

State of Palestine

Ministry of Finance

**Fiscal Developments & Macroeconomic Performance:
Second Quarter and Mid-year Report 2014**

Macro Fiscal Unit

July 22, 2014

Fiscal Operations Jan-Jun 2014

Budget Execution Highlights:

- **Total Budget Deficit** during the first half of the year 2014 reached NIS 2.81 billion, which is almost equal to the parallel period in 2013. The recurrent deficit, however, witnessed a decrease of 8% during the first half of 2014, standing at NIS 2.3 billion, compared to a NIS 2.47 billion in 2013.
- **Gross Revenues** amounted to NIS 5.42 billion in the first half of 2014 and thus witnessed a significant 21% increase with regards to the parallel period in 2013, which stood at NIS 4.48 billion.¹
- **Total Net Revenues** also experienced a sharp increase of 23% during Jan-Jun 2014 with regards to the same period in 2013. Total Net Revenues during the aforementioned period in 2014 stood at NIS 5.06 billion, whilst they stood at NIS 4.09 billion during the parallel period in 2013. This increase is attributed mainly to the increase clearance revenues and domestic tax revenues by 31% and 10%, respectively.
- **Total expenditures** during Jan-June 2014 increased by 11% when compared to the Jan-Jun 2013, mainly due to increases in the **wage bill**, **net lending** and **operational spending** by 4%, 59% and 71%, respectively. Social contributions increased by a slight 3%; and minor capital increased by 78%, taking into consideration that it is the smallest component of total expenditures. As a final note, transfers and interest expenditures were decreased from Jan-Jun 2013 to Jan-Jun 2014 by 6% and 69%, correspondingly.
- **Development Expenditures** increased by 60% during the first six months of 2014 relative to the same period in 2013; this increase was made possible by the 58% increase in development financing.
- **External Budgetary Support** achieved only 28% of its half-year budget and also witnessed a decline of 42% during the first half of 2014 compared to the parallel period in 2013. Moreover, **development financing** saw a 58% increase in the first half of 2014 when compared to the same period in 2013; however it only reached 22.5% of its budget. Meanwhile, external budgetary support declined by 42% in Jan-Jun 2014 when compared to Jan-Jun 2013; it also reached only 28% of its budget, which is a shortfall of NIS 1071 million (44.8%).
- **Total domestic debt stock** amounted to 4.29 NIS billion at the end of June 2014, where the treasury managed to decrease its debt by NIS 118 million during the first six months of 2014.
- **Total net accumulation of arrears** from January until June 2014 reached NIS 1.4 billion, of which NIS 190 million account to development expenditures, NIS 52 million to tax refund arrears and NIS 1.162 billion to total expenditure arrears. Arrears to the private sector including the “other” component of tax refunds arrears amounted to NIS 761 million.

¹ Gross Revenues is the summation of Gross Domestic Revenues and Clearance Revenues.

