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Updated Report:

PNA financial crisis: Reality vs. tough choices

2021

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Executive Summary

The Palestinian government has repetitively announced its intention to adopt a policy of budget-tightening and austerity to mitigate its financial crisis. When encountered with an escalated crisis because of Israel's withholding of tax and customs-clearance money [collected on behalf of the PNA] and decreasing foreign aid, it rushes to announce plans to tighten the budget, cut expenses and improve tax collection. However, all these attempts failed to reduce the budget deficit because of its inability to substantially cut expenses or to adopt an informed vision and plan to mitigate the effect of the targeted expenses on the structure of running costs.

The Civil Society Team for Enhancing Public Budget Transparency, whose Executive Office is headquartered at AMAN Coalition, prepared a report on areas of budget-tightening and expenditure rationalization[1] around five years ago. It is therefore important to prepare an updated report to identify the areas of possible cuts in government spending. The report aims to propose solutions to the financial crisis via a diagnosis and improvement of taxation policies with focus on improving collection. The Team also provided additional recommendations adapted from the previous report by either reiterating the same or referring the those that have not been enforced.

The updated report also accounts for the COVUD-19 pandemic and its negative effects at all socioeconomic levels in Palestine as well as the financial crisis of 2019 following detention of tax-clearance money by the Israeli side and tangible drop in foreign aid.

The PNA's financial crisis escalated to an extent that undermined its ability to fulfill its different obligations in a manner which may devastatingly affect the Palestinian economy and increase pressure on the PNA budget.

The methodology adopted in the report depended on a desk review of previous literature and studies on financial and administrative reform plans with a diagnosis and analysis of the levels and trends of public expenditure in the targeted areas. The report further elaborates on the key findings that indicate possible cuts in expenditure and a potential to increase local and tax-clearance revenues. It also proposes a restructure of an improved relative weight of these revenues in the public budget and formulates recommendations for rationalization of expenses. It then details the preliminary outcome of the discussions.

The report summarizes facts and data on the financial position of the Palestinian National Authority, as follows:

- Current expenditure continued to rise in most of the previous years outweighing revenues; it increased from USD 2.9 billion in 2010 to around USD 5 billion in 2021, marking an accumulative increase of approximately 70%.
- The net lending fluctuated with narrow changes since 2010, but skyrocketed in the past five years to represent about NIS 1 billion a year.
- The structure of public expenditure remained static and inflexible without any changes as expenses are mostly current expenses, representing 88-95% of the total expenditure. The expenses are seemingly still computed on item basis in spite of a resolution to adopt a program and performance-based budget.

1 The Civil Society Team for Enhancing Public Budget Transparency, Team's Secretariate: Coalition for integrity and Accountability (AMAN). Report on "areas of government spending rationalization and austerity", 2015.

• Expenses' sectoral distribution has not varied significantly throughout the years. For instance, the economic sector's share of current expenditure stayed at 305% (mostly as overhead rather than developmental expenses). The agricultural sector's share remained below 1% compared to the government and security sectors, which have been allocated 21% while the social sector received 43%.

• Expansion of operational expenses like rents, travel costs and post privileges continued, marking an increase from USD 1.5 billion in 2015 to USD 2 billion in 2020.

• data also show ongoing rise in public expenditure (from USD 3.7 billion to USD 4.7 billion). On the other hand, the increase in revenues has been much slower (from USD 3.6 billion to USD 3.7 billion).

• The result is increased annual deficit, which averaged USD 1.092 and created the need to fund the deficit via mainly international aid and increased public debt.

• The international assistance as well dropped from USD 766 million to USD 566 million in the period from 2016 to 2019, to mark record drop in 2020-2021 to below USD 100 million.

• Official domestic and foreign public debt rose from USD 2.5 billion to USD 3.6 billion with total liabilities to contracting parties with the PNA that exceed USD 9 billion, being 65% of the nominal Gross Domestic Product (GDP).

• The zero net appointment policy resulted in a relative freezing of created jobs; nonetheless, the actual spending on salaries increased although its share in the past seven years dropped below 47% of the current expenditure. On another level, short-term contract-based appointments continued. This budget tightening policy resulted in an precedented increase in unemployment rates and deprived graduate job-seekers from the opportunity to join the labor market, disengaging as such an important human resource.

• Data revealed an improvement in tax collection following some measures to upgrade the annual revenues system in the years 2014-2016, but the taxation policy is still weak and flawed, most notably:

- Failure to expand the tax base in a satisfactory manner leaving broad sectors and segments without any tax registration.
- Failure to put an end to tax evasion and leaks as data from the Ministry of Finance showed that they remain at USD 500-600 million per year
- Weak tax justice system in terms matching taxes with income brackets (progressive taxes).

Temporary solutions to the financial crisis are diminishing
Consequently, the budget continued to endure a high deficit ranging from USD 1.3 – 1.6 billion per year. To overcome the deficit, the PNA tapped on the following sources:

1. International assistance (continually dropping and unsustainable).
2. Bank loans (reached the upper ceiling and may compromise the safety of the banking system).
3. Arrears and delaying payments to the private sector (destructive policy for the private sector).
4. Non implementation of many operational or development plans, which undermined basic public services (and is in contradiction with sound austerity bases).

Democratization of the Budget: A steppingstone for financial reform

- The relatively high customs and tax revenues, which constitute approximately 25% of the GDP, shows that the Palestinian society is increasingly contributing to covering public expenditure and bears a heavy tax burden compared to the level of income and consumption.
- This means that Palestinian citizens are an important – probably the most important – financial source to pay for government expenditure. Consequently, the Palestinian people have full right to hold the government accountable for its public policies and to take part in their formulation. The government must be more transparent in the drafting and implementation of these policies.
- Adopting “strong controls” to ensure compliance with the maximum ceilings of spending in the public budget.
- Enhance civil society participation in the drafting of the budget and in monitoring government’s performance. The budget must be made accessible to citizens in a friendly comprehensible manner (citizen’s budget) and effective accountability mechanisms need to be instituted in the absence of the Legislative Council.
- It is necessary to understand that the PNA financial crisis is not triggered only by scarcity of financial resources, but also from the management of these resources. Even with a dramatic development on the revenue side and funding expenses, the dilemma will remain on how the resources are managed, how the expenses are prioritized and what are the rules and standards on which budgeting is based.
- Reforming public finance at both expenses are revenues side has become a strategic option as the other conventional options like waiting for assistance, bank loans or business funding are not viable or sustainable.
- The proposed interventions must consider the basis of austerity and socioeconomic justice in the distribution of budget-cutting burdens in order to safeguard acquired rights and avoid com promising public services.

Following are some proposed solutions to address or mitigate the financial crisis:

- **Civil service**

• Cleanse the salaries' bill to end disguised unemployment by reshuffling civil servants to vital responsibility center, early/retirement and/or termination of service after careful review of their files.

• Adopt a systemic policy of rotation of staff to transfer some of them to other centers of responsibility based on needs and appropriateness of their qualification and expertise.

• Stop the policy of appointment of short-term staff members, consultants or experts based on exceptional rules and limit such appointments to when the necessary financial allocations are clearly stated in the budget for this purpose.

• Take the necessary measures to compel the centers of responsibility to implement government resolutions on the cuts of job perks, privileges and allowances. To do so, the exception granted to ministers and some other officials to approve such expenditure must be repealed.

• Finalize and ratify the amended Civil Service Law to ensure control of expenditure and short-term recruitment, consultancy contracts and other non-procedural appointments.

- **Security Service:**

• First: The key recommendation is to downsize the staffing of each agency depending on its mandate. It is recommended to rotate many security agents or transfer them, after training, to the civil or customs police.

• Second: Enforce internal and external control via:
- Issuing the executive regulations of the Law on Service in Security Forces, mainly as regards appointments, promotions, and penalties; revisiting the Law on Military Service, which grants numerous privileges to military agents, mainly high-ranking officers.
- Prepare detailed budgets for each security agency and they include it as a unified budget depending on administrative affiliation.
- Expenditure officers in security agencies must comply with the Law on Public Procurement and Tending.
- Internal control and audit units must be instituted in each security force and report to the Central Military Finance Oversight at the Ministry of Finance via the Military Finance Directorate.
- Adopt a special system to monitor the cost of fuels used in security forces allocated vehicles.

- **Net Lending:**

• Central agreements have been concluded between the PNA and Israeli companies, suppliers of goods and services on the trade competition basis so that any flaws of implementation or harm to the Palestinian consumers following individual agreements can be redressed.

• Reaching understandings with relevant agencies on the issue of electricity in the West Bank and Gaza Strip to ensure continuing provision of power in Gaza without harming poor families and alleviate the financial burden on the public budget.

• Prepayment meters have been installed to ensure that more subscribers and local distribution agencies and local authorities pay for the prices of electricity while taking into account the needy.

• Allocation of budgets to rehabilitate the current network and reduce technical losses. These procedures must coincide with PNA's compliance to transfer the share of local authorities in taxes and other fees.

• Intensive use of alternative energy sources (solar and wind) to reduce the value of the electricity bill payable to the Israeli supplier.

Health system and medical transfers:

- Enact a law to establish an efficient and comprehensive health insurance that balances resources and coverages.
- Adopt an action plan for the Ministry of Health with a time ceiling to develop some basic health services that are not readily available at the hospitals of the Ministry of Health.
- The Council of Ministers needs to issue regulations to organize medical referrals and comply by them.
- Immediately stop exceptional medical referrals unless according to the regulations issued by the Council of Ministers.
- Provide qualified human resources and the necessary IT support to audit and follow up on the bills of treatment in Israeli hospitals to prevent any manipulation of the cost of therapy and rationalize expenses.
- Enforce internal and external audit tools and procedures to control the performance of the de partments in charge of the medial referrals.

Tax policies and proposals to improve collection:

Notwithstanding the limited resources, increasing and restructuring public revenues requires further resources, as follows:

- Reform the tax systems (at both legal and administrative levels) to expand the tax base and apply a progressive tax system to achieve the highest level of socioeconomic justice.
- Examine the possibility of adjourning tax and customs privileges and exemptions accorded to investment project as per the Law on Investment promotion for a certain time.
- Strategic restructuring of the Palestinian economy to boost local production rather than imports from abroad.
- Empower executive tax and customs authorities (tax directorates and customs police). It could be useful to consider merging the PNA revenue departments in a single directorate.
- Adopt a modern Palestinian law to address property tax simultaneously with the land settlement project.
- Itemize the tax and customs clearance money to put an end to financial leaks (a detailed study of the items and their allocations). This study will help to perform the following:

  1) Reduce dependency on the clearance money to generate revenue to increase the focus on self-collection.

  2) Weaken Israeli blackmailing of the PNA via withholding or cutting on the clearance funds’ transfer.

