

*The Secretariat of the
Ad Hoc Liaison Committee*

**AID EFFECTIVENESS IN THE
WEST BANK AND GAZA**

Draft Report

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Table of Contents

Table of Contents	i
Figures	ii
Text Boxes.....	iii
Executive Summary	iv
1.0 Introduction: Assessing Aid Effectiveness	
Aid, Development, and Peacebuilding: The Challenge of Assessment.....	1.5
Relationship to Previous Work.....	1.19
2.0 Overview of the Aid Effort	
Political and Economic Developments.....	2.3
Development Planning and Economic Policy.....	2.11
Donor Coordination.....	2.15
Patterns of Donor Assistance.....	2.17
Macroeconomic Effects of Donor Assistance.....	2.36
Sectoral Impacts of Donor Assistance.....	2.47
Conclusions.....	2.102
3.0 Beneficiary Assessment of Donor Assistance	
Economic Conditions.....	3.5
Donor, PA, and NGO Performance.....	3.8
Public Perceptions of Sectoral Impact.....	3.12
Variations in Beneficiary Assessment of the Development Effort.....	3.32
Building Social Capital: Perspectives on Palestinian Civil Society.....	3.54
Aid and Support for the Peace Process.....	3.61
Conclusions.....	3.63
4.0 Towards Sustainable Palestinian Development	
Fiscal Challenges.....	4.4
Demographic Growth.....	4.14
Shifts in Donor Assistance.....	4.17
Permanent Status Arrangements and Palestinian Economic Development.....	4.25
Conclusions.....	4.36
5.0 Donors, Aid, and Policy Reform	
The Context and Impetus for Reform.....	5.5
The Role of Donors in Supporting Good Policies and Strong Institutions.....	5.19
Conclusion: Putting It All Together.....	5.35

Bibliography

Figures

- Figure 2.6 Economic Performance (1993-98)
- Figure 2.7 Palestinian Employment (1993-98)
- Figure 2.17 Donor Commitments and Disbursements in the WBG (1994-99)
- Figure 2.18 ODA Receipts Per Capita for Selected Post-Conflict and MENA Countries (1997)
- Figure 2.20 Relative Allocations of Donor Assistance
- Figure 2.29 Infrastructure and the Delivery of Aid
- Figure 2.34 Changes in Disbursement Rates (10 major donors)
- Figure 2.36 Donor Assistance as a Proportion of GDP (1994-98)
- Figure 2.38 Three Scenarios for Real GNP
- Figure 2.41 Donors' Share of PA Expenditure (%)
- Figure 2.51 WBG Electrical Consumption
- Figure 2.57 Road Construction and Rehabilitation in the WBG
- Figure 2.74 Actual and Projected Student/Classroom Ratios in the WBG
- Figure 2.82 Clinics in the WBG (1995-98)
- Figure 2.84 Hospital Beds in the WBG (1995-98)
- Figure 2.89 Relative Indicators of Private Sector Activity (1996-98)
- Figure 2.95 Adoption of Economic and Regulatory Legislation
- Figure 3.5 Palestinian Perceptions of Past and Future Economic Conditions
- Figure 3.8 Palestinian Perceptions of Donor, PA, and NGO Performance
- Figure 3.9 Public Perceptions of PA Performance (by sector)
- Figure 3.11 Regional Perceptions of Donor Performance
- Figure 3.13 Palestinian Perceptions of Sectoral Impact
- Figure 3.21 Public Assessments of PA Institutions
- Figure 3.24 Palestinian Perceptions of Accountability and Transparency in Public Institutions
- Figure 3.25 Trends in Public Assessments of Palestinian Institutions
- Figure 3.30 Public Identification of Future Aid Priorities in the WBG
- Figure 3.33 Public Perceptions of Conditions (by region)
- Figure 3.36 Public Perceptions of Conditions (by locale)
- Figure 3.39 Public Perceptions of Conditions (by income)
- Figure 3.40 Poverty Rates in the WBG (selected districts)
- Figure 3.41 Public Perceptions in High- and Low-Poverty Areas
- Figure 3.43 Public Perceptions of Conditions (by gender)
- Figure 3.48 Positive Evaluations of Performance (mass and elite samples)
- Figure 3.50 Elite Views of Aid Distribution
- Figure 3.62 Public Attitudes to Donors and Support for the Peace Process
- Figure 4.6 Growth of PA Employment and Wages
- Figure 4.16 Projected Palestinian Population of the WBG (1997-2025)
- Figure 4.21 Commitments and Disbursements of Donor Loans in WBG
- Figure 5.28 Technical Assistance in the WBG

Text Boxes

Box 1.11	Peace and Conflict Impact Assessment
Box 1.20	Improving Access to Development Information
Box 2.16	Improving Aid Coordination
Box 2.64	The Gaza Water and Sanitation Services Project
Box 2.92	Gaza Industrial Estates
Box 2.94	Supporting Small and Medium-Scale Business
Box 2.96	Public Institutions and Private Sector Development
Box 2.101	The Women's affairs Technical Committee
Box 5.11	The Challenges of Civil Service Reform

Executive Summary

- The aid effectiveness study examines the impact of donor assistance in the West Bank and Gaza since 1993. The project is undertaken jointly by Japan and the World Bank, with the financial support of the Government of Japan and UNDP. This report reflects field-level consultations with donors and the Palestinian Authority, as well as discussion in the Joint Liaison Committee. It also reflects input received on an interim progress report presented at the October 1999 AHLC meeting in Tokyo. The report addresses four major areas: the macroeconomic and sectoral impact of donor assistance (Section 2.0); Palestinian public perceptions of the aid effort (Section 3.0); issues of sustainable social and economic development in the WBG (Section 4.0); and the role of donor aid in supporting institutional and policy reform (Section 5.0).
- The WBG has represented a complex operational environment for the donor community, characterized by a highly dynamic economic and political context. Moreover, donor assistance in the WBG has been intended to meet not only the traditional goals of sustainable development, but also the imperatives of peacebuilding. This assessment fully reflects those requirements and constraints.

Economic Performance and Sectoral Accomplishments

- Overall Palestinian economic performance through 1994-97 was weak, characterized by declining per capita incomes and rising unemployment. A variety of factors—most notably closure and other restrictions—accounted for this. During this period, donor assistance played an important role in offsetting economic decline and stimulating employment. It also played a crucial role in supporting the establishment of those institutions critical to self-government. Since 1997, the WBG economy has experienced modest economic growth, including rising per capita incomes and employment growth. Overall, donor assistance has served to increase annual GDP per capita growth rates by 1-2%, and GNP per capita in 1998 was an estimated 6-7% higher than it would have been without donor assistance.
- During this period, both Palestinian development planning process and the structures of donor coordination have undergone significant evolution since 1994. This has served to enhance the effectiveness of donor assistance. Donor assistance too has undergone change. There has been a relative shift away from budgetary and transitional support to infrastructure investment—although there has been little absolute increase in the latter. There is evidence that loans are accounting for an increasingly large share of donor commitments. Finally, while aid remained at a fairly constant rate of disbursement in 1994-97, it declined markedly in 1998-99. Although many factors may have caused this, it would appear that reductions in disbursements by several larger donors account for much of the decline. If continued, this represents a worrisome trend: in addition to reducing the level of resources available to support peacebuilding and economic development, it also hampers PA economic planning and erodes donor credibility.
- Sector-by-sector analysis of donor assistance shows substantial capital investments and measurable improvements in most areas of infrastructure and services. Electrical consumption is up sharply. More than 264 km of new roads, 1,755 km of new water pipes,

393 km of new sewage lines, 3,764 additional classrooms, scores of new clinics and hundreds of additional hospital beds have been constructed with donor assistance since 1994. Donors, the PA, and NGOs have undertaken a variety of measures to facilitate private sector growth. Donors have also played a key role in supporting institutional development in the public sector.

Public Attitudes

- Palestinians generally report a significant decline in their economic condition since 1993. However, a significant proportion are now optimistic about their future.
- A majority (60%) of Palestinians have a positive view of donor performance in the WBG, while few (17%) have a negative views. NGO performance is also rated positively, although somewhat less so. Public evaluations of PA performance are more mixed, although with more positive than negative assessments being offered.
- Palestinians report significant improvements in the education and transportation sectors since 1994, and mixed but generally positive evaluations with regard to health, solid waste and sewage. Only in the areas of water, and public institutions (including democracy and the rule of law) are evaluations negative overall. Over time, a significant deterioration can be seen in public appraisals of the transparency and accountability of the Palestinian Authority. This threatens to have a corrosive effect not only on the legitimacy of public institutions, but also on support for the PA itself.
- Education and health are rated by the general public as the most important areas for future donor assistance, followed by water and electricity. Support for gender programs, vocational training, democracy (in the West Bank) and solid waste (in Gaza) are rated as relatively low priorities.
- Overall, Palestinians in the West Bank (and especially those in rural villages) have seen less improvement in services and infrastructure than those in Gaza, notably in the sectors of health, roads, and solid waste. Those living in refugee camps report slightly greater improvements than the average in these same sectors. Lower-income Palestinians and those residing in high poverty areas tend to offer slightly more positive evaluations of donor efforts than others. Women also tend to be more positive. Political affiliation and attitude to the peace process are only weakly correlated with attitudes towards donor efforts. However, public opinion leaders tend to be much more negative in their appraisals of development efforts than do members of the general public.
- There are a number of important warning signs with regard to the state of Palestinian civil society. These include both the declining level of resources available for NGO activities since 1993 and the ability of NGOs to freely organize and operate.

Sustainability

- The sustainability of development efforts in the WBG must be assessed against a backdrop of fiscal stability, demographic change, and possible shifts in donor assistance. Despite success in revenue mobilization and balancing the recurrent budget, the medium-term fiscal outlook for the PA remains fragile. Population growth rates are high, and expanding social need can

only be met through overall economic growth. Donor disbursements have declined in 1998-99, and there may be a shift to greater use of loan-based assistance.

- Continued growth of public sector employment would be a serious threat to the sustainability of development efforts. It is also essential that both the PA budget and the development planning process more effectively address the recurrent (wage and non-wage) implications of donor investments. The PA must also assume greater responsibility for capital investments, particularly those (such as school construction) that it will continue to face annually for the foreseeable future. A more systematic approach must be adopted for tracking, prioritizing, and managing loan-based development assistance.
- Permanent status arrangements will have profound implications for the sustainability of development efforts in the WBG. In the case of the refugee issue, for example, future demographic growth, the delivery of social services, fiscal stability, and patterns of private investment, consumption and savings will all depend to a large degree on the nature of political agreements reached by the parties. The social and economic implications of other permanent status issues are equally profound. While recognizing the political sensitivity of these matters, economic planning now is important to assure a smooth transition to future arrangements.

Donors, Aid, and Policy Reform

- Comparative evidence from other developing countries underscores that effective institutions and good policies matter a lot. Without them, aid is rarely effective in the long term. In the WBG, there have been notable successes in these areas, but there are also serious challenges that need to be met.
- In pressing forward an agenda of institutional and policy reform, Palestinian leadership of (and ownership of) the reform process is essential. However, donors also have an important supporting role to play.
- The simple provision of assistance—*money*—can have both positive and negative effects on institutional development. Some donor practices have served to fragment, rather than reinforce, Palestinian capacities. *Conditionality* is not likely to be a major, or effective, component of encouraging institutional development and policy reform. *Technical assistance* can play a useful role, but only if demand- rather than supply-driven. While some donor TA has been very useful, there is substantial evidence that much of it has been of only limited value.
- Donor support for institution-building and policy reform must focus not only on structures but also on underlying political dynamics. It must include frank policy dialogue with the PA, built on a sense of genuine partnership, and backed by positive incentives for progress in these areas.

1

INTRODUCTION: ASSESSING AID EFFECTIVENESS

- 2.1 Since the signing of the Israeli-Palestinian Declaration of Principles in September 1993, the international donor community has mobilized substantial economic resources in support of the search for peace. These resources have been intended to enhance the capacities of the Palestinian Authority, generate tangible improvements in the lives of ordinary Palestinians, and lay the groundwork for future sustainable development.
- 2.2 The aid effectiveness study, jointly undertaken by Japan and the World Bank with the financial support of the government of Japan and the United Nations Development Program, examines the impact of donor assistance in the West Bank and Gaza. The format and approach of the study are the product of an extensive process of consultation with the key stakeholders in the development effort. The initial design of the study was first raised in the Joint Liaison Committee in the summer of 1999. This was followed by a series of field interviews by the project team with Palestinian and donor officials. A progress report was subsequently presented to the Tokyo meeting of the Ad Hoc Liaison Committee in October 1999, thus allowing all AHLC members an opportunity to have further input into the design of the this study.
- 2.3 As a consequence of this process of consultation, the aid effectiveness study focuses its analytical attention on four key areas:
 - 1 Section 2.0 of this study examines **the measurable economic and social effects of the aid effort** since 1993, including the macroeconomic impact of donor assistance on economic growth, investment and employment; key patterns in the allocation and disbursement of assistance; and key sectoral indicators of the impact of donor investments. The object here is to provide, to the extent possible, an empirical foundation for assessing the extent to which aid has contributed to the goal of Palestinian social and economic development.
 - 2 Section 3.0 of this study examines **Palestinian perceptions of the aid effort** through newly-available survey and other data. This analysis not only complements the earlier economic findings, but also offers new and unique insight into how the real effects of aid have been felt "on the ground" in the everyday lives of ordinary Palestinians.
 - 3 Section 4.0 of the study examines **the future sustainability of the development effort**. In doing so, it looks at the importance of fiscal stability, possible shifts in the volume and composition of donor assistance, and the implications of demographic growth. It also

underscores the fundamental importance of future permanent status arrangements in shaping the foundations for sustainable development in the WBG.

- 4 Section 5.0 of the study addresses the **important role of donor assistance and policy dialogue in supporting institutional development and policy reform**. This discussion emphasizes the essential importance of “getting policies and institutions right” if donor assistance is to have positive effects, and highlights ways in which donors may support such efforts in more constructive ways.
- 2.4 In examining each of these areas, two further considerations have shaped the present study. The first of these concerns the need to adopt a flexible and contextual approach in assessing aid effectiveness during an ongoing peace process. As noted below, many of the traditional approaches to economic assessment provide an incomplete picture in situations where supporting the transition to peace is a primary objective of donor assistance. The second consideration is the desire to maximize the value-added of the present study by building upon, rather than repeating, the findings of earlier work. To do this effectively, therefore, it is important to summarize what we know—and don’t know—about social and economic conditions in the West Bank and Gaza.

AID, DEVELOPMENT, AND PEACEBUILDING: THE CHALLENGE OF ASSESSMENT

Traditional Approaches

- 2.5 The traditional approach to measuring aid effectiveness has been to identify outputs and measure impacts, often on a project-by-project basis. Such an approach is useful in assessing the degree to which a particular initiative meets the objectives set for it. However, it may reveal relatively little about the extent to which a given project (or a series of different projects by different donors) may affect medium and long-term development within a given sector, or how such developments may in turn influence the broader prospects for economic growth and social development. Conversely, macroeconomic analysis can be useful in estimating the aggregate impact of development assistance on broader economic performance (gross domestic product, employment, sectoral growth, and so forth), but reveal little about the effectiveness of particular projects and programs.
- 2.6 Assessment is further complicated by the fungibility of aid, unknown opportunity costs, and possible effects on agenda formation. Development assistance in one area may free up recipient resources for possible expenditure in other areas. The decision to allocate development resources to one project implies that those same resources are not available for alternative investments. Finally, the potential provision of development assistance creates incentives for recipients to emphasize projects in those sectors most likely to attract donor support, with the result that development agendas may become heavily (if indirectly) donor-driven. All of three of these aspects can have important ramifications for the effectiveness of donor assistance.
- 2.7 In short, therefore, the assessment of aid effectiveness along narrow, quantifiable, sectoral or macroeconomic lines provides only part of the picture. It is a very important part of the picture, to be sure: ultimately, improvements in empirical indicators are an

essential measure of progress in social and economic development. Accordingly, considerable attention is devoted to assessing these dimensions of the aid effort in the WBG in Section 2.0 of this study. Subsequently, in Section 4.0, the economic sustainability of current development efforts will also be explored. However, something more than this is also required if the underlying connections between aid and long-term growth are to be fully explored.

Aid, Institutions and Policy Reform

- 2.8 In particular, recent comparative research on aid effectiveness has emphasized that a good policy environment, and improvements in public institutions, are essential if development assistance is to foster growth, reduce poverty, and improve social conditions. In such contexts, aid complements (rather than crowds out) private investment. Effective aid strengthens institutions and policies so that services can be delivered more effectively. In many cases, the provision of good ideas is as important, if not more important, than the provision of donor funds. Finally, a participatory approach to service delivery, characterized by the active engagement of civil society, has positive effects on public services (World Bank 1998a).
- 2.9 Research on aid and reform also suggests that donors often fail to design and target their assistance in ways that encourages and reinforces the process of reform. Indeed, large amounts of aid to countries with bad policies can actually serve to sustain those same policies (World Bank 1999a).
- 2.10 Given this, the aid effectiveness study devotes substantial attention to these issues. Among other aspects, sections 2.0 and 3.0 examine the progress that has been made in the development of Palestinian public institutions. Similarly, sections 2.0 and 4.0 highlight the importance of effective economic planning, in terms of both structures and process. As previously noted, particular attention will be devoted to these issues in Section 5.0 of the study, with a focus on the extent to which donor policies have contributed to (or hampered) effective institutional and policy development by the Palestinian Authority.

Aid and Peacebuilding

- 2.11 Above and beyond all of this, however, it is essential to recognize that development aid to the West Bank and Gaza is part of an ongoing process of peacebuilding. Assessing aid effectiveness in such situations poses two particular challenges, one operational, the other conceptual.

