresh graduates will be trained. In addition, taxes on banks' profits on credit portfolios for small projects that they manage will be reduced in order to stimulate lending to micro and small projects. The ceiling of the financial cycle of small projects will be raised from US$ 200,000 to US$ 1 million (i.e. expanding the category of small projects in relation to their financial resources). This will increase the number of projects benefiting from this reduction in the income tax applied to portfolio profits, which was reduced in 2014 from 15% to 10%, to stimulate banks to lend projects under this category since their profits are exempted from income tax.[7]

Another proposed smart incentive is establishing a long-term lending fund for implementing renewable energy projects with an initial capital of US$ 20 million that will be raised to US$ 40 million. The suggested mechanism is that the bank is charged 2% for borrowing from the Fund, and charges 4% on lending, whereas the 2% difference goes to the government's treasury. This way, and since it grants long term loans, the fund serves the interests of all involved parties,

[7] The profits of small projects portfolio, constituting about 30% of the portfolios profits were subject to a 10% income tax, whereas the other credit portfolios' profits (constituting 70% of total) were subject to a 20% rate. Following the new amendments, the tax burden was carried completely by the other portfolio's profits, as the profits of the small projects portfolio became exempted, while the other portfolios profits were 100% and subject to a 20% tax rate.

especially that Palestinian banks, in most of the time, grants short term loans. As such, the fund presents one way out of this dilemma.

Fourth- Standardizing applicable fees in the northern and southern governorates, to achieve equity among all sectors of society. In the northern governorates, fees constitute 10% of total domestic revenues, while in the southern governorates they are 25% of domestic revenues. There is also a need to revise fees' rationale in many sectors, including oil, judicial and land sectors.

3- Assessment of the FY 2018 Budget and New Policies

The above review presented the FY 2018 Budget in detail and identified its main policies, many of which are new ones that might have positive or negative outcomes. Although this cannot be decided now, it does not mean that these policies cannot be assessed at this stage. The available data and indicators provide an adequate basis for evaluating the budget and identifying pros and cons, based on which, the following observations are pertinent:

1. Generally speaking, drawing comparison between the FY 2018 Budget and previous budgets shows that growth in expenditures surpasses growth in revenues. It also shows that the revenue coverage to expenditure indicator has declined from 84% in the FY 2017 Budget to 80% in the FY 2018 Budget.
2. The government's commitment to strengthen the public-private sector partnership was not maintained in the FY 2018 Budget, which is shown in a 41% decline in tax refunds. These refunds pump liquidity into the business market and provide for the private sector's expansion.
3. The financial sustainability dilemma is still paramount, especially after incorporating additional budgetary needs of the southern governorates, and with the high ratio of current expenditures reaching 40% of total. On the other hand, the decline in actual domestic revenues to levels below estimates leads to uncertainty regarding domestic revenue collection. These revenues are still around 22% of total, and the negative deviation in revenue estimates is around 21%. The current situation is the result of unsuccessful implementation of policies as announced in the Budget statement, which emphasizes the need for reassessing these policies. Cutting expenditures is not an adequate measure to enhance financial sustainability, and needs to be implemented in conjunction with measures for increasing revenues.
4. Although the FY 2017 Budget has succeeded in reducing the salaries bill through applying strict measures, the same progress was not possible on the level of current expenditures and net lending, which became even higher than previous years. Achieving significant changes to both items requires the enactment of laws, policies and strict measures.
5. The FY 2018 Budget introduced policies and measures which are novel and in the right direction, among these: tax amendments, smart incentives and exemptions, standardization of applied fees, as indicated in the "necessary track" policies in the Baseline Budget. These policies are considered a quantum leap in terms of the distribution of the tax burden, adoption of a progressive tax approach, as well enhancing the development of the small-scale private sector and increasing employment.
6. Estimates of income tax revenues are based on assumptions and expectations, and cannot be definitive. Therefore, the income tax rate was adjusted four times within three years. Estimates were high, and the actual did not meet expectations. This deviation between the actual and the estimate is ascribed to using the trial and error method, and not relying on systematic methods. The pertinent question that needs to be answered is: could introducing a fourth tax bracket (20%) adversely impact the private sector's expansion? Or discourage investments?
7. The Budget statement expects that reducing the income tax brackets will expand the tax base by 10%, which could raise revenues collected from individuals by 35% and from corporates by 50%. However, these revenue expectations are uncertain assumptions and forecasts that the FY 2018 Budget cannot fully rely upon. It is unlikely that income tax revenues could double in just one year of enforcing the amendments of the tax brackets.

8. Table (4) shows the distribution of the Budget items by the four government sectors, which includes 54 responsibility centers. The Government's Sector and the Social Sector's shares of total expenditures is 47% each; while the shares of the Infrastructure and the Economic Sectors are 3.7% and 2.3% respectively. The inability to allocate additional resources to the Economic sector because of the security and social services expenses which dominate budget resources, is considered an indicator of limited economic growth.

