STATE OF PALESTINE

UNLOCKING STATEHOOD

The Government of Palestine's Report to the

Ad Hoc Liaison Committee

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I. EXECUTIVE SUMMARY

The Government of Palestine, headed by Prime Minister Dr. Rami Al Hamdallah, is delighted to submit the Palestinian report to the Ad Hoc Liaison Committee and would like to seize this opportunity to reaffirm its commitment towards the state-building efforts and reforms initiated by the previous governments across a variety of sectors, including public finance management, accountability, rule of law and other core dimensions. In addition, the Government would like to express its appreciation for the generous support provided by our international partners and stress the importance of continuous dialogue and coordination in order to realize the aspiration of the Palestinian people for self-determination within a viable, sovereign and independent State of Palestine.

The Palestinian government has repeatedly reiterated its commitment to the two-state solution, based on the borders of 4th of June 1967 and international law. The prospects for realizing the two-state solution, however, have been vastly sabotaged by the continued Israeli policies of colonization, dispossession and brute force on the ground.

As a genuine partner for peace we will do our utmost to reach a breakthrough in the US-sponsored peace talks. Building on our domestic and international achievements, we will continue to invest all energy into realizing an independent and sovereign State of Palestine. Failure would have catastrophic consequences for the peoples in our region and we do hope that the Government of Israel will internalize the same sense of responsibility.

The Government is confronted with a severe financial crisis that has been mounting since 2010. This crisis is further complicated by a bleak economic outlook for the remainder of 2013 and 2014. Growth in the West Bank, which generates most of the revenues, continues to slow down. The West Bank's real GDP shrank by 0.6% in Q1 2013. Real GDP growth in the Gaza Strip, mainly induced by donor funded projects, amounted to 12% in Q1 2013, thereby resulting in an overall real GDP growth rate of 2.7% for Palestine. This contrasts significantly with the double-digit growth figures experienced only three years ago. As a result, the Government is forced to undertake painful fiscal retrenchment policies to reduce its deficit, which in turn further negatively impact economic growth and fiscal revenues. The consequence is a downward spiral.

Within the first half of 2013 gross revenues were below budget targets, while expenditures slightly exceeded budget projections. Contributing factors to this predicament were financial flows mainly outside the direct control of the Government, such as clearance revenues and external aid, which fell short of the budgeted amounts. To maintain its liquidity and manage the sharp rise in domestic debt, the Government has to balance high levels of bank loans against the accumulation of arrears in the private sector.

Official Development Assistance (ODA) was insufficient to bridge the deficit of NIS 572 million during the first half of 2012. External budget support declined dramatically from an average of USD 1.4 billion in 2009-10 to USD 761 million in 2011 and USD 826 million in 2012. This sharp drop since 2009 is equivalent to 12% of the GDP. Difficult fiscal reforms, however, require strong support from the international community, as well as sustained cooperation from the Israeli authorities.

The Government has initiated a number of reforms to broaden the revenue base and reduce expenditures. Those measures include the reorganization of the Ministry of Finance's revenue department, enhancing the operations of the Large Taxpayer's Unit, reviewing generous tax exemptions for new enterprises under the Investment Promotion Law, phasing out on petroleum subsidies, and pushing the Government of Israel to share full information on revenue transfers with the aim of avoiding tax evasion. On the expenditure side we have made great progress in reigning in the wage bill. Based on limitations imposed on hiring and salary increases in the public sector the wage bill has declined from 26% of GDP in 2006 to 16% in 2013. The full implementation of the Procurement Law in Q1 2014 will result in further substantial savings.

In spring 2013 the Government of Palestine (GoP) cooperated with the World Bank, the European Union, France and the UNDP in conducting a Public Expenditure and Financial Accountability (PEFA) assessment. The assessment credited institutional reforms within the Ministry of Finance and confirmed noticeable improvements to the public financial management (PFM) system, particularly in the field of transparency, comprehensive budgeting, control and audit, as well as aspects of accounting and reporting. The PEFA confirms that, "despite a challenging political and institutional context in recent years, PFM reform has been high on the agenda of the PA. Significant work has been done towards implementing international good practices, and there is broad agreement between the PA and the international development community to continue to pursue these efforts." Concurrently, the "prospect of continued fiscal stress affecting the PFM reform agenda is still high."

Despite the vigorous reform efforts exercised by the Government, fiscal stability is unattainable without an end to the Israeli occupation and its prohibitive restrictions.

After decades of Israeli imposed de-development, the Palestinian economy experienced donor-induced growth more recently, which was important to offset some of the consequences of Israeli restrictions on access and movement. However, as the International Financial Institutions have repeatedly pointed out, donor-induced growth is unsustainable in the long term and falls short of unleashing economic development under conditions of belligerent occupation.

