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Report to the Chairman, Committee on International Relations, House of Representatives

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FOREIGN ASSISTANCE

PLO's Ability to Help Support Palestinian Authority Is Not Clear

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National Security and
International Affairs Division

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November 28, 1995

The Honorable Benjamin A. Gilman
Chairman, Committee on International
Relations
House of Representatives

Dear Mr. Chairman:

This report responds to your request for an unclassified version of the classified report we issued in June 1995 on the Palestine Liberation Organization's (PLO) finances. The objectives of that report were to (1) assess PLO's ability to help finance the Palestinian Authority's operations in the West Bank and Gaza Strip, (2) review whether the international donors effectively analyzed the need to help fund the Palestinian Authority's operating and start-up expenses, and (3) determine whether appropriate controls have been implemented to ensure that donor funds will be adequately accounted for.

We were unable to independently verify PLO's current financial condition since PLO was unwilling to provide us with requested accounting records and supporting documentation. However, we were able to obtain some unclassified and classified data on PLO's finances. At your request, we asked officials from both the Department of State and the Central Intelligence Agency (CIA) to declassify the classified material they provided to us.[1] CIA responded that with certain minor exceptions, none of the CIA material used in our report could be declassified. The State Department allowed most of its data to be used in this report.

Background

On October 1, 1993, an international donors group met in Washington, D.C., to raise funds for long-term development projects in the West Bank and Gaza Strip in support of the Declaration of Principles signed between PLO and the government of Israel. A total of $2.3 billion for a 5-year period beginning in 1994 was pledged by 35 countries and organizations (including the United States, which pledged $500 million). The United States has committed $47 million (or approximately 25 percent of its 1994 and 1995 pledge amounts) to help fund the Palestinian Authority's operating expenses.

[1]Information used in GAO-produced reports carries the classification of the originating source. The authority to declassify or downgrade information is vested solely with authorized executive branch officials.

International donors traditionally insist that aid go to specific development projects rather than to general government expenses. However, the donors decided they would temporarily help the Palestinian Authority meet its civil servant payroll expenses, police salaries, and start-up costs. The rationale for providing this assistance is that the Palestinian Authority is working to establish an adequate domestic tax collection system and acceptable revenue-sharing arrangements with Israel.

The donors formed an Ad Hoc Liaison Committee that meets periodically to discuss funding and coordination issues. The World Bank acts as the Secretariat for the Committee and has assumed responsibility for tracking donor commitments, helping coordinate donor assistance, and managing several trust funds geared toward providing the Palestinian Authority with technical assistance and support for short-term operating costs and start-up expenses.

Results in Brief

We were unable to reach a definitive conclusion on PLO's ability to assist the Palestinian Authority with its operating expenses. We were able to determine, however, that some of PLO's administrative, military, and social welfare expenses have been subsumed under the Palestinian Authority's budget. At the same time, we found that several traditional PLO revenue sources were not included in the Palestinian Authority's budget.

In 1994, donor contributions accounted for $120 million, or 68 percent, of the Palestinian Authority's budget. In 1995, donor contributions are expected to account for about $200 million, or 45 percent, of the budget. In an effort to control and eventually eliminate the Palestinian Authority's need for external assistance, the donor community called on the Palestinian Authority and Israel to implement an action plan designed to increase domestic tax revenues and revenue transfers from Israel. The donors, however, have not paid equal attention to the Palestinian Authority's expenditure plans, which require significant outlays for a 30,000-member civil service and an 18,000-member police force. The donors agreed to help fund these staffing levels without adequately appraising the rationale behind them.

Most donor aid is being disbursed through traditional channels, such as bilateral aid programs, nongovernmental organizations, and the United Nations, which utilize established financial control procedures. In addition, the donors implemented a number of financial controls that are designed to reduce the risk that operating funds provided directly to the

Palestinian Authority will be mishandled. These controls include (1) a World Bank-managed trust fund, which relies on audits of filed claims to monitor the use of donor funds; (2) the establishment of a Palestinian Economic Council for Development and Reconstruction (PECDAR), which serves as a focal point for receiving and accounting for aid that is disbursed to the Palestinian Authority; and (3) a standard disbursement mechanism for police salary payments, with accounting and oversight controls provided by the United Nations Relief and Works Agency. We have not independently determined that these controls are effective. As we were finalizing our June 1995 report, we received documents from you and Senator Jesse Helms having possible implications that some funds may have been diverted by the Palestinian Authority. We are reviewing this matter and will advise you of the results in a separate report.

