INTERNATIONAL MONETARY FUND

WEST BANK AND GAZA

REPORT TO THE AD HOC LIAISON COMMITTEE[1]

March 9, 2018

KEY ISSUES

Geopolitical turbulence and concerns for the peace process are more elevated than in recent memory. Views of the international community have diverged following the United States' recognition of Jerusalem as Israel's capital. Despite renewed calls to revive the peace process, so far there is no agreed path forward. In the meantime, rigid border constraints, spending cuts, and threats of further donor funding declines have compounded the already perilous humanitarian conditions in Gaza, severely impacted the local economy, and increased the potential for unrest. Although progressing slowly, moves toward reunification offer a potential bright spot.

Reunification offers genuine, albeit limited, prospects for economic betterment, provided the associated challenges are handled well. In Gaza, growth could rebound in the near term to the high single digits and stabilize over the medium term at more than 5 percent per annum. These improvements could gradually reduce poverty and unemployment. However, without progress toward reunification, the Palestinian economy would stagnate at around 2⅓ percent growth, too little to generate enough jobs or meaningfully improve living standards.

These circumstances require a transformational, rather than transactional, approach to reforms *and* engagement. This means comprehensive reforms by the PA tailored to the circumstances of Gaza, and focused on enabling private sector-led growth and jobs more broadly. While reunification can provide impetus for reform, policies to contain fiscal imbalances, rebuild critical infrastructure, improve public service delivery, and ensure a financial stability remain equally important if reunification is slow or shallow. Given the substantial and heavily front-loaded costs of reunification, success also rests on securing additional donor financing, making tangible progress toward reducing fiscal leakages, and ensuring easier cross-border transactions. While economic prospects improve under reunification, there are also elevated risks if reunification fails to launch or proceeds without sufficient preparation.

[1] The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public expenditure management, banking supervision and regulation, and statistics. See www.imf.org/wbg for recent reports.

Approved By
Juha Kähkönen (MCD) and Yan Sun (SPR)

Discussions were held in East Jerusalem and Ramallah during February 4–14, 2018, and the report was updated to reflect subsequent developments. The staff team comprised Karen Ongley (head), Jean van Houtte and Ahmed Zorome (all MCD), Robert Tchaidze (IMF Resident Representative), and Hania Qassis (IMF Resident Representative Office). The mission met Finance Minister Bishara, Palestine Monetary Authority Governor Shawwa, Palestinian Central Bureau of Statistics President Awad, Minister of National Economy Odeh, other senior officials, donors, and private sector representatives. The mission prepared a concluding statement and issued a press release. Cecilia Pineda and Alexander de Keyserling also contributed to producing this report.

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POLITICAL CONTEXT

1. **Prospects for the peace process have ebbed to a new low.** The Palestinian Authority (PA) and most international partners rejected the United States' recognition of Jerusalem as Israel's capital in December. With views diverging among key stakeholders, there is currently no agreed way forward on the peace process. Almost all participants at the extraordinary meeting of the Ad Hoc Liaison Committee (AHLC) on January 31 reaffirmed their support for a two-state solution and restarting a political process to resolve the outstanding final status issues. In his recent address to the United Nations, President Abbas called for an international conference to establish a multilateral mechanism to advance the peace process, while Israel is calling for direct negotiations.

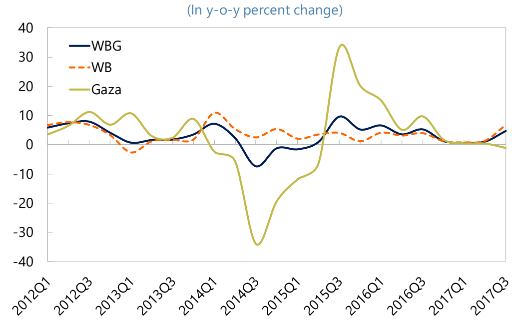
2. **Mounting socio-economic strains could test the security situation.** Palestinian protests and sporadic unrest followed the U.S. announcement on Jerusalem. Despite progress during 2017, economic dialogue between the PA and Government of Israel (GoI) has faltered since December. The alarming deterioration of humanitarian conditions in Gaza, amid chronic power and water shortages and exacerbated by PA spending cuts, provides fertile ground for unrest. Doubts about U.S. financial support for the PA and relief agencies are casting a shadow over the ability to avoid a deeper collapse in Gaza. Despite disruptions, security cooperation remains broadly on track, with both Israel and the PA trying to avoid an escalation. However, proposed new GoI laws intended to annex settler outposts in the West Bank and withhold PA revenue risk adding to tensions.

3. **Revived reconciliation efforts offer a path toward improved domestic conditions, but progress will be challenging.** Steps toward reunification are progressing slowly following the provisional Fatah-Hamas reconciliation agreement in Cairo last October. The first phase—transferring to the PA control of three border crossings into Gaza—has been partly completed, but may face further delays due to security concerns. Discussions on the handover of administrative control, including parameters of integrating Gazan employees into the PA civil service, are ongoing. Presidential and parliamentary elections that are expected to follow reconciliation would be tightly contested, amid waning support for Fatah and lack of succession planning. The strained geopolitical context could make it difficult to make progress on reunification or organizing elections.

RECENT DEVELOPMENTS

4. **Economic activity is strained.** Real GDP growth for the first three quarters of 2017 averaged around 2½ percent, down from 4.1 percent in 2016. Growth was generated almost entirely in the West Bank, led by construction, trade, and manufacturing. As the PA continued to adjust in the face of lower donor funding, and households and businesses ran down their economic and financial buffers—most acutely in Gaza—liquidity constraints held back consumption and investment.

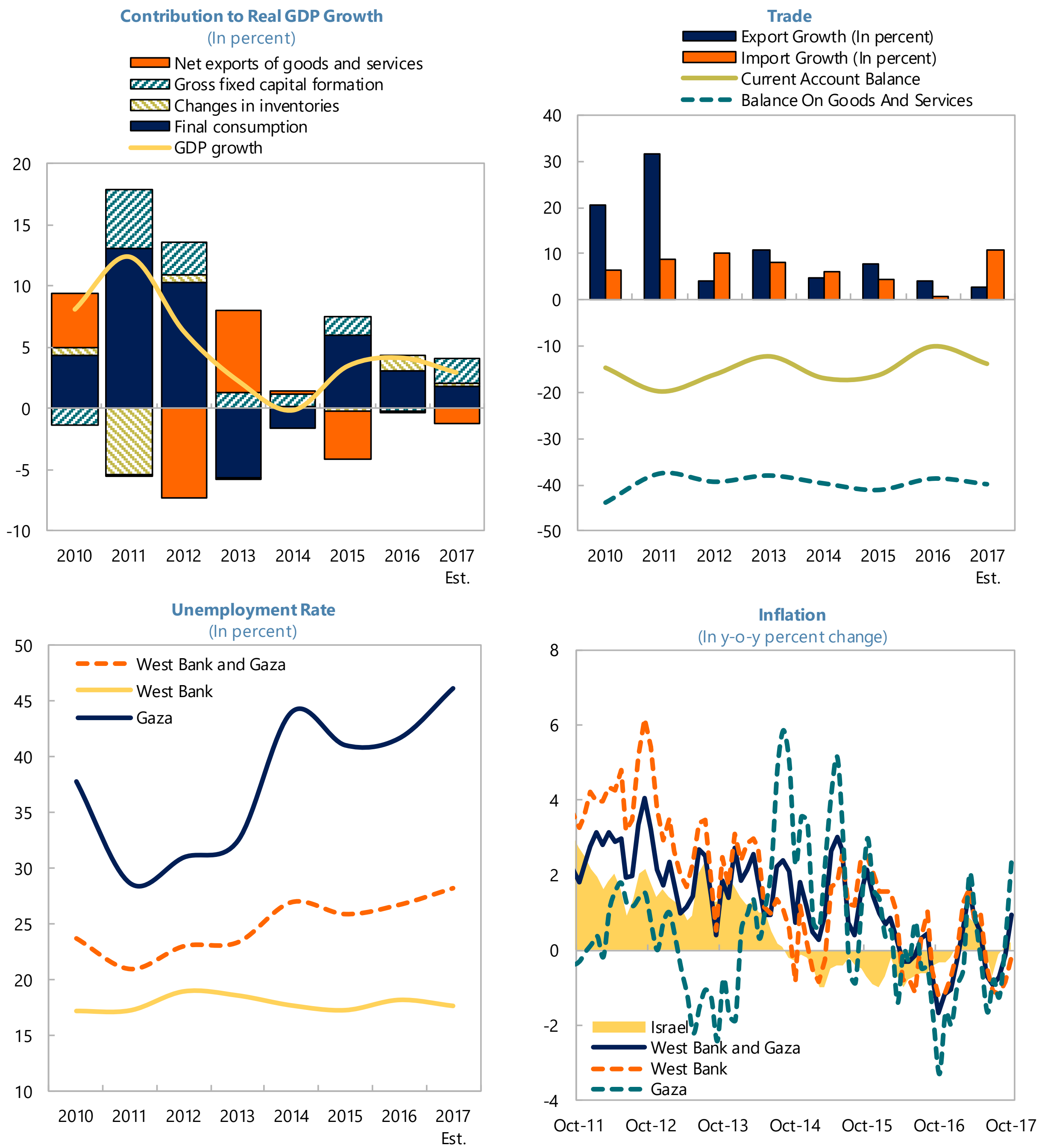
Real GDP Growth, 2012-2017Q3
(In y-o-y percent change)



Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates.

While early indicators provide a mixed picture of the fourth quarter, staff estimates growth will remain below 3 percent for the year.

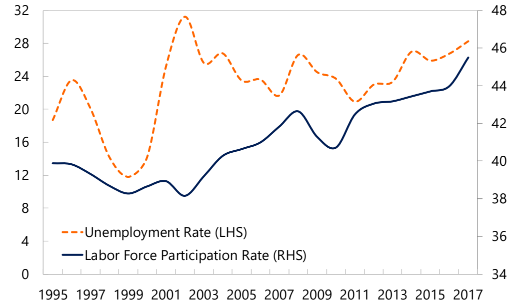
Figure 1. West Bank and Gaza: Recent Economic Developments, 2010–17



Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates and projections.

5. Socio-economic conditions continue to stagnate in the West Bank, with deeper concerns in Gaza. Unemployment improved somewhat in the West Bank at end-2017, falling below 14 percent, although it remains near 43 percent in Gaza. As economic opportunities remained scarce, labor force participation in both regions is only 44 percent (with women more disadvantaged with participation below 20 percent). Poverty remains entrenched, especially in rural areas and Gaza. Both employment and household survey data highlight the dire situation in Gaza, where youth unemployment topped 60 percent.

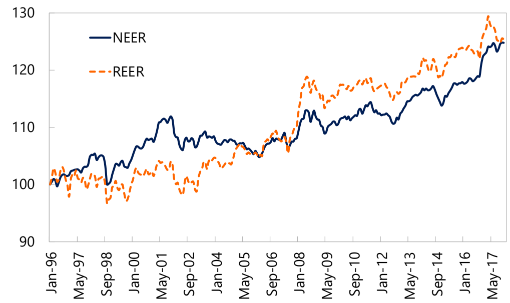
Labor Market Developments
(In percent)



Sources: Palestinian Central Bureau of Statistics; and IMF staff estimates.

6. Inflation remains subdued, with overall prices declining by 0.3 percent in January (y-o-y). The continued appreciation of the shekel in 2017 had a deflationary effect on the prices of imported goods, while the price of food, which is largely produced domestically or in Israel, remained low. Nevertheless, competitiveness did not improve as the real effective exchange rate continued its appreciating trend and non-price factors (e.g., the broader security situation and the impact of Israeli restrictions on the ease of trading and investing) remain a dominant factor.

Effective Exchange Rate
(Index, Jan 1996 = 100)



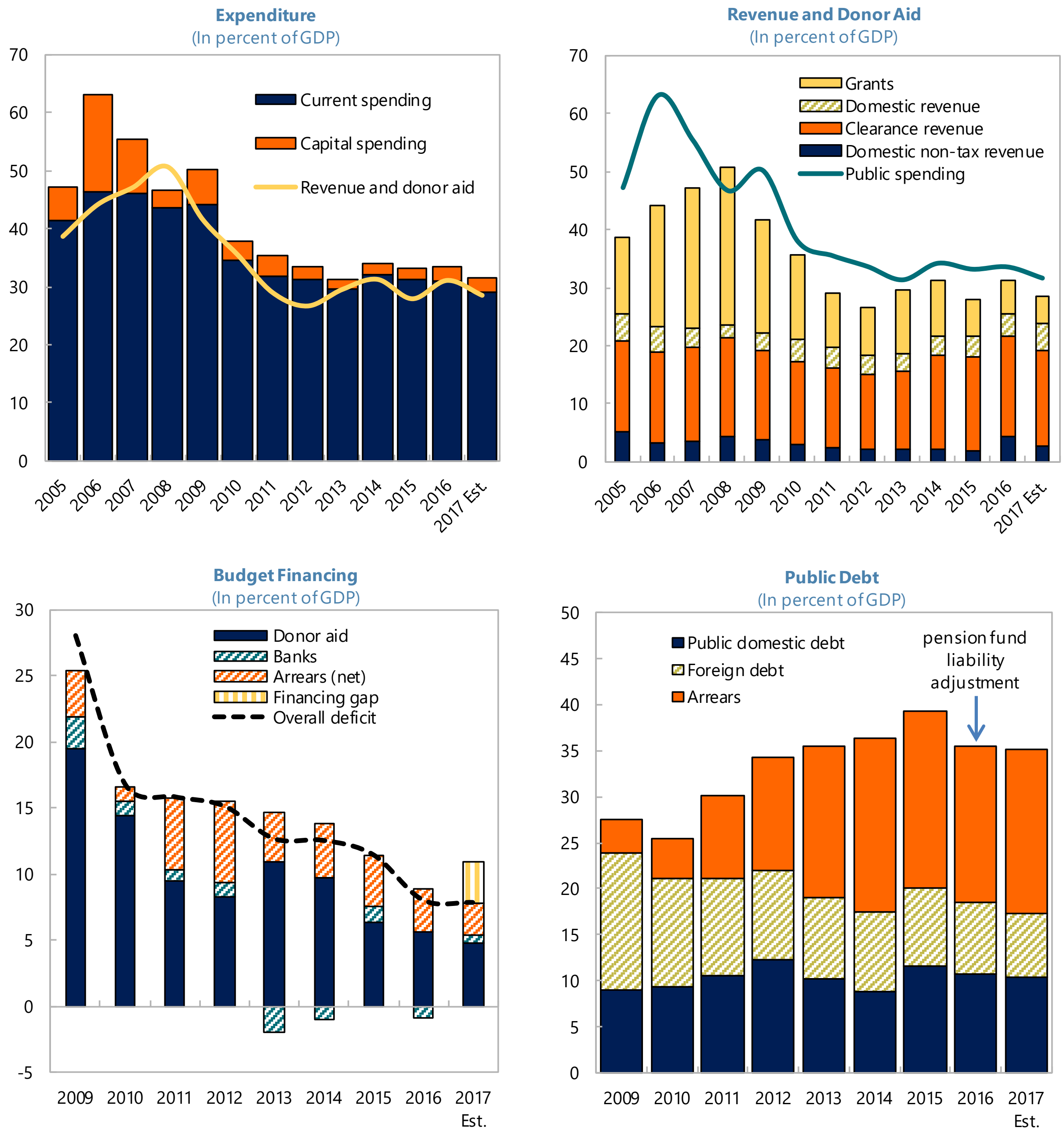
Notes: An increase indicates appreciation. Weights based on 2015 trade data.
Sources: Haver Analytics, Information Notice System; and IMF staff calculations.

