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# WEST BANK AND GAZA UPDATE

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MOVING BEYOND THE  
“**MOVEMENT AND ACCESS**”  
APPROACH

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# Economic restrictions moving beyond the “movement and access” approach



On September 22, the Ad Hoc Liaison Committee (AHLC) convened in New York for the third time since the establishment of the PA Caretaker Government in June 2007. As in the previous two meetings, the World Bank presented an Economic Monitoring Report assessing progress on the three parallel conditions required for Palestinian economic revival: (1) Palestinian Authority (PA) reforms; (2) donor aid; and (3) Israeli resolution of movement and access restrictions. The analysis provided in this latest report, however, expanded its scope, examining, for the first time, *economic restrictions* as a comprehensive set of barriers -- not only physical, but also institutional and administrative -- that combine to prevent Palestinian realization of the full economic potential of the West Bank and Gaza, in both domestic and international spheres.

The current approach prevalent in the international community reflects a consensus on the paralytic effects of movement and access restrictions. However, this view currently extends only to the network of physical barriers riddling the West Bank, and partitioning the West Bank from Gaza, Israel and the rest of the world. In reality, these restrictions go beyond concrete and earth-mounds, and extend to a system of physical, institutional and administrative restrictions that form an impermeable barrier against the realization of Palestinian economic potential. Thus, tackling checkpoints alone, while potentially having a massive impact on economic revival, must be complemented with a broader address of the institutional and administrative barriers retarding Palestinian economic growth.

The *economic restrictions* identified through this comprehensive analytical approach fall into three broad categories.

1. **Access to economies of scale.** Palestinian businesses are unable to achieve sufficient ‘economies of scale’ to warrant additional investment, business growth and/or additional entrants into the market. This is why over 95% of businesses are 10 employees or less. Capital intensive industries are also few and far between, and occupy the bulk of the market space. This is due to Israeli restrictions that have fragmented the West Bank’s Palestinian population into economically isolated pockets, increasing the costs of trading with each other. The West Bank and Gaza are now almost completely delinked, with Gaza in stark transformation from a potential trade route to a walled hub of humanitarian donations. These restrictions, furthermore, prevent full trade with Israel, and with the rest of the world. More importantly, the restrictions against movement in and through East Jerusalem preclude a main economic hub for Palestinian businesses.
2. **Access to natural resources.** This covers a number of resources essential to the exploitation of Palestinian economic potential. Key among them is access to land, water, cultural heritage and telecommunications frequency.
3. **Access to an investment horizon.** Beyond the physical impediments affecting access to inputs, supply chains, and markets, investors in a Palestinian economy face an unclear horizon with which to measure and mitigate their risks. This is linked, first and foremost, to the uncertain political horizon, and the resulting unpredictability in the investment horizon. In addition, the system of permits and visas makes it difficult for foreign investors and creates uncertainty for local investors.

Adoption of the economic restrictions approach is an important step in the ongoing effort to restore the virtuous cycle of economic growth required for the establishment of a viable and prosperous Palestinian state and it will remain a central component of the Bank’s analytical work and advocacy.

Country Director  
A. David Craig



# West Bank and Gaza

## The Economic Effects of Restricted Access to Land in the West Bank

In developing countries, land is of fundamental importance to economic activity and development: it is often the most common means of storing wealth and a powerful economic asset; it provides a foundation for economic activity in sectors as varied as agriculture, industries, housing and tourism; it is also a key factor in the functioning of market (e.g. credit), and non-market institutions (e.g. local governments). In the West Bank, land takes on a particular significance, as economic activity has been stifled by the ongoing conflict; and as much of the land area is inaccessible due to Israeli restrictions on movement of people and access to natural resources. This policy note aims at analyzing the channels through which land access restrictions and market distortions constrain productive and public sector investment, and trace their effects on the development of key economic sectors.

The 1995 Oslo interim agreement split the West Bank into three Areas A, B, and C, with different security and administrative arrangements and authorities.<sup>1</sup> The land area controlled by the Palestinians (Area A corresponding to all major population centers and Area B encompassing most rural centers) is fragmented into a multitude of enclaves, with a regime of movement restrictions between them. These enclaves are surrounded by Area C, which covers the entire remaining area and is the only contiguous area of the West Bank. Area C is under full control of the Israeli military for both security and civilian affairs related to territory, including land administration and planning. It is sparsely populated and underutilized (except by Israeli settlements and reserves), and holds the majority of the land (approximately 59%). East Jerusalem was not classified as Area A, B or C in the Oslo interim agreement and its status was to be resolved in final status negotiations.

This allocation, which establishes the Palestinian administration over most of the populated areas and gives it limited control over natural resources and agricultural lands, was meant to be only transitory, with the Palestinian Authority expected to assume control over an increasingly larger share of Area C. However little territory has been transferred to PA control since the signing of the Oslo interim agreement, and this process has been completely frozen since 2000. As the Palestinian population grows and its resource and development needs increase, this long-lasting situation has become an increasingly severe constraint to economic activity.

The effects on the Palestinian economy of the current territorial distribution extend much beyond its most obvious manifestations. The physical access restrictions are the most visible, with 38% of the land area reserved by the Government of Israel to serve settlements and security objectives and a system of checkpoints, road closures, the Separation Barrier, and permit requirements that constrain movement of people and goods. Recurrent destruction of trees, private homes and public infrastructure, as well as settlers' encroachments on private land create a permanent state of insecurity that deters investment in Area C. At the same time, the land use and planning regulations in effect in Area C have less obvious consequences but are no less detrimental to Palestinian economic development. These regulations tend to limit development within the confines of existing villages, with too little suitable space for demographic growth, causing irrational land use and unsound environmental management. The construction permit system slows down or halts altogether most construction. And the land administration system does not adequately protect the property rights of the Palestinian people, a source of uncertainty incompatible with investments and growth.

Predictably, economic activity in Area C is limited primarily to low intensity agriculture. High intensity agricultural, industrial, housing, tourism, and other investments are hindered by the difficulty in obtaining construction permits and the limited amount of titled land available due to the cessation of systematic land registration since 1967. Land development is constrained by the application of archaic regional plans dating back to the British Mandate. Where village master plans are available, they are prepared by the Israeli Civil Administration without community participation and limit development primarily to filling in existing developed areas. Building permits are rare and difficult to obtain, with only a handful approved annually for the past several years. In the meantime, unlicensed construction continues due to the needs of an expanding population despite a demolition rate that far outpaces building approvals by the Israeli authorities.

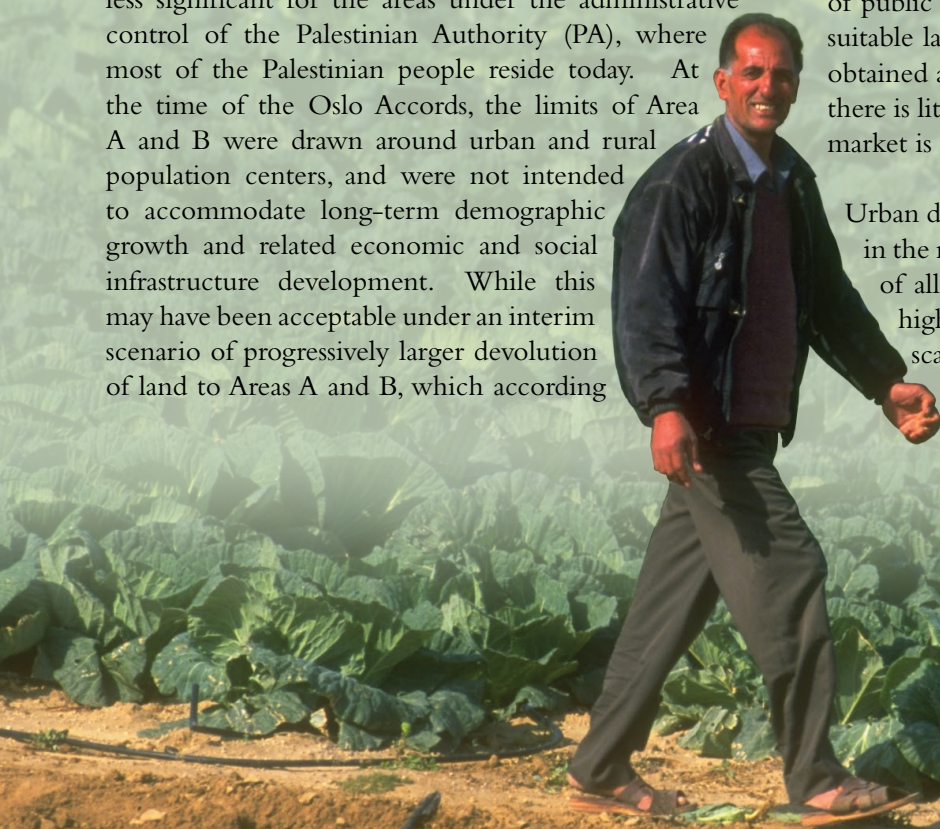
Today, only a fraction of the Palestinian population resides in Area C, where the incentive framework and the lack of legal recourse are not conducive for people to stay. Area C dwellers are mainly farmers and herders, who tend to fare worse than the general population in terms of social indicators, being underserved in public services and infrastructure, and being denied permits to upgrade their homes or invest in agriculture and other businesses. The comparison is even less favorable with other Area C residents, namely Israeli settlers, whose access to land is much greater, and who face more flexible planning and building regulations and have more legal remedies.

The consequences of the territorial distribution are no less significant for the areas under the administrative control of the Palestinian Authority (PA), where most of the Palestinian people reside today. At the time of the Oslo Accords, the limits of Area A and B were drawn around urban and rural population centers, and were not intended to accommodate long-term demographic growth and related economic and social infrastructure development. While this may have been acceptable under an interim scenario of progressively larger devolution of land to Areas A and B, which according

to the Oslo interim agreement should have been concluded within eighteen months, after thirteen years with minimal Israeli redeployments from Area C the situation has now become untenable<sup>2</sup>. Land transfer from C to A/B has not kept pace with population growth, and roads reserved for settlers constitute additional barriers for Palestinians. Reserved roads, to which Palestinian access is restricted, coupled with the development of settlements often in close proximity, or directly adjacent to Palestinian towns, have fragmented the Palestinian space even further. This has reduced the accessibility and hence the value of some vacant land in Area B and A now separated from the centers of economic life.

This territorial division distorts land markets by creating artificial land shortages. Vacant land is scarce in Area A and only the most accessible parts of Area B are suitable for development, while Area C is not desirable for development purposes due to the difficulties in obtaining construction permits from the Israeli authorities. At the same time, demand is rising rapidly from a growing population who receives public sector salaries and/or remittances, as well as from investors lacking other profitable opportunities. As a result, land prices are shooting up and in certain towns are becoming prohibitive for all but high value commercial activities, or high rise apartment building. Residential development is crowding out other economic activities on scarce plots available for development, yet there remains a housing shortage. Industrial development is handicapped by a combination of trade impediments and unavailability of industrial plots at viable prices. Public investment in infrastructure likewise has nearly ceased, in part due to lack of public funds; but even when donor funds are available, suitable land is mostly in Area C where permits are rarely obtained and even then after long delays. In Areas A and B, there is little municipal land and often resorting to the land market is not an option due to the high prices.

Urban development cannot be planned and implemented in the most rational manner, thereby aggravating, instead of alleviating, the environmental problems caused by high population densities. Overcrowding and land scarcity skew the pattern of urban development towards housing and away from economic



activities and basic public infrastructure. For the latter, difficulties are compounded by the need to obtain permits from GOI to locate certain types of polluting infrastructure, such as sewage treatment or landfills away from the population. The inability to obtain such permits leaves Palestinians at risk from health and safety hazards due to obsolete or inadequate installations. The same constraint leads some industries to establish polluting or dangerous plants in towns with similar risks for their population. Finally in Palestinian towns, there is not enough land to provide open spaces for the people to enjoy some greenery.

