

Rebuilding Hope

The Government of Palestine's Report to the
Ad Hoc Liaison Committee

22nd September, 2014

New York, USA

LIST OF ACCRONYMS AND ABBREVIATIONS

GoP	Government of Palestine
COGAT	Coordinator of Government Activities in the Territories (branch of the Israeli military, de-facto unelected sovereign of the West Bank and the border crossings with Gaza)
GERRP	Gaza Early Recovery and Reconstruction Plan
IDP	Internally Displaced Person
MFU	Macro-Fiscal Unit
MoF	Ministry of Finance
MoPAD	Ministry of Planning and Administrative Development
NDP	National Development Plan 16-2014
ODA	Official Development Assistance
PFM	Public Finance Management

Executive Summary

Since the AHLC convened last time we have witnessed another war on Gaza which killed 2,131 Palestinians and left Gaza in ruins. The recent destruction and human suffering in Gaza has made it abundantly clear that the status quo is no longer sustainable. Reconstruction will take years in the best case scenario if border restrictions are lifted.

At the same time the economic and fiscal situation across Palestine is extremely precarious and volatile. Economic growth has plummeted from double digit growth rates in 2010 and 2011 to an estimated real GDP growth rate of 1.9% in 2013. For 2014 real GDP is expected to contract by 3.7%, with significant regional discrepancies. In the West Bank economic output is expected to stagnate as a result of continued Israeli access and movement restrictions, combined with political uncertainty stifling investment. In Gaza, as a result of the massive physical destruction, the GDP is expected to shrink by a staggering 15%. The net result is a rapid decline in real per capita GDP, along with rising unemployment, poverty and food insecurity.

The struggle for Palestinian statehood is an uphill struggle, as the option for a two-state solution needs to be preserved against an Israeli-imposed policy of military occupation, siege and dispossession on the ground. Accordingly, the National Consensus Government will address the following strategic priorities in tandem:

- **Reconstructing Gaza and consolidating the authority of the National Consensus Government;**
- **State-building along the parameters of the National Development Plan 2014-16;**
- **Preservation and development of “Area C” of the West Bank, including East Jerusalem;**
- **Bolstering fiscal sustainability;**

The Palestinian people is determined to confront these challenges reunited, under the umbrella of the National Consensus Government. The political programme of the National Consensus Government is a reflection of the programme of the President. Both the President and the Prime Minister have repeatedly reiterated their unequivocal commitment to the two-state solution and the principles of recognition of Israel and previous agreements signed with Israel, as well as the principle of non-violence. The formation of the National Consensus Government is thus a prerequisite for a comprehensive political settlement.

Our Arab brothers and international partners, including the European Union, the United Nations, and the United States, have equally viewed reconciliation, based on the Quartet principles, as vital for statehood and for a comprehensive peace settlement comprising Gaza. The National Consensus Government would like to seize this opportunity to commend our partners for their constructive stance.

Following the vast scale devastation brought onto Gaza, early recovery and reconstruction is the immediate priority, as the war turned more than 110,000 Palestinians into homeless internal refugees and critical infrastructure for basic services across Gaza into rubble. The National Consensus Government, with support from our Arab brothers and international partners, drafted a plan to reconstruct Gaza, which will be formally launched on 12 October in Cairo. A “Bridging to Recovery” initiative, part of the larger reconstruction plan, will address immediate priorities for internally displaced persons, for vulnerable families and for Gaza’s infrastructure at large.

Effective early recovery and reconstruction, however, requires the support of our Arab brothers and international partners as the burden for rebuilding Gaza cannot be shouldered by the Palestinian government’s narrow resources. Previous to the war, the Government had already allocated 48% of all expenditures to Gaza, while at the same time it was only able to collect 3% of its revenues from Gaza. Over the next two years the Gov-

ernment of Palestine (GoP) expects that approximately USD 4.0 billion¹ will be required to carry out reconstruction works. The short-term requirements during the immediate relief and early recovery phase amount to USD 623 million. In this context we appeal to our Arab brothers and international partners to ensure the availability of funding for refugees and non-refugees in a balanced manner, and support the return of IDPs to their homes.

While focusing on recovery and reconstruction in Gaza one must, however, not lose sight of the larger picture, which is the realization of a viable, democratic and sovereign State of Palestine within a two-state solution. We firmly believe that such a two-state solution is the only alternative to continued conflict and bloodshed.

For this very reason we have outlined our strategy for continued institution building, social protection, economic development and an adequate infrastructure within the National Development Plan 2014-16. The Palestinian government owes its people a continued focus on the longer-term perspective and the institutional requirements for a democratic state, with a clear division of powers, supported by an efficient and effective public administration that is capable of unleashing the entrepreneurial spirit of the Palestinian people. The overall financial envelope for development investments over the three-year period totals some USD 1.5 billion. Financial assistance towards implementing this plan will be paramount for realizing statehood.

Within Palestine, mainly in the West Bank, we need to carefully safeguard the principle of a two-state solution by striving for the integrity of the Palestinian territory within the pre-June 1967 borders. Here “Area C”, comprising some 63.9% of the West Bank (including East Jerusalem) becomes central for the realization of an independent, sustainable and viable State of Palestine, as confirmed by the latest World Bank report, titled “Area C and the Future of the Palestinian Economy”. Palestinian development in “Area C”, either for the local Palestinian

1. This estimate is subject to change as finalization of assessment is still undergoing

population or for the larger Palestinian economy, is denied as a matter of routine. Meanwhile, Israel unilaterally exploits the natural resources of “Area C” for its benefits and the benefits of the settler population. Just a few weeks ago, on 30 August, the Israel announced the confiscation of another four square kilometers of Palestinian land for the construction of a new settlement in the southern West Bank. This act of dispossession mirrors the Israeli government coalition’s disdain for the two-state solution and reemphasizes the importance of focusing on “Area C”.

The World Bank, in its October 2013 report titled “Area C and the Future of the Palestinian Economy” estimates potential direct and indirect economic benefits of unconstrained access to “Area C” at some USD 3.4 billion, equal to 35% of the GDP in 2011. The extra resources would cut the recurrent deficit by more than half and significantly improve employment opportunities and livelihoods.

In order to be able to address development needs and requirements in “Area C” in a more targeted manner, the Government, with support from our Arab brothers and international partners, has developed the “National Strategic Framework for Development Policies and Interventions in “Area C” (2014-16)”.

Consistent with previous messages communicated in past AHLC reports we encourage our Arab brothers and international partners to provide continued funding towards Government-led, multi-donor mechanisms in support of “Area C”, including East Jerusalem, such as the FAIR, CRDP and EU funded Programmes.

As the Palestinian government, we will strive to intensify our interaction with the international donor community to ensure the predictable, stable and uninterrupted flow of aid for the realization of statehood. At this critical time we particularly call on our Arab brothers and international partners meet their commitments towards budget support. Ahead of the war on Gaza the financing gap for recurrent costs amounted to USD 350 million and additional government expenditure will occur as a result of the war. While recovery and reconstruction efforts in Gaza are a

top priority they must not come at the expense of pursuing the ultimate goal of a two-state solution through state-building.

Towards this end, the Palestinian government remains fully committed to its institutional, fiscal and economic reform agenda, which is critical to achieve sustainability and true independence.

While pressure for additional governmental spending in Gaza is enormous after the recent war, the Government cannot simply be expected to assume additional financial liabilities given the bleak fiscal situation. Additional budget allocations for Gaza, be it within the framework of Gaza reconstruction or the reconsolidation of the public administration, need to be based on a sustainable fiscal foundation, unless they would cause irreversible damage to the treasury. Returning Gaza to the fiscal position it had prior to the siege will require heavy investment, a full return of Gaza to the fiscal and administrative envelope of the National Consensus Government, and above all the lifting of the siege to allow for sustainable economic growth.

