

PALESTINIAN ECONOMIC BULLETIN

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Main reports

The IMF's Fiscal Affairs Department conducted an estimation of the revenue cost of the Palestinian Authority's income tax holiday provisions.

The fourth annual Socio-Economic and Food Security Survey for the West Bank and Gaza was published. Results show that in 2012 the proportion of households facing a food insecurity situation increased.

In 2012 only a fifth of households went on at least one domestic trip in the West Bank, compared to 62% of Gazan households.

The Palestine Monetary Authority Business Cycle Indicator experienced an improvement from June to July but dropped again in August.

Public Finance

In 2012 public expenditure by the Palestinian Authority (PA) amounted to \$3.6bn, a 6% rise from the previous year.¹ Central government accounted for around 90% of total expenditure (\$3.27bn), with local government (municipalities) responsible for the remaining 10%. 56% of total current expenditure by the central government was on payment of public employees' salaries, while 15% corresponded to the payment of social benefits.

At the same time, total government revenues were \$3.3bn, a decrease of 4% from 2011. The drop in revenues partly reflects lower GDP growth in 2012 (5.9%, down from around 12% in 2011). Central government revenues accounted for 89% of the total (\$2.95bn). The main sources of finance were taxes collected by the PA (67%) and international grants and aid (32%). Revenues collected by local government (mainly from taxes on property and direct assistance from foreign governments and international organisations) reached \$361.6m.

In a recent report, the IMF pointed out that due to a combination of lower revenues, higher net lending, and unbudgeted pension spending, in 2012 the recurrent deficit reached 14.2% of GDP (before external support), adding that '*combined with lower-than-expected aid disbursements, the higher deficit led to large arrears accumulation and increased borrowing from domestic banks.*'²

The Minister of Finance, Shukri Bishara, has raised concerns about the consequences of the fiscal crisis and stated that possible difficulties might include delays in the payment of public sector salaries.³ The Minister added that the fiscal deficit was partly due to the failure of Arab donors to meet their commitments to the PA.

Based on developments in the first half of this year, the IMF projects an overall deficit of \$1.7bn for 2013 (15% of GDP, about 3 percentage points higher than budgeted), which would result in a financing gap of \$0.3bn. In a bid to secure sufficient donor funds to bridge this gap, Caretaker Prime Minister Dr Rami Hamdallah requested increased assistance from the World Bank and the European Commission during meetings held in July and August.⁴ During 2012 the majority of foreign budgetary support came from the World Bank (\$266m, or 34% of the total) and the EU (\$212.3m, 28%).⁵

IMF Assessment of Investment Tax Incentives

A recent mission of the IMF's Fiscal Affairs Department (FAD) conducted a preliminary estimation of the revenue cost of the income tax holiday provisions granted through the PA's Encouragement of Investment Act.⁶ The mission also reviewed the overall progress of the reform of the tax incentives system in the West Bank.

1 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_GFPpress2011E.pdf and www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_PCBSMofGenGovF2012E.pdf

2 www.imf.org/external/country/WBG/RR/2013/091113.pdf

3 www.maannews.net/eng/ViewDetails.aspx?ID=622062

4 www.maannews.net/eng/ViewDetails.aspx?ID=614121 and www.maannews.net/eng/ViewDetails.aspx?ID=623241

5 www.pmf.ps/documents/10180/246009/december_2012.pdf

6 www.lacs.ps/documentsShow.aspx?ATT_ID=7611

Income tax holidays constitute the main type of investment tax incentives in Palestine. Under current regulations, projects in numerous sectors and sub-sectors, including manufacturing, tourism, agriculture and information technology (IT) are eligible for tax incentives. In most sectors the duration of an income tax holiday depends on the size of investment, ranging from seven years for amounts between \$0.25m and \$1m, to 11 years for investments exceeding \$5m. For IT projects the length of the tax holiday is determined by the number of local professional employees involved, reaching a maximum of 10 years' holiday for initiatives with 30 or more employees. Currently more than 400 taxpayers enjoy a tax exemption (including custom duties and others).

The IMF mission acknowledged the debate around the use of tax incentives. Economic theory suggests that they are justified if the social gains derived from a project exceed private benefits. In the Palestinian economy, tax holidays are argued to have encouraged much needed investment by the private sector. On the other hand, in the context of increasing fiscal difficulties some argue that incentives should be limited due to the loss of current and future tax revenue.

