



Semi-Annual Report on Public Budget 2019

August 2019

Introduction

This analytical paper aims to review and analyze the implementation of the public budget for the year 2019 in the first half of the year. It is based on relevant financial reports, notably June Financial Report, taking into consideration the particular emergency situation for the current fiscal year, as well as the directions of the financial plan to organize budget performance for this year. The plan covers the following principles until end of the current financial crisis because of non-reception of tax and customs clearance money (Maqqasah) from the Israeli side, which represents around 65% of the PNA revenues:

- Prioritize disbursement of the allocations to the families of martyrs and wounded and the retiree.
- Halt any recruitment or promotion.
- Cut down operational expenditure by 20%.
- Reduce capital expenditure by 50% (suspend purchase of property, vehicles, furniture or equipment except in minor cases upon the decision of the President).
- Abstain from approving any new allocations to developmental expenses and stay at the developmental projects from the previous year.
- Adopt payment of full salary of employees, as stipulated in the budget, provided that a maximum percentage is disbursed (of no less than NIS 2000 and no more than NIS 10000). The remaining pay shall be registered as debt to be repaid by the Ministry of Finance. This measure is expected to reduce the payroll by 30%

Contents of the Paper:

- I. The Legal Framework of the Emergency 2019 Budget
- II. Presentation and analysis of performance in the first half of the year
- III. Conclusions

The paper stems from data analysis on the basis of commitment and not consensus, with comparison with the budget in previous year on the one hand, and on the declared directions on reducing expenditure to implement the plan announced by the Ministry of Finance till July.

Legal Framework of 2019 Contingency Budget

Following Presidential decree, no (26) for the year 2019 on 25 March 2019 on implementing the same 2018 budget, expenditure and revenues, for 2019. Spending shall be on monthly allocations at the ration of 1/12 for every month based on the calculations of the elapsed fiscal year. The Ministry of Finance and Planning has the authority to collect revenues as per the provisions and terms of effective regulations while Article (2) prescribed that “all new appointments and promotions shall be halted as well as purchase and rental of buildings, vehicles and any other decisions that may entail financial commitments that compromise the austerity and budget tightening, until the regular public budget law is approved for the year 2019, **except in cases of emergency by decree from the President of the State.**

Upon review of the compliance of the Ministry of Finance with the regulatory framework, the following remarks may be raised:

1. Legally speaking, the Basic Law and the Law on the Regulation of Public Budget of 1998 do not provide for a possibility of contingency budget. The President only ratified the same budget as 2018 for application in 2019, provided that it is disbursed on monthly allocations basis, as per the afore-mentioned administrative instructions.
2. The delay in enacting the law is unjustified. The Government should have completed its consultations and budget drafting by end October 2018 and approve it as per applicable law before end 2018, i.e. before the resignation to the government and the occupation’s decision to seize part of the tax clearance money. However, the government uses this legal exception as an acquired right to justify the delay of ratification of the budget as stated in the law.
3. The delay in the production of monthly financial statements till May is unjustified (it was explained on the website of the Ministry of Finance as a requirement of the emergency law and legal repercussions of the relationship with the Israeli side. This pretext suspended the financial statements temporarily). Reservations are also raised against the use of the emergency law.

Presentation and analysis of the items of the public budget of 2019 after six months of entry into effect

The financial statements of the 2019 budget will be presented and analyzed in comparative tables and graphs, including:

- Presentation and analysis of **revenue** statements in the first half of 2019 with comparison with the first half 2018.
- Presentation and analysis of **public expenditure** statements in the first half 2019 with comparison with the first half 2018
- Presentation and analysis of **net lending** statements
- Presentation and analysis of **developmental expenses** in the first half 2019
- Presentation and analysis of the **financial deficit, grants and aid** in the first half 2019
- Presentation and analysis of the **public debt** statements in the first half 2019
- Presentation and analysis of the **centers of responsibility related to the social sector.**

I. Analysis of Revenues

In reason of the ratification of monthly allocations at a fraction of 1/12 of the annual budget per month, and since revenues are collected in accordance with the mechanisms, terms and amendments in applicable legislation, comparison will be held against the budget of the first half of 2018. The total realized net lending on accrual basis reached (6229.1) million NIS, while the actual net lending on cash basis (or the revenues actually collected) reached NIS 3371.2 million because the revenues from tax clearance were not collected.

