



Academic Paper

# Public Debt Development of the Palestinian Authority in its Political and Economic Context



**Khalid Abu Amer**

June 2021



Al-Zaytouna Center for Studies & Consultations

The opinions expressed in all the publications and studies are those of the authors and do not necessarily reflect the views of al-Zaytouna Centre.

## Table of Contents

<b>Table of Contents</b> .....	1
<b>Introduction</b> .....	2
<b>First:</b> Historical Context of the PA Public Debt Crisis .....	3
<b>Second:</b> The Legal Context of the PA Public Debt.....	6
<b>Third:</b> The Political Context of the Public Debt Crisis .....	8
<b>Fourth:</b> The Palestinian Division and the Administrative Failure of the PA .....	12
<b>Fifth:</b> The Clearance Crisis Between the PA and Israel .....	13
<b>Sixth:</b> Scenarios for the Next Stage.....	17
<b>Recommendations</b> .....	19

# Public Debt Development of the Palestinian Authority in its Political and Economic Context

Khalid Abu Amer<sup>1</sup>

## Introduction

Since the establishment of the Palestinian Authority (PA) in 1993, due to many factors, including Israeli control and restrictions, the Palestinian economy has fluctuated, adversely affecting it.

Israel has shaped the Palestinian economy to serve its own commercial and economic interests, and has extorted Palestinian financial resources by imposing conditions and arbitrarily deducting from clearance revenues.



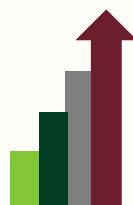
Moreover, donor countries have funded operating expenses, and their aid was subject to political fluctuations, hence destabilizing PA public finances.

The Palestinian economy is an emerging economy because many of its components depend mainly on cash donor support (grants and loans). They are mostly spent on Palestinian budget, organizations and United Nations (UN), relief and operational agencies, the most important of which is the United Nations Relief and Works Agency for Palestine Refugees in the Near East (UNRWA), in addition to cash transfers from Palestinians working in Israel.<sup>2</sup>



<sup>1</sup> Researcher specializing in Palestinian economic affairs, who has a master's degree in development economics from the Islamic University of Gaza.

<sup>2</sup> Palestine Economic Policy Research Institute - MAS, *Nahwa Tawzif Anja' li al-Musa'adat al-Kharijiyyah al-Muqaddamah li al-Sha'b al-Filastini* (Towards a More Effective Use of Foreign Aid to the Palestinian People) (Ramallah, Palestine Economic Policy Research Institute (MAS), 2005), <http://mas.noursoft.com/records/1/15536.aspx>



Throughout 1994–2017, the Palestinian territories received more than \$35.4 billion in grants and \$1.06 billion in loans. The general budget aid accounted for the majority of this funding with a total of \$13.5 billion, and 37%.<sup>3</sup>

Despite this huge external support, the Palestinian general budget has suffered from an almost permanent deficit, since the first PA budget was approved in 1995 and until the end of 2020. This has caused a structural crisis posing a challenge to the Palestinian decision-maker. It has increased the PA public debt, especially in recent years.<sup>4</sup>

### First: Historical Context of the PA Public Debt Crisis

The PA developed its first general budget in 1995 with the help of the International Monetary Fund (IMF), where it was subject to Jordanian and Egyptian customs and laws in effect prior to 1967. In 1998, it issued Law No. 7 regulating the public budget and financial affairs, in force to this day.<sup>5</sup>



According to Palestinian law, the Palestinian budget is divided into two parts: revenues and expenditures, where the former includes domestic and non-tax revenues, clearance, and external revenues, while the latter includes current and capital expenditures.

Public debt is defined by Palestinian Law No. 24 of 2005 as the outstanding balance of unpaid financial government commitments, and it is divided into two parts:<sup>6</sup>

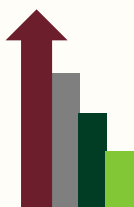
1. External debt: This includes the financial obligations the government has to pay in repayment of the money it has borrowed from countries, agencies and international institutions, according to the law.