Despite the volatility of the overall relationship with Israel, we are determined to continue investing in an improved commercial relationship. As a result of continued GoP efforts to enhance revenue performance, clearance revenues have increased by 31% during Jan-June 2014 compared to the parallel period of the previous year. This is mostly due to field campaigns conducted by GoP customs officials in purpose of tracking merchants that undervalue their import declarations. The over-performance of clearance revenues can also be attributed to as an increase of fuel imports to Gaza after the closure of the tunnels. Additionally, domestic tax revenue during the same period grew by 10% relative to the previous year, mainly due to GoP efforts to widen the tax base and enhance compliance; since the beginning of the year, the GoP has expanded its tax base to an additional 5000 taxpayers.

While the enhanced exchange of information has yielded tangible results, the economic relationship with Israel is far from optimal. Among the pending issues that need to be addressed in

a joint manner are the full disclosure of actual sales to the Palestinian market in order to allow for effective tax enforcement, the transfer of taxes on imported goods from Israeli merchants other than VAT, the transfer of taxes levied on Palestinian workers inside Israel, as well as an adjusted deduction mechanism for processing fees retained by Israel. If the above issues are resolved in a fair manner, Palestinian revenues would increase by close to NIS 1 billion annually, equal to some 20% of our budget deficit.

In a region of instability and during times of upheaval, the Palestinian government has remained a stable anchor owing to its solid institutional basis and its broad social consensus. We need to jointly exert all efforts to preserve these institutions and expand effective government responsibility across Palestine within the framework of the National Consensus Government. Hence, it should be in the interest of all parties to ensure that the transfer of clearance revenues to the Palestinian side continues uninterrupted and is insulated from politics.

President Abbas and the National Consensus Government have fully embraced the vision of the two state solution and will continue working relentlessly towards realizing this vision. We have to do everything within our power to offer a better future in peace for the next generation.

It is against this goal that we call upon our Arab brothers and international partners, who have embraced our statehood vision over the past two decades, to stay on course and intensify political and financial efforts in light of Gaza reconstruction requirements. We urge our Arab brothers and international partners to link their financial commitment towards realizing the two-state solution with strong political engagement, since our problems are the result of a continued political impasse and since time works against the two-state solution. At this point we are truly at a crossroads for the future Israeli-Palestinian relations.

Political Overview

When the Ad Hoc Liaison Committee convened last year the Palestinian government perceived to be engaged in serious and substantial US-sponsored negotiations on the realization of a State of Palestine, living in peace and co-existence with the State of Israel.

Our expectations were nixed by Israeli government policies, which, under the cover of a diplomatic process, intensified the settlement enterprise in order to foil the establishment of the Palestinian state it supposedly discussed in negotiation rounds.

During the course of the nine months of negotiations the Israeli government launched plans and tenders for at least 13,851 settlement units in occupied Palestine², killed over 60 Palestinians, and demolished a total of 508 Palestinian structures, 312 of which were homes.³ Furthermore, much of the announced settlement construction is slated for isolated settlements deep inside the State of Palestine, clearly contradicting Prime Minister Netanyahu's lip-service to the two-state solution. The inevitable breakdown of the mock negotiations occurred in late March, when the Israeli government reneged on its previous commitment to release the last batch of pre-Oslo prisoners.

Against this background President Abbas and the Palestinian leadership made the decision to accede to 15 international treaties with the aim of bolstering the legal status of the State of Palestine in light of the entrenched Israeli occupation. These treaties include the Fourth Geneva Convention (on the protection of civilian persons in time of war); the Convention on the Rights of the Child and the Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in armed conflict; the Convention on the Elimination of All Forms of Discrimination against Women; the Hague Convention (IV) respecting the Laws and Customs of War on Land and its annex: Regulations Concerning the Laws and Customs of War on Land;

2. Peace Now, „Summary of the 9-Months Talks: Unprecedented Settlement Development“, 29 April 2014

3. Ma'an News Agency, «Abbas to propose timetable for peace talks with Israel», 2 September 2014

the International Convention on the Elimination of All Forms of Racial Discrimination; the Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment; as well as the International Convention on the Suppression and Punishment of the Crime of Apartheid.

Over the past two decades rounds of negotiations have failed to produce a Palestinian state. The Palestinian people cannot afford losing more years during which dispossession and settlement expansion will close the slim remaining window of opportunity for a viable and sovereign State of Palestine. Time has become a critical factor.

The Palestinian people is determined to confront these challenges reunited. As a result of President Abbas' successful efforts, a reconciliation agreement was signed in Gaza on 23 April, paving the way for the formation of the National Consensus Government on 2 June. Reconciliation and the National Consensus Government, led by the President, are strategic instruments for negotiations towards a two-state solution, as they reinforce the Palestinian position and mandate.

The political programme of the National Consensus Government is a reflection of the programme of the President. Both the President and the Prime Minister have repeatedly reiterated their unequivocal commitment to the two-state solution and the principles of recognition of Israel and previous agreements signed with Israel, as well as the principle of non-violence. The formation of the National Consensus Government is thus a prerequisite for a comprehensive political settlement.

While the international reaction to the formation of the National Consensus Government was overwhelmingly positive, Israeli Hasbara, though unsuccessfully, attempted to portray it as a choice between peace and terror. Refusing to see the opportunities for a peaceful settlement that underpinned the formation of the National Consensus Government Israel was quick to denounce it and impose sanctions on its members, including a travel ban for Ministers from Gaza, which severely restricted the

ability of the new government to perform its work effectively.

From an Israeli government perspective the prospect of Palestinian unity clearly entails the risk of being coerced into meaningful negotiations with a broad-based Palestinian partner. As a result Israel would either be obliged to respect international borders and law within a peace framework, or risk isolation by maintaining its rejectionist insistence of an Israel that usurps the State of Palestine. Since neither option seems desirable for the majority of the current Israeli government, a return to Palestinian division and the associated status-quo ante would be the best available alternative. Palestinian division would allow for a business-as-usual approach, characterized by entrenched occupation and eternal conflict management.

The deplorable kidnapping and murder of three West Bank yeshiva students was thus utilized as an opportunity for a wide-scale Israeli campaign aimed at undoing national reconciliation. The crackdown on the West Bank in June claimed the lives of nine Palestinians⁴ and led to the arrest of some 880 Palestinians⁵. Economic life in the southern West Bank was paralyzed for weeks.

In East Jerusalem Mohammed Abu Khdeir, a sixteen year old teenager, was abducted and burnt alive, following an unsuccessful attempt by the same perpetrators to kidnap a 10 year old Palestinian girl. Only days later, Israeli police were caught red-handed on camera while beating Mohammed Abu Khdeir's cousin unconscious while he was handcuffed.

4. UNOCHA, Protection of Civilians - Weekly Reports;

5. UNOCHA, Protection of Civilians - Weekly Reports;

Violence in Jerusalem

Events in Jerusalem this summer ostensibly shattered the Israeli construed myth of an “eternal, undivided capital”. Following the deplorable murder of three West Bank yeshiva students, kidnapped earlier in June, Israeli mobsters gathered in the streets of West Jerusalem in search for Palestinians, yelling “Death to Arabs”. While the police managed to prevent lynchings of Palestinians in public places of West Jerusalem, little to no efforts were exercised by the Israeli security apparatus to apprehend the attackers and bring them to court. The atmosphere was reminiscent of a pogrom and culminated in the attempted abduction of a 10-year old Palestinian girl and the subsequent actual abduction and abhorrent killing of 16-year old Mohammed Abu Khdeir from Shuafat, East Jerusalem. Successive protests in East Jerusalem were handled with heavy violence by Israeli security forces. The assault of the handcuffed cousin of murdered Mohammed Abu Khdeir by Israeli forces gained media attention as it was caught on camera, though it was far from being exceptional. A second Palestinian teenager, 16 year old Mohammad Abd Al-Majid Sunuqrot, was lethally shot during protests and succumbed to his wounds in early September. Related to the protests some 350 Palestinian protesters were arrested and prosecuted in East Jerusalem by mid-August, while none of the Israeli rioters of West Jerusalem was prosecuted. Today, Palestinians inhabitants of Jerusalem face an increased risk of indiscriminate, racially motivated attacks by Israeli individuals and mobs - all on top of the occupation induced discrimination Palestinians in Jerusalem have suffered for decades.

