

SALARIES IN THE PALESTINIAN PUBLIC SECTOR: CHALLENGES AND IMPLICATIONS

Since December 2014, public employees in the occupied Palestinian territory (oPt) have not received their full salaries. Israel is currently withholding clearance revenues which it collects on behalf of the Palestinian Authority (PA) – a step that is interpreted as collective punishment for the Palestinian initiative to become member of the International Criminal Court (ICC). The interruption of revenues flows, which accounts for roughly 127 million dollars a month, has again manifested the serious liquidity problems of the PA and the unpredictability of revenues. With constant restraints on its financial resources, the PA's ability to pay its public employees has again deteriorated – with serious consequences: The insufficient payment of Palestinian public employees is already showing considerably negative effects on the entire economy and the collapse of the PA apparatus seems to become a possible scenario.

Israel's withholding of Palestinian tax money, however, is only one of the elements contributing to the unpredictability of salary payments. Government revenues are low in general due to the weak private sector and high unemployment rates in the West Bank and Gaza. Consequently, salaries still depend to a large extent on international aid that tends to be granted on a rather irregular basis. The ongoing tensions between Hamas and Fatah over responsibilities for salaries of the public sector in the Gaza Strip add another layer of complication to the challenge. The first to suffer are of course employees who often support a whole family with their income. This paper aims to shed light on the critical situation of salaries in the Palesti-

nian public sector by focusing on several key features.

Firstly, general facts and figures will be presented: What percentage of the Palestinian workforce is employed by the Palestinian government? How much money is spent on salaries in the public sector? Have there been significant shifts in the size of the public sector work force?

Secondly, there will be a closer look on the financing of the public sector which depends to a large extent on international aid, Israeli transfers and bank loans. Thirdly, challenges and constraints within and for the public sector are tackled: the double structure of public employees in Gaza and the problem of low domestic revenues in the oPt. Finally, possible solutions regarding the shortage of budgetary funds both on an internal and external level are going to be discussed.

1. The public sector: Facts and figures

At the end of 2014, the public sector employed 22.9% of those in employment², with significant differences among the regions in the oPt. In the Gaza Strip, almost half of the employed were working in the public sector (39.6%) whereas in the West Bank, the public sector represented only 16.5% of the employed.¹ In absolute numbers, the PA employed about 180,000 persons. Their salaries accounted for almost 200 million dollars a month.³ As such, the wages and pensions of the public sector represented almost half of the PA's annual expenditure. Moreover, the share of the public sector in overall employment has risen over the last years.

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According to the World Bank, “the expansion of the public sector was largely driven by growth in health and social work, education, and public administration.”⁴

2. Financing of the public sector: International aid, Israeli transfers and Bank loans

The public sector in the oPt is financed to a large extent by tax revenues and international aid. In 2014, clearance revenues accounted for 1.818 billion dollars – compared to 924 million dollars from domestic taxes – and constituted 70% of net public revenues.⁵

According to the 1994 Paris Protocol, the economic appendix to the Oslo Accords signed by the PLO and Israel, the latter has the responsibility to collect taxes (clearance revenues) on behalf of the PA for goods and products entering Palestinian territories via Israeli customs offices. Israel is supposed to transfer the funds on a monthly basis and levies a 3% service charge for this transfer. The Paris Protocol was initially established for a transitional period of five years, ending in 1999, and with a clear perspective of an independent Palestinian economy.

However, it is de facto still in force and guides the economic relationship between the PA and Israel due to the lack of an

alternative and sustainable regulation in the long-term. The PA is therefore highly dependent on the transfer of clearance revenues. With the suspension of the transfer since the end of 2014, the PA has not been able to pay its civil servants more than 60% of their regular salaries – and even so only through guarantees and bank loans. In view of the very serious financial situation of the PA, the withholding of clearance revenues has a direct impact on the payment of salaries in the public sector.

