Economic Feature
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The Portland Trust

REDUCING AID DEPENDENCY IN THE PALESTINIAN TERRITORY

Aid to the Palestinian Territory reached record levels in recent years. Whilst this has undoubtedly helped underpin economic recovery in the West Bank, the medium term strategy of the Palestinian Authority (PA) is to reduce dependence on aid. In this special economic feature, the Bulletin outlines the issue of aid to the Palestinian Territory and the measures being pursued to reduce it. The importance of private sector development is also highlighted.

Introduction

The issue of aid, and more specifically that of aid dependency, has risen in importance in recent years. The leaders of a number of developing countries have committed to reduce aid dependency as a priority, and in November aid exit strategies will be discussed for the first time, by donors at the High Level Panel for Aid Effectiveness being held in South Korea.[1] In line with this trend, the Palestinian Prime Minister, Dr. Salam Fayyad, has highlighted the reduction of aid dependency as a priority for the PA.

The Palestinian Context

Aid dependency is clearly an issue in the Palestinian Territory. Aid increased by almost 500% in the last decade, exceeding $3bn in 2009.[2] This meant that on a per capita basis the Palestinian population received one of the highest levels of aid in the world.[3] Aid is also significant compared to the size of the Palestinian economy. With a GDP of only $6.2bn in 2009, aid effectively represented just less than half of the economy. In addition, it is a dominant source of finance for the PA budget, with budget support covering 42% of recurrent government spending in 2009, and 38% in 2010.[4]

While almost half of all aid in 2009 came from the top two donors - the US and EU - it has historically come from a larger pool of over 40 donors. Moreover, there are an estimated 2,100 Palestinian NGOs registered (with 1,500 thought to be active) that received around $250m of funding in 2008, approximately 10% of total aid.[5] Given the diverse range of agencies and organisations involved, the management and coordination of aid is therefore a significant challenge for the PA.

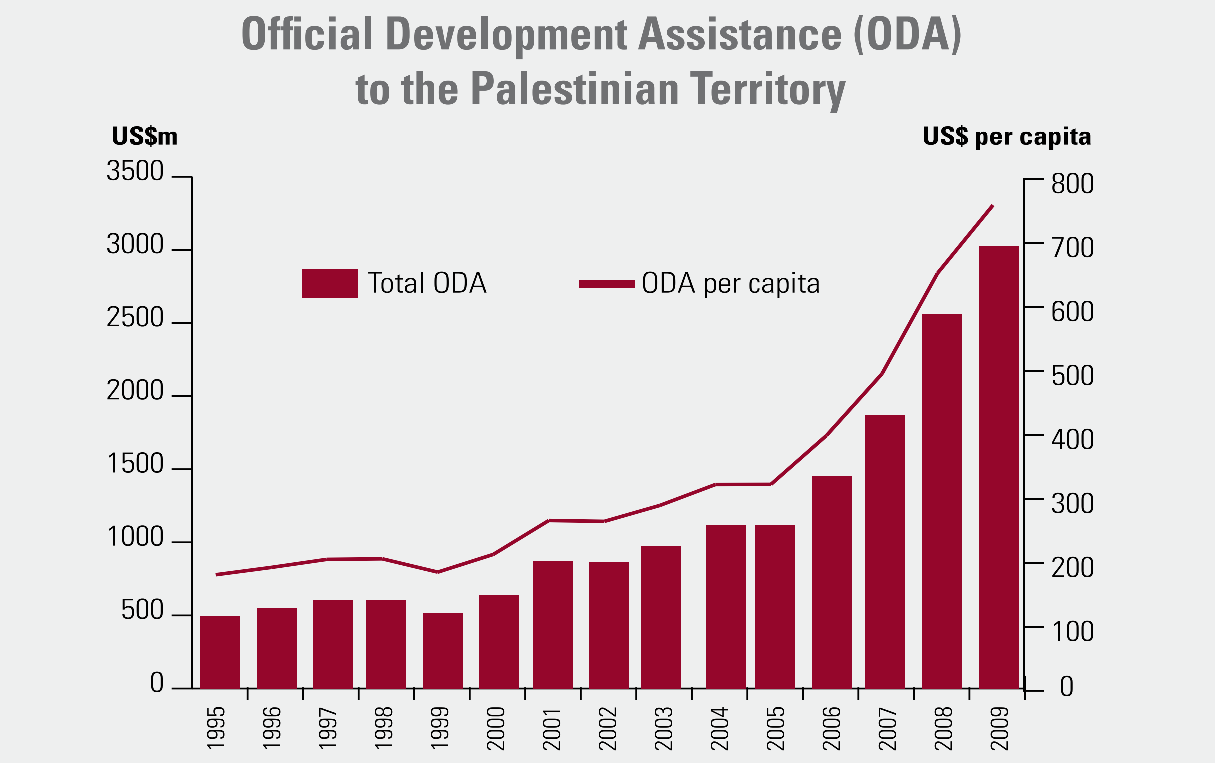
1 Countries committed to reducing aid dependency include Rwanda, Liberia and Tanzania.