In the meantime, land administration and registration within the PA controlled areas has been slow and lacking in institutional capacity and resources. The Palestinian Land Authority (PLA), the mandated institution responsible for all aspects of land administration has only been formed in the last few years and has yet to build sufficient capacity to effectively manage public land resources and provide efficient land registration and administration services to the public. An inventory of public lands in Areas A and B, which are under PLA authority, is not yet available. Systematic registration has only just begun and is expected to take decades to complete unless significantly more resources are provided. Meanwhile, the legislative framework has yet to be reformed to deal with improved registration, reorganization of the PLA, and more transparent public land allocation and management.

In the aftermath of the Oslo Accords, the Palestinian economy was expected to enter a period of sustained and rapid growth. Instead, after a few years of growth, starting in 2000, the economy has been in steady decline, with overall GDP and per capita GDP respectively down 14% and 40% from their peak in 1999<sup>3</sup>, and poverty on the increase. Meanwhile foreign aid has succeeded in doing little more than slowing down the deterioration of the economy, despite ever larger volumes.

The reversal of the downward economic trend will require stimulating private and public sector investment. This in turn will entail increasing the economic space available for Palestinian urban and rural development in the West Bank, including addressing the increasingly entrenched and expanding impact of Israeli settlement activity on the Palestinian economy, and enabling the use of land through a participatory planning system and land

administration policy that foster rather than constrain growth and development and promote the rational use of land resources in the entire West Bank.

In parallel, the PA will need to strengthen its own capacity for planning and land administration. It is not too soon for the PA to improve its governance in all aspects of land management, most importantly land use and development planning and public land allocation and management, while also developing PLA capacity to implement systematic land registration. Recently, the Palestinian Cabinet made an important step with the approval of a new Land Policy Framework, including key measures to reform the land sector. Pending approval of the Action Plan to implement the policy package, donors including the Bank stand ready to support the policy reform and a national land registration program.

In time, increasing the stock of Palestinian land with secure titles will boost private sector activity, and better land records will facilitate land use planning and the acquisition of municipal land for public services. Under present circumstances nonetheless, where constraints on urban development are very serious and induced distortions on land markets are enormous, the economic impact of improved land administration by the PA will have its limit. As long as access and movement restrictions are in place, and the majority of the West Bank remains to a large degree inaccessible for Palestinian economic investments, the investment climate will remain unfavorable and business opportunities much below potential. Yet the conditions for security of property rights and an efficient land market will be in place, and latent investments and growth will be ready to take off once a final resolution is reached, the movement restrictions are lifted, and the land situation becomes more favorable.

1 The Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip, Washington, D.C. (September 28, 1995), Article XI

2 Article XI of the Israeli-Palestinian Interim Agreement on the West Bank and Gaza Strip, Washington, D.C. (September 28, 1995) states: "During the further redeployment phases to be completed within 18 months from the date of the inauguration of the Council, powers and responsibilities relating to territory will be transferred gradually to Palestinian jurisdiction that will cover West Bank and Gaza Strip territory, except for the issues that will be negotiated in the permanent status negotiations." Territorial issues that will be negotiated in the permanent status negotiations are mainly the settlements and Jerusalem.

3 World Bank, West Bank and Gaza Update, March 2008, page 16.

# Palestinian Trade: West Bank Routes

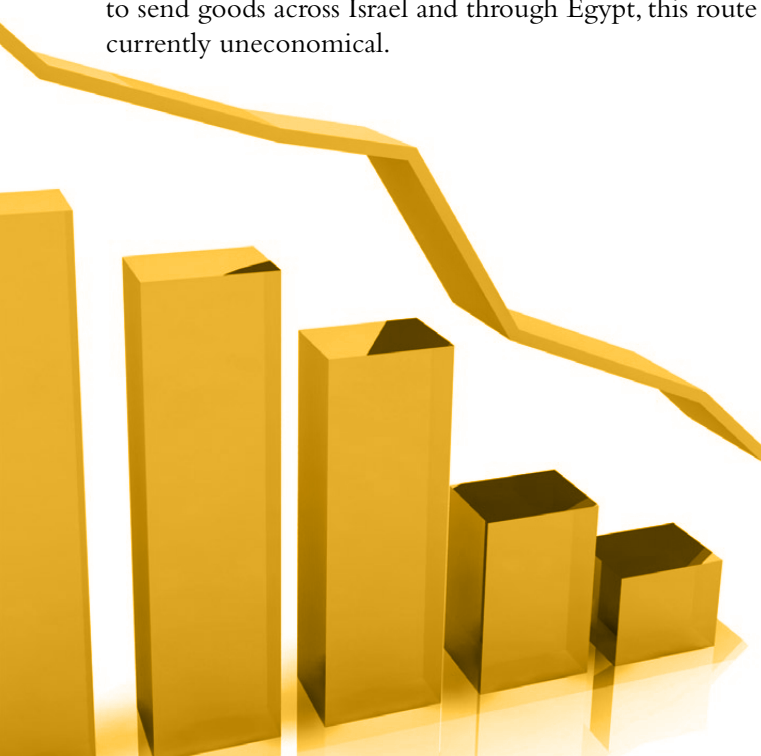
West Bank and Gaza (WBG) is a small, resource poor economy. Consequently, its growth depends on maintaining open trade with its neighbors. Trade flows are nearly 85% of GDP with the vast majority – probably around 90% – with Israel.<sup>1</sup> However because of the deteriorating security situation the Government of Israel (GOI), has increasingly imposed restrictions and closures that impede trade. In addition, changes in the Israeli economy have reduced the market for traditional Palestinian products.<sup>2</sup> Though the Israeli economy will remain WBG's main trading partner for some time to come, future growth will depend upon Palestinian enterprises being able to reach beyond Israel and access new markets in the rest of the world.

In a previous paper, the World Bank analyzed the logistics of trade corridors from Gaza through Egypt as an alternative to sending exports via Israel. This paper extends this work and examines the viability of different trade routes from the West Bank. West Bank enterprises have essentially two options to access the world market: 1) out through Israeli ports or airport, 2) across the Jordan River and out through Jordan ports or airport. While, it is also possible to send goods across Israel and through Egypt, this route is currently uneconomical.

To access the wider world market, Palestinian enterprises must first face the challenge of moving within the West Bank itself. The numerous Israeli road blocks, closed areas, restricted roads and growing settlements have cut the Palestinian communities into isolated cantons, which raises transportation costs and significantly limits the ability of Palestinian enterprises to achieve economies of scale.<sup>3</sup> To develop a better understanding of how the current level of internal restrictions affect transportation costs, the World Bank commissioned the Palestine Trade Center (PalTrade) to conduct two rounds of surveys of companies engaged in transport between June and September 2007. The surveys targeted transport companies or enterprises actively engaged in the transport of their own goods.

The survey results indicate that the increasing restrictions on movement of goods and services in the West Bank have a negative effect on at least three dimensions. First, they increase transport costs directly through higher costs of labor and equipment, and indirectly by increasing transaction costs associated with delays at checkpoints. Second, they induce low levels of utilization of the current truck fleet, by reducing trade volumes for an existing level of capacity, which results in high fixed costs per kilometer. Third, they introduce high levels of uncertainty that prevent Palestinian firms from entering the international market, which demands guaranteed delivery times.

In addition to the internal movement restrictions, GOI has recently constructed commercial crossing points in their Separation Barrier that have the potential to become another serious constraint to Palestinian businesses. Once the Separation Barrier is complete all commercial traffic will have to move through the Commercial Crossings using a back- to- back system similar to the one used for Gaza. The GOI has stated that the Barrier and Crossings will allow a relaxation of the internal movement restrictions. However, the terminals are almost fully operational and internal restrictions have actually increased. Consequently, the Commercial Crossings have become an additional layer, over and above the existing restrictions.



Mindful of the delays and corruption previously experienced at the Karni crossing for Gaza, the GOI has stated that they will not allow the crossings to become a “bottleneck” to trade. To this end, they have established a civilian run Crossing Point Authority (CPA) and have committed to expanding the facilities as necessary to ensure that there are no queues at the terminals and that all vehicles will move through the Crossing points in 30 to 60 minutes.

In January 2008 the World Bank commissioned PalTrade to begin monitoring four of the biggest crossings. The monitors have not observed any long queues or any of the severe corruption previously experienced at the Karni. However, because the other routes out of the West Bank have not yet been completely closed, the Commercial Crossings are currently handling only a fraction of total traffic between the West Bank and Israel. For example a recent study by the Economic Cooperation Foundation found that Tarqumiya, the southern Crossing, was handling only 15% of total traffic in the southern portion of the West Bank including Hebron. Despite this, the average time to process a shipment out of the Palestinian areas is much higher than the CPA’s target. Counting the time spent waiting to enter the terminal, in June 2008, the average for all crossings was about one hour and 58 minutes. In addition, the restricted working hours make it impossible for Palestinian enterprises to make just in time shipments.

The establishment of the Commercial Crossings and the requirement for back-to-back transfers creates a yet another hardship for Palestinian businesses, no matter how efficiently they are run. In addition to creating delays and uncertainties, the Crossings also result in substantial damages to goods when they are cross loaded or manually inspected. Many goods, such as furniture, can not be palletized, which leads to handling damage. The Crossings lack the equipment to handle very heavy goods or fragile goods like glass. There are no facilities for cold storage for perishables and the CPA has no plans to establish them, even though Palestinian shippers report that currently perishable goods can be left in the heat for one to two hours. In addition, most of the inspection stations are not sheltered from the weather.

As trade with and through Israel becomes more difficult, Palestinian enterprises must look outwards to the rest of the world for new opportunities. Currently, most trade goes through Israeli ports and Ben Gurion Airport. However, as Jordan improves the facilities at Queen Alia Airport and the Port of Aqaba, the Jordan route will become more attractive.

Israeli ports offer less expensive and faster shipping to destinations in Europe and North America. And even with the additional burden of the Commercial Crossings, the Israeli security requirements do not increase costs enough to remove this advantage. However, for shipments to Asia the Port of Aqaba offers less expensive and slightly faster service. This route will become even more economical as the Port of Aqaba continues to improve and attracts more ships.

Queen Alia airport near Amman now offers service almost on par with Ben Gurion. Though air freight costs are higher at Queen Alia, the cost of ground transportation to Ben Gurion and its high security fees make Queen Alia more competitive for sending large air shipments to many destinations. There are fewer flights from Queen Alia than from Ben Gurion Airport. However Israeli security requirements restrict most Palestinian shipments to cargo aircraft and prohibit them from flying on passenger aircraft. Consequently, the disadvantage of fewer flights from Queen Alia is not that serious and Palestinian shippers are increasingly interested in using the airport in Jordan but are deterred by the difficulties of crossing the Allenby Bridge.

For shipments to the Arab Gulf, the most cost effective way is by land across Jordan. However, all routes through Jordan, whether it is through Queen Alia, the Port of Aqaba or overland are constrained by operations at the Allenby Bridge. Exports through Allenby require back-to-back transfer of pallets; containers may not be used. The loading and unloading not only raises costs but as at the Commercial Crossings can lead to significant damage to goods. There are no cold storage

facilities at Allenby and the loading and unloading areas are not protected from the weather. Given that the crossing takes four to eight hours this significantly limits the shipment of perishable goods. The Bridge crossing is not open during Israeli holidays, the Israeli weekend or in the evening. These restricted hours make it difficult for shippers to meet the just in time shipping schedules demanded to be internationally competitive in many sectors.