Furthermore, the PA receives a considerable amount of donor funding. Foreign budgetary support accounted for 1.3 billion dollars in 2014 alone – which represents one third of current expenditures.⁶ In this respect, the European Union (EU) provided one of the largest aid programmes to the Palestinian Territories through the so called PEGASE Direct Financial Support (DFS) mechanism.

It is the main instrument to channel financial assistance from both the EU budget and EU Member States to support running costs of the PA like recurrent expenditures and the delivery of public services. Within this framework, the EU directly assists to pay 69,000 civil servants and pensioners – making a significant contribution to covering the PA’s salary bill.

¹ Persons aged 15 years and over who were at work at least one hour during the reference period, or who were not at work during the reference period, but held a job or owned business from which they were temporarily absent. Employed persons are classified according to employment status as follows: Employer, self-employed, paid-employed (wage employee) or unpaid family member (PCBS).

² Palestinian Central Bureau of Statistics (2015): *Labour Force Survey. October-December, 2014 – Round Q4/2014*. Available at http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_LFS-Q4-2014-e.pdf.

³ Ma’an News Agency: *Palestinian workers left broke as Israel freezes funds, February 11th 2015*. Available at <http://www.maannews.com/eng/ViewDetails.aspx?id=755697>.

⁴ The World Bank (2013): *Fiscal Challenges and Long Term Economic Costs. Economic Monitoring Report to the Ad Hoc Liaison Committee*. Available at <http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/AHLCMarchfinal.pdf>.

^{5/6} The Democracy and Workers’ Rights Center in Palestine (2014): *Overview of the Palestinian public budget for 2014*.

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European countries, through this mechanism, provided 1.2 billion euro (about 1.31 billion dollars⁷) between 2008 and 2014 for the payment of civil servants and pensioners which equals an average of 170 million euro (about 186 million dollars⁸) each year.⁹ Donor countries can determine special criteria for the distribution of their money. In this regard, the EU excludes employees of the security forces and civil police or Ministers and Deputy Ministers, among others, from receiving financial support by European funds.¹⁰

However, the question of sustainability of these funds has repeatedly been addressed by European stakeholders and the European Court of Auditors has called for reforms of the civil service. The EU is therefore currently developing a 'Results oriented Framework' with specific indicators in order to enhance efficiency and effectiveness of the DFS funds.

Despite the considerable amount of donor funds, the PA faces constant liquidity constraints. Many donor countries face domestic fiscal pressures themselves and cannot deliver on their pledged financial support, particularly given the (re-) earmarking of funds for reconstruction in Gaza. The PA, after the latest tax withholding from Israel, has borrowed funds from private banks via guarantees and loans to pay at least parts of the salaries of its civil servants. This approach, however, is neither sufficient nor sustainable and entails many risks due to the high interest rates.

Palestinian official have expressed doubt whether banks will continue to lend money to the PA. In mid-March 2015, the Palestinian Monetary Authority (PMA) announced that banks have reached their limits in being able to lend money to the government. The PA already has more than a billion dollars of debts to banks. The liquidity of the government in order to pay its employees even a small fraction of their salaries is therefore highly critical.

3. Challenges and constraints within and for the public sector: Low domestic revenues and a double structure of public employees in Gaza

The public sector in the West Bank and Gaza faces serious challenges and constraints for a solid revenue basis and a secure payment of its employees. In this regard, the oPt's high rate of unemployment¹¹ and weak private sector are both factors with direct implications on a considerable low level of domestic revenues to the government budget.

According to data from the Palestinian Central Bureau of Statistics (PCBS), the unemployment rate among labour force participants in the oPt amounted to 26.5% at the end of 2014 – which accounts for about 195,000 persons in the Gaza Strip and 142,000 in the West Bank.¹² Overall, unemployment has constantly increased over the last years, from 13% in 1999 to more than a quarter today – meaning that also fewer people pay taxes and financially contribute to the public budget.

⁷ Exchange rate of March 26th 2015.

⁸ Idem.

