

PALESTINIAN ECONOMIC BULLETIN

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Main reports

On 29 March the Palestinian Economic Policy Research Institute (MAS) held a roundtable meeting to discuss its paper titled “Value-Added Tax Law: Between the Public and Private Sectors.”

March witnessed the launch of several programmes, agreements, conferences, and donor pledges in the field of economic development, environmental sustainability, empowerment, and education.

In March, the AI-Quds index decreased by 0.25% from the previous month, reaching 613.8 points on the last day of trading.

PNA Budget for 2022

On 31 March, the Palestinian President, Mahmoud Abbas, approved the public budget for the 2022 fiscal year with a deficit estimated at \$1.1bn, a 30% decrease compared to 2021.¹ Budgetary support (by donors) is forecasted to drop by a quarter, from \$686m in 2021 to \$523m, about \$250m of which is in direct budget support.

Table 1: Palestinian public budget for 2021 and 2022, \$m (accrual basis)

Item	2021 (budget)	2022 (budget)
1. Net public revenues	3,880	4,771
A. Domestic revenues	1,324	1,714
B. Clearance revenues	2,663	3,057
C. Tax rebates (-)	-107	-183
2. Public expenditure and net lending	4,905	5,885
A. Salaries and wages	2,320	2,553
B. Transfers	1,367	1,166
C. Operating expenses	733	739
D. Net lending	229	295
E. Other current expenditures	256	369
3. Current account deficit before financing	-1,026	-352
Development expenditure	683	763
4. Total deficit before aid and grants	-1,709	-1,114
A. Direct budget support	441	250
B. Development expenditure support	245	300

Source: Palestinian Ministry of Finance²

Public spending

Government spending is forecasted to reach \$5.9bn in 2022, a 7% increase from last year. According to statements by Prime Minister, Mohammad Shtayyeh, the budget will focus on strengthening recovery from the pandemic, stimulating economic growth, socio-economic development and resilience, in addition to creating 2,800 additional jobs in the public sector.

In terms of the composition of the announced budget, around 20% is allocated to education, 14% the health sector, and 20% to social protection and development.³ This shows a significant new focus on social and human capital development compared to previous budgets: the share of these three sectors combined did not exceed 42% in 2021 and was around 39% in pre-2020 years.⁴ While the exact share of security expenditures is not cited in the (summary) budget statement, it is expected to stay the same as in previous budgets, about 20%, most of which is in the form of salaries and wages. Other public sector posts, operational expenditures and payment of arrears and debt servicing account for the remaining 25% of the budget.

In terms of geographical allocation, around \$1.9bn, 32.2% of total expenditure will be allocated to the Gaza Strip, an increase from 30% in 2020. Another \$250m (4.3%) will be allocated to East Jerusalem.

Public revenues

The budget plans for an 8% increase in revenues during 2022 to \$4.8bn.⁵ To achieve this, the Government plans to focus on improving the sources of government revenues by combating tax evasion and expanding the tax base without imposing additional financial burdens on citizens who already pay taxes, in addition to controlling public debt.

¹ Percentage changes in the budget are based on the information published by the Palestinian Cabinet and are in comparison with the actual figures of 2021. <http://www.plo.ps/article/56740/>; <http://www.palestinecabinet.gov.ps/portal/meeting/details/51988>

² The MoF stopped issuing their financial reports; the actual figures for 2021 were not available. <https://www.facebook.com/palmof/posts/34874723952952>

³ www.palestinecabinet.gov.ps/portal/meeting/details/51988

⁴ <https://mas.ps/publications/2871.html>

⁵ www.palestinecabinet.gov.ps/portal/meeting/details/51988

Although the Palestinian National Authority (PNA) has made significant achievements in widening its tax base, the efficacy of its plans for tax reform plans are likely to be determined by its capacity to enforce them. In the past decade, the PNA's capability to deliver such policies has been seen to be severely eroded, with proposals for key social policies often facing wide public push-back. The latest of these reforms is the new VAT Law (discussed in this issue), which underwent four revisions and is still unable to meet private sector and civil society expectations or receive their endorsement.