Finally events in the West Bank spilled over into Gaza at the beginning of July and once again highlighted the existence of 1.8 million Palestinians, dwelling in overcrowded conditions, struggling with a faltering infrastructure, and being virtually cut off from the outside world. The unprecedented assault on Gaza claimed the lives of 2,131 Palestinians, some 70% of them being civilians, including 501 children. Some 110,000 citizens of Gaza have been displaced by the military assault as their houses, which have been destroyed or severely damaged. More than 6,100 industrial facilities and commercial establishments were totally destroyed or damaged. On the Israeli side 71 soldiers and seven civilians lost their lives, including one child.

Israel and the international community were once again confronted with the fact that the status-quo in Gaza is unsustainable by any definition, a message the Palestinian government has highlighted repeatedly in its reports to the Ad Hoc Liaison Committee and on other occasions. Years of blockade and isolation cannot be tolerated by any nation. If the intention was to break up the National Consensus Government, the Israeli offensive has achieved the opposite. The Oslo Accords explicitly state that the West Bank and Gaza Strip form a single territorial entity. The National Consensus Government is fully committed to restoring this status at the administrative and social level, while at the economic level all energies will be invested to lift the siege.

Over August and September, President Abbas has initiated talks with our Arab brothers and international partners on a commitment towards a three-year timeframe to bring an end to Israel's decades long occupation. The process is meant to commence with a nine-months period for resolving the final status issues and the delineation of borders within three months. If the borders of the State of Palestine cannot be delineated within such a timeframe, attempts to arrive at a negotiated two-state solution will realistically need to be considered history.

A political agreement firmly rooted in international law and taking into account Palestinian protection requirements and right to freedom is the only alternative to a return to bloodshed and war. Only a viable, democratic and sovereign State of Palestine will bring stability to this part of the Middle East. Continued attempts to manage the conflict without offering a political horizon will backfire and cause more violence.

20 Years after Oslo

On 4 May 1994, the PLO and Israel signed the Cairo Agreement, by which the Palestinian National Authority was established - originally limited to Gaza and Jericho. What was designed as a five-year interim period now lasts for 20 years. Based on figures of UNOCHA and B'Tselem more than 9,000 Palestinians were killed by Israeli security forces and by Israeli civilians since 1994. Twenty years into the Oslo process the number of settlers in the West Bank, including East Jerusalem, has almost tripled from 198,000 to some 550,000. The June-1967 boundaries have been erased by Israel and a new line has been drawn by the Separation Wall, which criss-crosses the West Bank along the triple length of the actual border with Israel. Within the West Bank, Palestinians have been confined to less than 40% of the territory, while Palestinians in East Jerusalem have been isolated from their hinterland. Living conditions in Gaza have deteriorated steadily as a result of war and a suffocating siege.

Gaza Recovery and Reconstruction

Fifty days of heavy fighting have killed 2,131 citizens of Gaza and injured over 10,000. Beyond the tragic human costs material and economic damages will cripple Gaza for years to come. Some 110,000 Palestinians will remain displaced for months, and possibly years, after their houses were destroyed or severely damaged. Around 6,100 industrial and commercial enterprises were destroyed or damaged as a result of shelling and bombardments. Accordingly, the IMF projects that Gaza's GDP will contract by 15% in 2014. Vital infrastructure, such as the Gaza Power Plant, was deliberately targeted in order to mete out collective punishment.

Prior to the war, in 2012, the UN compiled a report titled "Gaza in 2020", which already painted a dark picture of Gaza's future. The report projects that Gaza's water may become unusable by 2016 and that damage to the aquifer may be irreversible by 2020. Furthermore, "fundamental infrastructure in electricity, water and sanitation, municipal and social services, is struggling to keep pace with the needs of the growing population." In order to keep Gaza inhabitable, the report concludes, "by 2020, electricity provision will need to double to meet demand, damage to the coastal aquifer will be irreversible without immediate remedial action, and hundreds of new schools and expanded health services will be needed for an overwhelmingly young population. Tens of thousands of housing units are needed today." The recent war has ruined domestic electricity production capacities, it has destroyed and damaged tens of thousands of housing units, it has destroyed and damaged schools and health facilities, and it has impaired the already dilapidated water and sewage network. Already before this war the siege of Gaza did not allow for urgently required infrastructure investments, such as a large scale water desalination plant, which would prevent a collapse of the aquifer. Livelihood expectations for Gaza were bleak before the war, today they are gloomy.

In the absence of decisive action by the international community, some 2 million Palestinians will be forced to live under abysmal conditions, without access to basic infrastructure and services, without employment, without access to the outside world, and without hope, subjected to aid charity by the international community at Israel's grace. We have to bear in mind that this misery in Gaza was not caused by a natural disaster, but is artificial and man-made - and as such reversible. Furthermore, it is not a result of the recent war, but a result of decades of tightened restrictions and sanctions under occupation, starting with the permanent closure imposed in January 1991. Frequent escalation has been the result ever since.

Such an oppressive blockade is unacceptable for any nation. The solution cannot be simply quiet for quiet. Only a political process that deals with the core problems of the Gaza crisis through a comprehensive peace settlement, based on the two-state solution, will bring about an end to suffering in our region.

While detailed damage assessments are currently being conducted, preliminary assessments by the Government, the private sector and International Organizations suggest that the recent war caused some USD 3bn in direct damages to infrastructure and USD 0.5bn in indirect damages (production losses for the private sector). Reconstruction costs will amount to approximately USD 4.0 billion⁶, primarily because some 110,000 internally displaced persons will require temporary shelter and service solutions for prolonged periods. Moreover reconstruction includes economic revitalization measures, particularly short-term employment opportunities, to reduce the massive unemployment and wide-spread poverty in Gaza.

The Government established a Higher Inter-Ministerial Committee for Gaza Recovery and Reconstruction, headed by the Deputy Prime Minister, Dr. Muhammad Mustafa, and supported by a Technical Committee, to develop a recovery and reconstruction plan for Gaza.

6. Please refer to footnote 1

In a first step, within a “Bridging to Recovery” initiative, the National Consensus Government has identified and is moving forward on critical immediate relief and early recovery interventions, as part of the first phase of the overall “Gaza Early Recovery and Reconstruction Plan”. The prime objectives of this first phase are to:

- Increase the availability of public services in Gaza;
- Provide temporary housing solutions and facilitate Internally Displaced Persons (IDPs) to return home as soon as possible; and
- Relieve financial stress and enable the private sector to participate in recovery and reconstruction.

As indicated, these first phase interventions link into the larger “Gaza Early Recovery and Reconstruction Plan”, which over a two-year timeframe, covers relief, early recovery and reconstruction intervention, as well as a small number of critical longer-term development projects required for Gaza’s economic recovery. The plan will be used to consolidate resources and help the Palestinian people in Gaza rebuild their livelihoods. It is envisioned that the plan will form the basis for an international conference in Cairo on 12 October, which seeks to mobilize urgently required resources for the reconstruction of Gaza.