PLO's Ability to Contribute to Palestinian Authority Expenses Is Not Clear

Our review of available information did not lead to a definitive conclusion on whether PLO could financially assist the Palestinian Authority. We generally could not verify the accuracy of public reports on PLO's finances. Most significantly, we were unable to verify a widely quoted estimate of PLO's finances prepared by the British National Criminal Intelligence Service (NCIS). A February 1994 NCIS briefing document stated that: "A conglomeration of Palestinian movements [under the umbrella of the PLO] constitutes the richest of all terrorist groups. Despite denials to the contrary, it is estimated that they have world wide assets approaching $8-10 billion." Citing the confidential nature of his sources, the author of this statement declined to provide us with any data or documentation to support this claim.

Media allegations of tangible assets proved difficult to confirm or refute. Since at least the mid-1980s, newspaper and magazine articles have identified general or specific assets alleged to be owned or controlled by PLO or its economic arm—Samed.[2] For example, several media reports alleged that PLO owns or controls several national airlines around the world. We were unable to confirm such allegations. In general terms, we did establish that Samed operated a number of different businesses in the past, including agricultural cooperatives, a film studio, a children's clothing factory, and a shoe factory. According to a State Department cable, PLO owned a duty-free shop in Tanzania that subsequently closed down. The cable also notes that "the PLO has other money-making ventures

[2]PLO's Executive Committee created Samed in 1970 and tasked it with establishing profitable businesses that could provide employment opportunities for thousands of Palestinians from the refugee camps in Lebanon and Jordan. Samed was expected to operate as a profit center that could help alleviate PLO's dependence on Arab state contributions.

here. A popular Middle Eastern restaurant, the Cedars Club, is run by the PLO. Undoubtedly, there are other economic enterprises as well."

Certain PLO Expenses Subsumed Under Palestinian Authority's Budget

Historically, PLO's major expenses have included (1) an administrative staff in Tunis, Tunisia; (2) diplomatic missions in over 100 countries; (3) armed militias in several Middle Eastern states; (4) civil servant pensions and supplementary salary payments for certain Palestinian civil servants in the West Bank and Gaza Strip; and (5) several social welfare programs offering such benefits as free schooling, free health care, and martyr payments to compensate families of deceased fighters or those injured or disabled in fighting for the Palestinian cause.

Prior to the outbreak of the Persian Gulf War, PLO spent heavily in all these areas. However, as a result of Chairman Arafat's support for Iraq's invasion of Kuwait, PLO had to significantly cut back its expenses after August 1990 when the Gulf states stopped all official aid to PLO.

Early budgets prepared by the Palestinian Authority showed that certain PLO expenses were transferred to the new civil administration.[3] This was done with the knowledge and encouragement of the World Bank. As explained by a senior World Bank official, the Palestinian Authority was asked to maintain unified budgets showing both PLO and civil administration costs. The goal was to avoid having two budgets, that is, a public budget for the Palestinian Authority and a shadow budget covering PLO's expenses.

One major PLO expense transferred to the Palestinian Authority was the salaries of former PLO militia members hired by the Palestinian Authority to join its police force.[4] Other transferred expenses included social welfare expenses, martyr family payments, civil servant pensions, and supplementary civil servant salary costs.

[3]The Palestinian Authority has developed a series of four prospective budgets beginning in January 1994 and concluding with its latest budget issued March 27, 1995. These budgets have been rudimentary in nature and generally do not include detailed cost and revenue schedules, although early versions of the budget did include footnotes that stated certain PLO expenses were included in the Palestinian Authority's budget. It is unclear whether other PLO costs (such as those costs associated with its office in Tunis and a number of overseas missions) are included in the budget since they are not explicitly identified. The World Bank and the International Monetary Fund are working with the Palestinian Authority to improve its accounting and budget development apparatus. A more formal budget is not expected until 1996.

[4]Under the peace accord, PLO and Israel must approve all proposed police force hires to prevent the hiring of former known or suspected terrorists.

