The Portland Trust

PALESTINIAN ECONOMIC BULLETIN

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Main reports

The Palestinian Prime Minister's Office issued a statement on 20 November announcing that the compliance with the Social Security Law, which took legal effect in its first phase on 1 November, will not be mandatory until mid-January 2019.

Sharakat Investment Fund and the Palestine Industrial Investment Company signed an agreement on 17 October 2018 to establish an animal feed plant in the Hebron Governorate.

On 10 October 2018, the Qatar Fund for Development pledged $150m in humanitarian aid to alleviate the humanitarian crisis in Gaza.

On 25 October, the Palestinian Monetary Authority and the Central Bank of Israel agreed on a new mechanism to facilitate bank transactions between Palestinian and Israeli banks

The Palestinian National Authority's Report to the Ad Hoc Liaison Committee

On 27 September, in advance of the Ad Hoc Liaison Committee (AHLC)[1] meeting in New York, the Palestinian National Authority (PNA) submitted its report on the status of the Palestinian economy entitled: "Stopping Fiscal Leakages".[2] The report reiterated the PNA's call for an end to the longstanding restrictions and related arrangements to the implementation of the Protocol on Economic Relations between the Government of Israel (GoI) and the Palestine Liberation Organisation (PLO) also known as the Paris Protocol, signed in Paris on 29 April 1994 and subsequent accords. The report estimates the PNA's fiscal leakages resulting from these restrictions at around $350m per year (~29.2% of the PNA's expected budget deficit in 2018).

Leakages resulting from lack of control over Area C

Pursuant to the Paris Protocol and related accords, the GoI is authorised to levy and collect VAT and income tax and deduct Israeli businesses' income accrued or derived in Area C in line with the Palestinian tax code and transfer such funds to the PNA. The report estimates that around 2,000 Israeli businesses and individuals currently operate in and derive income from Area C. It further states that in 2000, the GoI ceased all tax transfers and stopped informing the PNA about Israeli commercial activities in Area C. The report estimates accumulated unpaid taxes and fees from Area C since 2000 at around $360m (or 35% of the PNA's 2018 projected budget deficit).

Leakages resulting from "handling fees"

Under Article III of the Paris Protocol, the GoI is required to transfer to the PNA the customs, excise and value added tax (VAT) - i.e. "clearance revenues" - collected on goods the destination of which is within areas under PNA jurisdiction. According to the Protocol[3], the GoI is authorised to deduct a 3% "handling fee" in exchange for its processing of these funds.

The report states that the PNA has consistently called for lowering the handling fee, citing that the fee does not reflect the actual costs incurred by the GoI. Based on the recommendation by the World Bank Group (WBG)[4], the PNA calls for this fee to be set at 0.6% to reflect the share that Palestinian imports comprise of Israel's total import cost. The report estimates that since 2006, the PNA has lost around $540m in revenue (or 48% of its 2018 projected budget deficit) due to handling fees imposed on merchandise trade.

Leakages resulting from fees on fuel purchases

Since the establishment of the PNA in 1994, Palestine has imported fuel through Israeli companies. According to the report, between 1994 and 1996, the GoI transferred the

1 A 15-member committee which serves as the principal policy-level coordination mechanism for development assistance to the Palestinian people.
2 http://www.lacs.ps/documentsShow.aspx?ATT_ID=36702
3 Annex V: Economic Relations Protocol – Supplement to the Protocol on Economic Relations. https://bit.ly/2glwovH
4 https://bit.ly/2r67wgL

excise tax for fuel purchases to the PNA separately from other clearances and, given the lack of administrative work involved, did not deduct a handling fee.[5] However, according to the report, the GoI started transferring the excise tax with the other monthly clearances in 1996 and imposing an additional 3% handling fee. The report estimates that the PNA is currently losing around $26m each year (~40% of clearances transferred by the GoI) as a result of the GoI's deduction of a handling fee on the fuel purchases.

Leakages resulting from indirect imports

According to Article III of the Paris Protocol, the clearance of revenues from all import taxes and levies between the GoI and the PNA is based on the principle of final destination.[6] As such, the GoI is obliged to transfer all import taxes and other levies it collects on goods that are either directly imported or where their final destination falls under Palestinian jurisdiction. However, according to the report, a significant amount of the goods entering Palestinian markets from Israel are goods that were originally imported to Israel by Israeli importers, with the intention of later selling them in Palestine.[7] As a result, the GoI receives the import taxes on these imports even though they are to be sold in the Palestinian market. The report estimates that the PNA loses around $30m per annum in customs duties on such goods that are imported as destined for Israel and then sold in Palestine.

