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Financial Crisis Grips Fayad Government

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Palestinian prime minister Salam Fayad recently appealed to the World Bank in an effort to bridge the current budget gap preventing the Palestinian Authority (PA) from paying government salaries this month. Despite a three-year \$7.5 billion assistance pledge from the 2007 Paris donor conference, the PA remains in a financial crisis, with a projected shortfall of \$400 million for the second half of 2008, as reported by the Ad Hoc Liaison Committee in May. Since Fayad's technocratic government has no independent political base, its legitimacy stems from the PA's financial solvency. He has survived ongoing attacks from rival Fatah leaders only because Palestinian president Mahmoud Abbas recognizes him as the linchpin to Western donor assistance. If the financial crisis persists, however, Fayad's political future is in doubt.

Source of Budget Crisis

Although Fayad has made significant financial strides and instituted a systematic budget process dating back to his time as finance minister, the PA now faces a serious fiscal crunch. The PA budget for 2008 totals \$3.3 billion: \$1.4 billion for salaries of public employees, \$1 billion for operational costs of government ministries, \$500 million for development projects, and \$400 million for arrears. To cover these expenses, the PA anticipated \$1.5 billion in revenue, which includes more than a billion from Israeli taxes, and the remaining \$1.8 billion to be covered by donor assistance.

According to the PA's Ministry of Finance, spending for the first half of 2008 totaled \$1.3 billion, less than half the year's budgeted amount. During the same period, however, internal revenue was just \$900 million, which included a \$200 million contribution by the Palestinian Investment Fund, a company that handles Palestinian investments and is supervised by Abbas. This \$440 million deficit has been more than offset by the \$970 million the PA has received for budget assistance so far this year (\$350 million from the European Union, \$320 million from Arab countries, \$150 million from the United States, and \$150 million from the World Bank and other countries).

The problem is that the money contributed to budgetary assistance for the first half of 2008 is more than 60 percent of the total the Paris donors allocated to budgetary support for three years. Consequently, further budgetary support cannot be expected to bridge the rest of the year's projected deficit unless additional funds are raised, or money is shifted from developmental assistance. Direct budget support amounted to just 22 percent of the Paris pledges, with the remainder designated for development projects and humanitarian assistance.

Despite tighter spending practices and an improved revenue outlook since 2007, the PA is expected to face a significant deficit by the end of 2008. The Palestinian Investment Fund may not provide future contributions, and the decline of the dollar against the Israeli shekel (almost 10 percent this year) means projected expenses will be higher than anticipated.

The Gulf in Arab Assistance

According to the PA's Ministry of Planning, Arab contributions have made up 20 percent (or \$1.5 billion) of all donor money since 2002. By comparison, the European Commission has contributed \$2.1 billion during this period (of which more than \$775 million went to direct budget assistance) and the United States nearly \$1.9 billion (of which \$155 million was designated for budget assistance). Saudi Arabia, the United Arab Emirates (UAE), Kuwait, and Qatar together pledged \$400 million per year for three years to support the PA. Just \$170 million, however, has been delivered this year.

Although funds from the Gulf States have been vital to the PA's survival, the amount pledged is paltry compared to what they can afford, given the high price of oil. A bulletin from the Organization of the Petroleum Exporting Countries (OPEC) reveals that Saudi Arabia doubled its income between 2002 and 2007 from \$189 billion to \$366 billion. Similarly, the income of the UAE grew from \$74 billion to \$192 billion, Qatar earned \$63 billion in 2007 compared to just \$19 billion in 2002, and Kuwait's income ballooned from \$38 billion to \$111 billion. Moreover, with the recent spike in oil price, *Reuters* reported, "The nominal GDP of Saudi Arabia, the UAE, and four other Gulf oil producers will mushroom by almost a third this year to \$1.08 trillion from \$821 billion in 2007."

The Gulf States' limited support for the Palestinians originated when Yasser Arafat decided to support Saddam Hussein's occupation of Kuwait during the first Gulf War. As a result, the Gulf States cut off all financial assistance to the Palestinian Liberation Organization (PLO), a policy that remained intact even after the establishment of the PA following the Oslo Accords. Reports of corruption only served as a further excuse to retain the boycott throughout the 1990s, and direct aid from the Gulf States first occurred only in 2002, after United States pressured them to support the Palestinian reform program.

During the boycott of the PA, the Gulf States supported Hamas financially and politically, since it condemned Iraq's occupation of Kuwait and opposed the PLO. This relationship led some Gulf countries, such as Saudi Arabia and Qatar, to embrace Hamas after it won the 2006 elections. In addition, Qatar pledged \$250 million to Hamas when it headed the government (previously contributing just \$15 million), while Saudi Arabia followed suit with a \$1 billion pledge to the PA during the Mecca talks in March 2007. Since the unity government collapsed in the wake of Hamas's July 2007 seizure of Gaza, the Gulf States (except the UAE) are attempting now to use their financial leverage to impose Palestinian unity. Moreover, with the rising influence of Iran and Hizballah, the Gulf States have been further drawn to Hamas as a Sunni Islamist group that can counter Shiite influence in the region.

Conclusion

So far this year, the PA has reportedly received only \$950 million of the pledged \$1.9 billion of donor assistance for its 2008 budget assistance. The UAE gave the PA an additional \$42 million to pay July's salaries, but similar problems will likely recur in the following months. If the remaining pledged funds do not arrive soon, Fayad's government will have difficulty remaining in office. Failure to pay salaries will shake the public's confidence in Fayad, who has a record of delivering financial stability and improving law and order in the West Bank. More significantly, a budget crisis will likely allow Hamas to further consolidate its control of Gaza, since the PA has remained relevant there only because it continues to pay 77,000 employees.

Increased Arab support for the PA could easily solve this budget crisis. Although such assistance is well within the financial means of the Gulf States, it remains unlikely to materialize, given their hesitancy to appear taking sides in the ongoing conflict between Fatah and Hamas. And even with U.S. and European diplomatic pressure, Saudi Arabia and Qatar are unlikely to alter their strategic tilt toward Hamas. Consequently, it will be up to the rest of the donor community to act creatively and reshuffle funds -- from developmental assistance to budgetary support -- as the Ad Hoc Liaison Committee recommended in May. If such moves are not taken, the PA government will collapse, creating political chaos and making it nearly impossible to complete long-term development projects.

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