Palestinian Authority Budget Does Not Include Traditional PLO Revenues

Historically, PLO has had four principal sources of income: (1) official contributions from Arab states, such as Saudi Arabia, Kuwait, Libya, Iraq, the United Arab Emirates, Algeria, and Qatar; (2) the Palestinian Liberation Tax Fund—a 3.5- to 7-percent tax on Palestinian workers in Arab states; (3) income from investments; and (4) donations from wealthy Palestinians and various philanthropic organizations. Each PLO faction apparently has its own sources of funding, such as membership dues and contributions from Arab states and other sympathizers.[5] The Palestinian Authority's budgets do not include references to any of these traditional PLO revenue sources—some of which have lapsed and some of which remain active.[6]

Palestinian Authority Spending Has Not Been Fully Analyzed by Donors

State Department cables indicate that the United States had originally hoped that the Palestinian Authority could operate without any external assistance. Later, however, it became apparent that the Palestinian Authority could not immediately finance its operations with local tax collections and revenue transfers from Israel. To meet the Palestinian Authority's need for immediate cash assistance, the donors have spent $120 million to cover the Palestinian Authority's operating deficit for 1994.[7] The donors have pledged that they will strive to cover the Palestinian Authority's estimated 1995 budget deficit of over $200 million.[8] As noted earlier, the United States has committed $47 million (or close to 25 percent of its 1994 and 1995 pledge amounts) to help pay the Palestinian Authority's operating costs. The vast majority of this support has gone to

[5]Several analyses of PLO's finances we reviewed included allegations that PLO amassed significant sums of money from illicit activities, such as extortion, theft, arms dealing, and drug trafficking. Most of these allegations were linked to the period PLO was based in Lebanon (1970-82). According to Drug Enforcement Administration officials, there was no evidence to suggest that PLO was ever formally involved in the production, transportation, or sale of illegal drugs.

[6]One partially active revenue source is Palestinian Liberation Tax Fund receipts and private donations. State Department documents indicate that Saudi Arabia and Qatar continue to collect taxes and private donations for PLO, while Kuwait and the United Arab Emirates have officially discontinued this activity.

[7]The Palestinian Authority reported that its total operating budget for July through December 1994 was $176.5 million. Palestinian Authority revenues were reported to be $57.1 million over the same time period.

[8]The Palestinian Authority's estimated operating budget for 1995 is $443.6 million, with estimated revenues of $216 million.

civil servant and police salaries. U.S. funds have not been used to pay PLO administrative expenses, armed militia salaries, or martyr payments.[9]

Donor Attempts to Eliminate Future Calls for External Assistance

In an effort to control and eventually eliminate the Palestinian Authority's reliance on external assistance, the donors have pressured the Palestinian Authority and the Israeli government to improve their revenue collection efforts. However, less attention has been paid to the Palestinian Authority's expenditures, and the donors have agreed to pay for certain costs, most notably civil servant and police salaries, without an adequate analysis of the support for such costs. For example, it is not clear why the Palestinian Authority needed to hire about 9,000 employees to replace the approximate 1,600 Israeli employees who previously worked for the Israeli civil administration. Nor is it clear why the Palestinian police force has grown to an 18,000-member force when the Gaza/Jericho Agreement between PLO and Israel stipulates a 9,000-member force for the Gaza/Jericho enclave. The donor community has capped the number of policemen it will fund at 9,000. However, Palestinian Authority spending above this level decreases the amount of local revenue that can be devoted to the expenses the donor community is willing to underwrite.

At a donors' meeting in Brussels in November 1994, a memorandum of understanding with the Palestinian Authority was developed that outlines the need for greater progress in revenue collection efforts. On the issue of expenditures, the donors' focus was on holding the Palestinian Authority to the expenditure totals in the budget presented to the donors at that meeting.

After a donors' meeting in Paris in April 1995, at which the donors agreed they would strive to cover the Palestinian Authority's budget deficit through December 1995, an action plan was developed that again stresses the need for continued progress in generating additional revenues. The action plan also noted the Palestinian Authority's commitment to freeze salaries and hiring at existing levels and the need to hold expenditures to the levels outlined in the Palestinian Authority's March 1995 budget. The action plan makes clear, however, that the donors will consider underwriting additional expenses related to the implementation of subsequent phases of the peace accord.

[9]As a general rule, the donors have avoided paying for traditional PLO expenses. However, the Palestinian Authority is free to spend domestic tax revenues and revenue transfers from Israel on budget items the donor community will not fund. As noted by World Bank officials, Palestinian Authority spending has increased the financial burden on donors since less local funds are available to cover donor-approved expenses such as civilian salaries.

State Department officials told us they were not aware of any analysis performed by the United States or any other donor nation that examined the appropriateness of the Palestinian Authority's staffing levels or mix of job skills. However, a team of financial experts from the International Monetary Fund did work with Palestinian Authority officials to produce the budget provided to the donors in early April 1995. State officials believe that this involvement by the International Monetary Fund suggests that the Palestinian Authority's staffing levels have been generally validated. State Department officials noted that the United States and the other donors were not consulted about the Palestinian Authority's hiring plans and that early consultations, while not required, could have been useful.