The mission concluded that investment tax incentives in the West Bank resulted in a revenue loss of between NIS97m and NIS346m (\$27m and \$98m, or 0.4%-1.3% of GDP) for the PA. In particular, companies operating in highly profitable sectors, such as telecommunications, finance, mining and quarrying and pharmaceuticals were said to be those that benefited the most from tax holidays. On the other hand, the private sector has argued that tax holidays, as the only available incentive in a difficult and uncertain environment, have played a key role in attracting vital investment to Palestine.

Food security

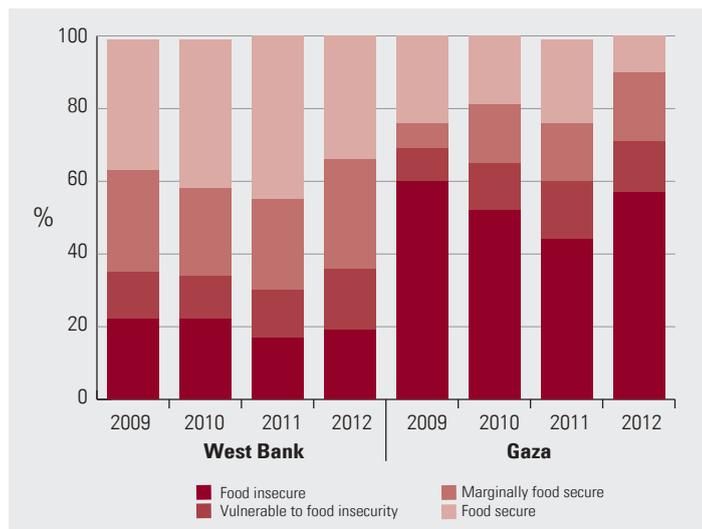
The fourth annual Socio-Economic and Food Security Survey for the West Bank and Gaza was jointly published by the Palestinian Central Bureau of Statistics (PCBS), the World Food Program (WFP), the Food and Agriculture Organization (FAO) and the United Nations Relief and Works Agency for Palestine Refugees (UNRWA).⁷ Results show that in 2012 the proportion of households facing a food insecurity situation increased by seven percentage points with respect to 2011, to reach 34% (1.57m people). Food security is estimated as a function of economic access to food. The high food insecurity ratio in 2012 is also only two percentage points lower than that observed in 2009, representing an almost complete reversal of the continual improvements in food security reported since then.

The situation is considerably worse in Gaza than in the West Bank. Only one in 10 Gazan households were classified as food secure last year, a much lower proportion than the one third observed in the West Bank, and a major drop from nearly a quarter in 2011. As many

as 57% of households in Gaza were food insecure in 2012, an increase of 13 percentage points from 2011.

In the West Bank, while there was also a sharp drop in the proportion of food secure households compared to previous years (from 45% in 2011), the majority of those whose situation deteriorated fell one or two categories into the 'vulnerable to food insecurity' or 'marginally food insecure'. This resulted in the proportion of food insecure in the West Bank rising by a relatively lower 2% in comparison to 2011 (to reach 19% in 2012).

Figure: Household Food Security Levels in the West Bank and Gaza, 2009-2012



Source: PCBS, WFP, FAO, UNRWA

Palestinian households adopted different measures to minimise the effects of food insecurity, these included default on payment of utility bills, use of life savings and sales of home assets. Such measures, particularly the depletion of savings and the sale of productive assets, are among the self-reinforcing mechanisms which can result in persistent poverty (or 'poverty traps'). Additionally, households in the West Bank typically purchased food on credit and consumed fewer and less expensive types of food items. In Gaza, the food insecure also asked friends and relatives for assistance, purchased low-quality market leftover food and reduced the number of daily meals.

The joint report attributes the increase in food insecurity to the general deterioration of socio-economic conditions in both the West Bank and Gaza, including rising unemployment and falling purchasing power. Recommendations to improve food security in Palestine remain similar to those issued in previous years, and include a renewed call for the lifting of the blockade on Gaza and an easing of restrictions in the West Bank, as well as a bid for increased international budgetary support to the PA.