7. Fiscal performance in 2017 was better than expected. The authorities contained the overall deficit to 7.8 percent of GDP and the recurrent deficit to 5.3 percent of GDP, similar to 2016. Total revenue declined by only 1.7 percentage points of GDP as the strong performance of domestic customs revenue and income taxes ameliorated weaker non-tax revenue (e.g., absent telecom license payments) and still-high tax refunds (i.e., subsidies). Average monthly clearance revenues (CRs)[2] from Israel were slightly higher, with payments to settle legacy claims in late 2017 broadly offsetting the large one-off payments in 2016. The PA kept overall spending in check, down by 0.8 percentage points of GDP, mainly due to underspending on goods and services, and reduced outlays in Gaza (retrenchments, and cuts to allowances and electricity subsidies).

8. However, the precarious fiscal financing situation hampered efforts to reduce arrears. As donors stepped back further in 2017, external budget support declined to 3.6 percent from 4.5 percent of GDP in 2016. However, the PA continued repaying old arrears to the private sector and kept borrowing from banks within the regulatory limit. As a result, staff estimates that the PA accumulated $361 million in new arrears, mainly to the pension fund and for health care referrals.

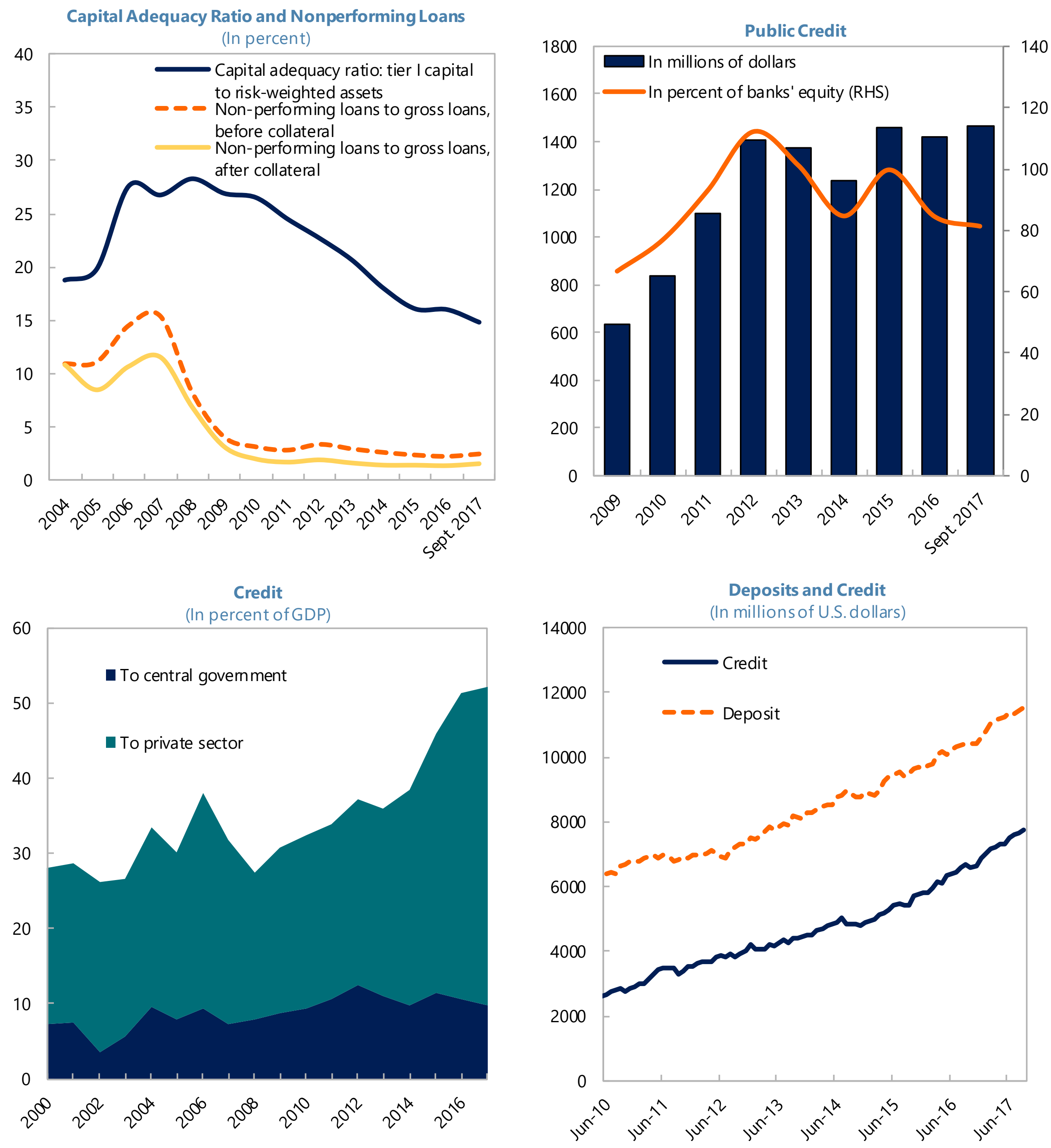
[2] Revenue transfers refer principally to clearance revenue (i.e., mainly indirect taxes) collected by Israel on behalf of, and later transferred to, the PA.

Figure 2. West Bank and Gaza: Fiscal Sector Indicators, 2005–17



Sources: Ministry of Finance and Planning; and IMF staff estimates and projections.

Figure 3. West Bank and Gaza: Financial Sector Data, 2000–17



Source: Palestinian Monetary Authority.

9. Financial sector pressures continued to rise as prudential ratios deteriorated further.

- Credit to the private sector continued its double-digit growth, ebbing only slightly as growth weakened, and remains concentrated in consumption, construction, and trade finance. The capital adequacy ratio continued to decline, reaching 17.6 percent in December 2017.
- While nonperforming loans (NPLs) edged up, the number of delinquent creditors increased sharply (particularly in Gaza, and among small and medium-sized enterprises (SMEs)). With the PA cutting allowances of civil servants in Gaza in 2017, the Palestine Monetary Authority (PMA) granted an emergency waiver on provisioning. However, the resulting decline in provisions in percent of NPLs (from 65.8 percent to 58 percent in the year to December 2017) points to increased vulnerabilities.
- While banks' direct lending to the PA remains comfortably below the regulatory limit (and broadly unchanged during 2017), they have a similar level of additional exposures to the PA via credit to PA employees and holdings of promissory notes. Moreover, two non-systemic banks remain particularly vulnerable with an exposure of about 50 percent or above.

10. Efforts continue to maintain effective Israeli-Palestinian banking relations. A new, higher limit on transferring shekel cash from the West Bank to Israel, in place since late 2017, should help alleviate pressures in managing excess liquidity for banks operating in the West Bank. The authorities are close to finalizing their National Risk Assessment (NRA), with World Bank support, in preparation for a comprehensive evaluation of WBG's anti-money laundering and combatting the financing of terrorism (AML/CFT) regime. Temporary financial and judicial assurances proposed by Israel in January 2017 to help preserve CBRs are being finalized.

OUTLOOK AND RISKS

11. The resilience of the Palestinian economy in the face of long-standing political and security constraints is being tested. Geographic fragmentation, the scarcity of productive capital,[3] and restrictions on movement and access severely constrain the potential for private sector-led growth. The geopolitical situation in and around the region is more strained than usual, and prospects for the Palestinian economy are highly uncertain. Against this backdrop, the erosion of economic and political buffers is increasingly a binding constraint on growth (Box 1).

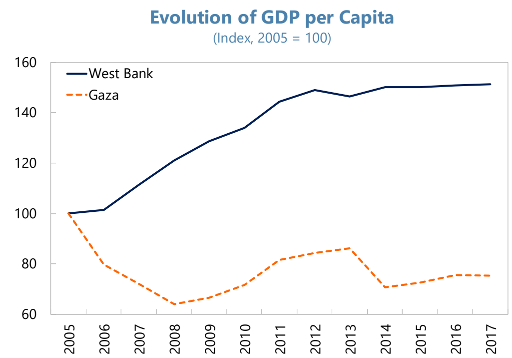
12. Absent clear progress toward reunification, the economic outlook will remain bleak. Under a "business-as-usual" scenario—assuming no major policy changes, no reunification, no escalation of unrest, and no change in the peace process—growth would stagnate at around 2⅓ percent over the medium term (2.1 percent in the West Bank and 2.8 percent in Gaza). In these circumstances, the lack of fiscal space and financing, and increasing vulnerabilities in the financial sector leave little room for policy maneuver. With growth falling below population growth, this would see rising unemployment and declining real per capita incomes.

[3] See Annex III of IMF staff's August 2017 *Report to the AHLC*.

Box 1. The Risk of Eroding Economic and Political Buffers

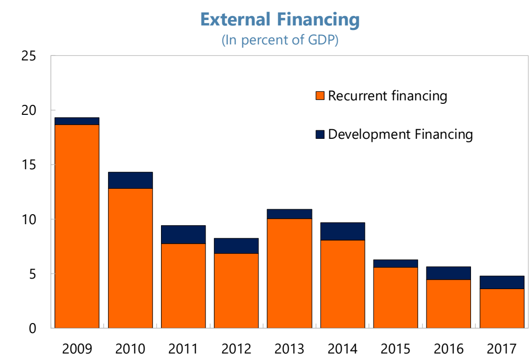
Strains on the Palestinian economy are more evident, particularly in Gaza where the humanitarian costs are mounting. While reconciliation cannot substitute for the ultimate breakthrough on peace, it can provide the basis for reunification and much needed economic progress. However, the steady erosion of economic buffers leaves the economy more susceptible to risk and with little room for policy maneuver.

After a decade of near isolation, an escalating humanitarian crisis looms over Gaza. Since 2007, Gaza has experienced near constant closure of its borders, and economic and political relationships with the West Bank have been curtailed. Previous staff analysis suggests that political uncertainty and conflict contributed to a virtual collapse in Gaza's productive capacity,[1] severely impairing infrastructure and the provision of basic services (power, clean water, medical assistance). With the widening gap between per capita income in Gaza and the West Bank, soaring youth unemployment, and diminished personal savings, Gazans have few remaining economic buffers.



Sources: IMF World Economic Outlook and IMF staff calculations.

While reunification can help, the PA's strained finances and dwindling donor support severely limit the policy response. Since 2014, donor aid to the PA has declined on average by 20 percent a year. Persistent declines in budget support can force further expenditure compression or arrears accumulation. This limits the resources available for investing in infrastructure and people, and can impede the PA's ability to cushion the loss of funding to relief agencies (e.g., UNRWA) or take on their quasi-governmental operations (e.g., schools and hospitals). With a significant share of Gaza's population dependent on international assistance, loss of funding could directly harm the economy or increase human hardship.[2]



Source: Ministry of Finance and Planning.

Political buffers—the degree of trust and cooperation—are also running thin at a time when political will and flexibility are most needed. Shifting geopolitical positions and regional alliances are another layer of strain. Reunification efforts in such an evolving situation will prove challenging. The PA now questions the role of the U.S. as the main mediator and is calling for internationalizing the peace process.

Declining economic and political buffers put WBG at a crossroads. While the economy's development can only go so far without clear progress on the peace process, reunification could help alleviate economic hardships. However, it is an increasingly challenging undertaking. Its success will require a fundamental shift in policies and engagement: reigniting donor support, managing the fiscal costs of integration, easing the severe access restrictions to and from Gaza, and broad support from key geopolitical actors.

Prepared by Hania Qassis and Robert Tchaidze.

[1] See Annex III of IMF staff's August 2017 *Report to the AHLC*.

[2] For instance, more than two-thirds of the population are registered as refugees under UNRWA. In 2017, UNRWA employed more than 30,000 Gazans, either directly or through its cash-for-work and construction projects.

13. Risks continue to escalate (Annex I). Even the "business-as-usual" scenario is vulnerable to the risk of further declines in donor support (for the PA or relief agencies) or widespread social unrest, which would lead to lower growth. Geopolitical uncertainties exacerbate these risks and the potential for unrest reflects not only the sustained dearth of economic opportunity, but possible unfulfilled expectations of reunification, delayed development policy initiatives given divergent priorities among external partners, or lack of political clarity or prospects for peace. The threat of disruptions to Israeli-Palestinian correspondent banking relations (CBRs) remains a persistent economic and financial risk.

14. While reunification could provide a basis for sustained economic improvements, this depends on fundamentally stronger policies by the PA and engagement by all stakeholders. Gaza's accession to a new development path requires rebuilding its depleted productive capital base and grossly inadequate infrastructure, and reducing the distortions caused by economic isolation. These structural constraints can only be alleviated over time, but the fiscal costs will be large and up-front. Staff's illustrative "reunification" scenario points to a sustained but modest boost to growth over the medium term (Box 2).[4] This is contingent on meeting the fiscal costs through PA reforms and donor support, *and* a sufficient easing of restrictions to allow materials to enter for infrastructure projects and for trade more broadly. While reunification could yield a larger peace dividend if it helps revive the peace process, this scenario is not predicated on it. Shifting to a much higher sustained growth path still depends on a breakthrough in the peace process.

POLICY DISCUSSIONS

The Palestinian economy is nearing a crossroads. Despite long-standing political and security constraints, particularly Gaza's decade-long isolation, the economy has continued to grow, albeit not fast enough. However, with fewer buffers to sustain growth and increasing geopolitical uncertainties, the economy's resilience is being tested. The prospect of reunification—and the PA resuming administrative control of Gaza—promises to normalize economic life, improve public service delivery, and give new momentum to growth. The authorities are positioning themselves to capitalize on this opportunity. This will not be easy, not least because of the large fiscal costs. Discussions focused on the priorities for successful reunification and, given the higher stakes, the imperative of deeper policy reforms, stronger Israeli cooperation, and reigniting donor support.

A. Managing the Fiscal Costs of Reunification

15. Given the ongoing reunification discussions, staff welcomed the thoughtful approach to the 2018 budget. The authorities outlined a multi-step budget: a core budget representing a continuation of current policies; and a Gaza-specific supplement that would become effective once

[4] Staff previously assessed that growth would need to consistently exceed 4 percent to absorb new labor market entrants. This remains valid under current demographic pressures. See Box 1 of IMF staff's August 2017 *Report to the AHLC*; and Kock, Sumlinski and Qassis, *West Bank and Gaza: Labor Market Trends, Growth and Unemployment*, 2012.

Box 2. Illustrative Scenario—Macroeconomic Implications of Palestinian Reunification

A comprehensive and lasting reunification between Gaza and the West Bank holds the promise of improved economic conditions, particularly in Gaza. However, realizing the macroeconomic benefits depends on all stakeholders—the PA, Israel and donors—comprehensively addressing the fiscal costs.

In October 2017, Fatah and Hamas signed a provisional reconciliation agreement in Cairo. The agreement affirmed the creation of one executive, one parliament, and one judiciary. Elections for the presidency and a new unified parliament are expected to follow.

The PA resuming control over Gaza will require merging the administrative and policy frameworks, which will have direct budgetary implications.[1]

- Illustratively, integrating up to 20,000 Gazan civil servants (but not security personnel) could cost up to an additional 1.5 percent of GDP annually. Reopening government ministries would add another 1.5 percent of GDP annually in non-wage operating expenses.
- Immediate infrastructure investments will be required to achieve basic public service delivery (water, sewage, electricity) in Gaza. These could also cost around 1.5 percent of GDP.
- While reunification will generate revenues, these would be modest at first given the high incidence of poverty and the time it will take to redeploy the tax administration in Gaza. Staff takes a conservative approach and this scenario does not rely on these revenues.

The scenario also assumes the PA will implement mitigating measures[1]—primarily, revenue reforms—that could amount to 1½–2 percent of GDP. However, additional expenditure savings could yield over 1 percent of GDP. Given it will take time to agree on the parameters of reunification, the scenario assumes only a half-year effect in 2018, with a full-year effect from 2019 onwards.

This scenario also assumes that donor projects gather pace and, over time, would be joined by increased private investment. To provide a real impetus to the economy and revenue intake, any boost in investment would need to be matched by a sufficient easing of restrictions on the entry of goods and services.