In recent years, a number of projects have addressed the particular challenges of designing and evaluating development projects in contexts of war-to-peace transitions. In the case of Western donors, some of the earliest and most important was done by the Development Assistance Committee of the Organization of Economic Cooperation and Development. The *1997 DAC Guidelines on Conflict, Peace and Development Cooperation* outlined a number of important considerations in development programming in conflict areas, and subsequent work by the DAC task force has expanded the range of available analysis. Within the World Bank, the Bank's 1997 *Framework for World Bank Involvement in Post-Conflict Reconstruction* has been followed by more detailed work on the evaluation of Bank activities in conflict areas, both by the Operations Evaluation Department and by the Bank's Post-Conflict Unit.

More recently, both the International Development Research Centre (Canada) and the Conflict and Humanitarian Affairs Department of the Department for International Development (UK) have supported projects on conflict impact assessment, as have a number of other aid agencies and NGO consortia. There is also growing academic work in this area. The "CPR" network—established in 1997 to bring together the conflict prevention and post-conflict units of bilateral and multilateral aid agencies—has begun to collect and disseminate analytical tools addressing these issues.

Collectively, these various projects have contributed to a fuller understanding of how planning, assessment and evaluation efforts in conflict areas must be conditioned by the particular requirements of peacebuilding and conflict prevention. However, the dissemination of these insights (as well as feedback from the field) has sometimes been slowed by institutional disconnections between the policy or post-conflict units—engaged in analytical work—and line units and field representatives responsible for actual program management.

BOX 1.11: Peace and Conflict Impact Assessment

- 2.12 The *operational challenges* arise from the context within which development initiatives must take place. In most cases of war-to-peace transition, societal needs are great, the social and economic environment is more difficult and complex than usual, and political authority is in transition. The need to provide assistance is often unusually urgent, creating additional pressures on planners and officials. The aid flows involved tend to be relatively large, highlighting the need for close donor-donor and donor-recipient coordination, and heightening vulnerability to administrative bottlenecks or limited absorptive capacity in the local economy. Compounding this, recipient institutions and economic policies are in a state of flux, further complicating the developmental picture. Finally, social and economic data on countries in transition is often uneven, both in quantity and quality, making measurement of trends all the more difficult.
- 2.13 Any effort to assess aid effectiveness must necessarily take these operational challenges into account if it is to provide any meaningful and fair assessment of donor efforts. As one study of peacebuilding indicators argued, "results should be viewed within the context of the complexity of the task at hand, the need for quick action, and the high level of risk involved" (CIDA 1998a). In the case of the WBG, it is important to recognize how a multitude of factors (the complexities of building new institutions from scratch, the impact of external economic shocks and unforeseen political delays, and the policy and territorial constraints associated with the various interim agreements) have constrained both donors and the PA. In short, the impact of aid in such contexts ought to be measured not against the *ideal*, but against the *achievable*.
- 2.14 The *conceptual challenges* arise from the fact that donor assistance in areas undergoing war-to-peace transitions is intended to serve a broader range of objectives. On the one hand it is intended (as in other contexts) to foster sustainable social and economic

development. On the other hand, it is also intended to support political progress towards peace. Indeed, as the Development Assistance Committee of the OECD has emphasized, “While it may sometimes be difficult to articulate and analyze, this ‘peacebuilding’ objective must form the cornerstone of all development co-operation strategies and programs” (DAC 1997, para. 3).

- 2.15 Given this, any assessment of aid effectiveness must recognize the particular (often country- and time-specific) requirements of promoting peace. As one major project on peace and conflict impact assessment has noted:

The peace and conflict impact assessment of development projects differs from “evaluation” in the conventional sense because its scope extends far beyond the stated outputs, outcomes, goals, and objectives of conventional development projects or programs. Rather, it attempts to discern a project’s impact on the peace and conflict environment—an area it may not have been designed explicitly to affect. Thus, it is quite possible that a project might fail according to limited developmental criteria... but succeed according to broader peacebuilding criteria.... The converse also holds true. It is possible that a project may succeed according to pre-determined developmental criteria but fail in terms of a beneficial impact on peace (Bush 1998: 2).

- 2.16 A corollary of this is that, in some cases, traditional approaches to development (and development evaluation) may be ill-suited to assessing donor programs. In a major comparative examination of World Bank activities in post-conflict countries, the Operations Evaluation Department of the Bank concluded that:

Many “conventional wisdoms” of development learned over the past several decades also apply in post-conflict settings. Among these are the importance of relevance, client ownership, beneficiary participation, the policy and institutional environments, including a positive enabling environment for the private sector, and cost-effectiveness. But some characteristics of post-conflict settings... make some “conventional wisdoms” not applicable, at least not in the short run (World Bank 1998e: 33).

- 2.17 In one of its most recent reports, the DAC has further underlined the corresponding need to also recognize some of the unique (and highly political) aspects of development assistance in such contexts:

Aid managers need to face up to the political nature of all aid. This involves recognizing that perceptions matter as much as facts in aid impacts; that who gets which piece of the cake is usually as important as the total size of the cake; that efficiency may sometimes need to be traded for stability and peace; that the development discourse can be used for many political purposes; and, broadly, that process is as important as product (Uvin 1999: para. 8).

- 2.18 In the Palestinian case, the aid effectiveness study will not explore all of these aspects of peacebuilding, in part because they have already been explored elsewhere (Brynen 2000). However, as previously noted—and in keeping with the idea “perceptions matter”—Section 3.0 the aid effectiveness study examines mass and elite attitudes to the development effort in the West Bank and Gaza through a specially commissioned public opinion survey. In traditional evaluation terms, this survey provides insight into beneficiary needs and priorities, and hence contributes to a fuller assessment of past and future development priorities. Above and beyond this, however, the surveys also cast new light on the extent to which development efforts have met the objective of fostering real improvements in the everyday lives of ordinary Palestinians—thereby creating tangible benefits associated with progress towards peace.

RELATIONSHIP TO PREVIOUS WORK

- 2.19 The development effort in the West Bank and Gaza has produced voluminous amounts of data and analysis. This includes—but is not limited to—the Palestinian Development Plan, MOPIC donor matrices, substantial data from the Palestinian Central Bureau of Statistics (PCBS), regional and sectoral plans, technical analyses, commission findings, donor assessments, periodic UNSCO reports, World Bank analyses, the work of many other international organizations, documents prepared for meetings of the AHLC, CG, LACC, and various SWGs, journalistic reports, websites and email lists, and many published and unpublished analyses undertaken by local and international NGOs and academics.
- 2.20 This quantity and quality of available information represents an enormous asset for the development effort. As noted in the October 1999 aid effectiveness progress report, however, there is as yet no comprehensive collection of such material available to the PA, agency officials, researchers, or the private sector. The establishment of a systematic collection would represent a low-cost but valuable asset for future analyses of Palestinian economic development (Box 1.20).
- 2.21 As rich as these various sources are, there are also some weaknesses in the available data which inhibit efforts to evaluate the effectiveness of development efforts:
- Perhaps the most important of these is the absence of reliable baseline data for the pre-1994 period. Prior to the establishment of the Palestinian Authority, social and economic data—variously collected by Israel and by Palestinian NGOs—was often uneven or widely divergent. In the water sector, for example, the World Bank (1993e: 45, 53.) reported differences of over 20% in available estimates of rural water connections, and differences of up to 14 million m³ in estimates of annual Palestinian water consumption in the early 1990s. Without adequate baseline data, it is difficult to measure subsequent changes in economic and social conditions.

- Since the establishment of the PA, data collection has improved markedly. However, constant improvements and modifications in data collection and analysis methodologies limits the ability of analysts to make year-to-year comparisons, since apparent changes may be due to refinements in data collection rather than actual changes in the underlying variables. PCBS has, for example, modified the ways in which it calculates Palestinian national accounts, thus necessitating caution in any attempt to use such data for time series analysis. Similarly, early estimates often remain in circulation even when more recent data

Despite the large amounts of analysis available on development issues in the WBG, many of those involved in the development effort have only partial access to such material. Many consultant reports gather dust on shelves. Within MOPIC and the Ministry of Finance, studies are often distributed across different departments, offices, and individuals. Line ministries and specialized international organizations tend to have possession of only that material which most immediately affects them. In-house donor assessments are rarely given wide distribution. And, while the World Bank and UNSCO offices have modest libraries, they do not have systematic collections. Analyzing the development effort, therefore, often involves searching the shelves of key colleagues and organizations—and, in the process, often informing one actor of material previously published by another.

Donors, Palestinian institutions, NGOs and potential private sector investors would all benefit from the creation of one or more publicly-accessible collections of material which would allow “one-stop” access to existing data and analysis. This could be established within MOPIC or an international organization. A more effective and accessible approach, however, might be modeled on the library collection and legal database project at the Birzeit University’s Institute of Law.

BOX 1.20: Improving Access to Development Information

has become available.

- Donors themselves have supported a number of sectoral projects to improve data collection and analysis. In some cases, however, these projects are heavily dependent on short-term donor support. Data may thus only be available for specified locations or time periods, and may become unavailable when donor support for the project terminates.
- There is a relative lack of systematic or widely-disseminated work on the impact of completed projects in the WBG. This lack of impact assessment is in part due to the interim or “emergency” nature of much of the aid effort. Moreover, the PA’s ability to undertake such assessment is, at present, unevenly developed across ministries, and has often been sidelined by urgent planning, budgetary and project preparation needs. The post-project assessments undertaken by individual donors in connection with their own initiatives tend not to be widely shared, both because of the confidentiality of many in-house assessments, and because no mechanisms currently exist for doing so. One consequence of all this is that anecdotal assessment of the aid effort has tended to predominate, particularly in the media. Such reporting may offer policymakers, parliaments, and publics alike an incomplete picture of the substantial achievements of the development effort during the past six years.

2.22 In an effort to complement available data—particularly on infrastructure investments—the aid effectiveness study constructed (from available MOPIC data, as well data provided by other PA and donor agencies) a database on the outputs of donor projects.

Specifically, this database records certain quantifiable project outputs from donor programs in the areas of health facilities, education facilities, road construction/rehabilitation, water and sanitation, and electricity. While not sensitive enough to permit year-to-year comparisons, it does allow measurement of some of the overall effects of donor investments, as well as permitting the limited disaggregation of such data on a regional basis.

- 2.23 More broadly, the aid effectiveness study has sought to avoid repeating what is already well-known by focussing its efforts in those areas where there was little existing research, or where existing analytical work could benefit from further emphasis or expansion.

2

OVERVIEW OF THE AID EFFORT

- 2.1. This section provides an overview of political and economic developments in the West Bank and Gaza since 1993. This includes a brief description of the evolution of economic policy, development planning, and donor coordination during this period, as well as an examination of changing patterns of donor assistance.
- 2.2. This chapter also offers an assessment of the economic and social impact of development assistance in the WBG. This is done in two ways. First, estimates are made of the aggregate macroeconomic effects of donor assistance on national income, employment, and public investment. Second, the sectoral outputs of donor-financed investments in infrastructure, health, and education are examined. Although less amenable to quantitative measurement, effort is also made to identify the effects both of donor programs intended to foster an enabling environment for private sector investment, and those designed to promote institutional development and capacity-building in the public sector. Any of these sectors or subsectors could easily sustain one or more full-length studies in and of their own, and several have already been the subject of more detailed World Bank analysis. Thus, rather than offering in-depth treatment, the intention here is to provide donors with a broader sense of the effects that development assistance is having.

POLITICAL AND ECONOMIC DEVELOPMENTS

- 2.3. Shortly after the signing of the Israeli-Palestinian Declaration of Principles in September 1993, the international donor community met in Washington to mobilize support for the peace process. The \$2.4 billion pledged at that first donor meeting has since grown to over \$4.6 billion (as of 30 June 1999), of which more than \$2.5 billion has been disbursed to support social and economic development in the West Bank and Gaza.

2.4. During this period, major progress has been made towards a just and lasting peace in the Middle East. The May 1994 Agreement on the Gaza Strip and Jericho Area was a fundamental milestone on this road, setting the stage for the establishment of the Palestinian Authority later that year. In September 1994 and August 1995, agreement was reached on the transfer of further powers and responsibilities to the PA. In September 1995, the Interim Agreement set the stage for additional Israeli troop redeployments, an expansion of the area under PA administration, and elections in the West Bank and Gaza. The issue of Hebron was dealt with in a separate protocol in January 1997. The Wye River Memorandum of October 1998 and the Sharm el-Sheikh Memorandum of September 1999 saw the parties renew their commitment to cooperation, negotiation, and the implementation of existing agreements. They also committed themselves to resume permanent status negotiations in an accelerated manner, in a determined effort to achieve their mutual goal of reaching a permanent status agreement

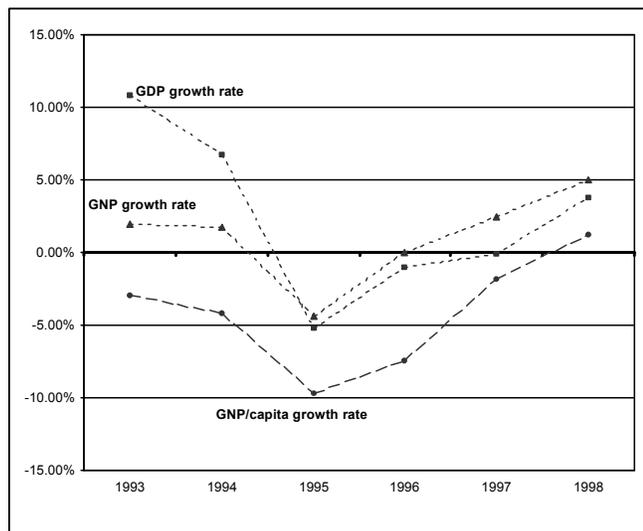
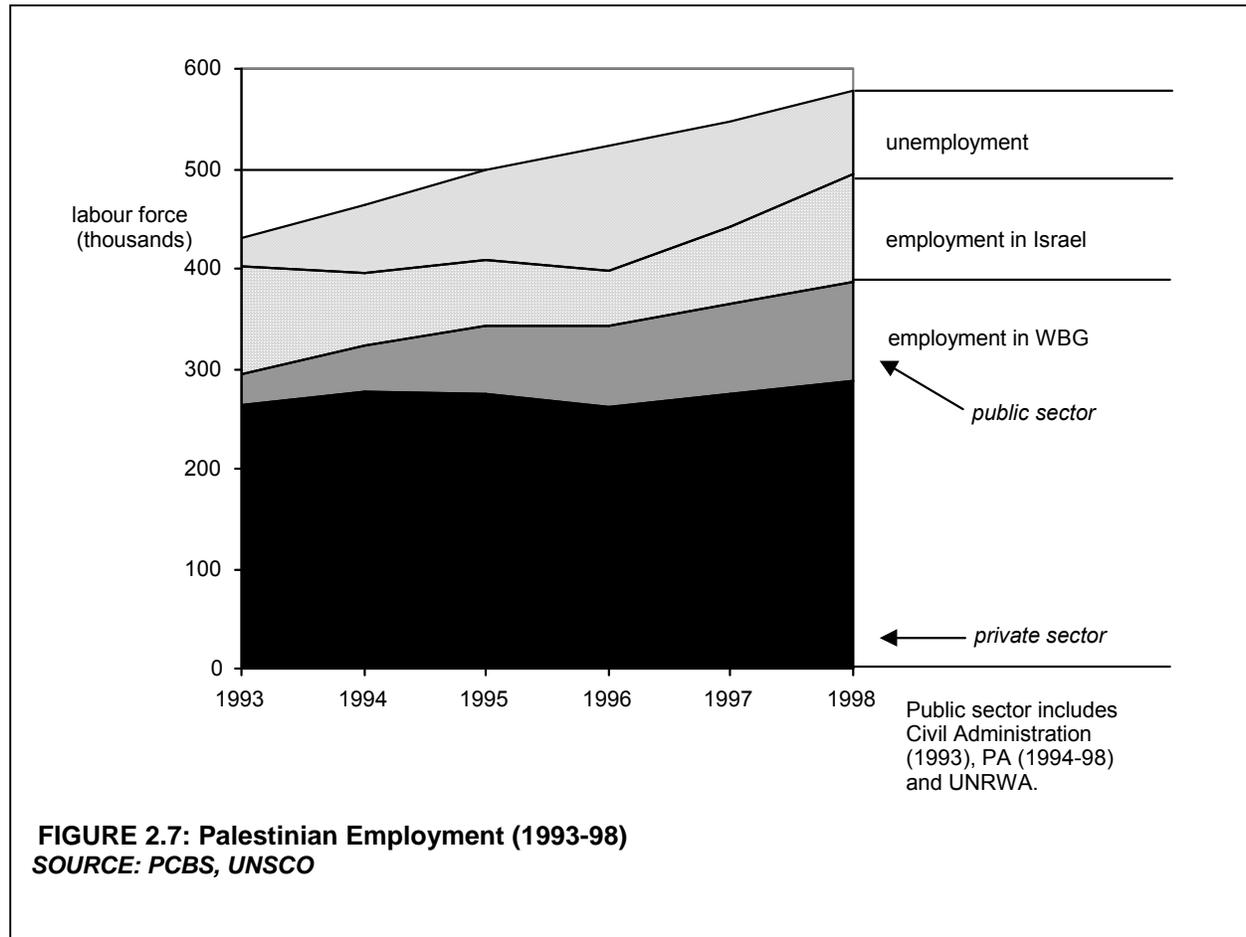


FIGURE 2.6: Economic Performance (1993-98)

SOURCE: World Bank data

- 2.5. During this same period, and with the financial and technical assistance of donors, the Palestinian Authority has constructed an extensive array of political, administrative, economic and service institutions. In contrast to many other cases of war-to-peace transitions, where there may be a weakened but existing state structure to build upon, this institutional development has taken place in a context where (with the partial exception of the health and education sectors) few bureaucratic structures were inherited. Thus, while significant tasks of capacity-building and institutional reform remain, the achievements to date should not be underestimated.
- 2.6. Economic performance in the WBG was, until relatively recently, poor. GNP per capita declined through 1993-1997, before showing a modest increase in 1998 (Figure 2.6).
- 2.7. During this period, unemployment rates trebled, from an average of 5.6% in 1990-93 to an average of 17.8% in 1994-98 (Figure 2.7). In 1997 an estimated 15.6% of persons in the West Bank, and 38.2% in Gaza, fell below the poverty line (NPEC 1998: 50).ⁱ Poverty rates in Gaza are highest in the south (50.8%) and in refugee camps (41.7%). Poverty rates in the West Bank are highest in the north (18.1%) and south (24.4%), and in rural villages (18.2%).