1. Introduction:

Over five years ago, the Council of Ministers decreed austerity in public spending. However, the government has not prepared a detailed time-framed plan with the sectors and priorities of budget cuts and rationalization[2]. The decision enforcement mechanisms have not been defined to address any potential socioeconomic problems. In the stead, in relevant meetings, they brought up resolutions to budget-tightening in the use of government vehicles, and allowances for use of mobile phones and fuel as well as new appointments. Proposals included revisiting the ranks and perks granted to the heads of non-ministerial agencies, which are not subject to the Civil Service Law. The privileges have been granted without any plan or assessment of their potential impact on the budget. Without doubt, implementation of these recommendations will result in a drop in the overall public expenditure. However, it will not suffice to achieve the central goal of balanced overhead budget and acceptable financial sustainability. This goal can be achieved only via a comprehensive well-informed plan with measurable indicators and impacts on yearly basis.

It should be noted that the government had repetitively announced its intention to adopt an austerity policy to address its financial crisis. Every time it felt that the crisis was escalating because Israel withheld the customs and tax clearance money and foreign aid dropped, it immediately announces a plan of budget-tightening and improvement of tax collection. However, these efforts cold not help it solve the chronic budget deficit due to failure to introduce substantial cuts on spending and weak compliance by senior officials in responsibility centers to restructure government spending.

The Civil Society Team has then (five years ago) prepared a report with recommendations for rationalization of expenses[3]. The report included a precise and comprehensive diagnosis and detailed recommendations of the areas of expenditure that may be subject to rationalization and austerity measures. Five years after this first report, it must be updated to explore other mechanisms and areas of rationalization. The report aims to propose solutions to the financial crisis via an accurate diagnosis of the tax policies to improve collection locally and from clearance transfers. It also adds to the recommendations of the previous report while reiterating the still applicable recommendations.

The updated report is particularly important after the outbreak of COVID-19 pandemic and its repercussions on Palestine. Arab and other world countries have endured an economic crisis, which is aggravated in the already fragile economy of Palestine. In 2019, the Israeli government withheld the tax clearance money payable to the PNA while international aid dropped sharply. On the other hand, local revenues collected by the Palestinian government represented only 25% of the total revenues while foreign aid and grants from international governments and organizations constituted 25% of the revenues. The remaining 50% are from the tax and customs clearance money collected by the Israeli occupation government and transferred to the PNA after deduction of fees to manage Palestinian imports via Israeli ports and crossing points. The share of each revenue varies from time to time depending on the clearance transfers, foreign aid and the government's ability to collect taxes locally. The Palestinian government faced difficulties to impose lockdown and social distancing protocols that would disrupt production because of its inability to compensate businesses for the losses or provide aid to the severely affected population. Furthermore, public sector salaries have not been paid, which affected many areas of the economy. With escalating financial crisis, the PNA became unable to pay its debts, arrears and other dues, which subsequently compromised the economy and increased pressure on the PNA.

2 Although both terms are use alternately in this report, there is a subtle difference in their meaning. Austerity means changing the overall spending whether the budget structure changes or remains unchanged while rationalization refers to a change in the spending structure without necessarily affecting its size or upper ceiling. The first is concerned with cuts in expenditure regardless of the distribution of these cuts to the budget items while the other focuses on the size and type of these cuts for more efficient spending.

3 The Civil Society Team to Enhance Public Budget Transparency, Team's Secretariate: Coalition for Integrity and Accountability (AMAN). Report on "Areas of Government Spending Rationalization and Austerity", 2015.

Budget tightening has been re-underlined as a solution to the financial crisis in the financial strategy issued in annex to the 2015 budget. However, these attempts and efforts failed to reduce the budget deficit in a sustainable manner because of failure to substantially cut expenses and lack of compliance of senior officials in centers of responsibility as well as weak weight of these expenses in the current expenses structure.

Experiences from other countries and published literature showed that a successful budget-tightening plan must answer the following questions:

- **What are the foundations and considerations that govern the general outlines of the austerity?**
- **In what areas or sectors should austerity be applied, as relevant to the approved foundations?**
- **Which expenditure items must be cut in all areas or sectors to be subjected to budget-tightening on the basis of identified?**
- **priorities?**
- **What are the socioeconomic and political conditions?**
- **Finally, who will bear the cost of austerity (individuals and groups)?**

AMAN Coalition believes that many sectors may be subject to budget tightening including the civil service, namely financial allowances granted to senior officials and allocations to short-term contractors and other outsourced organizations, unions, private businesses of powerful individuals and calculation of years of service in PLO factions for seniority allowances in addition to misuse of financial resources in the sectors of security, energy, foreign affairs, health and social affairs. However, an in-depth study of these sectors is needed to identify the areas of waste of public funds and propose specific reforms per sector to overcome the gaps and cut public expenditure while upgrading the effectiveness of employment and use of the scarce financial resources available.

1.1 Preliminary remarks:

- The total public debt till end June 2021 reached NIS 12.1 billion, with accumulated net arrears of NIS 8.6 billion till end 2020[4].
- Without ending the occupation and imposing Palestinian national sovereignty on the entire territories, resources, borders and people, the PNA's economic and financial situation will continue to suffer severe crises.
- The PNA's financial crisis is magnified because of the political split.
- Palestinian citizens contribute to coverage of public expenditure, as testified by the relatively high share of tax and customs revenues (25-30% of the GDP). Citizens cannot bear additional tax burdens to solve the crisis.
- Participation is the foundation of success of an austerity and budget-tightening plan.

1.2 Rationale behind the present report and recommendations for an austerity plan:

AMAN coalition proposed this initiative to serve the following goals:

1. Provide the Palestinian government with specific recommendations that decision-makers can apply to introduce the necessary reforms and prepare a national budget-tightening plan.
2. Support decision-makers in devising the necessary measures to develop the tax policies and enhance collection to solve the PNA's aggravated financial crisis.

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4 Monthly statements published by the MoF on its webpage: http://www.pmof.ps/pmof/documents/accounts/monthly/2021/June.2021.Ar.pdf

1.3 Methodology:

The methodology included the following steps:

- Literature review of previous studies on the PNA's public financial management to examine the regulatory framework, expenditure control tools and the bases that must be considered in the preparation of a public expenditure austerity plan.
- Gather relevant information on financial and administrative reform plans previously approved by the government and other agencies concerned with the Palestinian financial affairs, like AMAN Coalition.
- Diagnose and analyze the size and trends of public expenditure in the targeted areas based on actual financial data.
- Spending on the targeted areas of expenditure.
- Analysis and specification of the key findings on possible areas of budget cuts.
- Analysis of the potential opportunities for increase in local revenues, and clearance transfers and restructuring of their share of the public revenues and budget.
- Proposal of areas for rationalization and austerity in public expenditure and of enforcement mechanisms in addition to exploration of areas of possible increase of revenues and mitigation of the financial crisis.
- Public discussion with the civil society and official institutions to propose recommendations and submit them to the government.

The report will focus on key areas of expenditure in its analysis:

1) Salaries and wages represent around 50% of the current expenditure. It is important to dif ferentiate pay of civil servants from that of security agents because they are subject to different regulatory frameworks and executive financial orders. This item is common among all the PNA's centers of responsibility.
2) Privileges and financial allowances granted to senior posts as well as short-term contracts for the recruitment of regular staff members or temporary consultants or experts. These privileges and contracts are concentrated in the governance and security sector (Presidency office, Council of Ministers, security agents, Judicial Council, Ministry of Justice, and Ministry of Finance).
3) Cash assistance paid by the Ministry of Social Development to needy families, which appear as part of the transformational expenses.
4) Net lending resulting from the importation of electricity and water by providers and distributers in the Palestinian areas, which is usually deducted by the Israeli occupation government from the PNA's clearance entitlements.
5) Medial referrals to domestic and international hospitals. Part of these referrals appear under the net lending item.

1.4 Report Chapters:

1. Introduction: which covers the report's goals and methodology.
2. Background: the background of the financial crisis and basis of budget-tightening.
3. Diagnosis of the public expenditure in the government sectors (as referred to).
4. Tax policies and means to improve tax collection.
5. Findings: problems and gaps that lead to waste of government financial resources.
6. Recommendations: proposals to solve the problems challenges with a general outline of a government budget-tightening and tax collection enhancement plans.

2. Background:

2.1 Budget-tightening, improved collection and the financial crisis:

For the purposes of this report, financial crisis means the chronic deficit in the PNA budget. It is a structural problem that began with the creation of the PNA while its solution cannot depend only on technical and financial tools. The main reason behind the crisis is the Israeli occupation because of its control over crossing points, borders and natural resources including all the land in the so-called Area (c), water and all forms of energy. Furthermore, it has quasi full control of over two-thirds of the PNA financial resources, known as tax and customs clearance money. This cause must be well understood because most of the applicable proposed solutions including rationalization or budget-tightening – although morally and financially important – will only mitigate the crisis but will not end it.

Budget-tightening must be combined with other short-term and long-term strategic measures. It must be coupled with a restructuring of tax revenues with enhancement of collection via horizontal expansion to minimize tax evasion and promote justice in taxpayers' tax burden as well as reduction of tax deficit. On the long run, a national strategy must be devised to restructure the Palestinian economy and redeem the status of industry and agricultural rather than trade and services. These sectors are more liable to create jobs, reduce poverty rates and boost the national economy's tax potential, consequently decreasing the budget deficit and lowering the share of clearance revenues I the overall revenues (they currently represent 70%). As a result, dependency on the Israeli decision for finance will be reduced.

The haphazard spending policy without any transparency policy or controls applicable since the advent of the PNA resulted in a deep and escalating crisis. The most important features of this policy may be summarized as follows:

- Current expenditure continued to escalate over the past years to reach 5 billion US Dollars in 2021 budget. The purpose of rationalization and restructuring of current expenditure will not succeed regardless of the government's attempts to tighten the belts from time to time. For example, current spending increased from USD 2.9 billion in 2010 to USD 4.6 billion in 2020. Most of the rise was consumed by salaries and other non-salary operational expenses, mainly transformational expenses. On the other hand, the net lending kept fluctuating at narrow levels in 2010 and dropped from its peak in 2007 (USD 550 million) to USD 250 million. It re-increased in the past five years to reach NIS 1 billion annually. In contrast, developmental expenditure has dropped from on year to another, which does not make economic sense.
- The structure of the public expenditure has not changed as it remained mostly overhead spending (ranging between 88 to 95% of the total spending), with static distribution (inflexible). Spending is still on item basis in spite of a resolution to adopt a program and performance budget.
- The sectoral distribution of the expenses has not changed much either. The economic sector's share of the current expenditure stayed at 3-5% (mostly overhead not developmental), while agriculture received less than 1%, compared to the governance and security sector, which consumes 21% and the social sector at 43%.
- Spending on salaries continued to rise I the past seven years despite a zero-appointment policy. Spending on this item rose from USD 1.4 billion in 2005, to approximately USD 4 billion in 2014, and ranged from USD 1.7-2.2 in the period from 2015 to 2021. It should be noted that the salaries increased in actual figure while its share in the past seven years dropped to less than 50% (46.4%) of the overall spending.

- The PNA has been applying a policy of expansion of operational spending like rents, travel costs, post perks in a manner that is inconsistent with the resources available. The result is increasing deficit across the years. The government's overspending led to waste of public funds. This attitude may be described as "easy spending or overspending". Spending in 2015 budget amounted to USD 1.5 billion, representing 48% of the current expenditure. It rose to USD 2 billion in 2020, being 43.3% of the current expenditure.
- Developmental budget dropped sharply in the past years (6-8% of the public budget). It appears on a separate item on the current budget and is fully funded via international aid that may not be consistent with national priorities, trends, vision and interest. It should be noted that the actual spending of this item remained at 60-70% because its financing depends fully on international aid.