	Jan-Jun 14	Jan-Jun 13	Jan-Jun 2014/Jan-Jun 2013	Q2 2014	Q2 2013	Q2 2014 / Q2 2013	2014 Budget	6/12 share of budget	% of budget	Deviation from budget	Deviation from budget
	NIS million	NIS million	%	NIS million		%	NIS million	NIS million	%	NIS million	%
Gross Revenues	5422.1	4482.5	21%	2516.9	2100.6	20%	9871	4936	54.9%	487	9.9%
Total Net Revenues	5052.5	4097.7	23%	2360.4	1887.6	25%	9311	4656	54.3%	397	8.5%
Gross Domestic Revenue	1754.6	1672.3	5%	665.9	679.2	-2%	3326	1663	52.8%	92	5.5%
Domestic Tax Revenues	1251.1	1137.8	10%	423.9	471.3	-10%	2329	1165	53.7%	87	7.4%
Income Tax	483.6	434.0	11%	125.2	121.3	3%	742	371	65%	113	30.4%
Value Added Tax	515.3	386.2	33%	191.2	202.7	-6%	912	456	57%	59	13.0%
Customs	121.8	87.6	39%	57.8	39.0	48%	225	113	54.1%	9	8.3%
Excises on Beverages	1.2	2.3	-50%	0.7	1.1	-35%	13	7	9.1%	-5	-81.9%
Excises on Tobacco	121.6	219.8	-45%	48.3	106.7	-55%	422	211	28.8%	-89	-42.4%
Property Tax	7.6	7.9	-4%	0.6	0.6	8%	15	8	51%	0	1.1%
Clearance Revenue	3667.6	2810.2	31%	1851.0	1421.5	30%	6545	3273	56.0%	395	12.1%
Customs	1197.6	951.8	26%	631.6	492.4	28%	2247	1124	53.3%	74	6.6%
Value Added Tax	1155.2	946.5	22%	575.6	458.0	26%	2120	1060	54.5%	95	9.0%
Purchase Tax	6.2	1.8	236%	7.3	-3.6	-302%	23	12	26.9%	-5	-46.1%
Petroleum Excise	1265.2	901.8	40%	630.9	470.3	34%	2145	1073	59%	193	18.0%
Income Tax	43.3	8.1	432%	5.6	4.4	25%	10	5	433%	38	766.3%
Tax Refunds (-)	369.6	384.8	-4%	156.5	213.0	-27%	560	280	66%	90	32.0%
Fuel	324.7	331.0	-2%	141.5	200.1	-29%	480	240	68%	85	35.3%
Other (2)	44.9	53.9	-17%	15.0	12.9	16%	80	40	56%	5	12.3%
Nontax Revenues	503.5	534.5	-6%	242.0	207.8	16%	997	499	50%	5	1.0%
Domestic Fees and Charges	467.3	471.7	-1%	241.8	207.8	16%	897	449	52%	19	4.2%
Investments Profits (3)	36.2	62.8	-42%	0.2	0.0	#DIV/0!	100	50	36%	-14	-27.6%
Total Expenditure	7321.5	6574.8	11%	3901.7	3350.6	16%	13916.0	6958	53%	364	5.2%
Wages and salaries	3581.8	3436.0	4%	1821.9	1728.1	5%	7265.2	3633	49%	-51	-1.4%
Social contributions	329.9	319.9	3%	167.9	158.4	6%	655.3	328	50%	2	0.7%
Use of goods and services	1430.0	837.3	71%	832.8	450.6	85%	1937	969	74%	461	47.6%
Transfers	1396.5	1478.4	-6%	757.8	720.3	5%	3162	1581	44%	-185	-11.7%
Minor capital	19.2	10.8	78%	12.8	7.5	70%	76	38	25%	-19	-49.6%
Interest	51.8	169.7	-69%	19.4	78.8	-75%	220	110	24%	-58	-52.9%
Domestic	45.7	163.3	-72%	16.3	74.7	-78%	205	103	22.3%	-57	-55.4%
External	6.0	6.4	-5%	3.1	4.0	-23%	15	8	40.3%	-1	-19.4%
Net lending	512.3	322.8	59%	289.1	206.9	40%	600	300	85.4%	212	70.8%
Current Balance	-2269.0	-2477.2	-8%	-1541.2	-1463.0	5%	-4605	-2302	49.3%	33	-1.5%
Development Expenditures	539.2	336.8	60%	251.3	195.7	28%	1260	630	42.8%	-91	-14.4%
Balance	-2808.2	-2813.9	0%	-1792.5	-1658.7	8%	-5865	-2932	47.9%	124	-4.2%
Financing	2808.2	2813.9	0%	1792.5	1658.7	8%	5865	2932	47.9%	-124	-4.2%
External Budgetary Support	1321.6	2275.9	-42%	690.2	461.3	50%	4785	2393	28%	-1071	-44.8%
Development Financing	242.9	153.5	58%	119.6	73.3	63%	1080	540	22.5%	-297	-55.0%
Net Domestic Bank Financing	-115.3	-378.9	-70%	253.6	234.7	8%					
Expenditure Arrears (Net Accumulation)	1351.5	660.1	105%	891.5	474.9	88%					
Clearance Revenue Adjustment	-14.4	-37.8	-62%	-5.1	-111.9	-95%					
Tax Refunds (Arrears)	51.9	-101.6	-151%	-48.2	191.9	-125%					
Residual	-58.8	167.4	-135%	-119.1	110.7	-208%					

Revenues

The 2014 budget was based on the baseline scenario of the medium term macro-fiscal framework (MTFF). The 2014 budget assumes status-quo; with no breakthrough in the peace talks, and no change in Israeli restrictions on the Palestinian economy. Yet, despite all these challenges, MoF managed to achieve moderate increase in revenues due to the reform efforts conducted based on the revenue strategy, such as:

1. Widening the tax base
2. The LTU- the unification of all taxpayers files into a single file
3. Revision of tax holidays and the investment promotion law
4. Improving trade and financial relations with the Israeli side through Joint Economic Committees/Sub-committees to resolve outstanding issues and enhance clearance revenue collection.