⁹ European Union: *PEGASE Direct Financial Support of Recurrent Costs of the Palestinian Authority Budget. Implementation Progress, 28 February 2015.*

¹⁰ Other donor countries have different criteria. The USA for instance support the security apparatus.

¹¹ Unemployed persons are those individuals aged 15 years and above who did not work at all during the reference period, who were not absent from a job, were available for work and actively seeking a job during the reference period.

¹² Palestinian Central Bureau of Statistics (2015): *Labour Force Survey. October-December, 2014 – Round Q4/2014.* Available at http://www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_LFS-Q4-2014-e.pdf.

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Furthermore, according to a World Bank report, "there is growing consensus that private sector led growth is the only sustainable future for the Palestinian territories."

However, the road to a sustainable economic development within the Palestinian private sector is paved with serious obstacles: political uncertainties and security issues in the region as well as restricted access to land and resources, especially in Area C of the West Bank. The International Monetary Fund (IMF) points out that "as long as Israeli restrictions remain in place, the public sector would have to be the economy's engine."

Moreover, average income in the public sector is significantly higher than in the private sector and employment is considered stable whereas it lacks of social security in the private sector. For a lot of people, the public sector is therefore the more attractive workplace. With a struggling private sector, however, the PA lacks important tax revenues to finance the public sector and to become financially independent from donor funding. In light of some 1.3 billion dollars of foreign budget support annually, the 924 million dollars from domestic taxes seem to demonstrate the limited role of these revenues (numbers expected in the beginning of 2014 for the same year).

Yet another major challenge contributes to the situation of unsecure payment in the public sector: the double structure of public employees in the Gaza Strip, which has evolved due to a political division between Hamas (the de facto governing power in the Gaza Strip) and Fatah in 2007. When the Hamas movement took over in the Gaza Strip, about 70,000 Palestinian employees of the former government were ordered by the West Bank government to go on strike and to stay at home. About 60%

of them followed the order – especially the employees of the security apparatus – but nearly 40% continued working for the de facto government in Gaza. Nevertheless, all of them continued receiving their salaries on the PA's payroll. Hamas hired about 28,000 new employees and was financially responsible for them. In June 2014, a national unity government officially took over power in the Gaza Strip, ending seven years of separate administration. The so-called consensus government insisted on rehiring its former staff which had been unemployed since 2007 and to replace the employees hired under Hamas. The latter have only been paid partially and irregularly since June 2014. This has caused a series of protest and strikes in Gaza. The unresolved question of the integration of the public employees under the Hamas administration threatens the fragile reconciliation between Fatah and Hamas.

Gloomy Outlook: The PA apparatus at the brink of collapse

The PA budget revenues are highly unstable and often unpredictable. This situation has immediate consequences for the PA's ability to pay its public employees. Currently, the Palestinian government does not have sufficient own revenues to pay public employees their full salary. Other factors such as the current Israeli tax withholding contribute to the constraint situation. In the short and mid-term, the PA therefore depends on international donor money to finance the shortages. Regarding the fact that 180,000 Palestinians in the West Bank and Gaza are on the PA's payroll and that the non-payment of their salaries has serious consequences on a personal and macroeconomic level (with the collapse of the PA a possible scenario), a solution seems even more pressing. Two dimensions have to be tackled in this regard.

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For the “inner-Palestinian” dimension, it is highly important that the funds available are used both effectively and efficiently.

- **End of dual-structure payment system in Gaza.** The solution of the dual-structure payment system for public employees which has evolved due to the political division between Hamas and Fatah in Gaza is of utmost importance. In this regard, a proposal negotiated by Swiss government representatives aiming to reintegrate the public employees hired since 2007 is currently reviewed by the different parties involved. A rapid agreement is necessary since the situation is not only costly but furthermore obstructive to reconciliation between the Palestinian factions and common national aims.
- **Tackling issues of donor funds misuse and fostering a simplified management system.** Issues of misuse of donor funds should be tackled and a simplified management system should be fostered. So far, donor countries have restricted influence on their provided funds. The EU, for instance, can track each donated euro to the beneficiary through monitoring and control and audit systems which aim at full transparency and accountability. However, EU funds are unconditional and are very likely to remain so. The EU is therefore currently developing a ‘Results oriented Framework’ which aims at introducing an indirect conditionality: the better the PA can demonstrate progress achieved, the easier it will be for the EU and EU Member States to mobilise funds to continue their support.