Strained Financial Situation

For the fourth month in a row, the PNA has only been able to pay 80% of the salary of its 134,000 public servants.⁶ The struggle to pay salaries reflects the PNA's strained financial situation as it faces strong inflationary forces, declining donor aid and the withholding of vital tax revenues by Israel. In July 2021, the Government of Israel increased its monthly deductions from \$15m to \$33m, adding to the PNA's strained financial situation.⁷ The accumulated amount of such deductions since 2019 had reached \$450m by the end of 2021 – a full 37% of the PNA's 2021 budget deficit.⁸

Adding additional strain, on 22 February, the EU further delayed transferring €214m in (2021) annual aid to the PNA, amid a divisive proposal led by Hungary to condition the aid on reviewing and editing Palestinian schoolbooks for alleged "incitement".⁹ The EU contributes about €150m annually to the PNA budget, of which €90m is for civil servant salaries.¹⁰

Fiscally pressured, the PNA will face difficulties to accommodate increases in the public budget, heightening the need for measures to improve budgetary efficiency. With political and security tensions rising since March 2022, there is increased likelihood of another Palestinian confrontation with Israel. A similar confrontation last year was the catalyst for widespread Palestinian protests across Israel and Palestine, ending in a military confrontation in Gaza. Such developments could significantly disrupt the PNA's financial planning process.

The Prime Minister explained that the PNA would implement reforms that would strengthen public finances through the application of the Ministry of Finance "Tax Revenue Strategic Plan 2021-2025", while ensuring a continued provision of basic social services and controlling public debt.¹¹

New VAT Law

The new Value Added Tax (VAT) Law has been under discussion throughout 2021 and 2022. Since the start of the consultative process in October 2021, about 250 amendments have been under consideration in response to private sector and civil society proposals.

On 29 March the Palestinian Economic Policy Research Institute (MAS) held a roundtable meeting to discuss its paper on the draft Law "Value-Added Tax Law: Between the Public and Private Sectors." The paper addressed the justifications for the VAT Law and its stated objectives, while placing the Law in the context of widespread private sector reservations, as well as domestic and global challenges restricting its implementation.¹²

⁶ <https://bnews.ps/ar/node/18560>

⁷ <https://english.wafa.ps/Pages/Details/128181> - see B178 for more details

⁸ Ibid

⁹ <https://bit.ly/3M1uD3z>

¹⁰ <https://bnews.ps/ar/node/18560>

¹¹ www.al-ayyam.ps/ar_page.php?id=1536c0d8y355909848Y1536c0d8

¹² https://mas.ps/attached_uploads/download/2022/03/29/rt2-vat-1648537046.pdf

The paper concludes that despite the significant contribution of indirect taxes such as the VAT to PNA revenues, comprising about 90% of total tax revenue, the current law regulating VAT is mired in shortcomings. According to the analysis, the VAT Law is ambiguous in its treatment of various issues and sectors, and lacks clarity given it was translated from a 1975 Israeli military order issued in Hebrew. The Law also fails to meet the objectives of the "Tax Revenue Strategic Plan 2021-2025" or keep pace with changes in the Palestinian economy, like the development of the ICT sector.

Government Justifications and Objectives

The Ministry of Finance (MoF) defined a set of objectives for the implementation of the new VAT Law, the majority of which related to reforming the tax administration, expanding the powers granted to tax officials, and increasing the tax base.

The Ministry also envisioned that the new VAT Law would be a step towards Palestine's disengagement from the Paris Protocol, providing flexibility to set VAT at different rates across goods and sectors, depending on the domestic economic situation. Based on the provisions of the Protocol, the PNA can set the VAT rate only at in a narrow band of 2% plus or minus the VAT rate applied in Israel across all sectors (17%). VAT in Palestine is currently at 16%. This is in addition to the MoF's stated goal of achieving social justice through the new Law by expanding the tax base to professions and imposing lower rates on basic goods consumed by people with lower income.