In our opinion, cutting current expenditure should have taken place years ago, mainly following the political division, which deprived the treasury of the revenues from the Gaza Strip. It was clear that the PNA was on the verge of a suffocating crisis that requires serious and rigorous austerity measures. Nevertheless, the government expanded its expenditure disregarding the new situation following the split and irregularity of assistance. It had to resort to domestic and foreign loans, which has exacerbated the problem.

This miscalculated spending was accompanied with an increase in public revenues, but they did not suffice to solve the budget deficit in a tangible way. The net tax revenues increased from USD 1.8 billion in 2008 to USD 2.8 billion in 2014, rising to USD 2.9 billion in the past four years. It reached USD 1.9 billion in June 2021. It only covers 70% of the current expenditure. The rise in tax revenues shows either an improvement in collection or an expansion of the Palestinian economy's tax potential following the growth in the past years.

The relatively high tax and customs revenues, which constitute about 25-30% of the GDP, who that the Palestinian society is increasingly contributing to covering public expenditure. The Palestinian economy is not rentier but depends on the efforts made by individuals and organizations to produce goods and services under harsh political and security conditions and scarce natural resources. The Palestinian population bears a relatively high tax burden, compared to income and consumption. Since Palestinian citizens are an important source, probably the most important source, of financial resources available to government spending, they have the right to participate in the formulation of public policies and hold the government accountable for them. The government must be more transparent in drafting and enforcing these policies.

Good governance, especially in the management of public funds, is based on taxpayers' right to monitor public spending and ensure it is consistent with the law, and on their right to hold the government accountable for any form of waste of public funds or spending on other than the society's priorities.

In spite of slight improvement in tax collection following the introduction of some measure sin the revenue system strategy in the years 2014-2016, the tax policy still has some lacunae:
- Failure to expand the tax base in a satisfactory manner leaving many sectors and segments without tax registration to date.
- Failure to reduce tax evasion and leaks: statistics of the Ministry of Finance refer to a total of USD 500-600 million per year.

As a result of this situation, the budget deficit protracted at a high level ranging between USD 1.3-1.6 per year. To cover this deficit, the PNA depended on international assistance, which funded 83% of the deficit in recent years while the remaining part was financed via bank loans or arrears to the private sector or changes to some operational or developmental projects, which compromised basic public services.

Conclusion:

Public budget tightening is a choice that must be considered to resolve the PNA financial crisis, which may exacerbate in the near future for political, security and economic reasons. However, austerity should not be the only option because it will not be enough. Austerity is not only a financial necessity, but also a moral and policy obligation of an authority that does not enjoy full sovereignty and a people that is still struggling to be liberated from military occupation. Rationalization or expenditure tightening in the Palestinian case is of great political importance because it redresses the PNA financial vulnerability and immunes it against the political pressure exerted by Israel through the economy. Furthermore, budget tightening may result in negative socioeconomic effects that outweigh the financial savings. The size and type of these effects depends on the areas of austerity.

Therefore, any austerity plan must take into account the prevailing socioeconomic conditions. It must read indicators of poverty and unemployment rates, purchase power, economic growth and social inequality to identify the directions and priorities of government spending cuts. Based on this understanding, bases that enjoy national consensus must be drafted for any austerity plan. Thus, AMAN Coalition suggests the following to the government.

2.2 Bases of good budget-tightening

A public spending austerity plan must be just and balanced. It requires detailed technical analysis of all the spending items to identity the areas of budget cuts. An effective austerity plan is needed to save money without increasing the socioeconomic burdens. Therefore, this plan must consider the following to achieve its objectives:

1- Distribute the burdens of austerity with consideration of social and economic justice.
2- Preserve staff legitimate and earned rights.
3- Avoid compromising the quality of basic services provide to the public like education, health and social care.
4- Account for the socioeconomic conditions of citizens, especially as relates to poverty and un employment rates.
5- Invite the private sector to share part of the burdens (social responsibility fund)

The following steps are necessary to establish a rationalization and austerity plan:

1. The Council of Ministers must identity its directions benefiting from the ideas proposed by the civil society organization and form a ministerial committee chaired by the Prime Minister to ratify the bases and limitations of the desired rationalization and austerity.
2. The Ministry of Finance must draft the austerity bases and limitations as per the directions ap proved by the Council of Ministers.
3. All centers of responsibility must be offered the possibility to participate in the discussion of the budget via the approved teams to set the priorities of rationalization in the allocations made to these centers.
4. The ministerial committee should prepare the austerity plan based on the feedback from the centers of responsibility.
5. Political institutions and civil society organizations must be given the chance to express an opinion in the draft plan.
6. The final plan with an implementation timeframe and enforcement mechanism must be adopted by the government for submission to the Legislative Council and the President for ratification. The government should then implement the budget as per the approved schedule.

3. Diagnosis and analysis of the areas of public spending

This part of the repot covers the five key areas of spending identified earlier: salaries, public posts and special contracts perks, social assistance, net lending and medical referrals. The size and nature of each area will be described and analyzed to identify the gaps and flaws and help formulate specific recommendations for an effective austerity plan.

3.1 Salaries and wages (payroll)

This item continues to consume the largest share of the Palestinian public budget (41.7% of the total current spending and net lending in 2020 and 45% of the current spending). This is an indication of an amplified wages bill, compared to some neighboring countries.

Based on the previous report, the main features and changes of this item after 2014 may be summarized as follows:
- The total number of employees does not include the retired staff "registered at the Ministry of Finance", who account for 14,000 retired employees. The salaries bill of NIS 400 million per year does not account for their pension pay.
- The increase in the number of civil servants and the wages bill from one year to the next is within a fixed and acceptable limit. This is an indication that this item has not significantly changed.
- The average salary of civil servants remained low and close to the general average, which means that the margin to cut on their pay is very narrow, or even nil.
- The government succeeded in controlling appointments and complied with the terms set in the public budget law in recent years. New appointments in vital sectors, like education and health, have not been subjected to the rule of appointment based on vacancy but rather on natural need. For instance, the government approved in its session of 15 September 2015 a cut of 15% in the employment contract in government departments that have not been filled to date (in 2015), namely in the Ministry of Higher Education. The Ministry of Health was excluded of this decision.
- The appointment and promotion procedures in many centers of responsibility improved tangibly in recent years to become more compliant with the civil service law, mainly Articles 14-29, which provide for advertisement of vacancies in daily papers, and competitions and interviews by specialized committees with membership of representatives of the General Personnel Council. Selection of employees is based on merit. Furthermore, promotions to a more senior post are more controlled and consistent with the law[5].
- The largest share of staff and their pay is in the social service sector, namely the Ministries of education, Health and Social Development. They represent 73% of staff and 78%of pay. This highlights the importance of these sectors in the public spending. Therefore, any significant cuts on salaries are difficult and unrealistic.
- A question is repeatedly raised about the possibility of downsizing these ministries via early retirement or removal from office. However, this option will be faced with the challenge of bearing the cost of pension pay of new retirees, especially under the current difficult living conditions and high rates of poverty and unemployment. Justice and PNA institutional building must be the rule in the distribution of the burden of budget tightening
- Is it possible to revisit the pay of employees and introduce cuts on this pay, or limit cuts to the senior posts only by amending the Civil Service Law? **To answer these questions, we must take into account the employees' acquired rights, and purchase power of their salaries at their current value.**

5 Interview with Mosa Abu Zeid, President of the General Personnel Council and Mr. Fathi Khudeir, Director of the Directorate of external administrative control at the Council.

- Is it possible to reshuffle or redistribute employees to the existing or rebuilt institutional structure via an informed merging of the similar or complementary centers of responsibility to boost their productivity and job satisfaction? The allocations to the different sectors may be reshuffled to the new posts without any impact on the size of spending. This process will be closer to rationalization rather than austerity? **To answer this question, the scope and quality of public services must be considered to match staff qualifications and experiences with the new posts.**
- An unknow number of employees receive salaries without any real need or even placement on the officially approved organizational structures. The number of the officially approved staff members and the value of salaries bill in many PNA institutions do not match, especially in the governance sector. However, the social and economic sectors do not seem to endure this mismatch. This situation may be attributed to the overlapping of the political and administrative levels in some governance agencies. An area of budget tightening may be by redressing the status of these employees or by putting them on early retirement or terminating their service following a thorough audit of their files to analyze their appointment and tasks.
- It is probable that a large number of civil servants have unlawfully double posts. The difference matches the number of staff members outside the official organizational structures. The General Personnel Council and concerned centers of responsibility need to thoroughly examine this situation and redress their employment to correspond to the law. Failure to do so means that the other options is to terminate their service or refer them to early retirement under agreed upon terms.
- The reduction of the permanent civil servants via termination of their service without pension rights, even for those outside the organizational structures, does not appear to be a realistic option under the high unemployment rates and poor living conditions with limited absorption capacity of the Palestinian economy. There isn't any convincing legal basis to apply such measure because they have been in their positions for many years and have consequently acquired rights. Such an option may be faced with strong popular and political resistance. The financial savings secured by this option may not be equal to its socioeconomic and political cost. Thus, the realistic option to downsize staffing to reduce the salaries bill will be by referral to retirement under satisfactory and just terms, mainly in the case of politically appointed staff members who have been in service for a long period or who are nearing the legal retirement age. Furthermore, most of these employees have other work options and may adjust their economic situation more easily than other employees.
- Cuts on civil servants pay are also unrealistic and may not be advocated for because these salaries are already low compared to the cost of living.
- Reshuffling of civil servants to the different centers of responsibility consistent with their qualifications and expertise may boost their productivity and job satisfaction. Subsequently, PNA services to the public will improve. This measure may be applied with a full and holistic restructuring of the PNA institutions. This measure will require merging or abolition of some centers of responsibility or departments within the same center of responsibility.
- The reduction of the permanent civil servants via termination of their service without pension rights, even for those outside the organizational structures, does not appear to be a realistic option under the high unemployment rates and poor living conditions with limited absorption capacity of the Palestinian economy. Realistically, a technical committee with membership of the General Personnel Council and the Ministry of Finance in addition to impartial parties nominated by the Prime Minister must be formed to audit the surplus staffing files and redress their situation as per the following principles:

1. Referral to retirement must be on satisfactory and just terms, since most of the appointments were political not professional; the staff members have been in service for many years and may be close to the legal retirement age.

2. reshuffling of staff: employees may be relocated to another center that concords with their professional qualifications and expertise. Consequently, their productivity and job satisfaction together with the quality of services may improve.

3. restructuring PNA institutions to merge or maybe abolish some centers of responsibility, central and district offices.

4. Regarding the civil servants with unlawful double positions, their files must be audited by GPC and the centers of responsibility to redress their status according to the law. Failure to do so, their service must be terminated, or they should be place don early retirement under agreed-upon terms.