All in all, reunification could increase growth to 8 percent in Gaza in the near term, and more than 5 percent thereafter. The WB economy would also benefit (for instance, private suppliers increasing trade with Gaza), with growth slated to exceed 3 percent in the near term and hover around 2⅔ percent thereafter.

Even with reforms and mitigation measures, reunification would increase the financing gap for the foreseeable future. These budgetary considerations, which are reflected in the authorities' 2018 budget plans, are a central part of the policy discussions. However, additional measures or donor support would be crucial to closing the larger financing gap and boosting growth.

Selected Macroeconomic Indicators, 2017–19

	Est.	Baseline Scenario		Reconciliation Scenario	
	2017	2018	2019	2018	2019
	(Annual percentage change)				
Real GDP	2.9	2.3	2.3	4.3	4.3
West Bank	2.9	2.1	2.1	3.1	3.1
Gaza	3.0	2.8	2.8	8.0	8.0
	(In percent of GDP)				
Revenues	23.8	24.0	23.9	24.7	24.9
Recurrent expenditures and net lending (commitment)	29.1	29.3	29.2	30.4	31.0
o/w Wage expenditures	14.1	14.1	14.0	14.7	15.2
o/w Nonwage expenditures	13.2	13.3	13.5	13.9	14.5
Recurrent balance (commitment, before external support)	-5.3	-5.3	-5.3	-5.7	-6.1
Development expenditures	2.4	2.4	2.4	3.2	3.2
Overall balance (commitment, before external support)	-7.8	-7.7	-7.7	-8.8	-9.3
Financing gap (in percent of GDP)	...	3.3	3.7	4.1	4.9

Sources: West Bank and Gaza authorities; World Bank; and IMF staff estimates and projections.

Prepared by Jean van Houtte.

[1] Discussed further in the context of the policy discussions. See section "A. Managing the Fiscal Costs of Reunification."

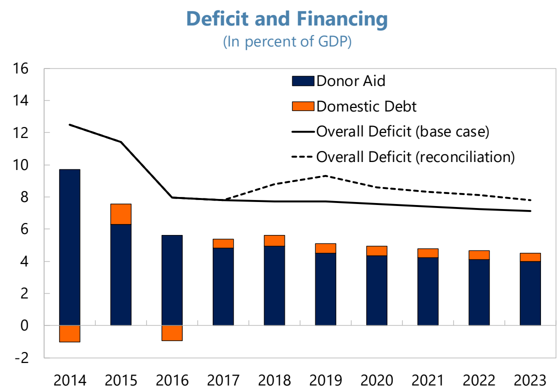
there is political agreement on how to reunify the civil administrations of Gaza and the West Bank. The budget also proposes two sets of reforms: a package of mostly revenue-enhancing reforms to help narrow the financing gap; and separate emergency measures to help ameliorate the costs of the Gaza-supplement. Staff noted this approach enables the authorities to effectively implement the core budget without further delay, while also allowing a nimble and prudent response once there is a political agreement on reunification.

16. The authorities and staff recognized that, even if reunification does not proceed this year, the continuation of current policies would imply a large fiscal financing gap in 2018. Revenue performance is expected to improve only marginally, reflecting sustained administrative improvements in customs and income taxes from 2017. Expenditures would increase by 0.2 percentage points of GDP, with the reversal of the 2017 subsidy cut for electricity to Gaza and a 3.2 percent increase in wages. The overall deficit would therefore remain virtually unchanged at 7.7 percent of GDP. Despite a small boost to external financing relative to 2017, staff projects a still sizable financing gap of 3.0 percent of GDP, making a further accumulation of arrears unavoidable.

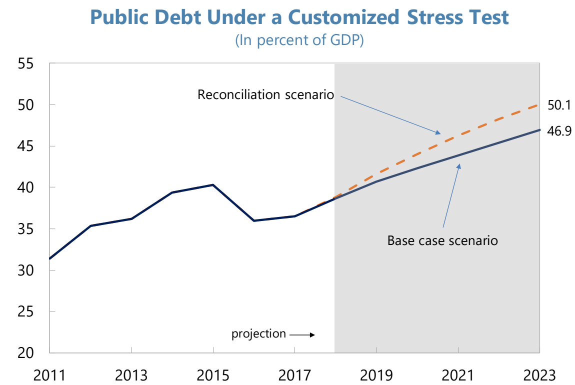
17. The authorities underscored the large fiscal costs of resuming control over Gaza. The spending needs in the Gaza-supplement, as reflected in staff's reunification scenario, center on reintegrating civil service employees, reopening government agencies, and investment to address crucial infrastructure gaps. The immediate costs are expected to outweigh the near-term revenue gains. Staff estimates that the addition to the deficit could initially approach 4½–5 percentage points of GDP annually, with the impact dissipating after the initial investment surge. Depending on the number of Gazan civil servants and the terms of their reintegration (Box 3), the annual addition to the wage bill would be 1–2 percent of GDP.

18. Staff welcomed the authorities' proactive approach to developing a reform package. The package of proposed revenue measures aligns well with staff's earlier policy advice, including increasing the top corporate income tax rate to 20 percent, redesigning income tax brackets, re-activating the 10 percent dividend withholding tax, and reducing net lending. The emergency measures that the authorities are considering, such as rationalizing largely inefficient investment tax incentives, are also generally in keeping with past IMF technical assistance (TA). Staff estimates that, collectively, these measures could mitigate the financing gap by around 2 percent of GDP annually.

19. Even though the authorities' mitigation measures would have an important immediate impact, they would not fully offset the cost of reunification. Assuming reunification is initiated mid-year, the overall deficit could grow to 8.8 percent of GDP in 2018 (more than one percentage point of GDP higher than the "business-as-usual" scenario). The full-year effect becomes apparent in 2019, with the overall deficit under the reunification scenario reaching 9.3 percent of GDP. Even if the authorities' planned reforms consistently deliver, the medium-term fiscal outlook worsens significantly, with financing gaps of more than 4 percent of GDP and a less sustainable debt profile.



Sources: Ministry of Finance and Planning; and IMF staff calculations.



Sources: Palestinian authorities; and IMF staff.

20. Staff urged the authorities to adopt an even wider set of fiscal reforms. The current situation offers an opportunity to undertake long-needed fiscal reforms—it calls for a more transformational, rather than transactional, approach to reform. However, the depth of WBG's fiscal constraints calls for immediate action irrespective of progress toward reunification. A balanced mix of expenditure, tax policy, and fiscal structural reforms could help secure fiscal sustainability by: (i) reducing the deficit directly; and (ii) encouraging faster GDP growth by creating fiscal space for productive public investments while setting the right incentives for entrepreneurs.

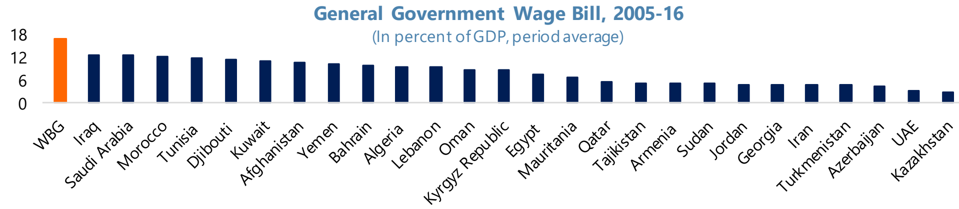
- Rather than undertake further revenue reforms in an incremental way, staff suggested a comprehensive review of tax and non-tax revenue policies. Past IMF TA suggests that there is scope, beyond the measures already being considered, to increase the tax intake and improve progressivity. Possible revenue reform options include simplifying the regime for SME taxation, raising the VAT threshold, and reforming property taxation (see Annex III). The authorities expressed interest in further TA on comprehensive tax reforms. Staff noted that these reforms would not negate the need for more active progress toward reducing leakages from CRs, which could generate significant revenue, but depends critically on Israeli cooperation.

- The prospect of a permanent increase in the already oversized wage bill gives added importance to the need for expenditure reforms, anchored in a comprehensive civil service review. The World Bank's 2016 Public Expenditure Review includes recommendations that remain valid and may be easier to introduce as the civil services merge. While understanding the importance of such reforms, the authorities emphasized the need for caution in the current environment. Other priorities include reforming the electricity sector and pension system, and reducing fuel subsidies which could generate upward of 1 percentage point of GDP annually.

- The authorities' 2017 Public Financial Management (PFM) strategy needs to be implemented in earnest. They noted progress toward closing the audit of the 2013 financial accounts, and initiating a bundled audit for years 2014–16. Staff urged further PFM reforms, with a special focus on addressing weaknesses in debt and cash management to help ensure resources are used efficiently and facilitate new expenditure. Staff and the authorities discussed the importance of coordinating with international partners to fill technical gaps without delay.

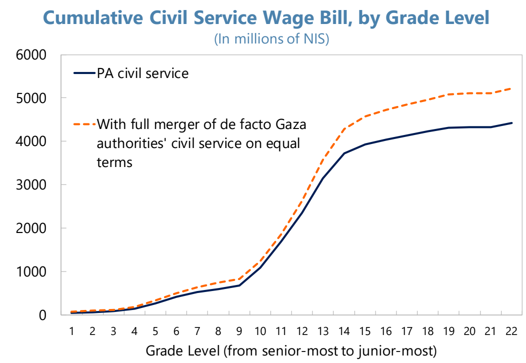
Box 3. Wage Bill Pressures and the Need for Comprehensive Civil Service Reform

The public wage bill in WBG has long been high by international standards. Both relative to GDP and as a share of expenditures (almost half), the wage bill compares unfavorably to comparators.[1] While base wages are broadly adequate and the distribution of civil servants is not top-heavy, allowances are high and the number of civil servants is high in some departments.



Sources: IMF, World Economic Outlook; country authorities, and staff estimates.

Reunification would add to these pressures. The need for a political breakthrough to gain momentum on reunification will mean that the merger options are unlikely to be cost neutral. For instance, a merger on equal terms mirroring the PA's existing civil service structure would increase the wage bill by up to 1.5 percentage points of GDP. This assumes 20,000 Gazan civil servants (excluding security personnel) are added to the PA civil service (excluding security personnel) at a grade distribution mirroring the PA's civil service.



Sources: Palestinian Authority; and IMF staff projections.

While other approaches might be somewhat less costly, they would fall short of achieving a sustainable wage bill. They might also raise other concerns about fairness or political feasibility. Absorbing Gaza civil servants on a lower grade distribution could limit the wage bill increase, but would still add significantly to fiscal imbalances, and risks alienating Gaza civil servants if they feel they have been treated unfairly. A merger on equal terms, but adjusting key parameters of the wage bill for the new unified civil service could still see a net increase in the wage bill. Negotiations over allowances, numbers of grades, staffing by department and location, etc. could be protracted and risk delaying reunification.

Reunification raises the stakes on much-needed civil service reform in WBG. At more than 14 percent of GDP in 2017, the wage bill is not sustainable. It compromises a productive expenditure mix, crowding out vital public investment. By permanently raising the wage bill, reunification amplifies the need for comprehensive civil service reform that is mindful of: (i) the sustainability of the wage bill; (ii) the quality and equity of public service delivery; (iii) merit-based career management; and (iv) synergies with reforms in other policy areas and the economy. A successful merger also requires carefully managing the transition, including sequencing reforms.[2] Important considerations include: the need to model fiscal aspects of civil service reform to understand alternative proposals; a communication strategy that involves key stakeholders; and some time-bound compensation to offset the losses of the PA's current employees.

Prepared by Jean van Houtte.

[1] See the "Cross-Country Public Expenditure Diagnostic" (Annex III) in IMF staff's August 2016 *Report to the AHLC*; and the World Bank's *Public Expenditure Review of the Palestinian Authority—Towards Enhanced Public Finance Management and Improved Fiscal Sustainability*, June 2016.

[2] See *Public Wage Bills in the Middle East and Central Asia*, IMF, 2018.

21. Alongside comprehensive reforms, a fundamental shift in Israeli and donor engagement will be vital for reunification to succeed. This means faster progress on reducing fiscal leakages, easing restrictions to facilitate trade, and a significant increase in donor flows. Absent that, forced arrears accumulation would choke the economies of both West Bank and Gaza, with deleterious effects on suppliers, banks, and ultimately growth. The scarcity of resources underscores the need for all parties to adopt a holistic approach: carefully prioritizing investment projects *and* providing sufficient support to maintain effective public policies and institutions.

B. Building an Open and Unified Platform for Growth

22. The authorities and staff agreed that successful reunification and broader economic improvement rest in large part on improved access to external markets, which requires the active involvement of Israel. Staff welcomed the operationalization of one scanner on the Jordanian border and progress in readying the industrial zone near Hebron, with Israeli cooperation. They inquired about the possibility of replicating this concept for Gaza, where security and political considerations have hampered the business environment even more. The authorities noted delays in implementing new initiatives, like the electronic payment of wages of Palestinian workers in Israel, and the stifling effect on economic diversification of Israel's expanded "dual use" list of goods.

23. Staff stressed that the PA can also continue efforts to improve aspects of the enabling environment within its control. Despite welcome progress, the business environment remains difficult, with excessive red tape, burdensome security restrictions, and limited public infrastructure.[5] Staff welcomed the lifting of Israeli restrictions to WBG operators providing 3G mobile services from January 2018. They encouraged both parties to finalize the power purchase agreement to supply electricity to the West Bank and consider its coverage of Gaza. The authorities noted that they will soon pass the new Companies Law, but have faced difficulties in advancing laws on competition, tenancy, and property rights. Improving and enforcing the rules governing the PA's activities in the context of PFM reforms (e.g., procurement, payment programming) can reinforce efforts to ensure a more hospitable business environment. Moreover, shifting the PA's expenditure mix toward infrastructure could improve the prospects of bailing in more private investors. Finally, staff also cautioned against the creation of new, exceptional, and complex tax regimes[6] that do little to alleviate the obstacles to growth, and undermine fiscal sustainability.

C. Gearing the Financial Sector to Support Economic Normalization in Gaza

24. Staff emphasized that strengthening and sustaining growth also requires active regulatory oversight to address growing financial sector risks.

- The authorities highlighted their progress in promoting financial inclusion. Staff commended these efforts, but underscored the importance of managing this so as not to jeopardize financial

[5] The World Bank's Doing Business Indicators recorded a pronounced improvement in WBG's ranking—from 140 in 2017 to 114 in 2018—due largely to a marked improvement in access to credit.

[6] The persistence of multiple definitions for an SME contributes to fragmenting incentive frameworks.

stability. In the longer run, a sound and well-understood financial sector will provide the basis for greater financial inclusion, particularly in Gaza (Box 4).

- Staff cautioned that some indicators—capital adequacy, delinquent loans, and bounced checks—have worsened, calling for closer scrutiny and corrective actions. The authorities noted plans to increase bank capital by mid-2018. They also pointed to the more than threefold increase in onsite inspections in 2017 and the resulting sanctions imposed on several banks, mostly for minor AML/CFT violations. While the waiver on provisioning for Palestinian banks operating in Gaza was a necessary emergency measure in the wake of last year's allowance cuts, as the situation has become more protracted staff supports the authorities' plans to remove it in March. The authorities should also be attentive to financial risks associated with possible UNRWA funding cuts.

- While private sector credit growth eased as activity slowed during 2017, it still averaged close to 20 percent for the year. Staff noted that rapid credit growth within the limited pool of corporates, some of which are connected, increases banks' exposure concentration. Staff urged the PMA to make full use of both its macro- and micro-prudential toolkits. They also encouraged the authorities to develop a comprehensive measure to monitor the financial sector's direct and indirect exposure to the PA. They also noted the rise in credit to consumers from non-bank financial institutions beyond the PMA's purview as a potential regulatory gap.

25. While Israeli-Palestinian CBRs remain intact, sustained action is needed to quell persistent risks. The PMA committed to continue improving its AML/CFT regime, benefitting from IMF TA and the World Bank-supported NRA. The authorities remain committed to a comprehensive evaluation of WBG's AML/CFT regime commencing in 2020. The authorities and staff welcomed the interim solution as a constructive move to manage the threat to CBRs. However, staff pointed out that risks may persist given the Israeli authorities' condition of an IMF-led AML/CFT evaluation. Hamas-Fatah reconciliation may also heighten the perception of CBR risks in Israel. Staff encouraged direct talks between the two sides.

