



## **THE EFFECT OF PUBLIC DEBT ON DOMESTIC PRODUCT AND UNEMPLOYMENT (AN EMPIRICAL STUDY ON THE PALESTINIAN ECONOMY)**

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### **ABSTRACT**

*This study sought to recognize the effect of public debt on unemployment and domestic product. Also, it aimed to identify the developments that occurred in some indices in the Palestinian economy. To achieve the goals of this study, the researchers employed the data covering the period (1999–2014) as well as the simple regression analysis. The findings showed that the percentage of public debt to gross domestic product amounted, on average, by 20%. Furthermore, it was found that there is a connection of statistical effect between the rate of public debt and the independent variable, rate of debt, to gross domestic product. Meanwhile, the findings showed no connection between the rate of public debt and gross domestic product.*

**Keywords:** Public debt, Domestic product, Unemployment, Empirical study, Development, Palestinian.

Received: 24 June 2016/ Revised: 27 July 2016/ Accepted: 24 August 2016/ Published: 16 September 2016

### **Contribution/ Originality**

Very few studies sought to tackle the topic of this study, or at least this topic was not dealt with from all angles. This paper is an addition to existing literature as it contributes to recognize the effect of public debt on unemployment and domestic product. Furthermore, this study is among very few studies that use regression analysis in the period between (1999) and (2014) to highlight the aforementioned relationship.

### **1. INTRODUCTION**

The Palestinian economy is considered one of the emerging economies in terms of structure. This economy is facing many restrictions that influence its development. On the ground, the Palestinian economy is characterized by fragility and poor performance as it is dependent on the Israeli economy which obstructs its development.

The economic path is tracked through a number of statistics and reports issued periodically, and these are known as economic indices. These measure the general performance of the various economic sectors, and clarify the track whether economy is gaining momentum or seeing a setback. Economic indicators help those concerned to set economic forecasts and estimates that contribute to put the appropriate economic policies. Among these economic indicators are rate of domestic product, rate of public debt and rate of unemployment ([Central Palestinian Bureau of Statistics, 2010](#)).

It is evident that public debt is one of main obstacles that face the Palestinian Authority, especially as it is short of investment opportunities and it is facing unsolved growing rates of unemployment. Another fact, which hinders most sustainable development plans, is that Palestine is still under the Israeli occupation. Although Palestine adopted the system of free market, which depends on supply and demand, this policy made it possible to import

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goods without any restrictions. This is reflected on the national industries that are influential in gross domestic gross.

## 2. STUDY PROBLEM

Most current studies, whether theoretical or empirical, focus on the developments that took place in the Palestinian economy without studying the relationship among the economic changes. This study depended on the descriptive, analytical method. On the international level, because data differ, the findings vary widely in all countries. Thus, the relationship between some factors may differ from an economy to another. This study tried to concentrate on the relationship between some variables in the Palestinian economy (domestic produce, unemployment and rate of public debt). Two main questions were raised:

- 2.1. To what extent does public debt impact domestic produce?
- 2.2. To what extent does public debt influence unemployment?

## 3. OBJECTIVES

- 3.1. Identifying the developments that affected some indices in the Palestinian economy from (1999) to (2014), and these were (gross domestic product, unemployment and public debt)
- 3.2. Recognizing the track the Palestinian economy follows, and investigating the relationship between the variables of macro economy, rate of unemployment and rate of debt to gross domestic product on one hand and the rate of growth in domestic produce and the rate of debt to gross domestic product on the other hand, in Palestine.

## 4. SIGNIFICANCE OF STUDY

- 4.1. This study enables those concerned to put future plans for the Palestinian economy and draw up successful economic policies.
- 4.2. This study highlights the developments which affected some of the indices in the Palestinian economy between (1999-2014). (the gross domestic product, unemployment and public debt) are among the most important of these.
- 4.3. This study looks into the effect of public debt on unemployment and growth in the domestic product.

## 5. REVIEW OF LITERATURE

[Al-Adayla \(2015\)](#) investigated the hierarchies of public debt in Jordan and its effect on the economic growth. This study employed Johansen Co-integration Test and the True / False Test to recognize the relationship between the public debt and external debt to gross domestic product as an independent variable on one hand and the gross debt to gross domestic product as a dependent variable, on the other hand. The findings of the Co-integration Test showed a single complementary dimension which describes the behavior of variables on the long run. The true/False Test revealed that 90% of the standard deviations of the dependent variable will be corrected yearly.