5. Revisiting the staff pay: the option to cut civil servants' pay is unrealistic and may not be advo cated because the pay is low. Therefore, the salaries of senior officials in state and non-ministe rial agencies to set an upper ceiling of their remuneration that is consistent with the PNA financial situation. A rigorous revision of their perks is needed. Instead of appointing new employees, existing staff surplus must be reshuffled. Purchase of vehicles and premises and renting of premises must be suspended for three years.

Regarding the wages and salaries of security agents, the following remarks are made:

- The number of security agents have noticeably increased from 57,000 in 2004 to 82,000 in 2006 to settle at 65,00 across the different forces in later years until today. They represent approximately 43% of the total public servants employed by the PNA. The report does not focus on an assessment of the increase in their number, which does not respond to specific security needs. Spending on security until end 2020 constituted 21% of the public expenditure.

- Military staff represent about 43% of the total staffing, however, they receive 50% of the overall spending. Basic calculation reveals that the average monthly pay of a military staff is higher than a civil servant of the same rank, considering that there are fewer security agents than civil servants.

- **Noting that most military staff are low ranked (non-commissioned officers), with an average monthly pay that is not much lower than the average pay in the security sector, we can deduce that the pay of senior officers and military staff, which represent a minority, is very high.**

- **The share of the security sector** of the current budget is high (over 21%) while the largest share is spent on wages and salaries (80%). It is however noted that the average monthly pay of a security agent is higher than the pay of a civil servant of the same rank. This indicator means that the budget and allocations must be revisited to reassess the Military Service Law, which grants many benefits to military staff, mainly the high-ranking officers.

3.2 Operational expenses

Notwithstanding a declared policy of rationalization of expenses and budget-tightening, the government's budgeting of different sectors, especially the security sectors, does not support this statement of austerity. The government continues to prepare its operational budget as a single figure without detailing the items of expenditure.

The privileges granted to public officials are registered under operational expenses, which englobes non-salary current expenses. The operational expensess are necessary for the conduct of business in the centers of responsibility. They are not associated to the services offered by these centers to citizens. These expenses represent the total sum spent by the centers of responsibility included in the public budget on the use of goods services during any given fiscal year. Examples of these expenses include transportation and housing allowances to staff members, travel allowances for official missions, treatment abroad, rents, hospitability, building administrative and technical capacities of staff members, improvement of the buildings of the premises of the centers of responsibility, payment of public utilities bills like water, energy, telecommunication, IT and public debt service among other. In summary "the staff member, rather than the public service is the main trigger" of most of these expenses.

Consequently, the rise in the number of public services increases these expenses but not in a linear relation. Any change in the staff placements because of promotions lead immediately to an increase in these expenses. The same applies to the salaries' payroll. Table (1) below shows the operational expenses as distributed in a selected number of years.

Table (1): Current non-salary expenses in selected years (million USD)

Item	2011	2013	2014	2015	2017	2019	2020
Current non-salary expenses	1,400	1,577	1,673	1,800			
Operational expenses	530	560	602	650	626	701	628
Security sector share: Governance sector share Social sector share Infrastructure and economic sector share	397 103 258 36	415 108 270 37	452 120 290 42	481 125 312 43			
Transformational expenses	800	950	1050	1070	890	1444	1685
Capital expenses	70	67	71	80	17	18	22

Source: calculated by researched based on MoF data

The table above shows that operational expenses in general, mainly the civil sector's share, increase from one year to another at a normal rate averaging 7%. It should be noted that this slight increase is still taking place in spite of government's declared austerity measures. The Council of Ministers issue numerous resolutions and regulations since 2011 to tighten the budget of the operational expenses, especially for travel and work missions' allowances (travel, bousing, telecommunication, fuel) and supervisory allowances, among others. The last resolution was issued about two months ago. However, these resolutions could not reduce the costs due to poor compliance and exceptions granted to ministers and other officials in their rank with the approval of the Minister of Finance to exceed the budget restrictions, as necessary[6].

The governance sector is clearly consuming 26% of the operational expenses, compared to 65% to the social sector and 9% to the infrastructure and economic sector. The operational expenses per staff member is around USD 5,600 per year in the governance sector, compared to USD 4,600 in the social and economic sectors. This difference seems larger considering that most of the operational expenses in the social sector is concentrated in the Ministries of Health and Education (around USD 180 million and 55 million respectively). This money is used to buy medication and other medical and educational supplies that benefit citizens, unlike expenses in the governance sector. The position privileges of the governance sector are said to represent the largest share of the operational expenses, compared to the other sectors for two reasons: 1) the nature of missions and responsibilities of the sector's staff, which requires public relations and traveling; 2) the number of senior ranked positions in this sector is relatively large compared to the other sectors. Privileges, miscellaneous expenses, allowances for vehicles and fuel and other cost are expensed to these staff members outside the budget allocations.

Because of insufficient details on the itemization of these expenses, it is difficult to assess the increase in these privileges over the years to identify their area of budget-tightening. However, the privileges are estimated at an average of 25-30% of the total operational expensess of all sectors. They however rise to 40% of the governance sector, ranging from 100 – 130 million USD per year. Thus, cuts in these expenses will surely be welcomed by the public, which criticizes these expenses identified as a waste of public funds. These expenses directly benefit the officers of high ranks at the expense of public services provision or development and of public interest and taxpayers. The direct benefit, or as explained in literature on administration and governance "Agency Cost", is geared to top ranking officers.

Finding 1: Cuts in operational expenses, mainly post privileges, represent the most realistic and popular option, which is the least costly at political, social and economic levels. The centers of responsibility in the governance sector must be targeted more than other centers in the social sectors because any budget-tightening in these centers will not have an adverse effect on the public services. The value of these privileges are close to UDS 100 – 130 million per year.

Special and short-time contracts with regular employees or consultants: Appointments according to these contracts follows Council of Ministers' resolution (3/5/15/2013), which provided for the condition of availability of the necessary fund allocations for such contracts. The procedures appear satisfactory and able to control consultants and experts' contracts. However, these contracts, which are designed to be short-term, ended up protracted as if they were permanent contracts. This situation explains successive government decisions to give these contractors priority of appointment in the event of vacancy in the centers of responsibility they are employed with.

6 Interview with Mr. Ismat Abu Rabee', Director General of the Department of Economy Control at the State Administrative Audit and Control Bureau

> **Finding 2:** Budget-tightening is reasonably possible in these contracts and can be applied via restriction of these exceptions to real needs and application of regular procedures to any later appointments. This seems to be a realistic option to rationalize expenses and abide by the short-term nature of such contracts. As such, more unemployed youth graduates may be offered an opportunity to work (they represent about 55% of the total number of graduates).

*** Security sector's share of operational expenses:**
States development is identified by its population's welfare and sustainable development. Usually, spending on the security sector at the expense of other basic service and developmental sector like health, education and social care, has a negative effect on the population's welfare and development, especially in countries with scarce economic and financial resources like the PNA. Therefore, a large rationalization of spending in the security and civil sectors is needed. Table (2) below presents the share of the Palestinian security sector in PNA budgets in selected years.

Table (2) Share of the Palestinian security sector of the current budget in selected years[7]

Year	Share of current budget
1997	27%
2000	35.1%
2003	27.2%
2005	24.2%
2007	39.4%
2008	35.2%
2009	27%
2010	30%
2012	28.8%
2013	28.1%
2014	28.5%
2015	25.6%
2016	29.8%
2017	30.2%
2018	26.4%
2019	21.4%
2020	20.6%

Table (2) shows that spending on the security sector in Palestine has fluctuated in the period from 1997 to 2020 depending on the prevailing political conditions. There is a noticeable increase in 2007 due to recruitment of new agents who received salaries from the security forces. In this year alone, 77,000 new agents were recruited. However, staffing levels dropped in later years to stay at 65,000 military agents without accounting for the 14,000 security agents recruited by Hamas government in Gaza following the political division.

7 PNA budget, several years

Security expenses represented 30% of the current expenses in the period from 1997 to 2013. Their share dropped later to 26.3% in 2014 – 2020 to decrease to 20.6% in 2020. The drop is due to the government's decision to impose compulsory and/or voluntary early retirement. Of the 27,000 public servants referred to early retirement in 2017, 18,000 were military staff of a total of 62,000 military staff in the West Bank and Gaza Strip[8].
The share of salaries in the security budget drops tangibly in 2014 to reach 85% before it stopped at 75.6% in 2020. The value of salaries was noted to be NIS 2.6 billion in 2020, compared to its previous value of NIS 3.4 billion. Data show a decrease in the share of salaries in the security sector with an increase in other current and operational expenses. The remaining part of the budget is spent on capital and transformational expenses, which amount to NIS 128 million in 2020. (See Table 3).

Table (3): Operational expenses in the Security Sector (2011-2015) NIS million

Item	2011	2013	2014	2015	2017	2018	2020
Operational expenses of the Security Sector	133	145	150	169	314	321	434

Source: calculated by researcher based on MoF data

Speaking of legal and institutional framework of the security sector's operational expenses, we should refer to the Palestinian Basic Law's definition of the security and police forces. They are a regular force, considered to be the armed forces of Palestine. The Basic Law referred regulation of the security and police forces to specialized laws[9]. Prior to 2005, no regulation existed to govern security forces, except for the Civil Defense Department. The mandate of security forces was defined via instructions issued by the field leaders of these agencies. The absence of governing regulations resulted in great overlapping of their mandates and ambiguous administrative and financial procedures. After 2005, a tangible progress was made with the promulgation of the Civil Service and Security Service Laws as well as the General Intelligence Law and the Decree Law on Preventive Security[10].

For financial matters, the Palestinian security sector, since its inception, depended on miscellaneous daily payment claims to cover its expenses via direct orders from the President. The security agencies have not worked according to approved financial procedures, regulations or rules as per the Public Budget Regulation Law No (7) of 1998. This mechanism held many problems that compromised the reputation of the security forces and provided a fertile environment for financial infractions. The budget of the security sector has not been prepared in accordance with the law nor was it ratified by the PLC. The different agencies have not been compelled to submit financial statements under the pretext of confidentiality.

Generally speaking, some laws and regulations have been enacted in recent years to govern the finance of the security sector although with some flaws and gaps in their provisions. However, what matters more than the existence of a law is its enforcement on the ground. The past situation continued leaving room for gaps and further criticism. Many observers of the financial affairs of the Palestinian security sector describe the situation as a secret budget[11]. This procedure enables heads of security agencies to spend via periodic payments, which hinder the possibility of tracking, analyzing and submitting recommendations relating to the different budget items.

8 Coalition for Integrity and Accountability (AMAN). 2019. Eleventh Annual Report – Integrity and Anticorruption in Palestine 2018. Ramallah - Palestine
9 Basic Law, Article 84.
10 Al-Barghouthi, Mo'en, Institute of Law 2009, Law and Security Series, Regulatory Framework of the Security Sector in Palestine: Analysis of legislations issued post 1994, p. 11

In 2014, the average expenses of a military agent amounted to USD 2,320 per year. When compared to their counterpart in the civil sector, a huge difference is noticed in favor of the civil sector. The lower average income of military agents compared to civil servants of the operational expenses is explained by two reasons: 1) the high share of a civil servant is mainly concentrated in the governance sector where there is high need for operational expenses to cover public relations and travels; 2) most of the security staff are of low ranks without any privileges or high spending levels. The privileges are strictly granted to high-ranking officials, who represent a small percentage of the security sector staff. These figures are an important entry point for Palestinian decision-makers to start exploring the possible areas of rationalization of operational expenses in the security sector, without jeopardizing the beneficiary sectors or undermining the basic principles of rationalization detailed in the beginning of this paper.

