



This quarterly socio-economic bulletin published by the Democracy and Workers' Rights Center in Palestine aims to inform workers about the latest economic and social developments in the occupied Palestinian territory.

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Overview of the Palestinian public budget for 2014

Basic information about the public budget for 2014

Current expenditures (including net loans)	3866 million US\$	Net public revenues (total revenues after deducting tax returns)	2586 million US\$
Total public expenditures	4216 million US\$		
Current budget deficit before funding	1.3 billion US\$	Total deficit before funding	1.6 billion US\$

Some keys to understanding the public budget:

1. The public budget is the financial plan of the government that includes estimates of public revenues and expenditures for the coming financial year, which should be approved by the legislative authority.

The public budget is an instrument that enables the government to achieve its economic, social and political goals and choices. Taxes and public expenditures are tools of fiscal policy. After the public budget is adopted by the legislative authority, it becomes a law, which permits the executive authority (the government) to collect revenues and make expenditures according to public budget allocations. The budget is much more than mere figures. Revenues and expenditures are not only financial tools, they are also economic, social and political tools that can be used to fight unemployment, inflation, and achieve economic stability. For example, they can be used to stimulate savings and investment, create jobs and raise people's standard of living, and reduce poverty and inequality through fostering income and wealth distribution among members of the society. The Palestinian government's budget of 2014 has the following characteristics:

2. The year 2014 budget is dominated by salaries and current consumption expenditures

The total current expenditures and net lending represent 91.7% of the public budget, and are composed mostly of wages and salaries, amounting to 2.018 billion US dollars. This is equivalent to more than half (52.2%) of the total current expenditures and net lending. When compared with the year 2013 budget (as re-estimated), the wage bill has increased by 92 million US dollars. It seems that the increase in wages and salaries is resulting from salary raises agreed upon through agreements signed by the government with trade unions and professional unions, and which are estimated at about 396 million NIS (or the equivalent of 110 million U.S. dollars at the exchange rate of NIS 3.60 / 1 USD). It should also be noted that although net lending is still high, it has decreased compared to the year 2013 (re-estimated budget). It has an allocation of 167 million US dollars in the budget of 2014 (representing about 4.3% of the total current expenditures, including net lending), compared with 216 million dollars in the 2013 budget. Net lending consists of medical referrals, electricity and water bills, and other amounts owed to Israeli companies that are providing these services to local Palestinian councils. These amounts are deducted by the Israeli government from the clearance revenues owed to the Palestinian Authority by Israel. Net lending also includes the amounts paid by the public treasury to the electricity generation and distribution company in the Gaza Strip. Net lending constitutes an additional pressure on limited financial resources. At the same time, it reflects the state of deterioration in the collection of electricity and water bills from taxpayers. In addition, transfers amount to about 1061 million US dollars, or the equivalent of 27.4% of total current expenditures and net lending! Thus, there appears to be little left for development and operating expenditures of ministries and governmental institutions.

3. Development expenditures reach 350 million US dollars, which represents only 8.3% of total public expenditures

Development or investment expenditures are necessary for capital formation and economic development, in particular in the field of infrastructure development in order to improve the investment environment and stimulate private sector investment, which is needed to increase economic growth, generate employment, and reduce high unemployment and poverty rates. Despite the great importance of development expenditures, their share is very limited; in fact, Palestinian governments are accustomed to dealing with development expenditures as superfluous or secondary. In times of crisis, these governments usually reallocate part or perhaps all the amounts earmarked for development expenditures for financing the deficit in current expenditures.

For social and political reasons, the distribution pattern of public expenditures leaves little flexibility for the fiscal policy of the Palestinian Authority. The Palestinian government cannot afford to reduce staff salaries, which are the primary and perhaps sole source of income of employees and their family members. Likewise, it cannot reduce the expenditures related to social assistance and allowances to the poor, the families of martyrs, prisoners, and pensioners (i.e. transfers). Furthermore, the fiscal policy of the Palestinian Authority is constrained by the Paris Economic Protocol.

