REVENUE SOURCES OF PALESTINIAN MUNICIPALITIES: FINANCE OFFICERS EXPLAIN REALITY AND POSSIBILITIES

Ross Rubenstein, Katherine Willoughby and Russ Lipari

INTRODUCTION

Perhaps no other area of the world has experienced the persistent economic and political strife that has been a hallmark of the Middle East. A holy land for three of the world's major religions, the areas now known as Israel and Palestine have been the center of much of this conflict. A primary source of discord over the past fifty years has been the establishment and continued existence of the Israeli state, and the status of Palestinian residents within this state. Historic strides toward peace have occurred since 1993, though, as Israeli and Palestinian representatives have met face to face for the first time to negotiate Palestinian self-government.

Like most developing areas, Palestine has faced significant growing pains while trying to establish the legal and fiscal institutions needed to govern the West Bank and Gaza Strip (WBGS). The problems have been exacerbated by the uniquely interdependent relationship between Israel and Palestine. While the WBGS has a well-developed system of local governments, intergovernmental relations and revenue assignment between the central and local governments have been subjects of ongoing debate. This article examines Palestine's revenue structures and intergovernmental fiscal relations in the context of these recent political developments and as perceived by fiscal officers from a number of local governments in Palestine.

Specifically, this article draws heavily on discussions with Palestinian local government finance officers who convened for two weeks of training in the United States in May of 1999. These officers received training regarding American budgeting systems and practices of financial management (specifically fund accounting). They provided information to researchers about their revenue sources, expenditure categories, budgeting systems and greatest strengths and weaknesses of their budget and financial reporting systems. Transcripts of a roundtable discussion between participants and academic faculty from Georgia State University provide much of the information presented below.

The following section provides background and context for this study through a discussion of Palestine's history and current efforts to establish statehood, as well as a description of its present economy. A brief overview of traditional local government revenue structures in the United States follows. A discussion of revenue sources and expenditure categories, budget systems, financial reporting activities and issues of concern as described by the training participants is then presented. The article concludes with recommendations regarding the development of revenue structures in local governments of Palestine.

POLITICAL CONTEXT

Palestine is carved out of two non-contiguous pieces of land on the West Bank of the Jordan River and the Gaza Strip. The country is home to nearly three million people, with the majority of residents in the larger – and somewhat more prosperous -- West Bank (Palestinian Central Bureau of Statistics, 1997). The area has been under the control of various empires for thousands of years. Between the first and second World Wars, Palestine came under British control. A potential Jewish state in Palestine was first promised in Britain's 1917 Balfour Declaration, though a 1939 White Paper retreated somewhat from that position (Smith, 1996). In 1947, the United Nations -- spurred in part by increased clashes between Jews and British forces, as well as American support for increased Jewish immigration -- established a special committee on Palestine to investigate and make recommendations on the future of the territories (Smith, 1996).

Though split, the committee recommended division of the territory into separate Jewish and Arab states, with “special international status” for Jerusalem (Smith, 1996). Britain pulled out in May 1948, Israel immediately declared its independence, and an Arab-Israeli war ensued (Peretz, 1996). Following an armistice in 1949, the West Bank (including East Jerusalem) was placed under Jordanian control and the Gaza Strip under Egyptian control (Peretz, 1996).

Frequent physical and political battles marked the next half-century following Israeli independence. The Palestine Liberation Organization (PLO) was established in 1964, although it did not gain widespread support among the Palestinian people until after the 1967 “Six Day War” (Robinson, 1997). During this war, Israel more than doubled in size by capturing the West Bank and Gaza Strip, along with the Syrian Golan Heights and the Egyptian Sinai Peninsula. The PLO was eventually recognized as the sole legitimate representative of the Palestinian people in 1974 at the Arab Summit in Rabat (Smith, 1996).

Major strides toward peace in the Middle East were achieved in 1978, when President Jimmy Carter helped to negotiate the Camp David Accords between Israel and Egypt. The agreements led to Israeli withdrawal from the Sinai and called for “full autonomy” for the WBGS, including an elected government (Peretz, 1997).