Leakages resulting from Passenger Exit Taxes

According to the Redeployment and Security Arrangements Protocol of 1995, which defines the operations of international border crossings accessible to Palestinian citizens, the GoI is entitled to collect a $26 exit fee from each passenger leaving the PNA's territory, while the PNA is entitled to $12 for each of the first 750,000 passengers and $16 for each passenger thereafter. According to the report, the GoI's transfer of the fees owed to the PNA has been irregular and partial. In addition, the GoI has unilaterally raised the passenger exit fees, standing now at $43. The report estimates the PNA's accumulated losses resulting from the GoI's failure to fully transfer passenger exit fees at $145m since 2008.

Leakages due to faulty VAT Clearance Mechanism

Under the Paris Protocol[8], bilateral trade between Israeli and Palestinian businesses is subject to the VAT rate applicable in the market where goods are sold and accrues to the tax administration with which the payer is registered.[9] VAT revenues are then cleared between the PNA and the GoI through monthly clearance sessions. According to the report, the PNA suffers from major fiscal leakages during the process due to smuggling and fraud, which occur when transactions between two parties take place without issuance of official invoices, after which goods are smuggled into the PNA's territory given the lack of a physical border. Other fiscal leakages occur when Palestinian businesses under-report VAT paid to Israel to minimise their tax obligation or when the PNA fails to obtain invoices from Gaza. Whilst the Israeli Ministry of Finance does receive copies of invoices from Israeli sellers, it does not disclose that information to the PNA, citing doubts over whether the Israeli goods have actually left Israel.[10] According to the report, the reliance on a paper-based clearance system, rather than a joint electronic system, not only slows down clearance flows but also increases the opportunity for tax evasion. The GoI has conditioned acceptance of such a joint electronic clearance system on the passage of goods through specified Israeli commercial crossings built inside the West Bank, which the PNA in turn considers contrary to existing agreements. The report estimates a loss of approximately $120m (11% of its 2018 projected budget deficit) due to the faulty application of the VAT clearance mechanism installed by the Paris Protocol.

Social Security Law Implementation Postponed

On 20 November, the office of the Palestinian Prime Minister, Dr. Rami Hamdallah, issued a statement announcing that the compliance with the Social Security Law, which took legal effect in its first phase on 1 November, will not be mandatory until mid-January 2019, to allow further time further consultation.[11] The deferral comes against the backdrop of demonstrations against the implementation of the Law. On 12 November, thousands of Palestinians protested in Ramallah demanding a delay in the implementation of the Social Security Law until it has been modified.[12] Criticism of the law focused on its statutory (non-voluntary) effect, alleged lack of transparency in certain aspects of its planned implementation, uncharted impact on local consumption patterns and economy, as well as uncertainty as to the ability of small enterprises to comply.

In its first phase, the Law focuses on private sector companies with more than 200 employees and consists of monthly employee and employer contributions to the newly established Palestinian Social Security Corporation (PSSC).[13] In accordance with the Law, each employee will contribute 7.2% from their salary, while employers will pay an additional 10.9% per employee, constituting a total of 18.1% of disposable income. The Law provides retired private sector employees (the law sets the retirement age at 60 years) with a monthly pension based on the number of work years, the number of monthly deductions before retirement and the level of an employee's last salary. The

5 https://bit.ly/2r67wgL
6 Article III, Point 15 of the Paris Protocol https://bit.ly/2imD695
7 https://unctad.org/en/PublicationsLibrary/gdsapp2013d1_en.pdf
8 Article VI, Point 5 of the Paris Protocol https://bit.ly/2imD695
9 https://bit.ly/2r67wgL

10 https://bit.ly/2r67wgL
11 http://english.wafa.ps/page.aspx?id=gNPWKGa106517340501agNPWKG
12 https://bit.ly/2r67FAP : https://bit.ly/2E195oO
13 http://www.aliqtisadi.ps/article/64098/ : http://www.aliqtisadi.ps/article/64134/

scheme also provides coverage in case of disability or death, employment injury or maternity.

Since the Law came into force on 1 November, the PNA launched a new round of dialogue with all parties, while upholding the central tenets of the social security scheme (including its mandatory status) and affirmed its readiness to make such amendments to the Law as may be concluded necessary to ensure greater public confidence and engagement in its implementation.

The Social Security Law was issued in 2016 as a presidential decree, following a long period of national dialogue between the PNA, the private sector and civil society. The discourse around the Law focused on the need for a social safety net for private sector employees, which constitute 53% of the workforce.[14] An encouraging factor was the possibility of the GoI transferring the social security contributions that it has collected from Palestinians working in Israel, in accordance with the Paris Protocol. The transfer of these resources has been conditional on the establishment of a Palestinian social security fund to which these accumulated funds could be entrusted.