4. Foreign dependency of the national budget:

Net public revenue reaches 2586 million dollars, including 924 million dollars from domestic taxes, and 1818 million dollars from the clearance revenues from Israel. This means that the clearance revenues from Israel constitute more than two-thirds (70.3%) of net public revenues. It indicates that the Palestinian government continues to rely on customs taxes and duties on imports, especially from Israel, to finance current expenditures. This is a dangerous policy that inflicts serious damage to domestic production, and the trade balance in the public budget itself. The majority of tax revenues originate from indirect taxes. This type of taxes is described as neutral, which means that they do not distinguish between the rich and the poor. Value-added taxes are paid by all consumers, when they buy a commodity, but their impact is much greater on the poor. On the other hand, direct taxes such as income tax offer a wide margin for exemptions for social and economic reasons. However, the share of these taxes is limited and does not exceed an average of 6% to 8% of total domestic revenues.

5. Reliance on foreign aid to cover the budget deficit:

The total deficit for the year 2014 budget, before foreign support, was 1629 million dollars (based on commitments), representing about 13.4% of the GDP. Despite a decline of this ratio compared to previous years, it is still much higher than the global standard for deficit adopted by European Union countries, which is 3% of GDP!

Financing of the year 2014 deficit depends entirely on external funding. Support to current budget expenditures reaches 1329 million dollars, and estimated foreign grants for financing development expenditures reach \$ 300 million. Local funding from banks operating in Palestine is zero, which is a step in right direction, since government borrowing from banks entails many risks. These include, most notably, high interest rates on short-term bank loans, as well as the fact that the government competes with the private sector for access to credit, in addition to the credit risk arising from a focus of banking facilities on the government sector (nearly half of bank loans) in the case of Palestine!

6. Absence of accumulation of arrears in the 2014 budget:

Usually, the Palestinian budget includes an item for net change in arrears, which increases or decreases depending on political and economic circumstances, and crises. Arrears are sums of money that the government owes to the private sector, such as contractors and suppliers, and sometimes include money owed to public sector employees (back-pay). The estimated arrears (debt) owed to the Palestinian Pension Agency reached 1.4 billion dollars in 2012, and decreased to approximately 550 million dollars at the end of the year 2013. Despite this, no net arrears appeared in the 2014 budget. In the 2013 budget, bank financing appeared at minus 315 million dollars, representing payment of bank debts. Net change in arrears was 512 million dollars, representing the accumulation of debts to the private sector. There were tax returns (late) amounting to 213 million dollars, while there was a negative balance is \$ 151 million. This raises questions due to lack of clarity. At the same time, no amount for net changes in arrears is indicated in the 2014 budget. The World Bank estimated that the accumulated domestic debt owed to local banks had reached 1.4 billion dollars in 2012, or the equivalent of 14% of GDP at the end of that year, and 112% of the total capital of banks operating in Palestine!

The Ministry of Finance strategy for public revenues for the years 2014-2016

The Minister of Finance, Mr. Shukri Bishara, has announced that his ministry is in the process of finalizing a strategy focused on increasing revenues. It includes tax cuts for businesses and individuals, and on property tax, while broadening the tax base and reducing tax evasion. The implementation of the tax reductions is expected by the end of this year, specifically after making sure that reforms have taken place. (Al-Ayyam newspaper, issue of 18.03.2014).

Reduction of income tax from 20% to 15%, and property tax from 17% to 12%.

The strategy includes reducing corporate income tax from 20% to 15%, the rate in force before the year 2011, highlighting the fact that its increase to 20% did not lead to any tangible results. On the contrary, it has caused a decline in indirect tax collection as a result of income tax evasion. The strategy also includes a property tax decrease from 17% to 12%, as well as decisions to reduce income tax on microfinance programs from 20% to 10%, the cancellation of the 5% rate on citizens' bank deposits interests, the abolition of income tax on capital gains for companies, and the adoption of a tax of 10% on dividends of bonds and equities that will be deducted from the source, besides an amendment to the law for encouraging investment ...

