

WEST BANK AND GAZA STRIP

Conference on Assistance to the Palestinians

Paris

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Statement by Mr. Stanley Fischer, First Deputy Managing Director
of the International Monetary Fund

It is indeed a great pleasure to address this important Conference on behalf of the International Monetary Fund. With the Palestinian Authority (PA) elections less than two weeks away, the Conference comes at a critical juncture in an ongoing historical process of the greatest importance.

By any realistic standard, the Palestinian Authority and the Palestinian economy have made remarkable progress in the last two years. On the economic front, the Palestinian Authority has achieved three critical initial goals:

- first, it has established key economic institutions;
- second, it has significantly strengthened its fiscal position; and
- third, it has begun to address immediate infrastructure rehabilitation needs.

Most importantly, recent information on construction activity, bank deposits and lending, and merchandise trade, suggests that private sector confidence and economic activity began to recover in 1995.

While these developments and the dynamism of the population augur well for the future, the economic tasks ahead are immensely complex. The

priority is to achieve rapid and sustainable growth over the medium term, in order to raise living standards and to reduce the intolerably high rates of unemployment in the West Bank and Gaza Strip.

We therefore welcome and support the overall strategy outlined to the Conference by the Palestinian Authority. As you might expect from the Fund, we consider the achievement of a strong fiscal position to be of paramount importance in laying the foundations for growth and avoiding the burdens of future debt servicing. Accordingly, we welcome the PA's fiscal performance in 1995 -- and here praise indeed goes to Finance Minister Nashashibi -- and its commitment to limit the recurrent budget deficit to US\$75 million in 1996, to achieve recurrent balance in 1997, and to generate surpluses in the recurrent budget thereafter.

On the revenue side, a modern VAT system is in place and should be maintained. Nonetheless, there is scope for further improvements in the domestic income tax system. Expenditure management is a critical area -- and one in which progress decisive progress will have to be made in 1996 by building the institutional structure and hiring personnel needed for firm fiscal expenditure control. For budget targets to be achieved, both civilian and police recruitment will need to be strictly limited to the ceilings stated in the 1996 budget, and a general wage increase will have to be avoided this year. Moreover in future years increases in government employment will have to be kept to the essential minimum and the wage bill will need to be strictly contained.

Turning to structural policies, the PA needs to establish conditions to encourage domestic investment, attract foreign direct investment, and create jobs. That requires the introduction of a transparent legal and regulatory framework, open trading arrangements that integrate the Palestinian economy into the world economy, and a market-oriented financial system subject to sound prudential regulation, all within a stable and supportive macroeconomic framework.

Indeed, and somewhat ironically, the PA now has a unique opportunity to benefit from the lessons of the history of the last few decades and avoid pitfalls that often complicate economic management. In particular, experience shows that the role of the public sector should be limited to providing public services, including a social safety net, and operating infrastructure; trade monopolies should not be granted; price controls should be avoided as expensive and ineffective; and tax exemptions and investment subsidies should be strictly limited in scope and time.

After a long period during which protective barriers in many Middle Eastern countries were extremely high, both quantitative and tariff barriers in neighboring countries are being reduced, and the prospects for enhanced trade in the region and with the rest of the world are improving. In this environment, it is especially important to avoid the temptation to support particular sectors through high tariffs or quantitative restrictions. Experience shows that such measures rarely succeed except in imposing large burdens on consumers and other producers in the economy.

We concur with the cautious approach taken by the PA towards introducing its own currency. If and when a new currency is introduced, it should be a stable currency -- the prerequisites for which are a fiscal position that can be sustained without inflationary financing, and the establishment of a well-regulated financial system.

The implementation of the PA's strategy will require continued close cooperation among the PA, the Government of Israel, and the donor community. Israel-PA cooperation in revenue clearances in 1995 was key to the improved fiscal situation. By keeping its goods and its labor markets open, and to the extent that border closures are avoided, Israel will help to ensure the prosperity and economic stability of the West Bank and Gaza Strip.

Continued donor support will be critical for the success of the Palestinian economy. The IMF views as appropriate the PA's request for US\$75 million in external financing to cover the recurrent budget deficit in 1996, as well as its request for US\$550 million this year to support the core investment program endorsed by donors last October. Timely disbursements of pledged funds will be essential to facilitate the PA's cash management and its control of recurrent expenditures. By permitting early implementation of the core investment program, they will help foster stronger economic growth along with fiscal sustainability.

Finally, let me reiterate to the Palestinian authorities and the donor community assembled here, that the IMF is proud of its role in supporting the development of the Palestinian economy. The scale of our technical assistance to the PA is without precedent for a non-member and very large by

any standards. We are looking forward to continuing to assist the Palestinians with the tasks of institution building in the fiscal, banking, and macroeconomic areas. We also stand ready to continue assisting the PA in monitoring the implementation of the 1996 budget, in macroeconomic analysis and policy formulation and, together with our colleagues from the World Bank, in updating the medium-term policy framework on an annual basis or as circumstances warrant.

The PA can be assured of our best wishes and our active support in its economic endeavors.

Thank you.