This mechanism is supposed to furthermore improve the impact in terms of policy leverage, service delivery and development effectiveness.¹⁷

- **Strengthen the private sector and increase domestic tax revenues.** Strengthening the private sector is one of the key issues in order to increase domestic revenue flows. In this regard, the latest boycott of Israeli goods could have positive effects for the local production. Another approach focuses on fiscal policy. PA Finance Minister Shukri Bishara suggested both a better tax collection system with the help of technical and bureaucratic improvements as well as tax cuts for individuals and companies in order to stimulate economic activity and to solidify the public budget.¹⁸

Finally, there is a wider “external” dimension to the issue: It is important to underline that a stable solution between Palestinians and Israelis is indispensable in order to resolve the question of public funding of the PA and to secure the regular payment of public employees.

- **Palestinian sovereignty over their borders.** This includes an agreement on the sovereignty of Palestinians regarding their borders. It would grant the PA sovereignty over its clearance revenues and therefore end the dependence on Israeli transfers. The Paris Protocol, which until today manifests the Israeli role to collect clearance revenues on behalf of the PA, was initially established for a transitional period ending in 1999 – with the clear aim of an independent Palestinian economy.

¹⁷ Mentioned by interview partner from the Office of the European Representative to West Bank and Gaza, Shereen Abu Eid.

¹⁸ Hass, Amira: *PA finance minister: We can no longer hold the pieces together.* Published in Haaretz on March 13th 2015. Available at <http://www.haaretz.com/news/diplomacy-defense/.premium-1.646764>.

With this perspective, donor countries accepted to financially support the PA for the transitional period. However, at the end of the transition period, Israel has not agreed to end the occupation and has not consented to an independent sovereign Palestinian State. Hence, the dependency both on Israeli transfer of clearance money and on foreign aid remains the case until today. Consequently, donor countries keep on paying considerable amounts of money in order to maintain the financially fragile PA system. With the absence of any bilateral negotiations between Israel and Palestine and little perspectives for any in the near future, the Palestinians should continue their efforts to obtain sovereignty within international institutions such as the UN Security Council.

- **Palestinian sovereignty over Area C and end to Israeli siege on Gaza.**

Furthermore, Palestinians have to obtain sovereignty over the Israeli-controlled Area C of the West Bank. With the natural resources on this land out of reach for Palestinians (and often used by Jewish settlers), a sustainable development of the private sector is highly unlikely. Additionally, the ongoing siege on and disconnection of Gaza hinders any economic development in the Palestinian enclave. In this respect, an independent Palestinian seaport is of utmost importance in order to stimulate foreign trade and domestic economic activities.

The question of solid finances of the PA budget and the regular and full payment of employees in the public sector should not be seen as an isolated problem. It must be solved in the wider context of an Israeli-Palestinian agreement. With a peace process that has not led to any sustainable (economic) solution for more than 20 years, the international community and key players such as the US and the EU should take clear steps in order to support Palestinians in their efforts to obtain statehood and self-determination. The international community would not only act according to international law and obligations, but it would furthermore contribute to the solution of an unsustainable situation. At this moment, the PA survives only due to the continuation of international funding.

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Abbreviations

DFS	Direct Financial Support
EU	European Union
ICC	International Criminal Court
IMF	International Monetary Fund
oPt	Occupied Palestinian territory
PCBS	Palestinian Central Bureau of Statistics
PMA	Palestinian Monetary Authority

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