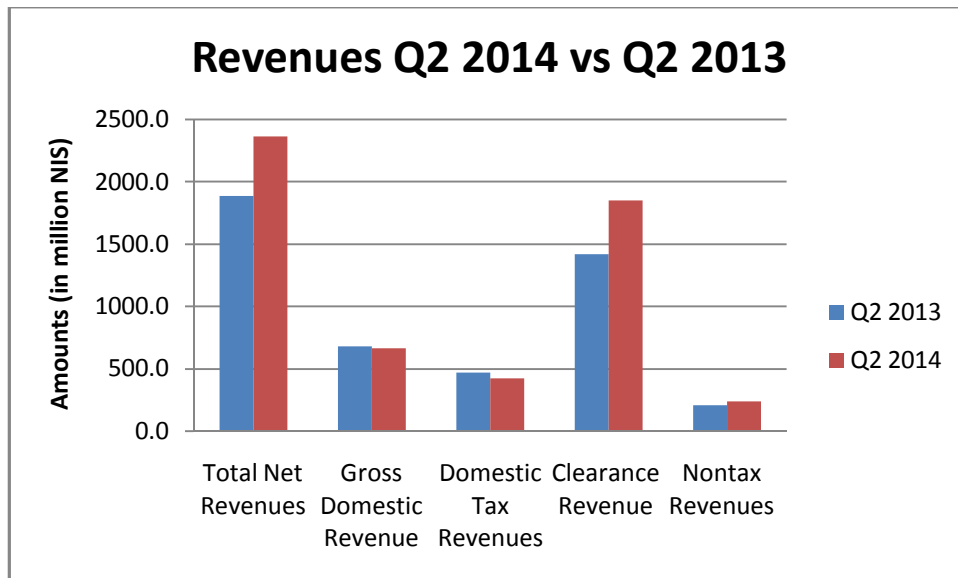
Gross revenues in Q2 2014 amounted to NIS 2.52 billion, which is a 20% increase over Q2 2013. **Total net revenues** also witnessed an increase in Q2 2014 over Q2 2013 by a significant 25%, and amounting to NIS 2.36 billion, which is 8.5% above the budget. During the first half of 2014, **gross revenues** amounted to NIS 5.42 billion, which is a 21% increase over the same period of 2013, where gross revenues stood at NIS 4.48 billion. As for total net revenues, a noticeable increase also occurs from NIS 4.09 billion in Jan-Jun 2013 to NIS 5.05 billion in Jan-Jun 2014. Total net revenues and gross revenues exceeded their half year budget target (by NIS 397 million and NIS 487 million, respectively) mainly due to the over-performance of clearance revenues and domestic tax revenues above the half year budget by NIS 395 million and NIS 87 million, in that order.

Domestic tax revenues amounted to NIS 423 million during Q2 2014 and to NIS 1.25 billion during the first half of 2014, representing a 10% decrease when compared to Q2 2013 and a 10% when compared to the first half of 2013. The decline in the second quarter of 2014 over the same period of 2013 is mainly attributed to the underperformance of **excises on tobacco**, which declined by 55% from NIS 106.7 million in Q2 2013 to only NIS 48.3 million in Q2 2014. **Domestic Income Tax** during the first half of 2014 witnessed an 11% increase over the parallel period last year, and stood above the budget target by a significant 30.4%. **Domestic VAT**

amounted to NIS 191 million in Q2 2014, a 6% decrease over Q2 2013 where domestic VAT stood at NIS 202 million. When looking at half year figures, however, domestic VAT seems to have jumped a significant 33%, from standing at NIS 386 million during Jan-Jun 2013 to NIS 515 million during Jan-Jun 2014 which is 13% above the budget target. Domestic VAT collections amounted to 32 million paid by the Arab Bank in June 2014 in the form of advances or payment of back taxes.