In terms of local intervention, urgent measures need to be taken to revive the productive capacity of the Palestinian economy, with a particular focus on food production and

⁷ www.bit.ly/1fbRvN

exports. Recommendations also include the reinforcement of household coping strategies and the gradual adoption of a needs-based targeted approach to develop assistance.

Economic and Social Conditions

A separate report by the PCBS, FAO, WFP and UNRWA presents the results of the Economic and Social Conditions Survey for the year 2012.⁸ Nearly 40% of Palestinian households received assistance during the second half of 2012: 23% in the West Bank and 74% in the Gaza Strip. Moreover, around 46% of households receiving assistance depend completely or substantially on it for a living.

Two-thirds of households on benefits received assistance on three or more occasions during the second half of 2012. Food assistance, including school meals, was the most extended form of assistance (78% of the total). UNRWA was the single most important assistance provider (46%), followed by relatives, friends and neighbours (23%) and the PA Ministry of Social Affairs (19%).

Total monthly income remained the same in the second half of 2012 for more than 80% of Palestinian households (implying a decrease in real terms), while it decreased in nominal terms for 14% of households. Revenues from private sector activities (formal and informal, including self-employment) remained the most importance source of income for Palestinian households.

Table: Percentage of households in Palestine by sources of income on which they depend, January 2013

Source of Income	% of Households
In kind aid	31.9
Public sector	22.7
Private sector regular wage	21.6
Private sector irregular wage	20.7
Transfers from friends and relatives	16.0
Cash aid	14.8
Agriculture (including livestock)	14.4
Israel and settlements	12.9
Private sector self-employment	12.1
Social insurance, pensions and retirement	10.5
Private sector employer	6.5
Properties and rents	2.2

Source: PCBS (Percentages do not necessarily add up to 100% since a single household typically depends on more than one source of income)

Among the main difficulties faced by Palestinian households during the second half of 2012, 88% reported to have suffered from the rising cost of living, more than a quarter faced delays in receiving wages (presumably those households in which the main source of income comes from public sector employment), and more than 20% reported having faced mobility restrictions, including difficulties in reaching their workplace.

Finally, nearly all Palestinian households were connected to the public water and electricity networks last year;

however, more than a third said water is not available every day. Nearly 14% of all households were connected to the national public or Israeli water network for less than 5 days a month. Slightly more than a half of all households used the public network for wastewater disposal, while the rest utilised a cesspit. Almost all Palestinian households have access to electricity via the public network, while 0.3% own a private generator.

Improvements to basic infrastructure are much needed as a way to enhance the enabling environment for economic activity in Palestine. In the beginning of September the World Bank pledged to support the PA with \$8.3m in grant from the Global Partnership on Output-Based Aid (GPOBA) scheme to improve access to solid waste management services for 840,000 Palestinians in the Hebron and Bethlehem governorates.⁹ In addition, France announced the contribution of €10m (\$13m) for the establishment of a solid waste management plant in Gaza.¹⁰

Domestic Tourism

In 2012 35% of Palestinian households had at least one member participate in a domestic trip or leisure activity, while 11% travelled outside Palestine.¹¹ Gazan households were much more active as 62% went on at least one domestic trip, compared to only a fifth in the West Bank.

In the past four years the Gazan tourism sector has experienced remarkable growth, most of which was based on the development of leisure facilities for the domestic population.¹² Four new hotels, ten resorts and fifty restaurants have opened. Today, domestic tourism represents 5% of Gaza's GDP and has helped create employment opportunities, especially among the youth and recent graduates.

Prolonged restrictions on cross-border movement have resulted in domestic trips and activities becoming the main option for Gazans. In addition, the prolonged power cuts in the Gaza Strip are said to have attracted people to the tourist resorts as they have electricity for longer hours than households.

The most visited governorates in the West Bank were Tulkarm and Nablus, while in Gaza tourists visited Khan Younis and Gaza City. Average expenditure during domestic trips was \$47 (\$66 in the West Bank and \$42 in Gaza), a decrease from \$55 in 2010. Nearly all domestic trips were one-day visits. Increasing the average spend of tourists and prolonging the length of stays are among the main challenges for the future development of the Palestinian tourism sector.