Effective early recovery and reconstruction requires the support of our Arab brothers and international partners, as the burden for rebuilding Gaza cannot be shouldered by the Palestinian government’s limited resources. Over the next two years, the Government expects that approximately USD 4.0 billion⁷ will be required to carry out reconstruction works. The requirements during the immediate relief and early recovery phase amount to USD 623 million. In this context, we appeal to our Arab brothers and international partners to ensure the availability of funding for refugees and non-refugees in a balanced manner, and support the return of IDPs to their homes.

7. Please refer to footnote 1.

A rapid assessment forms the backbone of the plan. Conducted by Government institutions with the support of local and international partners, it uses the situation prior to the assault as a baseline, but contextualizes it within the experience of Israel's long and continuing blockade of Gaza. Through this plan, the National Consensus Government will steer closely linked interventions to ensure rapid improvements to livelihoods in Gaza. The GERRP will be implemented in cooperation with civil society, the private sector, and our Arab brothers and international partners, while ensuring critical national ownership.

The bulk of financial support will be required for the rehabilitation and reconstruction of infrastructure, including 60,000 destroyed and damaged houses, 78 destroyed public buildings, many kilometers of destroyed and damaged water and sewage networks, water tanks, roads and municipal infrastructure, as well as the Gaza power plant. In the medium-term larger infrastructure projects will be required to stimulate Gaza's devastated economy, including upgraded border crossing facilities, the reconstruction of the Gaza International Airport, and the construction of a commercial seaport.

More than 20% of Gaza's industrial and commercial enterprises were totally destroyed, and many more damaged. Agriculture was hit hard by the complete destruction of 17% of the total cultivated area. With the destruction of economic capital, many employment opportunities were lost. The destruction and damage caused to some 6,100 industrial and commercial enterprises, as well as to agricultural assets requires vast resources to rehabilitate and revive the already struggling private sector in Gaza. Within this context the construction sector will need to be prioritized in the short term so construction companies can rapidly move into reconstruction for other sectors. Beyond immediate rehabilitation and reconstruction, economic stimulation measures will be essential to revive the ailing economy and reduce the staggering unemployment rate.

In the social sphere the GERRP will ensure the resumption of education, health and psycho-social services. During the seven

weeks of war, one hospital was totally destroyed, while 9 governmental hospitals and 28 governmental clinics were damaged, along with a number of UNRWA health facilities. Tens of thousands are expected to require psycho-social support after experiencing traumatic events. To ensure pupils' return to schools, 141 governmental schools require rehabilitation works, along with a number of UNRWA education facilities. Social protection services need to be expanded to cater for IDPs and to cover 20,000 additional households affected by poverty following the war, as well as some 4,000 new orphans and thousands of persons who were permanently disabled during the assault.

In order to enable overall recovery and reconstruction efforts to take off, the National Consensus Government will furthermore request funding to maintain and restore the operational capacity of central and local government institutions, and move towards a consolidated public administration in Gaza.

The National Consensus Government will assume overall ownership for the implementation of the Recovery and Reconstruction Plan, in line with global development effectiveness principles. Accordingly, the Government requests our Arab brothers and international partners to collaborate with the Higher Inter-Ministerial Committee for Gaza Recovery and Reconstruction, or a body designated by the Committee, in terms of resource allocation and funding channel.

Beyond the existing governmental coordination structure under the Higher Inter-Ministerial Committee for Gaza Recovery and Reconstruction, the Government will establish an implementation unit. This unit will report to the Higher Inter-Ministerial Committee and work closely with government entities, as well as the international community, civil society and private sector, to ensure the execution of the priority recovery and reconstruction interventions as per the recovery and reconstruction plan. The unit will provide monthly status reports to the Council of Ministers through the Inter-Ministerial Committee during the first six months of recovery reconstruction, and move to a quarterly reporting basis in thereafter. The reports will focus on progress of

the most critical elements of the plan and recommendation regarding accelerating implementation. The unit will also support government entities in the implementation of decisions from the Council of Ministers as they relate to the reconstruction of Gaza.

In order to ensure ownership and coherence in the implementation phase the Government's preferred funding channel for Gaza reconstruction is the Central Treasury Account, as well as UNRWA for refugee related interventions. Alternative funding channels, mainly building on existing mandates and mechanisms of International Organizations with a strong presence in Gaza, are outlined in the Gaza Early Recovery and Reconstruction Plan. Utilization of these designated funding channels will avoid a proliferation of implementation mechanisms and substantially ease coordination.

A lifting of the siege and the opening of border crossings are essential prerequisites for any reconstruction activity in Gaza. Under the current access regime the reconstruction of Gaza will remain an illusion. With present limitations to the import of construction material re-housing projects dating back as far as 2003 are still pending implementation, not to mention more recent displacement. As of April this year, UNRWA for example, had not received any new project approvals by COGAT for over a year, despite the agreement that approvals should be obtained within a two months timeframe. 38 new project proposals worth over USD 111 million were awaiting COGAT approval by April and even the import of construction material for approved projects has been cumbersome.

The reconstruction of the massive damages in Gaza and economic revival requires the swift entry of construction materials and commodities in the short-term, as well as open borders for persons and for import and export beyond the short-term.

Building Palestine - The National Development Plan 2014-16

The Palestinian government has embarked on an ambitious state-building enterprise over the past years aimed at realizing the two-state solution by developing strong institutions as the foundation of the State of Palestine. The international community has recognized the soundness of the Palestinian institutions and of the public financial management system in past AHLC reports and meetings.

Despite the many occupation-related constraints the National Consensus Government was able to accomplish tangible achievements across a range of sectors:

The Government has over the past year strengthened the enabling environment for economic engagement in Palestine. New laws and by-laws were issued, among them a by-law meant to provide affirmative action for the struggling Palestinian economy by prioritizing local products in public tenders. Furthermore, the President has signed an amendment to the Law on the Encouragement of Investment in Palestine. The amended law will provide better targeted incentives towards specific sectors that contribute to the development of the national economy and have the potential to reduce unemployment. The Government also aims for better integration of Palestine into the global economy, an effort which is supported by donors who assist the Government in improving the competitiveness of Palestinian products and services, and provide vital skills for cross-border business engagement.

In mid-June the President endorsed a new Water Law, which is the legal prerequisite for the implementation of a wide-ranging water sector reform. The implementation of the new law will have a direct impact on the quality of water services and the financial viability of water service providers, as it separates ministerial oversight functions from regulatory and service-pro-

vision functions. The later functions will be exercised by independent public entities.

Reliable provision of energy is vital for a thriving economy and for functional public services. To increase domestic electricity supplies the Government has embarked on preparing tenders for a 100MW power plant in the southern West Bank. The tender is expected to be announced within the upcoming months. The Palestinian energy sector thereby endeavors to reduce its heavy dependence on energy imports. In addition, the Palestinian Electricity Transmission Company (PETC) was established in October 2013 to modernize the transmission infrastructure and minimize losses. Our success so far comes despite enormous challenges: three major wars on Gaza within six years, combined with a continued siege; access and movement restrictions in the West Bank, particularly in those 64% categorized as “Area C”, including East Jerusalem; settlement construction and political blackmail through a halt to revenue transfers; a significant decline in the aid volume; and the internal split between the West Bank and Gaza, which was just overcome this spring.

The Palestinian government owes its people a continued focus on the longer-term perspective and the institutional requirements for a democratic state, premised on a clear division of powers, supported by an efficient and effective public administration, and capable of unleashing the entrepreneurial spirit of the Palestinian people.

Following another devastating war on Gaza, our Government is obliged to also look beyond the immediate needs and continue its path of developing Palestinian institutions, reinforcing the social fabric, inducing private sector driven growth, and providing adequate infrastructure.

