**Source : United Nations Conference on Trade and Development (UNCTAD)** **3 December 2014**

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

# Palestinian Fiscal Revenue Leakage to Israel under the Paris Protocol on Economic Relations

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**Executive Summary**

The Protocol on Economic Relations, also known as the Paris Protocol , was signed in 1994 between the Palestine Liberation Organization and the Government of Israel. It remains the general framework that governs Palestinian trade relations and economic, business and tax policies. The chronic structural distortions and problems arising from this framework were not limited to the general performance of the Palestinian economy. Rather, the framework determined the main sources of Palestinian fiscal revenue by placing the trade relations in the context of a unilateral, semi-customs union. More important still is the unilateral and selective application by Israel of the basic conditions of the Protocol. This gives the Israeli Government a disproportionate influence on the collection of Palestinian fiscal revenue, leading to deficiencies in the structure and collection of customs duties resulting from direct and indirect importing into Palestine.

This study focuses on the Paris Protocol sections dealing with imports, customs and value added tax (VAT) policies, highlighting its main shortcomings. These stem mainly from the fact that the Protocol is outdated and related to a transitional period that was supposed to end in 1999. As a result, it no longer addresses the current challenges before the Palestinian economy or its prospects within an independent Palestinian State; neither does it mention the lack of Israeli commitment to the terms of the Protocol, such as the obligation to transfer to the Palestinian National Authority its full financial entitlements to the collection by the Government of Israel of purchase taxes and customs duties on Palestinian imports cleared through Israeli ports of entry.

The study reviews in detail all the tax and customs policies arising from the Paris Protocol and the Israeli tax system which it embodies, as applied in the Occupied Palestinian Territory. The policy framework has caused continued instability and uncertainty for the Palestinian treasury, fiscal leakage resulting from a restrictive trade relationship that allows for indirect imports through Israel, minimal Palestinian control over the flow of external trade, inconsistencies in the working mechanism for collection of purchase taxes and evasion of customs duties. The study finds that these problematic issues are largely caused by the type of trade relationship engendered by the Paris Protocol and the Israeli logic in applying it.
The study also proposes a methodology to estimate fiscal leakage resulting from importing from or through the Israeli market, and the ensuing evasion of customs duties. This estimate is made on the basis of official Palestinian statistics of total imports from Israel. Customs duties evasion is estimated by identifying relevant percentages and indicators from the available data. The analysis shows that fiscal leakage from the aforementioned sources exceeded $310 million in 2011, equivalent to 3.6 per cent of total gross domestic product (GDP) and 18 per cent of the tax revenue of the Palestinian National Authority. Around 40 per cent of the fiscal leakage is related to direct and indirect imports from Israel, and the remaining 60 per cent is in the form of evasion of customs duties.
The study suggests a number of recommendations pointing to the pressing need to change the modus operandi of the Palestinian import regime to ensure Palestinian rights in all economic, trade, financial and taxation areas. This will require new trade arrangements that cover borders, customs and a tax collection mechanism to prevent fiscal leakage to Israel. With regard to indirect imports, information should be exchanged regularly between the Palestinian and Israeli authorities, customs and monitoring systems should be developed and the Government of Israel should acknowledge Palestinian financial entitlements to purchase taxes on goods made in Israel and sold on the Palestinian market and to the customs duties and purchase tax revenue collected on products indirectly imported through Israel.

**Preparation of this study benefited from review and comments by Raja Khalidi and Randa Jamal.*

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