Fighting between Israel and its neighbors, as well as with the PLO, continued during the early 1980s. In late 1987, amid growing unrest among the Palestinian population in the WBGS, a road accident in which a number of Palestinians were killed and injured by an Israeli army transport sparked widespread rioting and began the period known as the *Intifada* (resistance) (Peretz, 1996). The *Intifada* eventually caused the death or injury of an estimated 10 percent of the Palestinian population, and led to severe economic constraints on the region (Robinson, 1997).

The movement also united a number of disparate Palestinian factions while increasing dissension over the Palestinian question in Israel (Peretz, 1996).

Following the Gulf War in 1990, momentum shifted toward meaningful progress and negotiation. In 1993, Israel and the PLO signed the Declaration of Principles (DOP) that created an interim self-government in Palestine, with the interim period extending no more than five years. In letters of Mutual Recognition, the PLO recognized Israel's right to exist, while Israel recognized the PLO as the legitimate representative of the Palestinian people (Smith, 1996).

In the first Palestinian elections, held in January 1996, PLO leader Yasir Arafat, was elected as head of the new Palestinian National Authority (PNA). The 1998 signing of the Wye Memorandum between Israel and Palestinian officials closed a number of loopholes to ensure the continued peace and security of the region once permanent statehood was granted to Palestine. Most notably, the Wye Memorandum laid out a specific timetable and mechanisms for implementing earlier agreements (Aruri, 1999). The Wye accord included provisions that would enable Palestine to be permanently recognized as a State, with confirmation targeted for May 4, 1999. However, an April 27th, 1999 meeting of PLO leadership resulted in the decision to postpone statehood to a later date in light of the election of a new Israeli Prime Minister, Ehud Barak.

The 1993 Oslo accords, as well as several subsequent Israeli-Palestinian agreements, delineated the basic framework for the new central Palestinian government and paved the way for Palestinian elections and self-government (Sayigh and Shikaki, 1999). The Palestinian National Authority (PNA), led by Yasir Arafat, functions as the government's executive, while the Palestinian Legislative Council (PLC) is the country's legislative branch. By 1996, the

Palestinian public sector had grown significantly, employing over 13 percent of the area's workforce (Diwan and Shaban, 1998).

The Palestine Economy

Economic crises were pervasive in the early post-Oslo years, fueled by frequent closings of the borders with Israel, which remains a primary source of Palestinian employment and a market for Palestinian goods. More recently, however, unemployment fell in 1998 to below 13 percent in the WBGS (9 percent in the West Bank and 21 percent in Gaza in 1998), a sharp decline from the 28 percent unemployment of 1996 (Palestine Economic Forum, 1999; Diwan and Shaban, 1998). Also in 1998, the PNA recorded its first surplus after years of deficits, caused in part by improved revenue collection and higher than expected revenues (Sayigh and Shikaki, 1999). Despite these positive trends, the country and its citizens remain relatively poor. The PNA's Ministry of Local Government (MLG) provides both support and oversight to local governments throughout the WBGS. Local government revenues and expenditures remain limited, however, accounting for only 2.3 percent of GDP in 1996, as compared to averages of 12.7 percent in OECD countries and 4.6 percent in other developing nations (Sewell, 1998).

TRADITIONAL LOCAL GOVERNMENT REVENUE SOURCES IN THE UNITED STATES

While Palestine is home to some of the world's oldest cities, its local government revenue structures and system of intergovernmental fiscal relations are much less stable than those in the United States. At the same time, Palestine's government structure is considerably less complex than that in the U.S., with its 86,000 governments. Regardless of the differences, however, we find that a variety of local government revenue issues in the United States are relevant to the Palestinian situation. These include local government dependence on property taxes (including issues of property tax administration), efforts to diversify local revenue structures (including the increasing reliance on user fees) and the U.S. system of intergovernmental grants.

