WEST BANK & GAZA AND THE IMF

The Israeli-Palestinian conflict has been one of the most intractable and damaging conflicts in recent world history. Its resolution has long been one of the most sought-after objectives of the international community. The Oslo Accords signed between the Israelis and Palestinians in 1993-95 offered the first real hope for a peaceful final resolution. Under these accords, the Palestinian Authority (PA) was established with the task of building new institutions from scratch and developing a policy and legal framework for the West Bank and Gaza (WBG) that could provide the basis for a future Palestinian state. Considerable progress was made toward these objectives, until the outbreak of the second "intifada" in 2000. Despite efforts to put the peace process back on track (the "road map"), the situation continued to deteriorate, culminating with the election of the Hamas-led government in 2006, the subsequent Israeli blockade and the effective division of WBG into separate political blocs for Gaza and the West Bank. Throughout all this time, the PA has struggled to maintain its relevance, keep up the reform effort, and prevent the ongoing economic crisis turning into a humanitarian disaster.

The role of the IMF

The IMF was mandated to engage with the PA under the Oslo Accords. The IMF cannot provide financial support to WBG (because it is not a member state), but it is able to provide policy advice in the macroeconomic, fiscal, and financial areas and it has been doing this since 1994. It has also been providing technical assistance with a focus on tax administration, public expenditure management, banking supervision and regulation, and macroeconomic statistics. Most recently, IMF staff worked with the PA to develop the Palestinian Reform and Development Plan presented at the Paris Donors' Conference in 2007. IMF staff reports reviewing progress in implementing the plan, with a focus on the macroeconomic and fiscal areas, have been taken into account by donors in their disbursement decisions (see www.imf.org/wbg for recent reports).

Following its creation in 1994, the PA began a program of reform and institution building, financing its operations from customs revenue (collected by the Israeli authorities on its behalf) and donor support. The worsening relations between the Israelis and the Palestinians in recent years has, however, resulted in frequent interruptions to the transfer of customs revenue and so the fiscal burden has fallen increasingly on foreign donors. The economic recovery that began in 1994 came to an abrupt halt in 2000 and then went into reverse in 2006. Between 2006 and 2008, real GDP per capita fell by about 5 percent. The rate of unemployment remains very high (20 percent in the West Bank and 40 percent in Gaza).

Despite these difficult conditions, the PA has managed to reduce the fiscal deficit (before grants) to 19 percent of GDP in 2008 from 24 percent of GDP in 2007. The PA has also made important progress in strengthening the Public Financial Management System (to help prioritize and raise the quality of public spending). The PA has also maintained tight controls on public sector employment and wages, implemented measures to improve the payment of utility bills, and repaid arrears.

The challenges ahead

The macroeconomic and fiscal outlook is subject to substantial risks. First, the timely disbursement of foreign aid and the full remittance to the PA of its share of customs revenues will be essential to avoid the re-emergence of liquidity problems and expenditure arrears. Over the medium-term, the implementation of civil service and pension reforms will also be needed to ensure fiscal sustainability. Second, private sector growth and investment and reconstruction in the Palestinian territories will continue to be severely hampered as long as the border and movement restrictions persist. Third, related to these physical restrictions, are the problems resulting from restrictions on cash transfers to banks in Gaza. This is reducing the ability of Gazans to cover their basic needs through cash payments, and also undermining the viability of the banks. Finally, it is important for the Palestinians to form a unity government that ensures the integration of Gaza and the West Bank and helps maintain the international community's support. Close cooperation between the Palestinian Authority, the Government of Israel, and donors will be essential to reduce these risks and enable a recovery of the Palestinian economy.

The West Bank and Gaza economy has so far not been significantly affected by the global crisis, due to the lack of strong banking and trade links with the rest of the world. Nevertheless, looking forward, the global recession could reduce growth in Israel. This would adversely affect Palestinian exports, although these now represent only 15 percent of GDP. Also, the global recession could reduce donor financing, as well as remittances from Palestinians in the Diaspora.