Donor Financial Controls Remain in Place Despite Chairman Arafat's Opposition

The bulk of donor funds will be distributed through existing bilateral aid channels, nongovernmental organizations, and U.N. agencies for specific development projects. Donor concerns about accountability have tended to focus on the use of donor funds by the Palestinian Authority to pay for certain recurring and start-up costs. In response to these concerns, the donor community, in coordination with the World Bank and the United Nations, has developed a number of controls to monitor the expenditure of such funds. The United States has generally relied on these donor-developed controls to distribute assistance to the Palestinian Authority.

Chairman Arafat has stated publicly that he would refuse to accept donor controls over funding and has launched several attempts to frustrate these controls. He initially attempted to appoint himself as PECDAR's director but was rebuffed by the donors who demanded that a more independent director be appointed. He established competing decision centers in the Palestinian Authority and Tunis in an attempt to diminish PECDAR's role as a central contact point for donor aid. He also worked directly with certain donors to establish marquee development projects, such as airports, without the involvement of PECDAR officials. Although these attempts have created difficulties for the donors, the donors have consistently demanded that the Palestinian Authority manage donor funds in accordance with strict standards of accountability and transparency.

The World Bank, with the support and encouragement of the United States, has been implementing a transparent and accountable system to handle donor funds provided to the Palestinian Authority. This has been achieved through several mechanisms. The World Bank's Holst Fund[10] ensures transparency and accountability by (1) specifying the types of expenditures for which funds may be used, (2) using an established auditing firm to verify documentation of expenditures, and (3) stipulating that donor funds be channeled to the Palestinian Authority only to replenish approved and documented disbursements. PECDAR serves as a common address for all donor aid to be provided to the Palestinian Authority. Further, all Holst funds destined for individual Palestinian Authority ministries flow through this entity, which, in turn, interfaces with Touche Ross, Saba & Co.—the Bank's auditors.

The donors have established a separate control mechanism for handling the disbursement of police salaries. This mechanism relies on a United Nations Relief and Works Agency-managed disbursement and accounting system. The United States disbursed $5 million for police salaries in 1994. These funds were provided directly to PLO for the benefit of the Palestinian Authority because a disbursement mechanism was not in place when these funds were transferred. The United States contracted with an Egyptian audit firm to monitor the disbursement of these funds. The auditor's report documents that the $5 million was appropriately disbursed and used only for approved purposes. The United States does not plan to provide any further funding for police salaries.

We have not independently determined that donor-developed controls are effective. However, evidence that these controls appear to be working is provided in the payments that have been rejected by the World Bank and its auditors. For example, in violation of its grant agreement with the World Bank, the Palestinian Authority spent $2 million of Holst funds on martyr payments. When the Palestinian Authority applied for a replenishment of its account, this charge was noted by the Bank's auditors and promptly disallowed. A Bank official also told us that the Palestinian Authority filed claims for expenses relating to PLO's office expenses in Rome and Washington, which were disallowed.

A group in Israel called Peace Watch alleged that the first $13 million in Holst funds was disbursed to the Palestinian Authority without any conditions and that these funds were diverted to PLO forces operating in Lebanon. This $13 million appears to be related to the monthly funding cap that Holst fund administrators placed on Palestinian Authority spending. A

[10] After the signing of the Declaration of Principles, the World Bank established three trust funds to act as central repositories for donors wishing to have their pledges disbursed through the World Bank. The largest of these funds is the Holst Trust Fund, which was established to provide funds to the Palestinian Authority and PECDAR to help cover operating expenses.

written statement from the Bank's auditors indicated that the Palestinian Authority actually received an initial advance of $15 million. A Bank official told us that this initial advance was never diverted to Lebanon and that the entire amount was spent on authorized purposes, such as civilian salaries. The statement from the Bank's auditors confirmed that the entire $15 million was replenished on the basis of applications filed by the Palestinian Authority that were audited in accordance with standard Bank practices.

We conducted our review from July 1994 through April 1995 in accordance with generally accepted government auditing standards. We obtained comments on the classified version of this report from the State Department and CIA. The CIA comments remain classified; however, the State Department did agree to have its comments reproduced in this report. State Department's comments are contained in appendix II.

Copies of this report are being provided to the Secretary of State, the Director of Central Intelligence, the Director of the Office of Management and Budget, and interested congressional committees. We are also providing copies of this report to Members of Congress who specifically requested that we issue an unclassified report on PLO's finances. We also will make copies available to others upon request.