[Spilioti \(2015\)](#) aimed to identify the impact of governmental debt on economic growth in the Euro Zone by using the data between (1981-2014). The results showed that the influence of debt on economic growth is positive and statistically significant.

In [Wafi \(2015\)](#) did a study in which he sought to highlight the developments that affected the Palestinian economy after (1993), and to compare its indices with the occupation era and Al-Aqsa Intifada era after (2000). In addition, it aimed to identify how the Oslo Agreement and Paris Agreement affected this economy. This study used the analytical descriptive method. The findings were: As a result of the international pressure and the budgetary

deficit, the Palestinian Authority carried out a number of legal, administrative, monetary and financial reforms. The Paris Agreement, controlled by the Israeli side, made the growth of the Palestinian economy hostage of international trade and employment.

AL- Saraireh (2014) aimed to investigate the connection between unemployment, economic growth, foreign workforce, governmental spending. This study found a negative correlation between unemployment and foreign workforce. Also there was a significant relationship between unemployment as a dependent variable and governmental spending as an independent one.

Apere (2014) investigated the effect of public debt on private investment in Nigeria between (1981–2012) . Using Multiple Regression, the findings showed that public debt has a positive linear effect on private investment as percentage of domestic product.

Ibrahim and Khair (2013) aimed to analyze the effect of monetary policy on the indices of macro economy using the index of money supply as medium goal of the analysis of the effect of monetary policy on the macro indices of economy, as an ultimate goal . The researchers utilized the statistical descriptive approach and econometric approach. The study found that there is a direct correlation between inflation and money supply.

Fedeli and Forte (2012) sought to analyse the relationship between unemployment and the ratio of Deficit-GDP. This study covered the period between (1981–2009). The results showed that there is Co-integration among expatriates, and means that the policy of fiscal deficit creates unemployment.

Al-Mazrue and Jajma (2012) sought to recognize to what extent public expenditure affects gross domestic product from the perspective of current prices (1990–2009). This study also sought to identify to what extent public spending contributes to the changes taking place in the gross domestic product. As well, it aimed specify the effect of spending on the components of gross domestic product. The researcher used the experimental approach which involves analytical descriptive approach. This study found that there is a moral effect of government spending on the sources of gross domestic product at level (1%). Furthermore, it was found that the growth of gross domestic product was fast between (1990) and (2009) as the rate of growth amounted to (63%).

Rajab (2011) sought to recognize the economic and social effects resulting from the inflationary pressures in the Palestinian economy. Also, it purposed to analyze the agreement policies and the financial status of the Palestinian Authority. The researcher employed the analytical descriptive method. This study reached a number of results, among of which is : Building an agreement policy needs fundamental steps, primarily ending the occupation. Moreover, the study found that more than half of the Palestinian Authority's expenditure is spent on wages and salaries.

Suruji and Ghazawni (2009) aimed at recognizing the effect of food aids on the total economic indices in the Palestinian territories. The researchers used the descriptive method and regression analysis. This study reached the following findings: Food aids have a negative impact on the level of agricultural production in the Palestinian territories. Besides, it was found that there is a direct correlation between the rate of unemployment and food aids. Based on these findings, the study recommended that it is necessary to depend on these aids as they improve the level of living and spur the gross domestic product.

In Abu Al-qumssan (2005) did a study in which he sought to analyze the status of the Palestinian economy from the perspective of investment chances and the future challenges which reflected the future aspirations and the international economic with Palestine on the basis of mutual interests. This study also cast light on public private capital, workforce and the investment climate in Palestine. Besides, this research was an attempt to create practical mechanisms towards the future of the Palestinian economy and the horizons of its growth.

Zu'rub (2005) aimed to highlight the defect with the hieratical structure of the Palestinian economy and disclose how deep this economy is associated with the Israeli economy. The researcher depended on the analytical

method, and he came up with a number of recommendations among of which was that supporting the traditional industries to get to the international markets. Moreover, it was necessary to reduce unemployment and create new job opportunities through medium and small projects in the countryside and cities.

