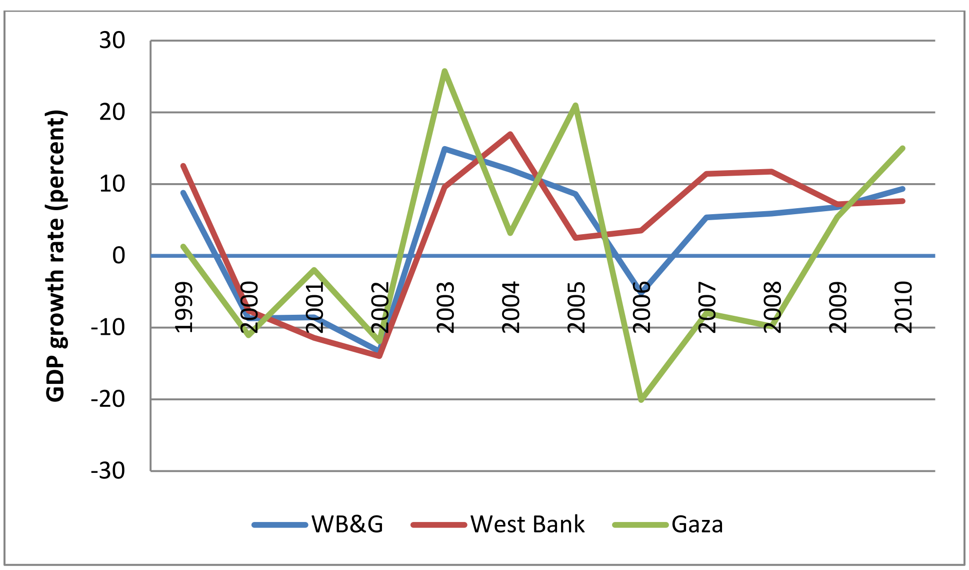
1. **Real economic growth in WB&G is estimated to have reached 9.3 percent of gross domestic product (GDP) in 2010, exceeding the PA's budget projection of 8 percent[1].** The Gaza economy appears to have rebounded sharply with the opening of the crossings to more goods and initial estimates suggest that real growth was nearly 15 percent of GDP in 2010, albeit from a very low base. In the West Bank, growth reached about 7.6 percent of GDP (see Figure 1). The fastest growing sectors in WB&G included agriculture, and hotels and restaurants, which grew by 22.8 and 46.3 percent, respectively. Construction grew by an impressive 35 percent, and public administration and defense continued to expand, growing by 6.4 percent in 2010. By contrast, initial estimates indicate that manufacturing output fell by nearly 6 percent and it remains more than 10 percent below its 1999 level.

2. **The patterns of growth were similar in the West Bank and Gaza.** Though firms in Gaza report that most needed inputs are now available, the increase in imports from Israel combined with the lack of exports appears to have led to a fall in manufacturing by nearly 4 percent. The loosening of restrictions on the import of agricultural inputs along with limited agricultural exports led the agriculture sector in Gaza to grow by almost a third in 2010. But the highest growth levels were seen in the construction, and hotels and restaurants sectors. Though construction material is still banned for most uses, projects by international organizations are permitted. In addition, there are increasing imports of construction material through the tunnels to Egypt. Thus, output in the construction sector in Gaza more than doubled in 2010. The hotels and restaurant sector grew by more than 65 percent with the increase in access to the territory.

Figure 1: Real GDP growth rate, 1999-2010



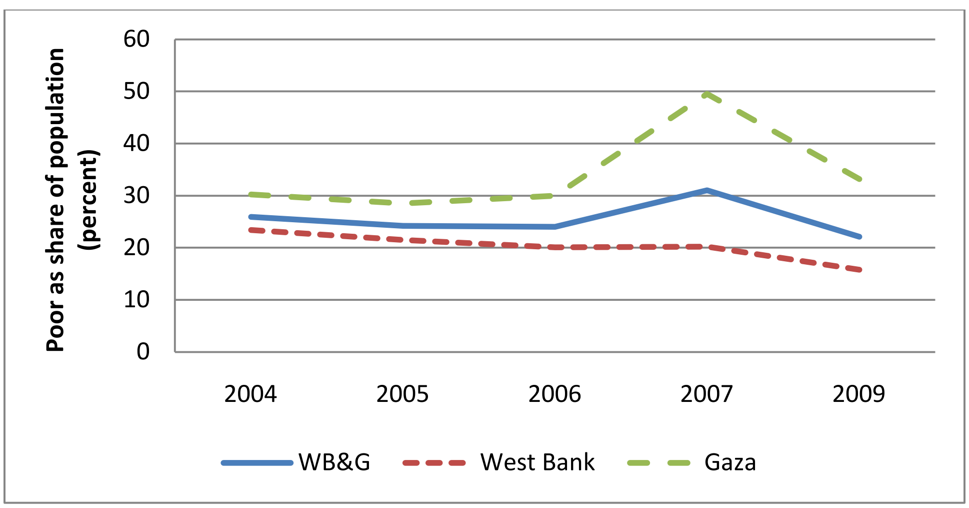
Source: Palestinian Central Bureau of Statistics

[1] These initial estimates are mostly based on labor surveys and may be revised when more data, such as on trade, are available.