PIF and PADICO to Establish an Animal Feed Plant in Hebron Region

On 17 October 2018, Sharakat Investment Fund, a subsidiary of the Palestine Investment Fund (PIF), and Palestine Industrial Investment Company, a subsidiary of PADICO Holding Company, signed an agreement to establish an animal feed plant in the Hebron Governorate of the West Bank with a total capital investment of $13m.[15] The plant aims to reduce the local market reliance on imported fodder, which constitutes 68% of the feed market in the West Bank. The current consumption of concentrated fodder in the West Bank is about 820,000 tons, valued at approximately $348m annually of which $237m are imported. The construction of the plant should be completed within 18 months, with a production capacity of 20 tons per hour at the first stage and will be later upgraded to 40 tons per hour. The plant will produce fodder at competitive prices, increasing farmers' profit margins, reducing the cost of raising livestock and contributing towards enhancing food security in Palestine.

Qatari Support for Gaza

On 10 October 2018, the Qatar Fund for Development (QFD) pledged $150m in humanitarian aid to alleviate the humanitarian crisis in Gaza.[16] QFD will work to make this aid package available via the United Nations Development Program (UNDP) and other relevant UN agencies, treating it as a matter of urgency.

14 https://www.ilo.org/beirut/media-centre/news/WCMS_561898/lang--en/index.htm
15 https://bit.ly/2AiQUGR
16 http://www.aliqtisadi.ps/article/63674/

In related news, on 9 October 2018, fuel trucks supplied by the State of Qatar (SoQ) crossed into Gaza to help supply Gaza's only power plant and increase electricity connection to eight hours per day. The trucks that entered Gaza transferred a shipment of fuel worth $60m donated by SoQ, which is sufficient to operate the power plant for six months. Between 2013 and 2017, SoQ provided $82m to Gaza to finance fuel for the power plant in order to address the ongoing electricity problems. During the same period, SoQ also supplied 25,000 tons of fuel worth about $20m to generate electricity.

Developments in the Palestinian Banking Sector

On 25 October 2018, the Palestinian Monetary Authority (PMA) and the Central Bank of Israel (CBI) agreed on a new mechanism to facilitate bank transactions between Palestinian and Israeli banks.[17] Under the new mechanism, an Israeli state-owned body will be established in order to serve as a substitute for Israel Discount Bank and Bank Hapoalim for dealing with Palestinian banks. The two Israeli banks carry the GoI's responsibility under the Paris Protocol to supply banks operating in Palestine with banking services such as credit-card processing, clearance of cheques and transfers of bank notes. The new mechanism aims to facilitate approval of cheques and wire transfers from banks operating in Palestine, reduce the use of cash and remove the liability risk for the Israeli banks.[18]

In related news, on 30 October 2018, the Palestinian Monetary Authority (PMA) announced that the new electronic cheque clearing system will be operational by early 2019 and will replace the existing clearing system which requires that cheques are physically transferred to the paying bank in paper form.[19] The new system will stop the transfer and circulation of paper cheques and reduce the clearing cycle to one day instead of the current three to six days. The PMA expects that reducing the long clearing period will help to prevent possible exploitation which has been an ongoing challenge in Palestine. The value of bounced cheques reached more than $1,154m in 2017 or 27% of current deposits in Palestinian banks.[20]

October Trading

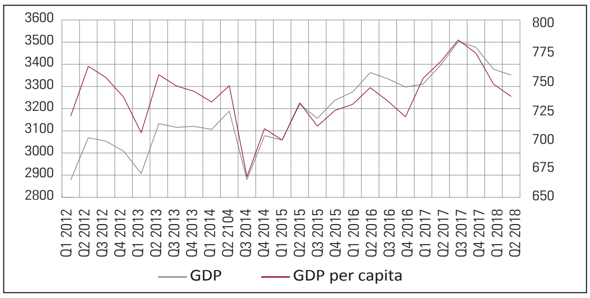
In October 2018, the Al-Quds index dropped by 1.1% from the previous month, reaching 522.8 points on the last day of trading.[21] A total of 8.2m shares worth $13.1m were traded during the month, marking a 43.4% decrease in the number of traded shares and a 51.9% decrease in the trading value compared to September 2018. The banking and financial services sector experienced the highest decrease (2.4%), while the industrial sector witnessed the greatest increase (-1%).