Finding 3: The operational budget allocated to the security sector is relatively high. Furthermore, spending procedures and control are flawed. Internal and external audit of the priorities and procedures of spending, mainly the expenses related to the supply of food, fuels and capital expenses, are very week, controversial and allow for waste and misuse of funds. In spite of a declared policy of rationalization and tightening of expenses, the government's actual allocation of budgets – mainly to the security sector – has not respected this declared policy. Despite declared austerity measures, the operational budget is still presented as a lump sum without any details on the items of expenditure.

- Continuing abuse of the special-contract appointments exception for the recruitment to new posts or to secure exaggerated monthly pay (special-contract staff members amount to 1,610).
- Budget tightening on the item of special contracts is possible if fair competition rules are applied to appoint staff and that these contracts are not protracted beyond the term needed.
- Freeze purchase of vehicles, and purchase or leasing of premises for three years.

3.3 Social Assistance:

The expenses of the Ministry of Social Development till end 2020 represented 9.1% of the public spending. Under the current harsh socioeconomic conditions in Palestine, with resulting dropping of most indices, increasing poverty and unemployment, the social role of the PNA must grow to preserve social balance and fulfill basic needs of many Palestinian households who live below the poverty line. The assistance usually included allocation of large sums in the public budget under the item of social assistance to needy families. This budget is managed by the Ministry of Social Development. In addition, there are allocations to the families of martyrs, injured and prisoners, which are managed by another government agency.

This part of the repot focuses on the cash assistance supervised and managed by MoSD because it is socially important. This assistance management mechanism needs to be examined to explore areas of potential budget-tightening without affecting the size and type of assistance provided to the needed households. The government has explicitly declared that its austerity plans do not include cuts on the allocations to poor and marginalized families notwithstanding the PNA's financial crisis. As a result of this policy direction, beneficiaries of the assistance programs continue to increase with the number rising from 106,000 households in 2009 to 110,000 in 2010 to reach 119,000 in 2014.

In addition, with the outbreak of COVID and the declaration of a state of emergency in Palestine, with subsequent lockdown and restrictions on mobility, many economic sectors endured huge losses. Many workers lost their source of income, especially those working without or daily contracts. Other workers were fired following closure of their work facilities. New households started to live below the poverty line while the already deprived and marginalized groups started to live in an even worse situation. 53,000 new households started to live below the poverty line. Some workers became critically vulnerable (nurseries' teachers, kindergartens' teachers, daily workers in the tourism sector, some freelancers) in addition to the persons with special needs, senior people and foster homes of battered women. In other words, COVID increased the number of poor households from 96,000 to 423,000. The relative impact was visible in the West Bank with the number of poor households jumping from 96,000 to 206,00 (increase at 114% higher than in the Gaza Strip, where the number increased from 180,000 to 217,000 (21% increase)[12]. It appears that the beneficiaries of the aid programs are marginalized groups or poor households or other social groups like families of martyrs, inured and prisoners. On the surface, it may appear unjust to call for a reduction of this aid. But, is the situation ideal or can the budget be reformed without jeopardizing these groups, can we explore areas of rationalization? This is the question we will attempt to answer in this part.

The Ministry of Social Development is implementing numerous social assistance programs under its Poverty Combatting Directorate. These programs include: 1) cash assistance program (cash transfers) through which the Ministry sends social aid to needy groups on the basis of a payment every three months. The total value of these payments amounts to NIS 328 million, dispersed in four payments (a payment of NIS 82 million every three months). The government covers 56% of these aids while the European Union and the World Bank cover the remaining sums. 2) Emergency Assistance Program, which provides contingency cash assistance that ranges from NIS 1000 to 4000 per case. The overall budget of this program is about NIS 6 million, on the basis of NIS 0.5 million per month. It is fully covered by the government. 3) Economic Empowerment Program, which provides loans ranging from USD 5-10 thousand to implement micro projects in cooperation with the Islamic Development Bank and UNDP to combat poverty and promote self-sufficiency via a number of developmental interventions, most importantly, micro and small income-generating projects[13].

In its strategy 2021-2023, MoSD introduced a radical transformation to shift from relief and protection toward social development. The purpose was to attempt to change the developmental situation of poor and marginalized communities and promote social cohesion. MoSD is fully aware of the challenges on the ground, mainly the protraction of the occupation but it adopted social development to make the necessary social change to empower the society, all households, individuals and institutions, and enhance its resilience and steadfastness. It endeavors to improve the quality of life for all and provide social protection and basic services to poor and vulnerable families to enable them to enjoy a dignified life and decent work opportunity. It also works to promote socioeconomic and political integration of marginalized groups.

A quick look at the emergency assistance and economic empowerment programs shows that the main problem is the unsustainability of their sources of funding. Both programs depend entirely on government funding and receive small allocations of barely NIS 0.5 million a month. A key problem with the economic empowerment program is its management since it is noted that around 50% of beneficiaries failed to repay their loans as scheduled in 2010 . Consequently, the number of beneficiaries cannot be expanded because of the inability to rotate the funds allocated to reach other needy households.

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12 Prime Minister's Office/ National Development Plan 2021-2023, Social Development Sectoral Strategy 2021-2023

13 State of Palestine: Sustainable Development Goals. First voluntary national review. Monitoring and implementation of the sustainable development plan 2030. June 2018

14 AMAN Coalition for Integrity and Accountability, Annual Report 2014.

As for **the cash transfer,** it is the largest program at the Ministry. It is part of its vision to provide cash assistance under a single program through an unlimited number of donors to benefit the largest number possible of households below the dire poverty line. To avoid any duplication of disbursements to the beneficiaries, the cash assistance was merged under a program (the Palestinian National Social Protection Program) with a campaign to enter beneficiaries' data on the PEGAS database[15]. The social security database allowed for detection of double entries of names and for the calculation of poverty rates and targeting criteria. The cash transfers program was ratified by the Council of Ministers in 2009, to outreach 119,000 beneficiary households (divided into 75,000 in the Gaza Strip and 44,000 in the West Bank). The overall budget amounts to NIS 540 million, expended on the basis of NIS 135 per quarter. The PNA covers 33% of the total cost (NIS 540 million) while the European Union provides 44% of the cost (NIS 286 million) and the World Bank contributes 3%.

Analysis of the social assistance program, its mechanism and regulatory framework shows the following:

- **Absence of a clear comprehensive law to regulate the matters related to social assistance programs.** The regulatory framework consists of some sporadic provisions deduced from pertinent Palestinian laws like the Labor Law, the Social Security Law and the Law on the Right of the Child in addition, quite obviously, to the Palestinian Basic Law, which explicitly provides for the basic rights entitled to each citizen, including the right to fulfill basic life needs including food, clothing and water as well as the rights to education and health services. In the management of this assistance, MoSD depends on a package of instructions and internal regulations. This shows that the government deals with social aid as contingency grants and not within a frame of sustainable regulated social protection and security programs.

- Poor institutional capacities of the service providers **due to absence of clear and transparent institutional arrangements and reference**. Several agencies follow up on the provision of the social assistance with weak coordination. The result is duplication of aid provided to some households and deprivation of other families in need because of the limited financial resources.

MoSD's beneficiaries' database has technical gaps due to wrong entries of data by some researchers or data entry staff. Consequently, aid continued to be paid to families whose situation has changed in a manner that should, otherwise, lead to reducing or stopping this disbursement and removing them from the beneficiaries' lists. The problem with the database is ongoing reliance on field social workers to identify the targeted groups and the aid they are entitled to. The decision to grant or not grant the aid depends on the field workers' reports. The program is assessed by donors (the World Bank and European Union) by selecting a sample of beneficiaries. This mechanism revealed in a World Bank Report the flaws in the application[16]. It is therefore important to revisit the tools and update data in the computerized system.

15 PEGAS is the European assistance mechanism that contributes to the cash assistance to poor and marginalized groups; it was launched mid-2008, the acronym is derived from the French name "mécanisme Palestinien Européen pour la Gestion de l'Aide Sociale"
16 Coalition for Integrity and Accountability (AMAN), Annual Report 2013

- Although payment is made in the West Bank via direct deposit into beneficiaries' accounts, in the Gaza Strip, payment is made via the Ministry's premises, it is then distributed to the district offices, which deliver checks to the beneficiaries, which they can cash at the issuing banks. Payment via this mechanism creates room for administrative and financial corruption as well as abuse of power at the districts level. It is therefore paramount to open bank accounts and proceed with a mechanism similar to the one in the West Bank.

- According to the Social Protection Sector Strategy, monitoring and evaluation systems are defections in social security interventions in general, whether provided by the government or other entities. The situation compromises accountability, transparency and proper monitoring and evaluation of performance as well as the overall efficiency of the programs.

Finding 4: Social assistance programs managed by MoSD receive large allocations from the PNA budget and benefits many groups. It is not socially acceptable to target these programs with any rationalization or budget-tightening policies because it will have a noticeable adverse effect on a key source of funding of the basic needs of the less favored households.

Nevertheless, satisfactory and practical solutions may be found to achieve the balancebetween the need to tighten spending on the one hand and to undertake full social and humanitarian responsibility on the other. To improve the situation, it is important to solve the gaps of the system and devise solutions to promote the programs' efficiency via:

- Formulation of a regulatory framework of social assistance programs.
- Enactment of regulations and issuance of instructions to be applicable by MoSD district offices.
- Enhance coordination between local and international governmental, civil society social assistance providers.
- Build human resources capacities to minimize errors and flaws resulting from human error and foster automation of the system.
- Promote the principles of accountability, integrity and transparency via effectiveinternal and external control mechanisms and community participationin the formulation and implementation of social protection programs.
- Put into effect the resolution on minimum wage with effective monitoring and implementation.

3.4 Energy Authority and Net Lending:

Local and international reports define the net lending as the net sums deducted by Israel on the tax and customs clearance money to repay debts to Israeli providers of health, electricity and water services distributed by Palestinian municipalities, and distribution companies in the West Bank and Gaza Strip.

3.4.1 Prices of electricity:

Since the establishment of the PNA, it started to repay the prices of electricity and water on behalf of municipalities and citizens because of failure to pay by local authorities and electricity and water distribution companies in the West Bank and Gaza Strip to suppliers. However, the formal arrangements of payment were established in 1997 by which these prices are deducted from the tax and customs clearance money upon delegation of the then Palestinian Minister of Finance to the Israeli government. The deductions were computed in a manner that contradicts with the law. They appear as expenses on the statements of the Miniseries and relevant spending centers[17]. But the net lending item appeared as a separate item for the first time in the PNA budget in 2003. It amounted then to USD 173 million.

Important developments followed as the net lending has become a main item on the PNA budget since 2003. The item continued to increase steadily to reach a peak in 2007 following the political split, amounting to USD 535 million, or 18.6% of the public expenditure.