## 6. STUDY METHODOLOGY

### 6.1. Models of Study

A. The model can be represented in the following mathematical formula:

$$U = a + b \cdot DB + e$$

This model represents the equation of simple regression, where the ratio of public debt to gross domestic product DB is the independent variable, while the rate of unemployment U is the dependent variable. a is the equation constant, b is the correlation coefficient, and e is random error.

B. The model can be represented in the following mathematical formula:

$$GG = a + b \cdot DB + e$$

This model represents the simple regression analysis, where the ratio of public debt to gross domestic product DB is the independent variable, while the rate of growth in domestic product GG is the dependent variable. a is the equation constant, b is the correlation coefficient, and e is random error.

### 6.2. Hypotheses

The null hypothesis was used to formulate the hypotheses:

HO: There is no statistically significant relationship between the rate of unemployment and public debt to gross domestic product.

HO: There is no statically significant relationship between the rate of growth of domestic product and public debt to gross domestic product.

### 6.3. Study Population

The population of this study is the Palestinian economy. Some statistical data, issued by the Central Bank and the Palestinian Bureau of Statistics, were investigated. These data were represented by the rate of unemployment, rate of public debt to gross domestic product, and the rate of growth in domestic product between (1999) and (2014).

### 6.4. Data Analysis methods:

The following tests will be employed:

6.4.1. Descriptive statistics is represented by mean, median, lowest and highest values and standard deviation as a dispersion measure.

6.4.2. Simple Regression Analysis.

6.4.3. Breusch-Godfrey Serial Correlation LM to test autocorrelation between residuals.

6.4.4. White Heteroskedasticity to test harmony of autocorrelation between residuals.

6.4.5. Jarque-Bera Test to recognize whether residuals follow normal distribution.

### 6.5. Data

Table (2) shows that the percentage of public debt to gross domestic product DB, amounted, on average, by (20%). The highest value amounted by (26.4 %) in (2008), while the lowest one amounted by (6%) in 1999 with

(5.5%) standard deviation which is higher than that of the percentage of unemployment. On average, the percentage of unemployment was (23%) and the lowest percentage was registered in (1999) and it amounted by (12%). The percentage of growth in domestic product was, on average (9%).

Table-1. Main Data:

Growth in domestic growth	Rate of unemployment	Ratio of public debt to gross domestic product	Year
0.0500	0.12	0.06	1999
0.0099	0.14	0.09	2000
-0.0718	0.26	0.2	2001
-0.1119	0.31	0.24	2002
0.1159	0.26	0.23	2003
0.0910	0.268	0.233	2004
0.1161	0.235	0.248	2005
0.0162	0.237	0.222	2006
0.1213	0.217	0.264	2007
0.2121	0.266	0.233	2008
0.0891	0.245	0.239	2009
0.2263	0.237	0.211	2010
0.1742	0.209	0.211	2011
0.0778	0.23	0.22	2012
0.1153	0.234	0.19	2013
0.0040	0.27	0.174	2014

Source: CPBS (2015)

## 6.6. Findings

### 6.6.1. Descriptive statistics

Table-2. Descriptive statistics

	DB	GG	U
Mean	0.204063	0.077219	0.233625
Median	0.221000	0.090071	0.237000
Maximum	0.264000	0.226315	0.310000
Minimum	0.060000	-0.111872	0.120000
Std. Dev.	0.055340	0.092691	0.047261
Skewness	-1.640635	-0.352510	-1.109359
Kurtosis	4.721216	2.658392	4.037003

Source: Researchers' analysis

It is noticed from this table that the explanatory power of this model is high as the value of R-squared is higher than (60%). This explains the rate of the independent variable to the dependent one. Meanwhile, the value of F-statistic equals (21.4 %), and it has a statistical significance at level (5%). Furthermore, it can be observed from this table that the value of DW equals (1.4 %), and it is an acceptable value.

Based on this, the null hypothesis was rejected, and the alternative hypothesis was accepted. This means that there is a statistically significant relationship between the percentage of unemployment and the independent variable, percentage of debt, to gross domestic product.

