

PALESTINIAN ECONOMIC BULLETIN

Issue 65

February 2012

Main reports

The Cabinet and the Coordination Council of the Private Sector have reached an understanding on income and corporation tax reform.

President of the World Bank, Robert Zoellick, met Prime Minister Dr Salam Fayyad to discuss the World Bank's ongoing support to the Palestinian economy.

The Palestine Investment Fund (PIF) and the Palestinian Development Fund (PDF) have signed an agreement to manage a \$2m lending facility for SMEs in the Jerusalem governorate.

The Multilateral Investment Guarantee Agency (MIGA) has provided investment guarantees to the National Beverage Company (NBC) for the expansion of the operations of its Gaza distribution centre.

PA's Arrears to the Private Sector Growing

The Palestinian Authority (PA) is accumulating significant arrears to the private sector, with potential negative consequences for the wider economy. The ongoing funding crisis, resulting from lower than expected foreign contributions and the recent general economic slowdown, has forced the PA to delay some payments for supplies and services for an indefinite period. Estimates from the Ministry of Finance show that in 2011 alone the government accumulated around NIS 1.94bn (\$541.4m) in delayed payments, of which NIS 929.6m (\$259.7m) is arrears to the private sector (operational expenses, development funding and tax refunds) and NIS 946.5m (\$264.4m) to the public sector pensions fund.¹ In addition, by December 2011 the PA had accrued NIS 1.91bn (\$533.7m) of loans to Palestinian banks.²

Arrears have been mounting for a number of years with the PA receiving contributions for their payment as far back as 2008,³ but this started to become a serious challenge in 2010. A standing clause in the Palestinian budget stipulates that "should we receive additional external budget support, we will allocate it to the repayment of arrears."⁴ Since disbursed foreign aid has always been less than promised, the PA has been unable to pay old bills.

With its limited resources, the PA has established priorities for its outgoing costs. Monthly wages, pensions and social allowances are paid first and are often funded by the EC and European countries. For example, this month the EU and Sweden contributed €24.7m for the payment of wages and pensions to public sector employees and retirees, and the EU has agreed to frontload €116.2m of its €155m package of support to the PA into the first five months of 2012 to help address the crisis.⁵ Operational expenditures and payments to local entities are high in the priorities list in order to stimulate economic growth or at least prevent collapse. Medical bills are also considered of high importance, although there are arrears to medical suppliers.⁶

The Arab League has called for its members to provide monthly support of \$100m to the PA.⁷ Arab states have previously committed to disburse \$330m every six months, but have failed to fulfil this promise.⁸

An ongoing inability to pay the private sector is likely to have a significant negative effect on the Palestinian economy. The small size of a typical Palestinian company does not allow enterprises to receive bridging finance from banks. In addition, private suppliers have lost confidence in the PA hampering its ability to conduct normal business with the private sector and the banking sector. There is some anecdotal evidence that private suppliers have started charging higher prices to the government in order to cover the interest on potential bank loans

1 www.pmf.ps/news/plugins/spaw/uploads/files/accounts/2012/01/table4_eng.pdf

2 www.pmf.ps/news/plugins/spaw/uploads/files/accounts/2012/01/table8a_eng_nis.pdf

3 www.idf.ps/documents/Show.aspx?ATT_ID=5068

4 www.pmf.ps/en/Budget%20Statement%20-%20English-%20March%2031,%202011.pdf

5 eeas.europa.eu/delegations/westbank/documents/news/20120207_pr_csp_payment_in_february_en.pdf

6 Bulletin 64, January 2012

7 www.egyptindependent.com/node/654471

8 Bulletin 59, August 2011

in case the PA does not pay on time. Private companies are also sometimes refusing to supply products or services to the PA's ministries and institutions.

If the financing problems persist, which seems likely, the PA will continue accumulating arrears in 2012 and the private sector and wider economy will be increasingly affected.