2.8. Poor economic performance in these years was a product of many factors:

3.0 Despite prior economic growth, many aspects of infrastructure and of the productive sectors of the economy had remained underdeveloped under occupation. Public investment was at very low levels.

4.0 The late 1980s and early 1990s saw a contraction of the regional MENA economy, characterized by a decline in workers' remittance from the Gulf and elsewhere. Following the Gulf war this decline accelerated, compounded by a weakening of regional support for Palestinian NGOs.

5.0 More important still, however, was a significant decline in the number of Palestinians employed in Israel. This fell from an average of 101,000 in 1990-93 to a low of around 25,000 in 1996.

6.0 This was aggravated by the effects of Israeli closure and permits policies, which inhibited internal mobility, constrained external trade, and deterred investment.

- 2.9. Since 1997, there has been a reduction in the use of closure, as well as an increase in the number of Palestinian employed in Israel and Israeli settlements. By 1998-99, the latter had rebounded to an average of over 45,000. With this there has come expansion of the West Bank and Gaza economy, marked by GDP growth and a decline in unemployment to 12.6% by mid-1999, almost half its 1996 peak. In its 2000 budget, the PA estimated that GDP grew by 4.5% in 1999, and predicted similar levels of growth for 2000-2002.
- 2.10. Nevertheless, the Palestinian economy continues to face major challenges. Even if current rates of growth are sustained, it will take a decade before real Palestinian GNP/capita reaches returns to its 1993 levels. The social and economic needs of the West Bank and Gaza remain substantial. Underlying population growth rates are very high, estimated at around 4% per year in 1997. Despite a reduction in the imposition of comprehensive closure, the present political and economic arrangements in the territories continue to represent a major constraint on economic development. One 1998 study, for example, found that permit requirements, security procedures and overlapping bureaucracies increased the transaction costs for Palestinian exporters by 30%, and increased shipping delays by 45% (CMECS 1998). Much remains to be done in improving the physical (infrastructure) and policy environment for private sector activity. Problems of accountability, transparency, alleged corruption, and inefficiency afflict some Palestinian institutions. Compounding these factors will be the inevitable challenges associated with the transition to whatever permanent status arrangements are agreed by the parties.

DEVELOPMENT PLANNING AND ECONOMIC POLICY

- 2.11. An initial impetus for development planning in the West Bank and Gaza came with the publication in 1993 of the six-volume World Bank study *Developing the Occupied Territories: An Investment in Peace*. This was followed in 1994 by the *Emergency Assistance Program*, which outlined \$1.2 billion in urgent short-to-medium term donor investments. In 1995, donors were presented with a \$550 million *Core Investment Program*, and in 1996-97 this gave way to the *Palestinian Public Investment Program*, which outlined \$1.3 billion in priority investments. Although each of these various development plans involved an increasing degree of Palestinian participation in setting the development agenda for the West Bank and Gaza, donors continued to play a leading role in shaping their content. Moreover, many of these were plans were largely short-term “shopping lists” of projects, prepared for presentation at Consultative Group or other donor meetings, rather than comprehensive national development strategies.
- 2.12. Qualitatively, Palestinian development planning entered a new phase with the first *Palestinian Development Plan* for 1998-2000. The PDP involved a much greater degree of host ownership, and a longer-term vision of development priorities. The subsequent 1999-2003 PDP extended the timeframe for planning further, and introduced a more robust macroeconomic framework for medium-term development planning. Four key national goals were set: economic growth and employment generation; rural development; improving social conditions and human resource development; and the development of financial institutions and policies. More attention was devoted to

developing strategies and priorities at the sectoral level. The prioritization process for PDP projects was further refined, including enhanced public participation through a process of local consultation. Finally, the PDP has been made available on-line, facilitating access by both donors and the general public.

- 2.13. Despite these developments, room for improvement remains in the development planning process. The overall macroeconomic strategy of the PA has remained sketchy in some important aspects. Planning has been undercut by weaknesses in the budgetary process as well as the failure to regularize all fiscal accounts. The recurrent cost implications of development initiatives must be addressed in a more sophisticated manner, as will be discussed in section 4.0 of this study. Donors continued to finance the vast majority of Palestinian capital investments, with the 1999-2003 PDP calling for \$141 million in development financing from the PA, \$200 million in concessional borrowing, and the remaining \$4.3 billion (or 93%) to be contributed by the international donor community. Consequently, at the level of line ministries, the selection of investment priorities has continued to be heavily shaped by perceptions of potential donor interest, and donors have thus continued to have a central, if indirect, role in shaping Palestinian development priorities. Compounding this, some donors have continued to pursue project opportunities outside the framework of the PDP. For their part, some donor officials suggest that the PDP—if it is to be a genuine development plan rather than a “wish list”—should become more focused, more effectively prioritized, and backed by greater detail at the project and program level.
- 2.14. As will be highlighted in Section 4.0, there is also a need for the Palestinian development policy process to address more effectively the recurrent cost implications of donor investments, as well as the utilization of concessional loans in financing certain strategic development initiatives. However, it is important to underscore that the PDP continues to evolve, that progress is underway in these and other areas, and that further improvements are planned. It is also important to emphasize that—given the sheer number of donors and volume of donor assistance—that effective development planning requires cooperation from donors themselves, and willingness by donor agencies to accept the overall principles of host country ownership of the development process.

DONOR COORDINATION

- 2.15. Since 1993, a complex architecture for donor coordination has been put in place in the WBG. Periodic international meetings of the Ad Hoc Liaison Committee (AHLC) and Consultative Group (CG) were complemented by the establishment (in late 1994/early 1995) of local aid coordination bodies—the Joint Liaison Committee (JLC), the Local Aid Coordination Committee (LACC), and the various Sectoral Working Groups (SWGs). Within the UN system, the establishment of the office of the United Nations Special Coordinator (UNSCO) facilitated coordination and agenda-setting. In the case of the World Bank, responsiveness was enhanced by the devolution of greater decision-making authority to the Resident Representative. Beginning with the “Understanding on Revenues, Expenditures and Donor Funding” in 1994, and the first Tripartite Action Plan

(TAP) in 1995, periodic trilateral agreements have committed the PA , donors and Israel

As part of broader research on aid effectiveness in the West Bank and Gaza undertaken by Japan and the World Bank, a study on the *Improvement of Aid Coordination for West Bank and Gaza* was conducted by a team of consultants and presented to the AHLC in October 1999. While the overall assessment of donor coordination mechanisms was positive, both donor and the PA officials interviewed for the report expressed a number of concerns:

- Donors expressed concern at the workload implied by the coordination structure; the lack of a more focused dialogue in some meetings; inadequate preparation for some meetings; uncertainty as to PA responsibilities in aid management; the duplication of project requests from the PA and the risk of donor overlap; implementation problems arising from both PA and Israeli action or inaction on certain issues; overall weaknesses in PA capacity and performance; potential problems of sustainability of PA services; and the lack of a well articulated connection between overall Palestinian development strategy and particular projects.
- PA officials expressed concern that donors tended to follow their own priorities and utilize their own channels; placed too much emphasis on technical assistance; and spent too much money on donor country contractors and consultants. There was also concern that donors were poor at sharing information, took too long in project preparation and implementation, and had procedures which imposed an excessive administrative burden on the PA.

The study made a number of recommendations for improving the donor coordination process. Key among these were:

- Strengthening the PDP process by linking it to the PA’s financial calendar, giving more weight to sectoral analysis and strategy, and enhancing the role of the SWGs in PDP preparation.
- Reviewing donor aid procedures in the context of a more explicit understanding of donor and PA responsibilities.
- Improving the documentation and transparency of the aid management and coordination system.

Central to these recommendations was the need to strengthen the Palestinian development planning system as a way of enhancing a leading Palestinian role in aid coordination.

BOX 2.16: Improving Aid Coordination

Source: Japan and World Bank 1999b.

to specific actions and targets.

- 2.16. This architecture has undergone further evolution over time. Changes have included a restructuring of the SWGs and an increasingly important role for MOPIC and other Palestinian institutions in the aid coordination process. As part of their broader analysis of aid effectiveness in the WBG, Japan and the World Bank presented an external review of the aid coordination process to the Ad Hoc Liaison Committee in October 1999 (Box 2.16). This study found that “the existing aid coordination structure provides a strong platform to build on,” but concluded that this needed to become “less dominated by the donors and less biased to the short term” (Japan and World Bank 1999b).

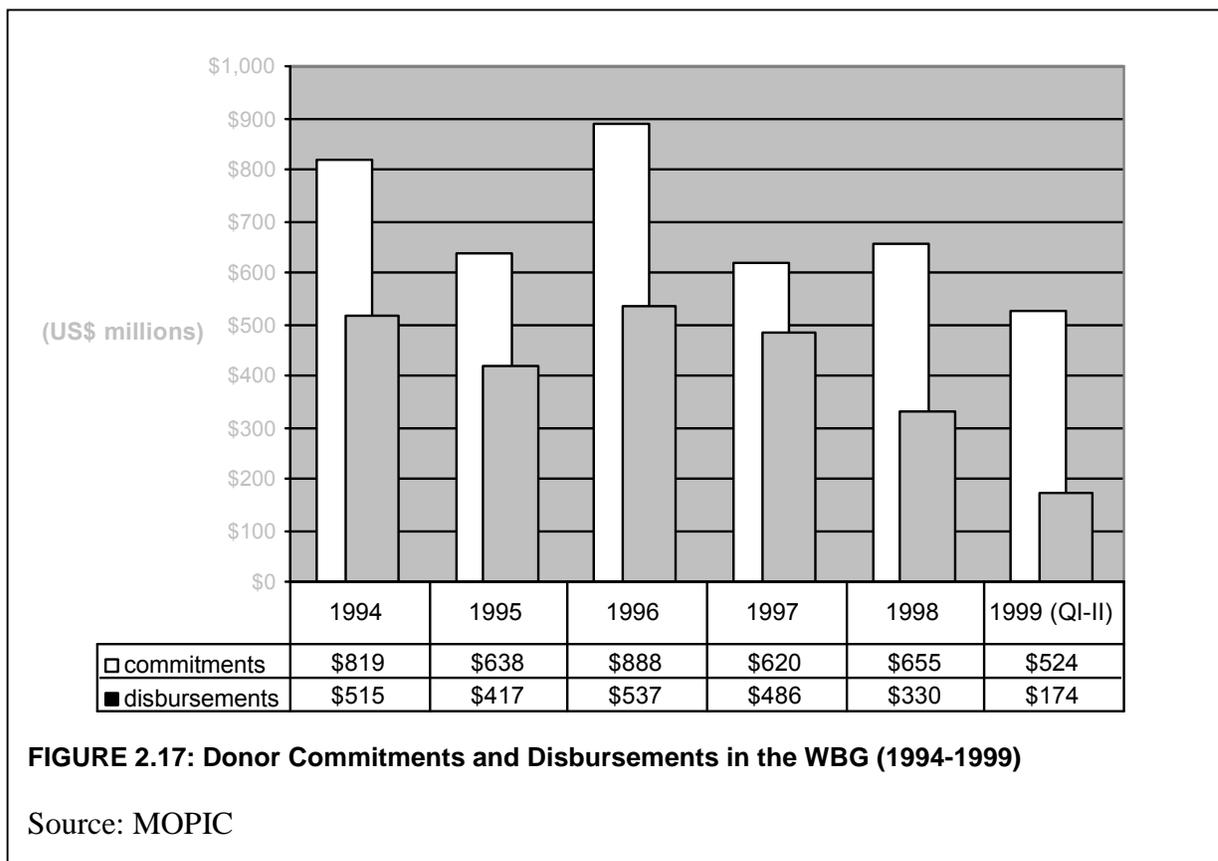


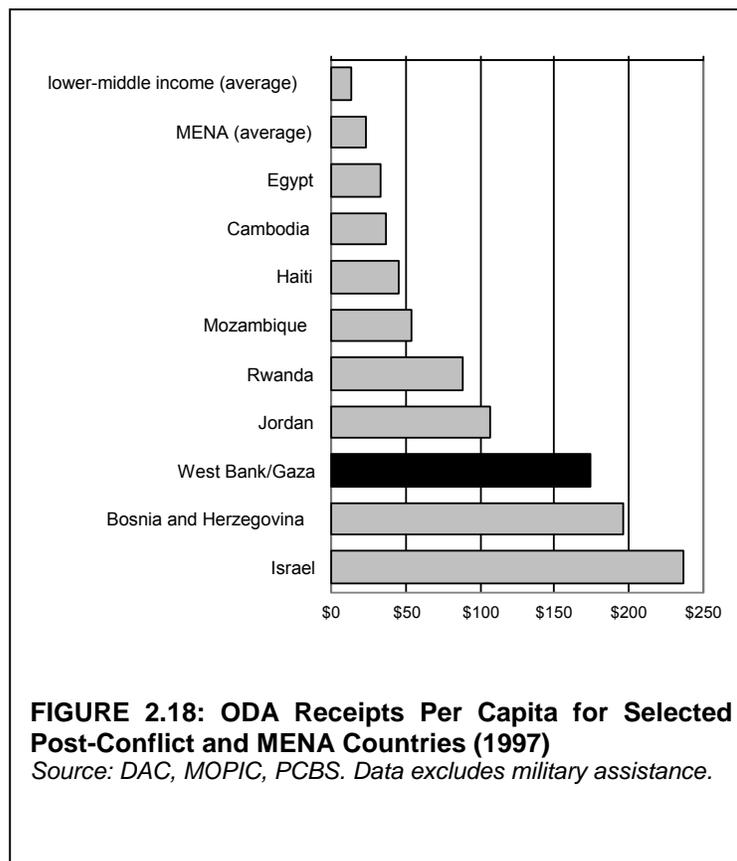
FIGURE 2.17: Donor Commitments and Disbursements in the WBG (1994-1999)

Source: MOPIC

PATTERNS OF DONOR ASSISTANCE

- 2.17. As of mid-1999, donors had pledged \$4.7 billion in assistance for the West Bank and Gaza Strip. Of this, \$4.2 billion had been committed against specific projects, and \$2.5 billion disbursed. Over this period, donor disbursements averaged \$489 million per year, ranging from a high of \$537 million in 1996 to a low of \$330 million in 1998 (Figure 2.17).
- 2.18. This level of assistance reflects the great importance that donors place on supporting the Middle East peace process. Indeed, at almost \$175 per capita (1997), aid to the West Bank and Gaza represents one of the highest levels of per capita official development assistance anywhere in the world (Figure 2.18).ⁱⁱ
- 2.19. The rate of aid implementation in the WBG—that is, the gap between cumulative aid commitments and cumulative aid disbursements—averaged 60% between 1994 and mid-1999. This would appear to be better than in many other cases of peacebuilding assistance. In Bosnia-Herzegovina, for example, aid implementation averaged 53% in 1996-98 (Dahrendorf and Ballan 1999: 64; see also Forman and Patrick 2000).
- 2.20. Overall analysis of donor assistance is provided by MOPIC in its *Quarterly Monitoring Report*, and will not be repeated here. Nevertheless, it is worth noting a number of significant shifts in the composition of donor assistance over time (Figure 2.20). Sectoral

analysis of aid disbursements shows a marked decline in the proportion of donor resources allocated to human resources and social development, from 33.4% (1994-95) to 20.6% (1998-99 QII). Over the same period, support for institutional development declined from 20.4% to 12.9% of disbursements, while support for infrastructure development increased from 19.3% to 39.3% of donor support.ⁱⁱⁱ Among the various types (“categories” in MOPIC terminology) of assistance, a dramatic reduction is evident in transitional and budget support for the PA, from 31.3% of all assistance in 1994-95, to 20.2% in 1996-97, to only 3.5% in 1998-99 QII. The proportion of donor support for public investment increased slightly over the same period, while the proportion of technical assistance remained roughly constant.



- 2.21. Overall, as of mid-1999, loans accounted for 16.1% (\$675 million) of cumulative total donor commitments and 5.9% (\$149 million) of cumulative donor disbursements. More important, however, has been a gradual but steady shift in the ratio of grants to loans over time. In 1995, loans accounted for only 6.3% of donor disbursements and 9.3% of donor commitments. In 1998, loans accounted for 13.0% of disbursements and fully 40.3% of all donor commitments that year. Part of this trend may reflect the initial delays that loans and investment guarantee funds experienced due to an uncertain investment climate in the WBG. However, this data may also signal a gradual shift in the mix of assistance likely to be made available for the WBG by the international donor community.
- 2.22. Also of importance are changes in the level of support available to Palestinian NGOs. Previous World Bank estimates suggest that by the early 1990s Palestinian NGOs were receiving somewhere between \$140-\$220 million each year from outside sources. By 1994, with the establishment of the Palestinian Authority, external support contracted to about \$90 million, and in 1995 and 1996 stabilized at about \$60 million per annum (World Bank 1997). MOPIC data shows reported donor support for NGOs at over \$60 million in 1994, dropping to around \$45-50 million through 1995-98.