Domestic revenues locally collected on accrual and cash basis reached NIS 2260.6 million, that is at the level projected in the Budget Law for the first half of 2018, which amounted to NIS 2266.5 million. This indicates that domestic collection was not affected by the disruption of tax clearance money or reduction of public expenditure in reason o the current situation.

Table (1): Comparison of net lending on accrual and cash basis in the first half 2019 with the first half 2018, in NIS million

	Realized first half 2019 on accrual basis	Realized first half 2019 on cash basis	Projections first half 2018
Total net lending	6299.1	3371.2	6848.5
Total local revenues	2260.6	2260.6	2266.5
Total revenue from tax clearance	4283.8	1300.9	4579
Tax rebates	245.3	190.3	93.5

As for the tax clearance revenues, the next table showed the revenues collected (NIS 1300.9 million), paid in the first two months, i.e. prior to the tax clearance crisis and occupation's looting of the money. The collection on accrual basis was estimated at (NIS 4283.8 million). This means that the occupation must repay NIS 2983.9 million.

Figure (1): Total tax clearance revenue collected in the first half 2019 on accrual and cash basis in NIS million

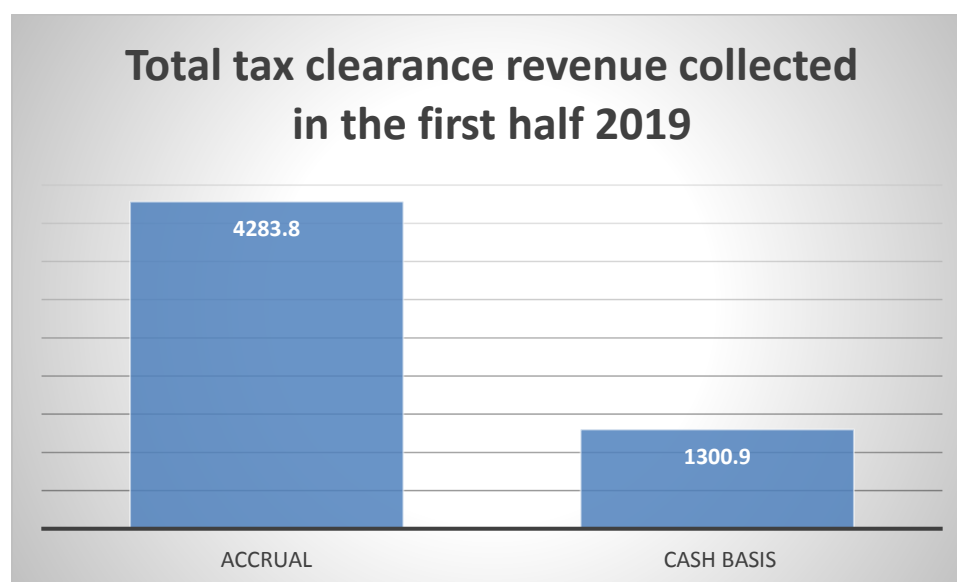
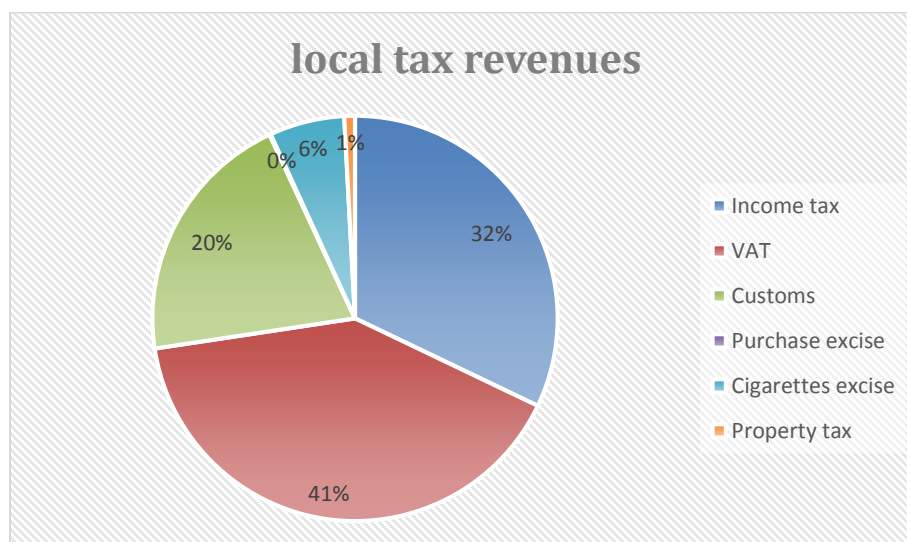