Nontax revenues amounted to NIS 242 million in Q2 2014, a 16% increase over the parallel period in the previous year is mainly due to an increase in licenses fees during April, May and June of 2014 when compared to previous months. However, when evaluating the period of Jan-Jun 2014, it is apparent that nontax revenues have declined from NIS 534.5 million during Jan-Jun 2013 to NIS 503.5 million during the same period in 2014. This is mainly due to no dividends or investment profits being collected from the PIF during the second quarter of 2014, where the last collection of dividends was made in February and amounted to NIS 36 million. Yet, nontax revenues did not fall below budget and actually exceeded the half year budget target by NIS 5 million or by 1%; whereas investment profits are significantly below the half year budget target by 27.6%.

Clearance revenues, which account for two thirds of the revenues, reached NIS 1.85 billion in Q2 2014, which is a dramatic 30% increase from Q2 2013 during which clearance revenues amounted to NIS 1.4 billion. Similarly, clearance revenues during the first half of 2014 were 31% over 2013 figures during the same parallel period; in 2013 mid-year figures, clearance revenues stood at NIS 2.8 billion, whereas in 2014 mid-year figures, they now stand at NIS 3.67 billion. The high performance of the clearance revenues in 2014 can be attributed to the improvement in all of its items, which have all experienced significant increases in 2014 over 2013 figures. In specific, customs, VAT, purchase tax, petroleum excise and income tax have witnessed a 26%, 22%, 236%, 40% and 432% increases, over 2013 mid-year figures, respectively. Additionally, even with good performance of clearance revenues in the first half of 2014, it is expected to perform even better during the second half of the year as historical trends of the revenues indicate.



Tax refunds witnessed a 4% decline in mid-year 2014 compared to the parallel period in 2013; they reached NIS 370 million during the first half of 2014 but were at NIS 385 million during the first half of the previous year. As for the second quarter of 2014, tax refunds NIS 156 million, which is a 27% decrease over Q2 2013, where tax refunds stood at NIS 213 million. Additionally, the average for the fuel subsidy in Q2 2013 was NIS 66.7 million, but for Q2 2014 the average was NIS 47.2 million. Thus, it is concluded that the decline in fuel subsidies is mainly attributed to PA policies which attempt to reduce the subsidy to sustainable levels.

Total Expenditures and Net Lending

Total expenditures and net lending in the first half of 2014 amounted to NIS 7.32 billion, that is 11% increase over the first half of 2013, and above the budget target by NIS 364 million (5.2%), where this increase can be mainly attributed to increases in Use of Goods and Services and net lending. In Q2 2014, total expenditure and net lending was equal to NIS 3.90 billion, an increase of NIS 481.9 million from the first quarter (14%).

Wage expenditure in the first half of 2014 was NIS 3.58 billion and increase of NIS 146 million when compared to the first half of the previous year. The 2nd quarter of 2014 experienced an increase of 5% from the 2nd quarter of 2013 and was equal to NIS 1.82 billion. Wage

expenditure was also below the target budget by NIS 51 million equal to 1.4%. Wage expenditure on commitment basis witnessed an increase due to the implementation of the agreement with the health services workers; however this amount was not paid on cash basis, but is acknowledged on commitment basis.

Table 1. Budget Execution Jan-Jun 2014, Wages and Salaries by Sector, NIS thousand.

Sectors	Wages and Salaries	2013 Sector Budget	% of Sector Budget
Central Administration	189,964	374,824	51%
Security and Public Order	1,581,851	3,272,515	48%
Financial Affairs	114,557	232,467	49%
Foreign Affairs	66,719	142,180	47%
Economic Development	93,278	187,798	50%
Social Services	1,440,352	2,860,384	50%
Cultural and Information Services	60,870	124,171	49%
Transport and Communication Services	34,204	70,819	48%
Total	3,581,795	7,265,159	49%

Social contribution of NIS 329 million in the first half of 2014 exceeded the budget target by 0.7% and increasing NIS 10 million over the first half of 2013. The 2nd quarter of 2014 amounted to NIS 167 million increasing by 6% over the 2nd quarter of 2013.