Declining Donor Disbursements? Possible Explanations

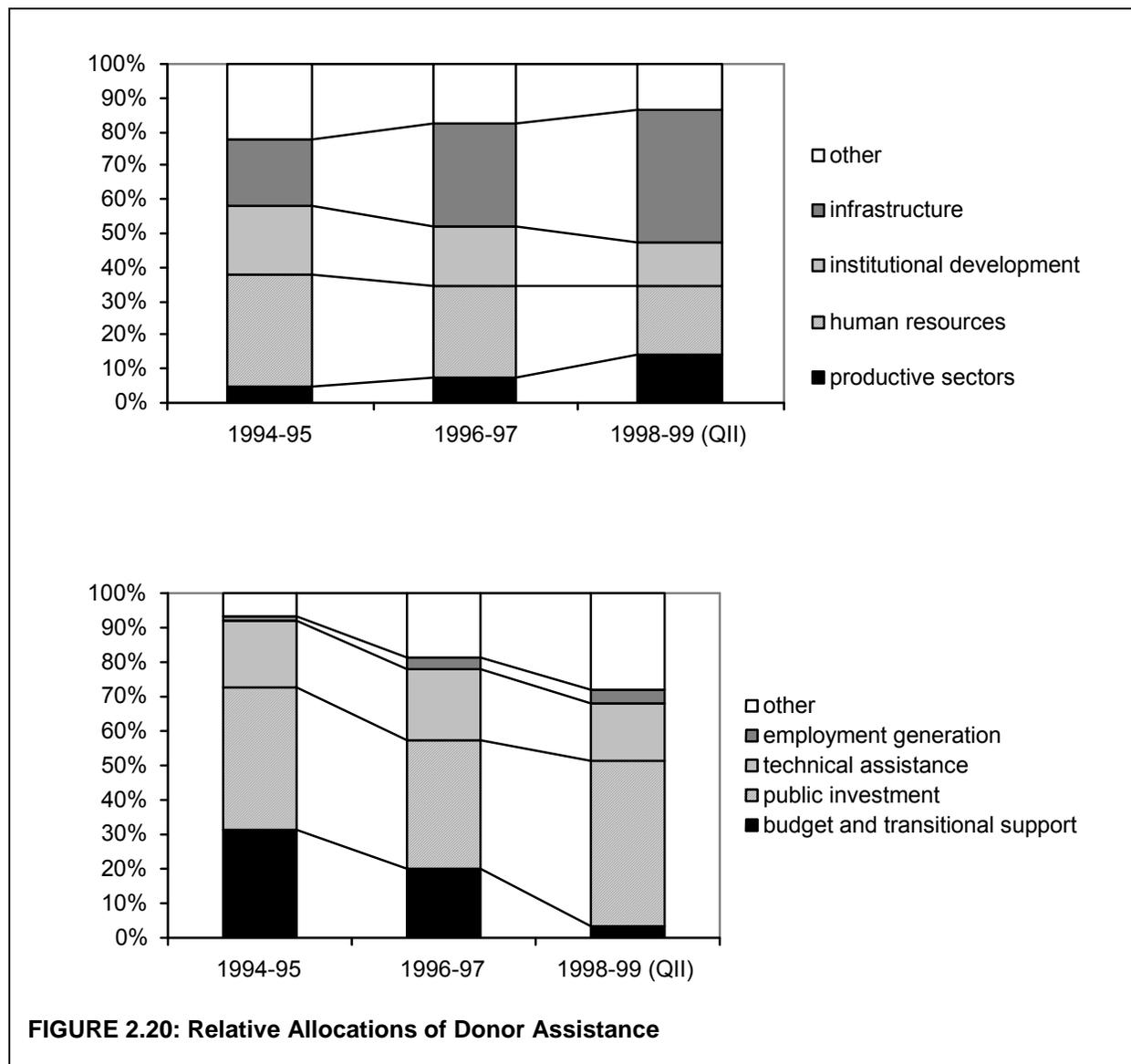


FIGURE 2.20: Relative Allocations of Donor Assistance

2.23. In 1998, donor disbursements fell to \$330 million, one-third below 1997 levels. In the first half of 1999, disbursements were almost 20% below the same period in 1998. Moreover, the rate of aid implementation has deteriorated, from a peak of 65.9% in 1997 to 63.1% in 1998, with a further decline to 59.3% by mid-1999.

2.24. Year-to-year fluctuations in aggregate levels of donor assistance are to be expected, of course. Indeed, it is important to note that the 1998-99 decline in donor disbursements was not a universal phenomenon. Of 42 active bilateral and multilateral donors in 1996-98, 26 (62%) showed a decline in disbursements in 1998 compared to their 1996-97 averages, while 16 (38%) showed an increase. However, the overall magnitude of the decline in disbursements is simply too large to be attributed normal year-to-year variance.

- 2.25. Currency fluctuations might also create apparent swings in the level of apparent donor assistance. For this to occur, however, would require a significant appreciation of the US dollar (the currency in which aid is reported) against the national currencies of major donors (the currency in which pledges and commitments are often made), or a significant appreciation of both of these currencies against the local currencies in use in the WBG (which would might reduce disbursements by decreasing local costs). However, this is inadequate to explain the apparent decline from 1997-98: measured in ECUs the drop is of similar magnitude; measured in NIS it is a still-substantial decline of 25.5%.
- 2.26. Another possible explanation for the decline in donor assistance might be a shift in the composition of external assistance—specifically, a shift from budgetary support and quick-disbursing employment generation programs to longer-term infrastructure and other public investment programs (Figure 2.20). Because these typically involve longer planning and implementation cycles, such a shift might be expected to slow the disbursement of donor funds.
- 2.27. In support of this explanation, there has been (as noted earlier) a sharp decrease in transitional and budget support for the PA since 1996, and an increase in the relative proportion of donor resources used to support infrastructure improvements and other public investments. Moreover, this explanation is consistent with the deteriorating rate of aid implementation, with a larger lag opening up between commitments and disbursements because of the longer period required for the implementation of infrastructure projects. Analysis of comparative rates of aid implementation among different donors does show a slight—but small—correlation between higher levels of donor involvement in infrastructure projects and lower rates of aid implementation in the WBG.
- 2.28. However, it is important to note that donor investment in infrastructure and public investment—while increasing in *relative* proportion—has not increased in *absolute* terms in 1998-99. On the contrary, actual disbursements for infrastructure and public investment peaked in 1996-97. Rather than budgetary support being replaced by new funds for public investment, the effective termination of the former does not appear to have translated into substantial increases in donor support for the latter.

2.29. Moreover, there appears to be no statistically-significant correlation between the level of donor involvement in the infrastructure sector and the deceleration of their aid program. This can be seen in Figure 2.29, which shows, for twelve major donors, both the decline (or increase) of disbursements between 1997 and 1998, as well the percentage of cumulative commitments in infrastructure. Clearly, the apparent decline in 1998-99 donor disbursements cannot fully be explained by reference to infrastructure investments.

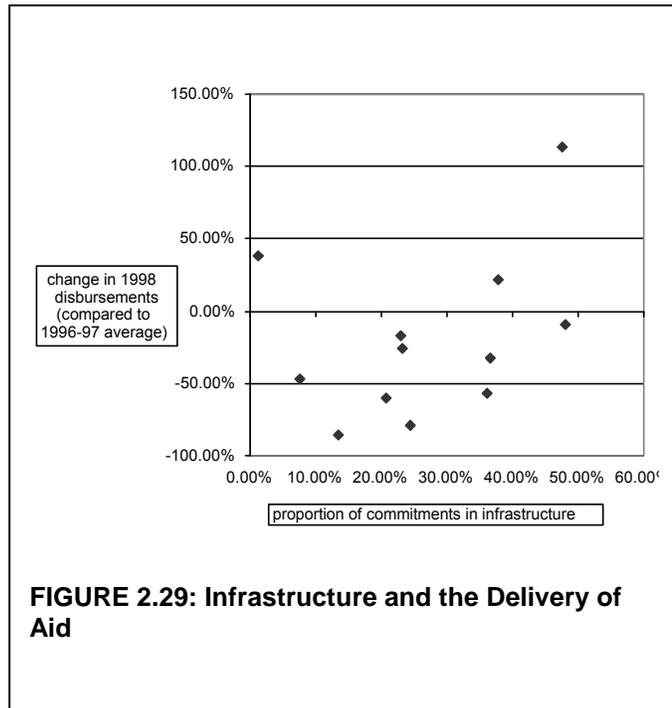


FIGURE 2.29: Infrastructure and the Delivery of Aid

2.30. Another possible explanation for declining disbursements concerns local bottlenecks and obstacles, especially those arising from actions or inactions on the part of Israel or the Palestinian Authority. In the *Improvement of Aid Coordination for the West Bank and Gaza* study previously prepared for the AHLC, donor officials pointed to both of these as sources of delay. The most recent Tripartite Action Plan, signed in Tokyo in October 1999, identified a number of efforts that the local parties could make to expedite the development effort. However, while these constraints are significant, they have not worsened in a way that would explain the apparent deceleration of donor disbursements.

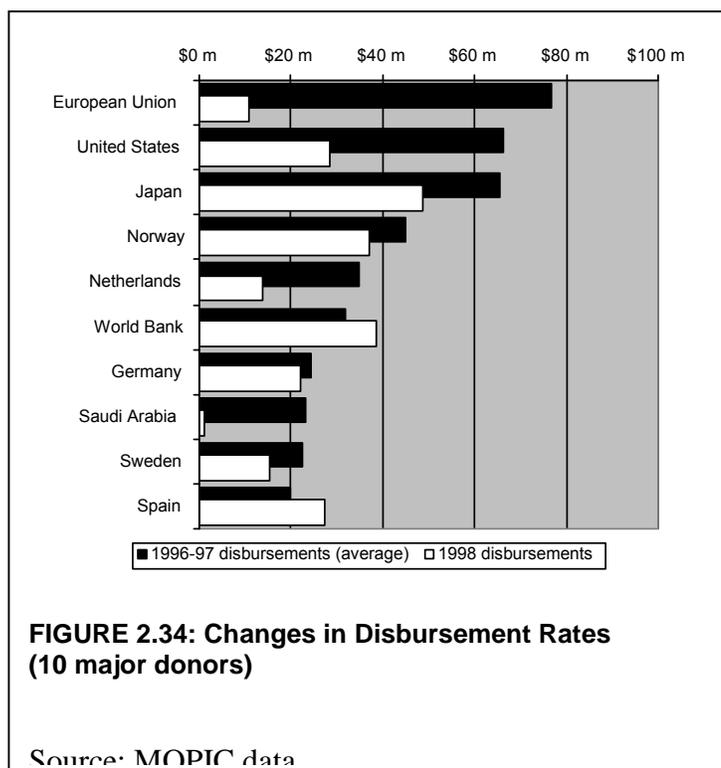
1.0 With regard to Israeli policy, improved security procedures and reduced use of comprehensive closure should have lessened rather than increased the constraints on development activities in the West Bank and Gaza.

2.0 With regards to the Palestinian Authority, there are also few grounds for believing that the current situation is worse than in 1994-95 or 1996-97, and hence a reason for the slowing of donor assistance. On the contrary, the PA has made major strides in building its policy and administrative capacity since it was established in 1994.

2.31. Regardless of whether the objective context for development efforts has improved or deteriorated, it is possible that growing concerns about institutional capacity, accountability and transparency may have heightened the caution of donor agencies, or weakened domestic support for the assistance program within donor countries. At least one major donor has encountered temporary difficulties in securing legislative approval of its previous aid pledges. This problem might be accentuated by changes in media reporting, which have quite naturally devoted increasing attention to the negative aspects of the development effort. Finally, it is not unreasonable that the expectations of donors

increase over time, and that their tolerance for obstacles may decline. The result of this may be an increasing conditionality—often implicit or unspoken—between the provision of continuing assistance and acceptable levels of accountability, transparency, project preparation, and implementation.

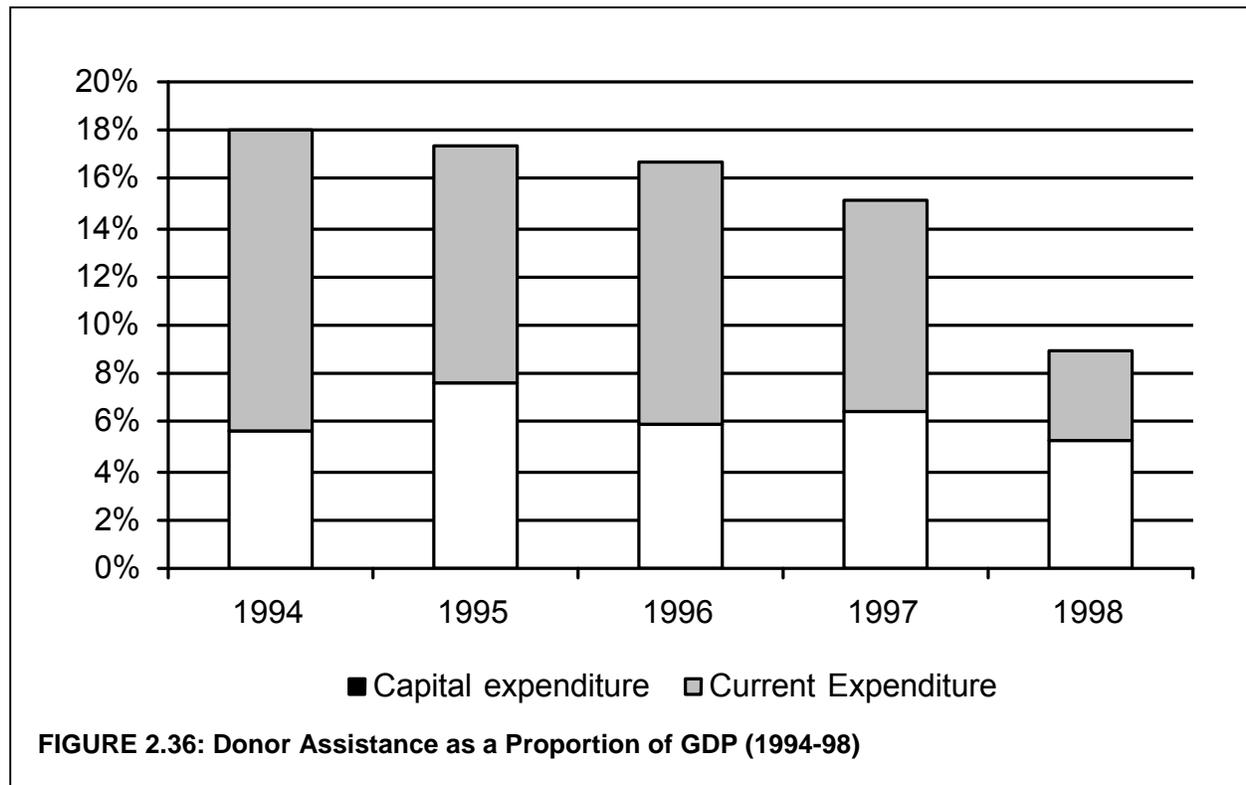
- 2.32. All of these effects may be further compounded by both a general reduction in the levels of official development assistance and increased competition among recipients for scarce aid resources. Total global ODA fell 18.0% in nominal terms and 20.8% in real terms between 1994 and 1997 (the most recent year for which data is available). During that same period, the proportion of global ODA provided to the



WBG actually increased significantly, from 0.78% to 1.24%, according to OECD data.^{iv} Further decline in global ODA will inevitably have some negative effects on the availability of future resources for the WBG. This may be further aggravated by competing needs from complex humanitarian emergencies elsewhere in the world. In particular, the urgent need to support peacebuilding in Kosovo and East Timor may well have negative effects on aid mobilization for the WBG in 1999 and subsequent years.

- 2.33. Declining donor disbursements might also be a result of an increasing “routinization” of the aid effort in the WBG, marked by the lack of pressing political crisis, and possible public, legislative, and/or donor fatigue. The data suggests that donor disbursements tend to be highest when there exists either pressing need (such as the establishment of the PA in 1994) or political and economic emergency (such as the crisis wrought by violence and closure in 1996). The decline in donor disbursements from 1996 to 1997 to 1998 might also suggest that the political uncertainty and a slowing of the peace process during this period had negative effects on the flow of aid. If so, it will be important to see whether aid commitment and disbursement figures increase in the latter half of 1999 and early 2000, as political momentum builds.

2.34. A final explanation for the apparent decline in donor disbursements in 1998-99 might



focus on a few key donors, rather than all. Within these key donors, special circumstances—many of them unconnected, and extraneous to the West Bank and Gaza or even the peace process—may affect the pace at which they are able to commit and deliver aid resources. There is some significant evidence for this idiosyncratic explanation from MOPIC disbursement data. The three largest donors (measured by 1996-97 disbursements)—representing one-quarter of total aid pledges and commitments for the WBG—account for two-thirds of the decline in 1998 disbursements, compared to 1996-97 average levels (see Figure 2.34).

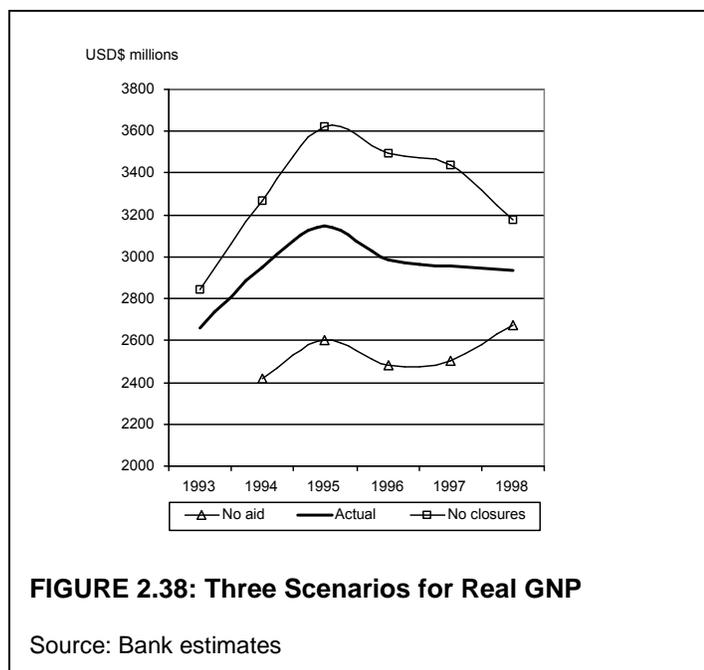
2.35. Overall, changes in the flow of donor assistance have implications not only for the level of development resources available, but also for the efficacy of the development process. At a time when donors are encouraging the PA to improve the linkage between macroeconomic forecasting and developing planning, unanticipated fluctuations in aid (representing, in the case of 1998, a drop equivalent to 4.3% of WBG GNP) complicate both. Similarly, any slippage in the rates of aid implementation (marked by a growing gap between commitments and disbursements) will do little to enhance the credibility of the donors at a time when they are pressing for more transparent, streamlined and efficient systems of project identification and implementation on the Palestinian side.