3. **Thus, growth is mostly confined to the non-tradable sector and probably reflects the importance of donor aid in driving the Palestinian economy.** Israel remains WB&G's largest trading partner, yet in the first three quarters of 2010, exports of goods and services to Israel were only about US$480 million in nominal terms. This is only 6 percent higher than in the same period in 2009 and nearly 22 percent lower than in 2008. Since Gaza has been closed since mid-2007, these figures are not affected by the situation there. Consequently, the fact that growth has taken place recently despite the slowdown in exports to Israel probably reflects the importance of aid in driving growth.

4. **In 2009, roughly 22 percent of the Palestinian population lived in poverty, a nearly 4 percentage point improvement compared to 2004 (see Figure 2)[2].** However, all of the improvement took place in the West Bank, where the poverty rate fell from 23 percent in 2004 to 16 percent in 2009. In Gaza, the rate increased from 30 to 33 percent during the same period. While the poverty rate in the West Bank has steadily declined, it has fluctuated dramatically in Gaza. In 2007, the poverty rate in Gaza spiked to nearly 50 percent during the initial days of the complete closure of the territory before falling back to about a third of the population. Not only has the number of people living in poverty in Gaza increased over the past five years, but the severity of poverty has increased. The poverty gap, which measures how far below the poverty line the poor are on average, has increased from 7.5 to 8.1 percent, i.e. the poor are getting poorer in Gaza.

Figure 2: Poverty incidence in West Bank and Gaza



Source: World Bank. Forthcoming. *Coping with Conflict? Poverty and Inclusion in the West Bank and Gaza*, page xii.

5. **The fall in poverty in the West Bank can be attributed to the increased economic growth spurred by recent reforms, increased donor aid, and some easing of Israeli restrictions**

[2] The poverty data provided here are from a forthcoming World Bank report entitled "Coping with Conflict? Poverty and Inclusion in the West Bank and Gaza".

-- but the improvement in Gaza between 2007 and 2009 is almost certainly due to vastly increased donor-funded assistance to the poor. By 2009, a staggering 71 percent of the Gaza population benefited from at least one form of social assistance. The reliance on social assistance means that even those households that are currently above the poverty line remain highly vulnerable, i.e. at high risk of falling into poverty. In 2009, 13 percent of the population in the West Bank and 16 percent of the population in Gaza consumed no more than 1.2 times the poverty line. Thus, any economic shock could have a profound effect on poverty rates and a 20 percent decline in income is well within the realm of possibility if aid flows falter or the security situation deteriorates. In fact, in 2007, the average per capita expenditure in Gaza fell by more than 20 percent.

6. **In 2010, the PA made significant progress in mobilizing domestic revenue and reducing its recurrent budget deficit.** The 2010 recurrent budget deficit was about US$1.15 billion, almost 8 percent below the 2010 budget target. Total expenditures and net lending were more than 3 percent below budget projections and 8.4 percent below 2009 expenditures[3]. Total net revenue hit the budget target and was about 15 percent higher than in 2009. External budget support, helped by a fourth quarter surge of US$494 million, reached US$1.147 billion, i.e. almost exactly what was needed to cover the recurrent deficit, albeit less than the US$1.243 billion anticipated in the budget[4]. Development financing was only about US$130 million, less than half of the PA's nearly US$300 million development expenditures.

7. **Because of the need to fund development projects for which designated aid was not received, the PA was forced to increase bank borrowing and accumulate arrears at an unsustainable rate**. Net domestic bank financing increased by about US$84 million, with gross borrowing of US$200 million, so that at the end of 2010, total domestic debt stood at about US$840 million, which may be close to the PA's borrowing limits. In 2010, the PA paid close to US$23 million in arrears in net lending, but it accumulated another US$144 million in new arrears. While most of this was to the pension system, about US$50 million was in non-wage and development spending. This suggests that some private providers of goods and services to the PA may be facing delayed payments.

8. **In 2010, the PA made considerable progress in mobilizing domestic resources and was able to fund nearly 63 percent of its recurrent budget.** Domestic tax revenues rose by nearly 50 percent compared to 2009 and exceeded 2010 budget projections by nearly 26 percent. In 2010, domestic tax revenues were equal to more than 15 percent of total spending, up from about 9 percent in 2009. The PA reports that the increased tax revenues have resulted from increased enforcement and stronger efforts of collection. Despite a nearly US$40 million dividend from the Palestine Investment Fund, non-tax revenues were 18 percent below budget target and 8 percent below 2009 non-tax revenues. The PA reports that it has agreed to return US$70 million, paid by the largest telecommunications company for a license renewal that it no longer wants. This will reduce the cash available to finance government operations.

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[3] In 2009, the PA added US$300 million to the budget to respond to the emergency in Gaza. The Ministry of Finance reports that about US$100million has been permanently built into the budget in the form of increased transfers. Thus, some of the reduction in spending between 2009 and 2010 is due to the absence of the Gaza emergency aid.

[4] Since budget support is generally received in US$ and the budget is in New Israeli Shekels (NIS), this report discusses external support in US$ and all other expenditures and revenues in terms of NIS. Borrowing is also usually done in US$ and is therefore reported as such.

9. **The 2010 wage bill was about 4 percent higher than budgeted and net new hiring exceeded the numbers foreseen in the Palestinian Reform and Development Plan (PRDP).** The PRDP calls for the PA to restrict net new hiring to 3,000 new employees per year, mostly in the health and education sectors. This was the number estimated to be needed to provide services to the growing population in both Gaza and the West Bank. In 2010, the PA kept net hiring to 3,317, but all of the increase took place in the West Bank, where net employment rose by 3,584 (i.e. more than estimated to be needed for both Gaza and the West Bank). The current PA payroll is just over 150,000.