Local government own-source revenues in the United States have historically been derived primarily from property taxes, which accounted for over 45 percent of own-source local government revenues nationally in 1995 (U.S. Bureau of the Census, 1998). Despite recent trends toward revenue diversification, property taxes remain the source of over 75 percent of local government tax revenues. The property tax has some obvious advantages as a revenue source, most notably its stability in economic downturns and its exportability through taxation of non-residential property (Monk, 1990; Bland, 1989). Additionally, it may be the tax that most closely follows the benefit principle of taxation, in that it funds local services -- such as education – that directly benefit homeowners in a community (Odden and Picus, 1999; Musgrave and Musgrave, 1989). Over-reliance on property taxes to fund local services has, of course, also led to persistent inequities in the quality of services available across communities. In the area of education, these inequities have been the subject of litigation in at least 44 states, and have led to increasing state-level efforts to equalize funding and local fiscal capacity (Minorini and Sugarman, 1999).

Since California's Proposition 13 ballot initiative in 1978, policy makers have faced mounting resistance to local property tax increases, leading to a growing reliance on alternate revenue sources, such as user charges and fees. User fees may be more palatable to taxpayers since their costs are directly related to benefits received and, in most cases, citizens can avoid the charges by choosing not to receive services (Rubin, 1997). Between 1977 and 1996, user charges as a percentage of state and local revenue increased from 15 percent to 18 percent and miscellaneous revenue increased from 7 percent to 12 percent (National Conference of State Legislatures, 1999). From 1980 to 1995, state and local revenues per capita from water and electric supply increased from $80 to $223 (U.S. Bureau of the Census, 1998). While user fees may help to ration scarce goods and resources, such revenue source but may also be regressive and lead to inequities in access to services (National Conference of State Legislatures, 1999; Lee and Johnson, 1998).

While the structure of own-source local government revenues has been changing in the United States, intergovernmental grants remain a critical local revenue source. Intergovernmental aid accounted for approximately one-third of total local government revenue in fiscal year 1996, with the vast majority coming from state governments (U.S. Bureau of the Census, 1999). The traditional system of fiscal federalism found in the U.S. has the familiar advantages of decentralized decision-making and efficient government production combined with the ability to equalize fiscal capacity and improve the equity of services available across communities (Musgrave and Musgrave, 1989). As noted above, though, extensive school finance litigation and restrictions on local property taxation have helped to increase state responsibilities for funding traditionally "local" services such as education and have led to further centralization of revenue collection at the state level (Odden and Picus, 1999).

REVENUE STRUCTURES IN PALESTINE

We now consider the current revenue situation in Palestine and the prospects for emergence of local revenue structures similar to those in the United States. Questions we attempt to answer include: *what is the typical revenue structure of Palestinian local authorities?; how does such structure differ from that typical to a local government in the United States; are budget systems similar?; what type of financial reporting do local finance officers conduct in this developing state?; and what do they consider the greatest weaknesses of their financial management systems?* Our interview sample consisted of a dozen local government finance officers from Palestine. Results from our interviews with these officers follows.

<u>Methodology</u>

Sponsored by the Municipal Infrastructure Development Program of the resident World Bank mission in the WBGS, twelve Palestinian government finance officers participated in the Local Government Fund Accounting and Budget System Training Program in Atlanta, Georgia during the first two weeks of May 1999. This program was developed in the Andrew Young School of Policy Studies (AYSPS) at Georgia State University to afford participants exposure to financial reporting, accounting practices, and budgeting systems typically used by local governments in the United States. The participants included three representatives from the Ministry of Local Government of the PNA and nine local government finance directors, managers or chief accountants representing municipalities of Palestine, including Beit Jala, Beit Sahoun, Bethlehem, Duha, Hebron, Jenin, and Nablus. While most of these municipalities are realtively small, several -- such as Hebron and Nablus – have populations approaching or above 100,000 people. Most of the finance officers hold college degrees in accounting or business administration; several have advanced (Masters) degrees in commerce or business administration. A few of the participants indicated experience in both the public and private sectors; their private sector experience was predominantly in the areas of accounting and/or business.