Tax Reform Update

As part of the national dialogue on the financial crisis, the Palestinian Cabinet and the Coordination Council of the Private Sector have reached an understanding on income and corporation tax reform. The original proposal from the PA was the introduction of two new higher income and corporation tax brackets of 22.5% for taxable income over NIS 125,000 and 30% for taxable income over NIS 200,000. These reforms were suspended last month following concerns from the private sector.⁹ The agreement removes the top bracket (30%) and reduces the 22.5% bracket to 20%. In exchange, the private sector has agreed to postpone tax breaks for investors for two years.¹⁰

As a result of the new tax system, individuals and companies with annual taxable income of more than NIS 165,000 will pay 20% tax. Other issues and policies will be negotiated in the coming two months between the parties.

Talking to the Bulletin, Dr Samir Abdullah, Director General of MAS and facilitator in the dialogue, emphasised the importance of the achieved deal as a compromise between the government and the private sector.

World Bank President visits PM

On his first trip to the region as President of the World Bank, Robert Zoellick met Prime Minister Dr Salam Fayyad to discuss the World Bank's ongoing support to the Palestinian economy.¹¹

President Zoellick said "World Bank research shows that the economic growth in West Bank and Gaza from 2008-2011 was driven primarily by donor aid, and therefore will be difficult to sustain without greater private sector growth. To boost private sector investment and creation of jobs, Israel needs to take further decisive action to ease access and movement constraints, while at the same time the Palestinians will need to make real commitments to safeguard security. The two steps would be mutually supportive." He also emphasised the efforts and achievements of Prime Minister Fayyad in his work for the PA.

In support of the Palestinian economy and society, the World Bank is providing \$217m for investment in education, energy, municipal development, water, solid waste management, social protection and NGOs, and another \$139m for job creation, strengthening the financial sector, promoting mobile phone use in Gaza and solid waste management.

9 www.palestinecabinet.gov.ps/site/461/default.aspx?tabID=461&ItemID=102558&mid=3173

10 www.palestinecabinet.gov.ps/site/461/default.aspx?tabID=461&ItemID=102561&mid=3148

11 World Bank Group news release, Ramallah, 1 February 2012

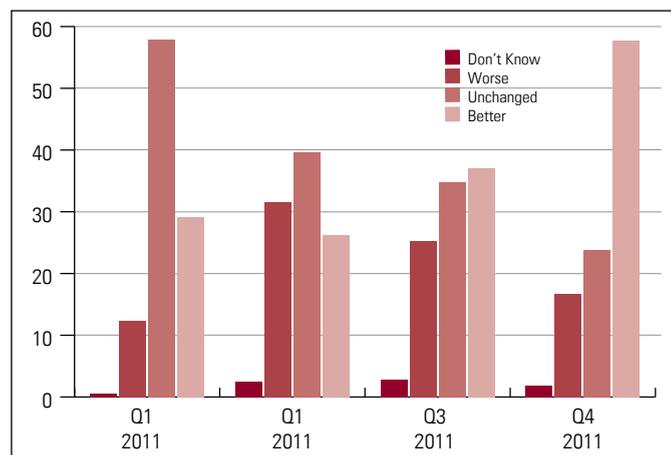
West Bank Business Perceptions¹²

The results of the Q4 2011 survey of the perceptions of owners and managers of industrial enterprises released by PCBS show that only 17.4% of them reported an improvement in performance in Q4 2011 against Q3 2011.¹³ This is a marked decrease against 28.0% in Q3¹⁴ and 34.4% in Q2.¹⁵ Since industrial activities account for as much as 12.7% of GDP,¹⁶ this low level suggests a weakening of the economy.

More than half of businesses that reported a decline in sales in Q4 gave the reason as being the decrease in consumer purchasing power; about a fifth pointed to seasonal variations.

Businesses perceived the closure of entry points as the most significant obstacle to exports, followed by payment guarantees. The survey found personal relationships were very important, with 97.6% of owners/managers relying on them to find customers in export markets and 63.4% relying on customer self-initiative. Less than half (48.0%) conducted market research.