Table (2): Comparison of local taxes revenue collected in the first half 2019 with tax revenues collected in 2019, NIS million

	Collected in first half 2019	Collected in first half 2018
Local taxes revenues	1393.3	1569.2
Income tax	447.3	499.5
VAT	564.6	637.1
Customs	284.9	315.4
Purchase excise	1.4	2.1
Cigarettes excise	83.3	104.6
Property tax	11.9	10.5

The table above shows that the total local tax revenue collected reached NIS 1392.3 million, which is close to the revenue collected in the same period in the past year. This indicates that local tax collected was not affected by the tax clearance crisis (41%), followed by income tax (32%).

Figure (2): Distribution of local taxes revenues for the first half 2019



It is noted that customs dropped slightly as compared to the same period in the past year, knowing that customs revenues represent the highest projected revenue through the tax clearance money. It was supposed to reach NIS 1707.2 million in the first half of this year, i.e. 6 times the locally collected revenues. Therefore, direct importation must be encouraged to minimize the Israeli backed fraud of some Palestinian importers, which leads to tax evasion as Palestinian traders do not pay customs and VAT.

Revenues from cigarettes excise in the first half of the year attained NIS 83 million, which is less than the revenue collected in the first half of the previous year. Although the government continues to reform the trade in tobacco and fuel and fees collected to increase revenues from this sector, results of the first half did not show any improvement. It should be noted that the expected revenues of all types of taxes in 2018 were not publicized. The revenues expected from cigarettes excise were not published, unlike 2017. Projections for 2017 were NIS 830 million, while the actually collected did not exceed 25% of projections. This means a government committee with membership of all stakeholders must be established to control customs on cigarettes and tobacco and to stop the wide-spread and visible smuggling prior to holding all parties accountable for oversight over trade in cigarettes.

II. Analysis of expenditure

Table (3): Total current expenditure and net lending in 2019 budget, compared to the actual spending in the first half of 2108 on accrual basis (NIS million)

	Spending in the first half 2019 on accrual basis	Spending in the first half 2019 on cash basis	Estimated first half 2018
Total expenditure	7260.7	4561.4	8089.5
Salaries and wages	3239.2	2285.7	3939
Provident fund	328.8	63.2	382
Use of goods and services	868.7	344.4	1043
Transformational expenses	1937.8	1696	2466
Capital expenses	25.6	12.7	39
Interest	99.9	84	152.5
Net lending	572	44.1	450
Special allocations*	188.6	31.3	

Special allocations are taxes and revenues entitled to the local government units: 90% of property tax, 50% of transportation taxes.

The above table shows that the actual spending in the first half of the year reached NIS 4551.4 million, less than the estimated for the first half of the previous year, because of the current circumstances and non-collection of revenues. The effect is clear on the cuts on the paid up salaries, which amounted to NIS 2285.7 million, which is lower by NIS 953 million of the total on accrual basis. This means that the government did not pay 30% of the total value of salaries, as stated in the Budget Plan 2019. This remaining sum represents a government debt in addition to the other accumulated debts.

Speaking of the government payroll, it should be mentioned that following referral to early retirement of 22 civil and military servants in 2017, the payroll was reduced before 2019 and the spurge of the financial crisis. Employees in 2019 reached 153,000 (50,00 military servants and

78,000 civil) while employees early 2017 reached 153000. Furthermore, many bonuses and other benefits were cut for the employees of the Gaza Strip in 2017 and 2018, which reduced the payroll by half. However, part of these cuts were repaid and made raised the percentage of their salaries paid from 78% to 85% in April 2019. With the cuts on salaries, the estimates with the current crisis were made on the basis of 78% of the total salaries of the Gaza Strip. This means, 50 – 78% of the salaries were paid to Gaza Strip employees¹.