However, **the government had backed away from reducing corporate income tax from 20% to 15%** in light of the unclear political situation and the uncertain context (Al-Ayyam, issue of 13.04.2014).

68% of the tax basis is untapped due to tax evasion

The minister pointed out that domestic tax collection covers only 32% of the tax base, which means that 68% of the tax base is untapped or lost as a result of tax and customs evasion, and a weak relationship between the tax department and taxpayers. Thus, total domestic revenue decreased from 25% in 2008 to about 20% of GDP in 2013. The Advisor to the Minister of Finance, Mr. Hatem Yousef, has indicated that the number of non-registered holders exceeds 40 thousand, and that 45,000 are not committed to providing tax returns. Disclosed customs values do not exceed 35% of the true values, because of the falsification of data. He pointed out the high rate of customs evasion in the market, giving the example of cigarettes smuggling; with an estimated 32 million packs of smuggled cigarettes, or about 45% of consumption, losses for the tax department are estimated at about 98 million dollars annually. He added that there is a total revenue loss estimated at 550 million dollars per year, which includes revenue losses as a result of customs and commercial tax evasion in area (c), estimated at about 200 million dollars a year, Israel's non-transfer of taxes derived from the indirect import of goods that are not of Israeli origin, causing a loss estimated at \$ 90 million dollars annually, and non-transfer by Israel of the tax dues of Israeli companies operating in area (c), causing losses estimated at about 50 million dollars annually.

Income tax constitutes 8% of total revenues and only 1.7% of GDP

The Minister's advisor indicated that income tax represents 8% of total revenues and 1.7% of GDP, which is the lowest rate in the Middle East, and that the collection rate of actual monthly income and value-added tax does not exceed 25% of the taxes, which should be collected, indicating a weakness in collection rates and a low taxation base.

Reducing income tax on individuals and companies from 20% to 15%, and reducing property tax from 17% to 12% may be a good way to fight tax evasion and increase tax revenues. However, if this tax decrease is not related to the objectives of an economic, social and political fiscal policy, it loses a lot of its importance. It will remain a financial goal only, which is increasing tax revenues by reducing tax evasion and broadening

the tax base. The goal of social justice, stimulating investment and reaching financial sustainability must be a priority of Palestinian fiscal policy. Furthermore, the tax decrease should not be general, but should differentiate between the sources of income by sector. It should also take into account personal circumstances and the estimated capacity of taxpayers. Thus, taxes should be reduced to a minimum in productive sectors and activities that generate job opportunities, while they should be increased for income generated by speculation and brokerage activities. Exemption for a minimum income should only be granted to low-income employees and workers, and small producers and sellers. There is no justification for exempting the rich and those with higher incomes from paying a minimum tax. Palestinian fiscal policy is still unable to achieve financial sustainability and reduce dependence on external aid, while the tax structure does not achieve equity in the distribution of the tax burden and is characterized by a limited percentage of increase.

Sustainable human development and working women:

Sustainable human development is people, job, and environmentally friendly development. It gives priority to the generation of productive employment, fighting against poverty, conservation of natural resources and the environment, and the opportunities and the interests of future generations. It recognizes the fact that it is not possible to achieve much without a significant improvement in the situation of women, and without opening all economic opportunities to them. Sustainable human development enables people to expand their choices, which is inconsistent with the Israeli colonial occupation, which confiscates freedoms, land and resources necessary for the process of productive accumulation, and economic and social development.

Women's participation in the labor market is extremely low

Women in Palestine constitute half of the society, and educate and nurture the other half. Women's participation in the world of work is a requirement for sustainable human development. PCBS data showed that despite an increase of women's participation rate in the labor market from 2001 to 2013, this percentage is still low, reaching only 17.3% of all women of working age in 2013, compared to 10.3% in 2001. On the other hand, men's participation rate in the labor force was 69.3% for all men of working age (15 years and above) in the same year, which is more than four times women's participation!

