

**Palestinian National Authority**

**Ministry of Finance**

**Fiscal Developments: First Quarter Report 2011**

**Macro-Fiscal Unit**

**6/19/2011**

### **Budget execution highlights during Q1 2011:**

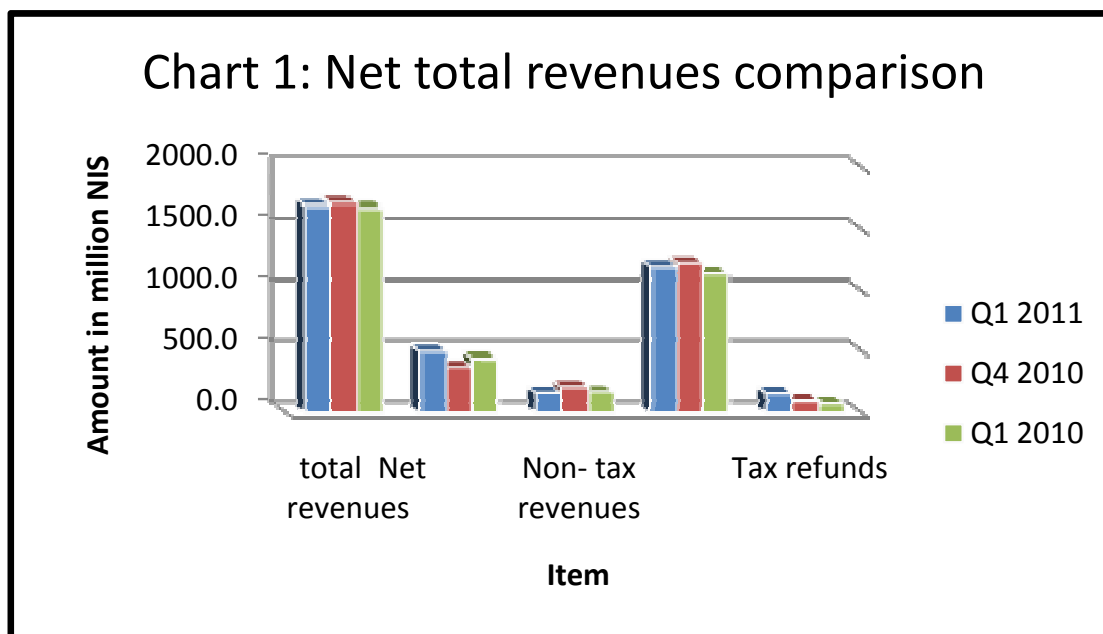
- **The current budget balance** of NIS 1.02 billion in Q1 11 is in line with the quarter budget deficit target.
- **Net revenues** of NIS 1.69 billion were around at the same level of Q1 10 and Q4 10, and is below the quarterly budget target by 4%.
- **Total expenditures and net lending** of NIS 2.71 billion decreased over the levels they had attained in Q4 10 and Q1 2010 by 7% and 2% respectively. PNA public spending is running below the quarterly budget targets (NIS 2.99 billion) by 2%.
- **The wage bill** in Q1 2011 is on track with the budget, except for a small overage on the quarterly budget target. PNA employment increases have been kept within projected limits.
- **Non wage expenditures** of NIS 940 million in Q1 2011 are running below, on an annual basis, budget targets for the year (NIS 5.04 billion).
- **Net lending** of NIS 159 million in Q1 2011 is on a declining trend and on track to meet the ambitious budget target of NIS 592 million.
- **Development expenditures** of NIS 215 million channeled through the Treasury in Q1 2011, and mostly directed at community development projects, are below the quarterly budget target by around 13%.
- **External budget support** of NIS 586 million in Q1 2011 fell short of the NIS 895 million quarterly financing requirements from donor countries. This, coupled with very little development financing channeled through the Treasury (NIS 85 million), the PNA managed to decrease its net domestic bank financing by NIS 122 million but still build up additional payment arrears (NIS 343 million).
- **2011 Budget** was approved in 31<sup>st</sup> of March 2011. See the Budget overview appendix.

