Overview Note

West Bank and Gaza

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Background

The Israeli-Palestinian conflict has been one of the most intractable and damaging conflict 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 its peaceful 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 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. The PA persisted with reforms, implemented since 2007 by Prime Minister Fayyad's government with assistance of the international community. In May 2011, the PA and Hamas signed a reconciliation agreement that called for the formation of an interim unity government and national elections within a year but implementation of that agreement has stalled

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. IMF staff also worked with the PA to develop the Palestinian Reform and Development Plan presented at the Paris Donors' Conference in 2007 and, more recently, its successor Palestinian National Development Plan, published in 2011. IMF staff reports reviewing progress in implementing the plans, 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).

Growth and Development

Real GDP per capita in WBG has fluctuated widely since 1994. From 1994 to 1999, the early years following the Oslo agreement, rising GDP per capita reflected increased private sector confidence and institution-building as the PA took over key administrative responsibilities from the Government of Israel, with open borders between Palestinian areas and Israel. From 2000 to 2002, real per capita GDP declined sharply with the unfolding of the second Intifada and sharp intensification of trade restrictions. From 2003 to 2005, it recovered to the

1994 level, in response to a limited relaxation of restrictions. Real GDP per capita then dipped again reflecting the onset of Gaza's blockade, before recovering in 2007 following the advent of Prime Minister Fayyad's government. Only by 2009, real GDP per capita in WBG had fully recovered to its 1994 level. The movement of overall real GDP per capita reflects a wide divergence in regional output paths. The West Bank's real GDP per capita has grown steadily since 2007 and is projected to be about 54 percent above its 1994 level by 2015. In contrast, Gaza's real GDP per capita has been on a downward trend since the blockade in 2006, with its recovery starting only in 2009. In Gaza, real GDP per capita is still 15 percent below its 1994 level. The improvement in macroeconomic conditions in the West Bank since 2007, and especially in 2009-2011, has reflected solid economic management by the PA, a relaxation of Israeli restrictions on movement and access as well as improved business confidence and substantial donor aid inflows. However, Gaza's situation remains difficult despite the lifting in mid-2010 of restrictions on imports of consumer goods and investment inputs for donor supervised projects. Severe restrictions remain in place on exports, on the movement of people across Gaza's external borders, and on private sector imports of raw materials and capital goods. The rate of unemployment remains very high (17 percent in the West Bank and 29 percent in Gaza), especially among young Palestinians (32 percent in WBG).

Public Finance and Financial Sector Reforms

Despite the difficult conditions, steady reforms in the public finance management system have enabled the PA to tightly control expenditures, apply budget preparation and execution practices, and establish fiscal transparency and accountability in line with international standards. These reforms, along with a prudent fiscal policy, have contributed to a rise in the quality of spending and a sharp reduction in donor aid for recurrent spending, from $1.8 billion in 2008 to $1.1 billion in 2010 (from 28 to 14 percent of GDP). However, this achievement has been marred by accumulation of payment arrears and domestic debt mostly owing to repeated shortfalls in aid disbursements. In 2011, aid declined to well below the level necessary to finance an already tight budget. The resulting liquidity difficulties were compounded by shortfalls in tax revenue. This led to substantial arrears to businesses and the pension fund, posing a serious risk to the PA's institution-building program and private sector growth.

The Palestine Monetary Authority (PMA)'s institutional reforms have enabled it to fulfill core functions of a central bank. These functions include the application of a rigorous banking supervision and regulatory framework, providing a strong credit and payment infrastructure, and monitoring compliance with a governance code and an anti-money laundering law. The PA has also made major strides since 2008 in raising the quality, transparency, and timeliness of the WBG's economic and financial statistics. The West Bank and Gaza met all the requirements of the IMF's Special Data Dissemination Standard (SDDS) in January 2012, and officially subscribed to the SDDS in April 2012, reflecting the best practices applied by the Palestinian Central Bureau of Statistics (PCBS) as well as by the ministries and agencies that provide the source data. Based on the track record of reforms and institution-building in the public finance and financial areas, IMF staff considers that the PA is now able to conduct the sound economic policies expected of a future well-functioning Palestinian state.

The Challenges Ahead

The WBG economy has not been significantly affected by the recent global crisis, due to the lack of strong trade and financial links with the rest of the world, and conservative banking practices. The spillovers from the regional events in 2010–11 had also been limited. However, the Palestinian economy has entered a difficult phase, with weakening growth in the West Bank due to persistent shortfalls in aid, slower easing since mid-2010 of Israeli restrictions on movement and access, the PA's fiscal retrenchment, and an increasingly uncertain domestic and regional political environment. Concerted actions by the PA, the Government of Israel, and donors are essential to stem the risks. The PA should maintain its solid track record by further improving revenue administration and accelerating key structural reforms. These reforms include implementing civil service reform, restoring the viability of the public pension system, continued strengthening of the social safety net, phasing out of electricity subsidies, and improving the legal and regulatory framework for businesses. Restrictions on movement and access should be eased to maintain the growth momentum, rebalance the composition of output, and reduce regional disparities. Finally, the timely disbursement of adequate donor aid is critical to cover the budget's financing requirements . This will stem liquidity problems and help the PA move in an orderly way toward fiscal sustainability in preparation for statehood.