<sup>3</sup> \$35.4 Billion in Foreign Aid Since the Establishment of the Palestinian Authority, Anadolu Agency, 13/2/2019, <https://www.aa.com.tr> (in Arabic)

<sup>4</sup> Nasr 'Abdul Karim, The Reality of Public Debt and Private Sector Arrears in Palestine, Coalition for Integrity and Accountability - AMAN, 5/9/2019, <https://www.aman-palestine.org/reports-and-studies/9022.html> (in Arabic)

<sup>5</sup> 'Umar 'Abdul Razzaq, *Haikal al-Muwazanah al-'Ammah al-Filastiniyyah* (The Structure of the Palestinian Public Budget) (Ramallah: MAS, 2002), <http://library.mas.ps/records/1/11409.aspx>

<sup>6</sup> Public Debt Law no. 24 for 2005, site of al-Muqtafi: The Judicial and Legislation System in Palestine, Institute of Law, Birzeit University, 2005, <http://muqtafi.birzeit.edu/pg/getleg.asp?id=15318> (in Arabic)



- 2. Domestic debt: This includes the financial obligations the government has to pay in repayment of the money it has borrowed through government bonds, or from local banks or other local financial institutions.

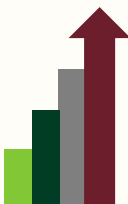
Accordingly, public debt is the deficit arising when the PA resorts to internal borrowing from banks operating in the Palestinian territories, or from external institutions, to cover the deficit resulting when its expenditures increase and revenues decline.

Palestinian public debt goes back to the first year when the PA assumed its official duties. In 1995, public debt reached \$83 million, and in 1996, it reached \$300 million, then it increased to \$648 million in 1999. External public debt ratio represented in borrowing from international bodies throughout 1995–1999 reached 52% of the total debt volume.<sup>7</sup>

**Table 1: Evolution of Debt 1995-2020**

Year	Total Debt		External Public Debt			Local Debt	
	\$ million	Growth rate (%)	\$ million	% of Total debt	Growth rate (%)	\$ million	Growth rate (%)
1995	83	–	–	–	–	–	–
1996	300	216	–	–	–	–	–
1997	403	34	148	36.7	–	254	–
1998	548	35	223	40.6	50.3	324	27.5
1999	648	18	293	45.2	31.2	355	9.4
2000	863	33	520	47.5	77.2	342	–3.4
2001	872	1	559	69.5	7.6	312	–8.7
2002	749	–14	597	87.1	6.7	151	–51
2003	849	13.4	611	79.8	2.3	238	57
2004	1,002	18	611	71	0	391	63
2005	1,196	19	624	63	2.2	572	46
2006	1,092	–8	629	67.6	0.8	462	–19

<sup>7</sup> Samir Abu-Mdalaleh and Mazen Elejlal, “The Evolution of Public Debt in the Palestinian Territories (2000–2011),” *IUG Journal of Economics and Business Studies*, Islamic University of Gaza, vol. 21, issue 1, January 2013, p. 276, <https://journals.iugaza.edu.ps/index.php/IUGJEB/article/download/388/354> (in Arabic)





2007	1,451	32	1,034	70.1	64	417	-9
2008	1,557	7.3	1,034	65.7	0	523	25
2009	1,736	11.4	1,087	62.7	5.1	649	24
2010	1,883	8.4	1,043	55.4	-4	840	29
2011	2,212	17.4	1,114	56.9	6.8	1,099	30
2012	2,482	12.2	1,097	53.6	-1.5	1,385	26
2013	2,376	-4	1,108	47.7	1	1,268	-8.5
2014	2,401	1	1,179	49.8	6	1,221	-3.8
2015	2,477	3	1,054	43.3	-11	1,431	14
2016	2,389	-3	1,004	43.1	-5	1,385	-1.4
2017	2,225	-7	908	41.9	-10	1,316	-6.5
2018	2,229	0.4	970	44.5	1.1	1,258	-4.5
2019	2,484	10	1,116	33.4	13	1,536	18
2020	2,998	17	1,215	42	8	2,115	27

Source: The table was prepared by the researcher based on the general budget data and reports on financial sustainability by the Palestinian Monetary Authority.

Table 1 shows the following:

- An increase in PA public debt since the PA first budget in 1998, with a growth rate of 36%. The PA's dependence on loans to finance the budget deficit continued until 2002, which witnessed a 14% decline compared to 2001.
- In the PA's early years extending from 1997 to 2000, the average foreign debt was at 42.5% of total public debt. However, with the outbreak of *al-Aqsa Intifadah* in late 2000, and until the PA obtained the status of an observer state in the UN in 2012, external debt acquired the largest percentage of total public debt, exceeding 87% and 79% in some years, as in 2002–2003.
- In 2006–2007, which witnessed Hamas's victory in the legislative elections, public debt grew by 40%, from -8% to 32%. This was because the PA was subject to a financial blockade by Israel and donor countries in rejection of the



elections results. Noticeably, the PA's public debt increased 8% annually, since its first budget in 1998 and until the end of 2020.