2 See: OECD-DAC data from World Development Indicators database (extracted May 2011) and http://www.pmof.ps/news/plugins/spaw/uploads/files/accounts/2010/01/table7_eng.pdf this includes, budget support, development support, NGO and direct assistance, as well as aid channelled through UNRWA.

3 Source: World Development Indicators. Only the Marshall Islands, Micronesia, Palau and Mayotte received a greater volume of aid per head.

4 See: http://www.pmof.ps/news/plugins/spaw/uploads/files/accounts/2010/01/table3_eng.pdf and http://www.pmof.ps/news/plugins/spaw/uploads/files/accounts/2010/01/table7_eng.pdf

5 See: http://ndc.ps/uploads/File/Researches/Tracking%20External%20Donor%20Funding.pdf

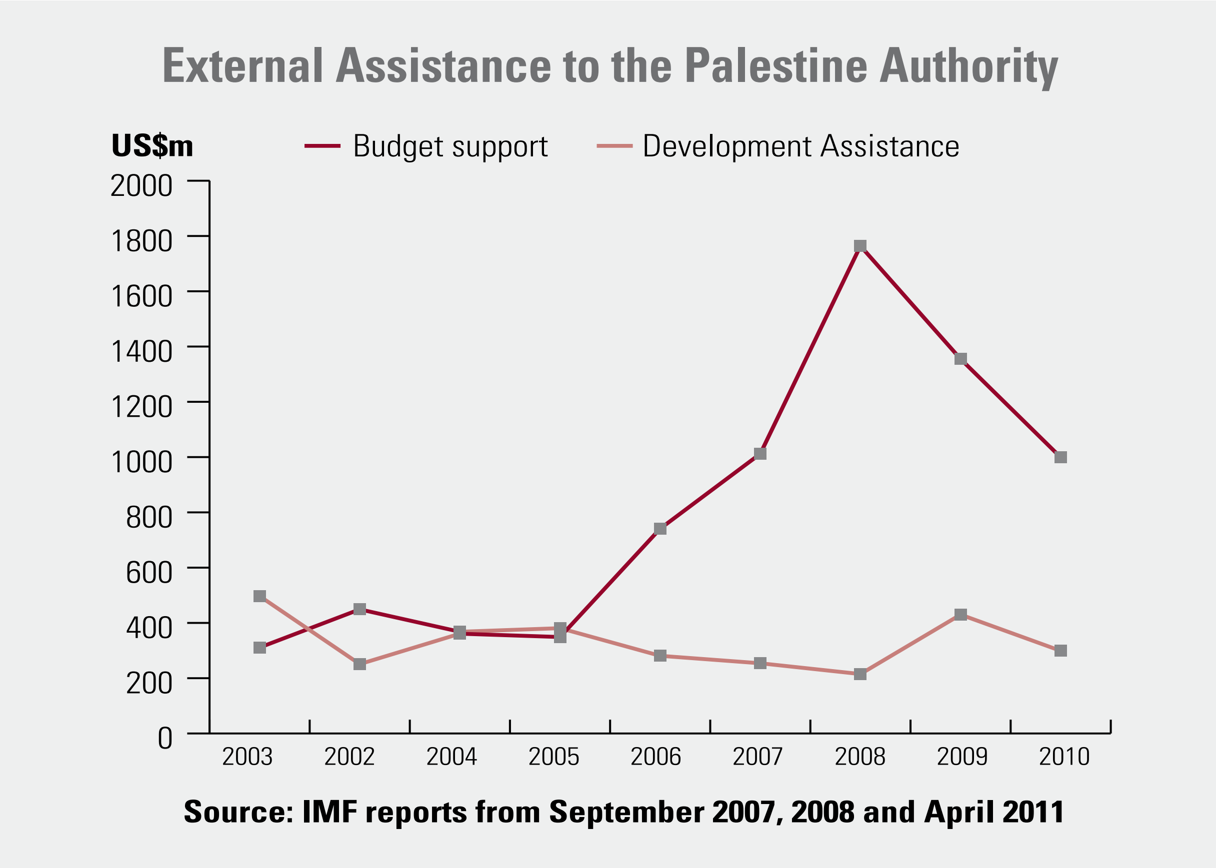


Source: OECD-DAC data from May 2011 World Development Indicators database (current prices)

In 2007, with the appointment of a new government led by Prime Minister Dr. Salam Fayyad, considerable effort was made to coordinate aid around the Palestinian Reform and Development Plan 2008-2010 (PRDP). $7.4bn over three years was pledged by donors in support of the PRDP. Yet, despite the high level of aid committed, the PA still frequently finds itself facing a shortfall of funds. This is due to the uncertainty and timing of aid delivery and the, often significant, difference between donor commitments and donor disbursements.[6] As a result, notwithstanding the large amounts of aid pledged, the PA has still had to resort to other sources of finance, such as borrowing from local banks. This has increased domestic public debt. By the end of 2010, the PA had borrowed $736m from the local banking sector (out of a total public debt of $1.8bn).[7]