On 23 April 2014 the Government approved its third tri-annual development framework, the National Development Plan (NDP) 2014-16. The NDP 2014-16 was circulated to our Arab brothers and international partners in early May and provides a coherent and results-based approach to policy development and implementation. The plan was prepared with the participation of a variety of stakeholders, including the private sector and civil society. Like its

predecessors the NDP 2014-16 is meant to guide government operations and spending over the next three years, and to steer the allocation of available resources.

Similar to the previous national development plans, the NDP 2014-16 is based on the National Policy Agenda, which defines the national vision, as well as approaches and policies across the following four macro-sectors: economic development and employment, good governance and institution building, social protection and development, as well as infrastructure. The macro-economic and fiscal framework of the NDP 2014-16 is based on modeled forecasts by the MoF's Macro-Fiscal Unit. Recent developments, including the war on Gaza, have, however, already undercut the more sober baseline scenario stipulated in the macro-economic and fiscal framework.

The enhanced status of Palestine as a non-member observer state to the United Nations and Palestine's subsequent accession to international conventions and agreements have created a new momentum with regard to the awareness and protection of Palestinian national and human rights. This new legal reality constitutes a cornerstone of the national plan's strategic outlook, which aims to roll back the occupation through realizing statehood, establishing sovereignty over Palestinian land and resources, and consolidating the institutions of a democratic and accountable State of Palestine.

Implementation of the NDP 2014-16 will be tightly linked to the new approach to budgeting and budget execution, whereby the budgets of government entities are undergoing a transformation from item-based budgeting to programme-based budgeting. Programme budgets, with defined qualitative targets and indicators, will be linked to the strategic objectives and priority policies of the NDP. The programme-based budgeting process will hence gradually develop into the main instrument for the execution of the NDP. For this reason the below NDP budget reflects both operational financing requirements to be covered under recurrent budget expenditures, along with development investment costs.

NDP Summary by Expenditure Categories

Macro-Sector	Sector	expenditures 2014 (USD millions)		expenditures (USD 2015 (millions)		expenditures (USD 2016 (millions)		Total expenditures (USD millions)	
		Operat- ing	Devel- opment	Operat- ing	Devel- opment	Operat- ing	Devel- opment	Operat- ing	Devel- opment
Economic Development & Employment	National Economic Development	20.1	23.3	20.7	41.8	21.3	42.2	62.2	107.0
	Labor	12.5	1.6	12.9	6.9	13.3	7.6	38.7	16.0
	Agriculture	27.0	27.8	27.8	35.7	28.6	59.7	83.5	123.0
	Tourism	5.1	2.5	5.2	4.6	5.4	4.5	15.7	12.0
	ICT and Post	9.5	8.7	9.8	11.0	10.1	9.0	29.4	29.0
	Subtotal	74.2	64.0	76.5	100.0	78.8	123.0	229.5	287.0
Good Governance & Institution Building	Security	1,019.0	32.0	1,050.4	34.0	1,082.0	27.0	3,151.4	93.0
	Justice	41.1	25.0	42.3	27.5	43.6	32.0	127.0	84.5
	Local Government	44.8	42.0	46.1	43.0	47.5	55.0	138.4	140
	Admin. Development & PFM	87.8	18.0	89.6	20.0	92.7	29.0	270.1	67.0
	International Relations	70.7	3.3	72.8	2.5	74.9	1.7	218.4	7.5
	Subtotal	1,263.4	120.3	1,301.2	127.0	1,340.7	144.7	3,905.3	392.0
Social Protection & Development	Social Protection	767.8	12.0	790.8	16.0	814.6	19.0	2,373.2	47.0
	Education	709.8	40.0	731.1	62.0	753.0	85.0	2,193.8	187.0
	Health	396.4	23.0	408.3	35.0	420.5	54.0	1,225.1	112.0
	Culture and Heritage	43.8	3.0	45.1	5.0	46.5	7.0	135.4	15.0
	Youth and Sports	20.1	10.0	20.7	13.0	21.3	17.0	62.0	40.0
	Empowerment of Women ((MoWA	1.7	2.0	1.8	3.0	1.9	4.0	5.4	9.0
	Subtotal	1,939.6	90.0	1,997.8	134.0	2,057.8	186.0	5,994.9	410.0
Infrastructure	Water	14.6	40.5	15.0	35.0	15.4	36.0	45.0	111.5
	Environment	4.1	6.5	4.2	15.0	4.3	13.2	12.6	34.7
	Energy	17.6	40.0	18.1	35.3	18.6	43.0	53.3	118.3
	Housing	3.1	2.0	3.2	27.0	3.2	16.7	9.5	45.7
	Transportation	44.4	36.5	45.6	27.0	47.1	43.0	137.1	106.5
	Subtotal	83.8	125.5	86.1	139.3	88.6	151.9	257.5	417.7
	TOTAL	3,361.0	399.8	3,461.6	500.3	3,565.9	605.6	10,387.2	1,506.7

Note: As the shift from item-based budgeting to programme-based budgeting is not completed, NDP operating expenditures may still differ from those stated in the budget for 2014.

The challenges to the implementation of the NDP 2014-16 are enormous and include first and foremost the human, economic and fiscal ramifications of the recent devastating war on Gaza, which forces the National Consensus Government to once again apply a humanitarian and recovery approach towards Gaza, which will only gradually make space for a longer-term development approach. In the West Bank, including East Jerusalem, the environment for development is characterized by the Israeli-imposed fragmentation of Palestinian lands and people, by continued policies of dispossession and ethnic cleansing, and by an entrenched settlement enterprise aimed at frustrating a two-state solution. The combined effect of the occupation-related challenges has strangled the private sector, which translates into declining per capita income and a shrinking tax base.

On the positive side one can observe an end to declining ODA volumes, particularly budget support/support to recurrent costs seems to rebound. We thus appeal to our Arab brothers and international partners to maintain their focus on the state-building efforts of the Palestinian government. While recovery and reconstruction efforts in Gaza are a top priority they must not come at the expense of pursuing the ultimate goal of a two-state solution through state-building. The overall financial envelope for development investments over the three-year period totals USD 1.5 billion and financial assistance towards implementing this plan will be paramount for realizing statehood.

Preserving and Developing “Area C”

While the reconstruction of Gaza and the end of years of siege is a top priority for the National Consensus Government, we must not lose sight of the continued dispossession and ethnic cleansing policies in the West Bank, particularly in “Area C”. Just a few weeks ago, on 30 August, the Israeli military announced the confiscation of four square kilometers of Palestinian land from five villages for the construction of a new settlement in the southern West Bank. This single largest act of dispossession over the past 30 years mirrors the Israeli government coalition’s disdain for the two-state solution and reemphasizes the importance on focusing on “Area C”.

“Area C” has been the focus of past Government reports to the Ad Hoc Liaison Committee since it is of such critical importance to unlocking the denied potential of the Palestinian economy and realizing sovereignty over the territory of the State of Palestine.

The classification of Palestine into Areas “A”, “B” and “C” dates back to the Oslo Accords and was meant as an interim (up to five years) delineation of administrative responsibilities to be exercised by the nascent Palestinian National Authority, until a final status agreement would be reached. Under the Oslo Accords “Area C” was meant to be gradually transferred to Palestinian responsibility. This classification in no way abrogates legitimate Palestinian rights enshrined under international law to any part of the State of Palestine, regardless of its classification under an interim agreement. “Area C” is no less illegally occupied Palestinian land than any other area of the West Bank or East Jerusalem. However, the categorization of the West Bank into Areas “A”, “B” and “C” has become the basis and legitimization for an Israeli system of control and oppression that considers “Area C”, comprising some 63.9% of the West Bank (including East Jerusalem), as exclusive Israeli property which is gradually being annexed in all but name.