- The clearance revenues crisis in 2019–2020 was accompanied by an almost complete PA dependence on loans from banks to cover its financial needs; most notably to cover 50% of the employee salaries, due to its reliance on the emergency budget.<sup>8</sup>
- The table also indicates that in 2020, public debt threshold reached a record high of \$3 billion, and in 2007 foreign debt increased by \$405 million, while in 2020, domestic debt witnessed a historic leap of \$579 million.

## Second: The Legal Context of the PA Public Debt

Article 30 in the preamble of Law No. 24 of 2005 laid down the legal framework of permitted PA public debt ceiling, both domestic and foreign, at 40% of GDP at current prices.<sup>9</sup>

This percentage is within the IMF set limits of the percentage of the public debt to GDP of Arab or emerging economies, including Palestine. The PA has not exceeded this ratio since its inception, and the highest percentage recorded for public debt was in October 2020 when it reached 12.3 billion shekels (\$3.6 billion).

This clause restricted successive Palestinian governments to not be extravagant in borrowing requests. Yet, at the same time, it created a compound crisis with the successive governments circumventing this condition, due to lack of financial resources, through deferred purchase and overdraft from local banks. Consequently, the PA arrears exceeded 15 billion shekels (\$4.4 billion) according to available data until November 2020.<sup>10</sup>

By adding public debt to the PA arrears, the total sum due to be paid until the end of 2020 is 26.8 billion shekels (\$7.9 billion), exceeding 50% of GDP.<sup>11</sup>

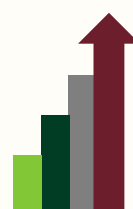
In recent years, Palestinian economists have been putting the PA arrears within the public debt as they are subject to the same conditions, in terms of maturity of

<sup>8</sup> See How Long Can PA Keep Borrowing Money From Palestinian Banks?, site of al-Monitor, 3/5/2019, <https://www.al-monitor.com/originals/2019/05/palestinian-authority-public-salaries-loans-banks.html> (in Arabic)

<sup>9</sup> The 2005 Public Debt Law no. 24, al-Muqtafi, Birzeit University, 2005. (in Arabic)

<sup>10</sup> Shtayyeh's Government's Public Debt Hits Record High in November, site of al-Iqtisadi, 27/1/2021, <https://www.aliqtisadi.ps/> (in Arabic)

<sup>11</sup> Ibid.



payment and government's priority of budgetary expenditures. The difference is that PA arrears come in the form of deferred loans payable at zero interest.

Salam Fayyad, the 12th prime minister (2007–2013), was the first to put an arrear mechanism to circumvent public debt law. These arrears are amounts owed by the government to local bodies, such as the pension authority, local and international suppliers as well as public sector employees.



**Salam Fayyad**

The absence of sound foundations in the local development process—when the PA emulated developed countries in building various institutions—has left the Palestinian economy with a lot of financial burdens and increased public debt to record levels, especially in recent years.

For example, there are more than 63 non-ministerial public institutions,<sup>12</sup> whose salaries and operating expenses are covered by the PA, which can be considered a form of corruption and favoritism. This type of special jobs is granted to certain figures, who are paid high monthly wages, and whose managers are paid up to 10 thousand shekels (\$2,800). This constitutes significant deviation from the average public wages of the PA's employees. It increases public expenditures and pushes the PA to take a loan in order to cover the deficit in expenditures.

Moreover, deficiencies in Palestinian legislation have constituted an additional environment for the decline of public revenues. For example, tax evasion is one form of such deficiency suffered by the PA.

According to a study conducted by the Coalition for Integrity and Accountability - AMAN in 2017, tax evasion amounts to 65% of total tax revenues.<sup>13</sup> According to a report issued by the Palestinian Economic Council for Development and Reconstruction (PECDAR), tax evasion costs the public treasury annual losses exceeding \$500 million of total tax value, which is the result of tax evasion and financial leakage.<sup>14</sup>



<sup>12</sup> Squandering the Palestinian Budget ... Job Compromises Through Institutions of Conflicting Tasks, site of al-Araby al-Jadid (The New Arab), London, 6/12/2020, <https://www.alaraby.co.uk/> (in Arabic)

<sup>13</sup> Summary of Working Papers on: Tax Evasion, Coalition for Integrity and Accountability - AMAN, April 2017, <https://www.aman-palestine.org>

<sup>14</sup> PECDAR: Tax Evasion in Palestine Equivalent to One-Third of Total Tax Value, site of *al-Ayyam*, Ramallah, 13/5/2016, [https://www.al-ayyam.ps/ar\\_page.php?id=10eddf85y284024709Y10eddf85](https://www.al-ayyam.ps/ar_page.php?id=10eddf85y284024709Y10eddf85) (in Arabic)