Table (1): Consolidated Fiscal Operation Analysis of Q1 2011 on Commitment Basis

Budget Classification	Q1 2011	Change from Q4 2010	Change from Q1 2010	FY 2010 Approved Budget	Q1 11 as share of the approved Budget
	NIS mill.	%	%	NIS mill.	%
Net total revenues	1687.2	-1.4	1.1	7951.4	21.2
· Tax revenues	499.0	31.3	12.2	1894.4	26.3
· Non- tax revenues	164.1	-23.8	-5.8	1110.0	14.8
· Clearance revenues	1185.7	-2.6	4.9	5335.1	22.2
· Tax refunds	161.6	59.8	103.4	388.0	41.6
Total Expenditures and Net lending	2708.2	-6.9	-2.4	11960.0	22.6
· Wage Expenditures	1609.7	7.5	8.1	6325.0	25.4
· Non- wage Expenditures	939.5	-25.2	-4.6	5043.1	18.6
- Operational Expenditures	468.2	-19.8	30.6	1863.8	25.1
- Transfers	465.8	-24.4	-25.0	3088.9	15.1
- Minor Capital	5.5	-90.1	-7.8	90.4	6.1
· Net lending	159.0	1.3	-47.1	592.0	26.9
Current Balance	-1021.1	-14.8	1.5	-4009.0	25.5
Development expenditures	215.3	-37.7	13.6	1850.0	11.6
Balance	-1236.4	-19.9	-4.6	-5430.0	22.8
Financing	1236.4	-19.9	-4.6	5429.7	22.8
· Budget Support	585.8	-63.5	-24.3	3579.7	16.4
· Development	85.2	-53.3	87.2	1850.0	4.6
· Net Domestic Bank Financing	-121.5	-8.3	-129.2	0.0	

## 2. Revenue

**Total net revenue** mobilized by the Palestinian authority during Q1 2011, of NIS 1.69 billion almost remained static compared to Q1 10, but showed a decrease of 1% over Q4 10 (tables 1 and 5). Extrapolating this revenue mobilization to the full year 2011, by applying the economic growth assumed in the PNA 2011 budget (9%) to the revenue proceeds during the remaining three quarters, the increase in cooperation between the PNA and the Israeli side on the clearance revenues and by adding the projected dividend receipts (NIS 189 million) expected before year end, the PNA can obtain the budget target of NIS 7.95 billion. Total net revenues obtained in Q1 2011 by the PNA, are below the budget target by 4% due to the shortfall of clearance revenues and the non-tax revenues by 3% and 10% respectively below the quarterly budget target.

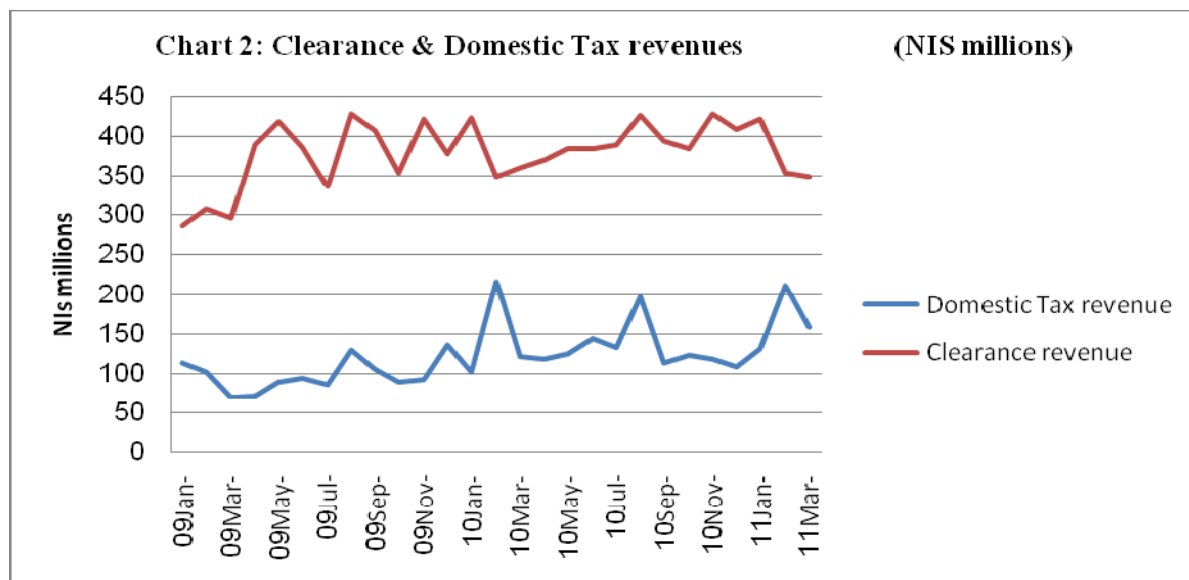


This strong domestic revenue is a result of administrative reforms in the domestic tax departments. Domestic tax revenue of NIS 499 million during Q1 2011 increased by 12% over domestic tax revenue collected in Q1 10 and 31% over Q4 10 (fiscal table 5 and Chart 1&2). Substantial revenue collection efforts were deployed by the income tax and VAT departments. Efforts at raising income tax revenues focused on enlarging the tax base, collecting payments in

arrears, and systematically reviewing tax liabilities by the 100 largest corporations. Greater controls by custom officers have also raised VAT revenues.