With the PNA financial crisis and the disappearance of any moral or legal grounds to burden the PNA with the payment of the cost of these services on behalf of municipalities and citizens, the PNA has undertaken some measures to lower the value of the net lending. A decree law on the regulation of the electricity sector was enacted in April 2009 to develop the sector and promote investment to secure electricity to subscribers at reasonable prices. As per the law, the “Electricity Regulatory Council” was formed to monitor the sector, revisit and propose a fair tariff. Prepaid meters have been broadly installed in some areas. PNA agencies have also started to provide assistance to the distributors of these services to enable them to recollect subscribers’ debt. The measures included imposing on citizens to issue a certificate of debt clearance from electricity and water service providers to place pressure on the defaulted subscribers.

In April 2011, the Energy Authority in Gaza and Ramallah signed an agreement, which enabled the Gaza Electricity Distribution Company to repay the prices of electricity to the PNA treasury (USD 4 million per month). However, these agreements were suspended a few months later as the government in Gaza opted for purchasing Egyptian oil via the tunnels connecting Gaza to Egypt. Furthermore, the Gaza Strip started to receive Qatari oil to operate the Palestinian generation plan. Additionally, the Energy Authority in Ramallah signed an agreement with its counterpart in the Gaza Strip relevant to the importation of oil for the electricity generation plant from Israel with exemption of the Blu Tax (NIS 3 per liter) but maintaining VAT. The cost of on liter of fuel imported by the electricity generation plant will thus drop by one-third. However, later the Palestinian government in Ramallah announced cuts on the exemption of payment of the Blu tax from 100% to 50%, attributing its decision to the suffocating financial crisis. Following this new resolution, the cost of one liter of fuel for the generation company became NIS 5.7, which was not accepted by the authorities in Gaza, which has later suspended the agreement.

17 Round table 3, Net Lending Dilemma… what then?, March 2015

These measures increased collection in the West Bank by 85% and in the Gaza Strip by 30%. The result was accelerated drop in net lending since 2007 to reach USD 264 million in 2010. The lowest level of net lending was achieved in 2011 at USD 139 million (following the two aforementioned agreements with between relevant authorities in the West Bank and Gaza). It continued to rise at a limited scale in subsequent years to stabilize at USD 287 million in 2014, which represents 8% of the total public expenditure (See Table 4)

In the 2021 budget, net lending was estimated at NIS 800 million, but the actual figure bypassed the projected value and reached NIS 1,166 million. A review of the actual net lending in the first half of the current year, it reached NIS 626 million, representing 78% of the projected value. The deviation and expected increase in net lending may be estimated to reach NIS 1.200 million till end 2021.

Table (4): Evolution and percentage of net lending in the public expenditure (2003-2021)

Year	Net lending	Public expenses	Percentage of public expenses
2003	173	1,635	10.6%
2004	157	1,528	10.3%
2005	344	2,281	15.1%
2006	376	1,707	21.5%
2007	535	2,877	18.6%
2008	447	3,488	12.8%
2009	374	3,376	11.1%
2010	264	3,200	8.3%
2011	139	3,255	4.3%
2012	277	3,255	8.5%
2013	211	3,419	6.2%
2014	287	3,606	8.0%
2015	1,169	15,673	7.5%
2016	1,029	16,460	6.3%
2017	960	15,995	6.0%
2018	967	14,829	6.5%
2019	1,138	16,674	6.8%
2020	1,166	16,493	7.1%
6/2021	626	8,020	7.8%

source: background paper, round table, MAS Institute, 2015. MoF website: http://www.pmof.ps/pmof/index.php

Notwithstanding the afore signs and references to the composition and value of net lending, important questions arise about the detailed itemization and the mechanisms to reduce this item on the budget to minimize waste of public funds and rationalize expenses.

On this issue, a detailed report by the Civil Society Team to Enhance Public Budget Transparency[18] referred to ambiguous detailing of the composition of net lending. It is then important to understand the different items that make up the net lending to ensure transparency of the public budget, especially when the actual spending exceeds the allocations by much. Analyses of the budget show that net lending may deplete the PNA budget as the Israeli side deducts these sums on the tax and customs clearance money. The report also refers to a two-fold problem related to the net lending, being lack of transparency or any details on the dumb figures and the huge deviation from projected value and actual value of previous years. Deviation in 2020 was the highest and represented 30%.

Some local and international reports addressed net lending with some details. A report[19] explained that net lending includes the following items: 76% to repay electricity bills on behalf of Palestinian municipalities in the West Bank and Gaza Strip, 11% for the cost of water and 11% to medical referrals to Israeli hospitals in addition to the 2% charges collected by Israeli in exchange of sanitation services and expenses related to the Palestinian Ministry of Agriculture.

To solve the problem of net lending, further research on its causes must be conducted. It appears that the electricity bills paid by the PNA on behalf of municipalities in the West Bank and Gaza Strip is the main reason for the net lending, representing 76% of the total value. It is therefore necessary to review the condition of the electricity sector and how these expenses accumulate and why municipalities do not pay the cost of electricity themselves since they collect the prices from subscribers?

It should be noted that the Palestinian areas receive electricity from Israel (86% of the total consumption), via 230 connections. Up till now electricity supply from Israel has not been government by the purchase agreement signed with the PNA but via bilateral contracts with local authorities and individual electricity distribution companies and the Israeli national electricity company.

Furthermore, limited amounts are imported from Jordan and Egypt (4.5%), while electricity is generated locally in Gaza using imported oil byproducts from Israel (around 10%). The bill of importation of electricity from Israel and neighboring countries reaches USD 400-500 per year[20]. Furthermore, in reason of the multiple connections in the West Bank (230 points) and outdated grid, the technical loss amounts to 24% of the purchased electricity. This is a large percentage, which the Palestinians pay without consuming. The PNA alone covers the price of this loss since the municipalities and distribution companies refuse to pay for it. Loss in neighboring countries is noticeably lower than in Palestine, being 14% in Jordan and 6.5% in Israel.

It should also be noted that most subscribers in refugee camps in the West Bank do not pay for the electricity they consume since the PNA had pledged to cover their bills, which leads in an increase in net lending[21]. Although municipalities collect the largest share of electricity prices from subscribers in the West Bank, they spend the money on other operational expenses or projects and do not repay the Israeli supplier. Municipalities justify their action by the fact that **the PNA delays or refrains from paying the municipalities' share from property tax and transportation fees** on monthly basis.

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18 Vision of the Civil Society Team to enhance PNA public budget transparency. Coalition for Integrity and Accountability (AMAN), 2012.

19 "Evaluation of the Palestinian-European Socio-Economic Management Assistance Mechanism (PEGASE) Programmes of Support to the Recurrent Costs of the Palestinian Authority (2011-2013)" 2nd Draft Final Report, March 2015

20 Sectoral strategy (2011-2013), Palestinian Energy Authority, 2011

21 Mr. Omar Kattanah mentioned that the overall accumulated debt of the camps for non-payment of electricity prices reached NIS 160 million.

Finding 5: The electricity bill paid by the PNA on behalf of the municipalities continues to represent the largest share of net lending. It is triggered by the following:

- Many subscribers in the West Bank and Gaza Strip have become accustomed to not paying their bills, which reduces the collection by distribution companies.
- Local authorities and the electricity distribution company in Gaza do not transfer the prices they collect to the PNA (in case of deduction of these sums on the clearance money).
- Many local authorities are not organized under the framework of distribution companies in the Palestinian Territories, which undermines the regulation and control of the electricity sector.
- Fragmentation of the distribution system in the West Bank across municipalities and distribution companies, and deteriorated grids undermine the efficacy and quality of electricity service and result in high technical loss. Furthermore, the non-technical loss is amplified by inefficient collection system and lack of enforcement of the law on combattingstealing of electricity.
- The repercussions of the political split between the West Bank and Gaza Strip affect the different aspects of life, including the electricity sector.

It is then clear that reduction and rationalization of net lending require:

- **Regulation of the electricity sector in the Palestinian areas via compliance with the legal and institutional framework of this sector.**
- **Conclusion of serious and permanent agreements with relevant parties in the West Bank and Gaza Strip to ensure regular and continuous flow of electricity to Gaza.**
- **Mitigate the burden on the public budget while ensuring no harm is caused to poor households.**
- **It appears that subscribers' compliance to pay to distribution companies and local authorities was achieved via prepaid meters.**
- **Allocation of budgets to rehabilitate the existing grids and minimize technical losses. Alongside these measures, the PNA must comply with regular transfer of taxes and other fees to local authorities to deter them from using the prices of electricity in expenses other than payment to the Israeli supplier, which leads to accumulation of debts.**

3.5 Ministry of Health (Health Insurance and Medical Referrals)

Private and NGOs medical institutions, including hospitals in East Jerusalem, admit patients following internal referrals. For external referrals, Israeli hospitals are the main destination with 10.4% of the overall medical referrals and 75% of external referrals. Other referrals were made to Egypt and Jordan till 2016.

Some positive developments have taken place since West Bank hospitals have been receiving the largest share, followed by Palestinian hospitals in East Jerusalem and then Israeli hospitals inside the Green Line. As for hospitals in the Gaza Stirp, they received a low share of 5% of the total referrals. It should be noted that the share of West Bank hospitals has risen gradually in previous years by over 21 percent, to jump from 27% in 2013 to 48.2% in 2020 (expenses of the Ministry of Health till end 2020 constituted 11.6% of the public expenditure). The increase in this share led to a drop by approximately 37% in the share of Israeli hospitals. In 2020, medical referrals to Israeli hospitals decreased to 4% compared to 41% in 2013. The drop resulted from the MoH's policy to localize treatment and rationalize medical referrals. A key reform included the signature of agreements with local hospitals and new procedures to review and audit medical referrals[22].

Table 6: Proportions of referrals by destination (2013-2020)

Referred to	2013	2014	2015	2016	2017	2018[23]	2020
Gaza Strip	1.4%	1.2%	1.9%	2.1%	2.6%	5.7%	7.4%
West Bank without East Jerusalem	27%	28.7%	34.4%	36.6%	38.2%	30.1%	48.2%
East Jerusalem	30.2%	26.6%	30.8%	34.1%	32.9%	38.4%	37.4%
Israeli hospitals	41.4%	43.6%	33.0%	27.2%	26.3%	25%	3.9%
Other (Egypt, Turkey, Jordan)	0.0%	0.0%	0.0%	0.0%	0.0%	0.8%	3.1%
Total percentages	100%	100%	100%	100%	100%	100%	100%
Total expenditure on referrals NIS million	579.3	800.5	726	835	876	725	826

Source: Falah, Belal et. Al., Ibid, Palestinian Ministry of Health. Annual Health Report, Palestine 2020. Ramallah, Palestine

The table above tracks the medical referrals and their cost. They are noticed to increase in the past years to reach 80,000 referrals in 2020, costing the PNA's treasury around NIS 1 billion.