THE MACROECONOMIC EFFECTS OF DONOR ASSISTANCE

2.36. Donor assistance to the West Bank and Gaza has averaged some 15% of GDP through 1994-98, with a significant decline in its relative importance over time (Figure 2.36).

There can be no doubt that such assistance has had a substantial positive effect on the domestic economy of the WBG since 1994. Most immediately, the inflow of donor resources has stimulated local economic activity and contributed to household incomes. In the longer term, it has enhanced the productive potential of the economy by supporting investments which serve to expand the underlying capacity for economic production.

- 2.37. Estimating the precise macroeconomic effects of aid, however, is a challenging task. The exact relationship depends, among other things, on the characteristics (labor intensity, important content, and so forth) of the individual sectors in which donor assistance is channeled, the type of assistance (budget support, technical assistance, infrastructure



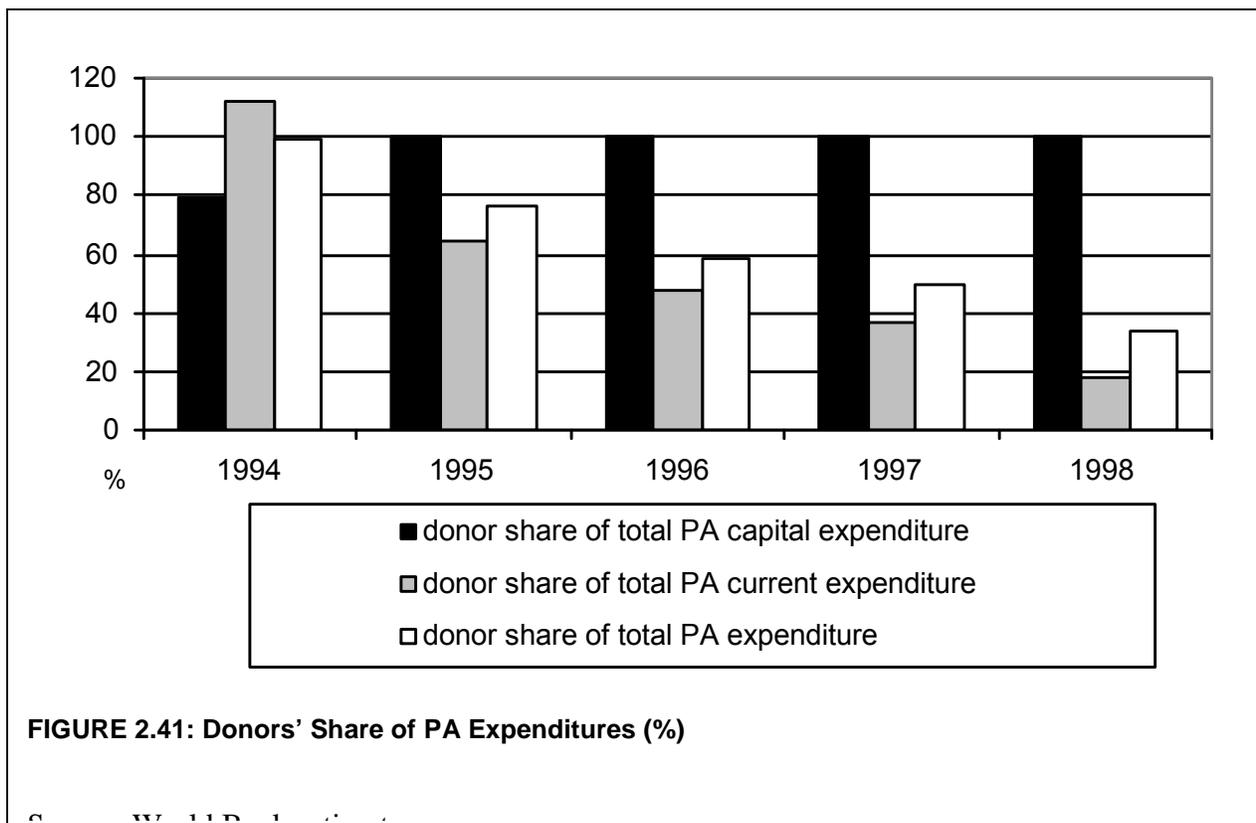
- investments), and the degree to which donor funds are actually disbursed in the WBG (as opposed to donor countries). The relationship is likely to be characterized, moreover, by a long and complex lag structure. Finally, the particular disarticulations of, and economic shocks experienced by, the Palestinian economy introduce further uncertainty into any estimates.
- 2.38. Despite the positive contribution from donor assistance to macroeconomic development in the WBG since 1994, real GNP in 1998 was still at more-or-less the same levels it was in 1994 (Figure 2.38), and GNP per capita was correspondingly lower. An important set of factors behind this rather disappointing fact were the various restrictions placed on the mobility of goods and persons in and out of the WBG, especially during the years 1995-97 when closure was imposed much more frequently. Such closures not only affected the income of would-be Palestinian workers in Israel, but also disrupted trade flows (with a possibly permanent loss of market share as a result). It can be estimated that, in the absence of restrictions, Palestinian employment in Israeli could have been some 50,000 persons higher in 1998 compared to its actual levels.^v This suggests that restrictions on Palestinian labor mobility have led to a loss of 15-20% of WBG GNP during the years 1995-97, but considerably less in 1998-99 when restrictions have been less severe.
- 2.39. Comparative analysis suggests that donor aid since 1993 has increased the GDP growth rate by 1-2% over what it would have been in the absence of such assistance. This calculation assumes that donor financed capital expenditures in the WBG directly augment the domestic stock of productive capital. Translated into levels of potential GNP per

capita, the production capacity of the WBG economy in 1998 was 6-7% higher than would have been the case without donor-financed capital expenditures (Figure 2.38). In short, through 1994-97 the positive effects of donor assistance were offset by the cumulative effects of closure and other restrictions. Yet, without such assistance, the Palestinian economy would have certainly experienced a much more precipitous—and politically destabilizing—decline. Since 1997, the economic effects of mobility restrictions have lessened significantly, and donor aid has played a key role in the modest growth experienced by the WBG economy.

Fiscal Developments

- 2.40. The Palestinian Authority has made major progress—with the assistance of the IMF and donors—in strengthening its revenue capacity. Total revenue as a percentage to GDP has risen from just 8.9% in 1994 to 24.1% in 1998. This compares favorably with many other lower-middle income countries, and even more so with those emerging from recent conflict. Continuing efforts are underway to further increase the efficiency of collection and increase rates of tax compliance. However, as the World Bank has previously noted (1999g: 8), the major gains from improved tax administration have already been captured. Consequently, the 2000 budget projects that PA revenue will increase only slightly, to a ceiling of around 25% of GDP in 2000-2002. Thus, there is relatively little scope for greater fiscal performance on the revenue side, other than through broader growth in the WBG economy. However, the short-term liquidity position and budgetary planning capacity of the PA would be enhanced by the centralization of all revenues under direct Ministry of Finance control.
- 2.41. Public expenditures grew sharply relative to GDP until 1997. This pattern was reversed in 1998, due to GDP growth and declining donor disbursements. The PA's 2000 budget anticipates that current expenditures will drop from 24.4% of GDP in 2000 to 23.5% by 2002, with this decline resulting from a relative decline in wage and salary expenditures.
- 2.42. Public investment—almost exclusively financed by donors—has almost doubled, from an average of 2.9% of GDP in 1990-92 to 5.7% in 1997-98. This is still a relatively low ratio, however, compared to Jordan, Egypt, or other economies at similar income levels, in part because of an unavoidable focus by donors on support for transitional costs, recurrent budget support and emergency employment. The current Palestinian Development Plan projects public investment rising to between 8.9% and 10.5% of GDP by 2003. PDP estimates, however, presume that donor support of \$800-\$900 million per year. While this reflects historical pledging levels, actual disbursements over 1993-99 have been significantly less than this. The PA's 2000 budget offers rather more modest predictions, suggesting expansion in public investment to at least 6-7% by 2002, supported in part by an expansion of the PA's contribution from 0.5% to 1.5% of GDP.
- 2.43. By far the largest effect of donor assistance on the PA's fiscal affairs has been on the expenditure side. There has, since 1994, been a sharp reduction in the level of donor support for current expenditures (Figure 2.41). The initial high degree of budget support provided by donors helped the PA establish its operations and avoid fiscal deficits at a stage when such deficits could have had a significant destabilizing effect. However,

recurrent budget support also facilitated an expansion of public sector employment that—



whatever its immediate political utility—was clearly in excess of what was needed to carry out the new responsibilities of the PA.

- 2.44. On the expenditure side, donors have supported PA efforts to improve the system of budgetary management and expenditure control. There remains room for further progress however, notably in implementing many of the reforms that have already been enacted. Moreover, donors have expressed particular concern about the growth of public sector employment and the recurrent wage bill of the PA, an issue discussed more fully in section 4 of this report.
- 2.45. At the local level, both the current structure of public utilities and the present system of local government would benefit from reforms to assure the efficient delivery of services and use of revenues. A number of donor programs in the water, electricity, fiscal, and local government sectors have encouraged such reform.
- 2.46. The overall fiscal picture is, as the World Bank has previously argued (1999g: 8), “fragile”. The PA is presently able to finance recurrent costs from domestic revenues. However, all of this could be placed at risk by a failure to deal with current fiscal challenges in a timely budget. Continued growth in the public sector wage bill could not only eliminate any prospect of PA support for public investment, but also requires expensive and burdensome borrowing to cover shortfalls in the recurrent budget.

SECTORAL IMPACTS OF DONOR ASSISTANCE

- 2.47. In assessing the sectoral effects of donor assistance, several important considerations should be kept in mind. The first—discussed in section 1.0 of this study—concerns the absence, in many cases, of appropriate baseline data against which comparisons might be made. Second, any fair assessment of aid effectiveness must recognize the many challenges to, and constraints on, development efforts the WBG. In many sectors, a variety of factors beyond the control of donors—requirements of the interim agreements, permissions and permit policies, closure, political uncertainty, or other aspects of the transitional period—have severely inhibited project implementation. Third, it must be recognized that some types of projects may require substantial planning, and may not show results for several years. While the period that has passed since the signing of the Declaration of Principles in September 1993 may seem long for those anxious to see the achievement of a just and lasting peace, it remains a relatively short frame against which to measure the dynamics of sustained development.
- 2.48. Ideally, analysis of the donors' various sectoral disbursements would be tied to a more sophisticated analysis of sectoral contributions to GDP and employment growth. However, the present data—and the particular circumstances of the WBG economy—make this extremely difficult. It is possible to identify a series of empirical indicators of donor in various sectors. In many cases these can be very revealing. In other cases, however, they tell little about the appropriateness or quality of the initiatives undertaken, or the opportunity cost of development decisions. In an ongoing context of peacebuilding, of particular importance is how development initiatives are felt by the intended beneficiary population. This aspect of aid effectiveness will be explored in some detail in Section 3.0 of this report.

Infrastructure

- 2.49. Since 1993, donor-supported infrastructure investment has involved a range of projects in the energy, solid waste, transportation, and water and sanitation sectors. In almost all of these areas, the Palestinian Authority inherited infrastructure that was relatively underdeveloped, lagging behind that of other comparable countries. The improvement of physical infrastructure is a key to improving conditions for the Palestinian population, attracting private sector investment, and laying the groundwork for future development. Consequently, it has been a major Palestinian priority, constituting almost half (48.9%) of all proposed investments under the 1999-2003 *Palestinian Development Plan*.

2.50. In the *energy* sector, the situation in the early 1990s was characterized by low consumption, high load factors, and high transmission losses. Approximately 138 rural villages in the West Bank were without full-time supply. Per capita consumption stood at about 540 kWh (1992), compared to 1054 kWh in Jordan, and 815 kWh in Egypt (World Bank 1993e: 26). The system of local municipal utilities was fragmented, inefficient, and unable to sustain the expansion or modernization of the system.

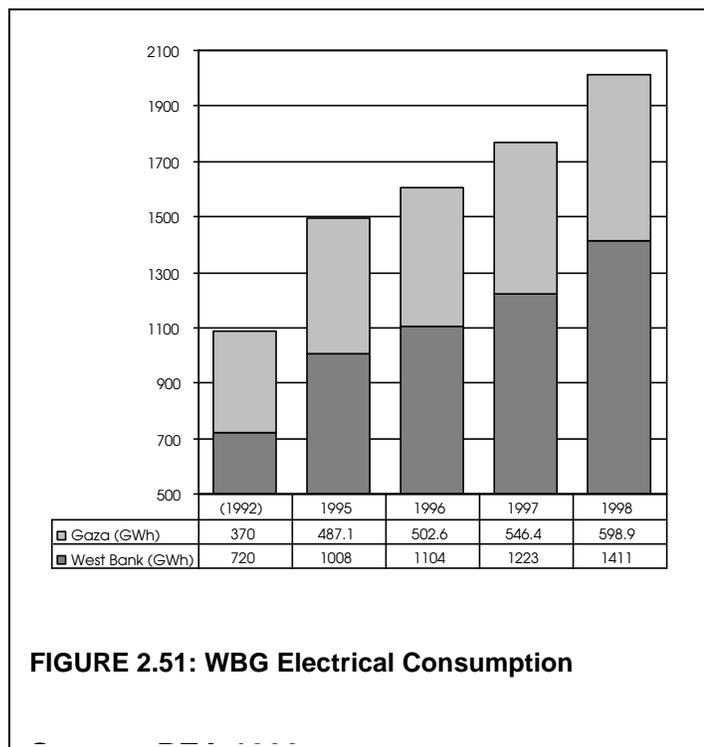


FIGURE 2.51: WBG Electrical Consumption

2.51. Between 1994 and mid-1999 donors committed some \$133.6 million to the energy sector, and disbursed some \$54.5 million of this. About half of these funds were utilized for rehabilitation

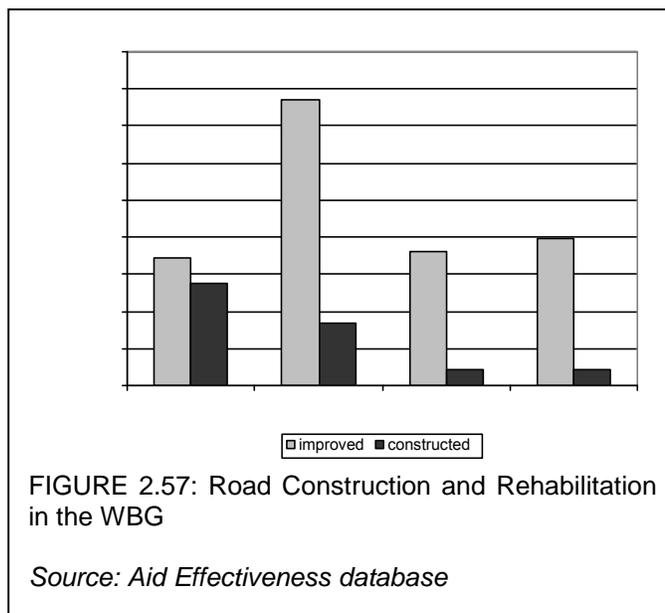
of the electrical distribution network in Gaza, and about half for both rehabilitation and the more gradual extension of the electrical grid to rural villages in the West Bank. Such improvements and extensions have led to sharp increases in aggregate demand (PEA 1999). Between 1995 and 1998, Palestinian electrical consumption increased by 34%—well over twice the rate of population increase—to 681 kWh (Figure 2.49).

2.52. The extension of reliable electrical supply to rural villages in the West Bank has dramatic positive effects on both local living conditions and improving the environment for private sector activity. It has been achieved, moreover, at a very impressive cost/beneficiary ratio: approximately \$66.56 per person, according to estimates derived from the aid effectiveness project database.

2.53. Challenges remain, however. Extending electrical supply to rural villages can involve a host of territorial issues that slow project implementation. Also, donor disbursements to this sector remain low, at under half the \$108 million envisaged under the World Bank's original Emergency Assistance Program (for 1994-96). Energy continues to be a relatively undersubscribed subsector of the PDP. Consequently, a significant population in the northern governorates is only now being connected to the electrical grid. Also, the process of institutional and policy reform in this sector—including the establishment of regional utilities in place of the previous system of municipal utilities—is still at a relatively early stage.

2.54. With regard to *solid waste*, donors committed some \$38.1 million as of mid-1999, and disbursed some \$18.6 million of this. This too represented significantly less than the \$57 million envisaged by the Emergency Assistance Program (for 1994-96), and solid waste is also a relatively undersubscribed subsector of the PDP.

2.55. At present, 25% of the West Bank population is not served by a solid waste collection system, and 30% of the population have no access to a nearby dump site (MOPIC 1998c: 47-49). Progress has been made in addressing these needs, however, particularly in the urban areas of both the West Bank and Gaza. While time-series data to show this is not available, progress is evident from survey findings, which show a majority of Palestinians reporting improved facilities in this sector (see Section 3.0).



2.56. In the *transportation* sector, donors committed some \$128.3 million between 1994 and mid-1999, and disbursed some \$55.4 million of this. This is close to the level (\$73 million) envisaged in the EAP, although below the levels called for the PDP. Such support has allowed the establishment of an airport in Gaza, and a number of donors have committed resources to the eventual construction of a port in Gaza. However, the bulk of investment in transportation has been, and will continue to be, in the rehabilitation and expansion of the WBG road network.

2.57. According to data collected by the aid effectiveness study, donor-supported projects have seen the construction of at least 264 km of new roads and the improvement of at least 939 km of existing road in the WBG (Figure 2.57).