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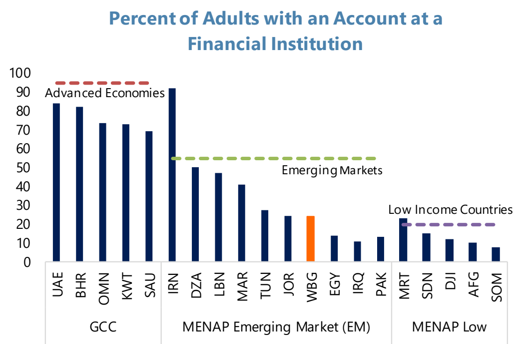
26. WBG faces a serious ratcheting-up of geopolitical tensions, and a materialization of risks could set back development significantly. Although GDP growth is estimated at close to 3 percent in 2017, the economic outlook has become more tenuous, and prospects of meaningful gains in the fight against unemployment and poverty remain dim. Moreover, the commitment to reunification (and associated electoral processes) and the tension around the viability of the two-state solution have increased the pressure on the PA to deliver results in the near term. This sense of urgency could be used to launch important structural reforms that have been prepared in past years.

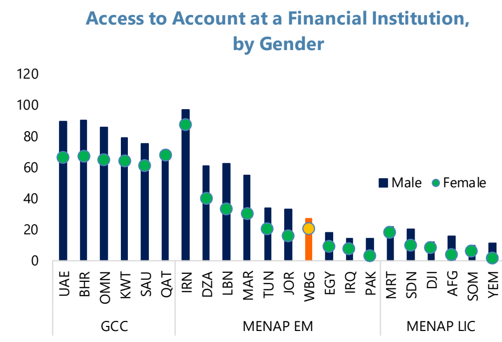
27. Despite a limited policy toolbox and the tense context, reunification could give more momentum to growth, especially in Gaza. It could provide a basis to lessen Gaza's international

Box 4. Responsibly Promoting Financial Inclusion in West Bank and Gaza

The West Bank and Gaza (WBG) authorities have embraced a policy agenda to promote greater financial inclusion. Their July 2017 *National Strategy on Financial Inclusion* aims to raise the share of financially included adults from about 36 percent[1] to 50 percent by 2025. This builds on a range of earlier initiatives, including campaigns to raise awareness regarding a "Primary Bank Account for Each Citizen" (2012) and the "Child and Youth Banking Week" (2013). In recent years, the PMA also introduced a credit registry, a credit scoring system, and a bounced checks system to facilitate lending.

Despite progress, there is significant scope to improve access to financial services. Credit to the private sector and deposits have grown rapidly since 2009, and banks have expanded their branch networks. Yet, WBG lags comparator countries in terms of the adult population's access to financial services. Electronic and mobile transactions are in their infancy, and significant numbers of Palestinians still rely on cash. As is common in the region, women and refugees are particularly vulnerable. Less than 10 percent of Small and Medium Enterprises (SMEs) use banks to finance investment compared to 24 and 28 percent in MENA and lower middle-income countries.[2] However, the authorities emphasized the recent growth in credit to SMEs.





While most factors hampering greater financial inclusion are not uncommon, others reflect WBG's unique circumstances. Seventy five percent of adults[3] cite lack of money as the main reason for not having a bank account. Other impediments include limited financial awareness and literacy, lack of affordable products and services, or products and services that are not well matched with the needs of the unbanked. Religion does not appear to be a major barrier to account ownership, but some 18 percent of adults choose not to patronize the financial system for religious reasons. Infrastructure gaps linked to the political and security environment have impeded the development of mobile banking. Internet penetration is estimated at 61 percent,[4] compared to 80 percent in neighboring Jordan and Israel. Palestinian operators will be able to commence providing 3G mobile services, following the lifting of Israeli restrictions in January 2018.

Reforms to expand the reach of financial services can benefit inclusive growth, but so too are efforts to address the associated supervisory risks and preserve financial stability. In the near term, authorities need to provide an enabling regulatory framework for the development of mobile payment services and explore ways to prudently increase the reach of microfinance institutions. Strengthening insolvency and credit rights would facilitate lending to SMEs. Over the medium term, measures to foster financial literacy (including well-targeted information campaigns) could enhance banks' penetration. Structural constraints also need to be tackled, including modernizing the communications infrastructure to support wide and affordable access to internet, mobile transactions and payment systems.

Prepared by Ahmed Zorome.

[1] This 36 percent includes bank deposit and insurance policy holders as well as borrowers (age 18+). However, the share of adults (15+) with an account in a financial institution was 24 percent in 2014 (World Bank's "Global Findex Database").

[2] World Bank, Enterprise Survey for West Bank and Gaza, 2013.

[3] World Bank "Global Findex Database", 2014, for all statistics and charts, unless specified otherwise.

[4] Internet World Stats, Middle East Internet Statistics and Facebook subscribers, June 30, 2017.

isolation, improve its basic public services, somewhat increase its access to markets, raise inward investment flows, and promote the design and enforcement of its regulatory environment evolving toward West Bank standards.

28. Reunification will be costly and complex structural measures with a significant fiscal impact need to be designed carefully, but implemented expeditiously. While the cost of reunification may help motivate these reforms, their rationale does not rest on the speed and depth of reunification. They should therefore be initiated without further delay, with strong political commitment. A broad civil service reform would be instrumental in meaningfully reducing expenditure, while aiming to improve service delivery. Overhauling the tax system should also increase domestic revenue and lessen the share of CRs, while shielding the poor and setting market-based incentives for the private sector to growth and generate jobs.

29. Sustained growth will also require better active oversight of the banking sector, especially given its potential for expansion in Gaza. Concerns over the ongoing deterioration of certain prudential ratios for the sector as a whole, and for a couple of banks in particular, call for closer scrutiny and corrective actions. In further strengthening its regulatory oversight function, it will be important for the PMA to engage with IMF TA as it prepares for the planned evaluation of its AML/CFT regime. Adopting an improved central bank law that addresses IMF staff comments, will also strengthen the PMA in the effective and responsive exercise of its functions.

Table 1. West Bank and Gaza: Selected Economic Indicators, 2015–23

(Per capita GDP: $2,813; 2016)
(Poverty rate: 16 percent in the West Bank and 39 percent in Gaza Strip; 2014 est.)

			Est.	Projections					
	2015	2016	2017	2018	2019	2020	2021	2022	2023
Output and prices			(Annual percentage change)						
Real GDP (2004 market prices)	3.4	4.1	2.9	2.3	2.3	2.3	2.3	2.3	2.3
West Bank	2.6	3.0	2.9	2.1	2.1	2.1	2.1	2.1	2.1
Gaza	6.1	7.7	3.0	2.8	2.8	2.8	2.8	2.8	2.8
CPI inflation rate (end-of-period)	1.0	-1.0	0.0	1.2	2.5	2.5	2.5	2.5	2.5
CPI inflation rate (period average)	1.4	-0.2	0.2	0.8	2.2	2.5	2.5	2.5	2.5
Investment and saving				(In percent of GDP)					
Gross capital formation, *of which:*	21.1	20.9	19.5	18.9	18.8	18.5	18.4	18.1	18.0
Public	4.7	5.2	4.6	4.4	4.4	4.4	4.3	4.2	4.1
Private	16.3	15.8	14.9	14.4	14.3	14.2	14.1	13.9	13.8
Gross national savings, *of which:*	4.8	11.0	5.6	5.5	5.5	5.8	5.9	5.9	5.9
Public	-4.0	-1.0	-1.7	-1.8	-2.2	-2.1	-2.1	-2.1	-2.1
Private	8.8	12.0	7.4	7.2	7.7	7.9	8.0	8.0	8.0
Saving-investment balance	-16.3	-9.9	-13.8	-13.4	-13.2	-12.8	-12.4	-12.2	-12.1
Public finances 1/				(In percent of GDP)					
Revenues	21.7	25.5	23.8	24.0	23.9	23.9	23.8	23.8	23.7
Recurrent expenditures and net lending	31.3	31.0	29.1	29.3	29.2	29.0	28.7	28.5	28.4
Wage expenditures	15.1	15.1	14.1	14.1	14.0	14.0	13.9	13.9	13.9
Nonwage expenditures	13.9	14.0	13.2	13.3	13.5	13.5	13.4	13.4	13.4
Net lending	2.4	2.0	1.8	1.9	1.7	1.5	1.4	1.2	1.1
Recurrent balance (commitment, before external support)	-9.6	-5.5	-5.3	-5.3	-5.3	-5.1	-4.9	-4.8	-4.7
Recurrent balance (cash, before external support)	-4.5	-1.1	-1.1	-5.9	-5.9	-5.7	-5.5	-5.3	-5.2
Development expenditures	1.8	2.5	2.4	2.4	2.4	2.4	2.4	2.4	2.4
(In millions of U.S. dollars)	230	335	367	395	412	432	453	473	495
Overall balance (commitment, before external support)	-11.4	-8.0	-7.8	-7.7	-7.7	-7.5	-7.4	-7.2	-7.1
Total external support, including for development expenditures	6.3	5.6	4.8	4.8	4.3	4.2	4.1	3.9	3.8
(In millions of U.S. dollars)	799	760	722	767	727	738	750	761	773
External support for recurrent expenditure (in millions of U.S. dollars)	709	603	546	570	520	520	520	520	520
Financing gap (in millions of U.S. dollars)	…	…	…	526	618	638	662	685	709
In percent of GDP	…	…	…	3.3	3.7	3.6	3.6	3.5	3.5
Monetary sector 2/			(Annual percentage change)						
Credit to the private sector	19.2	20.0	15.0	14.0	13.0	13.0	12.0	12.0	12.0
Private sector deposits	10.4	8.7	12.0	8.8	5.8	6.3	6.1	6.0	4.5
External sector				(In percent of GDP)					
Current account balance (excluding official transfers)	-21.8	-14.4	-17.5	-16.9	-16.3	-15.7	-15.2	-14.9	-14.6
Current account balance (including official transfers)	-16.3	-9.9	-13.8	-13.4	-13.2	-12.8	-12.4	-12.2	-12.1
Exports of goods and nonfactor services	18.4	17.9	16.8	17.2	17.0	17.0	17.1	17.2	17.4
Import of goods and nonfactor services	59.3	56.1	56.5	56.9	55.6	54.4	53.5	52.7	52.0
Net factor income	13.5	11.6	13.0	13.7	12.9	12.3	11.6	11.1	10.5
Net current transfers	11.2	16.6	12.9	12.6	12.4	12.4	12.4	12.2	12.1
Private transfers	5.6	12.1	9.3	9.1	9.3	9.5	9.6	9.5	9.5
Official transfers	5.6	4.5	3.6	3.5	3.1	2.9	2.8	2.7	2.6
Memorandum items:									
Nominal GDP (in millions of U.S. dollars)	12,713	13,551	15,014	16,143	16,853	17,678	18,510	19,365	20,221
Per capita nominal GDP (U.S. dollars)	2,715	2,813	3,031	3,169	3,217	3,282	3,342	3,401	3,455
Unemployment rate	26	25	28	29	30	31	32	33	34
Al Quds stock market index (annual percentage change)	6.0	-0.5	12.0	…	…	…	…	…	…

Sources: West Bank and Gaza authorities; World Bank; and IMF staff estimates and projections.

1/ Commitment basis.

2/ End-of-period; in U.S. dollar terms.

Table 2. West Bank and Gaza: Central Government Fiscal Operations, 2015–21

			Est.	Projections			
	2015	2016	2017	2018	2019	2020	2021
			(In millions NIS)				
Net revenues	10,712	13,276	12,841	13,375	14,057	14,797	15,553
Gross domestic revenues	3,323	4,701	4,155	4,336	4,568	4,824	5,094
Tax revenues	2,354	2,392	2,751	2,860	3,013	3,185	3,366
Nontax revenues	969	2,309	1,404	1,476	1,555	1,640	1,727
Clearance revenues (accrued)	7,988	8,930	8,947	9,226	9,642	10,110	10,601
Of which: arrears	35	58	-19	…	…	…	…
Less tax refunds (includes fuel subsidies)	599	355	261	187	152	137	141
Of which: arrears	335	-17	70	…	…	…	…
Of which: fuel tax refund (fuel subsidy)	494	244	261	68	27	5	2
Recurrent expenditures and net lending (commitment)	15,453	16,137	15,730	16,319	17,156	17,952	18,783
Of which: arrears	2,194	2,366	2,199	-345	-348	-351	-353
Wage expenditures (commitment)	7,439	7,837	7,631	7,873	8,242	8,657	9,092
Of which: arrears	603	505	568	…	…	…	…
Nonwage expenditures (commitment)	6,844	7,270	7,139	7,397	7,915	8,345	8,791
Of which: arrears	1,592	1,860	1,631	-345	-348	-351	-353
Net lending	1,169	1,029	960	1,050	1,000	950	900
Development expenditures (commitment)	893	1,287	1,321	1,361	1,436	1,516	1,599
Of which: arrears	206	463	400	…	…	…	…
Recurrent balance (commitment, excl. development expenditure)	-4,741	-2,861	-2,889	-2,944	-3,099	-3,154	-3,230
Overall balance (commitment)	-5,635	-4,148	-4,211	-4,305	-4,535	-4,670	-4,829
Total financing	5,635	4,148	4,211	4,305	4,535	4,670	4,829
Net domestic bank financing	677	-415	462	345	348	351	353
External debt repayment	-43	-71	-155	-154	-152	-157	-159
External financing for recurrent expenditures	2,757	2,318	1,965	1,965	1,812	1,824	1,837
External financing for development expenditures	347	602	632	680	722	766	812
Arrears accumulation (net)	1,876	1,697	1,308	-345	-348	-351	-353
Of which: repayment	-917	-1,215	-1,495	-345	-348	-351	-353
Residual/financing gap	20	18	-2	1,814	2,153	2,238	2,338
			(In millions U.S. dollars)				
Net revenues	2,756	3,457	3,567	3,879	4,034	4,219	4,402
Gross domestic revenues	855	1,224	1,154	1,257	1,311	1,375	1,442
Tax revenues	606	623	764	829	865	908	953
Nontax revenues	249	601	390	428	446	467	489
Clearance revenues (accrued)	2,055	2,325	2,486	2,676	2,767	2,882	3,000
Less tax refunds	154	92	73	54	44	39	40
Recurrent expenditures and net lending (commitment)	3,976	4,202	4,370	4,733	4,924	5,118	5,316
Wage expenditures (commitment)	1,914	2,041	2,120	2,283	2,365	2,468	2,573
Nonwage expenditures (commitment)	1,761	1,893	1,983	2,145	2,271	2,379	2,488
Net lending (commitment)	301	268	267	304	287	271	255
Development expenditures (commitment)	230	335	367	395	412	432	453
Recurrent balance (commitment, excl. development expenditure)	-1,220	-745	-803	-854	-889	-899	-914
Overall balance (commitment)	-1,450	-1,080	-1,170	-1,249	-1,301	-1,332	-1,367
Total financing	1,450	1,080	1,170	1,249	1,301	1,332	1,367
Net domestic bank financing	174	-108	128	100	100	100	100
External debt repayment	-11	-18	-43	-45	-44	-45	-45
External financing for recurrent expenditures	709	603	546	570	520	520	520
External financing for development expenditures	89	157	175	197	207	218	230
Arrears (net)	483	442	363	-100	-100	-100	-100
Of which: repayment	-236	-316	-415	-100	-100	-100	-100
Residual/Financing gap	5	5	-0	526	618	638	662
Memorandum items:			(In percent of GDP, unless otherwise stated)				
Revenues	21.7	25.5	23.8	24.0	23.9	23.9	23.8
Recurrent expenditures and net lending	31.3	31.0	29.1	29.3	29.2	29.0	28.7
Recurrent balance (commitment) before external support	-9.6	-5.5	-5.3	-5.3	-5.3	-5.1	-4.9
External financing for recurrent expenditures	5.6	4.5	3.6	3.5	3.1	2.9	2.8
Development expenditures (cash)	1.4	1.6	1.7	2.4	2.4	2.4	2.4
Overall balance (commitment)	-11.4	-8.0	-7.8	-7.7	-7.7	-7.5	-7.4
Overall balance (cash)	-5.9	-2.7	-2.8	-8.4	-8.3	-8.1	-7.9
Residual/financing gap	0.0	0.0	0.0	3.3	3.7	3.6	3.6
Nominal exchange rate (NIS per U.S. dollar)	3.89	3.84	3.60	…	…	…	…
Nominal GDP (in millions of shekels)	49,411	52,044	54,043	55,658	58,726	62,005	65,402

Sources: Ministry of Finance and Planning; and IMF staff projections.