High unemployment rates among economically active women, concentrated among educated women

The unemployment rate among women in the labor force is growing from year to year. It has increased from 13.8% in 2001 to 35% in the year 2013 (rates based on the ILO definition of unemployment)! Unemployment is concentrated among women, who completed 13 years of schooling or more, as their unemployment rate reached 47% in 2013. This means that unemployment rates increase with women's education level, which is inconsistent with the commonly held belief that women's education increases the employment opportunities available to them.

Poverty is higher among families headed by women

The latest data published by PCBS shows that according to monthly

household consumption patterns, more than a quarter of the population (25.8%) suffered from poverty in Palestine in 2011; the poverty rate reached 17.8% in the West Bank, compared with 38.8% in the Gaza Strip. The proportion of poor households headed by women is higher than the percentage of poor households headed by men. In the West Bank, 22.5% of women-headed households were poor compared to 17.5% of those headed by men. In the Gaza Strip, 39% of the households headed by women were poor compared to 29.7% of the households headed by men.

Decline in the percentage of women working in agriculture

There has been a significant decline in the participation rate of women (15 + years) in agriculture, fishing and forestry, as this rate has declined from 27.5% in 2008 to 20.9% in 2013. At the same time, an increase of the percentage of women working in service activities and other branches can be noted, which amounted to 59.3%.

The Israeli occupying power's policies, Israeli colonies and the Annexation/Apartheid Wall, are a key factor and a main obstacle to the growth and development of the Palestinian economy in general, and the agricultural sector in particular considering that the latter is at the heart of the struggle for land with the Israeli occupier. It is thus the duty of the Palestinian National Authority, and relevant civil society organizations, to intensify their efforts towards encouraging and supporting the agricultural sector, not solely in order to increase the contribution of women and agricultural production in the gross domestic product (GDP), but also as a way to resist Israeli occupation and colonization, and provide employment opportunities for Palestinian workers currently employed in Israeli colonies. This can be done by encouraging investment and agricultural land reclamation, the establishment of modern agriculture with high-yield and productivity, and by encouraging and supporting agricultural cooperatives for agricultural production and marketing. The announcement by the Palestinian Authority of a boycott of work in Israeli colonies, and the boycott of their products, is necessary, but not sufficient. It is necessary to strengthen this announcement or resolution through a number of practical measures and practices, such as the establishment of a fund for agricultural investment that offers facilities and agricultural loans on relaxed terms.

The proposed Social Security System for private sector workers (pension, work injuries compensations and maternity benefits)

1. The ILO's suggestions on standards for designing a social security system for private sector workers (July 2013)

In 2012 and at the beginning of 2013, the ILO undertook a series of consultations with tripartite stakeholders, presided by the Prime Minister, in order to discuss key challenges and priorities with regard to social security in Palestine. The key areas of interventions of ILO were agreed upon; it was agreed that the ILO would support the gradual establishment of a comprehensive social security system for private sector workers and their family members, run by an independent tripartite commission (with representatives of workers, employers and government), in order to provide decent benefits that will be implemented gradually, starting with retirement, work injuries and maternity benefits.

The ILO's recommendations concerning social security standards are based on the following:

- A series of intensive consultations with Palestinian stakeholders
- Dispositions related to the current pension system for public sector employees (Public Pension Law No. 7 of 2005)
- Dispositions related to the current Labor Law No. 7 of 2000
- ILO standards for social security and Social Security (Minimum Standards) Convention of 1952 (No. 102), as well as basic principles for social security.

2. Additional considerations include:

- Covering the largest number of Palestinian workers possible
- Making sure that the system has an acceptable cost, and is sustainable in terms of the contributions required from workers and employers, and benefits entailed
- Ensuring that the mechanisms necessary for the proper management of the system are in place, including a regular payment of contributions by covered workers and employers.

On these bases, the ILO is seeking to design a fair, low-cost and sustainable social system for Palestinian workers and their families, which should form the basis for a national social security law.

3. Design and actuary assessment of a proposed social security system

The ILO aims to support tripartite partners (workers, employers and government) in Palestine in developing and enforcing a social security system that includes long-term benefits (old-age pension, disability pension, survivors' benefits), as well as maternity benefits and work injuries benefits for private sector employees.