Figure 1: Expectations of Performance for the Next Quarter



Source: PCBS

As the chart above shows, across 2011 increasing numbers of businesses expected their position to remain unchanged. Looking forward, 29.2% of enterprises expected a better general performance in Q1 2012 and 31.2% predicted an increase in the volume of sales.

Exports from Gaza

In January a shipment of 15 pallets of furniture was allowed to leave the Gaza Strip for a commercial exhibition in Jordan as part of a DFID backed project. This was the first export of non-agricultural products since June 2007.¹⁷ Between 1 January and 4 February, a total of 64 truckloads of agricultural produce left Gaza: 47 with strawberries

12 The report for Q4 2011 covers the West Bank industrial enterprises only because of increasing non-response rate in Gaza.

13 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/text%20e26jan.pdf

14 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/ownmanInd_q32011e.pdf

15 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/IndusEnteQ2_2011e.pdf

16 Bulletin 64, January 2012

17 www.ochaopt.org/documents/ocha_opt_protection_of_civilians_weekly_report_2012_01_27_english.pdf

(236.4 tonnes), 10 with cut flowers (1,263,050 stems), 3 with sweet peppers (12 tonnes) and 4 with cherry tomatoes (29.1 tonnes).¹⁸ On 6 February two additional truckloads of cherry tomatoes were transported to Saudi Arabia.

Lending Facility for SMEs in the Jerusalem Governorate

The Palestine Investment Fund (PIF) and the Palestinian Development Fund (PDF) have signed an agreement to manage a \$2m lending facility for SMEs in the Jerusalem Governorate.¹⁹ The program is sponsored by the Arab Fund for Economic and Social Development. This soft loan facility will target established SMEs with sound business models and growth potential in order to support job creation and economic revival. The program will offer loans between \$25,000 and \$100,000 for periods up to five years in various economic sectors.

MIGA Investment Guarantee in Gaza

The Multilateral Investment Guarantee Agency (MIGA) has provided investment guarantees to the National Beverage Company (NBC) for the expansion of the operations of its Gaza distribution centre in support of private sector investment development in the Gaza Strip.²⁰ The \$2.3m coverage will insure the expansion of NBC's Gaza branch and the enhancement of its distribution facilities against the risks of expropriation, war and civil disturbance for a period of up to 10 years.²¹

Gaza Power Plant Stopped Production

As the Bulletin went to press, it had been reported that the only power plant in Gaza had stopped electricity production on 14 February due to a shortage of fuel leading to blackouts.²² A limited supply of fuel was reported as entering Gaza through the tunnels from Egypt on 20 February.²³ Discussions were underway with the Egyptian authorities on the future supply of fuel.

Kuwaiti Housing Projects

On 4 February the Kuwait Fund for Arab Economic Development pledged \$90m to support housing in the Palestinian Territory: \$45m for housing projects in East Jerusalem, \$25m in the West Bank and \$20m in Gaza.²⁴ The money will be provided as loans through Palestinian

commercial banks and will facilitate the housing of tens of thousands of Palestinians and create dozens of jobs.

Cash Crisis in Gaza

In January the PMA delivered a shipment of shekels to bank branches in the Gaza Strip in order to ease the cash crisis there.²⁵ The shortage of currency in Gaza has both delayed the payment of public sector employees in recent months and increased the price of US dollars.