A 2009 study on aid by the Palestine Economic Policy and Research Institute (MAS) identified a shift in the type and sources of aid in different political situations.[8] As might be expected, at times of political instability, humanitarian aid increases. This has been seen in recent years with the almost complete closure of the crossing points to Gaza following the Hamas takeover in 2007, when humanitarian aid almost doubled, from $491m in 2005 to $885m in 2008.[9] The relative volumes of the other two main types of aid – budget support and development assistance – are also shown to have changed over time. Reflecting global trends within official development agencies, budget support to the PA increased dramatically from 2005 reaching a peak in 2008. Development assistance has remained relatively static.

6 According to the 2009 MAS Study 'Tracking External Donor Funding' disbursements of aid are generally only equal to 75-85% of commitments, depending on the year and figures used. See page 12 of: http://ndc.ps/uploads/File/Researches/Tracking%20External%20Donor%20Funding.pdf
7 See: http://www.pmof.ps/news/plugins/spaw/uploads/files/accounts/2011/01/table8_eng.pdf
8 See: http://ndc.ps/uploads/File/Researches/Tracking%20External%20Donor%20Funding.pdf
9 See: http://www.globalhumanitarianassistance.org/count.



Impact on Growth

With the significant increase in aid, its effectiveness has been repeatedly questioned. While economic growth has averaged 8% a year, the World Bank and other observers have warned that it appears to be largely aid-dependent and unsustainable.[10] Part of the reason for this could be that, while the relative effectiveness of budget support verses development assistance is debated, aid directed to development projects has not seen the same increase as budget support. In addition, aid that is directed towards the productive development of the economy faces a number of constraints. An evaluation of the World Bank's programme to the West Bank and Gaza from 2001 – 2009 concluded that the impact of aid has also been reduced for reasons outside of donor's control (namely restrictions on movement and access in the West Bank and Gaza and investment in area C).