Israel generally does not scan exported goods, however on the Jordanian side they are subject to a risk management system that is cumbersome and leads to a high rate of physical inspection. All imports across the Allenby Bridge must be transferred through the back-to-back system and scanned by Israeli security. Containers are also not allowed for imports and pallets must be small enough to fit into the scanners. Cargo that can not be scanned in the small scanners at the Bridge must be trucked to Ashdod port at the shipper's expense for scanning. The back-to-back system significantly raises costs of imports and discourages the use of Allenby for imports. This in turn forces Palestinian importers to either source their goods through Israeli middle import through Israel where they also suffer delays and high security costs.

As long as the internal barriers exist and exports and imports are forced to go through a system of back-to back transfer, the Palestinian Private sector is unlikely to prosper. However, there are a number of steps that could still be taken to improve operations under the current Israeli security regime.

Improving operations at Allenby Bridge is a priority. Ideally operation of the Allenby crossing would be transferred to the PA so that it can control the border of a future Palestinian state and coordinate directly with Jordanian authorities. However, this is unlikely in the current political context. Consequently, the GOI should look for ways to speed up the back-to-back system, provide sheltered areas for cross loading and obtain larger scanners to help speed crossings and limit damage. Extending the working hours would allow Palestinian enterprises to be more responsive to buyers' delivery schedules. The use of containers would also greatly enhance the competitiveness of Palestinian exports.

Palestinian shippers have recommended that a secure logistics center be considered for the West Bank side of the Bridge. This center could not only provide storage and shelter for goods but provide an area where containers could be stuffed with Palestinian exports while meeting Israeli security needs. Palestinian shippers argue that eliminating the need to transfer goods to Jordanian trucks to send them across the bridge before putting them into containers, would make the Jordan route much more economical for most goods.

Successfully operating the Commercial Crossings or the Allenby Bridge requires close coordination between the Israelis and Palestinians. At this time, there is no viable Palestinian counterpart. Therefore, it is imperative that the PA develop the capacity of the General Administration of Crossings and Borders (GACB) and for the GOI to provide its officials access so they can coordinate the Palestinian side of the crossings and borders. However, the PA must limit the GACB so that it facilitates crossings but does not grow so much that it becomes an impediment to traders as border authorities have done in so many other countries.

Finally it is unlikely, that Israel will be able to meet the demand at the Commercial Crossings or an improved Allenby Bridge without instituting some form of risk management system that allows cargo from trusted shippers to flow through without extensive checks. This is standard practice at most borders but Israel's security regime currently does not allow for it. However, the CPA is studying the border operations in other countries to see what they can learn from them to improve operations at the Commercial Crossings.

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1 There are no accurate statistics for trade with Israel. Since the borders with the West Bank are porous, much of the trade takes place informally and is not reported. However best estimates suggest that trade with Israel accounts for anywhere from 85%-90% of total trade flows.

2 See the World Bank's 2006 Investment Climate Assessment for a discussion of the changing relationship between the Israeli and Palestinian private sector.

3 See World Bank 2007 for a detailed description of restrictions in the West Bank.

# Palestinian Reform and Development Plan

Quarterly Review April - June 2008

In July 2008, the Palestinian Authority (PA) published an update on its fiscal performance in the first half of 2008. In addition, it published updated tables on fiscal operations, revenues and expenditures. A close examination of this information, along with other information provided by the PA and IMF estimates reveals that throughout the first half of 2008, the PA made steady progress on implementing the reform agenda laid out in the Palestinian Reform and Development Plan (PRDP).

Government expenditures and the recurrent deficit remained within the projections set by the 2008 budget. Net lending is higher than budgeted, but this was due to higher world fuel costs and unexpectedly large debt payments demanded by the Government of Israel (GOI). The PA continues to make structural reforms that will strengthen its fiscal position and improve public financial management. Consequently, the World Bank, after consulting with the IMF, has agreed to continue disbursements from the PRDP-TF to support the PA's reform program. However, there remain areas of concern that must be closely monitored in subsequent quarters including continuing pressure to raise PA salaries.

The recurrent deficit on a commitment basis is estimated as about \$169 million in the second quarter and \$439 million in the first half of 2008, which is within the 2008 budget. Given that inflation is currently projected to be about 9.5%, well above the expected rate of 4%, in real terms the deficit is on track to be substantially lower than budgeted. It also suggests that the 2008 budget deficit will be some 12% lower than 2007. If the current trend continues, the recurrent deficit will be about 22.5% of GDP compared to 26.7% in 2007. This more than 4% reduction would be a remarkable step towards fiscal discipline given the difficult environment.<sup>1</sup> On a cash basis, the deficit is about 11% more than budgeted because the PA has made much larger arrears payments than planned. Arrears payments in the first half of 2008 are estimated at close to \$250 million while the budget calls for a total of only \$217 million during the entire year.

This deficit was financed by large inflows of external aid amounting to about \$947 million in the first half of 2008. This led to a recurrent surplus on a cash basis of \$77 million in the first quarter and \$201 million in the second quarter. However, the large surplus in the second quarter reflects a dividend from the Palestine Investment Fund (PIF), which was entirely used to pay back a debt to the PIF, thus the actual balance was close to zero.

Because of the ongoing closure of Gaza and economic and security restrictions in the West Bank, it has been difficult to carry out development projects. Consequently development expenditures have lagged. They are now expected to be no more than \$300 million compared to nearly \$500 million envisioned in the 2008 budget.

In the second quarter, expenditures continued in line with the budget. On an annualized basis in USD they are about \$100 million more than the budget. However, the USD continues to depreciate and in terms of local currency the expenditures are on track to hit the budget target. Given the unexpected inflation, this represents a large fall in the real value of expenditures. There have been no general increases in salaries except for a statutory annual increase of 1.5%. The wage bill during the first half of the year, in Shekel terms, is in accordance with the budget. The number of PA employees reported in June was 141,368, an increase of less than 1,000 from the end of the first quarter, and well below the ceiling established in the PRDP of 153,000.

The PA has made less progress than hoped for on reducing net lending, which in the first half of the year was about 20% higher than budgeted. As noted above, this was mostly due to the unexpected increase in world fuel prices and larger than anticipated deductions for debt by GOI. Nevertheless, Net Lending in 2008 is on track to be nearly 25% less than it was in 2007 in local currency terms. The PA reports that electric utilities have both increased their collection rates and their payments to the Israeli Electricity Corporation (IEC). The improvement in collection rates can be traced to structural changes the PA has initiated including:

- The Palestine Energy Authority (PEA) continues to distribute prepaid meters to households, and by the end of the second quarter had distributed about 42,000.
- The PA introduced a requirement for citizens to present Certificates of Payment (COP) to demonstrate that they were current in their utility bills to receive services. This requirement was suspended while it was reviewed by the courts. In the second quarter it was reinstated by the courts and as a result of the COPs and other measures, Net Lending fell substantially between May and June.
- The Ministry of Finance has begun to deduct overdue electricity bills from government employees' salaries and in May the MoF collected nearly \$5 million.
- The number of municipalities and local governments registered with the Northern Electric Distribution Company rose from 10 at the end of March to 50 at the end of June, including the cities of Nablus, Jenin and Tulkarem

The current pension systems for PA employees are insolvent and are operating on funding from the PA budget. The PA is accumulating Pension Fund arrears with respect to the payment of the government's contribution averaging nearly \$5.8 million a month in 2008. Consequently, pension reform is an important long term goal of the PA and is necessary if the PA is to reach fiscal sustainability. The PA has made planning for pension reform an important goal of the PRDP and in the second quarter of 2008 it continued to obtain technical assistance from the World Bank on options for reform. This assistance is ongoing and additional missions are planned for the next quarter. The PA is making some initial progress on its goal of having a long term strategy for pension reform.

While pursuing fiscal discipline, the PA continues building its social safety net to ensure the most vulnerable are protected. By the end of the second quarter of 2008, there were around 5,000 households receiving benefits through the new social safety program and the targeting data base had verified nearly 29,000 households. However, the Ministry of Social Affairs needs to take steps to make the payments more efficient and regular. In addition, there has been little progress towards producing a new strategy and unified system for the social safety net.

One of the two main focuses of the PRDP-TF is supporting the PA in its desire to improve public financial management. In the second quarter, the PA made steady progress in introducing new financial and accounting systems. The Accountant General Department is fully operational and is currently working on a functional design paper for the new computerized accounting system, and identifying necessary

amendments to existing financial regulations. The MoF prepared and issued a new unified budget circular, which integrates recurrent and development expenditures and asks ministries to articulate their objectives and strategies as a first step in the preparation of the 2009 budget. In addition, the PA continues to post monthly revenue and expenditure reports on the web.

The PA computer department has integrated 10 ministries into its network including the ministries of Education, Health and Public Works. These ministries now have access to the new computerized accounting system, although at present the operation of the system remains at the Ministry of Finance. The PA continues to plan for the introduction of zero balance bank accounts for line ministries recurrent expenditures and expects to implement the new system in the third quarter.

The PA is devoting substantial resources to building financial controls. By the end of June 2008, the MoF internal audit department had initiated audits of the following ministries: Ministry of Detainee's Affairs, Ministry of Communication and Information Technology, Ministry of Labor and the Ministry of Public Works and Housing. The risk assessment phase has been completed and the internal audit report is in progress. In addition, the Palestinian Broadcasting Corporation has been audited.

Overall, the PA continues to steadily implement the PRDP reform agenda. It is making progress on strengthening the fiscal position and improving public financial management, despite the lack of tangible progress in final status discussions or the removal of security restrictions on the private sector. However, because of the unexpectedly high levels of inflation and the lack of economic growth, the PA will find it increasingly hard to achieve its fiscal goals. The government has deflected some of the pressure to raise wages by speeding the payment of arrears. But as arrears are settled, the PA will be under mounting pressure to compensate workers for the rising cost of living. In addition, with a growing population and a stagnant private sector the government will continue to be looked towards as an employer of last resort. In the long term the insolvency of the public pension system is also a significant risk to the PA's fiscal position.

<sup>1</sup> The deficit figure has been adjusted to remove a \$197 million dividend received from the Palestine Investment Fund, which was not budgeted, and which was fully used to repay PA debt to the PIF.

# Economic Monitoring Note for West Bank and Gaza

September 2008

## 1. Overview

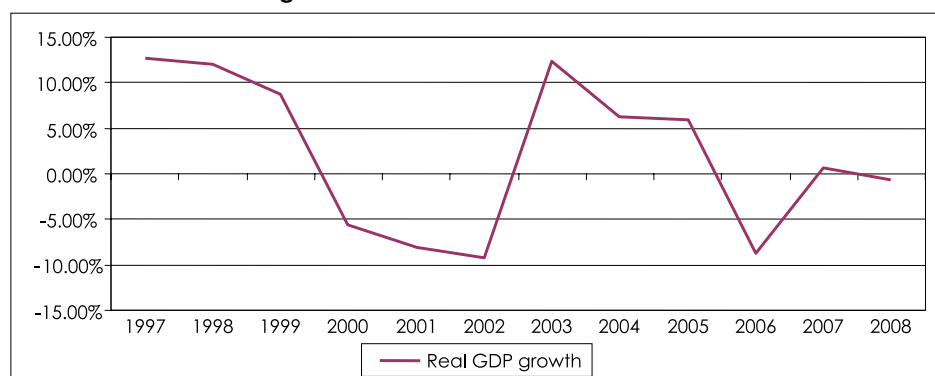
Over the past 9 months the PA has made significant progress on implementing the reform agenda laid out in the Palestinian Reform and Development Plan (PRDP). The PA has successfully contained its wage bill, reactivated the budget process and is projected to reduce its recurrent budget deficit on a commitment basis by over 23% from 2007. The donor community has responded to these reforms by generously supporting the PA with over US \$1 billion in budget support so far this year. However, there has been no progress on the third component of the equation for success. The Government of Israeli (GOI) has not relaxed its closure regime and has in fact increased economic restrictions as it expands settlements. As a result, Palestinian economic growth has been flat and the economy has continued to hollow out. This has put the PA on a path of increasing aid dependency, despite its internal reforms. The IMF estimates growth in 2007 at -.5% and predicts it to be only .8% in 2008.