**Non tax revenue** of NIS 164.1 million during Q1 2011, decreased over Q4 10 and Q1 10 by 24% and 6% respectively. For the recording purposes MoF decided to record the license fees coming from Jawwal each month as a commitment in non-tax revenues and add the same amount monthly to tax refunds. Moreover, there is still the projected dividends (NIS189 million) that will be disbursed anytime during the next three quarters.

Historically the data for licenses and fees reaches its peak in the third quarter each year, leading to a pick up in the non tax revenues each year towards achieving the budget target.



**Clearance revenues**, which account for two thirds of total PNA revenues amounted to NIS 1.12 billion in Q1 2011, an increase by 5% over Q1 2010 and a decrease by 3% compared to Q4 10. The clearance revenues fell behind the quarterly budget target by 3%, this is partly due to the decrease of petroleum excise (BLUE) from the Israeli side in February, which decreased clearance revenues by NIS 16 million per month (for a total of NIS 32 million in February and March). Moreover, people in charge in Gaza started using smuggled fuel which caused a quarterly loss of NIS 25 million compared to Q1 10.

A key fiscal objective of the PA has been to raise clearance revenue toward its full potential through joint steps with the Israeli side, including enhanced information-sharing and monitoring by PA officials of imports at crossing points/gateways. The Israeli side agreed to schedule regular meetings with the PA to identify and agree measures to raise and streamline the transfer of revenue to the PA. Officials from the Palestinian and Israeli ministries of finance began such meetings in March 2011. In a good step the Israeli side in February, 2011 released NIS 440 million which was withheld from clearance revenue, by court order.<sup>1</sup>

On the other hand, the PNA was owed NIS 1.54 billion in clearance revenue for Q1 11 including the NIS 440 million that was released by court order in February 2011, what was actually cashed in was NIS 1.49 billion, due to various deductions, including for water and electricity bills<sup>2</sup>.

**Tax refunds**, on a commitment basis amounted to NIS 162 million during Q1 2011, which increased over Q4 2010 and Q1 2010 by 60% and 103% respectively, reaching to 42% of its budget. This is due to the payments of some tax refund arrears carried from 2010, as well as recording the monthly revenues of Jawwal to tax refunds commitments (Referring to non-tax paragraph pages 5&6). However, on a cash basis, only NIS 39.4 million was disbursed, due to the large shortfall in external budget support.

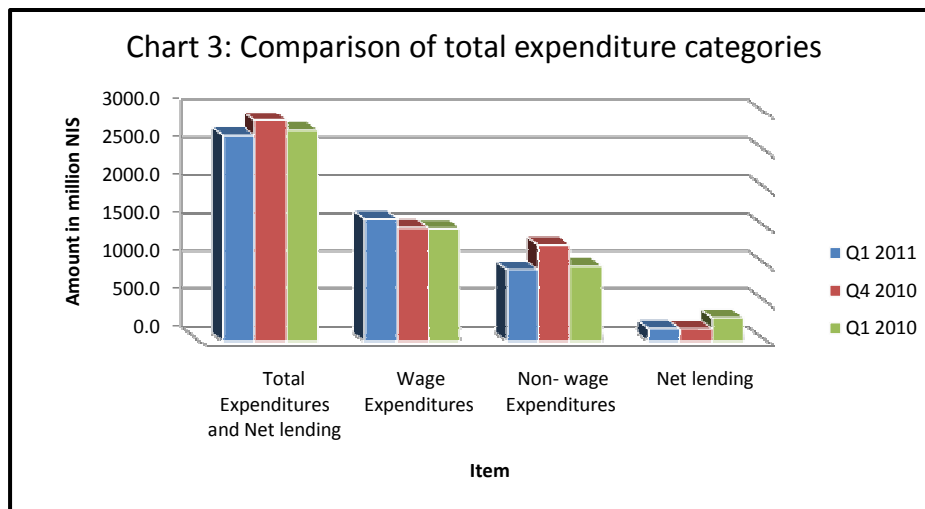
### **3. Expenditures and net Lending**

Total expenditures and net lending during Q1 2011 at NIS 2.71 billion, (on a commitment basis); fell by 7 % from the expenditure level in Q4 10, and by 2% from Q1 10. Overall, Q1 11 public spending, when projected on an annual basis, is expected to be below the 2011 Budget forecast.