As for the provident fund, or government's contribution to employees' pension, which is supposed to be paid to the Pension Fund, it appears that only 19% of the sum supposed to be paid were paid. This entailed an additional government debt of Nis 265 million for the first half of this year.

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The table shows that the actual operational cost reached NIS 344 million, which is less than the accrual basis estimates. This means that operational cost was cut by more than 50% and not only 20% as projected. The financial statements available do not provide a disaggregation of the operational cost per center of responsibility. It should be known, however, that the Ministry of Finance sent a circular to all centers of responsibility to reduce their expenditure, as per the aforementioned administrative orders. The cuts were supposed to reach 20% provided that there are cuts on travel, missions, hospitality and fuel bills be cut down.

¹ Interview with the Director General of Public Budget, Ministry of Finance, Mr. Tareq Mustapha, on 24 July 2019

III. Net lending

The net lending appropriations for the first half of the year amounted to NIS 572 million. This means that the sum is expected to exceed NIS 1 billion by the end of the year. Regardless of the current crisis, the net lending rises constantly. Thus, government's efforts to halt net lending and plan to cut it did not materialize. It should be noted that there aren't sufficient details on the net lending. It is necessary to adopt a transparent policy on the debts of local government units and the clearances between the central and local governments in this regard.

Figure (3): Comparison of estimated and actual net lending in the years 2014-2019

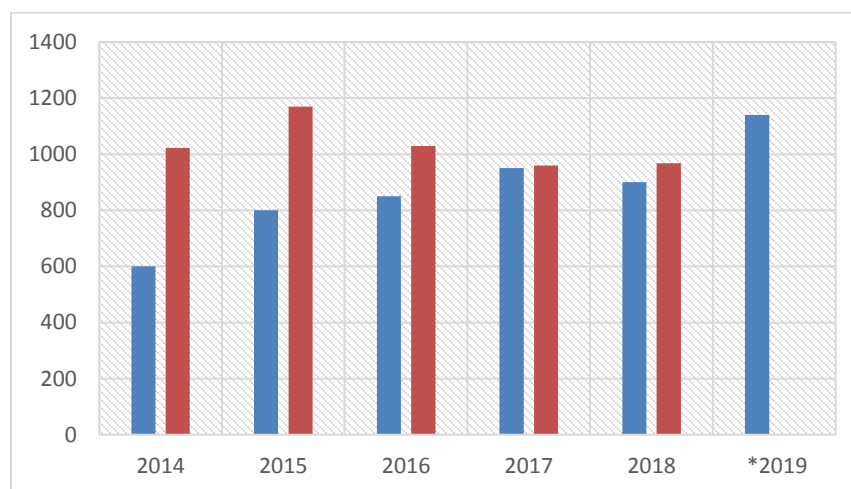


Table (4): Net lending in the years 2014-2019: estimates and actual in NIS million

Year	Projections	Actual
2014	600	1022.3
2015	800	1169.2
2016	850	1029.1
2017	950	960

The net lending for 2019 was estimated

IV. Developmental Expenses

Measures aiming at reducing public expenditure to face the crisis of non-transfer of tax clearance money including: halting approval of any new developmental expenses and stay at the projects commenced in the previous year only. The total developmental expenses in the first half of the year on accrual basis amounted to NIS 574 million, but what was actually expended (on cash basis) reached only NIS 312 million, which is NIS 200 million less. The financial statements published by the Ministry of Finance in its June 2019 monthly report showed that developmental funding in the first half of the year totaled (- NIS 261, million), which is a negative value since in January NIS 448 million were returned to the American Consulate following closure of the grant's account. In reason of lack of any statements that detail spending for every center of responsibility on cash basis, the following table shows some centers of responsibilities and their relevant developmental expenses on accrual basis. These represent 80% of the total developmental spending in the first half of 2019, and are compared to the expenses on accrual basis for the same period in the previous year. It should be noted that these expenses were allocated 60% of the overall developmental spending for the same period last year. In the absence of a budget and projections for 2019, comparison was made with what was expended in the previous year, noting that the expenses on accrual basis refer to sums of money that will be disbursed in a later period, which represent obligations and debt for the government.