2.58. It is more difficult, however, to assess the social or economic value of these projects. There is little substantial post-project impact assessment of even major road projects, such as the Salah al-Din Road in Gaza. And, while the substantial benefits of major road improvement are probably clear to anyone who (prior to the peace process) ever drove the poor, slow, often-flooded main road to Gaza, in other cases the picture may be more complex. A World Bank rapid assessment report on its Community Development Project, for example, found that road improvement did not always figure among the top priorities of local communities (World Bank 1998c). However, fear of losing potential funds could lead community leaders to accept such projects nevertheless. Israeli road construction in the West Bank, and as yet unknown arrangements that might be agreed to in permanent status negotiations, make it difficult to develop a strategic plan for the transportation

sector, although the PA has attempted to do so (MOPIC 1998). Data collected by the aid effectiveness project shows that 77% of road construction or rehabilitation in the West Bank has occurred in the northern or southern governates where need is greatest, suggesting a fairly efficient matching of donor investments to regional transport needs.

- 2.59. *The water and sanitation* sector has been the major area of donor support for public infrastructure investment in the WBG. Between 1994 and mid-1999, donors had committed \$634.1 million, and disbursed \$292.6 million. As is evident from the relatively high proportion of PDP projects funded, this has been an area where it has been comparatively easy to mobilize donor resources.
- 2.60. These levels of support reflect widespread recognition that the water sector is one of critical economic and social importance. Palestinian water resources are extremely limited—on a per capita basis, among the least in the developing world. Those resources are also shared with neighboring countries. Palestinian demand will continue to increase at a substantial rate for the foreseeable future, fueled both by economic development and by the underlying growth in WBG population.
- 2.61. This situation is compounded by limited and outdated water distribution networks. Water network losses vary from less than 10% in some locations to over 60% in others. Loss rates—and hence aggregate wastage—tends to be particularly high in urban areas (45% in Hebron, 45% in Jenin, 50% in Jericho). Overall, 88% of the West Bank population has access to piped water. However, some 193,000 persons in 282 localities do not have access. In the northern West Bank the problem is particularly severe, with 37% of the population of Jenin governate, and 22% of Nablus governate having no access to piped water. Indeed, in large part because of variations in local supply and the absence of a national supply system, the price of water can vary up to nine-fold across different locations in the West Bank (MOPIC 1998c). In Gaza, PCBS census data indicates that 92% of households had access to a public piped water in 1997 (PCBS 1997). However, the system was often inefficient, and loss rates high.
- 2.62. With regard to wastewater, PCBS census data shows that 24% of West Bank homes are connected to a public sewage system, while 73% utilize some form of cesspit (PCBS 1997). In urban areas, sewage connection rates average around 65%, ranging from a high of 85% in Bethlehem to a low of 50-55% in Hebron and Qalqilya. Connection rates in West Bank refugee camps average around 24% (MOPIC 1998c). In Gaza, just over half of all households were connected to a public sewer system in 1997. Throughout the WBG, many localities with sewage system do not yet have waste treatment facilities

2.63. Ultimately, developments in the water sector will be profoundly shaped by the outcome

The Gaza Water and Sanitation Services Project is supported by \$25 million from the World Bank and \$50 million in parallel financing from EIB/EU. The project consists of: (a) the provision of an international operator under a four-year management contract to implement a service improvement program; (b) the provision of operating investment funds for the operator built into the management contract, essential to fund goods, equipment, works and services required for improving services and attainment of performance targets; and (c) the provision of technical assistance to strengthen the newly created Palestinian Water Authority (PWA), to support implementation and monitoring of the project, and to provide independent auditors to monitor the operator's technical and financial performance. The implementing agency is the PWA.

The main achievements after three years of implementation of the project are:

- over 3,700 km of pipe have been surveyed for leaks and 11,000 illegal connections identified
- almost 14,000 service connections have been replaced, over 7,000 meters repaired, and a total of over 27,000 meters replaced
- unaccounted for water was reduced in year one from 48% to 44% and is currently about 38%
- reliable disinfection of the water supply
- increased revenue.

The work of creating the legal entity of the Coastal Water Utility in Gaza started in January 1999 and is due to be completed by the end of December 1999.

Box 2.64: The Gaza Water and Sanitation Services Project

of permanent status negotiations between Israel and the Palestinians, and whatever arrangements are agreed by the parties on the allocation and exploitation of regional water supplies. In the interim, there remains much that can be done to improve water distribution networks and extend piped water services to communities that lack them, improve water quality, reduce water loss through leakage and unauthorized connections, improve national planning and data capacities, strengthen water management systems, and improve the financial sustainability of local water utilities. Donor programs have been active in all of these areas. Donors have also been active in supporting waste water projects, intended to improve local health and sanitation conditions, and reduce the risk of cross-contamination.

2.64. According to data collected for the aid effectiveness study, between 1994 and mid-1999 donors supported more than 308 projects in the water and sanitation sectors. Such projects have resulted in the laying of more than 1,755 km of new water pipes, the construction of 70 new reservoirs and 35 water pumping stations, the laying of more than 393 km of new sewage lines, and the installation of 22 new sewage pumping stations. The impact of such activities varies from project to project, but the World Bank's Gaza Water and Sanitation Services Project (Box 2.64) provides one example of very positive effects.

2.65. Several challenges face donor efforts in the water and sanitation sector. The large number of donors involved—at least twenty one—raises the risk that initiatives may be poorly coordinated, thus negating potential synergies and undercutting efforts to develop a national water strategy. Some donor and PA officials already complain that this is a

significant problem. In some areas different donor-supported water projects are in very close proximity, but with little attention to integration or synergy. Greater sectoral coordination, including a leading role for MOPIC, the PWA, and the Palestinian Development Plan, is essential to address this.

- 2.66. The water sector is also one that has encountered significant practical obstacles to project implementation. In 1993, the Bank estimated that two hundred unconnected West Bank communities could be connected to piped water supplies at a cost of \$22 million. Six years later, however, only a fraction of this has yet occurred. Overall, the implementation rate in the water and sanitation sector is lower than the general average for the aid effort, with only 46% of committed funds having been disbursed as of mid-1999. A major factor in these delays appears to be the fragmented system of territorial authority in the West Bank, coupled with the present system requiring that new water and sewage projects be approved by the Israeli-Palestinian Joint Water Committee. As will be shown in section 3, such factors—coupled with drought and major water shortages—have contributed to a widespread public perception that little has been achieved in the water sector during the past five years. Public evaluations of progress in sewage facilities, however, are rather more positive.
- 2.67. An essential part of the problem is the underlying need to reform the institutional foundations of the water management system. The PA has committed itself to reorganizing the current system of municipal water utilities into consolidated regional utilities. Unlike the current system, these would have the technical expertise and capital resources to maintain and improve the water distribution infrastructure. The water sector must also be linked to other aspects of development strategy. A significant proportion of Palestinian water resources, for example, are used for agriculture. The costs and benefits of such usage—and the opportunity costs of having inadequate supply for other purposes—may not be adequately factored into current rural development planning.

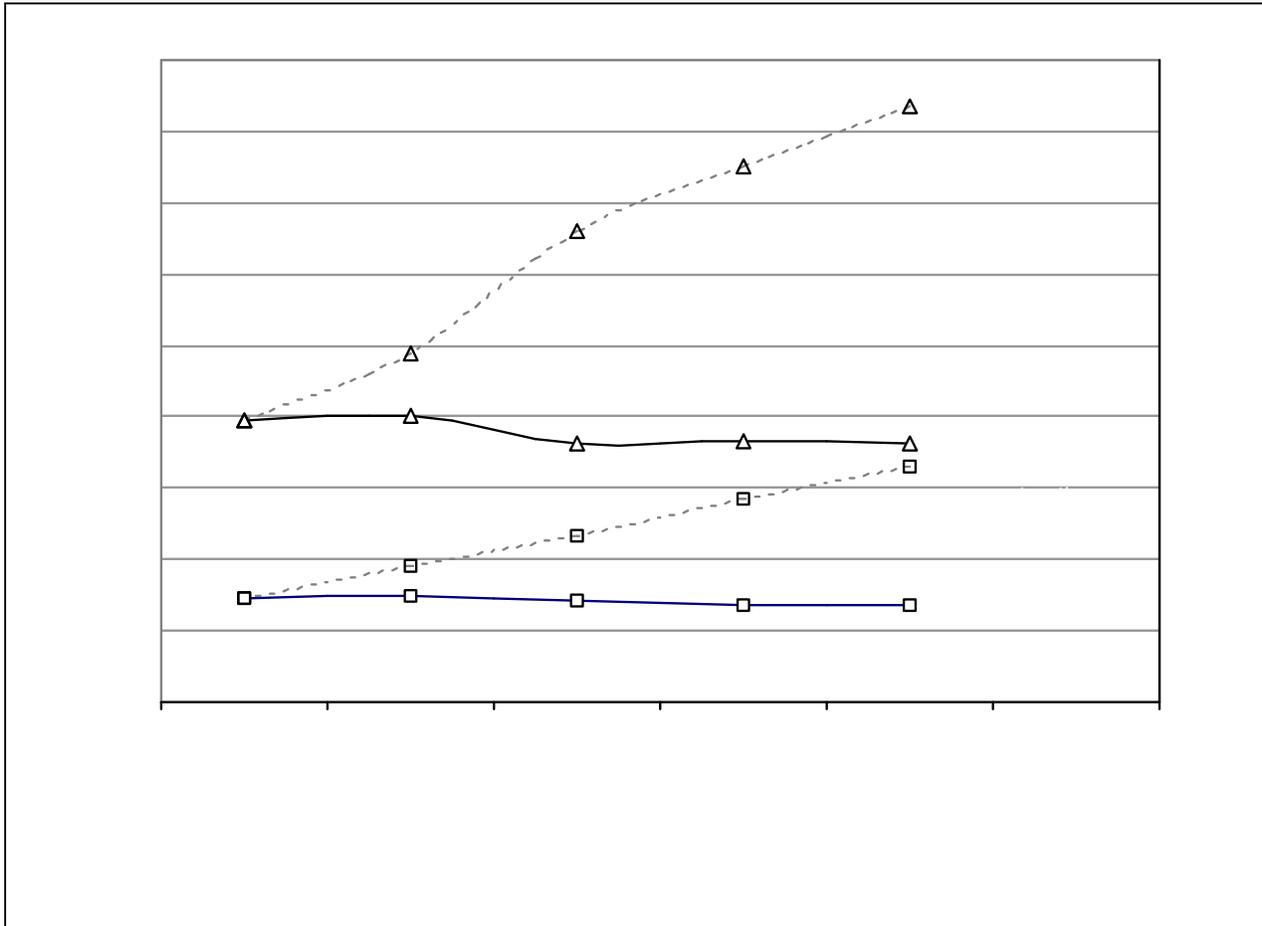
Education

- 2.68. The education sector in the WBG is characterized by very rapid growth in the number of school-age children, and hence of demand for schools, classrooms and teachers. Between 1994/95 and 1998/99, the number of students enrolled in schools and educational institutions rose from 654,697 to 889,895—a total increase of 35.9%, with the rate of increase larger for girls (38.1%) than boys (33.8%). The sharpest enrollment increases occurred among kindergarten students, with the number of pupils growing by 110% (to 77,173) over five years. The education sector is also characterized by multiple service providers: the PA, UNRWA, NGOs, and the private sector. In 1998/99, 67.6% of primary and secondary school pupils were enrolled in PA schools, 25.9% in UNRWA schools, and 6.4% in private schools.
- 2.69. Year-on-year increases peaked at 10.5% in 1996/97, before dropping to 6.1% in 1998/99. The rate of growth was particularly high in Gaza, where the total number of students grew by 49% between 1994-95 and 1998-99. There was also a shift in the distribution of students among different types of school: while government and UNRWA school

enrolments both increased by 31% over this period, the number of students attending private school dropped by 42%.

- 2.70. Between 1994 and mid-1999, donors committed some \$406 million to the education sector, and disbursed \$314.5 million of this. A steady decline in donor support for education is noticeable, however, with the level of assistance dropping from \$92.2 million in 1996 to only \$15.1 million in 1998. This is explained in large part by a sharp decline in the level of donor support for recurrent education and higher education expenditures. Donors and the NGO/private sector currently finance the overwhelming majority of all public investment in the education sector, providing 96% of all capital spending in the 1997 education budget (World Bank 1999g: 43). According to data collected for the aid effectiveness study, more than \$97 million in donor assistance was devoted to the construction of 152 new schools in the WBG and the renovation of 374 others, resulting in the addition of at least 3,764 new classrooms during this period.
- 2.71. In the early 1990s, total outlays on education were estimated at \$170-175 million per year, or about 5.3% of GNP (World Bank 1993f: 37). By 1997, total public outlays had increased to \$276.6 million (World Bank 1999g: 43), or about 5.9% of GNP. This is slightly higher than the 5.3% average for low and middle income MENA countries. In 1997-98, annual recurrent spending on education stood at approximately \$310 per student in UNRWA schools and \$270 in government schools.
- 2.72. In general, student/teacher ratios have improved slightly. In 1998/99, the overall student/teacher ratio stood at 29.5, compared to 31.5 in 1994/95. The ratio was highest in kindergartens (63.7), UNRWA schools (39.4) and in Gaza (34.7). The number of teachers at government school increased by more than 42.5% between 1994/95 and 1998/99, a rate of growth higher than the rate of student increase (31%). It should also be noted that, due to the introduction of new employment guidelines, the PA Ministry of Education has managed to increase the proportion of teachers with a university degree from less than 36% in 1994/95, to over 47% in 1998/99. In UNRWA schools, however, the number of teachers increased at a much lower rate of 22.5% over the same period, resulting in a slight deterioration in pupil/teacher ratios.

2.73. Indicators of classroom availability have also remained constant or improved marginally



since 1994. The overall student/classroom ratio stood at 35.4 in 1998/99, compared to 35.9 in 1994/95. The student/classroom ratios in Gaza (43.1) were significantly higher than those in the West Bank (31.7). In Gaza, the average amount of classroom area per student rose from 1.1 m² in 1996/97 to 1.19 m² in 1998/99. In the West Bank, classroom area per student has increased slightly from 1.0 m² in 1996/96 to 1.05 m² in 1998/99 at the elementary level, and from 1.3 m² to 1.52 m² at the secondary level. It is notable that the growth in the number of classrooms for female or coed classes has occurred at a faster rate (55.0% and 35.7% respectively over five years) than growth in the number of male classes (27.8% over the same period). Since the distance, crowding or unavailability of girls' classes is sometimes an obstacle to attendance, this may explain why there has been a greater rate of increase in female enrolments since 1994/95.

2.74. The contribution of donors to stabilizing and improving educational facilities has been extremely important. This is dramatically illustrated in Figure 2.74, which shows the actual trend in student/classroom ratios, and the projected ratios had there been no donor financed capital investment in school construction and rehabilitation. In the latter case, the absence of such investment would have seen the average number of students per

classroom increase to 43.1 in the West Bank, and soar to 66.7 students per class in the Gaza.

2.75. Several notable patterns can be seen from these statistics:

- First, there has been modest but perceptible improvement in most physical indicators of primary and secondary education: teacher/pupil ratios, the availability of classroom space, and in other aspects of education infrastructure. This is confirmed by survey data (discussed in section 3.0) which shows that most Palestinians perceive an improvement in education facilities. However problems of overcrowding remain, particularly in Gaza. A significant proportion of schools are double-shifted to deal with this. Such double-shifting has disadvantages, although it does optimize the utilization of physical space.
- Second, improvements in physical indicators for has been greater for PA than for UNRWA. This underscores the impact of budget constraints on UNRWA's ability to maintain existing levels of service to refugees.
- Third, there have been some underlying shifts in enrollment patterns. One component of this has been rapid growth in the number of kindergarten students, reflecting not only demographic factors but also a growing trend of enrolling children in preschool institutions. This may suggest a growing need to develop early childhood education policies. Another substantial element of change has been the marked decline in private school enrollments, which may be a consequence of deteriorating family incomes in recent years.

2.76. In reviewing these quantitative physical indicators, it is important to emphasize that they only partially illuminate the quality (as opposed to quantity and circumstances) of education in the WBG. In 1993, the World Bank's review of the educational sector noted that "the education now being provided to children living in the occupied territories does not meet reasonable quality standards," due in large part to a outdated and outmoded curriculum as well as weaknesses in teacher training and qualifications (World Bank 1993x: 41-42). While donors have supported curriculum reform, teacher training, and the production of instructional material, there is still much to be done, including enhancement of the Ministry of Education's ability to monitor and assess student and teacher performance. The Ministry of Education's participation, with UNICEF, in the "Education for All" international assessment program is a useful step in this direction. Not only has this helped to establish benchmarks and targets for the Ministry, but it has also indicated significant weaknesses in primary school achievement levels.

2.77. A further set of issues concerns the fiscal sustainability of this sector in light of the rapid growth of both students and teachers, as well as the future recurrent cost implications of school construction (World Bank 1999g: 43-47). This is an issue that will be further discussed in section 4 of the aid effectiveness study.

2.78. On the positive side, the Ministry of Education has a "deserved reputation in Palestinian civil society and among donors for transparency" (World Bank 1999g: 46), administrative efficiency appears relatively high, and the education SWG is regarded as

being one of the most productive of all Sectoral Working Groups (Japan and World Bank 1999b: 63-67). Ministry officials indicate they are well aware of problems in the quality of the current education system, and emphasize the need to press forward—in partnership with donors—to strengthen curriculum development, texts and teaching materials, teacher training, and assessment and monitoring capacity. All of this provides a firm base upon which to build further progress in the education sector.

- 2.79. The post-secondary education system consists of 12 universities and colleges, supervised by the Ministry of Higher Education. Higher education has largely been funded by external grants and tuition fees, with little central government support. Declining external support for university operating costs, however, have posed a significant challenge to post-secondary education, necessitating increased fees and economic adjustments. There has also been pressure from students, educators and the PLC to increase government support for the universities. In many countries, state support for post-secondary education can be a significant source of bias towards higher-income groups due to their greater use of these educational resources (World Bank 1999g: 44-45). However, it is unclear how rising tuition fees might affect post-secondary educational access by lower-income Palestinian students in the absence of any comprehensive system of financial support for needy students.