Initially, participants were briefed on the intergovernmental fiscal relationships in the United States. Then, these finance officers were exposed to lectures, discussion roundtables, and problem-solving sessions regarding fund types and the accounting practices for each type, analysis of comprehensive annual financial reports, calculation of fiscal capacity indicators, local government budgeting processes and systems as well as traditional bonding practices in the United States. AYSPS faculty members and several practitioners (including local government finance and program directors) provided lectures. Finally, participants witnessed first-hand a budget hearing conducted by the Athens-Clarke County, Georgia local council, and tours of several locally financed capital projects (one joint-venture jail facility; one local government civic center; and one local government budget and finance department).

During the two-week period, participants attended 13 half-day sessions that included lecture and/or problem solving activities; four off-campus site visits; and two roundtable discussion sessions. Material from the first roundtable discussion serves as data for this article. This discussion session sought information from participants regarding their revenue and expenditure sources, their government's relationship to the central government, and the issues they consider most critical regarding their budgeting and financial reporting practices.

The limitations of this study are obvious. This is a descriptive study only. We report training participants' answers to questions regarding how they raise and spend money in their governments. Also, we sought answers to questions about the most troubling aspects of the work that they do, as well as their "openness" to possible changes in their relationship with the PNA. For example, the Ministry of Local Government has interest in creating a uniform chart of accounts to which all local authorities of Palestine would subscribe. We wanted to understand the reasonableness of such a suggestion to these finance officers given their primary responsibility for the management and reporting of money in their government. For simplification only, subjects of this study are referred to generically as participants or finance officers in the section that follows.

Results

Generally, responses to questions about revenues during the roundtable discussion indicate that most local governments in Palestine operate with a very rudimentary revenue structure. In response to the question, *"what are the major revenue sources for your municipality?"* most responded, "taxes and fees." Taxes include those collected by the central government on behalf of local governments (like property and fuel taxes). According to one finance officer, "these taxes are collected by the central government, with 90 percent transferred to the local authority." Fees collected by municipalities include those for building, solid waste disposal, licenses, rent, market-related (vegetables, fruits, and slaughterhouse/meat transport), streets, pavement, fire services and dumping. By far the predominant revenue source for most local authorities results from user charges on utilities. Finance officers also discussed development revenues or donations as a source of revenue that flows through the central government to fund local projects. They viewed these funds as substantial, yet hardly reliable. For obvious reasons, these governments do not incur debt, although the finance officers were interested in exploring possibilities regarding the issuance of debt.

Table 1 presents a revenue source breakdown for a typical local government in Palestine. Unlike local government revenue structures typical in the United States, in which the property tax is the predominant tax source, the property tax proportion varies quite a bit across local governments in

Palestine, ranging from under five percent of total revenues to about 20 percent of the total. The Palestinian finance officers expressed a desire to enhance their use of this tax in the future to comprise upwards of 50 to 70 percent of their total revenues. Likewise the proportion of revenues from non-tax sources (like utilities) can range from below 20 percent to almost 90 percent, as indicated above (see also, Sewell, 1998).

Table 1: Example Revenue Structure for Municipality in Palestine[a]

Revenue Source	**% of Total Revenues**
Electricity	73.24%
Water	13.81%
Building Permissions	3.77%
Sewage Fees	1.83%
Vehicle Inspection Fees	1.63%
Garbage Fees	1.59%
Craft License	1.19%
Vegetable Market Fees	0.94%
Property Tax	0.93%
Crafts Fees	0.49%
Slaughterhouse Fees	0.32%
Properties Rent	0.14%
Library Fees	0.07%
Fire Brigade Fees	0.03%
Museum Fees	0.03%
Roads Fees	0.01%
Fuel Tax	0.00%
	100.02%

[a]Total over 100 percent due to rounding.

When asked about major expenditures, participants paint a picture of very basic "service" delivery effort on the part of most local governments in Palestine. Personal services is the predominant operating expenditure, then capital expenditures for both maintenance and development in the areas of roads, street lighting, garbage collection and gardens upkeep.