⁹ <http://bit.ly/18aZlqw>

¹⁰ www.lfd.ps/documents>Show.aspx?ATT_ID=7599

¹¹ www.pcbs.gov.ps/Portals/_PCBS/Downloads/book1996.pdf

¹² www.al-ayyam.com/article.aspx?did=221108&date=8/13/2013

Business Cycle Indicator

The Palestine Monetary Authority Business Cycle Indicator (PMABCI) - a monthly index which aims to capture both the current state and evolution of the Palestinian business environment, and reflect fluctuations in output and employment in the manufacturing sector - experienced an improvement from -7.71 in June to -1.21 in July, but dropped again to -3.88 in August.

Mohammad Atallah, Director of the Research and Monetary Policies Department at the PMA, told the Bulletin, *"The month of Ramadan is one of the main reasons for the observed increase of the index in July, mainly driven by activities in the food and textile industries."*

Last month, while the PMABCI continued to increase in the West Bank, it decreased in Gaza to -8.32, compared to 0.85 in June and 1.76 in July. With respect to this Atallah explained: *"Although the BCI continued to increase in the West Bank during August as a result of Ramadan and Eid and the increase in demand for gold, the performance in Gaza was poor, mainly due to the situation in Egypt, which resulted in the closure of the Rafah crossing and the destruction of many trade tunnels."*

Building Licenses Q2/2013

2,501 building licenses were issued in Palestine in Q2 2013, an increase of 9.6% and 14.2% from Q1 2013 and Q2 2012, respectively.¹³ Of the total, only 62 licenses were issued for construction in Gaza. The vast majority of licenses were issued for new residential buildings (91.2%). These grew by 11.6% with respect to the previous quarter, and by 17.8% from Q2 2012.

Construction continues to be an important sector for the Palestinian economy. In 2012 it contributed 14% to Palestinian GDP (10.8% in the West Bank and 23.4% in Gaza) and employed 14.4% of all workers (10.8% in the West Bank and 7.7% in Gaza).¹⁴ Nearly 40% of all construction workers were employed in Israel and the Israeli settlements.¹⁵

13 www.pcbs.gov.ps/Portals/_PCBS/Downloads/book1998.pdf

14 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_NatAccQ12013E.pdf

15 www.pcbs.gov.ps/Portals/_PCBS/Downloads/book1972.pdf

PCBS President to Chair International Association of Official Statistics

Ola Awad, the president of PCBS, was elected president of the International Association of Official Statistics (IAOS) during the organisation's executive committee meeting held in Hong Kong earlier in August.¹⁶ This is the first time that an Arab head of a national statistical office has been elected as president of the IAOS since its establishment in 1985. Ola Awad said that she would use this opportunity to enhance cooperation in various fields and develop official statistics in the Arab region by encouraging and strengthening participation of Arab countries in such organisations.

PEX Companies' Financial Results

On 21 August the Palestine Exchange (PEX) announced that nearly three-quarters of listed companies achieved profits in the first half of 2013, up from less than two-thirds in the same period last year.¹⁷ Net joint profits after tax equalled \$120m, a significant increase from \$97m and \$90.5m in the first and second half of 2012, respectively. The three companies which attained the highest profit levels were PALTEL (\$63.6m), Bank of Palestine (\$18.7m) and PADICO (\$13.7m).¹⁸

Ahmad Aweideh, PEX CEO, commented that *"the market is picking up again given various positive indicators"*. He highlighted that cash dividend yield is amongst the highest in the world, reaching 6.43% in 2012 and averaging 6.53% over the last five years. Aweideh added that *"...some progress on the political side (...) is positively affecting sentiment on the Exchange. Most listed companies on the PEX are profitable and showing progress in their business performance. Some leading stocks rallied more than 25% in the last two months."*

August Trading News

In August the Al-Quds index dropped by 0.97%. It reached its highest (490.17 points) and lowest (468.8) levels respectively on 13 and 29 August, the last day of trading.

A total of 21.1m shares worth \$30.3m were traded in 18 sessions. Market capitalisation was \$2.9bn.

16 www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_PresIOASE.pdf

17 www.pex.ps/PSEWebSite/NEWS/H1FinancialDisclosure20082013.docx

18 www.bit.ly/1b6Y3dt

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