## 2. Economic Developments

The PRDP budget called for growth to be about 3.5% in the first year rising to over 5% in the third year of the plan. However, these growth projections were based upon the assumptions that the GOI would relax its economic restriction and closure regime and that the situation in Gaza would improve. But as discussed above, both assumptions proved incorrect: the economic restrictions have intensified and the situation in Gaza continues to deteriorate. Consequently, the Palestinian Central Bureau of Statistics (PCBS) estimates that real GDP growth in 2007 was only about a half percent and this from an already low base. Results from the first quarter suggest that growth in 2008 is on track to be slightly negative. IMF estimates are similar and put growth at negative .5% in 2007 and project only .8% in 2008. In addition to flat growth, the economy's productive base continues to hollow out as evidenced by the changing GDP structure. When real GDP was at its height in 1999, Agriculture and Industry accounted for nearly 25% and Education, Health and Public Administration combined was less than 20%. In the first quarter of 2008, Agriculture and Industry were just over 19% and Education, Health and Public Administration accounted for almost 25% (Table 1). IMF estimates of GDP indicate that the PA's wage bill alone is equivalent to nearly 28% of GDP.

As the economy stagnates and the population grows, per capita income continues to fall. The PCBS completed a new census at the end of 2007, which revealed about a 2.6% average annual population growth for the last decade. With a growing population and a shrinking economy, real per capita GDP is now close to 30% below its height in 1999. From 1994 until 1999 before the second Intifadah the WBG economy was growing at about 6% per year. If this trend had continued, GDP per capita would be nearly 85% higher than it is currently.<sup>1</sup>

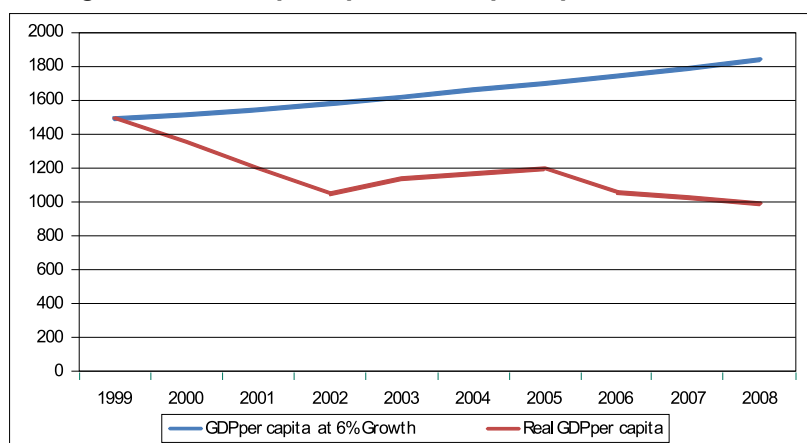
Figure 3: Economic Growth 1999-2008\*



Source: PCBS and World Bank Staff Calculations

\*2008 is estimated based on first half of the year

**Figure 4: Real GDP per capita vs. GDP per capita at 6% Growth**



Source: PCBS and World Bank Staff Calculations

As the WBG economy declines it is steadily becoming more aid dependent. So far this year the PA has received approximately US \$1.2 billion in budget support and appears on track to receive at least US \$1.8 billion and possibly more for the full year. Thus, with the IMF estimating nominal GDP at just over US \$6.6 billion, external budget support to the PA will be the equivalent of at least 28% of GDP (nearly 32% if development aid is added to budget support). In 2007 budget support was equivalent to 25% of GDP and if private sector growth does not resume it could be even higher in 2009 than in 2008.

**Table I: Real GDP in Remaining WBG by Economic Activity at Constant Prices (PCBS Estimates)**

	1999	2002	2005*	2006*	2007**
Agriculture and fishing	470.7	296.6	312.6	334	340.8
Mining, manufacturing, electr. and water	655.5	580	564.8	531.1	527.3
Mining and quarrying	35.7	33	18.3	18	21.3
Manufacturing	566.4	476.3	476.5	444	436.0
Electricity and water supply	53.4	70.7	70.0	69.1	70.0
Construction	616.9	67.5	119.4	104	103.8
Wholesale and retail trade	537.8	350	373.9	382.7	411.6
Transport, Storage and Communications	231.0	349.6	461.5	466	478.5
Financial intermediation	169.1	149.9	187.4	186.7	192.5
Other services	990.8	899.1	1,100.2	940.2	906.1
Real estate, renting and business services	444.3	392.7	446.8	447.8	343.2
Community, social and personal services	28.3	33.2	43.2	43.6	43.9
Hotels and restaurants	128.0	60.7	68.1	67.0	67.8
Education	262.4	287.7	342.5	255.3	314.8
Health and social work	127.8	124.8	199.6	126.5	136.4
Public administration and defense	497.7	578.1	796.1	552.7	570.0
Households with employed persons	8.7	8.2	8.5	8.7	8.6
Less: FISIM	-129.5	-109.6	-139.6	-138.3	-139.8
Plus: Customs duties	208.6	75.8	274.2	284.9	284.0
Plus: VAT on imports, net	254.4	338.2	443.6	454.3	450.0
<b>Gross Domestic Product</b>	<b>4,511.7</b>	<b>3,556.4</b>	<b>4,502.7</b>	<b>4,107.0</b>	<b>4,133.4</b>

Source: PCBS revised estimates

Base year 1997

\*Second Revision

\*\*First Revision

**Unexpectedly high inflation and a rapid appreciation of the Shekel against the US Dollar have shocked the Palestinian economy.** The Consumer Price Index increased by 11.7% between June 2007 and June 2008. In the first six months of 2008 the CPI increased by nearly 6% and the IMF is projecting a 9.5% average rate of inflation for the full year. This is well above the expected rate of 3–4% when the PRDP was drafted. In addition, the Shekel has gained nearly 30% against the US dollar in the past 12 months. Since most donor aid comes in dollars and many people and businesses plan and save in dollars, this has had a significant impact on the Palestinian economy.

**Investment has shown few signs of recovery during the past year.** It is difficult to exactly know public investment since almost all of it is project finance from external sources that are sometimes not reported to the Ministry of Finance. Minor Development and capital expenditures in the PA's budget was only US \$15.3 million in the first half of 2008. The budget calls for nearly US \$500 million in development expenditures, but current projections are for it to only reach US \$300 million and this figure is optimistic. The PCBS does not publish figures on private investment; however, monetary statistics suggest it is low. Claims on the private sector fell by over 6% to approximately US \$1.37 billion. At the same time, private sector deposits rose from US \$4.1 billion to \$5.1 billion leading to net claims on the private sector to decline by over US \$1 billion. In addition, net repayment of bank debt by the PA was US \$38 million. This large withdrawal of liquidity from the economy offset much of the external aid and indicates that in the current environment, few investors are willing to take risks and borrow from the banking system.

**In May, the PA hosted a large investors' conference in Bethlehem, during which over US \$1 billion in new investment deals were announced.** However, almost all of this investment comes from a small number of very large projects that had been negotiated over the previous year or longer. The announced investment deals included the second mobile phone operator, Al Wataniya, and at least two large housing construction projects, whose prospects depend upon mobilizing donor funds to support the needed infrastructure. Though the conference was a success in that it showed it is possible to bring investors to the West Bank and that there are some opportunities, it directly led to few new investments.

**Al Wataniya is an important new development and will have a significant impact on the Palestinian economy.** This US \$300 million deal was signed with the PA over a year ago, however, the GOI refused to release the required frequencies until July 2008. The company is now negotiating with the GOI for permission to import the necessary equipment. A second mobile operator will provide a significant boost to the local economy and to the PA's coffers; however it does not indicate that the investment climate is improving. In fact there is a quite contrary interpretation. If a well connected and large investor such as Al Wataniya cannot import equipment or receive its promised frequencies, then what hope is there for smaller investors?

**Consistent with the lack of borrowing, industrial output continues to decline.** According to PCBS estimates, in 2007 manufacturing output was approximately 1.8% lower than in 2006 and nearly 23% off from 1999 (Table 1). Agricultural output has been slowly recovering since its low of 2002 but it remains about 28% below its 1999 level. The lack of investment is also evidenced by the fact that the construction sector has seen little growth in the last four years and is less than 20% of its size in 1999. Recently, a few large housing construction projects have been announced in the West Bank, including a new planned community north of Ramallah, which will require over US \$500 million in private investment. If these projects actually come to fruition they would be a large boost to the construction sector and the Palestinian economy as a whole.

**There are no separate figures for output in the West Bank and Gaza but there are some indications that the West Bank could be experiencing a small increase in economic activity.** The Israeli Civil Administration reports that the number of trucks crossing between Israel and the West Bank in the first half of the year increased by more than 44% compared to the last half of 2007. In addition, tourist visits to Jericho and Bethlehem increased significantly in 2008. However, the figures on trucks also include traffic to Israeli settlements and tourism (hotels and restaurants) only contributed about 2.5% to GDP. In addition, the real value of domestic tax collections has fallen. Thus, if the West Bank is experiencing growth there is no reason to believe that it is substantial.

**The economic blockade has devastated the Gaza private sector and driven almost all industrial producers out of business.** Gaza businesses are not only unable to export but because the blockade only allows in humanitarian goods,

they are unable to import intermediate inputs. In addition, fuel and power shortages significantly hamper production. According to recent estimates by local business associations, only about 2% of industrial establishments are still functioning. They are mainly food processors who can obtain local inputs or who use inputs that are allowed to be imported on humanitarian grounds. Industrial employment has fallen from about 35,000 before the Israeli disengagement in 2005 to about 860 at the end of June, 2008. In addition, the business associations estimate that another 70,000 workers have been laid off from other sectors. The damage has been so severe, that it is unlikely that many establishments will be able to recover once the blockade is lifted.

The garment and furniture sectors, which were once among the most important employers, have been particularly hard hit.

A. Almost all garment workshops - approximately 960 enterprises - have been shut down. Five have relocated to West Bank and Jordan and about 16,000 workers have been laid off.

B. About 97% of establishments in the furniture sector have been closed and an estimated 5,450 out of 5,000 workers have been laid off.

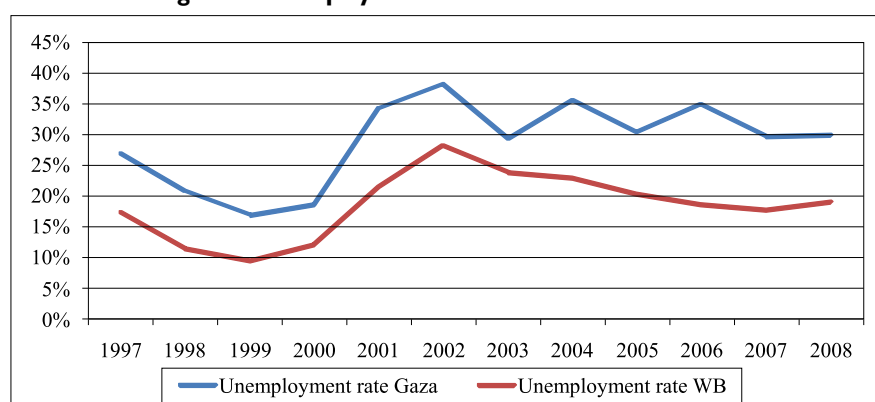
**The halt in exports and the prohibition on importing fertilizer, pesticides, packaging materials and other inputs has led to the loss of more than 40,000 jobs in the agriculture sector.** PalTrade estimates total agricultural export losses at US \$30 million in the 2007/2008 season. Only 109 out of 2500 tons of strawberries produced were allowed out, resulting in losses of about \$7 million. About 17% of cut flower production was exported, which led to losses of around \$6.5 million. The remainder of the crop was used for animal feed. In addition no cherry tomatoes were exported resulting in a loss of approximately \$1.5 million.