### Third: The Political Context of the Public Debt Crisis

The public debt crisis is one of the reasons that made the PA's management of public money reach dangerous levels. The Palestinian economy was already fragile and had limited resources, which made the accumulation of this crisis for years and the absence of administrative and financial planning lead to a change in development priorities. For the PA has set the advancement of the state as a desired goal, since the day it obtained the status of an observer state in the UN, on 29/11/2012.<sup>15</sup>

Managing this crisis required from the PA securing large financial resources and to remain a civil authority whose priorities are to pay its financial dues. However, the origin of this problem is in the PA's resort to domestic and external borrowing and deferred purchase, for it has a budget deficit due to increased expenditures and deteriorating revenues.

The PA relies on three sources of funding:<sup>16</sup>

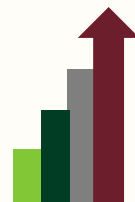
- 1. Local and non-tax public revenues, which come from taxes on individual income, corporate profits, internal customs, value-added tax, excises, property taxes, fees in addition to licenses and fines. They are usually worth \$1.25 billion, 25% of total public revenues.
- 2. Clearance revenues, which come from taxes and fees on Palestinian imports through Israeli ports. These constitute 50% of total public revenues estimated at \$2.5 billion annually.
- 3. Grants and external financing from various international development agencies and bodies at an average of \$1.25 billion, 25% of total revenues.

The second part of the general budget is public expenditures, which fall within the two items of current expenditures and include:

- 1. Wages, salaries, operating bonuses besides transfers to ministries, public institutions and other executive bodies of the PA.
- 2. Capital and development expenditures, which include government procurement, capital assets and depreciation.

<sup>15</sup> Palestine an Observer State at the UN, site of Aljazeera.net, 29/11/2012, <https://www.aljazeera.net/> (in Arabic)

<sup>16</sup> Nasr 'Abdul Karim, The Reality of Public Debt and Private Sector Arrears in Palestine, Coalition for Integrity and Accountability - AMAN, 5/9/2019.



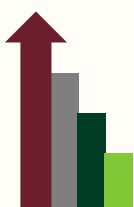
The PA's public finances have been characterized by instability since its inception until today, as deficit has been part of the general budget since the first budget, and this is due to two main factors:<sup>17</sup>

- 1. Fluctuation of external financing the PA receives from different countries, the most important of which are the US, Saudi Arabia, and the European Union (EU).
- 2. Subordination of this aid to the political factor as it is often associated with the extent of the PA's involvement in negotiations with Israel. Since talks were suspended in 2014, there was a significant decline in aid received from different countries, particularly the US, while the EU and its countries remained more committed than other countries.

**Table 2: External Financing for the PA 1997–2020**

Year	Aid to PA Budget (\$ million)
1997	10
1998	3
1999	7
2000	55
2001	523
2002	436
2003	261
2004	345
2005	348
2006	517
2007	744
2008	1,450
2009	1,176
2010	855
2011	749
2012	665

<sup>17</sup> Ibid.



2013	1,129
2014	945
2015	660
2016	593
2017	555
2018	491
2019	467
2020	419
<b>Total</b>	<b>13,403</b>

Source: The table was prepared by the researcher based on data from PECДАР.

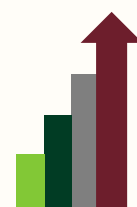
Table 2 shows the following:

- External financing for the PA was effected by the political situation, in general, and the relations with Israel, in particular. External financing, at the beginnings, focused on building civil and service institutions, including financing health, education and infrastructure sectors, where budgetary funding did not exceed \$10 million.
- With the outbreak of *al-Aqsa Intifadah*, at the end of 2000, external financing jumped from \$55 million to \$523 million, a \$468 million increase.
- It is also noted that following the Israeli unilateral withdrawal from Gaza Strip and parts of the West Bank in 2005, Hamas's formation of the tenth government after its victory in the legislative elections in 2006, and the subsequent schism,<sup>18</sup> external financing for the PA increased significantly by \$706 million between 2007 and 2008. It is noted that although this aid has fluctuated, it has remained within stable limits until 2014, when the PA-Israeli peace talks were suspended.<sup>19</sup> External financing for the PA declined from \$945 million in 2014 to \$419 million in 2020.



<sup>18</sup> 15 years Since the Israeli Withdrawal from Gaza... Major Achievements and the Most Prominent Failures, Aljazeera.net, 15/8/2020.