Table 3. West Bank and Gaza: Central Government Fiscal Operations, 2015–21 (GFSM 2001)

			Est.	Projections			
	2015	2016	2017	2018	2019	2020	2021
	(In millions of shekels)						
Revenue	13,816	16,195	15,438	16,020	16,591	17,387	18,202
Taxes	9,743	10,967	11,436	11,899	12,502	13,158	13,826
Domestic taxes	2,354	2,392	2,751	2,860	3,013	3,185	3,366
Clearance taxes	7,988	8,930	8,947	9,226	9,642	10,110	10,601
Tax refund	-599	-355	-261	-187	-152	-137	-141
Grants	3,105	2,919	2,597	2,646	2,534	2,590	2,649
External budget support	2,757	2,318	1,965	1,965	1,812	1,824	1,837
External development support	347	602	632	680	722	766	812
Other revenue	969	2,309	1,404	1,476	1,555	1,640	1,727
Of which: dividends	122	290	176	185	195	206	217
Expenditures	16,346	17,423	17,051	17,680	18,592	19,468	20,382
Expense	15,453	16,137	15,730	16,319	17,156	17,952	18,783
Compensation of employees 1/	7,439	7,837	7,631	7,873	8,242	8,657	9,092
Use of goods and services	2,530	2,547	2,502	2,400	2,532	2,674	2,820
Grants 2/	1,169	1,029	960	1,050	1,000	950	900
Other expense 3/	4,314	4,723	4,637	4,997	5,383	5,672	5,971
Net acquisition of nonfinancial assets	893	1,287	1,321	1,361	1,436	1,516	1,599
Gross operating balance	-1,637	58	-292	-298	-565	-565	-581
Net lending / borrowing (overall balance)	-2,530	-1,229	-1,614	-1,659	-2,001	-2,081	-2,180
Net financial transactions	-2,487	-1,140	-1,468	-159	-501	-580	-2,178
Net acquisition of financial assets	...	...	...	...	...	...	...
Domestic							
Currency and deposits	...	...	...	...	...	...	...
Net incurrence of liabilities	2,468	1,122	1,470	-1,654	-1,652	-1,657	-159
Domestic	2,510	1,193	1,624	-1,500	-1,500	-1,500	0
Loans	634	-486	307	345	348	351	353
Net domestic bank financing	634	-486	307	345	348	351	353
Other accounts payable	1,876	1,679	1,317	-1,845	-1,848	-1,851	-353
Foreign	-43	-71	-155	-154	-152	-157	-159
Loans	-43	-71	-155	-154	-152	-157	-159
Statistical discrepancy/financing gap	20	18	-2	1,814	2,153	2,238	2,338
Memorandum items:							
Gross operating balance excl. grants (commitment)	-4,741	-2,861	-2,889	-2,944	-3,099	-3,154	-3,230
Gross operating balance excl. grants (cash)	-3,164	-1,803	-2,097	-4,789	-4,947	-5,005	-3,583
Overall balance (NLB) excl. grants (commitment)	-5,635	-4,148	-4,211	-4,305	-4,535	-4,670	-4,829
Overall balance (NLB) excl. grants (cash)	-3,851	-2,627	-3,018	-6,150	-6,383	-6,521	-5,182
Revenue (percent of GDP)	28.0	31.1	28.6	28.8	28.3	28.0	27.8
Expenditure (percent of GDP)	33.1	33.5	31.6	31.8	31.7	31.4	31.2
Expense (percent of GDP)	31.3	31.0	29.1	29.3	29.2	29.0	28.7
Wage expenditure (percent of GDP)	15.1	15.1	14.1	14.1	14.0	14.0	13.9
Nonwage expenditures (percent of GDP)	5.1	4.9	4.6	4.3	4.3	4.3	4.3
GOB (commitment) excluding grants (percent of GDP)	-9.6	-5.5	-5.3	-5.3	-5.3	-5.1	-4.9
GOB (cash) excluding grants (percent of GDP)	-6.4	-3.5	-3.9	-8.6	-8.4	-8.1	-5.5
External support (recurrent)	5.6	4.5	3.6	3.5	3.1	2.9	2.8
in millions of NIS	2,757	2,318	1,965	1,965	1,812	1,824	1,837
NLB (commitment) excluding grants (percent of GDP)	-11.4	-8.0	-7.8	-7.7	-7.7	-7.5	-7.4
NLB (cash) excluding grants (percent of GDP)	-7.8	-5.0	-5.6	-11.0	-10.9	-10.5	-7.9
Total external support (in millions of shekels)	3,105	2,919	2,597	2,646	2,534	2,590	2,649
Nominal GDP (in millions of shekels)	49,411	52,044	54,043	55,658	58,726	62,005	65,402
Exchange rate	3.9	3.8	...	...	...	...	...

Sources: Ministry of Finance and Planning; and IMF staff projections.

1/ Wage expenditures.

2/ Grants to local governments related to purchase of water and electricity.

3/ Includes transfers (social benefits) and minor capital.

Table 4. West Bank and Gaza: Financial Soundness Indicators, 2011–17
(In percent)

	Dec-11	Dec-12	Dec-13	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Capital adequacy (for all banks)															
Tier I capital to risk-weighted assets	22.9	22.2	21.5	20.0	18.8	18.2	17.9	18.1	17.0	16.4	17.1	17.2	16.3	16.2	16.2
Regulatory capital to risk-weighted assets	21.1	20.3	20.0	18.9	17.8	17.2	17.8	18.0	17.4	16.7	17.4	18.0	17.1	16.8	16.9
Capital adequacy (for local banks)															
Tier I capital to risk-weighted assets	24.5	22.7	20.7	18.0	17.4	16.9	16.2	16.1	15.1	14.2	15.7	16.0	14.9	15.2	14.9
Regulatory capital to risk-weighted assets	20.3	18.8	17.8	16.3	15.7	15.3	15.4	15.4	15.2	14.1	15.6	16.5	15.4	15.5	15.2
Asset quality 1/															
Nonperforming loans (percent of total loans)	2.7	3.1	2.9	2.5	2.7	2.5	2.5	2.1	2.0	2.0	2.2	2.2	2.2	2.4	2.4
Nonperforming loans net of provisions to capital	3.8	4.9	4.7	4.0	4.9	4.2	4.2	3.4	3.3	3.1	3.7	3.7	4.3	5.0	5.0
Coverage ratio (provisions as percent of nonperforming loans)	60.9	60.1	59.1	61.4	58.6	63.3	63.6	67.3	68.8	70.4	66.4	65.8	63.7	60.2	62.0
Earnings and profitability															
Return on assets (ROA)	1.9	1.8	1.9	1.7	1.6	1.6	1.6	1.5	1.7	1.6	1.5	1.5	1.4	1.6	1.6
Return on equity (ROE) 2/	17.0	16.2	18.7	17.1	15.7	15.5	15.7	15.0	17.4	16.9	16.0	15.6	15.2	16.7	16.4
Interest income to gross income	71.7	72.4	74.0	72.4	71.5	70.6	71.7	72.2	70.4	70.9	71.9	71.4	70.2	68.8	70.6
Non-interest expenses to gross income	57.2	55.4	54.8	60.1	60.2	61.0	62.0	63.0	61.3	61.7	61.9	62.6	63.5	61.4	61.3
Personnel cost to non-interest expenses	55.5	53.8	53.9	51.5	53.0	52.8	51.8	51.3	52.0	52.0	51.3	50.4	52.7	52.8	52.5
Liquidity															
Liquid assets to total assets	38.2	37.5	39.5	35.4	34.1	33.4	35.9	34.2	33.9	33.1	32.7	33.0	34.0	31.3	30.8
Liquid assets to demand and savings deposits	74.4	71.6	74.7	65.9	62.9	60.0	65.3	62.3	61.8	61.7	61.7	61.2	65.2	58.9	57.5
Liquid assets to total deposits	46.9	45.8	48.1	43.2	41.8	40.0	42.9	41.0	40.6	39.9	39.7	39.9	41.0	37.7	37.2

Source: Palestine Monetary Authority.

1/ Nonperforming loans includes loans more than 90 day overdue.

2/ Return on equity (ROE) is a ratio of income before extraordinary items and taxes to average Tier 1 capital.

Annex I. Risk Assessment Matrix[1]

Nature/Sources of Risk	Relative Likelihood	Expected Impact If Realized	Policies to Mitigate Risks
		Domestic Risks	
Widespread social unrest due to discontent with the dearth of economic opportunity, unfulfilled expectations of reunification, or lack of political clarity or prospects for peace	***High***	***High*** Increased unrest could disrupt economic and financial transactions or the provision of public services, and undermine growth. Unrest could also lead to tighter Israeli restrictions or further uncertainty about donor support, compounding the costs to growth. A deeper conflict in Gaza would exacerbate the economic and humanitarian crisis. If this endangers the stability of banks, it could have spillovers to the West Bank.	Sound macroeconomic management could help instill confidence. However, in the near term, economic policies can do little to directly mitigate geo-political risks.
Declining and/or volatile donor support due to shifts in donor sentiment or competing demands on donor resources	***High***	***High*** A larger than anticipated decline in donor support—particularly if donors reconsider their long-term support for the PA or relief agencies—could compromise public service delivery and exacerbate the already large financing gaps. This would make fiscal management even more difficult, leading to additional arrears or deeper spending cuts that could be detrimental to economic growth and social cohesion.	(1) Instill confidence through strong domestic policies, anchored in gradual medium-term fiscal adjustment and reforms to strengthen government institutions. (2) Pro-growth policies, including adjusting the composition of budget spending and ensuring financial sector resilience, could over time reduce aid dependency and support fiscal sustainability.
Reduced financial services by correspondent banks	***High***	***Medium/High*** Persistent threats to terminate correspondent Israeli-Palestinian bank relations would lead to some trade and financial transactions being canceled, and others pushed into informality. This could undermine the functioning of WBG's payment system and financial stability, with repercussions for growth.	(1) Promote confidence by effectively implementing the new "Anti-Money Laundering and Terrorism Financing" law and related regulations. (2) Continue to enhance legal and regulatory frameworks, build implementation capacity, including with technical assistance, ahead of a comprehensive AML/CFT evaluation.
Economic fragmentation due to pressures from the divergence between the Gazan and West Bank economies or from settlement expansion	***High***	***Medium/High*** Further erosion of geographic control or increased restrictions would shrink the productive resources available to the Palestinian economy and stifle investment. The permanent negative impact on growth would jeopardize the economic viability of a Palestinian state and could fuel unrest.	Sound macroeconomic management could help instill confidence. However, in the near term, economic policies can do little to directly mitigate geo-political risks.

Nature/Sources of Risk	Relative Likelihood	Expected Impact If Realized	Policies to Mitigate Risks
		GLOBAL RISKS	
Intensification of the risks of fragmentation/ security dislocation in parts of the Middle East	***High***	***Medium/High*** Social and political unrest in the region could divert donor aid away from WBG and/or affect Israel's stance toward WBG, triggering fiscal pressures. Any direct spillover of regional instability and dislocation would exacerbate security and economic uncertainty in WBG.	Sound macroeconomic management, proactive reforms and engagement with partners could help instill confidence. However, economic policies can do little to mitigate external geo-political risks.
Structurally weak growth in key advanced economies	***Medium***	***Medium*** WBG is sensitive to a slowdown in Israel (for example, via developments in Europe). Fiscal strains in donor countries could limit available aid for the PA. This could further weaken growth, increase unemployment, and worsen the fiscal position.	(1) Instill confidence through strong domestic policies, anchored in medium-term fiscal adjustment. (2) Improve competitiveness of the economy via scaled-up investment in infrastructure and education to support human capital development.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Annex II. Debt Sustainability Analysis[1]

This annex assesses debt developments since IMF staff's August 2017 report to the Ad Hoc Liaison Committee. The debt sustainability analysis (DSA)[2] suggests that, assuming a continuation of current policies, public debt is likely to increase throughout the forecast period due to sizeable financing gaps. A scenario that illustrates the reunification of the Palestinian Authority (PA) with the de facto administration in Gaza, and includes measures to mitigate the fiscal cost, points to a higher rate of debt accumulation. In either case, debt sensitivity to growth and fiscal shocks suggests further debt sustainability concerns, particularly given uncertainties around weak growth and lower donor aid.

Structure of Public Debt

1. At the end of 2017, gross public debt[3] was estimated to be 36.7 percent of GDP. This represents an increase by 0.7 percentage points of GDP over the debt stock at end-2016, and a return to the trend of increasing debt after the one-off adjustment to pension liabilities in 2015. The public debt profile continues to show an increasing share of domestic debt of short average maturity, and decreasing external debt.

- Domestic debt represented around 81 percent of total debt at the end of 2017. Arrears to the pension fund, PA civil servants in Gaza whose allowances were withheld, and suppliers (including promissory notes) increased by almost 1 percentage point of GDP. Formal debt to the financial sector also increased, as banks again became net lenders to the PA in 2017.[4] Moreover, the rediscounting of promissory notes by cash-strapped suppliers points to a higher percentage of domestic debt held by banks.
- External debt represented 19 percent of total debt. Although it decreased only a little in nominal terms, it declined by 0.7 percentage points of GDP during 2017. It is mostly at long maturities and on concessional terms (with an effective interest rate of close to zero).

West Bank and Gaza: Total Debt Liabilities of the PA
(In percent of GDP)

	2015	2016	2017
Gross debt liabilities	40.4	36.1	36.7
Domestic debt	30.8	27.6	29.0
Bank loans and overdrafts	11.5	10.6	11.2
Arrears	19.3	17.0	17.8
External debt	8.5	7.7	7.0
Clearance revenue advance	1.1	0.8	0.7

Sources: Ministry of Finance and Planning, and IMF staff estimates.

[1] Prepared by Alexander de Keyserling.

[2] This DSA uses the 2017 Market Access Countries DSA template developed by the IMF; it is based on end-2016 domestic debt stock data, end-2017 external debt stock data, and estimated and actual 2017 debt flow data.

[3] Debt coverage includes accounts payable and pension liabilities in line with the IMF's *Public Sector Debt Statistics: Guide for Compilers and Users* (2013).

[4] Non-arrears debt is projected to carry an interest rate of 6 percent. Arrears are projected to carry a zero interest rate.

Macroeconomic Developments and Projections

2. **Under staff's "business-as-usual" scenario, macroeconomic indicators point to a less favorable outlook**. Real growth is projected at 2.3 percent per annum from 2018 onwards, while inflation remains close to 3 percent annually from 2019 onward. The overall fiscal deficit remains large, at 7.7 percent of GDP, and gradually decreases over the medium term to around 7 percent of GDP. As a result, and even with budget support grants from donors projected to reach US$570 million in 2018 and then hold constant at US$520 million from 2019, the financing gap averages near 3.5 percent of GDP.