Table 2. Budget Execution Jan-Jun 2014, Social Contribution by Sector, NIS thousand.

Sectors	Social Contribution	2013 Sector Budget	% of Sector Budget
Central Administration	15,003	28,341	53%
Security and Public Order	152,851	318,713	48%
Financial Affairs	10,324	19,672	52%
Foreign Affairs	1,527	2,973	51%
Economic Development	8,908	17,576	51%
Social Services	132,167	250,657	53%
Cultural and Information Services	5,829	10,646	55%
Transport and Communication Services	3,295	6,762	49%
Total	329,905	655,339	50%

Use of goods and services increased 71% over the first half of 2013, equal to NIS 1.43 billion which exceeded the target budget by 47.6%. Use of goods and services in the 2nd quarter of 2014 was equal to NIS 832 million, displaying an 85% increase over the equivalent period of 2013. The higher than budget amounts are mainly attributed to payment of arrears in the 1st quarter, and health referrals, which are deducted directly from clearance revenue by Israel; around NIS 31 million average monthly health referral deductions were made during half-year 2014 as opposed to NIS 15 million during half-year 2013.

Table 3. Budget Execution Jan-Jun 2014, Use of Goods & Services by Sector, NIS thousand.

Sectors	Use of Goods& Services	2013 Sector Budget	% of Sector Budget
Central Administration	132,062	304,486	43%
Security and Public Order	170,930	340,238	50%
Financial Affairs	15,785	73,875	21%
Foreign Affairs	38,925	92,980	42%
Economic Development	9,891	53,847	18%
Social Services	488,749	955,716	51%
Cultural and Information Services	32,899	100,957	33%
Transport and Communication Services	4,878	15,150	32%
Total	894,119	1,937,249	46%

Transfers which amounted to NIS 1.39 billion in the first half of 2014 show a decrease of 6% over the first half of 2013 which was equal to NIS 1.47 billion. The 2nd quarter of 2014 witnessed a 5% increase over the 2nd quarter of 2013; it is also below the target budget by 11.7%.

Minor capital expenditure amounted to NIS 19 million in the first half of 2014 increasing by 78% over the first half of 2013 which was equal to NIS 10.8 million. In the 2nd Quarter of 2014 minor capital was 70% above the 2nd quarter of 2013 and below the target budget by 49.6%.

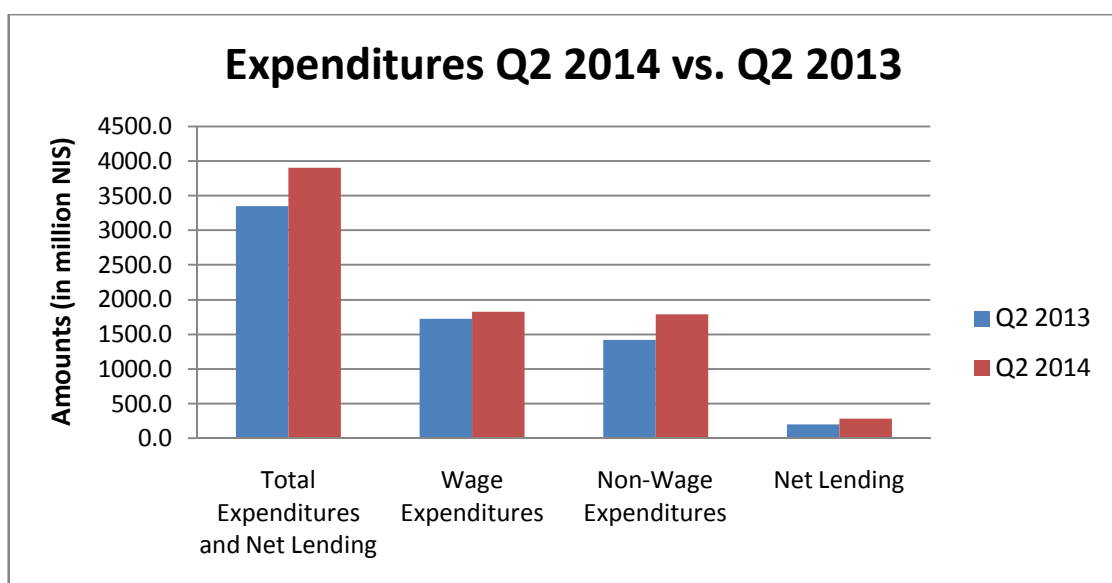
Table 4. Budget Execution Jan-Jun 2014, Transfers by Sector, NIS thousand.