<sup>19</sup> Israel Suspends Talks Until Further Notice, Imposes Economic Sanctions on the PA, Donia al-Watan electronic newspaper, 26/4/2014, <https://www.alwatanvoice.com/arabic/news/2014/04/26/528452.html> (in Arabic)



- It can be concluded that during the PA’s first years, it borrowed to cover the budget deficit. For the bulk of external financing was meant to support development activities, like building major facilities such as schools, hospitals and infrastructure, including water and electricity networks.

- It is also noted that after Israel’s “Operation Defensive Shield” (March 2002–July 2003), in which it invaded the WB and destroyed vast parts of it,<sup>20</sup> external financing for the PA declined from \$436 million to \$261 million. Consequently, public debt increased from –14% to 13.4% throughout 2002–2003. This, according to the researcher, was because the PA used a large part of the external financing (\$100 million) to rebuild what Israel destroyed, including major facilities and infrastructure.<sup>21</sup>



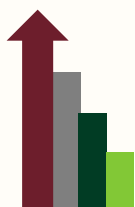
**Operation Defensive Shield**

- It can also be noted that with the Israeli withdrawal from Gaza in 2005,<sup>22</sup> external financing for the PA increased by \$169 million, which led to a decline in the public debt growth from 19% to 8%.
- During the third phase (2007–2013), external financing for the PA increased from \$744 million to \$1,129 million. However, this increase did not affect the public debt, which increased from \$1,451 million to \$2,376 million, during the same period.
- As for the fourth phase (2014–2020), external financing for the PA decreased from \$945 million in 2014 to \$419 million in 2020, thus increasing the public debt from \$2.4 billion in 2014 to about \$3 billion in 2020.

<sup>20</sup> Defensive Shield.. Israel’s Military Options, Aljazeera.net, 3/10/2004.

<sup>21</sup> Sameh al-Wadeya, *Al-Mas’uliyah al-Dowaliyyah ‘an Jar’im al-Harb al-Israeliyyah* (The International Responsibility for Israeli War Crimes) (Beirut, Al-Zaytouna Centre for Studies and Consultations, 2009), p. 100.

<sup>22</sup> Sharon’s Plan for Unilateral Withdrawal from Gaza, Aljazeera.net, 18/3/2005.



#### Fourth: The Palestinian Division and the Administrative Failure of the PA

Since mid-2007, there is schism between Hamas and Fatah, and in late 2018, the Palestinian Legislative Council (PLC),<sup>23</sup> which is authorized by law to monitor the performance of the executive authority and evaluate the general performance of its finances, was disrupted and dissolved. As a result, the successive governments in the WB, headed respectively by Salam Fayyad, Rami Hamdallah and Muhammad Shtayyeh, took advantage of these conditions and bypassed many of the law provisions defining how the PA should deal with public debt, including:



**Salam Fayyad**



**Rami Hamdallah**

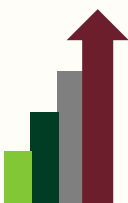


**Muhammad Shtayyeh**

- Chapter 4 of Public Debt Law No. 24 of 2005 stipulated for presenting debt agreements concluded by the Ministry of Finance with local and external lenders to the PLC for approval. This has not happened since 2007 because the PA has disrupted the PLC, while the Constitutional Court issued a decision to dissolve it in December 2018.
- Article 55 of Budget Law No. 7 of 1998, which is still in effect,<sup>24</sup> restricted the PA in terms of the size of borrowing to finance current expenditures, so that future generations do not bear the burden of current spending and the cost of debt, whether to repay the principal of the loan or its interests. The law stipulates for borrowing to be limited to support development projects, which were mentioned in infrastructure projects and public utilities that the private sector is reluctant to finance.

<sup>23</sup> Ahmad Al-Khalidi, An Advisory Opinion on the Dissolution of the Palestinian Legislative Council, al-Zaytouna Centre for Studies and Consultations, 14/1/2019, <http://eng.alzaytouna.net/2019/01/14/an-advisory-opinion-on-the-dissolution-of-the-palestinian-legislative-council-prof-ahmad-mubarak-al-khalidi/#.YK4ZqlQzZhE>

<sup>24</sup> Law no. 7 for 1998 regarding the organization of the general budget and financial affairs, Palestinian News and Information Agency (WAFA), 3/8/1998. (in Arabic)





Analyzing the general budget shows that 77% of total expenditures go for current expenditures with 60% covering employees' salaries.<sup>25</sup>

By analyzing the behavior of the PA in the two clearance crises of 2019 and 2020, we note from Table 1 a record increase in public debt, amounting to \$514 million. For the PA resorted to loans from local banks mainly, in order to pay the salaries of employees.<sup>26</sup>

Therefore, it can be concluded that the PA has exploited the division to pass many decisions, violating many laws and regulations that restrict PA excessive borrowing to finance current expenditures, instead of financing development projects of public interest.