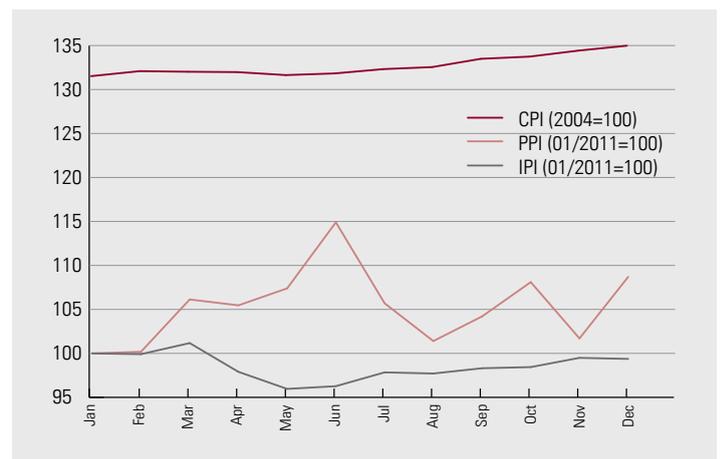
Under the current blockade transferring currency into Gaza requires coordination with the Israeli military authorities. Limitations on the operations of banks and reduced foreign aid have also contributed to the cash crisis, turning Western Union and other similar services into the most convenient method of moving cash in Gaza. However, recent restrictions on Western Union's transfer of money due to concerns about money laundering have worsened the cash situation.²⁶

2011 and January 2012 Price Indices²⁷

In 2011 the Consumer Price Index (CPI) for the Palestinian Territory reached 132.71, an increase of 3.88% compared with the previous year.²⁸ This rise was driven by increases in the prices of all major commodity groups with the highest increase in alcoholic beverages and tobacco (6.22%) and the lowest in education (2.10%).

The Producer Price Index (PPI) increased in 2011 by 2.11% reaching 98.53. The index increased by 3.38% for manufacturing and 0.41% for agriculture, and reflects the higher prices which local producers required for their output.

Figure 2: CPI, PPI, and IPI for 2011



Source: PCBS

CPI experienced a constant moderate increase throughout 2011, reflecting the gradual rise in consumer goods prices. The fall in PPI represents a decrease in the prices which producers received for their production. The volatility in

18 www.ochaopt.org/documents/ocha_opt_protection_of_civilians_weekly_report_2012_01_13_english.pdf, www.ochaopt.org/documents/ocha_opt_protection_of_civilians_weekly_report_2012_01_20_english.pdf, www.ochaopt.org/documents/ocha_opt_protection_of_civilians_weekly_report_2012_02_03_english.pdf, and www.ochaopt.org/documents/ocha_opt_protection_of_civilians_weekly_report_2012_02_10_english.pdf

19 www.pif.ps/index.php?lang=en&page=our_news&sub=132730766807&news_item=13273080181771

20 www.miga.org/news/index.cfm?aid=3251

21 www.miga.org/projects/index.cfm?pid=1038

22 www.alresalah.ps/ar/index.php?act=post&id=47275

23 www.maannnews.net/eng/ViewDetails.aspx?ID=461832

24 english.wafa.ps/index.php?action=detail&id=18892

25 www.maannnews.net/eng/ViewDetails.aspx?ID=452668

26 www.maannnews.net/eng/ViewDetails.aspx?ID=452395

27 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/CPI122011E.pdf, www.pcbs.gov.ps/Portals/_pcbs/PressRelease/PPI122011_E.pdf, and www.pcbs.gov.ps/Portals/_pcbs/PressRelease/IPI122011_E.pdf

28 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/CPI2011E.pdf

the Industrial Production Index was driven by fluctuations in the economy and seasonal factors.

Figure 3: CPI, PPI, and IPI for January 2012

	Consumer Price Index (CPI)	Producer Price Index (PPI)	Industrial Production Index (IPI)
	2004=100	01/2011=100	01/2011=100
Level	134.98	99.37	108.7
Change from 12/2011	+0.42%	-0.13%	+6.8%
Change from 01/2011	+2.75%	N/A	N/A

Source: PCBS

The increase in CPI in January this year was driven by rises of 2.15% in education and 1.11% in textiles, clothing, and footwear.

November Foreign Trade

In November 2011 Palestinian export of goods declined by 5.0% compared with the previous month, while imports grew by 0.8%.²⁹ This resulted in an increase in the trade deficit of 2.2% to a level of \$270.2m.

