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Resolving the PA Funding Crisis, But Not in Bahrain

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Brief Analysis

Rather than pinning false hopes on the Manama conference, the international community should focus on reforming the Paris Protocol and convincing the Palestinians to resume revenue transfers from Israel.

As the Trump administration gathers Arab and international finance ministers in Bahrain this week to discuss its "economic vision for the Palestinian people," the Palestinian Authority faces a profound and immediate funding crisis. The PA has been paying half-salaries to most West Bank employees and cutting back on other services since February, when it rejected the monthly transfer of tax revenues that Israel collects on its behalf. The transfers were reduced slightly after Israel implemented a new law requiring deductions because of PA payments to the families of "martyrs" and prisoners in Israeli jails. The law came on the heels of similar U.S. legislation known as the Taylor Force Act, aimed at pressuring the PA to stop payments that encourage violence. Speaking to the *New York Times* earlier this month, Prime Minister Mohammad Shtayyeh warned that the PA may soon be forced to furlough employees, including security personnel. Previously, the UN Special Coordinator's Office stated in April that financial, economic, and political challenges are threatening the PA's viability.

CURRENT ARAB AID IS NOT ENOUGH

Since February, the PA has instituted strict austerity measures, accumulated additional arrears, and increased borrowing from Palestinian banks. The Israeli deductions amount to only $11.5 million per month, or 6 percent of clearance revenues, but President Mahmoud Abbas nevertheless directed the PA to reject the transfers in total—meaning $188 million per month, or nearly 70 percent of the government's entire revenue. The PA argues that Israel's deductions violate the Paris Protocol, the 1994 agreement that outlined bilateral economic cooperation and set terms for their longstanding customs union and revenue transfer system.

Abbas's decision has yet to yield the concessions he likely expected from a new Israeli government

(https://www.washingtoninstitute.org/policy-analysis/view/israels-election-redo-implications-for-the-trump-peace-plan) , which will not be formed until October at the earliest following the announcement of new Knesset elections. External budgetary support has also been insufficient to stave off looming insolvency, and the donors assembling in Bahrain for the "Peace to Prosperity" meeting are unlikely to come forward with additional funding. Although the objectives for the workshop are unclear, Trump administration officials have stated that it is not a pledging conference.

On June 22, finance ministers en route to Manama gathered in Cairo for an emergency Arab League meeting where they recommitted to provide a "financial safety net" of grants or loans to help the PA cope with its funding gap. They did not announce specific pledges, however. The league made a similar call for funding in April, but so far only Qatar has come through with actual pledges: namely, $480 million in total, including a $180 million grant to Gaza and a $250 million loan to the PA, transferred in twelve monthly installments. The remaining $50 million will be given to the PA as a grant, which should allow it to pay partial salaries through August.

Qatar's grant comes at a critical time, as the PA is on the cusp of hitting a self-imposed cap on bank borrowing in July. At current spending levels, however, the accompanying loan of $21 million per month will be insufficient to keep the PA afloat into the fall unless other donors come through. If no resolution is found soon, the crisis could escalate just as Israeli voters go back to the polls in September.

IS THE PA PURSUING A "RESISTANCE ECONOMY"?

When he took office in April amid one of the PA's sharpest fiscal and governance crises in more than a decade, Prime Minister Shtayyeh announced an ambitious 100-day plan that includes "gradual disengagement" from Israel. For instance, claiming that it was overcharged for medical services, the PA has ceased referring Palestinian patients to Israeli hospitals, payment for which it says totaled $100 million in 2018. The PA has also announced that it will give emergency funding to the electricity sector and study the potential replacement of Israeli electricity imports with Jordanian-sourced energy. Other reports suggest that the PA has considered phasing out its use of Israeli shekels and replacing them with Jordanian dinars, U.S. dollars, or euros. And in May, during a Ramadan *iftar* for the families of Palestinians killed or imprisoned by Israel, Shtayyeh called on the Palestine Liberation Organization to reconsider agreements signed with Israel, stating, "We cannot continue to recognize Israel while it does not recognize us."

Although seeking practical areas in which to avoid dependence on Israel is politically popular, the PA is unlikely to pursue broad disengagement from the Israeli economy. Israel remains the West Bank's primary export market for goods and labor; this labor in turn supports roughly $4 billion per year in imports from Israel to the West Bank and Gaza. The Paris Protocol also stipulates that the shekel remain an accepted currency of exchange in the West Bank and Gaza. In any case, calls to cancel cooperation under the protocol are impractical because, in the absence of a new agreement, status quo arrangements would likely persist—namely, a customs union under which Israel has full control of external borders.

DON'T REJECT THE PARIS PROTOCOL, REFORM IT

The current crisis offers an opportunity to adopt a more efficient and transparent system that would mean more revenue for the PA—likely exceeding its income levels before Israel began its transfer deductions. Such a boost is crucial at a time when external support continues to decline from its peak in 2008.

The required reforms are well known, summarized most recently in the PA's September 2018 report to the Ad Hoc Liaison Committee (AHLC), which coordinates donor support in the West Bank and Gaza. They include:

- Reducing the fee that the PA pays for Israeli administration of customs collection.

- Waiving taxes and fees on Palestinian fuel imports, which are ultimately refunded to the PA in a manner that inhibits effective cash flow management.
- Adopting an electronic system for import receipts that would facilitate enforcement against tax avoidance in the West Bank and Gaza.
- Improving Israeli enforcement against customs evasion through transshipment of goods via Israel to the West Bank and Gaza.

At an AHLC meeting in Brussels this April, international actors encouraged Israel and the PA to improve implementation of the protocol.

Going forward, the donor community should continue pushing for resolution of the longstanding bilateral economic issues underscored in Prime Minister Shtayyeh's 100-day plan—not only through the AHLC, but also by reactivating the Israeli-Palestinian Joint Economic Committee established by the Paris Protocol. Such issues include implementing the 2017 Power Purchase Agreement aimed at improving the reliability of electricity in the West Bank and stabilizing revenues for the Palestinian utility. Finding a more permanent resolution to issues undermining financial cooperation would be helpful as well.

These and other reforms are important and long overdue. Even so, they would not give the PA sufficient political cover to accept partial revenue transfers from Israel or address the underlying problem of "martyr" payments. Donors should therefore continue pushing the PA to replace such payments with a needs-based social safety net for "martyr" families. In essence, these are fundamentally political problems, but passing the political hot potato to technocrats in existing bilateral and multilateral channels might be the only way to deescalate the current crisis.

Katherine Bauer is the Blumenstein-Katz Family Fellow at The Washington Institute and a former official at the Treasury Department. ❖

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