Since the establishment of the Palestinian National Authority, successive Palestinian governments and Palestinian citizens have been denied the right to develop those areas and to harness its natural resources, including land and water. “Area C”, including East Jerusalem, covers 3,617 square kilometers, out of which some 2,400 square kilometers are under the jurisdiction of settlements. Military firing zones in “Area C” add up to some 1,000 square kilometers and are equal in size to “Area A” and “Area B” enclaves combined. As of today merely 1% of “Area C” has been allocated for Palestinian habitation, albeit subject to stringent restrictions and a multi-layered process of difficult-to-obtain permits. Palestinian development in “Area C”, either for the local Palestinian population or for the larger Palestinian economy, is denied as a matter of routine. Meanwhile, Israel unilaterally exploits the natural resources of “Area C” for its benefits and the benefits of the settler population. Land is being confiscated for exclusive Israeli use; water is abstracted, pumped into Israel and partially resold to Palestinians; Dead Sea minerals are extracted and marketed as Israeli products; and touristic and historical sites are placed under exclusive Israeli control.

The World Bank, in its October 2013 report titled “Area C and the Future of the Palestinian Economy” views “Area C as key to future Palestinian economic development”. The World Bank estimates potential direct economic benefits from unconstrained access to “Area C”, as envisaged under the Oslo Accords, at USD 2.2 billion per year at a minimum, equivalent to 23% of Palestine’s GDP in 2011. According to the

World Bank, “the bulk of this would come from agriculture and Dead Sea minerals exploitation”. Jointly with indirect benefits the unconstrained access to “Area C” would increase the GDP by approximately USD 3.4 billion, equal to 35% of the GDP in 2011. The extra resources would cut the recurrent deficit by more than half and significantly improve employment opportunities and livelihoods. Unfortunately, however, Israel continues to deny our right to economic development at the expense of its settlement policy.

To highlight the lack of access to some two-thirds of the West Bank and flag the strategic priority of “Area C” for a two-state solution and economic development, the Palestinian government has defined a set of tangible actions for “Area C” in its AHLC report of September 2012, for which it has sought the support of the international community. The response of our Arab brothers and international partners has indeed been positive: specific funding mechanisms were established and re-sourced to support Palestinian communities in “Area C” and the issue seemed to attract more political attention among our Arab brothers and international partners. In order to be able to address development needs and requirements in “Area C” in a more targeted manner the Government, with support from our international partners, has developed a “National Strategic Framework for Development Policies and Interventions in “Area C” (2014-16)” in 2014. This Strategic Framework is grounded in extensive participatory research with affected communities in “Area C”.

The political and policy premise of the Framework centers on the fact that “Area C” is central for the realization of an independent State of Palestine and that the challenges and obstacles imposed by the Israeli occupation must be confronted. These challenges include restrictions on movement and access, constraints that prevent economic development, social justice, and a decent life for Palestinians in their homeland. A counter strategy requires the deployment of substantial human and financial resources, as well as cooperation between local and international stakeholders to implement the Framework at the local, regional, and national level.

The purpose of the National Strategic Framework is to safeguard the principle of a two-state solution by striving for the integrity of the Palestinian territory within the pre-June 1967 borders. The Framework seeks to assert Palestinian citizens’ right to freedom of movement and economic opportunity. It recognizes the importance of “Area C” for so-

cio-economic development and geographic integrity. Engagement of governmental and non-governmental stakeholders is viewed as a central element for effective support to “Area C”. The Framework is complementary to the National Development Plan (NDP) 2014-16, which recognizes the vital importance of “Area C” as a basis for a viable and sovereign State of Palestine. Insofar the Framework constitutes a spatial chapter of the National Development Plan (NDP).

In this context, and cognizant of the National Development Plan (NDP) 2014-2016, the government is committed to focus its efforts on addressing urgent public service requirements and development needs of “Area C”. The Framework defines development issues, challenges and sector priorities. It also aims to define a group of integrated and connected development interventions, framed as programmes, within the overall context of the NDP 2014-16.

Special focus is afforded to connecting the isolated Palestinian communities across “Area C” to national infrastructure services such as roads, water and sanitation networks. Concurrently, the Framework outlines the potential for exponential growth in vital sectors like agriculture, tourism, housing, and industry, and highlights opportunities to realize these potentials through expanded sovereignty over “Area C”.

“Area C”, outside municipal Jerusalem, is home to some 300,000 Palestinians and comprises such diverse localities as the Jerusalem belt communities, including densely populated areas such as Abu Dis and Ar-Ram, villages in the Jerusalem periphery such as Bir Nabala and Beit Iksa, as well as rural agricultural and pastoral communities (including some 35,000 Bedouins). Altogether 542 built-up Palestinian localities are located in “Area C”. The 300,000 Palestinians residing in “Area C” of the West Bank are confronted with a rapidly increasing population of some 360,000 settlers, who are backed by armed forces and by a government determined to squeeze the Palestinian population out and relocate it into “Area A” and “Area B”, as well as into tiny enclaves within “Area C”.

Based on the National Policy Agenda of the National Development Plan 2014-16 the “Area C” Framework defines 18 strategic issues along the fields of governance, social development, as well as infrastructure and economy, and outlines guiding principles, a strategic and policy direction, as well as medium-term and short-term programmes and priorities.

The strategic issues listed in the National Strategic Framework are the following:

A. Policy and Governance

- Israeli policies and impediments limit Palestinian urban planning and development;
- Palestinian areas are deprived of economic development and have been isolated from each other and their economic hinterland;
- Palestinians are deprived of their basic human rights;
- The absence of Palestinian sovereignty over “Area C”;
- Lack of capacity to overcome the political, development and humanitarian challenges in “Area C”.

B. Social Development

- Continued and systematic Israeli restrictions and policies undermine Palestinian freedom and prospects for statehood;
- Palestinian communities, especially those in “Area C” are increasingly becoming more dependent on humanitarian support and face constant threat of deportation and violation of basic human rights;
- Lack of quality education for communities in “Area C”;
- Palestinian communities in “Area C” are exposed to pollution and environmental sabotage by Israel;
- Lack of adequate health care system for Palestinian communities in “Area C”;
- Youth, women, children, and persons with disabilities in “Area C” are vulnerable to Israeli induced shocks;
- Presence of and investment by Palestinian government and non-government institutions in “Area C” has been weakened.

C. Infrastructure and Economy

Infrastructure:

- Lack of Palestinian sovereignty over water resources results in denial of Palestinian water rights and severely affects agricultural production of Palestinian communities in “Area C”, as well as availability of water for household consumption;
- Urban planning is very restricted and construction in the absence of permits entails a high risk for communities in “Area C”;
- Palestinian communities in “Area C” are disconnected from regional and national infrastructure and networks.

Economy:

- The economic potential of “Area C”, especially in agriculture, mineral extraction and tourism remains unrealized;
- Horizontal linkages between economic sectors are weak and investment is very limited apart from agriculture;
- Trade and taxation policies do not provide tangible benefits for small businesses in “Area C”.

In its final chapter the National Strategic Framework outlines opportunities and challenges, jointly with partnership arrangements relevant to the implementation of medium- and short-term measures associated with the above strategic issues.

As stated clearly in the government decree dated February 4, 2014, the Ministerial Committee for “Area C” (comprising of the Minister of Local Government, Minister of Planning, Minister of Agriculture and Minister of Jerusalem Affairs) is the address for implementing all types of activities and interventions in “Area C”. However, the Framework envisages a key role for collective local initiatives (women’s cooperatives, housing cooperatives, and local service and economic projects) and innovative methods of resilience in the face of Israeli intransigence. It encourages meaningful coordination amongst various stakeholders (Palestinian government, non-governmental organizations, international agencies, and local communities) to challenge the occupation and bolster steadfastness and development throughout “Area C”, including East Jerusalem.