6.6.2. Analysis of Simple Regression of the First Model

Table-3. Simple Regression

Dependent Variable: U  
 Method: Least Squares  
 Date: 11/01/15 Time: 13:43  
 Sample: 1999 2014  
 Included observations: 16

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DB	0.664375	0.143414	4.632559	0.0004
C	0.098051	0.030258	3.240541	0.0059
R-squared	0.605196	Mean dependent variable		0.233625
Adjusted R-squared	0.576995	S.D. dependent variable		0.047261
S.E. of regression	0.030738	Akaike info criterion		-4.010175
Sum squared resid	0.013227	Schwarz criterion		-3.913601
Log likelihood	34.08140	F-statistic		21.46060
Durbin-Watson stat	1.399758	Prob(F-statistic)		0.000388

Source: Researchers' analysis

6.6.3. Breusch-Godfrey Serial Correlation LM Test which is used to test the residuals

The null hypothesis: There is no autocorrelation among the residuals.

The alternative hypothesis: There is autocorrelation between the residuals.

The table shows that the value of Obs\*R-squared equals (0.624579) and the value of P is higher than (5%).

Consequently, the alternative hypothesis is accepted.

Table-4. Breusch-Godfrey Serial Correlation LM Test:

Breusch-Godfrey Serial Correlation LM Test:

F-statistic	0.243732	Probability	0.787485	
Obs*R-squared	0.624579	Probability	0.731770	
Test Equation:				
Dependent Variable: RESID				
Method: Least Squares				
Date: 11/02/15 Time: 15:56				
Pre-sample missing value lagged residuals set to zero.				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.003435	0.032429	0.105932	0.9174
DB	-0.012382	0.153217	-0.080812	0.9369
RESID(-1)	0.224602	0.334302	0.671853	0.5144
RESID(-2)	0.028481	0.334813	0.085064	0.9336
R-squared	0.039036	Mean dependent variable		-4.94E-17
Adjusted R-squared	-0.201205	S.D. dependent variable		0.029696
S.E. of regression	0.032546	Akaike info criterion		-3.799993
Sum squared resid	0.012711	Schwarz criterion		-3.606846
Log likelihood	34.39994	F-statistic		0.162488
Durbin-Watson stat	1.727990	Prob(F-statistic)		0.919549

Source: Researchers' analysis

White Heteroskedasticity Test. It is used to test contrast homogeneity between the residuals.

The null hypothesis : Homoscedastic.

The alternative hypothesis: Heteroscedastic

The table illustrates that the value of obs\*R-squared equals (0.903992) and the value of P is higher than (5%). Thus, we accept the null hypothesis. This is a good indicator of this model.

**6.6.4. Jarque–Bera Test to Find Out if the Residuals Follow Normal Distribution**

Null hypothesis: The residuals follow normal distribution.

Alternative hypothesis: The residuals don't follow normal distribution.

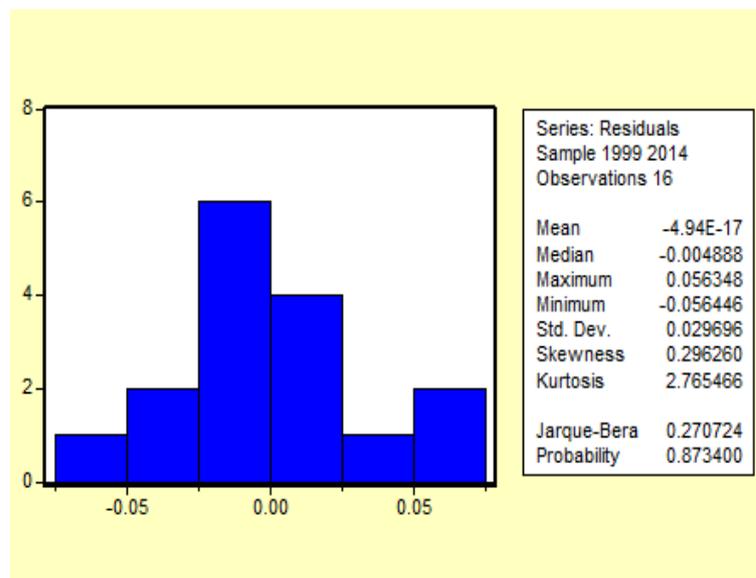
It is evident from the table that the value of Jarque –Bera equals (0.27) and the value of P is higher than (5%). So, the null hypothesis is accepted, and this is a good indicator of this model.