With ODA flows dwindling, the Palestinian economy reverses into an economic slowdown, triggering rising unemployment and poverty. Unemployment in Palestine, according to ILO standards, stood at 20.6% in the second quarter of 2013 (compared to 20.9% in Q2 of the previous year). To contextualize this figure it is important to know that unemployment on average drops by some 3% in Q2, compared to Q1 and Q3. Compared to Q2 2011, unemployment in the Gaza Strip increased by 2.3% while in the West Bank unemployment rose by 1.4% over the past two years. Youth unemployment among the age group of 15-24 reaches 29.1% in the West Bank and 54.2% in the Gaza Strip.

Unleashing the potential for economic development, particularly in "Area C," by granting Palestinians full access to their lands and natural resources would result in a cumulative GDP growth of 40%, based on conservative estimates. The resources generated by such domestically-driven economic development would exceed ODA levels by far and would form a strong pillar for a robust and viable State of Palestine, in which its citizens can live in peace and prosperity.

Within the tight corset imposed on us by the Israeli occupation we need to progressively improve Palestinian economic performance and expand on opportunities. Our strategic economic objectives are as follows:

- **Diversify the Palestinian economy;**
- **Develop an enabling business and investment environment;**
- **Enable and empower Palestinian institutions to facilitate economic development and regulate markets.**

In translating these objectives into tangible action we have achieved steady progress over the past years. The Government drafted a "National Export Strategy of the State of Palestine," based on selected priority sectors(1) and geared towards lowering unemployment and reducing the trade deficit. Palestine has been successful in concluding a number of bi – and multilateral free trade agreements with diverse partners such as the European Union, the European Free Trade Association, the Greater Arab Free Trade Area, Mercosur, Jordan, Egypt, Saudi Arabia, Canada, Russia, the United States and Turkey. In December 2012 a Draft Debt Resolution Law was finalized, which once enacted will address issues around resolving insolvency. Regulations on establishing private limited liability companies were revised in order to support entrepreneurs in starting a business. The burden of minimum capital requirements for these companies has been reduced significantly. Efforts are currently underway to reduce procedures, time and costs required for obtaining construction permits and for registering property. Recently, databases on credit scoring and bounced checks have been developed that assist banks and microfinance institutions in assessing credit ratings for companies and individuals. The databases are geared towards easing access to credit. Further, laws pertaining to land ownership, such as the Land Law and the Land Registration Law, will be prioritized despite Israeli imposed limitations on access to land registration records. A new Company Law is expected to unify legislation across Palestine and speed-up the process of establishing a business. In addition, a Secured Transaction Law will facilitate the utilization of movable assets for collateral purposes and thus expedite access to credit schemes. Functioning markets also require proper regulation. For this purpose we intend to enact an existing draft law on establishing an independent regulatory body mandated to maintain competitive markets.

The Economic Initiative, developed by the Office of the Quartet Representative and initiated by the United States Secretary of State, John Kerry, is a strategic initiative aims to substantially decrease unemployment and promote longer-term sustained economic growth in Palestine, by promoting the development of eight target economic sectors over the course of three years. The Economic Initiative draws on plans developed by the Government of Palestine and reflects many of our national development priorities. The Economic Initiative's successful implementation therefore is a strategic interest of the Palestinian government. This will however require the strong commitment of and coordination between different parties: the private sector, the international community, the Government of Palestine and the Government of Israel.

Palestinians are eager to trade with the world, to market quality products abroad and to welcome tourists from all corners of the globe, but we cannot do it alone, especially under the restrictions imposed by the occupation. The potential for a sustainable Palestinian economy is inextricably linked to a political settlement and the realization of the two-state solution.

The Government is in the process of drafting a national development plan for 2014-16, that will succeed the Palestinian National Development Plan (PNDP) 2011-13. The new development plan for 2014-16 will further integrate planning with budgeting, as part of the transition towards program-based budgeting. Once again the national development plan for 2014-16 will be underpinned by 23 sector strategies. Sectoral programs will become the basis for budget execution. The plan and the budget will be guided by a sound medium-term fiscal framework covering three years. We expect the approval of the National Development Plan for 2014-16, alongside the budget for 2014, by the end of December 2013.

Over the past year the Palestinian government has consistently called upon donors to pursue a more integrated approach across the political and development realm, particularly in those areas of Palestine currently categorized as "Area C." The response of our international partners has been encouraging and suggests that donors have recognized the importance of engaging in so-called "Area C" as a means of preserving the option of a viable State of Palestine. Within this report we present an example of best-practice engagement in "Area C."

To provide further guidance for engagement in "Area C" and East Jerusalem, the Government intends to issue a separate strategy paper before the end of the year. This "Area C/East Jerusalem" strategy paper will complement the National Development Plan for 2014-16.

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1 Selected priority sectors include products such as stone and marble, olive oil, agro-food, textile and garments, footwear and leather, furniture and priority services that encompass tourism and ICT.

Complete document in PDF format (Requires Acrobat Reader)