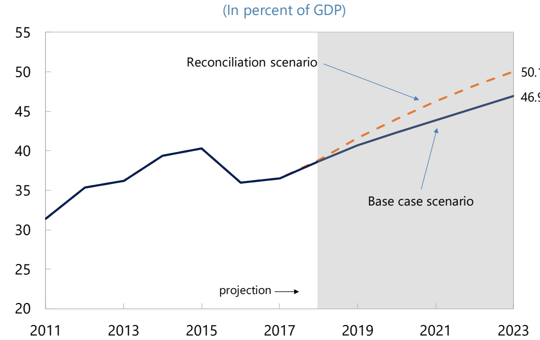
Debt Sustainability

4. **In the "business-as-usual" scenario, gross public debt is projected to steadily rise by more than 10 percentage points of GDP over the forecast period**, reaching 46.9 percent of GDP by 2023. This is slightly higher than 46.6 percent of GDP projected in August 2017, due to a lower GDP growth outlook and a minor increase in the financing gap. The latter is due to low budget support and an increase in expenditure from the reversal of cuts to electricity subsidies for Gaza. While this may appear a relatively low debt level, the ratio continues to rise without stabilizing over the projection period.

5. **Standard DSA stress tests show that an adverse growth shock is the greatest risk to sustainability.** A growth shock that illustrates the materialization of a key risk (see Annex I) would push public debt above 54 percent of GDP by 2023, almost doubling the accumulation of public debt over 5 years. A combined macro-fiscal shock that adds a temporary fiscal deterioration to the growth shock would push public debt to nearly 60 percent of GDP by 2023. West Bank and Gaza's policy constraints and relatively limited ability to manage shocks only heighten the risks of unexpected challenges.

6. **Reunification would have a substantial impact on debt.** Staff's illustrative "reunification" scenario (starting in mid-2018) results in a large financing gap. Even with the modest increase in growth and assuming the gap is covered with concessional financing, this scenario would increase the trajectory of debt and add over 3 percentage points of GDP to the debt stock over the projection period.

Public Debt Under a Customized Stress Test
(In percent of GDP)



Sources: Palestinian authorities; and IMF staff.

7. **The increased financing pressures associated with reunification raise questions about the sustainability of the PA's debt burden even when significant mitigation measures are implemented.** Without sufficient external resources, a significant share of financing needs will continue to be met through the accumulation of arrears. This could limit the improvement in growth under the scenario and put more upward pressure on debt. The inherently short maturity arrears creates a significant refinancing challenge that could lead to higher debt if their clearance with formal debt instruments is associated with a non-zero interest rate.

West Bank and Gaza Public Sector Debt Sustainability Analysis (DSA) - Base Case Scenario

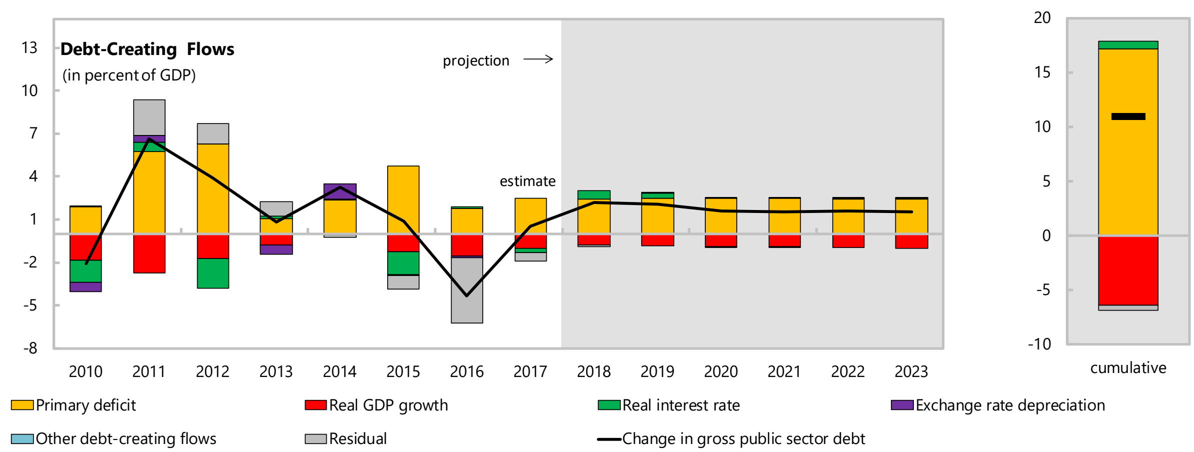
(In percent of GDP; unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						
	2009-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022	2023
Nominal gross public debt	29.2	40.3	36.0	36.5	38.6	40.7	42.3	43.8	45.4	46.9
Public gross financing needs		32.8	26.4	29.7	31.5	34.0	35.7	37.6	39.4	41.2
Real GDP growth (in percent)	5.1	3.4	4.1	2.9	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator, in percent)	3.5	5.2	1.2	0.9	0.7	3.2	3.2	3.1	2.8	2.7
Nominal GDP growth (in percent)	8.8	8.8	5.3	3.8	3.0	5.5	5.6	5.5	5.2	5.0
Effective interest rate (in percent) [3/]	2.0	1.0	1.5	0.1	2.5	4.1	3.2	3.1	3.0	2.9

Contribution to Changes in Public Debt

	Actual			Projections								
	2009-2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	cumulative	debt-stabilizing
Change in gross public sector debt	1.5	0.9	-4.4	0.5	2.2	2.0	1.6	1.5	1.6	1.5	11.0	primary
Identified debt-creating flows	-0.6	1.8	0.2	1.2	2.2	2.0	1.6	1.5	1.5	1.5	11.5	balance [8/]
Primary deficit	1.6	4.8	1.8	2.5	2.4	2.5	2.5	2.5	2.4	2.4	17.2	-0.9
Primary (noninterest) revenue and grants	37.3	28.0	31.1	28.6	28.8	28.3	28.0	27.8	27.7	27.6	196.7	
Primary (noninterest) expenditure	36.5	32.7	32.9	31.0	31.2	30.8	30.5	30.3	30.1	30.0	213.9	
Automatic debt dynamics [4/]	-2.2	-2.9	-1.6	-1.3	-0.2	-0.5	-0.9	-0.9	-0.9	-0.9	-5.7	
Interest rate/growth differential [5/]	-2.2	-2.8	-1.5	-1.3	-0.2	-0.5	-0.9	-0.9	-0.9	-0.9	-5.7	
Of which: real interest rate	-0.7	-1.6	0.1	-0.3	0.6	0.3	0.0	0.0	0.0	0.1	0.7	
Of which: real GDP growth	-1.5	-1.2	-1.6	-1.0	-0.8	-0.8	-0.9	-0.9	-0.9	-1.0	-6.4	
Exchange rate depreciation [6/]	0.0	-0.1	-0.1	...	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
0 (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroarea loans)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [7/]	2.9	-0.9	-4.6	-0.6	-0.1	0.0	0.0	0.0	0.0	0.0	-0.5	



Source: IMF staff.

1/ Public sector is defined as central government.

2/ Based on available data.

3/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

4/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

5/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi (1+g)$ and the real growth contribution as $-g$.

6/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

7/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

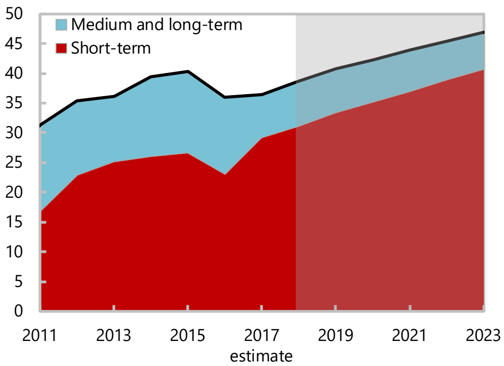
8/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

West Bank and Gaza Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

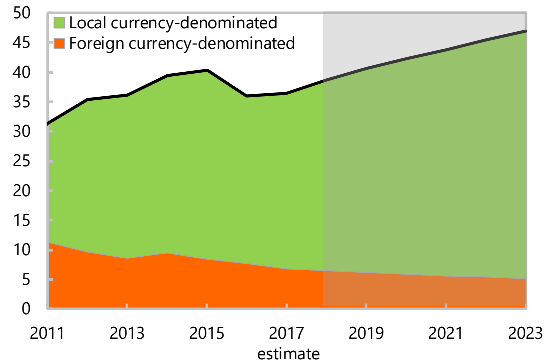
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

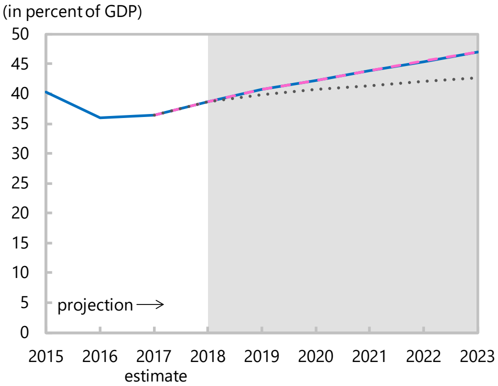


Alternative Scenarios

Baseline ········ Historical – – Constant Primary Balance

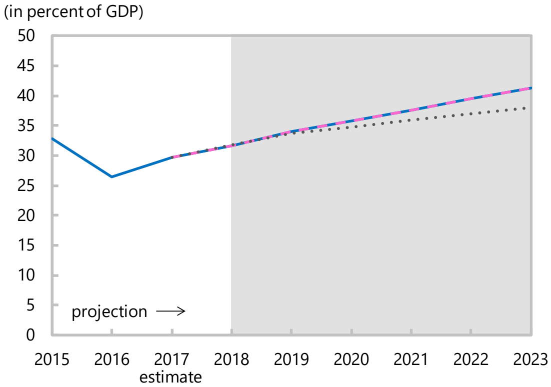
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

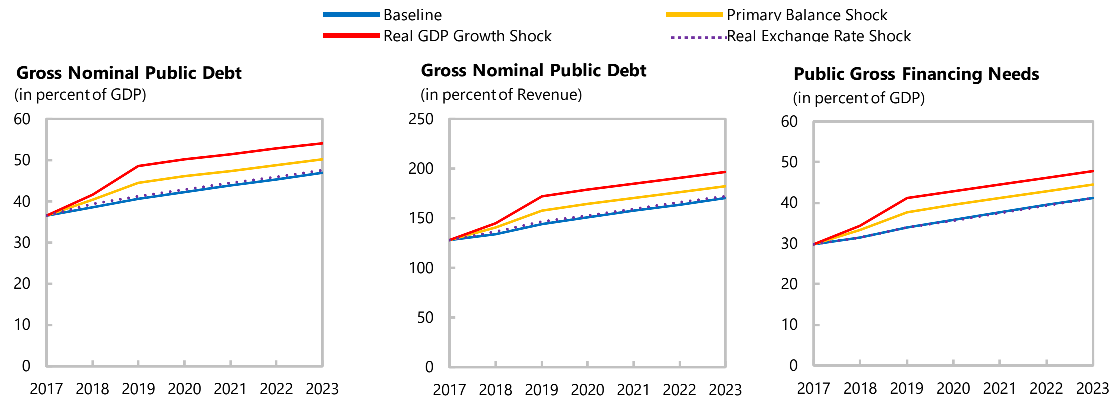
Baseline Scenario	2017	2018	2019	2020	2021	2022	2023
Real GDP growth	2.9	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	0.7	3.2	3.2	3.1	2.8	2.7
Primary Balance	-2.5	-2.4	-2.5	-2.5	-2.5	-2.4	-2.4
Effective interest rate	0.1	2.5	4.1	3.2	3.1	3.0	2.9
Constant Primary Balance Scenario							
Real GDP growth	2.9	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	0.7	3.2	3.2	3.1	2.8	2.7
Primary Balance	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5
Effective interest rate	0.1	2.5	4.1	3.2	3.1	3.0	2.9

Historical Scenario	2017	2018	2019	2020	2021	2022	2023
Real GDP growth	2.9	5.8	5.8	5.8	5.8	5.8	5.8
Inflation (GDP deflator)	0.9	0.7	3.2	3.2	3.1	2.8	2.7
Primary Balance	-2.5	-3.6	-3.6	-3.6	-3.6	-3.6	-3.6
Effective interest rate	0.1	2.5	2.4	1.4	1.2	1.0	0.9

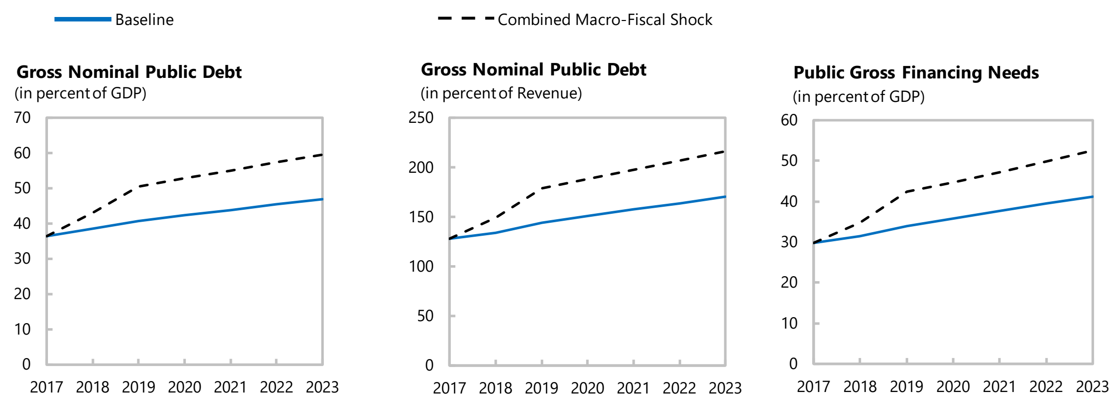
Sources: Palestinian authorities; and IMF staff.

West Bank and Gaza Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022	2023
Real GDP growth	2.9	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	0.7	3.2	3.2	3.1	2.8	2.7
Primary balance	-2.5	-4.3	-4.4	-2.5	-2.5	-2.4	-2.4
Effective interest rate	0.1	2.5	4.4	3.4	3.0	2.9	2.7
Combined Shock							
Real GDP growth	2.9	-1.3	-1.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	-0.2	2.3	3.2	3.1	2.8	2.7
Primary balance	-2.5	-4.3	-5.4	-2.5	-2.5	-2.4	-2.4
Effective interest rate	0.1	2.5	5.9	5.0	4.9	4.8	4.7

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022	2023
Real GDP growth	2.9	-1.3	-1.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	-0.2	2.3	3.2	3.1	2.8	2.7
Primary balance	-2.5	-3.8	-5.4	-2.5	-2.5	-2.4	-2.4
Effective interest rate	0.1	2.5	4.3	3.6	3.0	2.9	2.8
Real Exchange Rate Shock							
Real GDP growth	2.9	2.3	2.3	2.3	2.3	2.3	2.3
Inflation (GDP deflator)	0.9	1.1	3.2	3.2	3.1	2.8	2.7
Primary balance	-2.5	-2.4	-2.5	-2.5	-2.5	-2.4	-2.4
Effective interest rate	0.1	2.5	4.1	3.2	3.1	3.0	2.8

Source: IMF staff.