**Table 2: Industrial Decline in Gaza**

	June 2005 Pre-disengagement	Week 1, July 2007	NOV 2007	DEC 2007	FEB 2008	March 2008	June 2008
Industrial Working Establishm-ents	3,900	780	250	195	150	130	90
Industrial Employees	35,000	4,200	2,000	1,750	1,500	1,300	860
Exports from Gaza (truckloads)	748	0	0	0	0	0	0

Source: Palestine Trade Center (PalTrade) interviews with local business associations

**Figure 5: Unemployment in the West Bank and Gaza**



Source: PCBS

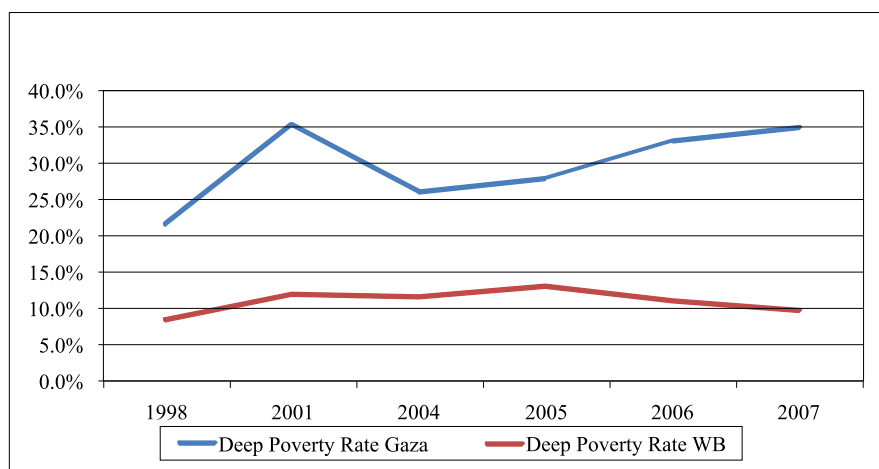
Unemployment in the West Bank rose from 17.7% in 2007 to 19% in the first quarter of 2008, while unemployment in Gaza has increased from 29.7% to 29.8%. In the second quarter of the year, unemployment in the West Bank fell to 16.3%, but unemployment falls almost every year in the second quarter and probably reflects increased agricultural employment. In Gaza, the PCBS reports that unemployment rose sharply to over 45% in the second quarter. However, recent events have made it difficult for the PCBS to operate in Gaza and the second quarter figures are from incomplete surveys. Thus, the first quarter figure of 30% is probably more accurate for the unemployment rate in Gaza. These figures do not give an accurate picture of the full impact of the economic crisis, because they do not take into account underemployed workers such as the large number who have turned to unpaid family labor or seasonal agriculture. The figures also do not include the many discouraged workers who have left the labor force.<sup>2</sup> Labor force participation rates are low and dropping. In the West Bank it fell from 44% at the end of 2007 to 43.5% in the first quarter of 2008 and in Gaza it held steady at 38%. Adding discouraged workers would increase the unemployment rate to 23.2% in the West Bank and 49.1% in Gaza.<sup>3</sup>

Because of the crisis, poverty continues to increase in Gaza where the official poverty rate rose from 47.9% in 2006 to 51.8% in 2007. In the West Bank poverty slightly declined, falling from 22% in 2006 to about 19.1% in 2007. The percentage of Gazans in Deep Poverty also continued to rise, increasing from 33.2% in 2006 to 35% in 2007.<sup>4</sup> These rates reflect actual consumption. If remittances and food aid are excluded and poverty is based only on household income, the poverty rate in Gaza and the West Bank would soar to 79.4% and 45.7% respectively and the Deep Poverty rates would increase to 34.1% and 69.9%.<sup>5</sup> This illustrates the high levels of aid dependency in the West Bank and Gaza, especially when you take into account the fact that the majority of the income of government employees is financed with foreign aid.

Poverty and the global rise in food prices have taken a heavy toll on Palestinian living conditions. The consumer price index for food rose by 28% in Gaza and 21.4% in the West Bank between June 2007 and June 2008. Despite the large inflows of aid, a recent WFP survey found that food insecurity continues to rise in WBG, and is estimated to have increased from 34% in 2006 to 38% in 2007.<sup>6</sup> Food insecurity is even more pronounced in Gaza reaching 56% of households. Almost 66% of income earned in Gaza is spent on food while in the West Bank the figure is 56%.

The survey revealed that to cope with this increase, 59% of households use credit to purchase food. However, this coping mechanism is increasingly exhausted and is no longer available to those without a reliable income. A WFP survey also found that that Palestinians are eating less – 75% of Palestinians have reduced the quantity of food they buy and 89% have reduced the quality. The consumption of fresh food and vegetables has decreased and many Palestinians don't consume fresh, red meat. The lack of protein and vitamins has increased the prevalence of anemia and other nutrient deficiencies and is likely to have long term health consequences on children.

**Figure 6: Deep Poverty in the West Bank and Gaza**



Source: PCBS

### 3. The PA Fiscal Position

The PRDP was published in December 2007 and it contained a detailed three year budget, which laid out a path towards fiscal strengthening. Though growth has been lower than projected and inflation higher than expected, the PA has implemented a number of difficult reforms and made substantial progress towards improving its fiscal position. However, the grave fiscal crisis remains and the government scrambles every month to scrape together enough bank borrowing and donor budget support to pay salaries and continue operations.

The recurrent deficit on a commitment basis is estimated at about NIS 4,891 million in the second quarter and NIS 5,356 million in the first half of 2008, which is within the 2008 budget. Given the current inflation projections, in real terms the deficit is on track to be substantially lower than budgeted. It also suggests that in nominal local currency terms the 2008 commitment budget deficit will be some 18% lower than 2007.<sup>7</sup> If the current trend continues, the recurrent deficit will be about 22.5% of GDP compared to 26.7% in 2007. This more than 4% reduction would be a remarkable step towards fiscal discipline given the difficult environment.<sup>8</sup> On a cash basis, the annual deficit is set to be almost 48% more than budgeted because the PA has made much larger arrears payments than planned. Arrears payments in the first half of 2008 are estimated at close to NIS 887 million while the budget calls for a total of only about NIS 781 million during the entire year.

Because of the ongoing closure of Gaza and economic and security restrictions in the West Bank, it has been difficult to carry out development projects. Consequently development expenditures have lagged. They are now expected to be no more than \$300 million compared to nearly \$500 million envisioned in the 2008 budget.

Revenues showed a sharp increase in the first half of the year and the IMF estimates in 2008 they may be as much as 23% higher in Shekel terms (Table 3). However, taking out the PIF dividend, reveals only a 9% increase. In nominal terms, tax revenues are predicted to be flat and clearance revenues, which are mostly VAT, also show only a slight increase. Thus, there is no indication from domestic revenues of any growth in the economy and in real terms revenue growth has been substantially negative.

In the first half of the year, expenditures were in line with the budget. On an annualized basis in USD they are about \$100 million more than the budget. However, the USD continues to depreciate and in terms of local currency the expenditures are on track to hit the budget target. Given the unexpected inflation, this represents a large fall in the real value of expenditures. There have been no general increases in salaries except for a statutory annual increase of 1.5%. The wage bill during the first half of the year, in Shekel terms, is in accordance with the budget and as discussed above, the number of PA employees is below the ceiling stated in the PRDP.

The PA has made less progress than hoped for on reducing net lending, which in the first half of the year was about 20% higher than budgeted.<sup>9</sup> As noted above, this was mostly due to the unexpected increase in world fuel prices and larger than anticipated deductions for debt by GOI. Nevertheless, Net Lending in 2008 is on track to be nearly 25% less than it was in 2007 in local currency terms. The PA reports that electric utilities have both increased their collection rates and their payments to the Israeli Electricity Corporation (IEC). The improvement in collection rates can be traced to the structural reforms including distributing prepaid meters and requiring Certificates Payment of utility bills to receive government services.

Despite the substantial reforms and the progress in reducing the deficit, the fiscal crisis persists. The PA relies on large inflows of external budget support to maintain operations and is unable to devote any internal resources for investment. In 2008, the need for external budget support is estimated at between US \$1.7 billion and US \$1.9 billion, of which only about \$1.5 billion has so far been secured. In addition, the pledged funds may not arrive when needed. Current projections indicate that the PA could face a liquidity crisis before the end of the year and be able to pay full salaries unless more donor aid is secured.