Table (5): Developmental expenses for the first half 2019 on accrual basis, compared to the first half of 2018

	Expended on accrual basis in the first half 2019	Percentage per every center of responsibility	Expended on accrual basis, first half 2018
Total Development expenses	574,017,000		574,973,000
Ministry of Interior and security	75,060,000	13%	68,505,000
Ministry of Local Government	96,185,000	17%	64,406,000
Water Authority	91,042,000	16%	106,803,000
Ministry of Agriculture	35,298,000	6%	590,000
Ministry of Education	137,726,000	24%	115,231,000
Ministry of Health	29,615,000	5%	28,481,000

The table shows that the Ministry of Education received the highest share of developmental expenses (24% of the total developmental expenses in the first half-year), followed by the Ministry of Local Government while the expenses for the Ministry of Health reached NIS 29 million, representing 5% of the total developmental expenses for this half year. Nonetheless, the Ministry of Health should receive the highest share of developmental expenses in order to upgrade the governmental health services and localize the provision of health services to minimize referrals outside the Territory, especially to Israeli hospitals. It is noticeable that the Ministry of Agriculture, based on the statement of the Ministry of Finance, received NIS 35 million on accrual basis while it represented less than one million NIS in the first half of last year. This raises questions about developmental agricultural projects and promotion of the sector.

V. Deficit and Arrears

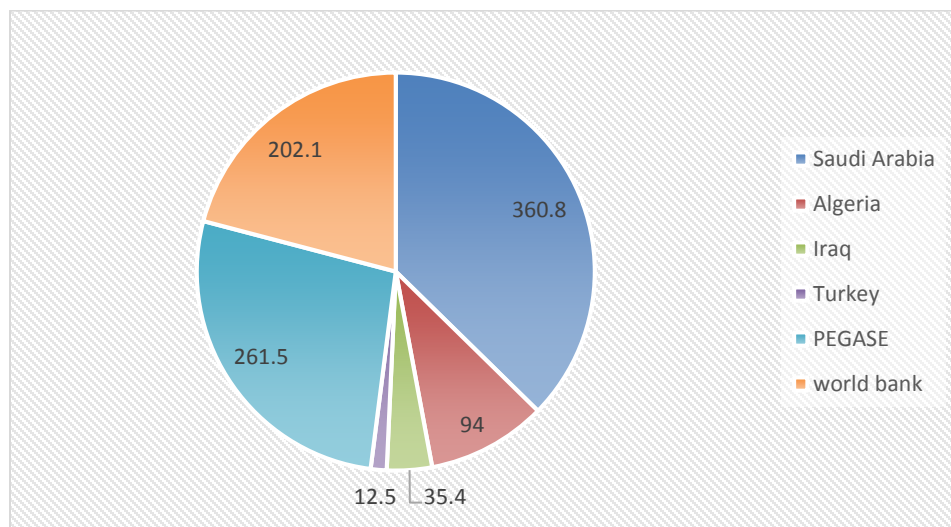
The pre-finance total deficit in the first half year 2019 reached NIS 1502.6 million, while the total funding and following deduction of the sums returned to the American Consulate, reached NIS 705.4 million. Thus, the budget deficit attained Nis 707.1 million. Part of the arrears entitled to the private sector were repaid through payment orders of NIS 496.3 million. Borrowing from banks reached \$ 284 million, which is equal to NIS 1022 million, but which remains less than the projections of the Ministry of Finance, which according to the government plans should have been \$ 427 million.

Table (6): Total external funding in the first half 2016 in NIS million

	Received in the first half 2019
Total external funding	705.5
Total deficit support	966.5
Developmental funding	-261

The total foreign funding for the first half year reached NIS 705.5 million while the total support to the budget attained NIS 966.5 and the total developmental funding attained (- NIS 261 million) following return of the American grant of NIS 448 million.

Figure (4): sources of budget foreign assistance in first half 2019



The table below shows that aid from USA did not arrive in reason of the political situation and the Palestinian stance toward the deal of the century together with subsequent freezing of grants. It also shows that most of the aid came from Saudi Arabia, followed by the Palestinian European Funding Mechanism to Support and Manage Social Assistance in addition to the newly received funding from Iraq, which did not exist in previous years.