Stakeholders' Response

Despite numerous amendments, the most recent fourth draft of the Law was met with disapproval from both the private sector and civil society.

According to the paper prepared by MAS, the draft VAT Law does not follow international standards for VAT developed by the OECD and IMF. The draft also fails to specify the policies regulating the tax rates applied to different sectors and products, the mechanism for calculating and imposing the tax, along with many other issues. It leaves an excessive amount of the Law's implementation to the judgment of the executive branch. Furthermore, the paper calls attention to the draft Law's lack of identification of the territorial scope subject to VAT. This omission has problematic implications as it may be interpreted as maintaining the status quo, and practically, it leaves the issue of applying the VAT in Area C.

In a February meeting organised by the Palestinian Businessmen Association, the private sector expressed their objections. Among their concerns, they opposed raising the tax rate on wages and profits in financial institutions from 15% to 16% and sought clarification on the nature of non-profit organisations on which VAT will be imposed. The private sector also considered that excessive powers are granted under the Law to the executive administration in both procedural and legislative issues and they objected to certain clauses, such as granting the Council of Ministers the power to amend or impose tax rates on activities as it deems appropriate.

Miftah, an independent Palestinian civil society institution focusing on democracy and dialogue, issued a research paper focusing on the implications of the new VAT Law on tax justice.¹³ According to the paper, indirect taxes

¹³ <https://bit.ly/3ryfXRC>

constitute most tax revenues in Palestine, which are taxes borne by the consumer or the end user, which they consider contrary to the principles of tax justice. The draft VAT Law does not respond to the concept of tax fairness and social justice, as it adopts a fixed tax rate on all goods in isolation from their nature and places the same financial burden on all social segments despite disparities. In addition, the draft Law restricts the work of non-profits by imposing limits on donations and support and controlling these organisations by necessitating Cabinet approvals for receiving receipts. It appears that the loose provisions of the Law could be used to withhold or prevent support from civil institutions without clear justifications.

Development Programmes and Grants

March witnessed the launch of several programmes, agreements, conferences, and donor pledges in the field of economic development, environmental sustainability, empowerment, and education.

Economic Development

On 23 March, the PNA's Investment Promotion and Industrial Estates Agency announced the Industrial Estates Incentive Programme in Palestine (PIEIP). This is a programme to provide incentives to investors and companies located in Palestine's industrial estates or intending to relocate to one.¹⁴ It is also designed to encourage technology investment in the industrial zones. The programme targets Palestine's five estates and zones: The Gaza Industrial Estate, Jenin Industrial Free Zone, Jericho Agro-Industrial Park, Bethlehem Industrial Estate and Tarqumiya Industrial Zone. In January, the European Union (EU) signed an agreement with the PNA to provide €9m in financial support to the programme, with €7m allocated to the Gaza Industrial Estate and the remaining €2m divided between the Bethlehem Industrial Estate and the Jericho Agro-Industrial Park. As many of the factories in industrial zones suffered losses during the recent pandemic, the programme seeks to help factories rapidly recover, with a goal of restoring them to 70% of earlier productive capacity in three months and full productive capacity in 6 months.

Sustainable Businesses

On 30 March, the Palestine Investment Fund (PIF) and the EU launched the second phase of the Jerusalem Grants Program, which will focus on financing projects by small and medium enterprises in Jerusalem that utilise environmentally sustainable technologies or expand renewable energy production.¹⁵ The Programme has so far benefited 75 enterprises and projects and helped create and maintain over 650 jobs in its first two phases, deploying about €7m in funding. This new phase of the programme launches with total funding of €2.4m, with 30-35 projects receiving grants up to 100,000 dollars. Over the 3-year implementation period, it is projected that the programme will provide about 110 direct job opportunities.