Health Insurance and Extra-ministerial Treatment Regulation No 11 of 2006 issued by the Council of Ministers details the mechanisms and eligibility criteria to benefit from the health services basket provided or outsourced by the Ministry of Health. This includes services provided by medical agencies affiliated to MoH and external medical services (medical referrals to centers domestically or abroad). A key condition to benefit from the insurance is to be a direct subscriber to the governmental health insurance system and comply with paying the monthly subscription fees. In this regard, all of the population of the Gaza Strip enjoy the services covered by this insurance although they are exempted of the payment of insurance instalments following a presidential decree in 2007. As a result of this exemption, the government health services funding endured a deficit, which later compromised the quality of government health services. This context pushed MoH to use medical transfers outside its affiliated centers.

22 Filah, Belal, et. Al. (2020): Assessment of the Palestinian Health Sector: Macroanalysis. MAS Economic Policy Research Institute. Ramallah- Palestine.
23 MoH, Palestinian Health Information Center. (2019). Annual Health Report – Palestine 2018, pp. 60-63
https://bit.ly/3GkYB0u

Two MoH departments follow up the medical transfers. The first one is the medical referrals committees (with an office in the West Bank and another in Gaza). These committees review the applications for medical transfers outside MoH services and issue relevant decisions. They also examine the medical files and treatment bills submitted to them. The second department is the Treatment Department, which undertakes the “purchase of services” and referral of patients to non-ministerial health centers in Palestine and abroad.

Thus, the key institutional framework, which influences the medical referrals, is the department purchasing services outside Palestine.

On another level, the service purchase department does not have the mandate to review the medical files selected for referral by the Military Medical Services. It does not decide on the eligibility of patients to treatment outside the governmental health centers inside Palestine or abroad. Its role is restricted to medicating with the Israeli hospitals, knowing that the cost of medical referrals to Israeli hospitals is deducted on the MoH budget while the military medical services budget is part of the security sector’s budget. These services also collect mandatory health insurance fees from members of the Palestinian security agencies[24].

Financial oversight is conducted by the MoH Finance Department, which tracks and audits the bills to follow up on payment to service providers from the local private sector or hospitals outside Palestine in accordance with defined accounting rules and mechanisms. The Finance Department focuses only on the accounting issues without any role in the technical or follow up mechanisms of patients’ files. It therefore cannot track, monitor, or evaluate compliance of the health services providers with the financial agreements.

The Coalition for Integrity and Accountability – AMAN accused on 20th February 2014 powerful executives of the PNA of intervening to adopt exceptional medical referrals’ decisions outside the formal referral system, thus unduly inflating the referrals’ bill.

The Anticorruption Commission has recently referred the medical referrals’ file of the Ministry of Health in Ramallah to investigation of cases of corruption, fraud and bribes following a long series of protests by citizens and institutions regarding the handling of this file.

Finding 6: The medical referrals file is one of the complex files that require through review and solutions because of the financial, social, administrative and health dimensions of this file. The impact of redressing the flaws in this file can be felt at the net lending level, as the treatment bills abroad (especially in Israeli hospitals) will decrease.

24 Harb, Jehad, Integrity, Transparency and Accountability in Medical Referrals to Services other than those of the Ministry of Health, Report 83, AMAN Coalition Reports Series. March 2015.

Major difficulties continue to exist and magnify the negative effect of the lack of integrity, transparency and accountability in the management of the medical referrals, most importantly:

- The absence of a comprehensive health system undermined the quality and availability of health services in the government's health centers. Furthermore, financing of the health insurance system was disrupted with the exaggerated exemptions of fees.
- Agencies outside the Ministry of Health continue to intervene in the medical referrals by request exceptional referrals from the offices of the President and Prime Minister as well as the military medical services. Some powerful PNA executives play a major role in these exceptions.
- Weak internal and external control mechanisms lead to further manipulation of Israeli hospitals and other external treatment bills.

Thorough reforms of the medical referrals will definitely rationalize expenses and halt the waste of public funds not to mention promoting the local medical centers. These efforts require cooperation of all relevant parties and sound management of this file.

Citizens and observers may accept such statistics when they represent a public service provided by the PNA to its citizens under the pretext that patient's needs cannot be fulfilled by local government services and other justifications explained in the beginning of this part of the report. However, other facts, signals or indicators leave room to suspect neglect or lack of due diligence in the medical referrals' file. This situation requires a thorough examination to identify the gaps that undermine the professional management of this vital file. A comprehensive review with immediate interventions are particularly needed under the current financial crisis and limited resources to cover the huge medical bills of these referrals.

> "Israel is systemically stealing financial funds from the Ministry of Health with possible presence of "accomplices" due to the loose administration. When editing the financial accounts of the medical referrals in the past ten years, MoH will be able to recover around USD 800-1,100 million to its treasury. An example to this, the bill in October 2016 reached 30 million USD although the real sum to be paid to Israeli hospitals is 11.4 million. Data show huge differences between the actual cost and the cost documented in MoH reports. For example, the actual cost in 2016 reached NIS 876 million but was reported as NIS 440 million.
>
> Osamah AlNajjar, Director General of Medical Referrals, MoH, to "a sand clock", talk show broadcasted on Want TV. Fallah, Belal, et. Al. idem.

3.5.1 Financial reserves:

A flagging item on the public budget is financial reserves, which represented NIS 100 million in 2014 and NIS 21 million in 2020. This item may be understood and justified by the need to cover unexpected expenses resulting from any emergency during the fiscal year. However, it is not clear who has mandate to determine the allocations under contingency expenses or the terms that classify such expenses under this item.

Finding 6: The item of financial reserves may be an area of budget tightening or at least rationalization of expenses.

4. Taxation policies and improvement of collection:

Although it is important to focus on government spending to remedy the subsequent chronic financial crises, Palestinian decision-makers should not neglect an important part of the budget, which is revenues. Policymakers use this tool to address crises and gear their economy by controlling the size of the financial resources (upward or downward) or by amending the brackets of the direct/ indirect or both types of taxes. An important legal rule should be applied, "imposition, amendment and abrogation of public taxes and fees is possible only by a law[25]." Therefore, amending the current tax brackets and rations requires a new law. In spite of the restrictions to the use of financial policies in Palestine, a reasonable margin of interventions is still possible.

The Palestinian government has a number of options to increase its revenues to finance its increasing spending resulting from the economic repercussions of the financial crisis. To be more specific, increase of revenues may be achieved via three channels:

I. Improve (direct and indirect) tax collection, mainly in the sectors that have not been affected by the current crisis. The government, for this purpose, may expand the tax base to include broad sectors that have been underpaying or not paying taxes. The government may also impose a new type of tax (or a wealth tax) to impose on the wealth of monopolizing companies and owners of accumulated wealth without any real contribution to development. In this regard, the PNA may benefit from the Israeli experience, where this tax has been effective since 2009 and from the Algerian experience, where the tax has been recently introduced. The intervention requires an amendment to the income tax and enactment of a property tax to substitute the effective laws. The government may also secure additional financial revenues by completing the land settlement project started in 2016.

II. Compel major taxpayers to repay their annual taxes (for the current year at least) in advance (advance tax payment). Privileges like tax and customs' exemptions and exceptions under the investment promotion law may be postponed.

III. Minimize tax evasion by reinforcing the efficiency of the executive offices (tax departments and customs police) and by compelling different economic operations in all sectors to use a billing system connected to the Directorate of income cash to ensure that all their transactions are accounted for in the tax calculation and minimize tax evasion. Other measures may be adopted to control the financial lean in the trade relation with the Israeli side[26].

To expand its tax base, the government may add broader sectors to this base. The targeted sectors may include lawyers, doctors, engineers, local e-commerce delivery companies, retailers, and real estate transactions. The government has not amended the income tax law since 2015 and it does not seem that it had made tangible efforts to improve the performance of tax departments to improve local collection. It could be reasonable under the current circumstances to impose a relatively high temporary income tax on the sectors that have not been affected, but in the instead prospered, by the economic crisis.

25 Article 88, Amended Basic Law of 2003 and Article 7, Public Budget and Financial Affairs Regulation of 1998.
26 Stopping Fiscal Leakages. The government of Palestine's report to the AD Hoc Liaison Committee meeting. Sep.2018.

Despite the small margin provided by the Paris Economic Protocol to the PNA to amend its VAT rate (by two percentiles less than the tax imposed in Israel), the VAT remained at one percentile below the Israeli rate (16% in Palestine compared to 17% in Israel). The government could have benefited from the possible margin to reduce the VAT by another percentile. Furthermore, the government has not exploited the authorities granted thereto in the Paris Economic Protocol and the changes in the Israeli VAT system like expanding the 0-VAT tax base or the exemptions provided in the Israeli system to boost the economy and alleviate the tax burden on taxpayers. Other Israeli measures include a differentiated policy, which starts with 0 tax on basic commodities and increases progressively on non-basic goods. Part of the drop in VAT revenues from basic commodities and economic sectors may be compensated by the tax on luxury items.

The government has not taken any measures to restructure the property tax file in the absence of a modern Palestinian law to regulate this sector. Amendment of existing regulations and tax bases and brackets may secure the public treasury and local authorities additional financial resources. It should be noted that over 80% of the local authorities in the Palestinian Territories are not subjected to the property tax regulation (107 local authorities of 480 are subjected to this regulation). Consequently, these municipalities do not collect property tax.

Further efforts may be employed to address the clearance money withheld by Israel. Innovative solutions must be devised to solve this repetitive crisis. One of the proposed solutions is to find a mediator (an Arab or friend state or international organization) to mediate to release the funds withheld by Israel. In parallel to this step, a compromise may be reached to enable the Palestinians to maintain their political position regarding freezing coordination with the Israeli side. The Palestinian government may collect monthly shares of the overall clearance money that may amount to NIS 500 million to enable the government to cover its expenses and solve – even partially – its current crisis.

Other steps include detailed itemization of the clearance money to benefit the Palestinian budget wither by reducing the financial leaks, which prevents the Palestinians of huge financial resources because of its management mechanism, or by lowering the relative weight of the clearance money in the public revenues. The clearance funds comprise three major components: VAT (25%), customs duties (45%), taxes on fuels (30%). This itemization is important to enable the negotiation body restructure the items and their weight to improve the Palestinian position in handling this file.

The relative share of the clearance revenues (65%) of the overall revenues is a huge pressure on Palestinian decision-makers. It increases the ability of the Israeli side to use these revenues to place economic pressure on the Palestinians to make concessions. An important step is to reduce the relative weight of these revenues. Since the tax on fuels (VAT plus Blu tax) represent 30% of the clearance money, extracting this part from the clearance revenues will automatically lower their weight of the overall revenues; in which case clearance revenues' share will drop to 45%. To achieve this, pressure must be placed on Israel to calculate the purchases of fuels by the Palestinian side based on cost prices (without VAT or Blu). It should be noted that Israel deducts a commission of 3% on the overall clearance money (including fuels). Removing fuels from these revenues will save about 30% (USD 24 million per year) of the total Israeli deductions on the clearance money, which amount to over USD 70 million per year.

Another important intervention relating to the clearance money focuses on VAT and customs duties. It would be possible to invite a European or a Quartet mediator to propose the introduction of computerized customs programs and mechanisms to monitor the movement of trade on both sides. The customs clearance can be made in the Palestinian bonded areas on the Palestinian imports directly. With this measure, financial leak due to smuggling into the Palestinian area or importation via Israeli middlemen will drop.