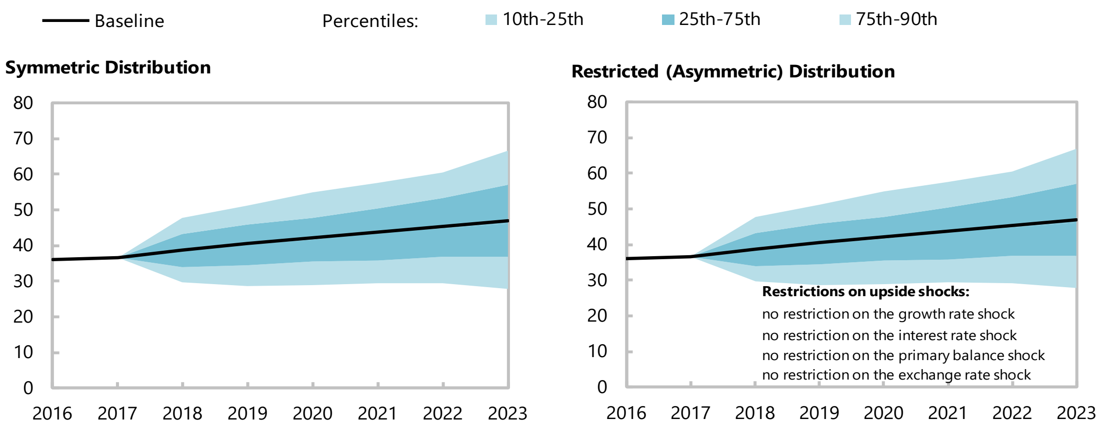
West Bank and Gaza Public DSA Risk Assessment

Heat Map

Debt level 1/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs 2/	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile 3/	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

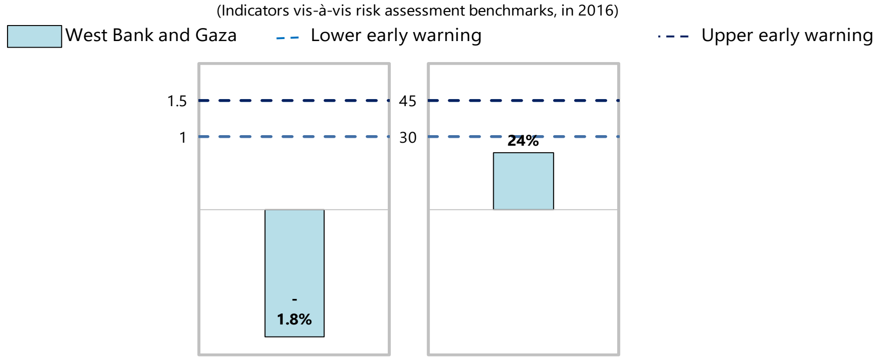
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Annual Change in Short-Term Public Debt
(in percent of total)

Public Debt Held by Non-Residents
(in percent of total)

Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 85% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 20% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.
Lower and upper risk-assessment benchmarks are: 400 and 600 basis points for bond spreads; 17 and 25 percent of GDP for external financing requirement; 1 and 1.5 percent for change in the share of short-term debt; 30 and 45 percent for the public debt held by non-residents.

Annex III. Tax Policy at the Crossroads—Issues and Options

The scope for wide-ranging tax policy reforms to address the structural under-resourcing of the budget and improve the equity of the tax system in West Bank and Gaza (WBG) has long been a topic of IMF policy advice and technical assistance (TA). The prospect of Fatah-Hamas reconciliation and the budgetary costs associated with the Palestinian Authority (PA) resuming administrative control of Gaza make it even more pressing to undertake reforms to help narrow the persistent financing gaps.

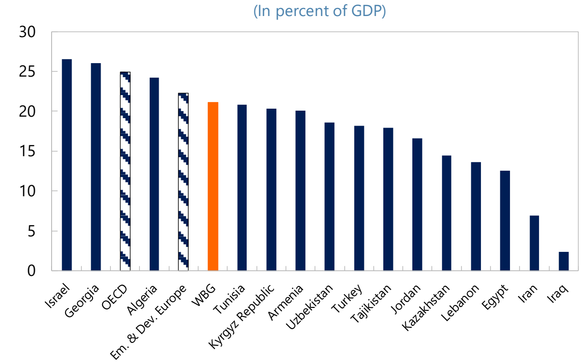
Intensifying efforts to improve tax policy and administration will be a crucial part of a comprehensive reform agenda. Revenue reforms would move on two parallel tracks: (i) policy changes to ensure a more efficient and more equitable tax regime; and (ii) efforts to re-establish a functioning tax administration in Gaza, with consistent policies across all of WBG.

This annex focuses on the former, discussing tax policy reform options based on past TA by the IMF's Fiscal Affairs Department.[1] *While it does not take up tax administration, this remains a priority in its own right and has also been the focus of past IMF TA.*[2]

Rationale for the Reform

1. **While WBG's tax-to-GDP ratio compares favorably to regional peers, it does less well among other comparator groups.** The ratio reached 21.1 percent of GDP in 2016, mostly on account of stronger performance in import duties and taxes. This puts WBG's ratio as one of the highest in the region, exceeding the average for comparator countries (17.5 percent of GDP) and even above that of some higher income countries (e.g., Lebanon, Jordan or Turkey). However, the region's tax revenue-to-GDP ratio is low[3] by international standards, which suggests there is scope for WBG to raise more revenues. WBG's tax-to-GDP ratio is below the average for Emerging and Developing Europe (22.3 percent of GDP) and significantly lower than for the average of OECD countries (24.9 percent of GDP).

Tax-to-GDP Ratio by Country, 2016
(In percent of GDP)



Sources: MCD, WEO, IMF staff calculations.

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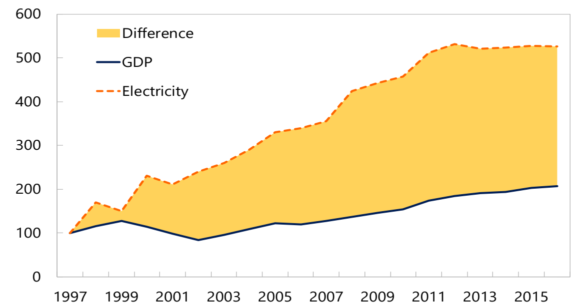
[1] R. Krelove, T. Matheson, and P. Mullins, *West Bank and Gaza: Improving Income Tax and Tax Incentives – Proposed Tax Policy TTF*, Washington, 2012 (hereinafter: 2012 TA Report); R. Krelove and A. Swistak, *West Bank and Gaza: Technical Memoranda on Investment Tax Incentives*, Washington, 2013 (hereinafter: 2013 TA Report); and A. Swistak, *West Bank and Gaza: Improving Taxation of SMEs: Design and Compliance Issues*, Washington 2015 (hereinafter: 2015 TA Report).

[2] Recent TA on tax administration is listed in Annex IV.

[3] *The Road to Higher and More Inclusive Growth in the Middle East and North Africa*, IMF, January 2018.

2. However, the potentially large informal economy implies that WBG's tax-to-formal GDP ratio may overstate revenue performance. Given the wide range of estimates regarding the size of WBG's informal sector it is not possible to calculate precisely an alternative ratio. However, the likelihood is that WBG's tax-to-GDP ratio could be lower than currently recorded. On the low end, the Palestinian Central Bureau of Statistics conservatively estimated that the informal economy accounted for 6.7 percent of GDP in 2015. Another common approach is to examine electricity consumption as a proxy for overall activity. In WBG, electricity consumption growth has outpaced official GDP growth by a significant margin since 1997. This may reflect a large amount of unobserved economic activity that is not captured by GDP. Assuming that productivity remained flat since 1997, this gives a much larger, and likely upper-bound, estimate that overall GDP could be up to two times larger than formal GDP in 2016. These estimates point to potentially significant scope to broaden the tax base.

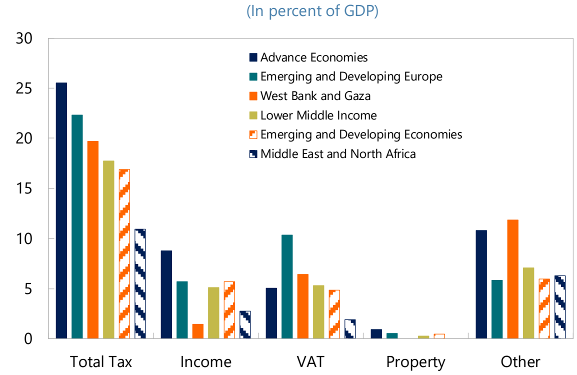
Electricity Consumption vs. Real GDP Growth in WBG
(Index: 1997=100)



Sources: PCBS; and Energy Information Agency (EIA).

3. Moreover, with the composition of tax revenue skewed towards indirect border taxes, this points to potential improvements in direct taxation. Income taxes, both personal and corporate, contributed only 6 percent of tax revenue, the lowest level among the region and other country groups. Domestic tax revenue (income and property taxes, as well as local VAT and excises) accounts for roughly 20 percent[4] of all taxes collected and has the advantage in WBG's case of being largely administered domestically. The remainder are the so-called "clearance revenues", i.e., taxes on imports to WBG[5] collected by Israeli authorities and remitted to WBG. Indirect taxes have traditionally been the major contributors to the WBG's tax revenue effort—in 2016 customs duties, VAT and excises accounted for 35, 32, and 26 percent respectively of total tax revenue in WBG.

Tax Composition by Country Group, 2015
(In percent of GDP)



Sources: MCD, WEO, IMF staff calculations.

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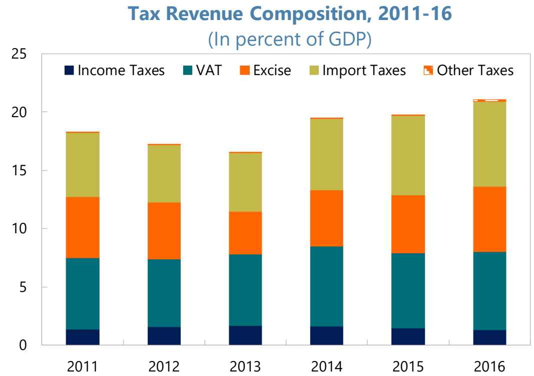
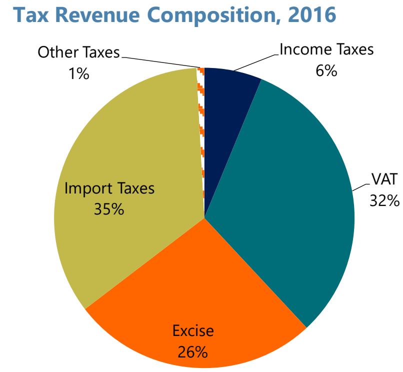
[4] Average for 2011–16.

[5] Clearance revenue includes a small portion of income tax revenue accounting for 0.5 percent of all clearance revenue.



Sources: MCD, WEO, IMF staff calculations.



4. The efficiency of WBG's tax system[6] requires improvement. While WBG's indirect tax collections perform relatively well among comparator groups (noted above), the overall efficiency of the WBG's tax regime is disadvantaged by very low income tax revenue productivity and little use of property taxation. Although indirect taxes in general are less detrimental to growth and better suited for countries with weaker tax administration due to their ease of enforcement, too heavy a reliance on indirect taxes can make the tax regime overly regressive. Depending on their design, indirect taxes (especially of non-VAT type) tend to partially fall on investment and/or production rather than consumption and hurt competition and entrepreneurship. For these reasons, there is scope in WBG to use more effectively direct taxes, including property taxes.

5. WBG's unique circumstances and the limits on its taxing powers weigh heavily on the design of the tax regime. Under the Paris Protocol,[7] WBG's tax policy design choices are restricted (e.g., the VAT rate must be set within 2 percentage points of the Israeli VAT rate) and Israeli customs authorities were assigned the collection of border revenue. The effect of Israel's tax policy and tax administration choices will therefore have to be properly assessed with a view to maximizing taxation for WBG within existing limitations. Therefore, and in addition to ongoing discussions between the PA and Israeli authorities to reduce "fiscal leakages" from clearance revenues, the WBG authorities should consider, wherever possible, simple policy choices to reduce WBG's dependency on Israel.

Past Policy Advice

6. Much of IMF's past technical advice has been geared towards strengthening income taxation.[8] However, as noted above, this is less about the overall level of taxation and improving the tax structure should be at the forefront of WBG's tax policy reforms, especially improvements to

[6] A tax system is deemed efficient when it raises revenue in the least distortive manner, i.e., taxes have relatively small negative impact on economic decisions of individuals and firms than with another system if it distorts behavior less.

[7] Formally known as the *Protocol on Economic Relations between the Government of the State of Israel and the P.L.O., representing the Palestinian people*, Paris, April 29, 1994.

[8] Indirect taxation has not been reviewed in recent years, except in cases incidental to the taxation of SME and agriculture (2015 TA Report).

direct/income taxation. The main weaknesses identified in the WBG tax regime include: numerous income tax exemptions; widespread and largely inefficient investment tax incentives; a sizeable informal sector; and lack of a simple and comprehensive regime for small and medium-sized enterprises (SMEs). Weak compliance and enforcement also add to low revenue productivity of income taxes.

7. Regarding corporate income taxes (CIT) reform, IMF advice focused on aligning the design of CIT with standard international practice. In this regard, the Fund recommended a single tax rate, preferably at 20 percent. The main design features that could be improved included: rationalizing the limitations to cost deduction, simplifying the rules on the depreciation of assets, strengthening thin capitalization and transfer pricing rules, and wider use of withholding taxes. Of no lesser importance was the call for more careful and parsimonious use of various tax concessions, if at all. Exemption of agricultural income, preferential tax treatment of underwriting profits by life insurance companies and—more importantly—the widespread use of generous, yet largely inefficient, investment tax incentives were of the utmost concern. Only the latter, as estimated by the 2013 TA mission, may have amounted to 0.4 to 1.3 percent of GDP in revenue forgone.

Key Tax Policy TA Recommendations (2012–15)

- Replace the progressive CIT rates with a single rate (20 percent).
- Enhance CIT's efficiency through improved rules on depreciation, capital losses, and thin capitalization.
- Rationalize investment tax incentives; eliminate tax holidays.
- Improve progressivity of PIT through adjustments in rate schedule, exemptions and tax credits.
- Eliminate generous housing related tax concessions.
- Tax capital income.
- Tax agricultural income; do not exempt agricultural inputs from VAT.
- Tax all pensions based on the E-E-T system, regardless of sector or funding status.
- Introduce simplified taxation of SMEs (presumptive taxes).
- Increase VAT threshold.
- Reform property taxation (switch to market value, eliminate exemptions, reduce reliance on transfer taxes).

8. The main goals for personal income tax (PIT) reform would be to increase revenue yields and progressivity. This should be achieved primarily by broadening the base, including by capturing capital income, taxing agricultural income and limiting deductions of pension fund contributions. Making the PIT more progressive could be done through converting the basic personal allowance and education expenses into a tax credit, adjusting tax-exempt allowance for dependents, streamlining the rate schedule and improving the tax treatment of pensions (move towards the E-E-T system[9] for all pensions and lump sum payout, regardless of sector or funding status). No reduction in the top marginal PIT rate (20 percent) was recommended.

[9] E-E-T system implies: Exemption of contributions, Exemption of returns, Taxation of retirement income.

9. Introducing a simplified tax regime for SMEs, including small farmers, was the mainstay of policy advice in 2015. The authorities were encouraged to implement proper taxpayer segmentation rules (including through VAT threshold adjustments) and adopt a comprehensive presumptive tax regime—a simple lump-sum tax for micro businesses and a turnover-based tax for small taxpayers. Medium-sized taxpayers should only benefit from simplified accounting and filing obligations. For small agricultural producers, an acreage based tax was recommended. The 2015 technical advice strongly argued against an outright exemption for the agricultural sector.

10. Advice in 2012 urged the authorities to mobilize more revenue from property taxation. For this to happen, the authorities would have to accelerate property registration and tax evaluations, move away from rental to market value as the base for tax assessment, eliminate costly and unjustified exemptions and reduce reliance on transfer taxes.

Recent Tax Policy Developments

11. There have been some positive developments in recent years. In 2013, WBG's VAT rate was increased from 15 to 16 percent, which came on the heels of an increase in the Israeli VAT from 17 to 18 percent. The introduction of the first social security system for the private sector in 2016 was one of the most important and commendable achievements. The network of tax treaties is also being expanded—during 2013–15 seven countries entered bilateral agreements with WBG.[10]

12. However, progress on income tax reform has been rather slow from both a revenue raising and equity improving perspective. In July 2015, the authorities eliminated the progressive CIT rate schedule and adopted a single low rate of 15 percent. The decline in CIT revenue collection from 1.68 percent of GDP in 2013 to 1.31 in 2016 is partly due to this change. A withholding tax on dividends at 10 percent (recommended by FAD in 2012) was considered, but not pursued due to opposition from the business community. The top PIT rate of 20 percent was also eliminated in 2015, and the personal allowance (or tax-free threshold) was increased, further weakening income tax revenue progressivity and revenue collections. In August 2016, an exemption of income derived from agricultural activities was provided to all individuals; for companies the first NIS 300,000 was exempt. The 2014 revisions to the Investment Act streamlined the concession granting process, but no tax incentives were eliminated. Instead, a slightly different version of tax exemptions and reduced income tax rates were enacted anew, with an extended applicability period.