**Table 3 West Bank and Gaza: IMF Estimates of Central Government Fiscal Operations, 2007-09**

	2007	2008					2009
	Est.	Year	H1	H1	H2	Year	Proj.
		Budget		Prelim.	Proj.	Proj.	
(In millions of shekels, unless otherwise stated)							
<b>Total net revenues</b>	<b>4,894</b>	<b>5,349</b>	<b>2,675</b>	<b>3,313</b>	<b>2,701</b>	<b>6,014</b>	<b>6,172</b>
Gross domestic revenues	1,326	1,507	754	1,545	744	2,288	1,917
Tax revenues	827	910	455	524	307	832	1,176
Nontax revenues 1/	499	597	299	1,020	436	1,457	741
Clearance revenues (accrued)	3,673	3,842	1,921	1,893	2,075	3,968	4,389
Clearance revenues (cash)	5,403	3,842	1,921	1,949	2,019	3,968	4,389
Clearance revenues (net arrears accumulation)	-1,730	0	0	-56	56	0	0
Tax refunds	105	0	0	125	118	243	134
<b>Total recurrent expenditures and net lending (commitment basis)</b>	<b>10,430</b>	<b>10,244</b>	<b>5,122</b>	<b>4,891</b>	<b>5,356</b>	<b>10,247</b>	<b>10,348</b>
Wage expenditures (commitment)	5,262	5,333	2,666	2,571	2,761	5,333	5,478
Wage expenditures (cash)	5,614	...	2,854	3,298	3,109	6,407	5,478
Wage expenditures (net arrears accumulation)	-352	...	-188	-727	-347	-1,074	0
Nonwage expenditures (commitment) 2/	2,974	3,471	1,736	1,454	1,815	3,270	3,324
Nonwage expenditures (cash)	2,718	...	1,939	1,615	1,858	3,473	3,536
Nonwage expenditures (net arrears accumulation)	256	...	-203	-160	-43	-203	-211
Net lending 3/	2,193	1,440	720	865	779	1,645	1,546
<b>Recurrent balance (commitment basis, before external budgetary support)</b>	<b>-5,535</b>	<b>-4,895</b>	<b>-2,448</b>	<b>-1,578</b>	<b>-2,655</b>	<b>-4,233</b>	<b>-4,176</b>
add: expenditure arrears (net accumulation)	-96	-781	-391	-887	-390	-1,277	-211
subtract: net clearance withheld (+) or transferred from past collections (-)	-1,730	0	0	-56	56	0	0
<b>Recurrent balance (cash basis, before external budgetary support)</b>	<b>-3,901</b>	<b>-5,676</b>	<b>-2,838</b>	<b>-2,409</b>	<b>-3,101</b>	<b>-5,510</b>	<b>-4,388</b>
add: external budgetary support	4,149	5,881	2,941	3,363	3,005	6,368	4,401
of which: external budgetary support yet to be secured	...	1,437	707	0	1,065	1,065	2,818
<b>Recurrent balance (commitment basis, after external budgetary support)</b>	<b>-1,386</b>	<b>986</b>	<b>493</b>	<b>1,785</b>	<b>350</b>	<b>2,135</b>	<b>225</b>
<b>Recurrent balance (cash basis, after external budgetary support)</b>	<b>248</b>	<b>205</b>	<b>103</b>	<b>954</b>	<b>-96</b>	<b>858</b>	<b>13</b>
<b>Development expenditures (Public Investment Program)</b>	<b>1,270</b>	<b>1,771</b>	<b>886</b>	<b>520</b>	<b>520</b>	<b>1,040</b>	<b>1,684</b>
<b>Overall balance (cash basis, including development expenditures)</b>	<b>-1,022</b>	<b>-1,566</b>	<b>-783</b>	<b>434</b>	<b>-616</b>	<b>-182</b>	<b>-1,671</b>
<b>Total other financing</b>	<b>1,022</b>	<b>1,566</b>	<b>783</b>	<b>-434</b>	<b>616</b>	<b>182</b>	<b>1,671</b>
Net domestic bank financing	-542	-180	-90	-148	-32	-180	0
Other domestic financing 1/	320	0	0	-653	0	-653	0
External financing for development expenditures	1,270	1,771	886	520	520	1,040	1,684
Net external debt	0	-25	-13	0	-25	-25	-13
Residual	-26	0	0	-153	153	0	0
<b>Memorandum items:</b>	(In percent of GDP; unless otherwise stated)						
Revenues 1/	23.6	24.4	12.2	14.5	11.8	26.2	25.1
Recurrent expenditures and net lending	50.3	46.7	23.4	21.3	23.4	44.7	42.0
Wage expenditures	25.4	24.3	12.2	11.2	12.1	23.3	22.2
Nonwage expenditures 2/	14.3	15.8	7.9	6.3	7.9	14.3	13.5
Net lending 3/	10.6	6.6	3.3	3.8	3.4	7.2	6.3
Recurrent balance (commitment basis) before external budgetary support	-26.7	-22.3	-11.2	-6.9	-11.6	-18.5	-17.0
External budgetary support (recurrent)	20.0	26.8	13.4	14.7	13.1	27.8	17.9
Overall balance	-4.9	-7.1	-3.6	1.9	-2.7	-0.8	-6.8
Total external budgetary support (recurrent & development, millions of shekels)	5,419	7,652	3,826	3,883	3,525	7,408	6,085
Nominal GDP (millions of shekels)	20,737	21,918	21,918	22,910	22,910	22,910	24,637
Nominal exchange rate (NIS per US dollar)	4.10	3.60	3.60	3.53	3.37	3.45	3.35

Sources: Ministry of Finance, and IMF staff estimates.

1/ In February 2008, the Government of Israel remitted NIS 76 million as interest on past frozen clearance revenues. In May 2008, the Palestinian Investment Fund (PIF) distributed NIS 653 million in dividends, which was then used to settle part of the debt to the PIF.

2/ Including minor outlays for domestically financed development expenditures.

3/ Including transfers related to the marketing of petroleum products. These amounted to NIS 160 million (\$45 million) in January-June 2008.

To this end, the World Bank is working with the PA to convince donors who have pledged project support to convert their assistance to budget support. The Bank's recent Development Policy Grant and its establishment of the PRDP multi-donor trust fund have encouraged some donors to move toward budget support. However, there is still a need for increased support.

Going forward, the 2009 budget calls for about US \$1.8 billion in external support. But only US \$1.3 billion is designated for budget support with the remainder allocated to development expenditures. However, with no economic growth and with the restrictions that prevent growth intensifying, it is highly unlikely that donor assistance can be shifted out of budget support to development assistance. With real wages for government employees declining and the private sector not expanding to provide jobs for the growing population, the PA will be under tremendous pressure to both increase the public work force and increase their wages. In addition, the need for social assistance will increase, especially if the situation in Gaza persists. Thus, despite their internal reforms, unless there is progress on the political front, the PA will most continue to need large amounts of external budget support.

#### 4. Palestinian Authority Reforms

In December 2007, the PA published its Palestinian Reform and Development Plan (PRDP). This laid out a comprehensive three year plan of institutional reforms with a particular emphasis on strengthening the PA's fiscal position, improving public financial management and restoring law and order. Since its introduction, the PA has made substantial and steady progress on implementing the PRDP's most important reforms. In addition to the security issues discussed above, some of the more noteworthy accomplishments are:

- The Ministry of Finance (MoF) is posting monthly revenue and expenditure statements on the web.
- The MoF distributed a 2009 budget circular to ministers and heads of agencies at the Council of Ministers on July 7, 2008. This budget circular attempts to integrate recurrent and development expenditures within the Medium Term Expenditure Framework provided in the PRDP. This unified budget circular is a first step in improving the integration of the government's policy, planning and budgeting process.
- The PA has reduced government employment from over 180,000 in late 2007 to about 141,000 in the first half of 2008, well below the 153,000 limit set in the PRDP.
- The MoF has adopted a new computer program that links 10 ministries into a new accounting framework, established by the MoF.
- The PA is further strengthening its system of financial controls. By the end of June 2008, the MoF's new internal audit department had initiated audits of four line ministries.
- The Caretaker Government has made significant progress in restoring a culture of payment of utility bills. The PA has won its appeal to the courts against the suspension of the "Certificate of Payment" for electricity bills which consumers must provide when requesting government services. In addition, 45,000 pre paid electric meters have been installed and over 50 municipalities have registered to join the Northern Electric Distribution Company.
- The Ministry of Social Affairs has taken steps to make the social safety net more efficient. It has established a new targeting database that has confirmed the poverty status of over 32,000 households.

The current pension systems for PA employees are insolvent and are operating on funding from the PA budget. The PA is accumulating pension fund arrears with respect to the payment of the government's contribution averaging nearly \$5.8 million a month in 2008. Consequently, pension reform is an important long term goal of the PA and is necessary if the PA is to reach fiscal sustainability. The PA has made planning for pension reform an important goal of the PRDP and in the second quarter of 2008 it continued to obtain technical assistance from the World Bank. This assistance is ongoing and additional missions are planned for the next quarter. The PA is making some initial progress on its goal of having a long term strategy for pension reform.

The Palestinian Monetary Authority continues to develop its capability to serve as a central bank for any future Palestinian state. With the technical assistance of the World Bank, the PMA is procuring and implementing a new electronic payments system, which will greatly increase the efficiency of the WBG payments system. In addition, the PMA has brought on line a new electronic credit bureau that will enhance banks' ability to assess risk. The PMA has also introduced a new set of anti-money laundering regulations, which are some of the most up to date in the world.

One of the key challenges for the PMA is to maintain the payments system in Gaza while ensuring strong Anti Money Laundering (AML) compliance. For much of the past year, the GOI of Israel has restricted the entry of cash into Gaza. In addition, nearly 30% of monthly cash injections into Gaza are sent back to Israel in commercial transactions. In August, Gaza was in desperate need of at least NIS 100 million. However, the GOI only authorized NIS 72 million. Consequently, Banks had to resort to partial payments in shekel and limit the amount of cash withdrawals in a single day. In addition, the Gaza market had a large number of worn out Israeli shekel notes which were removed from circulation by the banks. The PMA arranged a deal with the Central Bank of Israel to exchange 40 million shekels worth of deteriorated notes with new ones. The first tranche exchange of 17.6 million shekels was completed in mid August with another tranche expected in September. The PMA has worked diligently to ensure compliance with new AML rules and regulations. When Hamas seized a number of NGOs in Gaza, including Bank supported ones, the PMA moved quickly to freeze their accounts to ensure no funds were diverted.

Other issues of concern involve the banking relationship between Palestinian and Israeli banks. The values of transactions between Palestinian and Israeli Banks exceeded 20 billion shekels in 2007. But recently, two major Israeli banks have announced their intention to end correspondent relationships with Palestinian banks. One bank in particular has suspended cash transactions with its correspondent Palestinian Banks. The PMA is working with the Israeli Central Bank to come up with alternative arrangements possibly with an Israeli state owned bank.

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- 1 PCBS has not yet released revised population figures for years between 1997 and 2007. The graphs are based on the unrevised figures. Thus they slightly underestimated per capita GDP.
  - 2 Unemployment figures also do not include the large number of “workers absent from their usual work”. In the PCBS calculations, these workers are assumed to be temporarily away from jobs due to illness, work stoppage, natural disaster or for other reasons but still receiving normal pay. UNRWA estimates that nearly 45,000 Gazans have become “absentee” workers since the first half of 2007.
  - 3 PCBC Labor Force Survey Q1 2008
  - 4 PCBS uses two measures of poverty: Deep Poverty (absolute) and Poverty. The Deep Poverty line reflects a budget for food, clothing and housing only. For a family of six the deep poverty line in 2006 was NIS 1,837. The Poverty line adds other necessities including health care, education, transportation, personal care and housekeeping supplies; raising the line to NIS 2,300 for a family of 6. Thus, the percentage of households in Poverty includes those in deep poverty.
  - 5 PCBS: Poverty and Living Conditions in the Palestinian Territory, 2007
  - 6 WFP/FAO/UNRWA rapid food security survey conducted March/April 2008 as reported in World Food Program, “Food Security and Market Monitoring Report, July 2008: Report 19.
  - 7 Given the large depreciation of the US \$ in the past year the budget is best understood in terms of local currency.
  - 8 The deficit figure has been adjusted to remove a \$197 million dividend received from the Palestine Investment Fund, which was not budgeted, and which was fully used to repay PA debt to the PIF.
  - 9 Net lending refers to the amounts withheld from the tax clearance revenues by the GOI to pay for electricity, water and other services consumed but not paid for by local governments. They account for 15%-20% of expenditures.