Women and Youth Empowerment

On 28 March, the Palestinian Monetary Authority (PMA) and the Palestinian Federation of Credit Companies (Sharaka), in cooperation with the World Bank, launched a programme to support women's role in the specialised lending sector (mainly to micro, small and medium

enterprises).¹⁶ This programme falls within the 2019-23 national strategy for the specialised lending sector, which sets a goal of women becoming 50% of the beneficiaries of the specialised credit sector. The current share is 34%, and only 19% of the beneficiaries of the Estidama Fund, which was launched by the PMA to provide funding to small and medium enterprises impacted by the coronavirus crisis, are female entrepreneurs. The programme began with a workshop on accumulating gender data and will continue to focus on developing knowledge in the finance sector of women's financial needs and mechanisms to better serve female entrepreneurs.

Alongside this, the Ministry of the National Economy also launched a fund to provide grants to women and youth-led projects affected by the Covid-19 pandemic.¹⁷ This fund is overseen by an advisory board composed of representatives from public and private sectors, civil society, the United Nations and donors. The Minister of National Economy, Khaled Al-Osaily, stated that the formation of the board is the first step towards institutionalising a national fund for the empowerment of women and youth.

On 17 March, the EU launched the Youth Empowerment programme, an initiative aimed at enhancing the social and economic participation of youth through three main projects implemented by the Belgian Development Agency, the UN Population Fund, and the Sharek Youth Forum.¹⁸ The projects are anticipated to reach 8,000 beneficiaries across Palestine over the next three years. The main objectives are to better match young entrepreneurs with the labour market through training and entrepreneurship programmes, as well as improve youth participation in society through leadership programmes and the establishment of a youth council.

Education

Donors introduced multiple programmes to improve educational outcomes for Palestinian youth in March.

On 28 March, the World Bank allocated a \$20m grant to support the education system in Palestine as a part of a \$60m multi-phase programme (known as SERATAC) to be carried out over eight years.¹⁹ The World Bank aims to create gradual education reform through this long-term investment, with a focus on improving early Arabic language instruction (reading, writing, speaking, and listening) in grades one to four, reforming the secondary school final exam system (Tawjihi), and creating pathways to transition students to post-secondary education.

Finally, on 10 March, the Belgian Government launched a €70m programme for the years 2022-2026, in cooperation with the PNA²⁰, to address vocational training, youth entrepreneurship, and increasing youth employment through education interventions.

March Trading

In March, the Al-Quds index decreased by 0.25% from the previous month, reaching 613.8 points on the last day of trading.²¹ A total of 13.2m shares worth \$35.5m were traded during the month, marking a 3.3% decrease in the number of traded shares and a 43.4% increase in the trading value compared to February 2022.