Consistent with previous messages communicated in past AHLC reports, we encourage our Arab brothers and international partners to scale-up funding towards Government-led, multi-donor mechanisms in support of “Area C”, including East Jerusalem. At the same time, the Palestinian government calls upon its Arab brothers and international partners to take bold steps challenging the systematic and institutionalized Israeli discrimination of Palestinians in “Area C”. Securing Palestinian rights must not remain hostage to Israeli policies aimed at cleansing lands and denying access to natural resources across “Area C”. Though the challenges are formidable, neither inaction nor failure is an option if one is determined to preserve the option of a two-state solution to the Middle East conflict.

Economic and Fiscal Developments

After final status negotiations had resumed last year, accelerating internal reforms to leverage the benefits of a peace dividend was a top priority for the Government. At the same time the Government had to prepare for an alternative scenario under which we would need to withstand the inevitable shocks in case of failure of peace talks.

A year later, unfortunately, we all know that this alternative scenario has materialized and it is the consequences of continuing conflict that we are to contend with - especially following the latest war on Gaza.

The conflict heavily impacts on Palestinian economic and fiscal performance, and on the ability of the Government to implement critically required reforms:

The overall economic and fiscal situation in Palestine remains extremely precarious and volatile. Economic growth has plummeted from double digit growth rates in 2010 and 2011 to an estimated real GDP growth rate of 1.9% in 2013. For 2014 real GDP is expected to contract by 3.7%, with significant regional discrepancies. In the West Bank, economic output is expected to stagnate as a result of continued Israeli access and movement restrictions, combined with continued political uncertainty stifling investment. In Gaza, as a consequence of the massive physical destruction, the GDP is expected to shrink by a staggering 15%. The net result is a rapid decline in real per capita GDP, along with rising unemployment, poverty and food insecurity.

Unemployment in Palestine has increased by 5.7% in Q2 2014 com-

pared to Q2 2013 and thus stood at 26.3% in the previous quarter. Unemployment in Gaza climbed to 45.1% right before the outbreak of the recent war. Youth are disproportionately affected and accordingly youth unemployment (age 15-29) hit 63.3%, leaving almost two-thirds of youth in Gaza without income and without the prospect of a dignified future. Unemployment rates can be expected to increase significantly following the crackdown on the southern West Bank in July, and the war on Gaza with its heavy damage to agriculture, industry and commerce. To contextualize the unemployment figure for Q2, it is furthermore important to know that unemployment on average drops by some 3% in Q2, compared to Q1 and Q3. On top of wide-spread unemployment in Gaza tens of thousands of personnel in the public sector, though not formally unemployed, have not received regular salaries for up to a year. This problem affects municipal staff and personnel hired by the former de-facto authority.

The above figures are extremely alarming and call for sustained international engagement both at the political and aid level, unless Gaza is expected to become another regional hub for instability and chaos.

As for the fiscal performance of the Government, revenues have greatly exceeded their budget target during January - June 2014, mainly due to reforms aimed at enhancing revenue performance. Gross revenues have exceeded their budget target by NIS 487 million, where domestic tax revenues and clearance revenues exceeded their budget targets by NIS 87 million and NIS 395 million, respectively. The over performance of domestic tax revenues, which grew by 10% during the first half of 2014 relative to 2013, is directly attributed to the Government's commitment to enhance revenue performance through widening the tax base and enhancing tax payers' compliance. As a result, income tax revenue and VAT increased by 11% and 33%, respectively, during the first half of 2014. Since the beginning of 2014, the Government has added an additional 5000 taxpayers to the base, which were a main contributor to the increase in domestic tax revenue during the first half of 2014. The majority of these tax payers were added between January and May of 2014, where the number of taxpayers used to increase by an average of 60 per day; however, with the deteriorating security situation and escalations of the Israeli military especially in Hebron, which is the economic hub of the West Bank, this effort was reduced to an average of 15 tax payers added per day. Therefore, although revenue performance during the first half of the year was exceptional due to continued PA reforms, it is expected to slow down following the politi-

cal situation and the fiscal pressure following the Israeli war on Gaza. Additionally, further domestic revenues are foregone as the Government is unable to exercise basic rule of law functions over “Area C”, and over crossings from Israel into “Area C”. Traders take advantage of this weakness and smuggle in goods via “Area C” in order to avoid taxes and tariffs, causing enormous damage to Palestinian treasury.

The growth of clearance revenues during the first half of 2014 was also exceptionally high, where they grew by 31% relative to the parallel period of 2013. The overperformance of clearance revenue can be attributed to two factors: (1) the increase in fuel imports to Gaza following the closure of the tunnels; (2) The GoP efforts to enhance revenue collection by sending customs officials on field campaigns in aim of going after Palestinian merchants that underestimate the value of their imports; (3) Finally, the Palestinian Government is committed towards implementing the timetable and agenda for improving cooperation and information exchange on clearance revenues with the Government of Israel, as outlined in the exchange of letters from 31 July 2012 and in the bilateral meeting with the Israeli Minister of Finance on 16 June 2013. Beginning September 2013 data interface has taken place between Israeli and Palestinian customs officials, whereby Israel transfers to the Palestinians all customs declarations on direct imports on a post clearance basis within 24 hours. This is a major step forward but the transfer is not effected in real time which substantially reduces Palestinian customs officials enforcement capability. This enhanced performance in the GoP’s revenues, managed to reduce the recurrent budget deficit by a significant 8%. Although the GoP aims to continue enhancing revenue performance and reducing the deficit even further, these efforts seem dim in light of the new political events and the emergency spending that will be required for the immediate relief of Gaza. Therefore, under conditions of continuing military occupation and cyclical eruptions of warfare it, regrettably, became unrealistic to pursue the revenue strategy in an effective manner.

Correspondingly, the GoP has also inserted efforts to curtail its expenditures and enhance its fiscal performance. Although total expenditures have increased by 11% during Jan-Jun 2014, the GoP has managed to contain its wage bill, which represents around half of the GoP’s recurrent spending, to a growth of 4%, rather than the recommended 5%. Wage expenditure was also below the target budget by NIS 51 million equal to 1.4%. This is

mostly due to the continued implementation of the zero net hiring policy since 2012. This measure was implemented in conjunction with a reform of wage related expenses, such as transportation and supervisory allowances, which further reduced recurrent expenditures in a sustainable manner. The slight increase in wage spending can be attributed to: (1) Wage expenditure on commitment basis witnessed an increase due to the implementation of the agreement with the health services workers; however this amount was not paid on cash basis, but is acknowledged on commitment basis; (2) part of this increase is temporary because retirements and other departures usually occur towards the end of the year, whereas the new recruitments take place earlier in the year. Additionally, the Government gradually cut down on fuel subsidies over the past 12 months, thus saving an expense factor equal to about 1% of GDP. The Government has also re-structured the entire stock of commercial bank debts and thus managed to significantly reduce applicable interest rates on public debt by at least 3% per annum. Therefore, the growth in total expenditures is mostly due to an increase in use of goods and services, mostly due to an increase in health referrals from a monthly average of NIS 15 million to NIS 30 million, as well as an increase in net lending due to increased unilateral electricity deductions by the Israelis. Fiscal pressures are likely to increase as it will be difficult to reduce or even limit total expenditures due to additional and immediate spending that is already being given for Gaza's relief.