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<sup>1</sup> IMF AHLC report April 13<sup>th</sup>, 2011.

<sup>2</sup> Deductions for utilities are added to Net Lending



**Wage expenditure** of NIS 1.61 billion in Q1 2011 (table 1) increased by 8% over the wage bill in Q1 10, and including two one off disbursements<sup>3</sup>. The 3.5% cost of living allowance and 1.25% which is the annual increase, agreed to with the civil service union, became effective on January 1<sup>st</sup> 2010, and were disbursed in the February payroll. Also the allowances made to the teachers, school principals, and other employees in the ministry of education. The wage bill of Q 1 2011 also includes paying most of the budgeted retroactive payments to employees appointed at the end of 2010 but didn't get their salaries due to the long recruiting procedure. Projecting the wage bill for the full year, excluding one off items, the wage bill would be in line with the budget target.

Wage expenditures in cash (table 3) of NIS 1.56 billion fell short of the commitment level by NIS 50 million. Arrears were incurred on the employee contributions to the Pension Fund as well as for other items, all due to shortfalls in external budget support and resulting from liquidity shortages.

<sup>3</sup>. The January 2011 wage bill included a NIS 12 million payment for 2010 Jerusalem allowances to employees, retroactively to the beginning of 2010. In January and February, a payment of NIS 5.5 million was made to health and education sectors' employees for overtimes and replacements.

**Non wage expenditures** at NIS 940 million in Q1 2011 were lower than in Q4 10 in every category, but in comparison with Q1 10 it decreased by 5% even with the increase in operational expenditure by 31% (fiscal tables 1 and 2). As can be seen from Chart 2, non-wage spending peaked in March 2009 and declined thereafter. Yet, because of liquidity shortages, due to much lower actual external budget support than committed by the donors, about NIS 219 million in payment arrears were incurred (table 4).

Projections of Q1 2011 spending for the full year indicate that non wage spending may fall below budget appropriations by about 24%. It should be noted however that transfers and operational spending tend to build up during the year.

**Operational expenditures** of NIS 468 million during Q1 11 (table 2) decreased by 20% from Q4 10 level. On the other hand, when compared to the same period in 2010 there was an increase of 31%. Starting with the withdrawal of car privileges the PNA has adopted a policy to continue decreasing operational expenditure over the remainder of the budget year by measures such as:

- Government vehicles will only be assigned to heads of government institutions and their deputies. Vehicles have been withdrawn from all government employees below these ranks. This measure will save substantial fuel, maintenance and insurance costs, which will reduce operational expenditures.
- A committee has been established in the Ministry of Finance look into further expenditure cuts, including on the use of cell phones, travel and various allowances.

**Transfers** of NIS 466 million in Q1 2011 were also lower than in Q4 10 by 24% and also lower than its level in Q1 10 by 25%, reaching 15% of its budget target (NIS 3.09 billion). Since transfers spending is related to the availability of funds, this decrease is due to the lack of liquidity, which might be compensated when enough funds is available.

There was an upward spike in transfers in March 2010 , as opposed to an average of January-February. This was essentially due to disbursement of social allowances from PEGASE and the World Bank.



These are some of the measures done in Q1 2011 to increase the transparency and effectiveness of the social allowances:

- The selection criterion for needy families is now computerized and consistent with the international criteria. The MoSA staff conducts field visits to the families who apply to the social allowances program.
- The payments are now done through bank accounts. Beneficiaries were asked to open bank accounts to receive their social allowances.

**Minor capital expenditures** amounted to NIS 5.5 million, decreased over Q4 10 and Q1 10 by 90% and 8% respectively. To reach only 6% of its budget target for the full year at the end of the first quarter. This is mainly due to the delay of approving the 2011 budget.

**Net lending** amounted to NIS 159 million in Q1 2011 (tables 1 and 2), marking a significant decline (47%) over the levels reached in Q1 10 and remained almost the same as the levels attained in Q4 10. It should be recalled that the budget appropriation for net lending in 2011 has been sharply reduced from NIS 950 million in 2010 to NIS 592 million in 2011, in the context of a policy aimed at eliminating net lending altogether. Even though net lending was above the quarterly budget target by 2%, the declining trend of net lending during Q1 2011 from NIS 56 million in January to NIS 50 million in March indicates that the PNA is on track to meet the ambitious budget target of NIS 592 million.