Table -5. Simple Regression

<b>F-statistic</b>	<b>0.389239</b>	<b>Probability</b>	<b>0.685210</b>	
Obs*R-squared	0.903992	Probability	0.636357	
Test Equation:				
Dependent Variable: RESID^2				
Method: Least Squares				
Date: 11/02/15 Time: 16:17				
Sample: 1999 2014				
Included observations: 16				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.001280	0.002416	0.529903	0.6051
DB	-0.014897	0.032994	-0.451503	0.6591
DB^2	0.058108	0.101583	0.572020	0.5771
R-squared	0.056500	Mean dependent variable	0.000827	
Adjusted R-squared	-0.088654	S.D. dependent variable	0.001134	
S.E. of regression	0.001184	Akaike info criterion	-10.47297	
Sum squared resid	1.82E-05	Schwarz criterion	-10.32811	
Log likelihood	86.78376	F-statistic	0.389239	
Durbin-Watson stat	1.852436	Prob(F-statistic)	0.685210	

Source: Researchers' analysis

Table -6. Jarque–Bera



6.6.5. Simple Regression Analysis of the Second Model:

Table -8. Simple Regression

Dependent Variable: GG  
 Method: Least Squares  
 Date: 11/05/15 Time: 13:25  
 Sample: 1999 2014  
 Included observations: 16

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.001706	0.091893	-0.018567	0.9854
DB	0.386771	0.435552	0.888001	0.3895
R-squared	0.053321	Mean dependent variable		0.077219
Adjusted R-squared	-0.014299	S.D. dependent variable		0.092691
S.E. of regression	0.093352	Akaike info criterion		-1.788420
Sum squared resid	0.122003	Schwarz criterion		-1.691847
Log likelihood	16.30736	F-statistic		0.788545
Durbin-Watson stat	1.362240	Prob(F-statistic)		0.389542

Source: Researchers' analysis

It is noticed that the explanatory power of the model is high as the value of R-squared is low. The value of F-statistic equals (78%), and has no statistical significance at level (5%). Also, the table shows that the value of DW is (1.36), which is an acceptable value.

Upon this, the null hypothesis is accepted, which means that there is no statistically significant connection between the rate of growth of domestic product and the independent variable, rate of public debt, to gross domestic product.

6.6.6. Breusch-Godfrey Serial Correlation LM is employed to Test the Residuals

The null hypothesis: There is no autocorrelation between the residuals.

The alternative hypothesis: There is autocorrelation between the residuals.

The table shows that the value of obs\*R-squared equals (1.52), and the value of P is higher than 5%. As a result, we accept the null hypothesis.

Table-8. Breusch-Godfrey Serial Correlation LM Test:

<b>F-statistic</b>	<b>0.631845</b>	<b>Probability</b>	<b>0.548405</b>
Obs*R-squared	1.524390	Probability	0.466641

Test Equation:  
 Dependent Variable: RESID  
 Method: Least Squares  
 Date: 11/05/15 Time: 13:29  
 Pre-sample missing value lagged residuals set to zero.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.015276	0.095570	-0.159836	0.8757
DB	0.068878	0.452599	0.152183	0.8816
RESID(-1)	0.323043	0.298239	1.083168	0.3000
RESID(-2)	-0.020464	0.298921	-0.068461	0.9465
R-squared	0.095274	Mean dependent variable		-2.47E-17
Adjusted R-squared	-0.130907	S.D. dependent variable		0.090186
S.E. of regression	0.095908	Akaike info criterion		-1.638544
Sum squared resid	0.110379	Schwarz criterion		-1.445396
Log likelihood	17.10835	F-statistic		0.421230
Durbin-Watson stat	1.979430	Prob(F-statistic)		0.741168

Source: Researchers' analysis

- White Heteroskedasticity Test. This is used to test Homoscedasticity between the residuals.

The null hypothesis: Homoscedastic.

The alternative hypothesis: Heteroscedastic. The table shows that the value of obs\*R-squared equals (1.01) and the value of P is higher than (5%). Thus, we accept the null hypothesis, and this is considered a good indicator of this model.