Figure 4: Trade in Goods for November 2011

	Exports	Imports
Level	\$59.8m	\$330.0m
Change from 10/2011	-5.0%	+0.8%
To/from Israel (% of total)	83.8%	64.6%
Trade deficit		\$270.2m
Change from 10/2011		+2.2%

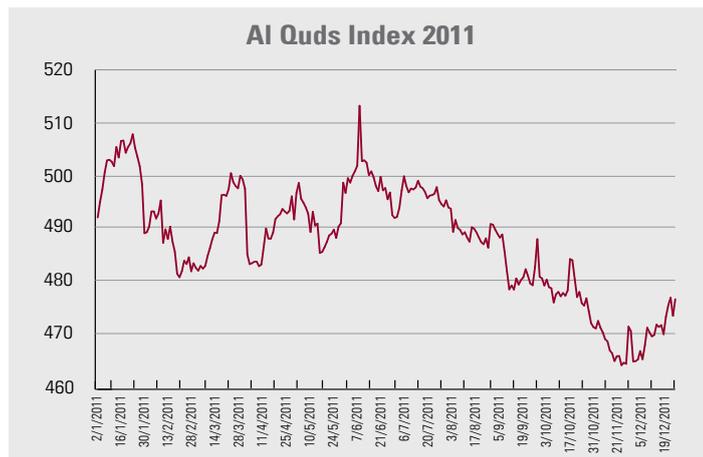
Source: PCBS

2011 and January 2012 Trading News

On 7 February the Middle East Investor Relations Society (ME-IR Society), an independent non-profit organisation, launched its Palestine Chapter with a new IR charter.³⁰ The charter will improve the quality of IR practices and educational resources in the Palestinian Territory.

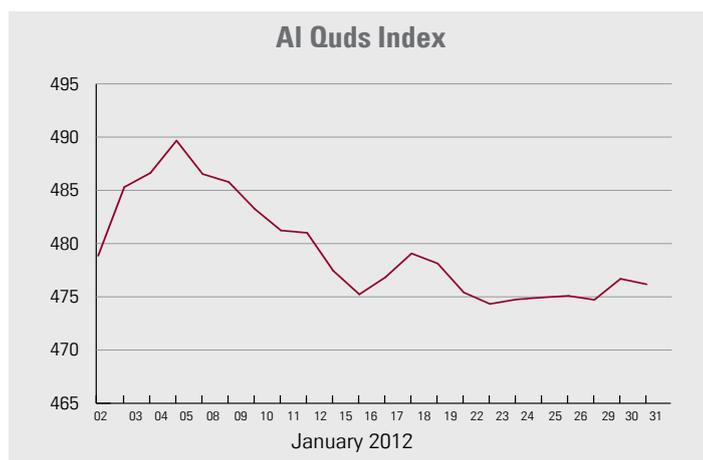
In 2011 the AI Quds Index experienced a general decrease but still performed better than other regional indices. It began at 498.5 on the first day of trading and closed at

476.9 on the last day of the year. The index marked its highest (513.3) and lowest (464.5) points on 9 June and 27 November respectively.



Source: PEX

In January the AI Quds Index marked a minor decline of 0.16%, closing at 476.2 points on the last day of trading. The index reached its highest (489.7) and lowest (474.3) levels on 5 and 23 January respectively. Last month a total of 18.1m shares worth \$31.5m were traded in 22 sessions. Market capitalisation was \$2.8bn.



Source: PEX

29 www.pcbs.gov.ps/Portals/_pcbs/PressRelease/RegEstTd20111E.pdf

30 www.pex.ps/PSEWebSite/NEWS/MEIR-Agreement_06022012-English.doc

The Portland Trust



The Palestinian Economic Bulletin is prepared by the Palestine Economic Policy Research Institute (MAS) and edited by The Portland Trust. Please send any comments, suggestions, or complaints to feedback@portlandtrust.org

© 2012 The Portland Trust

Printed for The Portland Trust in Ramallah by Al Nasher Advertising and PR