



INTERNATIONAL MONETARY FUND

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WEST BANK AND GAZA**REPORT TO THE AD HOC LIAISON COMMITTEE¹****KEY ISSUES**

Context: Since the breakdown of peace talks in April 2014, Israeli-Palestinian relations have been deteriorating. After the war in Gaza, Israel continued settlement expansion, and the Palestinian Authority (PA) took steps towards international recognition, including membership in the International Criminal Court. This prompted Israel to suspend the transfer of clearance revenue (CR), resulting in a major blow to the PA's finances.² Recently, such transfers resumed. Little progress has been achieved in the reconciliation between Hamas and Fatah, the rival Palestinian factions. This, combined with limitations on imports of construction materials into Gaza and shortfalls in donor aid relative to Cairo pledges, has stalled progress on Gaza reconstruction.

Outlook and risks: Economic prospects in 2015 are highly uncertain, and risks are elevated. Further interruptions in CR transfers or continued shortfalls in donor aid would lead to drastic fiscal retrenchment with adverse economic, and potentially social, consequences. In the medium term, without a sustainable political solution, growth will remain subpar and unemployment will rise, threatening social cohesion. On the other hand, if peace talks resumed and restrictions on trade were relaxed, economic prospects would brighten. In Gaza, the economic outlook depends on the availability of donor aid for reconstruction.

Key policy recommendations: While the resumption of CR transfers has reduced pressures, fiscal discipline is needed to instill confidence in highly uncertain times. Measures to contain the projected 2015 financing gap and avoid further arrears accumulation are needed, especially wage restraint and efforts to improve tax compliance. However, measures alone will not be sufficient, and additional aid is needed to cover the gap. Over the medium term, the key recommendation remains to move to a more viable financing model that combines lower deficits and a growth-friendly re-composition of expenditure with sustained donor aid, predictable revenue transfers, and an easing of Israeli restrictions.

Endnotes

¹The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public expenditure management, banking supervision and regulation, and statistics. See www.imf.org/wbg for recent reports.

²Clearance revenues are revenues collected by Israel mainly in the form of indirect taxes on imported goods. These revenues are later transferred to the Palestinian Authority, and account for two-thirds of total revenues.

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