Having briefly highlighted the fiscal situation of the GoP, along with the need for additional and emergency spending for Gaza relief, it is important to mention that the relief for Gaza cannot be fully financed by the GoP in order to avoid further fiscal deteriorations. Prior to the war, the Government had allocated 48% of expenditures to Gaza, while at the same time it was only able to collect 3% of revenues from Gaza (before the imposition of the siege Gaza had contributed some 45% to the budget). The pressure for additional spending in Gaza is enormous after the recent war, but given the bleak fiscal situation the Government cannot be expected to assume additional financial liabilities, be

it within the framework of Gaza reconstruction or the reconsolidation of the public administration. These spending pressures, are expected to significantly widen the financing gap, negatively affecting the Government's fiscal position. Additional budget allocations for Gaza need to be based on a sustainable fiscal foundation, unless they would cause irreversible damage to the treasury. Hence, it is critical to emphasize the importance of donor support during this difficult time, because the reconstructing of Gaza cannot be afforded by the Government alone without creating severe retrenchment in the Government's efforts to enhance its fiscal situation. Returning Gaza to the fiscal position it had prior to the siege will require heavy investment, a full return of Gaza to the fiscal and administrative envelope of the National Consensus Government, and the lifting of the siege to allow for sustainable economic growth.

Despite the current imposing need for donor aid and international community support, the long-term objective of the Palestinian Government is to reduce external dependency, yet enhancing economic and social policies. The Palestinian Government for this purpose needs to carry out several critical reforms towards improving fiscal revenues, expenditure and cost control, as well as sustaining economic growth. For this purpose, the GoP should broaden its revenue basis, and further reduce expenditures. The major constraint in broadening revenues is the Israeli imposed restrictions on access and movement, also Israeli policies that frustrates the Palestinian economy in Gaza and in "Area C" including east Jerusalem.

The GoP's efforts towards enhancing revenues and controlled expenditure are tangible, yet such reforms and improvements require the compliance of the international community and the Israeli Government in order to be effective and sustainable. As part of a long-term strategy for the modernization of revenue administration, in February 2014 the GoP began to implement a three-year Revenue Action Plan (RAP). The RAP aims to expand the tax base and improve compliance by establishing a fully integrated revenue administration of income tax, VAT, customs, and other direct and indirect taxes.

The RAP set nine priorities: (i) train staff; (ii) update laws and regulations; (iii) adopt a new computerized taxpayer system (Revenue Management System, RMS); (iv) implement a taxpayer awareness program; (v) adopt integrated revenue administration and a matching functional organization; (vi) reform the Large Taxpayer Unit (LTU); (vii) initiate taxpayer identification and registration units; (viii) improve taxpayer services; and (ix) initiate a taxpayer investigations program.

Several Revenue reforms are undertaken, and further are required to gradually achieve fiscal sustainability:

Revenue Reform: MoF is enhancing the field visits and follow up of profiling and registration on new tax payer to Expand the tax base and improve compliance. Till today the GoP was able to increase the number of tax payers by more than 5000 new tax payers. Moreover, amendments to income tax law were adopted by the Cabinet introducing a 10 % tax on distributed dividends. Also the income tax rate for the banks for the SME's loans was reduced from 15% to 10% . Also, the investment promotion law which was rectified and amended.

Fuel Subsidy: A key drain in the budget was the fuel subsidy, MoF managed to gradually and carefully reduced this subsidy to an average of below NIS 50 million from a peak of NIS 70 million without provoking anxiety in the street, and is further attempting to reach NIS 40 million. The GoP eventually aims to eliminate these fuel subsidies altogether.

Net Lending: The GoP continues to work on policies to restrict deductions in net lending and eventually to work on eliminating net lending altogether. Such policies include a Cabinet decision of obligating electricity providers in West Bank & Gaza to pay their bills and penalize delinquent municipalities, the establishment of the Palestinian Electricity Transmission Company (PETL) which will be in charge of establishing a modern transmission infrastructure, offering incentives to municipalities through paying their dues of property tax and transportation fees, the installation of prepaid electricity meters, and raising aware-

ness concerning electricity consumption and the importance of bill payments. With these efforts, it is expected that the growth in net lending will eventually decline, and eliminating net lending will become a feasible goal.

Public Procurement: In 2014, efforts continued to achieve further reform in public procurement after the enactment of a Public Procurement Law, where the law was finalized and approved from the cabinet.

Pension Reform: The total pension debt reached up to \$ 1.5 billion till april 2014, therefore public pension reform is a top priority. MoF made decisions to transfer funds monthly to the pension fund as of June 2014, in order to reduce the debt.

Restructuring debt to commercial banks: Mof managed to restructure various short term bank debts and reduce the interest rates from 8.5% to an average of 6.75%.

Despite these efforts by the Government, further integrated efforts are necessary to attain fiscal stability. Cooperation from Israel and other donors is essential for these future reforms to be effective. Critical reforms would be greatly facilitated if the Israeli authorities were to support Palestinian measures by improving the economic environment and confidence building measures. There are a number of repairs that can be undertaken which would greatly enhance our economic growth prospects and fiscal revenues. A proactive policy by the Israeli authorities should take place on several fronts:

- **Facilitation of movement and access within the West Bank and between the West Bank, the Gaza Strip, and East Jerusalem.** Exports from Gaza are the lifeline of our economy and Israel needs to allow the resumption of domestic trade between the West Bank, including East Jerusalem, and the Gaza Strip, as well as exports abroad in line with UN Security Council Resolution 1860. This will move Gaza away from the tunnel economy to orderly

trade relations with the West Bank, including East Jerusalem, and Israel, enhancing Government revenues substantially and improving growth prospects for Gaza, the West Bank and East Jerusalem.

- Israel can assist the Government in facilitating in-kind donations of petroleum products from friendly countries by allowing the buildup of the necessary infrastructure to channel petroleum products to the Palestinian market.
- Israeli cooperation is required on halting leakages in revenue transfers. For example, there are substantial custom duties on indirect imports through Israel not remitted to the Palestinian government. Estimates for this tax revenue forgone range between \$60 to \$75 million per year.
- According to the Paris Protocol the Palestinian government is expected to receive half of the border crossing exit tax (originally \$25 USD) collected by Israel on behalf of the Palestinian government. However, after the tax was in the meantime raised to \$42 the Palestinian side continues to receive half of the original tax. Israel would need to raise transfers to the Palestinian side to half of the tax.

Our fiscal strategy is undergoing a paradigm shift with the objective of attaining a primary balance in our recurrent budget. This stabilization strategy, which will be fully articulated, will accelerate reforms aimed at reducing the fiscal deficit both over the short and medium term. A more balanced budget would allow us to shift external aid from recurrent expenditures to development projects, thereby enhancing growth prospects. Achieving the objective of attaining fiscal sustainability will raise immense challenges and we will need strong support from the international community, as well as sustained cooperation from the Israeli authorities to realize our goals. Unless Israel responds positively by lifting economic restrictions and by allowing our tax authorities to operate in “Area C”, we will not be able to make this quantum leap towards stabilizing our budget.

Such reforms and pressure for lifting Israeli restrictions, as well as cooperation from the international community, are critical to enable the private sector to be the main driver of economic growth in the West Bank and Gaza. The private sector in Palestine has, however, for too long endured the consequences of endless setbacks in the peace process. Israeli restrictions have halted exports from Gaza, have fragmented the market, and have robbed the Palestinian private sector of most of its competitive advantages. The far reaching Israeli policy of siege and dispossession, coupled with the chronic budget deficit, has made it impossible for the Government to intervene effectively and boost the private sector.

As emphasized on previous occasions, economic development and fiscal stability are unattainable without an end to the Israeli occupation and its prohibitive restrictions. For this reason, we urge our international partners to link their financial commitment towards realizing the two-state solution with strong political engagement, as our problems are the result of a continued political impasse and time is clearly working against the two-state solution.