Table (7): Total foreign assistance (budget and developmental support)

Total foreign assistance (budget and developmental support)			
Year	Amount NIS million	Reduction	Change rate
2013	4915		
2014	4402	-513	-10%
2015	3104	-1298	-29%
2016	2905	-199	-6%
2017	2597	-308	-11%
2018	2411	-186	-7%

A reduction in foreign aid is noticed in previous years following impasse of the peace process in addition to gearing of support from donors to other areas (refugees' issues, fighting terror, emergence of humanitarian needs in Yemen, Syria, Turkey, etc. In spite of the drop in foreign aid, coping with this situation is still limited where there remains in problem in projecting the grants and aid and assessing the gap between the projected and actual sum.

VI. Public Debt

The overall public debt in 2019 reached NIS 8788.7 million. Statements of the Ministry of Finance show a rise in public debt end June 2019, to attain NIS 9323.2 million – that is an increase of NIS 534 million. Local debt, especially short-term debts reached NIS 1174.2 while long-term debts decreased by NIS 452 million.

Table (8): Comparing public debt from January 2018 – June 2019, NIS million

	January 2018	June 2019	Difference
Public debt	8788.7	9323.2	534.5
Local debt	4906.6	5628.8	722.2
Foreign debt	3882.1	3694.5	-187.6

Table (9): Comparing local public debt in the period from January 2018 – June 2019, NIS million

	January 2018	June 2019	Difference
Local debt	4906.6	5628.8	722.2
Short-term debt	2936.4	4110.6	1174.2
Long-term debt	1970.2	1518.2	-452

VII. Allocations to Ministries Concerned with Social Affairs

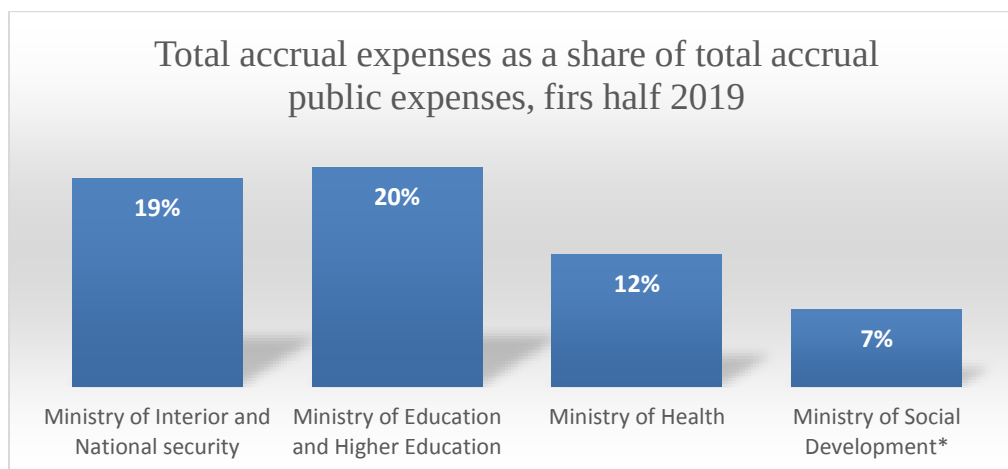
In this case study, the general expenses of ministries and centers of responsibilities related to social services (Ministry of Education, Ministry of Health, Ministry of Social Development) will be compared with the Ministry of Interior and National security for the first half 2019

Table (10): Comparison of expenses per center of responsibility (on accrual basis) in the first half 2019, NIS 1000

	Total accrual expenses, first half 2019	Total accrual expenses, first half 2018	Total accrual expenses as a share of total accrual public expenses, first half 2019
Ministry of Interior and National security	1,325,875	1,503,141	19%
Ministry of Education and Higher Education	1,402,523	1,400,582	20%
Ministry of Health	821,749	862,210	12%
Ministry of Social Development*	510,496	664,927	7%

* NB: The Ministry of Social Development comprises the Ministry of Social Developments and the Palestinian Authority Martyrs' Fund

Figure (5): Comparing actual expenses to the total expenses of the centers of responsibility (on accrual basis) in the first half 2019, NIS 1000



The above table and figure show the following:

The above table and figure show a reduction in expenditure in all centers of responsibility although the sums stated in the table are on accrual basis, i.e. not associated to the cuts resulting from the current crisis. Still, a cut is noticed in comparison to the same period last year. It should be noted that the Ministry of Finance set a circular to all centers of responsibility to reduce their expenses based on the afore-mentioned administrative instructions. The circular also included a drop in operational cost by 20% provided that miscellaneous, travel missions, hospitality and fuel be also cut down.