Proposed contribution rates

This system is expected to enter into force from January 2015. Proposed contributions are indicated in the table below:

	Workers	Employers	Total
Long-term contributions	7.5%	8.5%	16%
Maternity contributions	0.2%	0.3%	0.5%
Work injuries contributions	0	1.6%	1.6%
Total	7.7%	10.4%	18.1%

Source: International Labor Organization, Executive summary for the design and actuary evaluation of the proposed social security system, occupied Palestinian territory

Premises for designing the social security system:

1. The design and actuary study for the proposed social security system was based on an assumed return rate of 4% for social security funds, due to high uncertainty about economic conditions and restrictions affecting investment in Palestine.
2. The baseline scenario has assumed that the mandatory retirement age would be 60 years, in conformity with the public sector pension system. However, this mandatory retirement age is low compared to international standards, and contributes to a relative increase of the cost of long-term benefits.

Investment

The funds accumulated in the Palestinian social security institution are fundamental for the sustainability of the system. However, investment opportunities are rare and limited due to the various constraints faced by the Palestinian economy (lack of infrastructure, high price of facilities, lack of touristic areas, extremely high start-up costs as a result of security surveillance, and the difficulty of obtaining a visa for investors, etc.).

Taking into account the uncertainties in the availability of investment opportunities in Palestine, during the next phase, social security funds should be invested in government bonds with a fixed revenue if

available, because of the long-term prospects of the pension system and the continued growth of the reserves expected in the coming decades. Investments for social security funds should be long-term. Appropriate investments may include corporate bonds and mortgage loans, especially in light of the development of these markets. Due to the absence of opportunities, and risks of investing in Palestinian private sector stocks, at least a small portion of the investment portfolio should be invested abroad.

Transition in the coverage of work injuries

There may be a need to keep the current system of private insurance coverage for work-related injuries for a certain period, while the new social insurance starts operating. However, dual compensation systems (private insurance and social insurance) may cause some legal issues and problems in their application. It is necessary to determine the length of the transition period (two years, for example), so that employers cancel insurance contracts and the transition to the new social insurance system takes place. It is also necessary to maintain employers' liability in the event of a work injury during the period that precedes the transition to the new social insurance system.

Future actuary study

An actuary evaluation should be undertaken on a regular basis every three years, in order to assess the financial sustainability of the social security system and allow for periodic adjustments, whenever necessary. If the law includes a mechanism to determine future contribution rates, periodic actuary evaluations are a tool for determining these rates.

Management / Good governance

The institution that will oversee the management of the social security system should be managed by a tripartite board of directors (representing workers, employers, government). Investment of funds should also be clearly separated from daily management of the system. The new system requires an investment policy that is clear and fully independent from investment managers and the guarantor.

In conjunction with the government's preparations for the establishment of a social security system for the private sector, which does not include a mandatory health insurance system or a fund for protection from unemployment, the Palestinian Cabinet has approved a non-governmental pension scheme in February 2014. This step is not understandable in terms of serving the public interest, but rather serves the interests of certain powerful business persons, who insisted on this system. The Minister of Labor declared to the media that this scheme requires an amendment to current legislation, and is a complementary and optional system. It is not compulsory like the comprehensive social security system. It will target high income and wage workers in large companies that have provident funds, because it requires that those contributing to the scheme also contribute into the compulsory pension fund to be established within the social security system. The main purpose of the scheme for the private sector and those who have initiated it, is to invest the money saved-up for workers in the local market under the management of a private company. Scheme participants will benefit proportionately to their contributions levels.

The Democracy and Workers' Rights Center in Palestine (DWRC)

Ramallah, Al-Irsal Street, Al-Masayef Compound
P.O. Box 876
Tel: 00 970 (0)2 2952608
Fax: 02 970 (0)2 2952985
Email: info@dwrc.org
Website: <http://www.dwrc.org>

Gaza Al-Rimal, Al Shohada street P.O Box 5251
Tel: 00 970 (0)8 2849014
Fax: 00 970 (0)8 2849010
Email: gaza@dwrc.org

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