HEALTH

- 2.80. Like the education sector, the health sector is characterized by the twin challenges of a rapidly growing population and a fragmented system of service delivery. The World Bank has estimated that in 1996-97 the government sector (including health insurance outlays) and private sectors each accounted for around one-third of all health expenditures, while UNRWA, NGOs and donors each accounted for roughly one-tenth (World Bank 1998d: 11). Change was most notable in the NGO sector, which has declined significantly as a source of health care expenditures. Overall public expenditure on health averaged around 4.1% of GDP (3.7% of GNP) in 1995-97, significantly above the average of 2.3% for low and middle income MENA countries. However, in real terms, Ministry of Health expenditures declined by 9% between 1996 and 1999 (Jillison et al. 1999).
- 2.81. Between 1994 and mid-1999, donors committed some \$353 million to the health sector, and disbursed some \$180.8 million in actual assistance. This pattern of support was marked by a particularly rapid drop-off in annual levels of donor disbursements, from an average of \$42 million per year in 1994-96 to only \$15.6 million in 1998.

- 2.82. In the area of *primary health care*, Ministry of Health data suggests that the number of primary health care clinics in the West Bank and Gaza (including government run clinics, non-governmental clinics and UNRWA clinics) increased by 21% from 454 in 1995 to 547 in 1998. The greatest increase was in the number of government clinics which increased by 52% from 205 in 1995 to 336 in 1998. However, the number of non-government clinics fell by 26% from a total of 208 in 1995 to 161 in 1998, with this drop occurring entirely within the West Bank. NGO clinics were

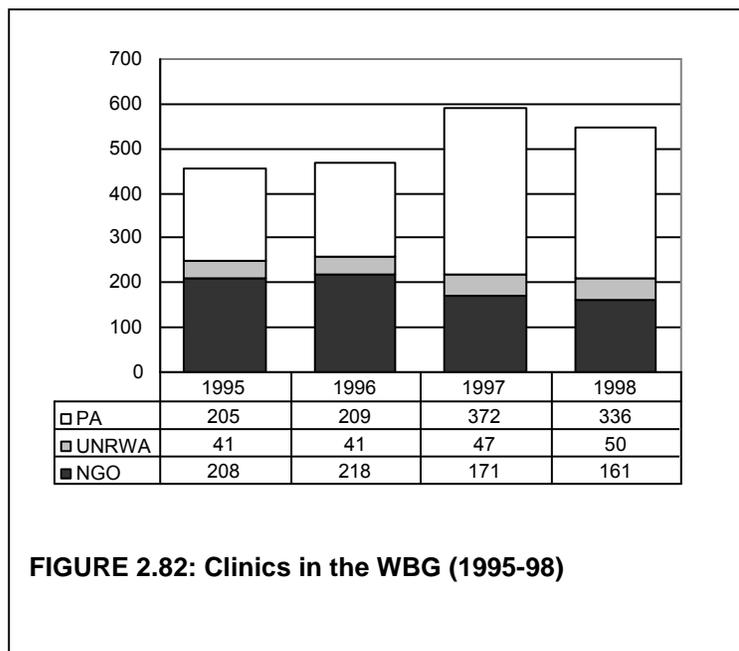
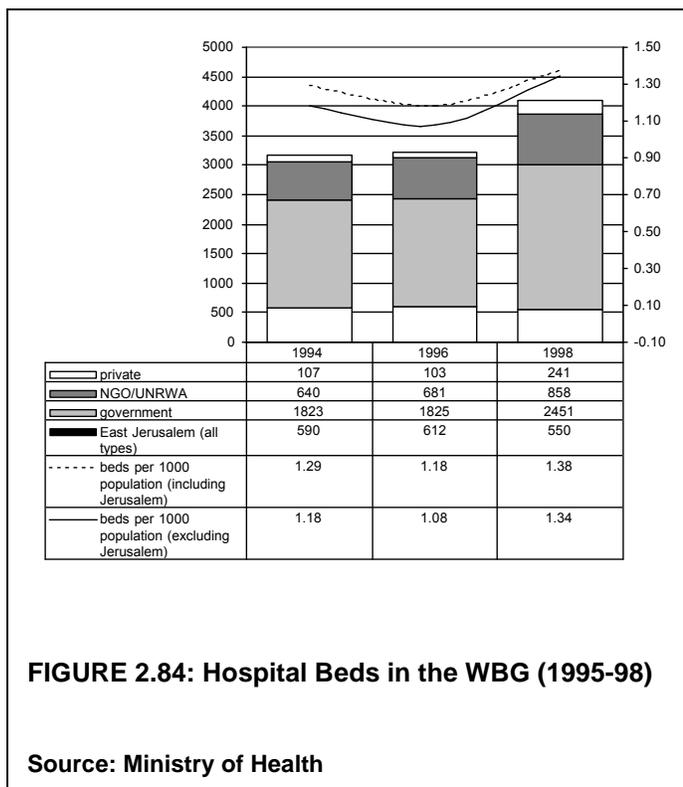


FIGURE 2.82: Clinics in the WBG (1995-98)

- closed largely as a result of the lack of finance (reflecting the shift in donor resources from the NGO sector to the PA) and in line with the transfer of responsibility for the health sector from NGOs to the Ministry of Health. During the same period UNRWA clinics grew slightly (see Figure 2.82). The number of clinics in the Gaza Strip grew at a faster rate than in the West Bank (rising from a total of 70 in 1995 to 109 in 1998 compared to the respective West Bank figures of 384 to 438). Within the West Bank itself, growth was most noticeable in notably in the districts of Jenin, Salfit and Qalqilya.
- 2.83. With regard to *secondary and tertiary health care*, the Ministry of Health's Strategic Health Plan shows that, at the beginning of 1999, there were 38 secondary health care facilities in the West Bank (including Jerusalem facilities and the Said-Kamal Psychiatric Hospital in Bethlehem) and 13 in the Gaza Strip. Over the course of the past three years, four new governmental hospitals have been built – two in the West Bank (the Jericho Hospital and the New Tulkarem Hospital) and two in Gaza (the European Gaza Hospital and the Husni Mubarak Hospital). Together, these new facilities provide an additional 483 beds. However, the European Gaza Hospital, the New Tulkarem Hospital and the Husni Mubarak Hospital are not yet operational. Two more hospitals are currently under construction – a community based hospital in Yatta (Hebron) and a community based hospital in the mid-zone of Gaza. These two add will an extra 100 beds to the total.

- 2.84. During the period 1994-1998, Ministry of Health data shows that the total number of hospital beds in the WBG (excluding East Jerusalem) grew by 38%, from 2,570 in 1994 to 3,550 in 1998 (see Figure 2.84).^{vi}

While the rate of expansion was largest in the private sector, it was growth in government beds (from 1,823 to 2,451 over this same period) that accounted for the largest share of the aggregate increase. This has resulted in a modest improvement in the ratio of hospital beds per 1,000 population from 1.18 (1.29 including East Jerusalem) to 1.34 (1.38 including East Jerusalem). These figures, however, include the substantial number of beds in the Tulkaram, Husni Mubarak, and Gaza European Hospitals, which are not yet fully operational. Donors funds have provided virtually all capital investment in the government hospital sector, and hence are responsible for well over half of all new beds in the WBG.



- 2.85. In the West Bank, the total number of hospital beds grew by 15% from 1645 in 1994 to 1898 in 1998. Facilities operated by the Ministry of Health account for 61% of this total, down from 63% in 1994. The largest proportional increases in the number of hospital beds took place in Jericho, Hebron and Jenin. In Gaza, the total number of hospital beds grew by 79%, from 925 in 1994 to 1652 in 1998 (including non-operational beds at the Husni Mubarak and Gaza European Hospitals). Facilities operated by the Ministry of Health account for 78% of all beds in the WBG, down from 85% in 1994.
- 2.86. In examining available empirical health care indicators, several caveats are in order. First, there may be significant variations in the data, depending on what types of facilities are counted, and whether data for East Jerusalem is included in aggregate totals. This makes time-series analysis difficult. Second, data on the expansion of facilities may obscure underlying problems of accessibility. In some rural areas, for example, clinics may only be open 1-2 days per week. With regard to hospital facilities, there appears to be an oversupply of facilities in some areas, and an undersupply of facilities in others. This is compounded by restrictions on the access of most Palestinians to Jerusalem, which constrains the contribution of East Jerusalem facilities to the overall health care system, and also threatens the financial viability of some of these institutions. Overall accessibility is also constrained by the decline in Palestinian disposable incomes as well

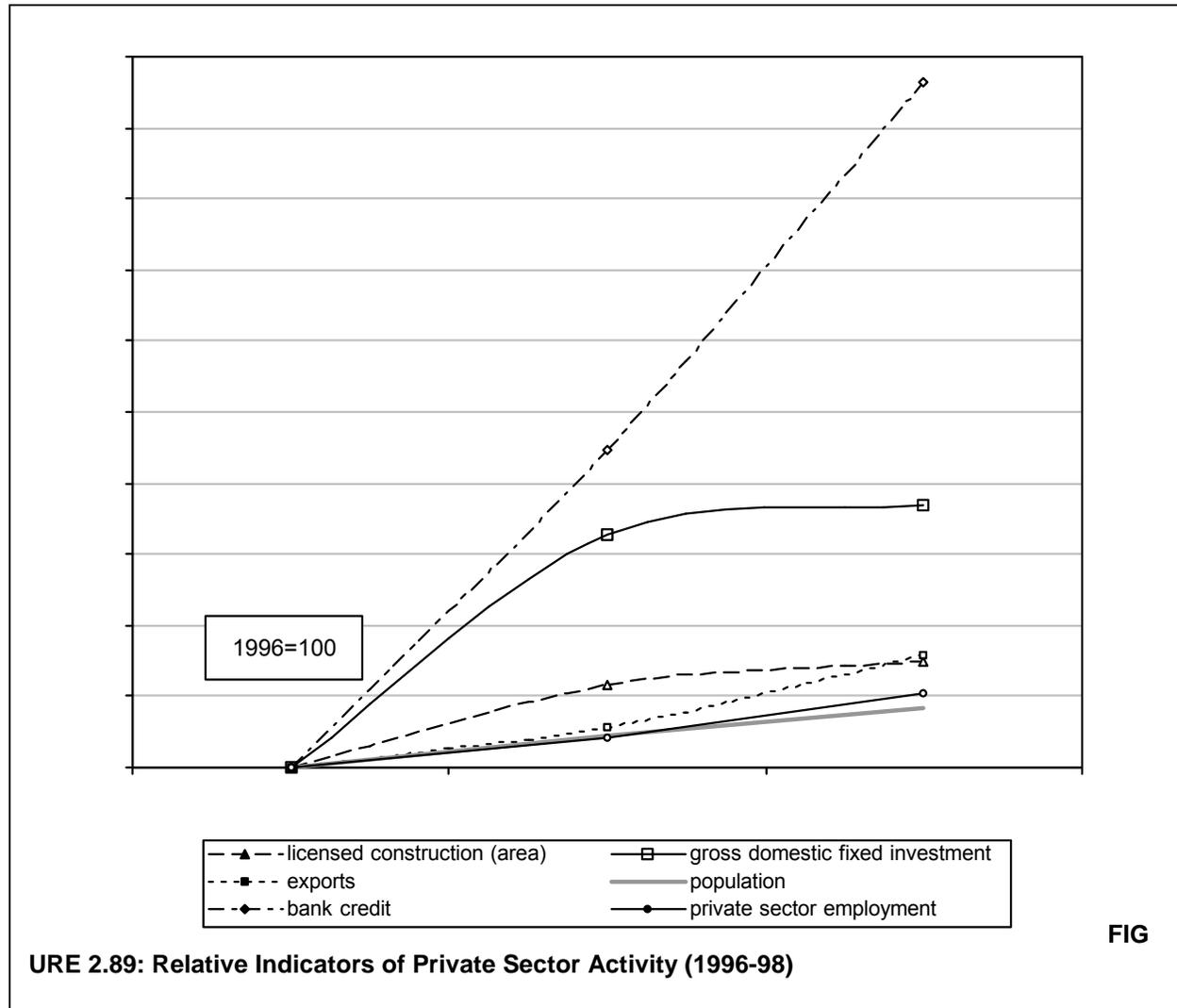
as major gaps in the current system of health insurance coverage. Some indication of these sorts of issues is given by marked variation in hospital bed occupancy rates: although most government hospitals report occupancy rates of 80% or more, the occupancy rate in Jericho stood at 55% in 1998 (suggesting a local oversupply of local facilities), at around 60% in East Jerusalem (suggesting the impact of mobility restrictions), and at less than 50% for most private/NGO hospitals (perhaps because these are not covered by government health insurance benefits) (World Bank 1998d; Jillison et al 1999). Finally, there are a number of important issues regarding the sustainability of current capital investments. The delays in opening the Gaza European Hospital highlight the problem, with the PA Ministry of Health reluctant to assume the high operational costs of the facility .

- 2.87. The empirical data presented here on healthcare infrastructure also says little about the quality of human resources in the health care sector, the appropriateness of health care provided, the allocation of PA and donor resources within the health sector, or the sustainability of current services and capital investments. Of particular note is the difference between UNRWA's model of service delivery (with its heavy emphasis on primary and preventative care), and relatively greater focus by the PA on the provision of acute care hospital facilities.
- 2.88. Some further treatment of these issues is offered in section 3 of the aid effectiveness study, which reports the views of health care consumers on the existing health care system. Section 4 of the aid effectiveness also highlights some key issues of sustainability. A much fuller analysis of the sector, however, can be found in the World Bank study *West Bank and Gaza: Medium-Term Development Strategy for the Health Sector* (1998d).

Encouraging Private Sector Growth

- 2.89. Private sector investment and strong private sector growth are the fundamental requirements of sustainable development in the WBG. In their absence, there will be inadequate employment for the rapidly expanding labor forces (resulting in declining household incomes) and insufficient growth in fiscal revenues to sustain the current level of government services. Since 1994, the Palestinian private sector has faced a number of external shocks and restrictions which have undercut both profitability and competitiveness. Some of these conditions appeared to be eased since 1996, however, creating more favorable economic conditions for investment and business expansion (Figure 2.89).

2.90. Donor support for private sector growth has taken a variety of forms, ranging from



infrastructure programs intended to provide a more attractive environment for private sector activity; risk insurance, loan guarantees, credits, and other forms of donor financing for investment activities; support for local microcredit programs; technical support for reform of the financial services sector; technical assistance in legal and regulatory reform; and the provision of equipment, technical assistance and policy advice to Palestinian ministries and other economic institutions. Growing donor recognition of the critical importance of encouraging private sector growth is evidenced by the level of disbursements in this area, which (unlike the social service sectors) have grown rather than declined over time, from \$30.8 million in 1996 to \$48.7 million in 1998.^{vii}

2.91. It is difficult to measure progress in this area, for several reasons, First, while donor support is substantial, it is small relative to the much larger fluctuations that the Palestinian economy has experienced since 1993. This, and the relatively short time frame, make it impossible to separate the aggregate (positive) effects of donor assistance

from the (negative) effects of other political and economic developments. Second,

The establishment of the Gaza Industrial, on a 50 hectare site at al-Muntar, is the first largely export-oriented industrial zone or "estate", established as a means of generating sustainable employment and stimulating industrial development in Gaza. The legal and regulatory regime for industrial and free zones in the WBG has been designed to attract investors, and the investment law revised in order to enhance the protection afforded to investors as well as to strengthen the incentive package. The GIE Project is expected to play a key role in attracting foreign and local investment, and to facilitate joint ventures and other models of cooperation and confidence building.

The GIE, managed and operated by a private sector company, Palestine Industrial Estate Development and Management Company (PIEDCO) is being developed in three phases. Some 34 firms had leased space at the GIE by the end of 1999, filling all space available under phase I. Of these, 14 firms are already operating, and currently employ some 500 people, with a further 200 or so occasional workers. PIEDCO is planning to launch Phase II construction shortly to double the available industrial sites. At full capacity, the GIE could create up to 20,000 permanent jobs on about 110 industrial plots, with a further 30,000 jobs created indirectly for services and associated manufacturing operations.

GIE has been supported by the World Bank, IFC, EIB and USAID, together with a long-term lease on the land from the PA.

Box 2.92: Gaza Industrial Estate

because donor programs intended to support private sector activity vary so much in focus and format, it is difficult to assess their effects other than through detailed examination of particular projects or specific economic sectors.

- 2.92. It is, however, possible to point to areas where close cooperation between donors and the Palestinian Authority has enabled major activities to be undertaken. One example of this is the Gaza Industrial Estate (Box 2.92). Another case is the Bethlehem 2000 project, in which multiple donors have contributed to the renovation of the Bethlehem and its transport and tourist facilities in anticipation of millennial celebrations in the city. Both projects, however also illustrate the many elements which must be put into place if an appropriate enabling environment for private sector activity is to be fostered. In the case of GIE, implementation was long delayed by the need to for the PA and Israel to agree on security and site access. There was also a need to establish an appropriate regulatory setting, as well as to construct the required local infrastructure (in partnership with the private sector). In the case of Bethlehem 2000, highly politicized issues of access have also loomed large. There has also been a need to coordinate the activities of not only multiple donors, but also the various ministries, local government units, private sector interests and even religious authorities involved.
- 2.93. Donors have supported a number of large, external investment, loan guarantee and risk insurance funds, whether to support local Palestinian investment or encourage outside investment. Many of these programs, however, were initially hampered by institutional procedures and commercial standards that were very poorly suited to the uncertain economic environment of the WBG. According to MOPIC data, despite approximately half a billion dollars in such support being offered, virtually none of these monies were

disbursed in support of private sector investment in 1994, 1995 or 1996. Thereafter,

The Palestinian Development Fund (PDF) is an example of the role that non-profit and NGO initiatives can play in promoting private sector development. PDF was established in August 1996 following the merger of three existing small scale credit agencies—the Arab Development and Credit Company, the Economic Development Group, and the Arab Technical and Development Corporation. PDF's activities support the small-scale private sector in the WBG—a category applicable to more than 90% of all industrial establishments—through advice, services, and the provision of medium term loans which are not generally available from the commercial banking system. To date, PDF has provided 1,824 loans with an average value of \$15,653, through which approximately 5,000 new jobs have been created. The PDF has succeeded in overcoming the historical problem in small-scale lending—low repayment rates as a result of the perception of small-scale credit as a charitable donation rather than a commercial loan. Repayment rates at the three founding institutions were historically low but PDF is now achieving dramatically improved rates of around 97%.