PA Strategy for Reducing Aid Dependency

In order to reduce dependency on foreign aid for budget support, one option is to increase tax revenues. Accordingly, the latest PA plans for fiscal reform (set out in the 2011 Budget) are ambitious. Domestic tax revenue in 2010 was only $474m.[11] However this is forecast to rise to $728m by 2013.[12] Youssef Qaddah from the Palestinian Ministry of Finance (MoF) told the Bulletin that the strategy for increasing domestic tax revenues is to improve and expand the mechanisms for collecting tax, reduce tax evasion and implement an austerity policy especially in the automotive and fuel sectors. The strategy will be executed by the relevant tax departments in the MoF. The overall expected impact is to reduce the requirement for budget support to $500m in 2013, from $1bn in 2011 and $1.8bn in 2008.[13]

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10 See: http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/WorldBankSep2010AHLCReport.pdf

11 Out of a total Gross Domestic Revenue of $1.9bn that includes clearance revenues of $1,242 received via Israel, tax refunds of $86m, and non-tax revenue of $270m. See: http://www.pmof.ps/news/plugins/spaw/uploads/files/accounts/2011/01/table3_eng.pdf

12 See: http://mopad.pna.ps/web_files/publishing_file/Establishing%20the%20State%20Building%20our%20Future_%20NDP%202011-13.pdf and http://www.imf.org/external/country/WBG/RR/2011/041311.pdf

13 Palestinian National Development Plan 2011-2013.

The other part of the PA's strategy is to foster private sector development across different sectors so it can achieve more sustainable growth, generate additional revenue and create jobs. Since 2007 the PA has taken serious measures and steps towards encouraging investment, reforming the legal and regulatory framework and fostering public-private partnerships. A continuation of these and other measures were set out in the new National Development Plan (NDP) for 2011 – 2013, which was presented in April.[14]

The Palestinian private sector themselves are also developing a number of large projects and taking measures to increase their access to finance and markets. This includes the recent issue of the first corporate bonds by PADICO, a number of international investment conferences, the new city of Rawabi, the telecoms operator Wataniya, roadshows by the Palestine Securities Exchange to London and other financial centres and the launch of private equity and venture capital funds.

Donors' Focus on Private Sector Development

Donors too are moving to focus more on private sector development. Antonia Zafeiri, Press and Information Manager at the EU Representative Office for the West Bank and Gaza told the Bulletin that 'the EU has been putting its focus on the development of the private-sector, through a comprehensive approach and via a number of different projects. These include loan guarantees, advice to businessmen on marketing strategies and reaching new markets, the new EU-PA trade agreement for quota-free, tax-free exports of agricultural products to the EU market, the Gaza Business Recovery Programme and EU assistance to the Ministry to set up a National Export Strategy.'

Conclusion

While the approach has been praised by donors and international financial institutions, the surrounding political context causes uncertainty over the PA's ability to deliver on its plan. Even if it is possible to implement, there is likely to be a transitional period before revenues from private sector growth are significant enough to reduce the need for external financial assistance. For this reason the total amount of aid can only be scaled down gradually and is still expected to be $1.59bn in 2013.[15] There is however a noticeable planned shift from budget support to development assistance (projected to reach $1.09bn in 2013, or 68% of total aid), which will hopefully generate more productive, long term and sustainable growth.

14 See: Portland Trust May 2011 Bulletin for background.
15 Palestinian National Development Plan 2011-2013.

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The Economic Feature

This economic feature is prepared by the Palestine Economic Policy Research Institute (MAS) and edited by The Portland Trust. Please send any comments, suggestions, or complaints to feedback@portlandtrust.org

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