Regarding the "Unified Budget":
First, it should be noted that the "Unified Budget" has not been issued by a Presidential Decree. Signing this part of the Budget into law (as it is still a proposal among the financial plans of the MoF), is contingent on political developments related to possible Palestinian reconciliation. In any event, the following observations are pertinent:

- The expected increase in revenues (6% only) does not indicate the real contribution of the southern governorates (Gaza Strip), which used to contribute in the past about 30% of the total revenues of the PA. The Unified Budget assumes that Gaza's clearance revenues will stand at NIS 420 million, and that domestic revenues will be NIS 480 million, i.e. domestic revenues were higher than clearance revenues, which has never been the case in the past.
- On the other hand, no tax refunds were allocated to the private sector in Gaza Strip. A clarification needs to be made in this respect.
- Some policies included in the "necessary track" of the Unified Budget might hinder the growth of the economy by cancelling or suspending investment incentives. Such measures could put pressure on the private sector and probably will not stimulate the economy.
- Finally, cutting medical referrals by 10% conflicts with the principles of supporting the poor and the rights of the marginalized in health services, especially that Gaza is suffering from a shortage in medical supplies and health services.

Generally speaking, from an economic growth perspective the continuing expenditure cutting policy, and reduction in investment incentives could lead unintentionally to economic stagnation in the future and does not stimulate demand in the economy. To measure the impact of this downward trend, economic studies needs to be carried out, to investigate to which extent spending can be reduced. Furthermore, this policy has implications on the quality of delivered services especially that the health, education and social services are already deteriorating and need improvement, which cannot be achieved without the necessary spending.

Questions and Pillars for Discussion
- What adverse economic repercussions could the expenditures cutting policy that was adopted over the last five years, bring forth?
- What mechanism should be put in place in order to apply the smart-incentives policy? Would banks commit to applying these incentives without enforcing binding regulations?
- How will introducing a fourth tax bracket (20%) impact the private sector's business expansion?
- What happens if reconciliation is stalled? How will that affect the additional column in the budget?
- What measures should be taken to bridge the financing gap if actual revenues are below estimates؟
- Which of the two options (suspension or activation of the Investment Law) would bring forth higher economic benefits?

Appendix

Table 1: the PNA's Expenditures, Revenues, and Funding Sources/ Budgets (actual) NIS million

Item	2016 Actual Budget	2017 Actual budget	2017 Estimated budget	2018 Baseline budget	Gaza's budget	Combined budget	Deviation in 2017 estimated Budget	Deviation in 2018 baseline budget from 2017 actual budget
Net public revenues	**11456**	**12617**	**13451**	**13505**	**900**	**14405**	-6.6	7.0
Total revenues	11897	12878	13821	13691	900	14591	-7.3	6.3
− Domestic revenues	3467	4156	5040	4533	480	5013	-21.3	9.1
− Clearance revenues	8430	8722	8780	9158	420	9578	-0.7	5.0
− - Tax refunds	441	261	370	187		187	-41.8	-28.4
Total current expenditure and net lending	16137	15729	16147	16180	1744	17924	-2.7	2.7
- Salaries and wages	7837	7631	8093	7878	843	8721	-6.1	3.2
- Other current expenditures	7270	7139	7104	7402	931	8333	0.5	3.5
- Net lending	1029	960	950	900		900	1.0	-6.3
Current account deficit before financing	3587	3113	2697	2675	874	3549	13.4	-14.7
+ Development expenditure	1287	1321	1639	1909	1080	2953	-24.1	41.8
Total deficit before aid and grants	4874	4434	4335	4584	1954	6538	2.2	2.1
Financing	4874	4434	4335	4584		6538	2.2	2.1
External Aid	2921	2576	1326	2790		2790	48.5	8.3
- Budget support	2318	1966	1950	2160		2160	0.8	9.9
- Financing development expenditure	603	609	546	630		630	10.3	3.4
Financing gap	1953	1858	3009	1794		3748	-61.9	-6.5

- Note that the Combined Budget was not promulgated by a Presidential Decree

Table 2: Amendments to Tax Brackets for Individuals

Income	Tax Rate	Amended Income	Amended Tax Rate
1-36,000	Exempt	1- 40,000	Exempt
36,001 – 75,000	5%	40,001-75,000	5%
75,001-150,000	10%	75,001-150,000	10%
More than 150,000	15%	150,001 -300,000	15%
The highest bracket		More than 300,000	20%

Table 3: Amendments to Tax Brackets for Corporates

Income	Tax Rate	Amended Income	Amended Tax Rate
The full tax base	15%	1- 3,500,000	10%
Large companies (franchise and monopolism)	20%	3,500,001 – 7,000,000	15%
Highest bracket		More than 7,000,000	20%

Table 4: The FY 2018 Baseline Budget by Sectors

# of Sector	Sector	Total Expenditures – NIS Million	Percentage of Sector's Expenditure to Total Expenditure
1	Government Sector	7771	47%
2	Infrastructure Sector	583	3.7%
3	Economic Sector	387	2.3%
4	Social Sector	7817	47%
	Gross Total	16,559	100%