Not only does PDF fill a vacuum in the financial market but it is also setting a precedent in small-scale finance and is aiming to establish the first development bank in Palestine. It has signed a memorandum of understanding with the Cyprus Development Bank to work together in developing the PDF's human resources and undertaking joint lending and investment activities. It has also applied for a banking license from the Palestine Monetary Authority.

The PDF operates as a (non-profit) private sector entity, with a transparent corporate structure and professional management procedures. The funding of PDF's three founding credit agencies was provided by various donors with the majority coming from the European Union in the form of grants. Part of the funding provided by the EU has recently been converted to equity in a foundation to form part of the PDF's initial capital. The Euro-Palestinian Foundation is a Cyprus-registered offshore charitable foundation. The foundation holds 98.8% of the PDF's \$20 million of paid-up capital with the remainder held by the 40 trustees of the three original credit agencies. The PDF recently signed an agreement with the European Investment Bank under which the EIB will take a euro 2 million direct equity participation in the PDF's share capital once it gains fully approved 'bank' status.

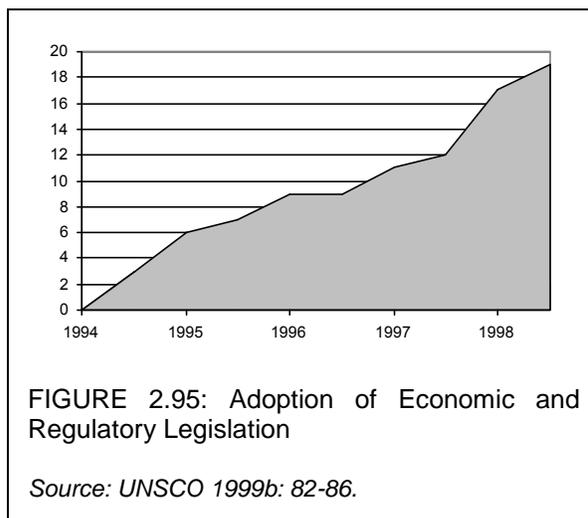
BOX 2.94: Supporting Small and Medium Scale Business

however, improvements in commercial circumstances in the WBG did result in increasing rate of donor activity. Aggregate loan disbursements of these types (including initiatives by the European Investment Bank, the International Finance Corporation, the Multilateral Investment Guarantee Agency, and the Overseas Private Investment Corporation) grew to \$3.7 million in 1997, \$9.4 million in 1998, and \$8.4 million in the first half of 1999.

- 2.94. At the other end of the scale, more than a half dozen the micro-credit and other small business programs operated by UNRWA and various NGOs have “continued to play an important role in the Palestinian credit market” (UNSCO 1999d: 12-13). In the first half of 1999, these disbursed some \$14.8 million in loans. While equivalent to less than 2% of commercial Bank loans in the same period, these programs are often effectively focused on the poor, who otherwise have little access to credit and the entrepreneurial prospects it represents. Somewhat larger loan programs, such as that operated by the Palestinian Development Fund (Box 2.94) aim at meeting some of the need of small and medium enterprises for consultancy services and financing. In all of these areas, the NGO sector

has an important role to play alongside other initiatives in facilitating private sector development.

- 2.95. One particularly important area where it is easier to measure progress is that of legal and regulatory reform. An appropriate legal environment—characterized by modern commercial legislation, a transparent and appropriate regulatory regime, and the rule of law—is essential for encouraging both local and external investment. The challenge in this area has been severe, given the complex legal legacy that existed in the West Bank and Gaza, comprising a mix of Israeli, Egyptian, Jordanian, British and Ottoman regulations. The progress that is being made can be seen in Figure 2.95, which shows the cumulative number of economic laws and equivalent regulatory instruments adopted between mid-1994 and mid-1999. As the recent Council on Foreign Relations study on *Strengthening Palestinian Institutions* noted:



[T]he relevant [economic] ministries have made a significant contribution to drafting new laws and revising existing ones to modernize and stimulate the Palestinian economy. Already in effect are the Laws for the Monetary Authority, Encouragement of Investment, and Condominiums. Others in draft form or awaiting promulgation, with the assistance of international institutions and donors, include laws on income tax, company registration, banking, insurance, investment, offshore companies, securities, secured lending and leasing, arbitration, industrial zones, commercial agency, accounting and auditing, pensions, labor, and intellectual property. Many of these are in advanced stages of preparation, and some are ready for promulgation. (CFR 1999).

- 2.96. The tasks facing the donor community in fostering an improved climate for Palestinian private sector development remain significant. Some donor and PA officials complain of poor coordination or a lack of collective strategic vision as separate donors support separate and potentially contradictory initiatives in, for example, the financial services sector. One key to more effective intervention, therefore, would appear to be the consolidation of a leading Palestinian role in developing a suitable strategic framework for donor activities in support of private sector development. The ability of the PA to do this, however, is still hampered by an unclear allocation of responsibility across ministries (see Box 2.96). It is also essential, as suggested above, to improve the quality of both commercial law and its application, and hence increase the predictability and transparency of the legal environment. Finally, the continued existence of para-public monopolies in some sectors, and of an sometimes foggy relationship between some commercial enterprises and the PA, serves to distort local markets and deter private investment. The need for continuing reform in all of these areas underscores that policy dialogue—the provision of ideas, and not only money—is a centrally important element of effective development assistance in the WBG, as elsewhere. These are issues explored in more detail in Section 5.0 of this study.

In its discussion of commercial regulation, development planning and economic policy-making, the report on *Strengthening Palestinian Institutions* placed considerable emphasis on increasing the coherence of Palestinian institutions in this area. Specifically, it reported:

Industrial and foreign investment, export promotion, and employment policies are fragmented among various ministries, to mention a few examples. The problem is compounded by the absence of effective, formal mechanisms for consultation, coordination, and collaboration. Similarly, sectoral working groups or strategies are also either absent or inadequate, and clustering of ministries and agencies is urgently needed.

Duplication, fragmentation, and inadequate coordination also lead to unproductive competition, conflict, and waste of resources. This is additionally worrisome in light of the shortage of qualified personnel in certain categories, leading to a mismatch of staff and jobs in some cases and to overstaffing and understaffing in others.

To exemplify the extent of duplication, at present the Ministry of Economy and Trade and the Ministry of Supply both regulate internal markets, while the Ministry of Economy and Trade and the Ministry of Justice both register companies. There is also considerable overlap between the Ministry of Economy and Trade and the Ministry of Planning and International Cooperation with respect to planning.

BOX 2.96: Public Institutions and Private Sector Development

Source: CFR 1999.

INSTITUTIONAL DEVELOPMENT

2.97. While Palestinian institution-building has benefited from several advantages—an educated and literate labor forces, a rich and vibrant network of associational groups within civil society, and substantial donor engagement and support—it has also been faced with the monumental task of transforming a nationalist movement into a functioning political administration. It has had to do so, moreover, amidst a highly variable and complex economic and political environment, in which both its territorial authority and the nature of policy instruments available to it have been defined (and redefined) by a series of transitional agreements with Israel. Territorial fragmentation and mobility restrictions have been further challenges to smooth institutional development. Any attempt to measure progress in this area must do so in a way that accurately reflects the constraints as well as the opportunities. As the *Strengthening Palestinian Institutions* report (CFR 1999) noted:

The Palestinian Authority should be measured against performance in the real world, not an ideal one. It has achieved levels of service delivery, revenue mobilization, financial accountability, and utilization of international assistance that are at least commensurate with, and in some aspects exceed, those in countries of comparable development and income. Recent data show an upward trend in key and economic indicators. Because these important achievements tend to be overlooked in reports such as ours that focus on remedial action, they deserve special emphasis.

2.98. At the same time, there remains—as the *Strengthening Palestinian Institutions* report also noted—“much remains to be done.” A number of reforms must be undertaken to improve the accountability, transparency and efficacy of key Palestinian public institutions (CFR

1999). Moreover, as the World Bank's report on *Strengthening Public Sector Management* (World Bank 1999g) made clear, additional challenges are posed by the rapid growth of Palestinian public sector employment, the need to develop more effective systems of budget management and service delivery, and the need for reform of the system of local government and utilities. Failure to address these issues will have serious long-term consequences for both economic development and public confidence government. Already, as will be shown in section 3.0 of this study, opinion surveys already suggest that ordinary Palestinians are expecting higher degrees of accountability, transparency, and performance from key public institutions.

- 2.99. Donors have played a key role in supporting Palestinian institution-building. Donor assistance for transitional costs and budget support was of fundamental importance in 1994-96. Indeed, it is difficult to see how, without such support, a functioning administration could have been established in this early, critical period. The mechanism used to transmit such assistance, the Johan Jørgen Holst Peace Fund, disbursed some \$254.4 million between 1994 and mid-1999, and is now widely seen a model to be emulated in other peacebuilding contexts. According to MOPIC data, donors have also committed some \$610.6 million in support for institution-building (including legal affairs) between 1994 and mid-1999, and disbursed some \$257.0 million of this. Focusing solely on projects that supported legal reform and the rule of law, a May 1999 UNSCO survey found more than \$100 million in donor support had been committed to some 322 past, current or planned activities, involving no less than twenty-four donors and thirteen UN agencies, together with a broad range of Palestinian and international NGOs (UNSCO 1999b: 11).
- 2.100. Clearly, reform requires political will, technical expertise, and donor support. In assessing the effectiveness of the latter, however, it is important not to view the aggregate level of disbursements or projects as an indicator of success in and of itself. Donor support may serve to aggravate, as well as ameliorate, problems of institutional weakness. Inappropriate forms of support may divert resources from other important areas. Poorly conceived projects may create short-term donor-supported institutions, capacities and staff positions that are unsustainable in the long term. Poor coordination among a multiplicity of donors may encourage institutional fragmentation. Finally, institutional development strategies may be shaped by the lure of donor resources rather than by the objective institutional needs of recipient organizations. To date, most reports have focused almost entirely on what the Palestinian Authority need do to promote further, and more effective, institutional development. While this is certainly an appropriate concern, it is important to identify what donors can (or should not) do to facilitate this. Consequently, in section 5 of this study, issues of policy dialogue, partnership and the role of technical assistance are explored in greater detail.

The Women's Affairs Technical Committee (WATC) represents an excellent example of an NGO that, through its activities, enhances the range of information and analysis available to public institutions in the WBG. WATC was established in 1992 as a semi-official coalition of affiliated women's organizations, institutions, and independent professional women, with the aim of providing input on women's issues into Palestinian policy planning. At the outset it operated on a voluntary basis, but now employs a director and administrative staff. In 1998, WATC's total expenditure amounted to \$846,589 and was drawn from 23 different funding sources.

Since 1992, the organization has gained greater independence. It has also achieved some success in lobbying for more rights for Palestinian women, training women in various skills, networking with other (local, regional and international) women's institutions, and undertaking public education on gender issues. The WATC monitors the drafting of new laws and regulations to ensure that women's concerns are taken into consideration and is currently working on the draft of the Family Law. The WATC also promotes women's political participation as both voters and candidates. Most notably, the WATC has been successful in pushing for gender-aware changes in emerging national regulations. In 1997, the WATC lobbied the Palestinian Legislative Council to modify newly-issued legislation that required that all Palestinian women applying for a passport should obtain the permission of a male relative. At the grassroots level, its female education sponsorship scheme assists low income families in the education of female household members.

WATC's strength lies in its resource base. The nature of the coalition—which combines a group of already well-established political and community bodies with broad-reaching mandates, representation and popular credibility—allows the organization to build on existing networks and resources. Since most board members represent an organization, the meetings serve to exchange information and engage in strategic planning.

WATC has established itself as a real force to be reckoned with in the field of protecting and promoting women's rights, notably amongst the national legislative institutions where men predominate. WATC unites experienced professional Palestinian women with established track records in policy advocacy, and targets the collective goals of its member organizations. WATC has also strengthened its institutional presence—increasingly important in what is a highly politicized environment—by creating a network with other international NGOs with similar mandates.

BOX 2.101: The Women's Affairs Technical Committee

2.101. Last but by no means least, any attention to institutional development must also devote suitable attention to the NGO sector. Comparative research suggests that the vibrancy of civil society and civil liberties has a strong relationship to the success of development projects, especially when beneficiaries are actively engaged in project design and implementation (World Bank 1998a: 87). Historically, NGOs been an important component of the development effort in the WBG. They continue to be extremely important, despite a general reduction in levels of donor support since the early 1990s. As noted earlier, NGOs provide a significant share of education, health, and other social services. They are also active in a range of other key areas, from facilitating private sector development (through technical advice and small-scale credit) through to human rights advocacy. In many cases—such as that of the Women's Affairs Technical Committee—they play an important and energetic role in facilitating new ideas, analysis, networking, and social advocacy (Box 2.101). Given this, it is important that it attract suitable levels of donor assistance, and be provided with a political and regulatory environment in the WBG that encourages its activities. As discussed in Section 3.0,

however, there are some worrying signs in this area, especially with regard to the public “space” within which NGOs can freely operate.

CONCLUSIONS

- 2.102. *Despite many challenges*—a highly dynamic political environment, complex legal and territorial arrangements, an underdeveloped local infrastructure, severe external economic shocks, the need to establish many Palestinian public institutions from scratch, and the difficulties of coordinating the efforts of scores of donors and international organizations—*the development effort in the West Bank and Gaza has had many substantial positive effects*. Donor assistance played a key role both in the establishment of the PA and in offsetting economic decline in the WBG in the first few years of the peace process. Today, it makes a significant contribution to the modest economic growth that the territories have experienced. Moreover, the various improvements associated with donor assistance—whether improvements in electrical supply, the quality of piped water, rehabilitation of portions of the road network, the extension of liquid and solid waste facilities, or other activities—have touched the daily lives of most Palestinians, despite the general difficulties of the WBG economy.
- 2.103. Despite the successes, however, there remain many tasks that must be undertaken. As donors and the PA look to the economic future, several areas emerge as development priorities.
- 2.104. There is still room for some improvement in donor aid coordination and Palestinian development planning. This is not to say, of course, that there hasn’t been substantial progress: there has, and several of mechanisms used to guide the development process in the WBG may well prove to be models for other peacebuilding efforts. Still, donor coordination would be improved to the extent that it assumed a more strategic character, and to the extent that robust and sophisticated Palestinian development planning provided a comprehensive vision around which donors could organize their efforts. Local ownership of the development process is a key to good development programming, in the WBG as elsewhere.
- 2.105. On the Palestinian side, the importance of accountable, transparent and effective public institutions emerges as a fundamental necessity. Here there have been many successes, often supported with donor assistance. There have also been some grounds for concern, however, and certainly room for continued improvement. Of particular importance is the need to establish a firm fiscal foundation for public services and public investment. Here the situation remains fragile, with the PA’s balanced recurrent budget (and its future contributions to expanded public investment) threatened by continued expansion of public sector employment, as well as continuing failure to centralize all government revenue and expenditure accounts under Ministry of Finance control.
- 2.106. On the donor side, the apparent slow-down in donor assistance in 1998-99 represents grounds for serious concern. Any growth in the gap between donor pledges, commitments, and disbursements undermines the credibility of the donor community even as it presses the PA to undertake reform of its own policy processes. It also severely

complicates the process of Palestinian economic planning, as well as hampering development efforts on the ground.

- 2.107. The importance of a vibrant NGO sector to Palestinian development is also underscored by this report. Here, both the PA and donors have important roles to play in assuring a supportive political-regulatory environment and an adequate level of funding for NGO initiatives.
- 2.108. Finally, section 2 of this study underscores the need to examine “aid effectiveness” not only from the perspective of macroeconomic effects, donor disbursements, or the facilities and other physical assets established. Since the laying of another kilometer of road, water pipe, or electrical transmission line is not an achievement in and of itself—but only insofar as it positively affects the lives and economic prospects of Palestinians—it is also important to determine how beneficiaries themselves view the impact of donor assistance. The benefits of donor assistance, moreover, will prove to be transitory if adequate attention isn’t paid to the sustainability of development initiatives. Finally, as stressed in the preceding sectoral examination, progress requires not only physical infrastructure but also the appropriate policy environment. Accordingly, each of these topics—beneficiary assessments, sustainability, and policy dialogue—will be examined in greater detail in the remaining sections of the report.

SECTION 2: NOTES

ⁱ The National Commission for Poverty Alleviation (1998) defined the poverty line in 1997 at a monthly income of NIS418 for an individual, or NIS1390 for a family of 6.

ⁱⁱ Figure 2.2. utilizes PCBS estimates of mid-year 1997 WBG population, and MOPIC data on 1997 donor disbursements. DAC data shows a lower (1996) population and a higher (1997) level of disbursements, resulting in a figure of \$289.35 for per capita WBG ODA receipts. Data does not include military assistance

ⁱⁱⁱ The category “productive sectors” includes MOPIC’s agriculture, industrial development, private sector, productive sector, and tourism sectors; “human resources” includes health, education, detainees, social development and humanitarian aid; “institutional development” includes institutional development, democracy, legal affairs and police; and “infrastructure” includes energy, environment, housing, infrastructure, solid waste, telecommunications, transport and water and sanitation.

^{iv} Data derived from DAC 1999, and adjusted using the deflators for DAC members (only). MOPIC disbursement figures differ from those provided by DAC. Using MOPIC data, aid to the WBG increased from 0.84% (1994) to 0.97% (1997) of global ODA.

^v This estimate assumes that the demand for Palestinian workers would, in the absence of restrictions, grow according to the overall demand for labor in Israel in the sectors which predominately employ Palestinians from the WBG.

^{vi} UNRWA beds are counted with NGO beds in the data supplied by the Ministry of Health.

^{vii} This total includes MOPIC’s agriculture, industrial development, private sector, productive sector, and tourism sectors.