Central government provides police and fire protection, preventive health care and hospitals, and education.

Review of the City of Hebron Revenues and Expenses for October 1994, provided by one participant, outlines expenditure categories typical of Palestinian bcalities. The category of General Management includes a few objects of expenditure such as personal services, stationary, telephone, general operating and municipality councilor meetings. The Accounts and Legal Department just lists payments to accountants and lawyers, pensions and to a day-labourer. We see similar categorizations in the other departments, with the Health Department "objects" indicative of some of the prevention programs provided like, malaria and rabies prevention, slaughterhouse, sewer, and "garbageyard" maintenance, including the purchases of garbage containers and truck accessories. The Engineering Department recognizes road and street work; there is a Security and Fire Department, General Library Department, and Mechanical Department. Water and electric projects expenditures are listed as well. The finance officers noted that these expenditure categories have not changed significantly in the last several years.

Participants were questioned about their budget processes and financial reporting activities. A typical local government budget process begins January 1st at which time the finance officer or chief accountant prepares the budget by collecting data from all departments in the municipality. In some communities, division heads ask their staff for a three-year plan and preparation of a budget based on expectations for the coming year. In any event, the finance officer has responsibility for compilation of budget "requests" or expectations. In some governments the finance director, municipal council and department managers submit their studies and expectations for revenues and expenditures to the finance department. Then, according to one participant, all materials are then put together and submitted "to the mayor and finance committee of the local council which holds a ‘primary meeting’ to discuss all issues and formulate an [overall] view." Municipal councils then revise the budget with the Ministry of Finance. The Ministry of Local Government must approve all final budgets. And, according to one finance officer, revenues must equal expenditures or the budget is not approved. Regarding mid-year adjustments, some participants found no use for supplemental budgets, while others said that when there are unexpected expenditures, they use a supplemental budget to "redo" the budget.

We were interested in finding out what kinds of analyses these officers conducted when preparing their budgets. When asked about budget data analyses, most responded that they depend on historical data that they then fold into information regarding "changes," new fees, inflation and new yearly resources. Many talked of collecting data for development plans and projects anticipated by departments, reinforcing the notion that much of what local governments do is capital- and not service-related.

All participants indicated that they use a cash basis of accounting. And, when asked what types of financial reports they produce, most stated that they compile trial balances, monthly and yearly reports (according to one, "by hand, because we do not have a computer system!"). Some officers did indicate use of computers and software to support reporting. According to one, "with Paradox (database) software we generate daily, monthly, yearly reports for every item of revenue and expenditure and are able to make budgeting comparisons."

All financial officers have responsibility for producing their annual budget. One officer stated that in addition to the annual budget, "we produce monthly reports including revenue and expenditures, salary and wage reports, electric and water fees and tax analysis reports." Finally, participants responded that the accounting standards that guide their documentation of the financial flows of their government are provided by the financial by-laws of local authorities and by the Ministry of Local Government.

A primary reason these finance officers came to the United States for training in fund accounting and budget systems was to learn about methods of financial management, accounting, and budgeting that can help them overcome weaknesses in their systems. The participants were very open regarding these weaknesses:

Financial Management
Basis of accounting; cash basis does not allow for sufficient control and accountability
No cost accountancy
No managerial accounting
You cannot know the new balance of allotments because the obligation for procurement is not used
No accounting for depreciation
Lack of internal auditing control
Inadequate reporting systems
Lack of advanced financial systems

Technological
Poor computer software

Strategic Planning and Budgeting
Continually operating in a deficit situation

Administrative
Weak and outdated administrative situation
Lack of skills for decision-makers
Lack of advanced administration system

Economic
Lack of cash flow due to the hard economic situation
Lack of grants

Political
Lack of grants
Lack of experience in the municipal council
Poor capabilities of the municipal councilor, especially regarding accounting issues

Participants were asked how they were trying to meet these different needs. Most expressed efforts to enhance strategic planning by managers, to take advantage of training opportunities to learn about possible financial management, budgeting and accounting systems (specifically related to fund accounting) and to compare computer systems that can accommodate specific anomalies related to financial management, administration and reporting in their government.