The PA has also violated the Public Debt Law by borrowing excessively without consulting the PLC, which is authorized under Public Debt Law No. 24 of 2005 to approve any borrowing operations.

### **Fifth: The Clearance Crisis Between the PA and Israel**

The second reason for the increase of PA's public debt was the crisis of clearance revenues. It has been an unstable issue, subject to Israeli bargaining and extortion. The latest round of this crisis was in 2020, when the PA refused to receive clearance revenues for six months between April and October,<sup>27</sup> thus confusing the public finances and prompting the PA to approve an emergency budget limited to paying 50% of employees' salaries.<sup>28</sup>



<sup>25</sup> Ahmad Abu Zeiter, *The Role of Local Resources in Financing the Palestinian Government's Budget: Suggestions to Strengthen the Local Resources Role in Financing the Budget Deficit (2000–2010)*, Master's thesis, Al-Azhar University, Gaza, 2012. (in Arabic)

<sup>26</sup> See *Government Announces a Halt to Any Employee Salary Deductions*, site of Ramallah News, 28/9/2010, <https://ramallah.news/> (in Arabic)

<sup>27</sup> *Palestine Refuses to Accept Tax Revenues From Israel*, site of Arabi21, 4/6/2020, <https://arabi21.com> (in Arabic)

<sup>28</sup> *Palestinian Government Pays 50% of Employees' Salaries due to Clearance Crisis*, *Al-Quds al-Arabi* newspaper, London, 2/7/2020, <https://www.alquds.co.uk/> (in Arabic)



**Table 3: Israeli Aggression on Clearance Funds<sup>29</sup>**

Periods of Freezing or Cutting clearance revenues	Political Context
August and September 1997	Palestinian-Israeli security tension
December 2000 – December 2002	The outbreak of <i>al-Aqsa Intifadah</i>
March 2006 – December 2007	Legislative elections and Hamas’s formation of the 10 <sup>th</sup> government
November 2011	Palestinian efforts to gain diplomatic recognition at the UN Educational, Scientific and Cultural Organization (UNESCO)
December 2013	Palestine obtains observer status at the UN
December 2014 – April 2015	Palestinian efforts to join International Criminal Court
February and December 2019	PA rejects receiving clearance funds after Israel cuts sums provided to families of martyrs and prisoners claiming “terror activities” funds
May –November 2020	PA rejects receiving clearance funds after President Abbas’s decision to stop all forms of civil and security coordination with Israel, in response to Israeli annexation plans within Trump’s plan known as Deal of the Century

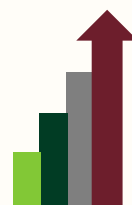
As part of the arrangements for the interim period between the PA and Israel, following the signing of Oslo Accords in 1993, the two sides agreed to sign the Paris Protocol on Economic Relations in 1994. The Protocol includes provisions requiring Israel to transfer the clearance funds, which are the tariffs on Palestinian monthly imports. They are to be handed to the PA in exchange for a commission of 3%.<sup>30</sup>

These revenues constitute three types of taxes:

- 1. **Direct taxes:** Income taxes from the wages of Palestinians employed workers in Israel and the settlements.

<sup>29</sup> Raed Hillis, The PA’s Clearance Revenues Crisis in its Political Context and Economic Repercussions, al-Zaytouna Centre for Studies and Consultations, 7/1/2021. (in Arabic)

<sup>30</sup> The Paris Agreement and Clearance... A Trap Restricting the Palestinian Economy, site of Turkish Radio and Television Corporation (TRT), 2/12/2020, <https://www.trtarabi.com> (in Arabic)



- 2. **Indirect taxes on imports from Israel:** The value-added taxes on Palestinian imports from Israel, and the purchase tax on oil derivatives, cigarettes and alcohol only.
- 3. **Indirect taxes on imports from abroad:** Value-added tax, tariffs, purchase tax and others.