Sectors	Transfer Expenditure	2013 Sector Budget	% of Sector Budget
Central Administration	56,825	131,915	43%
Security and Public Order	22,913	130,000	18%
Financial Affairs	539,856	1,039,100	52%
Foreign Affairs	5,294	14,000	38%
Economic Development	23,000	50,000	46%
Social Services	760,519	1,796,915	42%
Cultural and Information Services	-	200	0%
Transport and Communication Services	-	-	0%
Total	1,408,407	3,162,130	45%

Interest payments during the first half of 2014 amounted to NIS 51.8 million combining both domestic and external interest, that is 69% below the first half of 2013 which was equal to NIS 169 million. The 2nd quarter of 2014 also showed a decrease of 75% from the 2nd quarter of 2013, and is equal to NIS 19.4 million. Interest is also NIS 52.9 million below the target budget.

Net lending amounted to NIS 512 million a 59% increase when compared to the corresponding period of 2013. Net lending in the second quarter of 2014 is equal to NIS 289 million, increasing by 40% over the 2nd quarter of 2013. Net lending also exceeded the target budget by 70.8%. This substantial increase in net lending is mainly due to the increased clearance revenue deduction on the electricity debt to IEC.

Development expenditure is equal to NIS 539 million in the first half of 2014, 60% above the first half of 2013 which amounted to NIS 336 million. The 2nd quarter of 2014 also increased by 28% over the 2nd quarter of 2013 reaching NIS 251 million from NIS 195 million, yet it is below the target budget by 14.4%. This increase in development expenditure was made possible by the 58% increase in development financing and to payments of development arrears.



Balance and Financing

Balance: In the first half of 2014, the recurrent budget deficit amounted to NIS 2.26 billion, a 8% increase over the first half of 2013. The recurrent deficit exceeded the budget target by NIS 33 million (1.5%). In Q2 2014, the recurrent balance amounted to NIS 1.54 billion which is higher than the deficit in Q2 2013 by 5%. **Total deficit** during the first half of the year amounted to NIS 2.80 billion, with no change when compared to the first half of 2013 which was equal to NIS 2.81 billion. The total budget deficit was below budget target by NIS 124 million equal to 4.2%. The balance in the 2nd quarter of 2014 amounted to NIS 1.79 billion increasing by 8% over the previous corresponding period.

Financing: During the first half of 2014, external budget support amounted to NIS 1.32 billion, a 42% decrease below the same period of 2013. External budget support is 44.8% below the budget target. In the 2nd quarter of 2014 external budget support amounted to NIS 690 million increasing 50% over the same period of the previous year. **Development financing** in the first half of 2014 is 55% below the target budget, and is equal to NIS 242 million, an increase of 58%

² Non-wage expenditures include: social contributions, use of goods and services, transfers and minor capital.

over the first half of 2013. Development financing in Q2 2014 exceeded Q2 2013 by 63%, and amounted to NIS 119 million.

Arrears

Total net accumulation of arrears during the first half of 2014 amounted to NIS 1.4 billion, including development expenditure arrears of NIS 190 million, tax refund arrears of NIS 52 million and total expenditure arrears of NIS 1.162 billion. As for the arrears to the private sector, which includes use of goods and services, minor capital, development, interest, and the “other” tax refunds, have accumulated to NIS 761 million. With regards to the accumulation of arrears of transfers, it reached -11.9 by end of June 2014, mainly due to payments made in January of arrears from December 2013.

Table 5. Accumulation of Arrears Jan-Jun 2014	
<i>Budget Classifications</i>	NIS mill
Wages and salaries	304.2
Social contributions	329.9
Use of goods and services	535.9
Transfers	-11.9
Minor capital	7.9
Interest	-4.4
Development Expenditure	190.0
Fuel Tax Refund	20.7
Other Tax Refund	31.3
Total	1403.5