# The World Bank's Operations in West Bank and Gaza

September 2008

On-going Bank Group Operations	
Project Name & Details	Description
<p><b><i>Solid Waste and Environmental Management Project (SWEMP).</i></b>  World Bank: US\$9.5 million  Approval Date: October 10, 2000.  Closing Date: June 30, 2009  Task Team Leader: Andrew Mokakha</p>	<p>The overall objective of the project is to implement an environmentally sound solid waste management system for Jenin District. This objective has been pursued through the construction of a controlled sanitary landfill in Jenin District (Zahrat Al- Finjan); rehabilitation/closure of uncontrolled dumps; improvement in solid waste management (SWN) services in the district through the supply of equipment and the strengthening of management and operation capacities' building institutional capacity in the newly created Joint Services Council (JSC) for regional SWM services; and strengthening the institutional and monitoring capacity of Environmental Quality Authority (EQA). The Project is managed by the Joint Services Council for Solid Waste Management (JSU). The EC is financing the supply of collection vehicles and transfer stations relation set-ups.</p> <p>To successfully complete the key project activities that have been delayed due to the prevailing socio-political circumstances, the project's closing date was extended from June 30, 2008 to June 30, 2009.</p>
<p><b><i>Emergency Water Project (EWP).</i></b>  World Bank: US\$12.5 million  Approval Date: July 29, 2003  Closing Date: September 30, 2008  Task Team Leader: Sana Al Nimer</p>	<p>The main objective of the project is to support investments that would help alleviate the chronic shortages of safe water supplies; reduce water costs and health risks; and conserve scarce water resources by reducing system losses. The Project includes the following components: (a) Rehabilitation and improvement of Water Supply Transmission and Distribution System; and (b) Technical Assistance and Capacity Building provided to the Palestinian Water Authority.</p>
<p><b><i>Social Safety Net Reform Project (SSNRP).</i></b>  World Bank: US\$10.0 million plus US\$10.0 million additional financing approved in April 2008  Approval Date: June 3, 2004  Closing Date: June 30, 2012  Task Team Leader: Eileen Murray</p>	<p>The project was formally restructured in May 2007. The new project development objective is to mitigate the impact of the continued socio-economic crisis on a subset of the poorest and most vulnerable households. An additional is to strengthen the institutional capacity of Ministry of Social Affairs to manage cash transfer programs. The primary objective would be achieved by implementing a pilot incentive-based cash transfer mechanism with improved targeting modalities that would contribute to improving the living conditions of the beneficiaries. The Project also aims to strengthen the institutional capacity of PA agencies involved in the implementation of the proposed project, in particular in Ministry of Social Affairs.</p> <p>An Additional Financing of US\$10.0 million was approved on April 22, 2008 to help finance costs associated with the scaling up of the project and its transformation into a cash benefit program administrated by the Palestinian Authority, capitalizing on the Ministry of Social Affairs poverty targeting database.</p>
<p><b><i>North Gaza Emergency Sewage Treatment Project.</i></b>  World Bank: US\$7.8 million plus US\$12.0 million additional financing approved in April 2008  Approval Date: September 9, 2004  Closing Date: June 30, 2012  Task Team Leader: Sana Al Nimer.</p>	<p>The North Gaza Emergency Sewage Treatment project (NGEST) is the fourth in a series of Bank-funded water and sanitation projects since 1994. The Project consist of two parts: Part A - addressing the immediate and impending health, environmental and safety hazards to the communities near the poorly-treated and rapidly growing sewage lake in the Beit Lahia area of North Gaza. And Part B - a long-term solution for the adequate treatment and disposal of wastewater in North Gaza, which entails the construction of a new wastewater treatment plant expected to be financed by various donors. Approximately 300,000 people living in North Gaza will benefit from this project. The project overall estimated cost is about US\$ 63 million.</p> <p>An Additional Financing of US\$12.0 million was approved on April 22, 2008 to support the original objectives and the overall project design and components. Specifically, the additional financing will cover the overrun cost of Part A and risk management activities.</p>

## On-going Bank Group Operations

Project Name & Details	Description
<p><b>Land Administration Project</b>  World Bank: US\$3 million  Government of Finland: US\$3.1 million equivalent  Approval Date: January 26, 2005  Closing Date: December 31, 2008  Task Team Leader: Ibrahim Dajani</p>	<p>The objective of this project is to assess/learn the extent of commitment and readiness of the PA to reforming land administration by introducing policy, legal and institutional changes to achieve efficient procedures for the issuance of land titles and registration of property transactions, and transparent processes for the management and disposal of public land. The project is the first phase of a more comprehensive Land Administration Program, which aims at enhancing economic growth by improving land tenure security and facilitating the development of efficient land and property markets in rural and urban areas through the development of an efficient system of land titling and registration based on clear, transparent and coherent policies and laws and supported by an appropriate institutional structure. A second project which will build on the results and success of this first project is planned to be launched in 2009.</p>
<p><b>Tertiary Education Project</b>  World Bank: US\$10 million  Approval Date: April 26, 2005  Closing Date: December 31, 2009  Task Team Leader: Adriana Jaramillo</p>	<p>The project development objectives are: 1) to improve the regulatory environment for tertiary education management, relevance and quality assurance; 2) increase internal and external efficiency of the tertiary education system, as a first step towards seeking sustainability; and 3) to create incentives and provide the basis for improvements in efficiency, quality and relevance of tertiary education institutions in order to meet the socioeconomic needs of the Palestinian population. The project provides technical assistance on defining policies consistent with increasing the financial sustainability of the sector and improving the capacity to respond to labor market needs. It also provides incentive mechanisms to improve quality and relevance of the programs offered. On a competitive basis, institutions will apply for quality and management grants, administered by a Fund mechanism. In addition the project will provide technical assistance to improve the management of the current student loans program managed by the MOEHE, and will set the basis for expansion of the financial resources available for funding the student aid programs. The EC is providing co-financing in the amount of € 6 million.</p>
<p><b>Gaza II Emergency Water</b>  World Bank: US\$20 million plus US\$5.0 million additional financing approved in April 2008  Approval Date: June 7, 2005  Closing Date: January 31, 2010  Task Team Leader: Khairy Al-Jamal</p>	<p>This Project is a follow-up to the previous GWSSP. The development objectives of this Project are: (a) to develop a sustainable institutional structure of the water and wastewater sector in Gaza by supporting the functional establishment of a Coastal Municipalities Water Utility, as well as by enhancing and deepening the involvement of the private sector through a three-year management contract; (b) to continue improving the water and sanitation services by rehabilitation, upgrading and expansion of existing systems and facilities; and (c) to strengthen the regulatory and institutional capacity of the Palestinian Water Authority. The whole population of Gaza (around 1.5 million people) are benefiting from the project.</p> <p>Additional financing of US\$5.0 million was approved on April 22, 2008 to supplement the project overrun expenses. This additional financing will furthermore strengthen the ability of CMWU to consolidate the ongoing institutional reform process by covering the operational expenses for one more year</p>
<p><b>Avian Influenza Prevention and Control Project</b>  World Bank: US\$10 million  Global Fund for Avian Influenza US\$3 million  Approval Date: September 7, 2006  Closing date: January 31, 2009  Task Team Leader: Lucie Tran</p>	<p>West Bank and Gaza has been considered at high risk for Avian Influenza due to the large number of migratory birds crossing the territories and the high risk of spreading the infection among domestic poultry. In April, FAO/WHO confirmed AI H5N1 presence in 8 locations in Gaza and preventive culling was concluded in the infected areas. The project aims to strengthen the public and veterinary health sectors to respond to possible future outbreaks. The overall responsibility for overseeing and coordinating institutional and implementation arrangements is vested with the National Emergency Committee for Avian Influenza Control (NCAIC) which is chaired by the Minister of Health, while funds from the Global Trust Fund (US\$3 million) are being implemented by UNDP, focusing on quick implementation of the most urgent activities.</p>

## On-going Bank Group Operations

Project Name & Details	Description
<p><b><i>Second Emergency Municipal Services and Rehabilitation Project</i></b>  World Bank: US\$10 million  The Netherlands: € 5 million  AFD: €12 million  Approval Date: December 19, 2006  Closing date: June 30, 2009  Task Team Leader: Meskerem Brhane</p>	<p>A prolonged period of economic contraction has had serious consequences for municipal revenues and the ability of local governments to continue providing basic services. This has translated into sharply increased health, safety, and sanitation risks for the Palestinian population resulting from mounting solid waste, and deteriorating streets, water and wastewater networks, particularly in heavily populated urban areas. The objectives of EMSRP II are to (a) provide funding for infrastructure rehabilitation and maintenance to help mitigate further deterioration in the delivery of essential municipal services, and (b) create temporary job opportunities at the local level through the launching of labor-intensive employment generation schemes. In addition, through the Municipal Development Lending Fund (MDLF), the Project would pilot innovative initiatives to improve municipal service cost recovery (through the introduction of pre-paid electric metering systems) and leverage partnerships with local NGOs to deliver services more effectively. The total cost of the project is currently estimated at US\$40.2 million with financing of US\$10 million from the Trust Fund for Gaza and West Bank (TFGWB), and further commitments from Netherlands and Agence Française de Développement. On-going discussions for funding with KFW and Sweden are likely to cover the balance.</p>
<p><b><i>Third Palestinian NGO Project</i></b>  World Bank: US\$10 million  AFD: €6 million  Approval Date: December 19, 2006  Closing date: December 31, 2009  Task Team Leader: Meskerem Brhane</p>	<p>The objective of the project is to provide social services to those who are poor, vulnerable or affected by the deteriorating socioeconomic conditions by establishing an effective mechanism to improve the quality and sustainability of NGO social service delivery. The first two PNGO projects successfully built up Palestinian NGO capacity to carry out social service delivery activities. Now, there is a need to consolidate and sustain this capacity by moving the driving force for further NGO development firmly into the hands of the Palestinian NGOs. To this end, PNGOIII will support the transformation of the Project Management Organization (PMO), the implementing unit within the Welfare Association of the previous projects, into the NGO Development Center (NDC), an institution dedicated to grant-making and sector development. At the same time, the project will provide funding to develop and sustain specific NGO-sponsored social service delivery activities.</p>
<p><b><i>Emergency Services Support Program III</i></b>  World Bank: US\$10 million  Approval Date: December 13, 2007  Closing Date: December 31, 2009  Task Team Leader: Eileen Murray</p>	<p>The development objective of the Emergency Services Support Program is to mitigate the deterioration of service delivery brought about by the inability of the Palestinian Authority to meet its non-salary recurrent costs. The ESSP finances the non-salary expenditures of the key social ministries and based on the PA's recurrent expenditure program for these ministries.</p>
<p><b><i>Village and Neighborhood Development Project</i></b>  World Bank: US\$10 million  Approval Date: April 22, 2008  Closing Date: October 30, 2012  Task Team Leader: Meskerem Brhane</p>	<p>The objective of this project is to promote a coordinated development approach which builds the capacity of communities to plan for and manage development sources. The project will support small communities in planning local initiatives, prioritizing needs through an inclusive and participatory process. It will also provide small grants to support joint activities among several village councils for subprojects that are part of the local plan. This will provide incentives for small communities to work together and eventually amalgamate and become a municipality.</p>

## On-going Bank Group Operations

Project Name & Details	Description
<p><b><i>Electricity Utility Management Project.</i></b>  World Bank: US\$12million  Approval Date: May 15, 2008  Closing Date: June 30, 2012  Task Team Leader: Meskerem Brhane</p>	<p>The development objective of the Electricity Utility Management Project is to reduce the fiscal burden of the sector on PA's budgetary resources through interalia lower deductions from clearance revenues for arrears owed to IEC. This will be possible through adoption of appropriate sectoral efficiency enhancement measures taken and the key performance indicators of the electricity distribution utilities that will include: (a) improved collection performance; (b) lower technical/non-technical losses; (c) reduction in payables to IEC on account of electricity purchase; and (d) consolidation and increase in number of consumers. The Project will also ensure that NEDCO is fully operational through financing necessary capacity building measures.</p>
<p><b><i>Palestinian Reform and Development Plan (PRDP) Development Policy Grant</i></b>  World Bank: US\$40 million  Approval Date: June 5, 2008  Task Team Leader: John Nasir</p>	<p>The Bank will support the PRDP process in two complementary ways; (i) establishing the PRDP Trust Fund as requested by the PA; and (ii) providing a development policy grant of \$40 million. The development policy grant project is designed to support the PA as it implements the reform program detailed in the PRDP. To have the largest impact, the project focuses on two specific areas: (i) strengthening the PA's fiscal position; and (ii) improving private fiscal management.</p>