From Table 3, the following can be noted regarding the relation between the public debt crisis and the clearance tax crisis:

- Clearance funds were subject to blackmail by Israel, which sought to freeze their transfer to the PA to force it to make political concessions. These funds form the backbone of the PA's public finances, as they make around 50–60% of its total public revenues, at an average of 500 million shekels per month (\$150 million).
- During the first phase of the PA's suspension of receiving clearance funds in 1997, there was no apparent impact of this decision on the PA's public debt, as it was in the early stages of its establishment, and it had no financial obligations urging it to borrow to pay its dues.
- The second stage of Israel stopping the transfer of clearance funds to the PA came as a result of the outbreak of *al-Aqsa Intifadah* for two years. Yet, the effect of the decision was not significant, because it was accompanied by the increase of donor countries' financial aid to the PA from \$55 million in 2000 to \$523 million in 2001.
- The third stage came after Hamas's victory in the legislative elections until December 2007 and witnessed an increase in public debt by \$400 million, a 40% increase.
- Due to the clearance crisis between the PA and Israel, public debt increased 17% in 2020 and 10% in 2019, a \$514 million increase. The impact of this crisis on the PA was clear, as it coincided with decline in external finance.



Based on the above, it can be concluded that Israel has sought, through its agreements with the PA—the most important of which is the Paris Economic Agreement—to primarily serve its commercial and economic interests and destroy the Palestinian economy. This has negatively affected the PA’s public revenues and pushed it toward external borrowing to finance the public revenue deficit. Some aspects in this context include:

- Confiscation of lands and natural resources: Israel confiscated lands to build settlements and seized natural resources such as the gas fields, off the coast of Gaza, and the “Rantis” oil and gas field in the West Bank.<sup>31</sup> This has negatively affected tax and investment revenues that were supposed to go to the PA’s budget, and would consequently reduce dependence on borrowing.
- Given the direct investment returns of the PA’s revenues, it is expected that operating “Marine” gas field in Gaza, whose reserves are estimated at 33 billion cubic feet of gas, would yield \$150 million in annual revenues for the PA’s treasury.<sup>32</sup> A sum of one billion dollars is also expected in annual revenue for the PA’s budget from investment in the “Rantis” oil field, which includes 2.5 billion barrels of oil and 182 billion cubic feet of natural gas.<sup>33</sup>



**Rantis Oil Field**



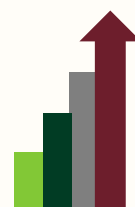
**Marine Oil Field**

- Israel’s control of the Palestinian digital space, through enabling Israeli telecommunications companies to operate freely in the WB and compete with Palestinian companies, has been reflected in the decline of PA’s revenues from income taxes on Palestinian companies. For these have lost a market share of

<sup>31</sup> Palestine’s Oil: Facts About “Stolen Wealth,” Palestinian Information Centre, 21/10/2017. (in Arabic)

<sup>32</sup> Hussein Mustafa, All You Need to Know About the Gas Field in Gaza and the Israeli Obstacles, Arabi21, 23/2/2021, <https://arabi21.com/> (in Arabic)

<sup>33</sup> ‘Adnan Abu ‘Amer, Palestinian Oil in Ramallah, al-Monitor, 19/1/2018, <https://adnanabuamer.com/>



more than 17% of the telecommunications market in the WB to Israeli companies. This control continues to grow,<sup>34</sup> leading to a decline in PA revenues.

- The repeated Israeli wars and invasions led to an increase in the PA's reliance on borrowing, especially in periods when Israel froze clearance taxes, as happened in the "Operation Defensive Shield" during the 2002 invasion of the WB, when Israel transferred only 16% of the clearance funds.<sup>35</sup>

## Sixth: Scenarios for the Next Stage

The PA's public debt crisis reflects the structural defect in the Palestinian economy due to overlapping factors, leaving the PA indebted to internal and external bodies.

One aspect of the debt burden is the annual debt interest paid by the general budget, at the expense of other priorities, making the PA postpone other priorities, such as the developing and promoting the economy, to get rid of its dependency on the Israeli economy.<sup>36</sup>

This crisis shows the dilemma the PA is in, as Israel controls 70% of its budget affairs through the clearance taxes,<sup>37</sup> using them as a pressure card. As a result, the PA had to borrow to pay its financial dues, especially the salaries of its 136 thousand employees, whose number increase to 210 thousand, when adding those with "semi-salaries," i.e. the retired persons, social allowances, families of martyrs, prisoners and former prisoners.<sup>38</sup>



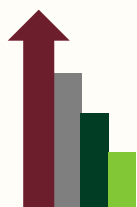
<sup>34</sup> Eight Israeli Telecom Companies Operating in the Palestinian Territories, Ramallah News, 25/9/2018. (in Arabic)