A lot of the literature refers to the positive effect of land settlement in terms of increasing access to bank credits and investment in lands as well as the increase in the value and productivity of lands and subsequent resources generated by the settlement activity for the central and local governments[27]. Progress in the land settlement, launched in 2016, is noticeably very slow. The project targets 188 local authorities with an overall area of 2,506.5 square kilometers. The already accomplished settlement reached about 100 square meters, being only 3% of the target until the first half of 2018.

The government may also take measures to combat smuggling of goods from the Israeli side. The additional restrictions imposed by the occupation authorities on the mobility of the Palestinian security and control agencies following the freezing of coordination undermined these agencies' abilities to fulfil their duties in combatting smuggling. The tax departments and customs police will need to hire additional staff and promote full coordination among relevant parties. Regarding tax evasion, studies estimated it represented 30-40% of the tax revenues[28]،. The government has not made enough efforts to understand the root causes and solve this problem. The same applies to the financial leak in spite many Palestinian requests to find a solution.

27 Han, Habeeb, Reading of the expected financial and economic impacts and challenges of the land settlement and registration in the West Bank, MAS 2019.

28 Possible measures to minimize tax evasion, Annual Economic Report 2015, PECDAR

5. Concluding Remarks:

1. The financial crisis: the PNA has been facing a structural crisis because of the conditions in which it was established. However, there are subjective reasons behind the exacerbation of the crisis. Therefore, a radical solution to the crisis cannot be conceived so long as the political and security situation remains unchanged. However, it is possible to alleviate the crisis and its impacts via several financial reforms, most importantly budget-tightening and rationalization of expenses. It should be clear that austerity in itself – although very important – is not enough to solve the crisis, even partially. It must be accompanied with other reforms including an improved tax policy.

2. To achieve the goals of the budget-tightening, an informed national plan must be prepared on agreed upon bases.

3. Spending on salaries: Salaries in the civil sector represent the largest expenditure item. It can be reduced under the government's austerity plan. However, this is a complicated spending item that requires an in-depth and detailed analysis to target the right cuts. Any reduction in this spending should account for the social, economic and political cost that may overweigh the financial savings. Analyses show that reducing the value of the salaries is not possible nor is it feasible to downsize the staffing by termination of service. however, some staff members, who are classified as disguised unemployment or who have other businesses, may be referred to retirement. This option must be considered with fair terms agreed upon by the targeted staff members. It is possible to rationalize expenses by a rigorous staff rotation policy to appoint staff members to positions that benefit from their qualifications and increase their productivity. This measure requires a restructuring of the centers of responsibility with abolition and/or merging of these centers with other centers with similar functions.

IV. The special short-term contracts with regular staff members or consultants are a possible option for budget tightening provided that they are governed by a policy that does not set an obligation of appointment of such contractors and does not allow for exceptions in their enforcement, as is the case now.

V. Position privileges are usually associated to the top management and represent the easiest and widely publicly acceptable area of budget-tightening

VI. Spending on the Security Sector. Spending on the **security sector** continues to receive the largest share of the PNA budget, mostly to cover salaries and wages. It should be noted that the average monthly pay of military agents is higher than their counterparts in the civil service. On the other hand, the operational budget allocated to the security sector is high and does not conform to clear spending procedures or rules. Furthermore, internal and external control tools and bases are weak regarding the priorities and procedures of expenditure, which leaves room for waste and misuse of public funds. It seems that budget-tightening and cuts on the expenditure on the security sector is difficult to achieve because the share of salaries of the sector's current budget is almost 80% not to mention that most of the security agents are of low ranks and low pay. It is therefore difficult to propose or actually cut on their salaries not to mention the legal restrictions linked to the employees' acquired rights. On another note, the security sector's operational expensess, contrary to prevailing impressions in the Palestinian society, were less than those of the civil sector. Thus, budget-tightening at this level is quite limited. However, more rigorous control may be exercised to rationalize spending and minimize waste of public funds, especially in the area of operational expensess.

VII. Net Lending: the main components of **net lending are:**

a- Prices of electricity covered by the PNA. Data show broad deviation and discrepancies between the allocations and actual spending on this item. The reason behind protracted and increasing net lending may be weak collection of electricity prices by the distribution companies and municipalities or by the fact that they refrain from transferring the collected prices to the service providers or the PNA (as a funding party). Moreover, the distribution system has technical flaws due to deteriorated grids, which undermine the quality and efficiency of electricity service and leads to high rate of technical loss.

b- As for the medical referrals, they must be examined at financial, social, administrative and health levels because it is not sustainable to continue wasting public funds under weak transparency, integrity and accountability. The key problems are the lack of an effective and comprehensive health system, in efficient insurance system and persistence of the financial deficit in addition to the exceptional referrals following intervention of powerful officials and weak internal and external control mechanisms. Consequently, reforms in this area are quite possible and may lead to tangible cuts on the net lending.

VIII. President Office and Foreign Ministry. The expenses of the Foreign Ministry, with its three divisions, until 2020 reached NIS 313.8 million, divided as follows: Foreign Ministry (NIS 67.7%), Embassies (NIS 244 million), Negotiations Affairs (NIS 2.1 million).

The expenses of the President's Office till end 2020 reached NIS 134.8 million. Salaries of the staff of the President's Office reach NIS 84.3 million while the current expenditure amounted to NIS 42.8 million. Developmental expenses reached NIS 7.8 million. Data is not available on the number of staff members, but considering the salaries' bill, the number could be estimated at 2000 employees. This figure does not sound possible and therefore necessitates a close examination to understand the detailed expenses on this item. However, this information is not available in the public data published by the Ministry of Finance.

IX. Emergency Expenses. A detailed a specific policy in place to regulate the mechanisms and areas of emergency expenses under the allocations of financial reserves in the budget.

X. Tax policies and improvement of collection: The current tax brackets must be amended under a new law. In spite of the restrictions on the use of the financial policy in the Palestinian context, it is still possible to intervene in this area. The Palestinian government has a number of options to increase its revenues to finance its increasing spending (either by improving its direct and indirect tax collection, especially on the sectors that have not been harmed under the current crisis or by compelling large taxpayers to pay their yearly taxes – at least in this current year – in advance and by suspending the tax and customs exemptions and exceptions, as per the Palestinian investment promotion law. It is also important to combat tax evasion and empower the tax departments and customs police to fully perform their role. In parallel, other measures are need to control financial leaks in the trade relation with the Israeli side.

6. Recommendations:

We have to understand that the reasons of the financial crisis endured by the PNA cannot be limited to scarce financial resources but extend to the management of these limited resources. Even with a dramatic development of revenues and funding of expenses, we will still be faced by the dilemma of how to manage the resources and prioritize expenses and on which bases. Out of this understanding of the financial crisis, efforts must focus on implantable solutions to better manage the resources and rationalize expenses. The budget-tightening and austerity efforts must account for socioeconomic justice in the distribution of austerity burdens to preserve the acquired rights and avoid jeopardy to public services. The following suggests have been drafted to help the Palestinian government to prepare a comprehensive plan to rationalize expenditure and minimize waste of public funds.

- **Civil Service:**

1. Clean up the salaries' bill to put an end to the phenomenon of inactive employees by either placing them in vital centers of responsibility or referring them to early retirement and/or ending their services after due diligent examination of their files.
2. Adopt a systemic policy of rotation to staff members to different centers of responsibility consistent with needs and with their qualifications and expertise.
3. Stop the policy of short-term appointments or consultancy and experts contracts via the abuse of the exceptions and limit such appointments to the cases when financial allocations are available in the budget for this purpose.
4. Take the necessary measures to compel the centers of responsibility to implement the government decisions to cut down position privileges, including allowances, salary raise and other allocations. In this regard, the exceptions granted to the ministers and other officials in their status must be repealed.
5. Complete and ratify the amended civil service law to ensure control of expenditure and special contract appointments and consultancy as well as any other appointment outside the applica ble due procedures.

- **Security Sector:**

• The key recommendation is to downsize the different agencies depending on their mandates as it its possible some agents to the police or customs police after adequate training.

• Enforce internal and external control via:

- Issue the executive regulations of the security service law, especially those related to appointment, promotion and penalties. Revisit the military service law, which grants many privileges to military staff, especially high-ranking officials.
- Prepare detailed budgets for each security agency and then list it in a unified budget consistent with their administrative affiliation.
- Expenditure officers in security forces must comply with the Public Procurement and Tendering Law.
- Activate internal and external control units in each security agency to that they can submit financial audit reports to the central military finance department at the Ministry of Finance or via the Military Finance Administration.
- Adopt a regulation to monitor expenditure on fuel of security forces' vehicles.

- **Net lending**

- The PNA needs to conclude centralized agreements with the Israeli providers of goods and services on trade competition basis in order to redress the injustice toward Palestinian consumers as a result of individual agreements.
- Understandings must be reached with competent parties int eh West Bank and Gaza Strip to ensure steady flow of electricity into Gaza and avoid harming the poor as a result of these un derstandings in addition to lowering the financial burdens of the public budget.
- Intensified use of prepaid meters to ensure compliance of subscribers and distribution com panies and local authorities with payment of electricity prices while taking into consideration the needs of the less favored groups.
- Allocation of budgets to rehabilitate the current grids and lower the technical loss. In parallel to these efforts, the PNA needs to transfer to the local authorities their share of taxes and fees on regular basis.
- Intensify use of alternative energy sources (solar and wind) to reduce the electricity bill to Israeli providers.

- **Health system and medical referrals:**

- Promulgate a law on comprehensive, effective and balanced health insurance that accounts for resources and scope of coverage.
- Adopt an MoH action plan with a timeframe to develop some key unavailable health services in government hospitals.
- The Council of Ministers needs to issue and comply with regulations on medical referrals.
- Immediate termination of the exceptional medical referrals unless compliant with the resolutions of the Council of Ministers.
- Provide qualified human resources and computerized accounting systems to audit and track treatment bills in Israeli hospitals to prevent manipulation of the cost of treatment and rationalize expenses.
- Enforce internal and external control mechanisms of the departments in charge of medical referrals.

- **Tax policies and improvement of collection**

Although the resources are limited, it is still possible to increase and restructure public revenues via the following steps:

- Reform the tax system (legally and management wise) to expand the tax base and ensure pro gressive tax to achieve higher socioeconomic justice.
- Examine the possibility of suspending tax and customs exemptions and exceptions granted to investment projects according with the Palestinian investment promotion law.
- Strategically, reform the Palestinian economy to boost local production to minimize imports from abroad.
- Upgrade the tools of the executive offices (tax departments and customs police) and it could be useful to examine the possibility of merging all PNA revenue departments under a single direc torate.
- Enact a modern Palestinian law on property tax while completing the land settlement project.
- Itemize the clearance revenues to achieve better benefits for the Palestinian treasury by minimizing financial leak (a detailed study on the clearance items). This step will help to:
  - Reduce reliance on the revenues from reliance and improve self-collection.
  - Reduce Israeli blackmailing of the PNA through withholding clearance revenues transfers.

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