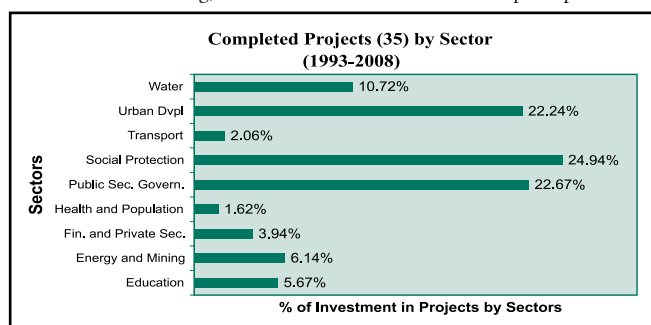


# West Bank and Gaza Portfolio

September 2008

	Trust Fund for the West Bank and Gaza				Co-financing			
	Committed	Disbursed	Undisbursed	Disbursed	Committed	Disbursed	Undisbursed	Disbursed
ON-GOING PROJECTS	US\$ Million				Percent			
01 Solid Waste and Environmental Management Project	9.5	9.2	0.3	97%	1.7	0.0	1.7	0%
04 Emergency Water Project	12.5	10.8	1.7	86%				
04 Social Safety Net Project	20.0	4.3	15.7	22%				
05 North Gaza Emergency Sewage Treatment Project	19.8	7.7	12.1	39%	4.6	0.0	4.6	0%
05 Land Administration Project	3.0	2.1	0.9	70%	1.5	1.1	0.4	72%
05 Tertiary Education Project	10.0	3.7	6.3	37%	3.9	1.4	2.4	37%
05 Gaza II Emergency Water Project	25.0	16.1	5.4	64%				
07 Avian Influenza Project	10.0	1.2	8.8	12%				
07 Palestinian NGO Project III	10.0	4.2	5.8	42%				
07 Emergency Municipal Services Rehabilitation Project II	10.0	6.8	3.2	68%				
07 Emergency Services Support Program III	10.0	3.0	8.0	30%				
08 Village and Neighborhood Development Project	10.0	0.0	0.0	0%				
08 Electricity Utility Management Project	12.0	0.0	0.0	0%				
08 PRDP- Development Policy Grant	40.0	40.0	0.0	100%				
Total On-going Projects	201.8	109.1	68.2	54%	11.7	2.5	9.2	21%
Total Completed Projects (1993-2008) **	515.9	484.7	31.1	94%				
TOTAL (On-going & Completed Projects)	717.7	593.8	99.3	83%				

\* For some cofinancing, investment income is added to the principal and disbursed, causing disbursements to go above 100%



ON-GOING REPORTS AND STUDIES
Higher Education Student Financing Scheme
Phase III: Palestinian Trade Facilitation
Economic Impacts of Access to Land
Housing Finance Sector
Health Policy Report
Social Inclusion and Gender
Transport Sector- Technical Assistance
Water Resource Management

ON- GOING RECIPIENT EXECUTED (RE:Trust Funds/Grants) (USD m)	Committed	Disbursed	Undisbursed	Disbursed
Palestinian Reform Development Plan MDTF (PRDP-TF)	219.8	219.8	0.0	100%
Avian Influenza Prevention and Control	3.0	2.3	0.7	77%
Emergency Services Support Program	65.4	59.5	5.9	91%
Total RE	288.2	281.6	6.6	98%
Total (On-Going Projects and RE )	490.0	390.7	74.8	80%

ON-GOING TRUST FUNDS BY DONOR	Commitment
Spain-Consorcio de Promocio Comercial de Cataluna	0.15
Danish International Devp. DANIDA -Min.Foreign Affairs	2.53
EU-Commission of the European Communities	16.73
Finland- Ministry for Foreign Affairs	1.47
Italy-Ministry of Foreign Affairs	17.71
Japan- Ministry of Finance	0.38
Norway-Ministry of Foreign Affairs	1.94
Swedish International Devp. Cooperation Agency - SIDA	5.04
UK- Department for International Development - DFID	2.31
World Bank Trust Funds	177.31
Total On-going Donor Funded TF	225.57
Total On-going Multi- donor TF	323.76
Total closed Trust Funds**	989.36
Total On-going & Closed Trust Funds-TF	1,538.69

ON-GOING MULTI-DONOR TRUST FUNDS (MDTF)		
MDTFs	Donors	Commitment
Investment Guarantee Trust Fund	European Investment Bank- EIB; Japan; Palestine Liberation Org.;	20.51
Emergency services Support Program	Australia; Austria; Belgium; ; EU/EC; France; Italy; Norway; Switzerland; Sweden; Spain; United Kingdom	70.78
Support for Palestine Central Bureau of Statistics Master Plan	Germany; France; Netherlands; Switzerland; United Kingdom	0.97
Rapid Capacity Building in West Bank and Gaza	Belgium; Brazil; Canada; Netherlands;Norway; Switzerland; UNDP	0.25
Palestine Facility for New Market Development	Belgium; Brazil; Canada; Netherlands;Norway; Switzerland; UNDP	1.20
Palestinian Recovery and Development Plan Multi-Donor Trust Fund (PRDP-TF)	Australia; Canada; Finland; France; Kuwait; Norway; United Kingdom	228.91

\*\*Total closed trust funds include all single and MDTF  
All figures in million of USD



# Second Emergency Municipal Services and Rehabilitation Project

The World Bank is actively contributing to developing the local government sector, with particular emphasis on municipalities. In close coordination with other key donors, the World Bank is financing the Municipal Development and Lending Fund (MDLF) to provide services, capital investments and capacity building to Palestinian municipalities. The MDLF has successfully established mechanisms for project implementation in municipalities such as criteria for fund allocation, financial management, procurement, and others that allow donors to harmonize their funding approaches.

The MDLF's Emergency Municipal Services and Rehabilitation Project II (EMSRPII), scoping USD \$10 million, supports all 132 municipalities in the West Bank and Gaza in making capital investments such as upgrading internal roads and rehabilitating public facilities (classrooms, green spaces, community centers etc). In addition, the project finances operating costs for essential municipal services like solid waste collection, street lighting, and water pumping. This assistance is vital in ensuring there is little deterioration of municipal services. The MDLF also provides technical assistance to municipalities as they implement their projects, thereby enhancing their ability to prepare, plan, implement and monitor services.

In Gaza, where infrastructure development has come to a grinding halt as a result of the continuing blockade, the EMSRPII finances operating costs for the provision of services like solid waste collection, water network maintenance, and public lighting. The EMSRPII is one of the few sources of donor finance for service provision in Gaza and is making a significant contribution to sustaining a minimal level of municipal service.

MDLF has raised the bar on municipality operating standards in the West Bank and Gaza. As its fund allocations to municipalities are based on a specific set of standards, municipalities must submit their prior year's executed budget, a budget plan for the current fiscal year, and a statement of year end financial accounts conforming to the Municipal Unified Chart of Accounts to be eligible for funding. These requirements have so improved municipal budgeting and financial reporting that all 132 municipalities are today compliant with the law.

The MDLF has effectively tested its systems through the implementation of the EMSRPII and has successfully managed to align and harmonize donor support. The EMSRPII is set to close at the end of June 2009, and has already disbursed about 80% of its funds. Drawing on the lessons learned from the EMSRPII and MDLF's technical assistance program to municipalities, the World Bank is now working to design a new sector-wide program. Working closely with all key PA entities – the Ministries of Local Government, Finance and Planning – as well as key donors in the sector, the World Bank is designing a project in which donors will finance a sector wide approach to municipality assistance, consistent with the priorities identified in the PRDP. Such an approach will be the first successful example of full donor alignment and could become a model for other sectors.

# Food Price Crisis - World Bank's Response

## \$5 million Additional Financing to the Social Safety Net Reform Project

Between March 2007 and April 2008 the consumer prices index of food rose by 14.6 % in the West bank and 16.3 % in the Gaza Strip.<sup>1</sup> Since less than 5% of cereals consumed in the West Bank and Gaza Strip are produced locally, the jump in international food prices has had a profound effect. Over the past 12 months, the price of wheat flour increased by 73% in the West Bank and 68 % in Gaza.

Soaring food prices have coincided with a period of declining income and growing unemployment, that together severely undermine the welfare of Palestinians. As earning power plummets and prices of essentials skyrocket, many are falling into heavy debt, and previously self-reliant families are progressively sliding into poverty. Poor food and income security are posing real threats to the livelihood and nutrition of a growing proportion of the population.

Several other factors also currently contribute to the erosion of Palestinians' health and welfare. The declining productivity of the agricultural sector in both the West Bank and the Gaza Strip, has failed to provide some local remedy to the global food crisis. The tightening of restrictions on the free movement of people and goods in the West Bank and prolonged closure of the Gaza Strip have increased scarcity many times over, even when supplies are in close proximity. The inability of humanitarian organizations to meet the increasing demand and cost of assistance, has left many Palestinians with truly no one to turn to. Each of these have further exacerbated the erosion of the livelihood of the Palestinian population.

The World Bank team proposes to directly respond to this food crisis by scaling up the World Bank funded Social Safety Net Reform Project by \$5 million. This extra injection will provide timely assistance to around 25,000 of the poorest households that have been most affected by the crisis with a one-time cash payment of \$ 200. An appraisal mission will take place in mid September 2008, after which the World Bank will aim to submit the project to its Executive Board of Directors in October 2008 for endorsement.



1 Palestinian Central Bureau of Statistics 2008

# World Bank Technical Assistance on Student Loan Scheme



The World Bank will provide technical assistance on the new Student Loan Scheme of the Palestinian Ministry of Education and Higher Education (MOEHE), expected to begin operation by January 2009. A new financing system aims to improve the financial sustainability of higher education in West Bank and Gaza, as well as to provide equitable assistance to Palestinian students in their pursuit of post-secondary education.

The higher education system in the Palestinian Authority is a binary system – with 11 universities that offer bachelor's through doctoral degrees, and 29 community (technical) colleges. The Palestinian higher education system is above average compared with the region, sharing indicator levels comparable to those of middle-income countries. With an enrollment rate of nearly 30% – higher than the average among Arab states – the system more closely resembles those of countries such as Mexico (21%), Costa Rica (21%) and Malaysia (27%).

Enrollment fees across higher education institutions are currently at two-thirds of normative costs, and the likelihood of increasing them by 50% in the near future, given the current economic circumstances, is unrealistic. Therefore, for the education system to overcome the difficulties of the financial crisis, a combined approach is needed: increased support to the PA, a gradual increment in enrollment fees, along with subsidies for lower-income students.

The MOEHE primarily relies on student loans to provide financial support to students, in addition to scholarships that are granted to the neediest families. Student loans are an imperfect financing method. On the one hand, they provide crucial assistance to students in obtaining higher education. On the other hand, current repayment levels are negligible, compromising the financial stability of the higher education system. Since the MOEHE Loan Scheme was first established in 2000, there has been no repayment of student loans by beneficiaries. MOEHE now wishes to activate repayment under this Scheme.

To restore financial soundness to the MOEHE, the World Bank will assist in establishing the Higher Education Loan Fund. The fund is expected to receive funding from donors like the Arab Fund, and past supporters of the student aid scheme. The fund will provide loans of up to 600 Jordanian Dinars (JD) per semester to students in all fields of study. (Those students seeking larger loans will be referred to the Bank of Palestine scheme).

This *revolving fund* will be administered by one or more commercial banks and overseen by an independent board. Each semester the banks will advance loan funds to universities and colleges based on student demand for loans and eligibility criteria. Students will receive accounts at the banks, at no cost to them. Each month the bank will automatically collect student payments and transfer them to the fund.

Students will pay minimum monthly payments at a rate of to 4-5% of the loan amount, from the month the loan is taken out until the time they reach a minimum income level. At minimum income level, equivalent to any type of employment, repayment on the loan begins at a rate of 7-10% of income. Students will have a two-year grace period following graduation, during which they can continue to pay the minimum monthly payments should they not reach minimum income level immediately. No real interest rate will be applied to the loans; however, the principal balance of each borrower will be adjusted annually to maintain real value.

The World Bank's technical assistance will support aspects such as implementation arrangements, eligibility rules and loan terms, collection mechanisms, governance, composition of the fund board, appeals mechanisms, performance indicators and monitoring, and the role of universities and colleges.