13. The prospect of reunification has caused a tax policy rethink. In the context of developing the 2018 budget, the authorities are considering a package of measures that, for the most part, would help improve the progressivity and efficiency of the overall tax system. These include: (i) increasing the top CIT and PIT rates to 20 percent, and adding a fourth tax bracket for both taxes; (ii) implementing the proposed dividend withholding tax of 10 percent; and (iii) increasing fees, the purpose of which is to raise revenue rather than effect cost recovery.

[10] Sudan, Serbia, the UAE (2013); Vietnam (2014); Jordan, Sri Lanka and Venezuela (2015).

Concluding Thoughts and Next Steps

14. Fund staff believes that there is scope to improve revenue generation in WBG, by refining tax policies, enhancing tax administration, and bailing in more of the informal economy. Past assessments of WBG's tax regime have underscored its inefficiency, regressiveness and complexity, suggesting tax policies are ripe for reform. A well-functioning tax system will need to be better aligned with the standard cannons of taxation (efficiency, fairness, and simplicity), and can also provide a basis to rebuild buffers and improve the economy's resilience to shocks.

15. Improving the structure of the tax regime, more so than boosting the overall level of taxation, should be the main motivation for reform. The PA has proposed raising the top rate and increasing the tax brackets for both PIT and CIT. The authorities are also considering other measures that staff supports: replacing CIT holidays and reduced income tax rates with more cost-effective investment incentives (e.g., accelerated depreciation and longer loss recovery periods), and adopting a simplified tax regime for SMEs. Adjustments to ensure a broad-based and progressive VAT—including reducing the number of exemptions, lowering thresholds, and introducing the taxation of services—should also be considered, which could also be used to replace nuisance fees and charges that are administratively cumbersome and costly. Finally, there is scope to improve the yield of property taxes over time.

16. While the authorities are taking steps in the right direction, much can be gained from further reforms, particularly if implemented as part of a more comprehensive strategy. Experience[11] suggests that reforms are most effective and durable if anchored around four key elements: (1) a comprehensive reform plan, with clear objectives for the near- and longer-term, and with an assessment of the impact on various stakeholders; (2) a far-reaching communications initiative, aided by improvements in transparency; (3) appropriately sequencing the introduction of reforms across various taxes, mindful of revenue objectives and the impact on the poor; and (4) targeted mitigating features of tax reforms to improve progressivity, or separate measures to help offset the impact of new tax liabilities on the poor. Lastly, much needed public financial management reforms can be a vital complement, both in ensuring the effectiveness of and building support for revenue reforms. For instance, better budget planning, execution, and transparency can boost trust in the government's use of public resources and can make tax reform more palatable.[12]

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[11] *Revenue Mobilization in Developing Countries*, IMF Policy Paper, March 8, 2011).

[12] Jewell, A. and al. (2015): *Fair Taxation in the Middle East and North Africa*, Staff Discussion Note 15/16, IMF.

Annex IV. Technical Assistance by the IMF to the Palestinian Authority, 2013–18

The IMF has provided technical assistance (TA) focused in the areas of public financial management, revenue administration, banking supervision, and national accounts. The priorities over the medium term remain on public financial management, tax policy and revenue administration, and banking supervision and stability. There is a need to periodically review and help enhance the authorities' statistical capacity, especially in GFSM 2001, the external sector, and national accounts (expenditures side). It is expected that the IMF's Fiscal Affairs Department (FAD) and Monetary and Capital Markets Department (MCM) will continue to provide TA, dependent on the authorities' commitment and progress, supported by Middle East Regional Technical Assistance Center (METAC).

Mission Date	Mission	Date of TA Report
Fiscal Sector: Since 2007, components of a modern public financial management system have been put in place and steadily upgraded. Progress to date in PFM was made in drafting legal frameworks for the budget process and the organization of the Ministry of Finance and Planning; adopting cash management standards and establishing a cash management unit; establishing an independent external audit agency; and establishing a macro-fiscal forecast unit. A new Public Financial Management Strategy 2017–22 has been adopted to chart a path towards new legislative and regulatory frameworks; review commitment controls and cash controls; cash planning; improve the management of debt, cash and arrears; and strengthen compliance with GFSM 2001 standards. Since 2010, the TA efforts aimed at modernizing the tax administration. The work program, derived from FAD's assessment of tax policy, will strengthen the administration of income tax and VAT for the large and medium taxpayer segments and reduce tax incentives and exemptions. Recent notable progress include creating a single Taxpayer Identification Number, and operationalizing the Large Taxpayer Unit. In the medium term, FAD TA priorities will also cover public financial management.		
Jan. 22–31, 2013	Public Financial Management Progress Review	Jan. 2013
Jun. 25–Jul. 8, 2013	Supplementary Technical Review: Investment Tax Incentives and Tax Expenditure Costs	Jul. 2013
Nov. 24–Dec. 5, 2013	Strengthening LTO Operations	Dec. 2013
Jan. 8–21, 2014	Public Financial Management Reform Agenda 2014–16	Mar. 2014
Nov. 9–20, 2014	Strengthening Large Taxpayer Unit	Nov. 2014
Nov. 23–Dec. 1, 2014	Public Financial Management Progress Review	Dec 2014
Mar. 8–19, 2015	Compliance Modeling in LTU and Tax Departments	Mar. 2015
Aug. 16–27, 2015	Revenue Management System	Aug. 2015
Aug. 23–28, 2015	Work Program for Macro-Fiscal Advisor	n.a.
Oct. 13–25, 2015	Improving Taxation of SMEs: Design and Compliance Issues	Dec. 2015
Jan. 10–21, 2016	Preparation of Files for Prosecution	Jan. 2016
May 15–26, 2016	Supporting Effective Risk Management in the General Directorate of Customs Excise and VAT	May 2016

June 12–24, 2016	Budget Preparation and Macro-Fiscal Forecasting	June 2016
July 10–22, 2016	Budget Preparation and Macro-Fiscal Forecasting	Aug. 2016
July 31–Aug. 18, 2016	Training on Investigative Technique and Preparation of Customs for Prosecution	Aug. 2016
April 3–13, 2017	Budget Preparation and Macro-Fiscal Forecasting	May 2017
April 30–May 11, 2017	Customs Risk Management	April/May 2017
August 28–31, 2017	Operationalization of the PFM reform strategy	Sept. 2017
Sept. 4–13, 2017	Budget Preparation and Macro-Fiscal Forecasting	Oct 2017
Sept. 6–7, 2017	Strengthening Large Taxpayers Unit (LTU)	n.a.
Nov. 27–Dec. 7, 2017	Budget Preparation and Macro-Fiscal Forecasting	Dec. 2017
Monetary and Financial Systems: TA in this area has supported the Palestine Monetary Authority (PMA) to become a competent monetary authority, with an emphasis on developing and strengthening its capacity to supervise and regulate banks, as well as steps needed to introduce government securities, operate a high-quality reserves management system, and prepare for eventual introduction of an independent currency for the Palestinian economy when conditions are right. The PMA established a credit registry, instituted periodic stress testing of banks, introduced a deposit insurance scheme, and prepared plans for contingency crises management. The authorities have stepped up efforts to strengthen the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) framework, with the support of IMF TA.		
Jan. 13–17, 2013	Reserve Management Policy and Investment Guidelines	Jan. 2013
Mar. 31–Apr. 11, 2013	Follow up on Risk-Based Supervision Manual	n.a.
Jun. 30–Jul. 10, 2013	Follow up on Risk-Based Supervision	July 2013
Nov. 3–14, 2013	Implementing Risk-Based Supervision*	Nov. 2013
Nov. 16–26, 2013	Credit Registry	Nov. 2013
May 25–29, 2014	Follow up on Risk-Based Supervision Manual	June 2014
Oct. 26–Nov. 6, 2014	Follow up on Risk-Based Supervision Manual	n.a.
Jan. 18–29, 2015	Follow up on Risk-Based Supervision Manual	n.a.
Mar. 8–19, 2015	Review of the Crises Preparedness and Management Framework*	May 2015
April 5–16, 2015	Implementing Risk-Based Supervision*	April 2015
April 13–17, 2015	Risk Assessment and Stress Testing*	May 2015
Feb 14–25, 2016	Follow up on Risk-Based Supervision Manual	n.a.
April 3–14, 2016	Implementing Risk-Based Supervision	April 2016
Mid 2016–Ongoing	Desk-based review of the AML/CFT framework	n.a.

Sept. 25–Oct. 6 ,2016	Implementing Risk-Based Supervision	n.a.
May 14–25, 2017	Workshop to develop the CFT legal frameworks of Jordan, Iraq, and West Bank and Gaza (in Amman, Jordan)	n.a.
Sept. 24–Oct. 3, 2017	Enhancing International Financial Reporting Standard 9 Implementation	Dec. 2017
Feb. 25–March 8, 2018	Implementation of International Financial Reporting Standards	n.a.
Statistics: TA on statistical issues has focused on implementing and aligning existing statistical compilation and dissemination systems with international statistical standards across three major datasets for economic policy analysis—government finance statistics (GFS), national accounts (NA), and external sector statistics (ESS). These efforts enabled WBG to become a subscriber to the IMF's Special Data Dissemination Standard (SDDS) in April 2012. Further work is needed in improving data consistency in ESS, strengthening the methodology for quarterly GDP data, developing an inter-institutional strategic plan for GFSM2001 implementation, and developing a set of high-frequency indicators to detect economic trends and risks.		
Jan. 27–31, 2013	Balance of Payments Statistics – IIP	n.a.
May 18–29, 2014	National Accounts	June 2014
May 21–June 3, 2014	Monetary and Financial Statistics	n.a.
Dec. 7–18, 2014	Price Index	Dec. 2014
Feb. 1–12, 2015	External Sector Statistics	April 2015
Feb. 22–26, 2015	National Accounts	Mar. 2015
April 17–24, 2016	National Accounts	n.a.
Aug. 28–Sept. 1, 2016	National Accounts	Mar. 2017
Oct. 2–6, 2016	Producer Price Index	Dec. 2016
May 7–11, 2017	National Accounts	n.a.
Dec 17–21, 2017	National Accounts	n.a.

n.a. – not applicable.

* Reports classified as confidential or strictly confidential.

Annex V. Statistical Issues[1]

(As of February 27, 2018)

I. Assessment of Data Adequacy

While data provision in the West Bank and Gaza (WBG) has some shortcomings, it is broadly adequate for economic analysis and policymaking. Statistics on government finance statistics and the external sector are priority areas for improvement—for the former, the comprehensive and timely reporting of liabilities is an important issue; for the latter, the main issues concern inconsistencies between BOP and IIP data.

National Accounts: The Palestinian Central Bureau of Statistics (PCBS) compiles and disseminates annual and quarterly GDP estimates. The quarterly estimates are mainly based on volume indicators, including an index of industrial production, and quarterly labor force statistics. Quarterly GDP by production, available since 2000, is calculated only at constant prices, while the expenditure components, available since 2011, are calculated at current and constant prices. PCBS has rebased the annual and quarterly GDP from 2004 to 2015, but the estimates require improvements. The authorities have committed to improving both source data and compilation methods. The 2013 supply and use tables will be finalized and integrated in the national accounts in the near term, enhancing the accuracy of GDP estimates. In improving annual and quarterly national accounts PCBS is supported by IMF technical assistance.

Price Statistics: The PCBS has compiled and disseminated a consumer price index (CPI) for WBG since January 1996. In January 2014, the weights and index reference period was updated to 2010 using expenditure weights compiled from the 2010 Palestinian Expenditure and Consumption Survey (PECS). The next PECS is expected to be published around April 2018, following completion of the field work that was undertaken with the support of the World Bank. The PCBS has disseminated a producer price index (PPI) since 1997. Current weights are based on data collected in 2013. An updated PPI was released in January 2016. There is a need to improve CPI compilation methods, mainly in relation to regularly updating the weights for aggregation of the indexes at a higher level, full implementation of the Jevons formula at the lower level, treatment of season items and quality change, and the inclusion of housing rent expenditures.

Government Finance Statistics: Data compiled by the Ministry of Finance and Planning's (MoFP) Financial Reporting Department are broadly aligned with the recommendations of the GFSM 2001. The general government sector is comprised of the budgetary central government, the social security fund, and some local government units. The latest annual data reported to the IMF Statistics Department (STA), with reference to 2015, excluded the social security subsector, reducing the usefulness of the data for fiscal analysis. The reported data also lack information on stock positions in financial assets and liabilities. Particular attention is needed to reconcile the stocks and flows of arrears, to develop an accurate record of public debt on a gross and net basis, and to produce real-time detailed debt statements. The Audit Report on the 2011 consolidated financial statements (published in May 2016) also points to fiscal accounting weaknesses, including the need for more frequent bank reconciliations and establishing a quality control function in the MoFP's Accounting Department. Quarterly and monthly series are disseminated by the authorities (http://www.pmof.ps/en/web/guest/43). The provision of institutional, transaction, and balance sheet information needs to be enhanced to fully meet the reporting requirements outlined in *Government Finance Statistics to Strengthen Fiscal Analysis* (February 2010) and the related Board decision on the use of the GFS analytical framework for fiscal analysis.

[1] Prepared by STA, with MCD inputs.

Monetary and Financial Statistics: The Palestine Monetary Authority (PMA) compiles and reports to STA monthly monetary data for the central bank, other depository corporations (ODCs), and other financial corporations (OFCs) using the standardized report forms (SRFs). The SRFs data for OFCs are on a quarterly basis and include insurance companies only. In general, monetary data for WBG based on the SRFs are in broad conformity with the recommendations of the *Monetary and Financial Statistics Compilation Guide* (*MFSMCG*), except that the source data for ODCs do not provide complete breakdowns by counterpart sector. For this reason, claims on public nonfinancial corporations include some claims on OFCs and extra-budgetary central government units, claims on the private sector include some claims on OFCs, and deposits included in broad money also include some deposits of extra-budgetary central government units. These departures from the *MFSMCG* are well noted in the metadata (country notes).
Financial sector surveillance: Following assistance from STA, the PMA reports quarterly Financial Soundness Indicators (FSIs) to the Fund, which are published on the IMF's FSI website. However, timeliness of reporting is an issue as the latest FSI reporting is as of end-2016. The reported FSIs comprise 11 core FSIs, 6 encouraged FSIs for deposit takers (one of which with more than two years of delay), 2 encouraged FSI for other financial corporations (OFCs), 3 encouraged FSIs for non-financial corporations (NFCs), and 2 encouraged FSIs for real estate markets.
External sector statistics: WBG reports quarterly balance of payments (BOP) and international investment position (IIP) in the format of the sixth edition of the *Balance of Payments and International Investment Position Manual* (*BPM6*). There are some inconsistencies between the IIP and BOP due to gaps in coverage, misclassifications in both datasets, and inconsistencies in the methodologies employed by the two agencies (PMA and PCBS) for recording related activities. The last BOP statistics mission was conducted in February 2015. WBG also provides monthly International Reserves and Foreign Currency Liquidity data to STA (as prescribed by the SDDS), participates in the Coordinated Direct Investment Survey (CDIS) with annual data for the period 2010–16, and in the Coordinated Portfolio Investment Survey (CPIS) with semiannual data from December 2015. However, CPIS data are not fully consistent with the IIP.

II. Data Standards and Quality	
West Bank and Gaza has been an SDDS subscriber since April 2012.	No data ROSC has taken place in West Bank and Gaza.