17 http://english.wafa.ps/page.aspx?id=60iHbya106216586553a60iHby
18 https://bloom.bg/2q6zZCv
19 http://www.aliqtisadi.ps/article/64123/
20 http://www.mas.ps/files/server/20182604153943-1.pdf
21 https://bit.ly/2AnOoiy

Palestine Economic Dashboard

Growth

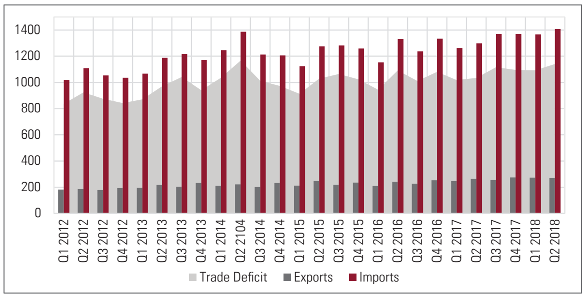
GDP (in million USD) and GDP Per Capita (in USD) in Palestine, Q1 2012–Q2 2018



GDP (Q2 2018): $3,351.3m   GDP per capita (Q2 2018): $735.8
Source: PCBS

Trade

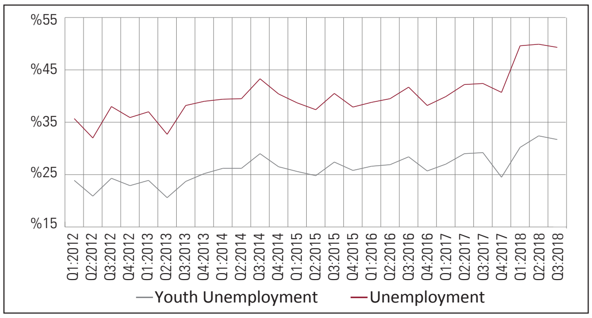
Exports, Imports and Trade Deficit in Palestine ('000 USD), Q1 2012–Q2 2018



Imports (Q2 2018): $1,409.2m   Exports (Q2 2018): $268.4m
Trade deficit (Q2 2018): $1,140.8m   Source: PCBS

Unemployment

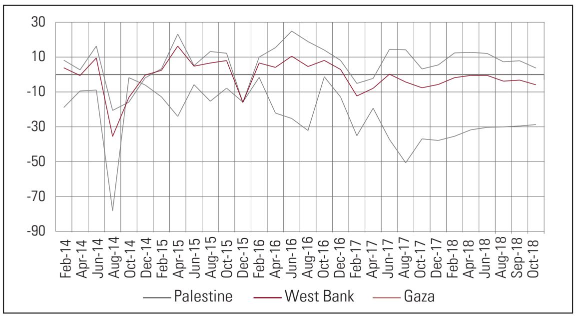
Unemployment & Youth Unemployment in Palestine, Q1 2012–Q2 2018



Unemployment rate (Q3 2018): 31.7%   Youth Unemployment rate (Q3 2018): 49.3%
Source: PCBS

Business Cycle Index

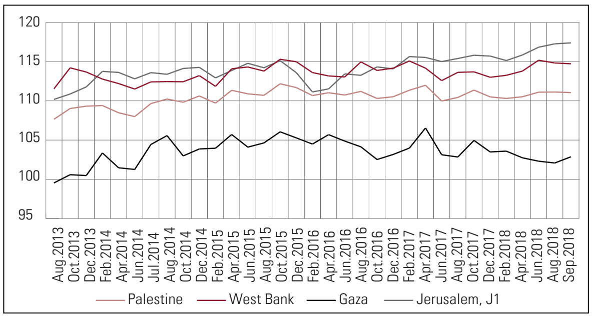
Palestine Monetary Authority Business Cycle Index, February 2014–October 2018



Palestine (October 2018): -5.9   West Bank (October 2018): 3.7
Gaza (October 2018): -28.7   Source: PMA

Inflation

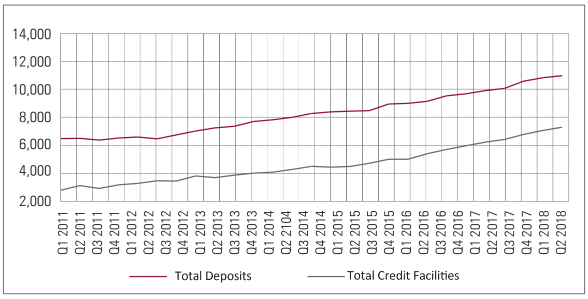
Consumer Price Index (Base year = 2010), August 2012 – September 2018



Palestine (September 2018): 111.05   West Bank (September 2018): 114.72
Gaza (September 2018): 102.87   Source: PCBS

Banking Sector

Total Credit Facilities and Total Deposits in Palestine ('000 USD), Q1 2011–Q2 2018



Total Credit Facilities (Q2 2018): $ 8,260m   Total Deposits (Q2 2018): $11,933.1m
Source: PMA

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