This report was prepared under the direction of Joseph E. Kelley, Director-in-Charge, International Affairs Issues. Other major contributors to this report were Diana Glod, Assistant Director; Michael ten Kate, Evaluator-in-Charge; Albert Fleener, Evaluator; and Kevin Craddock, Special Agent. Please contact Ms. Glod at (202) 647-1588 if you or your staff have any questions about this report.

Sincerely yours,

Henry L. Hinton, Jr.

Henry L. Hinton, Jr.
Assistant Comptroller General

Contents

Abbreviations

CIA	Central Intelligence Agency
NCIS	National Criminal Intelligence Service
PECDAR	Palestinian Economic Council for Development and Reconstruction
PLO	Palestine Liberation Organization

Scope and Methodology

The starting point for our review was an attempt to obtain financial information directly from the Palestine Liberation Organization (PLO). PLO told us to provide written questions on the information we required and then declined to respond to them. PLO also chose not to respond to our written request for meetings with PLO and Palestinian Authority officials in the self-rule territories. However, in the Gaza Strip, we were able to meet with a senior Palestinian Authority official.

In Washington, D.C., we interviewed Palestinian affairs experts and program officials from the Department of State, the U.S. Agency for International Development, the Overseas Private Investment Corporation, the Department of Treasury (Office of Foreign Assets Control and the Financial Crimes Enforcement Network),[1] the Drug Enforcement Administration, the Congressional Research Service, and the World Bank. We also conducted fieldwork in London, Tel Aviv, and Jerusalem and interviewed officials from the State Department, the U.S. Agency for International Development, the Drug Enforcement Administration, the World Bank, the United Nations Relief and Works Agency, nongovernmental organizations, and private industry in these locations. We also met with a number of private researchers who have studied and written about PLO's finances.

We reviewed relevant State Department cables prepared between January 1990 and February 1995 and conducted a detailed search of public articles and books on PLO. We developed a list of potential PLO agents and operatives using a number of sources. We gave this list to Treasury's Financial Crimes Enforcement Network, which searched its databases to identify the personal or corporate assets of these individuals. In collaboration with Treasury's Financial Crimes Enforcement Network, we attempted to verify media reports of specific assets alleged to be held or controlled by PLO.

We developed a data collection instrument to collect a wide variety of financial and operational data on PLO. We analyzed responses to this data collection instrument from U.S. embassies in 13 Middle Eastern States and 5 European countries. We also received information from U.S. embassies

[1]The Office of Foreign Assets Control is responsible for enforcing presidential executive orders mandating the seizure of assets controlled by sanctioned states. This office prepares agent/operative analyses that can lead to a Specifically Designated National label that permits the freezing of any assets belonging to Specifically Designated Nationals in U.S.-controlled accounts or assets. PLO has never been placed under the U.S. sanctions program. However, a number of prior PLO subfactions were named in the President's recent executive order pertaining to freezing the assets of several terrorist groups and individuals.

in one Latin American country and three African countries addressing public allegations that PLO owned duty-free shops in these locations.

We met with U.S. intelligence experts from (1) the State Department's Intelligence and Research Bureau, (2) the Central Intelligence Agency, (3) the Defense Intelligence Agency, and (4) the National Security Agency. British intelligence officials declined our request for meetings on the basis that they had no useful information to share. However, we did interview a senior official from Britain's National Criminal Intelligence Service to discuss a February 1994 estimate of PLO's finances.

Comments From the Department of State

United States Department of State

Chief Financial Officer

Washington, D.C. 20520-7427

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June 5, 1995

Dear Mr. Hinton:

Thank you for the opportunity to provide Department of State comments on your draft report, "FOREIGN ASSISTANCE: Financial Condition of the Palestine Liberation Organization," GAO Job Code 711090.

The State Department views this report as a serious effort to understand the PLO's financial status, particularly given the lack of reliable source information.

On the question of donor assistance to the Palestinians, the Department concurs with the report's conclusion that U.S. and World Bank efforts have achieved their goals of setting up a transparent and accountable system.

On balance, the report confirms problems that the Department has also encountered--the lack of reliable information regarding the PLO's assets and finances.

If you have any questions concerning this response, please call Mr. Scott McGehee, NEA/RA, at (202) 647-1378.

Sincerely,

Richard L. Greene

cc:
GAO/NSIAD - Ms. Glod
State/NEA/RA - Mr. McGehee

Mr. Henry L. Hinton, Jr,
Assistant Comptroller General,
National Security and International Affairs,
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