<sup>35</sup> The PA's Financial Crisis, MAS, 20/7/2011, p.4, [http://www.mas.ps/ar\\_download.php?id=41b4dy269133Y41b4d](http://www.mas.ps/ar_download.php?id=41b4dy269133Y41b4d) (in Arabic)

<sup>36</sup> International Monetary Fund, West Bank and Gaza Strip, Report on Macroeconomic Developments and Outlook, 30/6/2014, <https://www.imf.org/Countries/ResRep/WBG>

<sup>37</sup> Jafar Sadaqa, Bishara: Clearance funds not charity from Israel, Wafa, 15/1/2015, [https://www.wafa.ps/ar\\_page.aspx?id=sM54kOa657726993957asM54kO](https://www.wafa.ps/ar_page.aspx?id=sM54kOa657726993957asM54kO) (in Arabic)

<sup>38</sup> Jafar Qassem, Following "Clearance" Resumption... Paying Salaries of Palestinian Employees a Priority (report), Anadolu Agency, 19/11/2020. (in Arabic)





This crisis demonstrates the Palestinian economy's subordination to the external factors, where 25%<sup>39</sup> of the budget's public revenues depend on external financing. Furthermore, it is vulnerable to political factors, as was emphasized after US aid was halted in 2017,<sup>40</sup> and the Arab support declined or almost completely stopped in 2019–2020.<sup>41</sup>

Based on the above, the PA faces three scenarios:

➤ **The first scenario:** The Palestinian public debt problem is the decline of public revenues compared to the persistence or increase in public expenditures. The PA's reliance on domestic and foreign loans to cover its expenditures may decline in case of advancement of the external financing, which constitutes 75% of total public revenues. The most important parts of external financing are the US aid that has been frozen for four years, the donor countries pledges to support the PA budget, and Israel's abstention from freezing clearance funds. As a result, the PA's budget deficit would be covered during the current and the coming years.

➤ **The second scenario:** Given the current landscape, if results of the legislative and presidential elections do not coincide with regional and international desire, such as Hamas winning the elections as in 2006, the scenario of continued political and economic pressure by the US, Israel and the Arab countries seems to be potentially strong. In this case, the PA financial situation would further deteriorate, due to the continuation of US aid halt (under President Joe Biden), Arab financial blockade on the PA, and Israel's halt of clearance revenue transfer. Any of these three factors, whether combined or separate, will urge the PA to intensify dependence on domestic and foreign loans, hence increasing significantly the public debt.



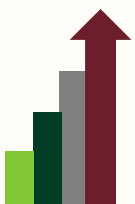
Joe Biden

➤ **The third scenario:** The PA would maintain the current situation, which is its limited reliance on clearance funds from Israel and the Europeans' continued financing of the budget, in addition to maintaining Arab support within its minimum limits. This will

<sup>39</sup> Bilal Kiswani, Experts: Palestinian Budget not Affected by Halting American Aid, Wafa, 8/2/2018, [http://wafa.ps/ar\\_page.aspx?id=8onx9pa810805994724a8onx9p](http://wafa.ps/ar_page.aspx?id=8onx9pa810805994724a8onx9p) (in Arabic)

<sup>40</sup> Hala Jaffal, Halting American aid to Palestinians and Searching for Alternative Leadership, Palestinian Centre for Policy Research and Strategic Studies (Masarat), 9/5/2019, <https://www.masarat.ps> (in Arabic)

<sup>41</sup> See 'Adnan Abu 'Amer, Arab aid for the PA since its inception, site of Arabicpost, 16/7/2020, <https://arabicpost.net> (in Arabic)



increase the financial pressure on the PA; an 18% increase of the public debt (which is the average annual increase of the public debt during the life of the PA).

The current developments indicate that the US aid return to the PA under Biden is possible. If elections are held (legislative, presidential and Palestinian National Council) and Fatah wins, the tension between the PA and the Arab countries may decline, hence the Arab financial support may be restored, and the PA's public debt would be reduced.

## Recommendations

- The need to control and rationalize current expenditures within a priority schedule, especially wages and salaries expenditures that constitute 60% of budget expenditures.
- Gradual decrease in operating expenditures for the benefit of development expenditures, while prioritizing the latter. Also, directing expenditures to projects that bring in investments and increase income taxes.
- Reconsidering the current tax laws in a way that would be consistent with the financial needs of the PA and does not negatively affect investment promotion laws.
- The need for the PA to adopt a radical reform plan concerning its institutions, by merging non-governmental institutions into ministries to reduce external expenditures financed by the budget.
- The PA's adoption of privatization and granting the private sector some powers to manage service activities that drain the budget.