Table-9. White Heteroskedasticity Test:

<b>F-statistic</b>	<b>0.439590</b>	<b>Probability</b>	<b>0.653532</b>
Obs*R-squared	1.013524	Probability	0.602443

Test Equation:

Dependent Variable: RESID^2

Method: Least Squares

Date: 11/05/15 Time: 13:30

Sample: 1999 2014

Included observations: 16

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	-0.013773	0.024830	-0.554691	0.5885
DB	0.241535	0.339127	0.712226	0.4889
DB^2	-0.626569	1.044115	-0.600096	0.5588
R-squared	0.063345	Mean dependent variable		0.007625
Adjusted R-squared	-0.080755	S.D. dependent variable		0.011703
S.E. of regression	0.012167	Akaike info criterion		-5.812878
Sum squared resid	0.001924	Schwarz criterion		-5.668017
Log likelihood	49.50302	F-statistic		0.439590
Durbin-Watson stat	1.762142	Prob(F-statistic)		0.653532

Source: Researchers' analysis

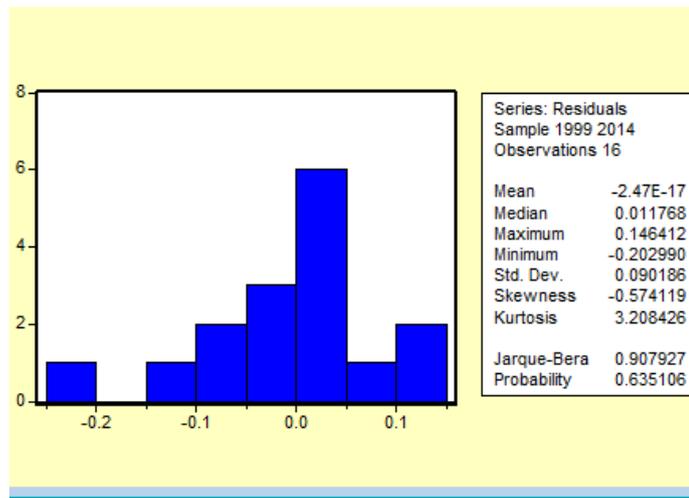
### 6.6.7. JarqueBera Test to Find Out if the Residuals Follow Normal Distribution

The null hypothesis: The residuals follow normal distribution.

The alternative hypothesis: The residuals don't follow normal distribution.

We can see, from this table, that the value of Jarque –Bera equals (0.90) and the value of P is greater than (5%) and so we accept the null hypothesis. This is a good indicator of this model.

Table-10. JarqueBera



## 7. SUMMARY OF RESULTS

After conducting many tests on the data and the models of the study, the results came as the following: Results of descriptive statistics: It was found that the percentage of public debt to gross domestic product DB was, on average, (20%). As for the highest value, it scored (26.4%) in (2008), while the lowest was (6%) in (1999), with (5.5%) standard deviation, which is higher than the standard deviation of the percentage of unemployment.

Regarding the simple regression analysis of the first model, the results were as the following: The value of F-statistic equals (21.4%) and this is statistically significant at level 5%. Moreover, the table shows that the value of DW equals (1.4), which is an acceptable value. Upon this, the null hypothesis was rejected, while the alternative one was accepted. This means that there is a statistically significant relationship between the rate of unemployment to the independent variable, percentage of debt to gross domestic debt.

The results of simple regression analysis of the second model were as the following: It is noticed that the explanatory power of this model as the value of R-squared is low. The value of F-statistic equals (78.8%), and has no statistical significance at level (5%). Moreover, the table demonstrates that the value of DW equals (1.36), which is acceptable. Based on this, the null hypothesis was accepted, that is, there is no a statistically significant relationship between the rate of growth in domestic product and the independent variable, the rate of debt to gross domestic product.

## 8. RECOMMENDATIONS

Upon the findings reached, we recommend the following:

- 8.1. The rate of public debt to gross product must be lowered as it poses danger to economy and it doesn't help reduce unemployment.
- 8.2. There is a need for sustainable development plans that should be controlled and oriented.
- 8.3. The private sector should play a pioneering role in national economy specially in drawing policies that help solve the problems of public debt and unemployment.
- 8.4. It is necessary to use standard research models to forecast the gross domestic product, especially as there are available reports about government spending.
- 8.5. The international treaties must be activated to make the best out of them.
- 8.6. Investment in Palestine must be encouraged under Palestinian and Israeli guarantees as Palestine is still under the Israeli occupation, and all imported or exported goods go through the Israeli ports.

Funding: This study received no specific financial support.

Competing Interests: The authors declare that they have no competing interests.

Contributors/Acknowledgement: All authors contributed equally to the conception and design of the study.

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