¹⁶ <https://bnews.ps/ar/node/18632>

¹⁷ <https://bnews.ps/ar/node/18579>

¹⁸ <https://bnews.ps/ar/node/18547>

¹⁹ <https://bit.ly/30B73ws>

²⁰ www.aliqtisadi.ps/article/86224/

²¹ Web.pex.ps

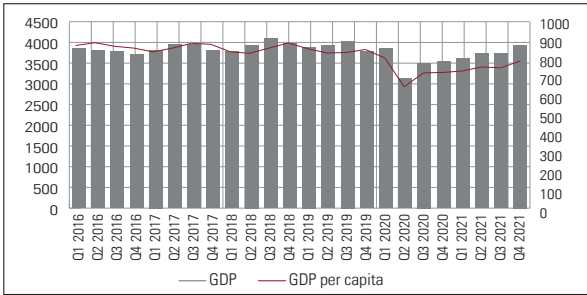
¹⁴ www.aliqtisadi.ps/article/86496/

¹⁵ <https://bit.ly/38GXX0N>

Palestine Economic Dashboard

Growth

GDP (in million USD) and GDP Per Capita (in USD) in Palestine, Q1 2016 – Q4 2021

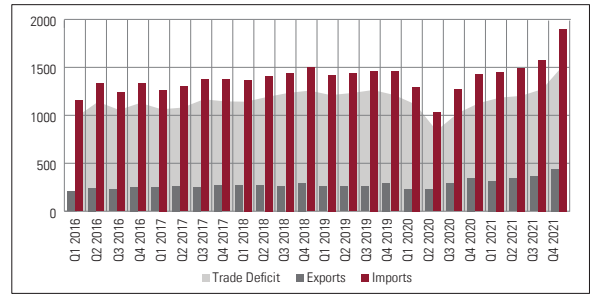


GDP (Q4 2021): \$3,940.9m
Source: PCBS

GDP per capita (Q4 2021): \$791.4

Trade

Exports, Imports and Trade Deficit in Palestine ('000 USD), Q1 2016 – Q4 2021

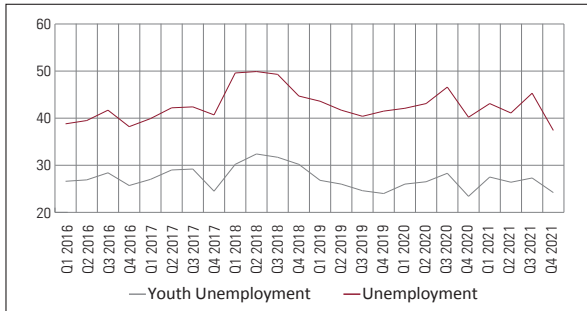


Imports (Q4 2021): \$1,898.2m
Trade deficit (Q4 2021): \$1,458.5m

Exports (Q4 2021): \$439.7m
Source: PCBS

Unemployment

Unemployment and Youth Unemployment in Palestine, Q1 2016 – Q4 2021

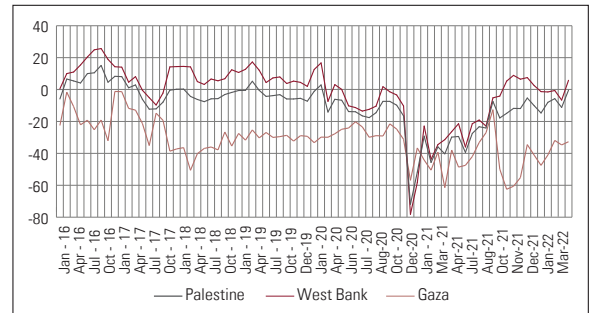


Unemployment rate (Q4 2021): 24.2%
Source: PCBS

Youth Unemployment rate (Q4 2021): 37.4%

Business Cycle Index

Palestine Monetary Authority Business Cycle Index, January 2016 – March 2022

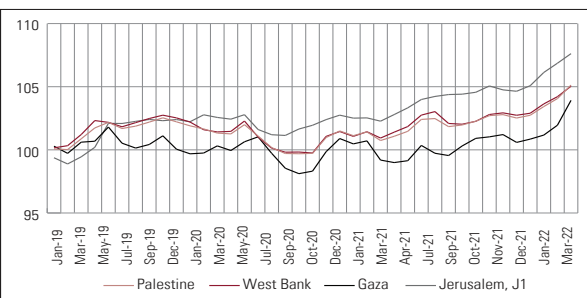


Palestine (March 2022): -0.4
Gaza (March 2022): -32.7

West Bank (March 2022): 5.8
Source: PMA

Inflation

Consumer Price Index (Base year = 2018), January 2019 – March 2022

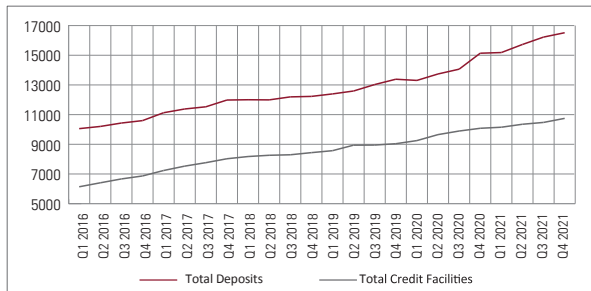


Palestine (March 2022): 105.13
Gaza (March 2022): 103.92

West Bank (March 2022): 105.04
Source: PCBS

Banking Sector

Total Credit Facilities and Total Deposits in Palestine ('000 USD), Q1 2016 – Q4 2021



Total Credit (Q4 2021): \$10,747.17m
Source: PMA

Total Deposits (Q4 2021): \$16,518.13m

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

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