An audit of the structure of expenses per every center of responsibility raised the following remarks:

- The Ministry of Interior captured 19% of the total public expenses while the overall expenditure in the first half of 2019 dropped by NIS 177 million, compared to its level in the previous year. Total expenses on payroll dropped by NIS 90 million while social aid decreased by NIS 56 million and operational cost diminished by NIS 30 million.
- The Ministry of Health received 12% of the total public expenses and its overall spending in the first half 2019 decreased by NIS 40 million compared to the first half 2018. Reduction of operational expenses reached NIS 39 million. Communication with MoH revealed instructions on itemized cuts on operational cost by 20%. However, MoH already has debts of NIS 1 billion, which means that the ceilings of its operational budget do not concord with its actual requirements. For instance, in the beginning of 2019, the medical referral budget was set at NIS 650 million, while the actual cost of referrals approved this year reached NIS 1 billion. The Director General of Financial Affairs at the Ministry of Health referred to problems related to accumulated debt, which compromise the services delivered to citizens. For instance, the cleaning companies contracted by hospitals went on a strike in June of this current year to claim payment of their entitlements. Thus, there is a need to additional budget allocations to the Ministry of Health to fulfil its actual needs.
- The Ministry of Education received 20% of the total public expenditure, which represents the highest share while no changes occurred to its total expenditure compared to the first half 2018. Furthermore, there were no changes in its spending structure.

- The Ministry of Social Development together with the Palestinian Authority Martyrs Fund received 7% of the total public expenditure. An audit of its internal budget items showed that its operational cost in the first half of this current year was less than the same period in the previous year, albeit very slightly.

Generally speaking, ministries do not publish periodic quarterly or semi-annual financial statements, which undermines the possibility of tracking its expenses and ensure they comply with the budget-tightening instructions. Furthermore, this obstructs the possibility of holding them accountable for their expenditure.

Main findings:

The findings of the report are as follow:

1. From a legal perspective, according to the provisions of the Basic Law and Law on the Regulation of the Public Budget and Financial Affairs No. 7 of 1998, there is no basis to enact an emergency budget. The President used the same 2018 budget to be executed in 2019. The budget will be disbursed on a monthly basis in line with administrative instructions on expenditure management.
2. Delayed approval of the law is totally unjustifiable. The government was supposed to finalise consultations and budget formulation at the end of October 2018. The budget had to be duly enacted towards the end of 2018; i.e. well before the government resigned and Israel decided to seize a portion of clearance revenues.
3. Contrary to the 1998 Law on the Regulation of the Public Budget, there is a problem with implementing the principles of transparency in relation to disclosing the public budget and relevant details. Issuing monthly financial reports in May is unjustifiable. According to the Ministry of Finance (MoF) website, “[d]ue to the Emergency Law and legal consequences with the Israeli side, financial reports have been temporarily suspended”. Reservations are expressed concerning the use of the term “emergency law”, which has no legal basis or definition.
4. **Revenues:** As a result of the current situation, revenues generated in H1 2019 represented almost half of the estimates owing to the non-receipt of clearance revenues and political position. However, this crisis has not affected local tax collection, which was close to the rates achieved in the same period of 2018.
5. In spite of the government approach to continuing to adjust and increase revenues from the tobacco and fuel trade, feasible results were not achieved in H1 2019. Hence, a government committee should be established, including representatives of all stakeholders, to control cigarette and molasses customs duties, put an end to the common and visible phenomenon of smuggling, and hold to account supervisory bodies in charge of cigarette trade.
6. **Expenditures:** Processes of monetary rationalisation and reduction of expenditure on a cash basis were complied with. However, this indicates an increasing debt burden on the government. Operating expenses were reduced, but there is a need to make clear what these

reduced operating expenses are. Development sectors that involve public service provision should necessarily be avoided.

7. **Net lending:** In view of the H1 2019 net lending estimates and apart from the current crisis, net lending is clearly on an upward trend. The government approach to curbing this item has not taken effect.
8. **Deficit and arrears:** Due to the current situation, reduced foreign assistance and suspended US aid, the budget deficit has risen, and so have the domestic debt and arrears.