**Development expenditures** channeled through the PNA Treasury amounted to NIS 215 million during Q1 2011 (tables 1 and 2). This is lower than the level attained in Q4 10 by 38%, but substantially higher than the NIS 190 million channeled through the Treasury in Q1 10. There was a slow build up in development spending, mostly on community development projects, starting with NIS 12 million in January and rising to NIS 139 million in March. It is expected that another 1000 projects will be completed by the end of the year.

#### **4. Deficit and Financing**

**The recurrent fiscal deficit** in Q1 2011 amounted to NIS 1.02 billion on a commitment basis (table 1). With the efforts of increasing revenues and the decreasing trend of spending the aim

is to keep the recurrent budget deficit within the budget appropriation. In fact, it is expected that some budgetary items such as net lending will decline during the course of the year, while clearance revenues should increase given the increased cooperation between the PA and GoL. The deficit on a cash basis was substantially lower, at NIS 340 million, mostly due to financing shortfalls (table 3) and the higher clearance revenues on cash basis.

**Financing** of the budget deficit in Q1 2011 from external budget support, amounted to NIS 586 million, mostly from the European Commission (NIS 216 million), from the World Bank Trust Fund (NIS 181 million, table 7) and the regional donors (NIS 189 million). However, this external budget support fell substantially short of the quarterly financing requirement of about NIS 895 million. Even with this shortfall the Treasury managed to decrease its net domestic bank financing by NIS 122 million during the first quarter. This shortage of liquidity also resulted in some accumulation of expenditure payment arrears (NIS 343 million) as well as tax refunds arrears (NIS 122 million). Development financing channeled through the Treasury only amounted to NIS 85 million.

## **5. Arrears**

Total Q1 2011 net arrears were NIS 343 million. This amount is divided into wage expenditure arrears (NIS 50 million), non-wage expenditure (NIS 219 million) and development expenditures arrears (NIS 75 million). The arrears to the private sector amounted to NIS 211 million.

## Appendix:

### 2011 Budget Overview:

The Budget of 2011 was approved and signed by the cabinet and the president in 31<sup>st</sup>, March 2011. The budget will focus government resources on completing the institutional build up presented in the Government's "Homestretch to Freedom: the second year of 13<sup>th</sup> government program" and the development strategy articulated for the first year of the PNP (2011-13).

### This is an overview of the budget items and figures:

The driving force behind revenue collection in 2011 will be the expected nominal economic growth rate (12%) plus the benefits from administrative reforms and a higher revenue share from Gaza.

1. Gross PNA revenue would be targeted at \$ 2.25 billion, a realistic 11% increase over revenue realized in 2010. It would cover 66% of recurrent expenditure in 2011, a significant increase over 2010 (63%) and 2009 (50%)
2. The domestic tax revenue target has been set at \$ 512 million, a conservative 8% increase over 2010.
3. Clearance revenue collection in 2011, projected at \$ 1.44 billion, is expected to increase by 14% over their collection level attained in 2010, on the strength of the normal increase associated with the projected economic growth, and higher economic activity expected in Gaza in the wake of larger imports of taxable commodities through the traditional border crossings.
4. Nontax revenue has been set at a conservative level of \$ 300 million, including a \$ 55 million dividend expected from the Palestine Investment Fund
5. The wage bill, projected in 2011 at \$ 1.71 billion, is expected to increase by 5% in NIS terms over the wage bill in 2010. This reflects a 3.5% cost of living allowance; the wage drift (aging and promotions of employees and the smaller increase in employment (1.5.
6. Non- wage expenditure, projected at \$ 1.36 billion, in 2011, has been projected at the same level as in 2010 in NIS terms. Substantial savings should be achieved in operational expenditure, with lower fuel, insurance and maintenance costs resulting from the withdrawal of government cars from PNA high ranking staff
7. Minor capital expenditures would also decline from \$ 29 million in 2010 to \$ 24 million in 2011.

- 8.** Net lending is expected to be further reduced from \$ 236 million in 2010 to \$ 160 million in 2011
- 9.** The total recurrent deficit on a cash basis would amount to \$ 967 million, \$ 163 million less than in 2010. The recurrent fiscal deficit in 2011 would be lower than the deficit in 2010 by 4% (in NIS terms), on a commitment basis.
- 10.** Development spending has been set at \$ 500 million in 2011, consistent with the PNP, on an execution basis, an 11% increase over the level of spending realized in 2010 (\$ 450 million).
- 11.** Most of the budget deficit financing in 2011 would be expected from donor countries in budget support (\$ 967 million) and in development funding to the fullest extent of project implementation.