CONCLUSIONS

There are major hurdles for these officers and their governments to overcome to enhance their cash flow, as well as the accountability and control of the funds that they manage. These governments place their heaviest reliance on utility revenues. However, Sewell (1998, 2) points out that, "…current initiatives to create regional self-financing water, wastewater and electricity utilities to generate technical, management and financing improvements will relieve local governments of these distribution services, but may result in revenue loss for some local governments." Devolution of property tax administration to local governments does have its problems as well. For example, there is little reassessment of property in Palestine (one finance officer noted that property taxes have been the same in his government since 1951). And while the finance officers expressed a desire to take greater advantage of the property tax, they indicate very little personnel and computing capacity in most local governments to properly support administration of the tax.

Many of the Palestinian finance officers agreed that a major problem with any changes to their tax structures will be cultural; they note that it will be hard to convince citizens to pay higher taxes to support new or enhanced services, particularly since household income levels tend to be low and unstable. Most unsettling is the reality that political unrest and instability fosters inequitable assessment of fees and taxes. Many Palestinians, as well as Israeli citizens living in West Bank settlements, are able to avoid paying fees and taxes because of the fluid political situation (Halkin, 1999). In fact, according to one finance officer, there are citizens of his government who have not paid taxes since 1987. Thus, another pointed out, the poor typically bear a disproportionately large share of fees and taxes.

Ultimately, Palestinian local authorities have the power to levy taxes but due to the poor economy it is difficult to establish revenue sources. Intergovernmental support from the PNA seems necessary, but is very suspect by local government finance officers. According to one participant, "there is difficulty in getting central government to fulfill promises." Overall these finance officers were very open to changes in their financing strategies and management practices, yet fairly restrained regarding their relationship with the PNA and the MLG specifically. This is not surprising, given that representatives of the MLG attended all sessions with participants. Local governments in Palestine currently receive no grant funds from the PNA, and according to participants, money (donations and grants from international agencies to the PNA) is slow to make its way down to municipalities. Thus, we are left with a picture of Palestinian local government revenue sources as characteristically erratic, unreliable, and certainly inequitable.

The Independent Task Force Report prepared by the Council on Foreign Relations ("Strengthening Palestinian Public Institutions," Sayigh and Shikaki, 1999) provides a list of recommendations regarding public finance in Palestine. In addition to calling for an central government executive budget system, consolidation of PNA accounts, improved financial accountability and auditing regulations, and central control of public-sector pensions, the authors suggest that the PNA leave collection of the property tax to local governments, and that "municipal authorities charge the real cost of services to users" (Sayigh and Shikaki, 1999, 20). It does seem apparent that such changes are necessary but can be expected to occur very slowly. Also, local governments will surely need some financial support from the central government as a jump-start for the administration of new or enhanced taxes. Given our conversations with local government finance officers from Palestine, we agree with the above recommendations, yet caution representatives in the PNA, as well as local officials that success will depend in part on the appropriate inclusion of local government representatives in decisions regarding the practices that will affect them. And, cultural change among citizens is equally important. Palestine, like Egypt, may need to conduct some "marketing" to its citizens regarding the services that government is, and potentially can, provide in order to soften citizen attitudes toward new or changed taxes, fees and charges.

Ultimately, Palestinians cannot ignore their current political and economic situation. While some progress has been made, Palestinian statehood and the financial stability of its government remains unresolved. Essentially, Palestine is typical of developing countries seeking political liberalism at the same time that economic growth is essential. According to Halkin (1999), it is imperative that Palestinians reconcile numerous political factions to promote unity in order to successfully evolve into a democratic state with a free party system and eventually a private sector-dominated economy. In the short term, economic success may be contingent upon a public sector economy in which the central government both takes on and absolves itself of certain responsibilities. Essentially, much work needs to be done in strengthening the economy, improving government administration, and more clearly defining the roles of central and local authorities.

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